

## Key Questions

# Wait... What Happened to the Payrolls Report?

June 9, 2020

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Positive “upside surprises” aside, we believe there is still a high degree of uncertainty with respect to the economic outlook.

Last week, it was revealed that US payrolls in May increased by 2.5 million. Ahead of the announcement, forecasters were anticipating that payrolls would decrease by roughly 7.5 million, translating into a forecasting error (albeit a positive error) of approximately 10 million jobs.

To be clear-- some forecasts weren't nearly as dire. But with a miss of this magnitude, some wondered if there was an error in the official Bureau of Labor Statistics (BLS) report: “perhaps the BLS forgot to include the negative (-) sign,” quipped one economist.

Similarly, last week we also learned that the US unemployment rate declined to 13.3% in May from 14.7% in April. Ahead of the announcement, forecasters anticipated that the unemployment rate would spike close to 20%, illustrating again that forecasters got the number wrong and were also wrong about the direction.

While we could devote the remainder of this essay to the perils of forecasting (and the related perils of placing too much emphasis on them), it's more useful to draw some conclusions from these less-terrible-than-expected data points and consider where we go from here. In short, and positive “upside surprises” aside, we believe there is still a high degree of uncertainty with respect to the

economic outlook, primarily due to COVID-19 and the related aftershocks. Part of this uncertainty may be based on a quirky fact that the household survey response rate and, therefore, the sample size used in tabulating the unemployment rate was much lower in May at 67% versus about 82% typically.

More clearly evident is the recognition that an unemployment rate of 13% is still massive. For context, this closely watched economic indicator peaked at 10% during the Global Financial Crisis in 2008-09. Positively, the trend from here may be lower, but it may take months of recovery to reach the levels we saw a mere four months ago.

A sluggish “return to normal” may be evidenced by a recent survey in which only about half of businesses are planning on bringing their numbers of employees and hours worked back to pre-pandemic levels. The other half of the companies surveyed felt that they would employ fewer employees with fewer hours or the same number of employees but with fewer hours. This sentiment could pose a headwind for many people seeking work in the months ahead.

Another source of potential uncertainty rests with Congress's massive support and whether it will be sustained past the summer. Political divisions over future spending proposals are hardening again: While we'd probably assign slightly better than 50/50 odds to another spending plan being enacted later this year, election-year theatrics could complicate the proceedings. In the meantime, when faced with vagueness over future employment prospects and/or incomes, consumers are likely to be reluctant to spend aggressively.

As it relates to what we know of the jobs that were added in May, construction workers were the relative winners: 44% of the jobs lost in prior months were restored in May. Other sectors saw smaller recoveries: Education and health services, retail, manufacturing, and leisure/hospitality (the sector hardest hit) all saw roughly 15% of the jobs previously lost return in May – good, but not great. Meanwhile, other sectors, most notably government workers, have still experienced net losses.

In totality, the gain of 2.5 million jobs in May is impressive and validates the view that the nadir in the economic cycle may have already occurred. Accordingly, market participants have repriced their assumptions about the speed of economic recovery.

That said, a gain of 2.5 million jobs represents a little over one-tenth of the jobs lost in the preceding two months, and the economy still has a long road back to normal. We also continue to contemplate risks involving “a second economic wave.” This wave might already be manifesting itself in the form of announcements of layoffs, furloughing of workers, and, in some instances, bankruptcies.

For these reasons, while we continue to nibble at select opportunities when they become too irresistible to ignore, such as we did in April by adding to small/mid-cap equities and corporate credit, we also believe caution is warranted.

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Publish Date: June 9, 2020

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