THE ECONOMIC OUTLOOK GROUP

475 WALL STREET
PRINCETON, NEW JERSEY 08540 TEL: 609 - 529 - 1300
WWW.ECONOMICOUTLOOKGROUP.COM

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

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Is the Labor Market Improving or Not?

No economic measure has lately caused as much confusion as those that gauge labor market conditions in the US.

In the last several weeks, government agencies and private organizations have released half a dozen employment-related indicators and rarely have they so disagreed with one another. Their inconsistency poses a problem not just for money managers but also for business leaders who are trying to anticipate consumer spending trends and, of course, to policymakers who view employment conditions as the ultimate report card on the economy.

So what are we to make of these disparate job statistics?

To begin with, not all employment reports possess the same value in their portrayal of the job market. Certainly today's release on the number of Americans filing for jobless benefits the week ending June 12 was a bit of a head-scratcher. New claims for compensation rose 12,000 during the latest week to 472,000, a one-month high. The increase is clearly a disappointment, especially with an economic recovery that's now a year old. By now one would have expected to see filings, at the very least, approach the 400,000 threshold. Instead, claims remain stubbornly high and this is obviously disconcerting.

I suppose one could find good news from the decline in the less volatile four-week moving average, which slipped to 463,500 from 464,000 --- or that the total number of people collecting all types of unemployment benefits dropped by 350,000 to 9.47 million in the latest week available (May 29). But even these improvements are not enough to shake the feeling that companies are simply in no rush to ramp up hiring, especially given the uncertainty of how much Europe's sovereign debt crisis will undercut U.S. economic growth. (That message also came through with the May jobs report when private sector employment increased by 41,000, the fewest since January.)

But here's the dilemma. Several other recent reports on employment showed labor market conditions are better than they have been in years and that firms have actually accelerated hiring! Take a look at the respected ISM (Institute for Supply Management) surveys. The employment index in manufacturing soared in May to its highest level in six years. And when the ISM polled service providers on jobs, a sector that accounts for nearly 90% of the economy, hiring expanded last month for the first time in 28 months!

Moreover, if the job market was so dismal we would have seen recent consumer confidence measures reflect that. Households are hypersensitive to changes in employment conditions. What we saw was that consumer optimism continues to climb. The University of Michigan's Consumer Sentiment report showed Americans in mid-June were in the best mood in more than two years. Even the Conference Board's Consumer Confidence index showed a similar two-year high during May, its latest month. One reason for those upbeat results is that consumers saw the outlook for employment improving currently as well over the next six months.

How then should we interpret this gallimaufry of employment reports?

When it comes to hiring, don't view the corporate sector as one homogenous entity. Business has bifurcated into two sectors.

Large goods-producing firms are doing considerably better than small and medium firms. For instance, large companies have access to capital markets, possess a more diversified product line, have lots of cash on their balance sheets, and are benefiting from the growth in exports. The result: Since March, these large firms (with more than 499 employees) have increased their payrolls.

On the other hand, small and medium-size goods-producers firms are still struggling. This is a sector that typically has less access to capital markets, offers a smaller line of products, has limited export opportunities, and possesses far less cash on their balance sheets. As a group, small and medium-sized goods-producers have reduced their payrolls since March and thus the likely main source for the stubbornly high filings for unemployment insurance. However, we expect conditions will improve for small and medium size goods producers in the second half of this year as the US economic recovery continues and the European debt crisis becomes more manageable.

Fortunately, we see little such division within the service sector. Small, medium and large service providers have all been adding to payrolls since the beginning of the year.

The bottom line:

Labor market conditions overall are not as weak as the jump in jobless benefits might imply. Other highly credible studies (e.g., the ISM releases, the consumer confidence series, the Challenger, Gray & Christmas survey on corporate downsizing) point to a job market that has been improving this year and that trend shows no meaningful sign of reversing.