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

November 8, 2013

October's Employment Report: Jobs, The Economy & The Effects Of The Government Shutdown

The jobs report has always been the most eagerly awaited of all economic indicators. But when you are buffeted again and again with statistical whiplash, it can utterly undermine the integrity of the data and complicate the decision making process for government policymakers, business leaders, and money managers.

Everyone knew the 16-day government shutdown and worries of the US breaching its debt ceiling would generate lots of distortions in the economic stats for the month of October. We saw this in the weekly jobless claims, which initially surged. The dysfunctionality in Washington and its impact on the economy also pummeled consumer and business confidence the last two months. Home sales weakened as well. Most disturbing was the first report on September jobs, which also contained August revisions. Both were downright ugly. In short, the economy looked like it was unraveling.

But then came the surprisingly strong (if somewhat uneven) GDP numbers for the third quarter. That report came after a pair of October PMI reports from the Institute for Supply Management, which indicated the economy, is in very good shape. Then today came October's employment report and it stunned most forecasters when job creation in the private sector turned out to be the best we have seen since February --- and it happened, astonishingly, in a month that saw absolute paralysis in Washington and dire warnings of sharply higher interest rates and a recession if the US defaulted on its debt.

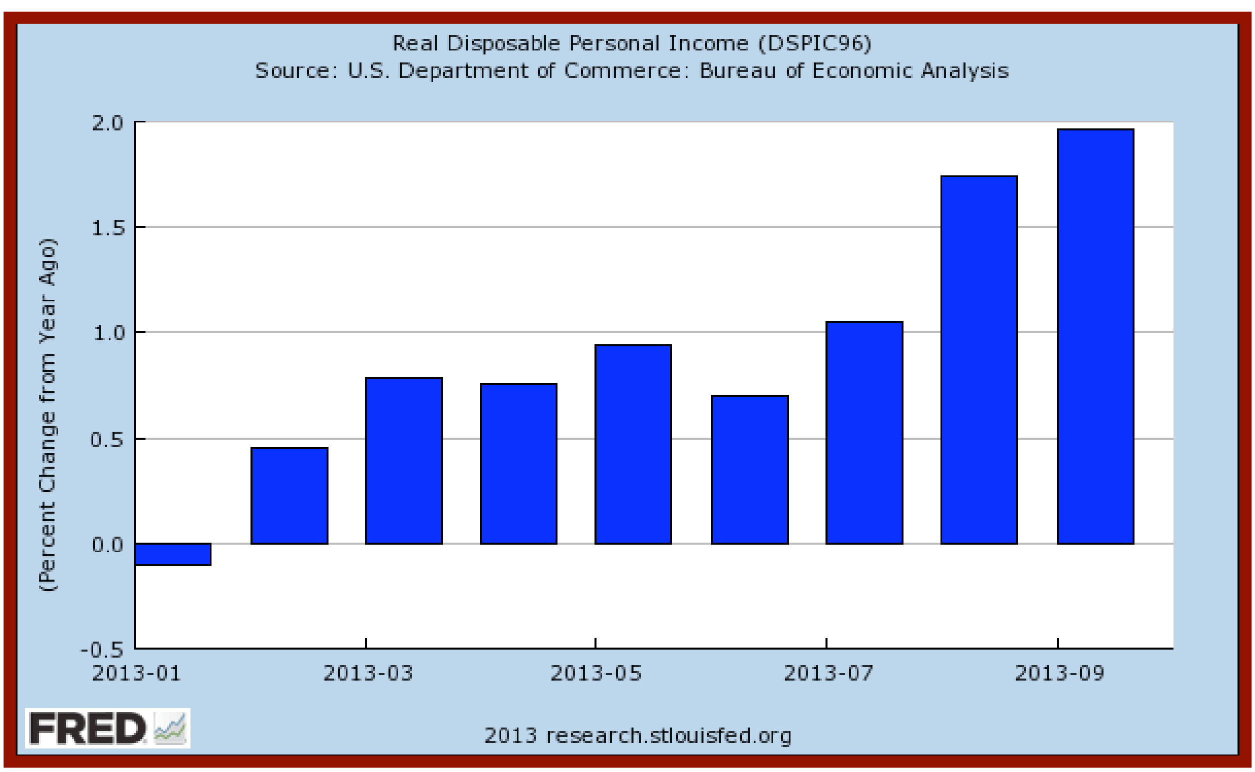
All of this begs two questions. Given the data whiplash, just what is the fundamental health of the economy? And second, how much weight should we give the latest job numbers?

