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ECONOMIC TALKING POINTS

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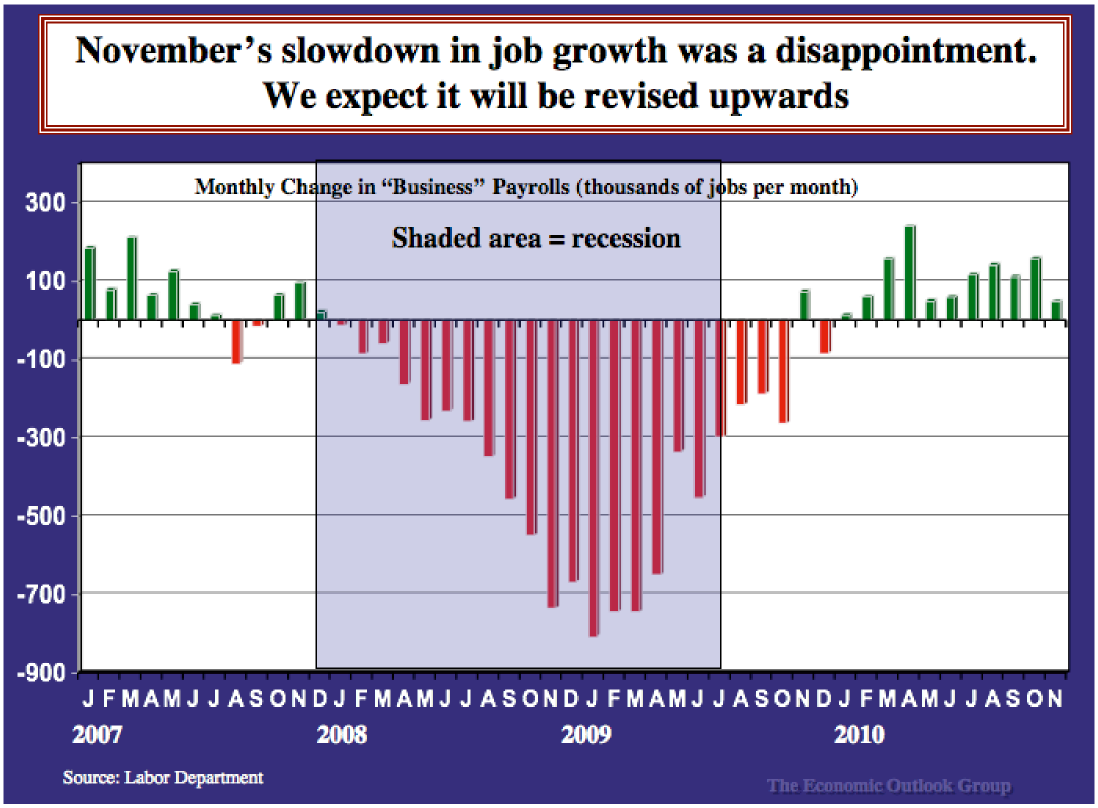
November's Employment Report Fails The Smell Test

The November jobs release was a stunning disappointment to say the least. Frankly, the headline numbers showing non-farm payrolls increased a bare 39,000 and private payrolls by an anemic 50,000 last month were wholly inconsistent with a slew of favorable economic indicators out recently. So perhaps we ought not be so hypersensitive to this particular employment report because it deviates so dramatically from the positive composite other barometers have drawn on the economy. Indeed, we expect the BLS to revise the payroll number higher as more data becomes available.

What could have possibly gone awry with the number crunching this time? Well, for one the BLS surveys 410,000 different businesses each month, with questionnaires sent out the week containing the12th of the month. But November tends to be a problematic month because those dates approach the extended Thanksgiving holiday weekend. You would think such holiday distortions would be corrected by seasonal adjustment factors, but we won't know for sure until months later. What we do know is that the percentage of survey responses returned to the BLS in time for the preliminary November report was 65.9%. Contrast that with the response rate in the three previous months, which averaged 73.5% for the first release. When the final employment revision for November comes out in February, the BLS should by then collect about 95% of the surveys and we believe the numbers will eventually show a substantial upward revision for last month.

