

## US Macroeconomics

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### Big Job Gains Can Occur Shortly Before Recession

Some market participants lowered their probability of a 2023 recession because of the blowout January employment report. The problem with this is that **jobs are not a leading indicator of the economy**. In fact, sometimes the economy adds a lot of jobs right up to the onset of recession. We may experience the same situation this time around because forward-looking series such as the Index of Leading Economic Indicators and the Fed's Senior Loan Officer Survey are pointing to imminent recession. If this indeed is the case, employment will follow.

**The labor market generated healthy job gains ahead of the 1973-75, 1980 and 1981-82 downturns**. Notably, these episodes were all characterized by high inflation like the current one. In the three months up to and including the November 1973 peak in economic activity, the initial reading on nonfarm payrolls showed hearty gains of 190k (September), 305k (October) and 201k (November). Given how much the data gets revised, we use originally reported figures because that is what market participants and policymakers were reacting to at the time.

This pattern repeated in the next recession that began in February 1980 when the labor market generated job gains of 218k (November 1979), 317k (December 1979) and 305k (January 1980). The next recession that started in August 1981 was a little different in that nonfarm payrolls fell in May (-16k) and June (-14k) of that year. However, jobs surged 383k in July 1981, which surely led economists to lower their probability of recession. What about the last two non-pandemic downturns?

While the 2001 and 2008-09 recessions were not immediately preceded by huge job gains like the runup to the 1973-75, 1980 and 1981-82 downturns, the data were also not indicative of an imminent recession. For example, even though nonfarm payrolls fell 86k during March 2001, which turned out to be peak in economic output, they had risen a healthy 268k in January 2001 and a decent 135k in February. For many economists at the time, a 2001 recession was not a foreordained outcome.

While the pace of employment gains was slowing throughout 2007, jobs still rose 166k in October 2007 and 94k in November 2007 before increasing just 18k in December 2007, the peak in economic activity. Consequently, investors should not place too much emphasis on January's gangbuster employment results. They do not tell us where growth is going but rather where the economy has been.

**In determining the risks to future real GDP growth, it is forward looking indicators of activity that matter most.** While no indicator is flawless, the Index of Leading Economic Indicators and Senior Loan Officer Survey have accurately foreshadowed past inflection points. In addition, more monetary tightening is forthcoming with the Fed committed to lifting the funds rate yet further and then keep it in restrictive territory for some time thereafter. This is leading to renewed bearish flattening of the Treasury yield curve.

**The bottom line is that we continue to project a 2023 economic downturn.** Whether it is mild or deep will depend in part on the Fed's reaction function to declining jobs and whether inflation continues to drift downward. Stay tuned.