

# THE ECONOMIC OUTLOOK GROUP



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## ECONOMIC TALKING POINTS

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### **The 10.2% Jobless Rate Was Awful, But What's The Report Telling Us About The Future**

Let's begin with a truism. We are a nation headline readers. Headlines neatly sum up events and help us easily digest complicated situations. We now have an economy with an unemployment rate of 10.2%, the highest in more than a quarter of a century. That alarming number will undoubtedly capture the headlines of every newspaper and top all news broadcasts this weekend. What came out today will reverberate in the media for weeks. It's a lousy number, even frightening, and does portray how difficult the job market has been. But what this report also tells us is that we are on the cusp of a turning point in the labor market and I'm afraid that message is going to be lost in the glare of the unemployment rate.

Embedded in this report are other solid data points that one must incorporate to get a full picture of where the job market is headed. I'm not talking about one or two obscure statistics that just happened to be positive. Buried deep in the latest release are indicators with a demonstrated track record of leading the economy --- and these measures ought not be ignored. So while there will be plenty of ink spilled today of just how awful labor market conditions have been ----and we concur they have been dismal --- we were also encouraged to see other measures paint a more optimistic outlook, with more jobs likely

to be created than eliminated by next spring.

Here's one quick observation. The BLS has a history over overestimating the loss of monthly payroll jobs when the numbers are first released. Time and time again, their initial set of figures have later been revised to show that employment conditions turned out better than first thought. We saw that again with this report. September payrolls were initially reported as falling by 263,000. Not so, the BLS now says. It only declined by 219,000. An even more dramatic correction occurred in August when the BLS first said the economy lost 216,000 --- and then scratched that figure out to show an actual decline of 154,000, the smallest in more than a year!! The point here is that we cannot take these preliminary numbers too seriously. Indeed, in the nine months worth of revisions so far this year, we saw changes made toward higher job numbers in six of those months and declines in three. By the way, two of the three that showed greater deterioration occurred in January and February. **The point here is that the BLS tends to overestimate job losses most often during periods of economic recovery**, which is why we believe that they will revise October's 190,000 to eventually show fewer jobs being eliminated.

Now on to the 10.2% unemployment rate. Yes, it's a horrible number, but hardly shocking since virtually every forecaster expected it to climb past 10% this year or next. Taking the brunt of this deterioration were teenagers, a group that now has a jobless rate 27.6%, up 1.7 percentage points in just a single month --- thereby growing at least four times as fast than any other demographic group.

Another vital point to consider is that there is an ever-widening gap between the unemployment rate (from the household survey) --- which is clearly worsening ---- and the payroll numbers (from the establishment survey) --- which has been dramatically improving. The unemployment rate, for example, has surged from 7.6% in January to 10.2%, an increase of 34%. But the drop in net payrolls has been getting smaller since the start of the year. It has plunged from a monthly average of 691,000 in the first quarter to an 188,000 average the most recent three months. Thus the pace of job losses has plummeted 73% since the start of 2009, while the unemployment rate shot up by 34%.

As we said before, most pundits will focus on the jobless rate breaking the symbolic 10% threshold and begin to speculate whether a double dip recession now looms larger. Such speculation is understandable, of course, until we examine why the jobless rate has been so stubbornly high. For one, the unemployment rate is a lagging indicator. Business leaders will not jump to hire workers at the first sign the economy has turned up. That's especially the case these days when there is still so much concern about a relapse into recession in 2010, a scenario we give no more than a 20% probability.

Second, we really have to make a distinction between a cyclical and a structural unemployment these days. There are major structural changes taking place in the labor market that will make it much more difficult for many to find work. Some labor-intensive sectors of the economy continue to undergo wrenching and permanent changes. The auto, construction and financial service industries have either underwent consolidation,

downsized, or gone belly up. Whatever the case, many of these jobs will never come back. However, that's not to say the rest of the labor market remains moribund. There are many other powerful leading indicators suggesting that the economic backdrop has improved and that hiring should soon accelerate. What specific indicators are we looking at?

**(1) Temporary employment.** If you take a look at 1990 – 1991 and the 2001 recession, you see temporary employment rebounded the moment the recession ended and was followed by an acceleration in permanent hiring roughly two quarters later. That trend is expected to be repeated this cycle.

What's happened to temporary employment this recession? It was falling since the start of 2007 (remember, the recession commenced in December that year) and these layoffs continued right up until the 2008 – 2009 recession was over. When the economy registered its first GDP growth in more than a year this summer, temporary instantly hiring turned positive and did so for the first time in nearly two years. This past month, the temp workforce jumped by another 33.7 million, the most since December 2006.

**(2) Weekly hours worked in Manufacturing.** Manufacturing is the most cyclically sensitive part of our economy. During economic downturns, retailers and wholesalers typically work off their existing inventories to improve cash flow. Given the extraordinary length of this recession, inventory levels are now nearly depleted. Since you can't sell anything you don't have, companies are rushing to replenish their inventories. That process is now underway and has lifted manufacturing output. So are they hiring? Not yet. Many factories are trying to produce more with fewer workers, which is not uncommon in the early stages of a recovery. Just take a look at the historic 9.5% jump in productivity in the third quarter. The trend to keep current workers on the job for longer hours has now been further substantiated in the October employment report. The average workweek in manufacturing last month increased to 40 hours a week, the most since last November.

**(3) Overtime.** Related to the expansion of weekly hours worked is the increase in overtime. Employers are asking their workforce to put in more OT. Overtime jumped 0.2 hours last month to 3.2 hours, the most since November. October's OT was markedly higher than the 2.7 hours of last April. But here's the problem: longer hours at work can lead to fatigue among employees and erode quality control, which means employers will come under increasing pressure to seek new workers in coming months.

Nor can the employment data be divorced from other positive news in the economy. For instance, consumer spending has accelerated. Household expenditures in the third quarter jump by the most in more than two years. Industrial output rebound in recent months as producers try to satisfy the surge in new orders. Exporters are selling more as the cheap dollar prices US goods and services more competitively in foreign markets just when the global economy appears to be growing again. There's also more federal

stimulus in the pipeline that will benefit the economy next year. Aside from the Obama stimulus package, Washington has both extended and expanded the home buying tax credit through April of 2010; unemployment benefits have also been extended by 14 weeks to all people in all 50 states without a job, and an additional six weeks to those in states where the unemployment rate exceeds 8.5 percent.

**Bottom line:**

October's 10.2% unemployment rate was unnerving to be sure. Our new forecast calls for it to inch up to 10.5% by early next year. But this rise does not quite reflect the promising shifts underway that will lead to more job creation and lower unemployment by mid-2010. Employers are beginning to reassess their staffing needs now that a recovery is taking shape. They saw the economy grow 3.5% last summer, a pace that may be equaled or surpassed this quarter. From our own research, we've noticed that business leaders are beginning to ask key questions on employment policy: Have they slashed too many workers too quickly? Should any plans to layoff more employees be put on hold? Is this a good time to consider hiring temporary workers? The answer will likely be yes to all of them and our first clue of that could come from the JOLT (Job Openings and Labor Turnover Survey) report to be released next Tuesday.

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