Does this adequately explain why November's payrolls were such an outlier? Not quite, and we may not know the reason for several weeks. However, those analysts who want to dwell on the disappointing employment figures and argue the economy is still highly susceptible to a double dip recession are making a mistake. To pluck one downbeat indicator from more than a dozen favorable ones as evidence the recovery is in jeopardy is silly.



What we can do as forecasters is take a look at the November jobs report and focus on the more reliable forward-looking sub-components for clues on the economy's underlying health and outlook. Here's where the data actually gets interesting.

• Employment in the temporary workforce keeps surging. November saw an increase of 39,500, the biggest jump since January, bringing the total temp employment to 2.22 million, the most in more than two years. We know from past business cycles that an increase in temporary workers leads to more permanent hiring in coming months.

• Another leading indicator we monitor is the demand for workers at child day care services. These centers tend to increase staff once parents find more jobs and need to place their children in day care facilities. Evidently child care providers are getting busier. Employment rose to 870,800 last month, the most ever recorded!

- A third important barometer we track is hiring activity in the leisure and hospitality industry. A robust economy will have business executives and individuals traveling more and booking hotel rooms. As we expected, leisure and hospitality employment did rise by 11,000, to 13.74 million, the most since early 2009.

- Restaurants and bars have also seen a pick up in business and that has led owners to bring on more workers too. They hired 11,700 additional people last month and brought total employment at restaurants and drinking places to 9.53 million, their largest workforce in more than two years.

- Truckers are carrying so much more freight to wholesalers, manufacturers, retailers, and to ports for exports, that supervisors have been forced to ramp up hiring in November. Trucking companies added 1,400 new drivers and other personnel to their payrolls and brought total employment in their industry to 1.24 million, the most this year.

- One aggregate statistic that completely contradicts the bleak headline payroll data is the number of Americans who were forced to accept part time work because they couldn't locate suitable full time employment. You would think that with the growth in total nonfarm payrolls dropping from 172,000 in October to 39,000 last month, the opportunities for full time employment would also diminish. Well, we saw just the opposite. The number of workers stuck in part time jobs fell for the second month in a row, to 8.83 million, the lowest since August.

What to make of it all? The answer is simple. One should never place too much emphasis on single measure. Any mosaic of the economy must by definition incorporate a variety of data points and it helps if they corroborate one another. Guess what? If you set aside the November employment report, the mosaic is indeed getting clearer.

Judge for yourself.

ADP

The ADP employment report for November was especially encouraging in that it showed small and mid-size businesses were at long last beginning to hire again. These companies are responsible for creating 70% of all new jobs in an economic recovery, but they have not been in a hiring mood the last three years because sales were dismal and credit hard to obtain. While the latter may still be true, there has been enough of a pick in sales lately to justify a resumption in hiring. Last month, small and mid-size firms took on more new workers than at anytime since the recession began in December 2007.

ISM – manufacturing

Factories are humming. The latest ISM manufacturing survey, which polls purchasing managers around the country, reported that business keeps getting better with each passing month. Manufacturing activity expanded in November for the 16th straight month. New orders, which translates into future production, has now been growing for 17 consecutive months. Employment at manufacturers has increased for 12 months.

ISM – services

Service sector activity also got busier in November. The non-manufacturing index rose to 55 last month, from 54.8 in October. This series has been expanding for 11 straight months. What about jobs? Here, again, we find more good news. The employment sub-index jumped to 52.7 from 50.9 in October, stretching job growth to three consecutive months. New orders increased to 57.7 from 56.7. That represents 15 uninterrupted months of expansions in new orders.

But we return to the news of the day. It bears repeating: Both the manufacturing and service sectors registered notable increases in employment last month, according to ISM.

Federal Reserve's Beige book

Regional Federal Reserve Banks chimed in this week when they reported on economic activity in their area. The result: 10 of the central bank's 12 districts acknowledged that growth was getting stronger.

