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ECONOMIC TALKING POINTS

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February Jobs Report: Getting the Right Perspective

Given the severe snowstorms across the country last month, the February jobs report turned out to be better than expected. Indeed, there is growing evidence we are now on the cusp of a rebound in hiring. Businesses are moving ahead with spending plans. Consumers have resumed shopping. Exports continue to rise. Interest rates are holding at record lows and inflation remains subdued. Moreover, there is still plenty of federal stimulus that has yet to make is way through the economy.

In many ways this is starting to look like a traditional recovery, with one notable exception: credit is still difficult to obtain. That can constrain economic growth, of course. But the if the pace of business activity continues into this spring, which is a certainty in our opinion, employers will be under increasing pressure to accelerate hiring. As household and business income rises, banks will gradually resume lending since the risk of default by new borrowers has diminished.

OK, some of you may be wondering what kind of cool-aid we drank this morning to come up with such an optimistic outlook, especially when February payrolls fell by another 36,000, followed by an upward revised loss in January of 26,000 jobs, not 20,000?

First of all, February's payroll numbers turned out to be far better than expected. A Bloomberg survey of forecasters predicted a drop of 68,000 with some economists seeing a decline of as much as 150,000 jobs. They also thought the unemployment rate would increase to somewhere in the range of 9.8% to 10.1%. Well, wrong again; it held at 9.7%.

We could go on an on about the widening divergence between the actual economic numbers and those predicted by forecasters. The point here is that too many economists fail to grasp the underlying strength of this recovery. Indeed, we believe February would have seen a net increase in payrolls had there not been any major storms last month.

Why are we so upbeat? Take a look at a few of the data points in the February jobs release.

• Temporary employment jumped by another 47,500 last month, its fifth consecutive increase. The size of the temporary workforce has now risen to 2 million, the most since December 2008. Historically, such a persistent rise in temp workers sets the stage for an increase in permanent hiring at this point in the business cycle.

• The household survey reported that another 308,000 Americans found jobs in February, and that followed an increase in employment of 541,000 in January. This is the first back-to-back increase in monthly employment in nearly two years and the biggest two-month gain since 2005! (Imagine what the numbers would have been had there been no storms!)

• The minute drop in average weekly hours, from 33.9 to 33.8 should also be viewed as positive, given the adverse weather conditions throughout the month. It's remarkable the fall in hours was not larger.

• But the real blow out numbers in last month's employment report can be found in the diffusion index. While this series is not followed as closely as the payroll numbers or the unemployment rate, it does have great value if you want to understand how widespread the changes in employment conditions are across different industries. For example, the diffusion index for the private sector is based on survey responses from 278 industries. They are asked whether their firm registered an increase in employment, a decrease, or no change at all during the month. The higher the figure, the greater the improvement in the labor market. February's diffusion index for all private business rose to 48, the highest in two years. (It was 17.1 a year ago!!) But the more impressive statistic was the result for manufacturing, which is based on 84 industries. Here the diffusion index soared to 54.9. It's the first time this measure rose above 50 since November 2007 and happens to be the highest in more than three years. It's more evidence that companies are now in the process of adding more workers and/or dismissing fewer employees.

But let's not stop with February's official employment release, which is based on surveys taken by the BLS between the 7th and the 13th of the month --- dates that included two major snowstorms. Take a look at other more timely surveys that touch on employment conditions around the country.

One is the Federal Reserve's latest Beige Book which examined economic conditions across the Fed's 12 districts based on information collected by Feb. 22 (i.e., more current than the BLS employment survey). That report found evidence that some districts have begun to show an increase in hiring as well as a slowdown in layoffs.

Another positive sign that recruiters are stepping up hiring came from the release of the Monster Employment Index, released just yesterday. That measure, which quantifies online job demand, surged to 124 last month, from 110 in January. February's turned out to be the highest since December 2008 and the largest month-over-month increase since the company began compiling the index in 2003!!

The ISM manufacturing report for February, released earlier this week, showed the employment index jumped to 56.1, the highest in more than five years. It's the fifth consecutive increase in this series. Moreover, 10 of the 18 industries polled in this survey said they hired more workers last month, a data point that corroborates the high diffusion index for manufacturing in today's employment report.

Bottom line:

The economy has now grown for more than 6 months. Up to now, employers have been pushing their existing workforce to put in longer hours. They've also added temporary workers to help satisfy the increase in orders from customers. But we are now approaching a critical inflection point in the hiring process. Employers are not just reducing layoffs, they are gearing up to hire again. Once payrolls turn positive, which could happen as early as this month, it will raise household income, improve consumer confidence and increase spending --- all factors that will help fortify this recovery.