First Trust
Monday Morning OUTLOOK

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So, Maybe That Drop In M2 Really Did Matter

If a tree fell in the woods, but the data said it didn't, does it really mean anything?

In spite of what appeared to be relatively good data, many polls throughout the 2024 election cycle showed more than half of all voters rated the economy as "poor." That left the Biden/Harris team often wondering why they couldn't get credit for what official statistics said was a robust economy.

Now it looks like we know why. The Labor Department estimated that it's going to need to revise down the amount of payroll growth between April 2024 and March 2025 by a total of 911,000. This doesn't mean payrolls outright declined during that year-long period; what it means is that contrary to prior reports of 147,000 jobs per month, jobs only grew about 71,000 per month in the year ending March 2025.

To be clear, these annual revisions are relatively small compared to total jobs (about 0.6% of the 160 million total), and we have seen revisions this large before. But this is the third year in a row of downward revisions, which is unusual outside of dramatic events like recessions.

What all of this suggests is that the economy was much weaker last year than previously thought. At present, the official GDP reports say the economy grew 2.0% in the year ending in March. But reducing job growth from 147,000 per month to 71,000 could mean a noticeable downward revision to real GDP growth when that annual revision is announced by the Commerce Department in late September.

Just as important is that now, after revisions, when we look back at the year ending in March 2025, government jobs plus government-dominated jobs in healthcare and social assistance made up more than 100% of all jobs created. As it turns out, private sector jobs outside of these areas declined. No wonder voters weren't happy about the economy.

More importantly, from an economists' point of view, it clears up an economic mystery. After surging in the first two years of COVID, the M2 measure of the money supply declined from early 2022 through late 2023, and yet economic growth appeared to be unaffected. No recession, no major slowdown.

But what if government statisticians missed the slowdown and are just now getting around to finding it? Moreover, what if the economic effects of the decline in M2 were temporarily masked or hidden in 2024 by a combination of (1) an unprecedented surge in immigration and (2) a reckless increase in the budget deficit?

If so, the risk of a recession in the next year or so is likely higher than most investors believe. In the past several months, immigration policy has been turned on its head, with a sudden shift from virtually open borders to what could be an immigration flow close to "net zero." Meanwhile, the Congressional Budget Office is hinting that this year's budget deficit will be smaller than last year's relative to GDP while DOGE cuts to bureaucrat jobs are reducing government employment.

Long term, we believe a smaller government will pay dividends, leading to greater private sector growth and more prosperity. But, in the very short-term, less stimulus could lead to some economic headwinds as workers and businesses have to adapt to the new environment.

In turn, this also means the Federal Reserve is almost certainly going to cut rates on Wednesday – we think by a quarter percentage point – and will be inclined to cut rates further in the fourth quarter, likely by another half a point total.

Some investors will see this as a reason to tilt even more toward risky assets. But we are more concerned about the downside risk these policy measures are designed to protect us from than the measures being taken themselves. If a firetruck shows up at a house, that's not a reason for civilians to run into the building, even if the data appear to say there is no fire.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
9-15 / 7:30 am	Empire State Mfg Survey – Sep	5.0	**-6.0**	-8.7	11.9
9-16 / 7:30 am	Retail Sales – Aug	+0.2%	**+0.3%**		+0.5%
7:30 am	Retail Sales Ex-Auto – Aug	+0.4%	**+0.3%**		+0.3%
7:30 am	Import Prices – Aug	-0.2%	**-0.2%**		+0.4%
7:30 am	Export Prices – Aug	-0.1%	**-0.3%**		+0.1%
8:15 am	Industrial Production – Aug	-0.1%	**-0.3%**		-0.1%
8:15 am	Capacity Utilization – Aug	77.3%	**77.1%**		77.5%
9:00 am	Business Inventories – Jul	+0.2%	**+0.2%**		+0.2%
9-17 / 7:30 am	Housing Starts – Aug	1.365 Mil	**1.365 Mil**		1.428 Mil
9-18 / 7:30 am	Initial Claims – Sep 13	240K	**252K**		263K
7:30 am	Philly Fed Survey – Sep	1.6	**-1.1**		-0.3