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ECONOMIC TALKING POINTS

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Deciphering the January Employment Report

Can it get any more confusing? The January employment report contained such a gallimaufry of numbers, it could be viewed as the perfect Rorschach test. Yet, as mixed as the data first appears, if you drill deeper into this release you'll find less ambiguity than first meets the eye. After getting our hands dirty digging into the statistical mire, we found a much more upbeat picture emerge on the labor front.

However, before probing further, it would be useful to see how these job numbers are first thrown together.

Each employment report contains the results of two separate surveys. One section is based on answers that come directly from "households." Here, telephone calls are made and surveys mailed out to 60,000 households every month. Recipients are asked a series of questions: Are you working? Were you working part time or full time? Were you employed part-time because you chose to do so, or because you can't locate any full time posts? If you were not working, how long have you been unemployed? If you're unemployed, have you been looking in the past four weeks?

In addition to the "household" poll, there is the "establishment survey" where government statisticians get in touch with more than 400,000 businesses each month. These employers are asked an entirely different set of questions: How many jobs did you fill in the month? How many did you eliminate? On average, how many hours did your employees work each week in the month? How many hours in overtime? How much has average hourly and weekly pay increased or decreased in the month?

Sending out the queries to households and businesses is the easy part. Where it gets problematic is that the Bureau of Labor Statistics, the agency that computes the monthly jobs report, does not receive all the responses back in time for the formal release. For instance, only 60% of the companies fill out and return the survey under the deadline. Firms tend to be notoriously late in answering the BLS inquiries. So the initial employment report is usually based on incomplete information. As the tardy responses flow in afterwards, government economists go back and revise the previous monthly job numbers.

On top of these monthly updates, the government also undertakes annual benchmark revisions (typically published every January) which not only folds in the most complete set of responses, it also reflects modifications made in the seasonal adjustment factors (which in this instance are a set of formulas that seeks to discern meaningful variations in employment from normal seasonal variations).

When all the employment numbers are counted, it stands to reason that the household and establishment surveys ought to agree on what's happening in any particular month. Ah, but they often don't. So one can reasonably ask then which one offers a more accurate picture of the job market — the household or establishment survey?

The answer depends on where we stand in the business cycle. The household survey tends to be a better leading indicator when an economy first emerges from recession, while the establishment survey typically sends out the first warning signals when a recession is in the offing. Thus for now, we ought to place more weight on the household survey. That does NOT mean we should ignore the establishment survey. The fact is each contains critical information about the economy that the other lacks.

Household Survey

With that in mind, let's review some key statistical points from the latest household survey because it contains some fairly good news.

1. Based on responses from households, 541,000 more people found jobs in January, nearly offsetting the 589,000 decline in employment the previous month.

2. The number of people who were unemployed last month declined by 430,000, to 14.8 million. This was the third consecutive monthly drop in joblessness and it brought the number of unemployed to lowest level since last July.

3. Another encouraging piece of news was that the labor force increased by 111,000, which means more Americans are sufficiently upbeat about the economy and the prospects for work that they have resumed looking for employment. (The point is that in order to be counted in the labor force, you are either employed or have applied for a job in the last four weeks. Those too frustrated to even bother searching are removed from the labor force count.) The January report is thus good news in that it reflects more confidence among Americans that the economic recovery will lead to more hiring.

4. Then there's the headline unemployment rate, which tumbled to 9.7% in January, from 10% the month before, bringing it to its lowest level since August. Does this mean unemployment reached its cyclical peak of 10.1% in October? Probably not. As much as we would like to believe the rate will decline from this point on, the upturn in the economy will likely cause the labor force to increase in size at a faster rate than actual employment. In other words, with the economic activity picking up more steam, the number of Americans rejoining the labor force will rise more rapidly than the pace of hiring, and that will kick up the unemployment rate to perhaps as high as 10.4% by spring, in our view.

