THE ECONOMIC OUTLOOK GROUP

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ECONOMIC TALKING POINTS

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August Jobs: Grab The Jeweler's Loupe To See a Recovery

The 9.7% unemployment rate for August will undoubtedly grab news headlines and top this evening's broadcasts. It's the number everyone will likely talk about when the topic turns to the economy. However --- and I do not mean to belittle the jobless rate --- when you examine the report in greater detail, we see on a net basis more evidence that the labor market is gradually improving, though you may need a jeweler's loupe to detect it.

Let's start with the unemployment rate. As you know, it is entirely based on a survey of 60,000 households. Keep in mind the questions Americans are asked in these surveys are fairly intrusive: Are you working? Do you have a part or full time job? If you weren't working, did you at least look for a job the last four weeks? How long have you been unemployed?

Although a lot of valuable information can be gleaned from the household data, it's important to bear in mind that it is all based on how candid people are. Some may be too embarrassed to admit they are unemployed and instead describe themselves as a "consultant." Others may express their anger over Washington's economic policies by declaring themselves unemployed, even though they may be successfully earning money in the underground economy. The point we want to make here is that we should not solely rely on the jobless rate as “the” indicator on how the economy is faring, especially during turning points in the business cycle.

For the sake of argument, let’s assume August’s 0.3 percentage point increase in the unemployment rate is valid. Aside from the fact that summer months generally play havoc with the employment numbers, the jump to 9.7% had some unusual features. For example, teenage unemployment surged last month by 1.7 percentage points, from 23.8% to 25.5%. That’s the highest joblessness for this group ever recorded by the Bureau of Labor Statistics (going back to 1948). In comparison, the unemployment rate for adult men rose 0.3 percentage points last month to 10.1%, reaching a level seen during the 1982 recession. Adult female unemployment inched up 0.1 percentage points, to 7.6%, which matched that of this June. So the sharp rise in teenage unemployment did contribute to the unexpected jump in overall unemployment.

It’s in the more reliable payroll survey, however, that we find some consistency that labor market conditions are changing – and changing for the better. First, the 216,000 decline in payrolls for August is consistent with the ongoing trend of progressively fewer layoffs each month. After peaking at 741,000 in January, layoffs have been winding down in 6 out of the last 7 months. August’s 216,000 job losses turned out to be the fewest since August of last year. What’s encouraging is that this decline took place even though the government laid off 18,000 workers last month. In other words, the private corporate sector cut its workforce by 198,000, which happened to be the lowest in a year. It is ***this*** series ---private business employment --- (i.e., ex government employment) that provides us with a purer measure of whether the economy and the job market are improving.

If you drill down deeper, you see that even construction and manufacturing layoffs tapered off as well. Builders cut 65,000 workers from payrolls last month, below the average monthly the pace of 124,000 in the first quarter and 80,000 in the second. Manufacturers eliminated 63,000 jobs in August. Though this was a pick up from July’s 43,000 cuts, the last two months were the smallest in more than a year.

Another interesting factoid is that the median number of weeks unemployed Americans were out of work fell to 15.4 from 15.7 in July. It’s the second consecutive drop in the duration of being unemployed.

One employment indicator that has an excellent track record of foreshadowing an improvement in the overall job market is the change in temporary employment. Employers tend to look at hiring temp workers once a recovery takes hold. Since the start of 2007, companies have been getting rid of temporary workers as economic conditions deteriorated. But the pace of temp layoffs may be on the verge of turning around. There were 6,500 fewer temp workers in August, the second lowest cutback in 20 months. We’re watching this measure closely since history has shown that once it turns positive, it would send a strong signal that a recovery is underway and probably sustainable.

We have also seen a turnaround in the diffusion index, which measures changes in employment at 271 industries. What's valuable about this statistic is that it avoids looking at hiring going on in just a few businesses. For example, a sharp increase in employment by only a few industries doesn't tell us very much about the macroeconomy. The diffusion index, however, monitors how widespread hirings are. The August index tells us that the number of industries that have moved toward hiring is now the highest in 12 months.

Bottom line:

If history is any guide, we will continue to see payrolls decline for at least another six months. Companies just do not commence hiring once a recession ends in part because it is so difficult to know with confidence that the economy has turned the corner for good. As a result, employers ask their existing workers to produce more. We'll eventually see more weekly hours worked and greater overtime. Bear in mind, we are so early in the recovery stage that we haven't yet even seen a pick up in hours. We do expect that to begin in the final quarter of this year, however. This maybe accompanied by an increase in temporary workers as well. But a cyclical improvement in the job market is still far off. Indeed, if the last two recessions are any guide, it takes more than two years after a recession ends for the economy to generate jobs on a scale that will bring down the unemployment rate. What the August numbers reminds us is an old Chinese proverb: "The journey of a thousand miles begins with one step." Those initial steps, though small, have begun.