Consumer are more optimistic and showing it

Consumers are turning confident about the economy and thus more comfortable about spending, especially on big-ticket items. Auto sales in November jumped a hefty 17% compared to the year ago pace, and lifted the number of vehicles sold to an annual rate of 12.3 million vehicles. The industry has recovered nicely this year as more Americans decided the time is right to replace their aging cars or buy new ones. We expect sales for the year to total 11.75 million, well above the record low of 10.4 million in 2009.

But let's not stop with autos. Recent data shows a rebound underway in home buying as well.

Pending home sales in October shot up at the fastest pace ever recorded by the National Association of Realtors! The index that gauges the number of signed contracts has been climbing in each of the last four months, and now stands at its highest since last April.

A one-month anomaly you think? It's possible, except the positive trend appears to be continuing. The Mortgage Bankers Association just reported that the number of mortgage applications to purchase a home the week ending November 26 climbed to its best level since early May.

Households are clearly in a much better mood these days too. The Conference Board noted earlier in the week that consumer confidence last month jumped to its highest level since June. Perhaps that explains why retailers are so giddy. Retail sales so far this holiday shopping season are coming in above expectations.

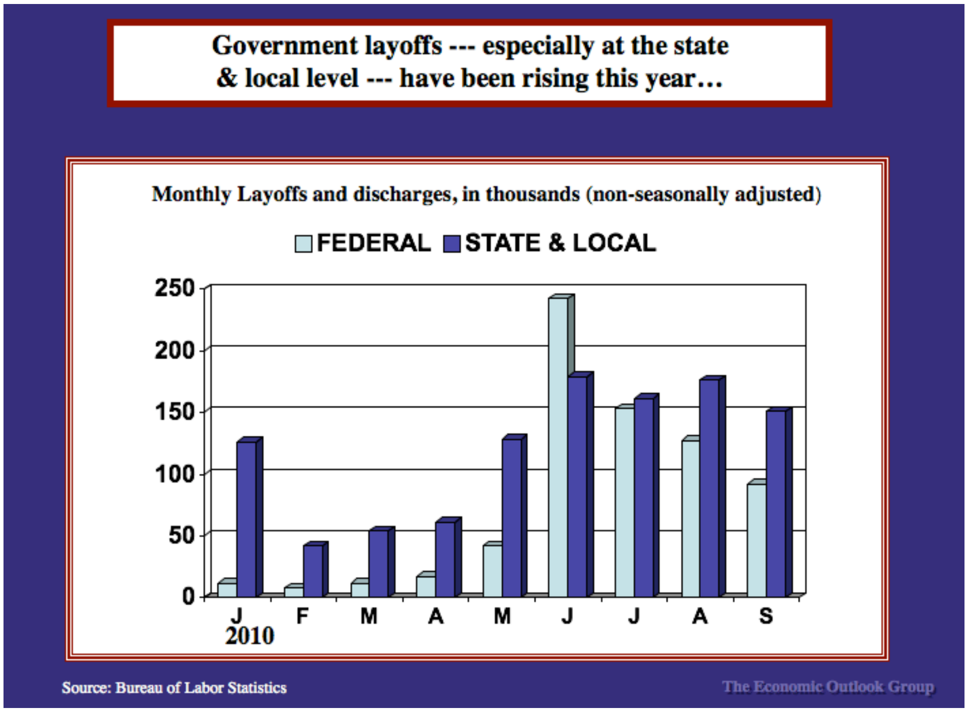
Construction Spending

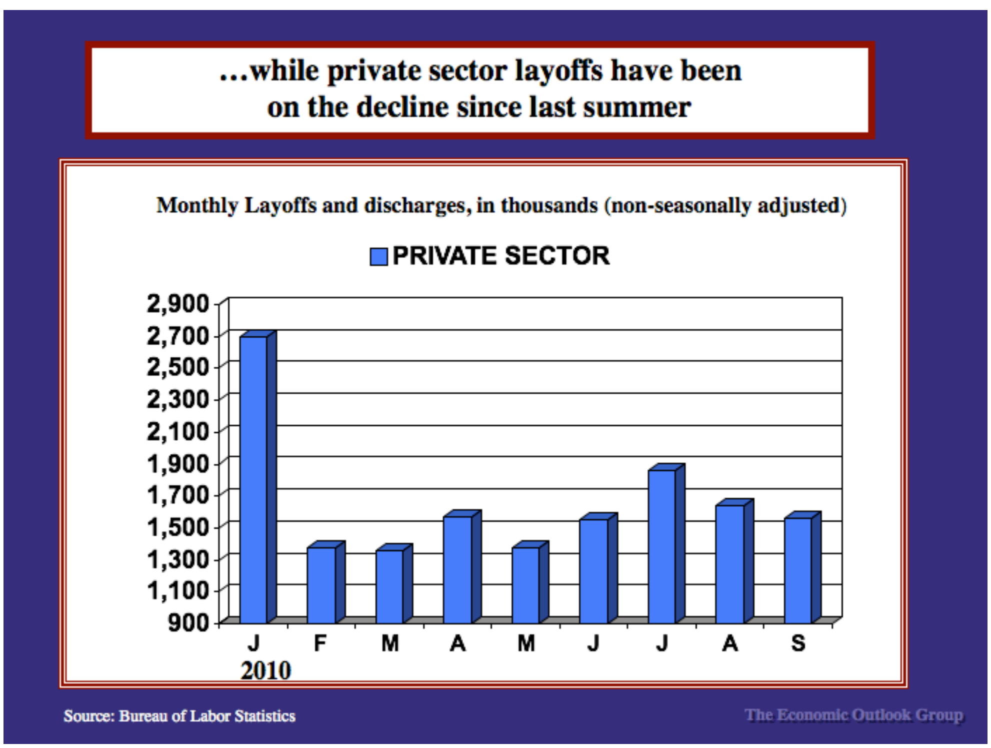
This was a nice surprise. Construction spending jumped 0.7% in October, marking the second monthly increase in a row. We haven't seen two back-to-back increases since last spring! The biggest contributor came from outlays in residential construction, where private builders spent 2.5% more in October than in September. A quick look at the November employment report showed home builders also hired more workers last month too. All good news to be sure, but…we're also realistic. The ongoing problems in the housing industry (low valuations, tight credit conditions, questions concerning the legalities of certain foreclosures, the emerging defects of some mortgage back securities) sadly means spending will likely remain depressed for much of 2011.