5. One key sign that conditions are improving in the job sector comes from the number of Americans who were stuck accepting part time work because they couldn't locate suitable full time employment. This group fell to 8.3 million --- the lowest in a year, suggesting that more full time opportunities are opening up.

6. Related to the point above is that the underemployment rate (also known as U-6), a series that has gotten a lot of attention in the business press lately, has now fallen to 16.5%, also matching the low figure of last July.

To be sure, the news wasn't all upbeat among households. One dissonant note was the jobless rate for Black and African Americans; it leaped to 16.5% in January from 16.2% the previous month. Secondly, the number of Americans who were unemployed 27 weeks or longer increased to 6.3 million in January, from 6.13 million the month before. Those out of work five weeks or less --- which would indicate more recent layoff activity --- rose to 3 million last month from 2.9 million.

Nevertheless, when you look at the totality of the household numbers, the basic story that emerges is that the job market has moved past the inflection point and is now turning up.

Establishment Survey

Now on to payroll survey, which possesses a jumble of statistics. Yet even here, there is an identifiable theme that is more positive than negative.

1. Payrolls fell by 20,000 in January, largely as a result of cuts in construction. If you simply remove the 75,000 job loss in construction, then hiring in the private sector actually surged by an impressive 63,000! In other words, it was just one specific industry that is to blame for the negative payroll stats.
2. Then we got the inexplicably awful revision for December. The government nearly doubled the 85,000 loss initially estimated, to an eye-popping drop of 150,000 last month.

But the most bizarre twist was in the revision of November's payrolls. New numbers showed a 64,000 hike in payrolls ---instead of a preliminary 4,000 increase. What accounted for this change? Better get out the Dramamine. The initial November numbers showed all 4,000 workers were hired by the government --- and NONE by the private sector. Well, now the BLS did a complete about face!! Private firms actually increased their payrolls by a net 75,000 in November--- and it was the government who eliminated 11,000 posts. Yes, that's good news for November but you have to wonder why they first got it so wrong.

3. Here's some more positive news. Average weekly hours worked in manufacturing, an important leading indicator for future employment, rose to 33.9 in January. This means production workers were on the job in January longer than at anytime since June of 2008! We find a similar story with overtime. Average weekly overtime has been rising steadily since last March and came in at 2.8 hours during January, the most in a year and a half.

4. Temporary employment added another 52,000 people to payrolls last month, the fourth consecutive monthly increase. Total employment in the temp sector is now the highest in a year, a strong precursor to more permanent employment.

5. One particular sector that suggests consumers are out in force and spending again is the jump in retail employment, which increased by 42,100 in January. In three of the previous four years, retailers would layoff workers the first month of the year since the holiday shopping season is essentially over. Not this time, however. The rise in retail hiring last month was the second largest for January in 15 years, and is consistent with a spate of better than expected news on consumer spending.

Bottom line:

No economic indicator is awaited with greater anticipation than the jobs report. It's the single most important report card on the economy and the reason we scrutinize it so carefully. So let's put it in perspective. Yes, the benchmark revisions were certainly horrific now that the government added another 930,000 to the number of jobs lost between April 2008 and March 2009. That brought total losses since the start of the recession to 8.4 million jobs. Not since the Depression have we seen so many positions lost in such a short period of time. These are sickening numbers, to be sure. But they also reflect events that occurred more than a year ago.

The climate has greatly changed since then. In the last few months we've seen a cascade of exceptionally strong reports on the economic front. GDP growth in the fourth quarter stunned many when it surged at a 5.7% rate, the fastest pace in six years! The future-looking ISM report on manufacturing expanded in January by the most in five years. Consumer spending has now been rising for three months in a row. Consumer confidence levels are now the highest in more than year. Fewer banks were tightening credit standards to businesses and households in the last quarter, according to the Federal Reserve. Business activity in the service sector is now the busiest in a year.

And today we got the January employment report, which if studied carefully, provides more concrete evidence this economic recovery is, at last, working its way into the labor market.