Should the Jobs Report Move the Stock Market?

Unemployment is a lagging indicator and can only indicate what happened

On the first Friday of every month, the Department of Labor releases its Employment Situation Report – also known as the Jobs Report – and it seems as if Wall Street immediately reacts.

Disappointing Jobs Report? The DJIA drops fast. Positive Jobs Report? The DJIA zooms to new heights. While both are exaggerations, the reality is that the unemployment rate does seem to affect the stock market. But why? Let's examine.

But first, let's do the numbers.

October Jobs Report

According to the Bureau of Labor Statistics, for October 2019:

- Total nonfarm payroll employment increased by 128,000 in October.
- Both the unemployment rate, at 3.6%, and the number of unemployed persons, at 5.9 million, changed little in October.
- Job growth has averaged 167,000 per month thus far in 2019, compared with an average monthly gain of 223,000 in 2018.
- In October, average hourly earnings for all employees on private nonfarm payrolls rose by 6 cents to $28.18. Over the past 12 months, average hourly earnings have increased by 3.0%.
- The average workweek for all employees on private nonfarm payrolls was unchanged at 34.4 hours in October.

Copyright © 2019 RSW Publishing. All rights reserved.
Distributed by Financial Media Exchange.

Macroeconomics 101

Remember from your economics class that the unemployment rate is an important macroeconomic indicator used to gauge the overall health of our economy? In more technical terms, economists call the unemployment rate a lagging economic indicator (as opposed to a leading indicator).

The difference between the two is a leading indicator can influence change whereas a lagging indicator can only record what has happened.

Said another way, the unemployment rate doesn't rise until after a recession has already started – and will continue to rise even after economy has started to recover.

In fact, the Great Recession of 2008 actually started in December 2007 and the unemployment rate didn't reach 5.5% until May of 2008. Further, the Great Recession lasted until June 2009, but unemployment peaked at 10.2% in October 2009.

The Ripple Effect

So why should a lagging economic indicator move stock markets? That's a great question. And there is a lot of esoteric debate on this very topic. But let's think about it in very simple terms.

Think about what would happen if your neighbor loses his job. First, there will be less money going to your local economy as your neighbor cuts back on non-essential items. Second, now there is one less person that will be paying state and federal taxes.

Maybe your neighbor is eligible for unemployment insurance and benefits. So now, your neighbor is taking money from the economy as opposed to contributing money to the economy (in the form of paying taxes).

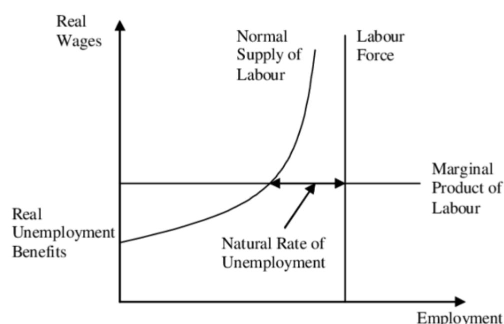
Now, your state's deficit increases as its tax revenue decreases. What will your state do in order to curtail its increasing deficit and falling revenue? Answer: increase taxes on you and your other employed neighbors.

Now that your taxes have gone up, you have less disposable income, meaning you spend less. And if you spend less at the local store, maybe someone else loses their job next. And the vicious cycle continues.

Making things worse will be the real estate market. Shockingly, studies have shown that 45% of mortgages enter foreclosure as a direct result of unemployment. So, if your neighbor loses his job, maybe his house will go into foreclosure, leading to bankruptcy. And if your neighbor's house is foreclosed upon, what do you think that does to the value of your house?

The Natural Rate of Unemployment

Everyone tends to think of unemployment as a negative and it certainly is when it happens to us, our family or our friends. But the truth is that a certain amount of unemployment is actually part of a healthy economy: the natural rate of unemployment.



The natural rate of unemployment is the unemployment rate that exists when an economy produces full-employment real output.

But to better understand the definition, we need to get into the three components of unemployment: cyclical, frictional and structural.

- Frictional unemployment is what it sounds like – your neighbor loses his job (or quits, it doesn't matter).
- Structural unemployment happens when new industries are created and old industries become obsolete. Think about manufacturing where robots are replacing workers.
- Cyclical unemployment is the result of the ups and downs of the business cycle. During recessions, cyclical unemployment increases

Copyright © 2019 RSW Publishing. All rights reserved.
Distributed by Financial Media Exchange.

and during expansions, cyclical unemployment decreases.

The natural rate of unemployment is equal to the sum of frictional and structural unemployment.

Said another way, “full employment” does not mean “zero unemployment.”

Back to the Original Question

Back to the original question: why does the unemployment number seemingly impact the market immediately? Especially if it’s a lagging indicator?

Well, look at it this way: the Jobs Report that gets released on the first Friday of every month just gives Wall Street more data from which to make decisions. The Employment Situation Report provides sign-posts that can either confirm or contradict opinions, as well as clues into corporate earnings.

Further, it indirectly provides insight on retail sales (a big part of our GDP) as well as monetary policy and interest rates (remember the Fed’s dual mandate includes maximum employment).

Finally, one more thing: of all the data released every month, many on Wall Street will suggest that the Jobs Report has the largest impact on the bond market.

But that’s for another day.

Copyright © 2019 RSW Publishing. All rights reserved.
Distributed by Financial Media Exchange.