Weekly claims for unemployment insurance was a disappointment --- but just who is responsible for the speed up in layoffs?

Why, if the economy is improving, are we still seeing applications for jobless benefits above 400,000? First time filings for unemployment insurance jumped 26,000 in the latest week, to 436,000. Moreover, the previous week's 407,000 applications were revised up to show a gloomier 410,000. What's going on here? Aren't companies getting the message that with the economy strengthening, it might make more sense to put layoffs on hold?

We were admittedly baffled by this latest run up and began to dig into the BLS database to find out what's happening. What we found is interesting, if not quite definitive. The recent jump in filings may not be coming from the private sector. Most of the dismissals appear to reflect firings in budget-bleeding state and local governments around the country.





Any layoff is regrettable, of course, regardless where it occurs, but our task is to track private sector employment so we can better understand what macroeconomy is up to. What we see is a very interesting trend. Dismissals in the private sector have actually been falling since last summer, while those at state and local levels remain high or are climbing. We'll see if this trend continues next week, when the BLS releases the Job Opening and Labor Turnover (JOLT) survey for October. However, we got a sneak preview with the November jobs report which noted that local governments and municipalities slashed another 14,000 off their payrolls last month, to 14.24 million, a 4-yr low.

Bottom line:

The November payrolls report just doesn't smell right to us. As has been the pattern in recent months, the government will most likely adjust those numbers upwards after they collect more responses. In the meantime, we are attaching much more weight to the plethora of positive economic news released by the government and private organizations. As result, any retreat in the stock market should be viewed as good time to buy equities, and any rise in bond prices on the belief the economy is getting weaker, a great opportunity to sell Treasuries!