Let me answer both questions right up front.

The current fundamentals of the US economy are actually the best we have seen in nearly a decade. Indeed, we continue to believe growth will accelerate beyond 3% in 2014. Why? Let's return to the basics.

First, there are no economic imbalances in the private economy right now. For example, neither consumers nor businesses are carrying excessive debt. Inflation is certainly not an issue at this time, or within the foreseeable future. If anything, there is greater concern at the Federal Reserve of deflation. Business inventory levels across the board (factory, wholesale and retail) are also well under control.

Second, household finances and net worth are in great shape. Real purchasing power is improving. Yes, nominal wage growth has been anemic, but inflation has risen at an even slower rate. Check out today's release on September's personal income & spending and you see that real (inflation-adjusted) disposable personal income jumped to 2% over the past 12 months, the highest annual increase so far this year!



Another factor brightening the economic outlook is that more central bankers around the world seem inclined to keep interest rates low for a longer period of time.

Fourth, though this may initially appear inconsistent with the previous point, we are also seeing a genuine improvement in the major economies of Europe, Japan and China, and this should lift US exports to record territory.

I'll throw in a fifth point which is that more and more Americans are becoming de-sensitized to the follies in Washington, a shift that should buoy consumer and business confidence in the coming months.

The combination of all these factors should support more vigorous economic growth next year.

How much weight we should give the latest jobs report?

We're going to give it a lot, and here's why. The first stat to look at in this case is ***not*** found in the employment report itself. We want to know how large the data collection was for this report. In other words, given the more than two week government shutdown, which included the statistical agencies, just how much feedback did the BLS get from their questionnaires to companies and government agencies (federal, state, local). Remember, every month about 145,000 businesses and government agencies, representing some 557,000 individual worksites, are asked to provide employment information.

Here's the surprising answer: The response rate turned out to be 83.5%, the highest the BLS ever recorded for a preliminary report on employment! This is due, of course, to the fact that agency statisticians had a couple extra days in November to collect October's responses. This high initial response rate, we feel, gives October's release more credibility.

So, while some analysts were looking for payroll numbers to come in ***below*** 100,000, we did not. But neither did we expect to see numbers above 200,000. After viewing the report and considering the collection rate, we do not view with suspicion the surprise 204,000 increase in nonfarm jobs last month, and the 212,000 jump in private sector positions.

Chart 1. Unemployment rate, seasonally adjusted, October 2011 – October 2013

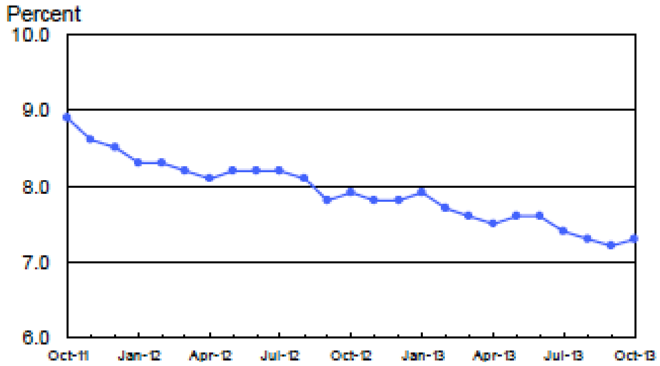
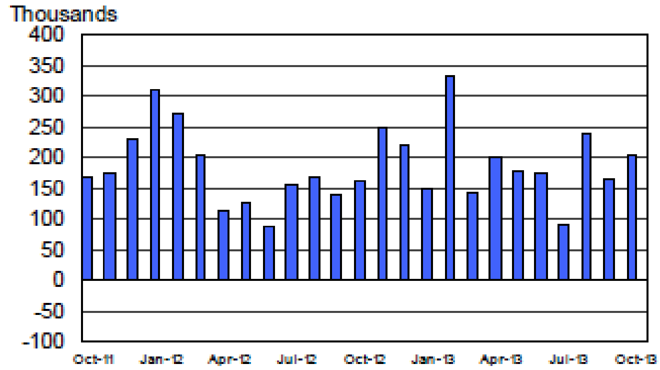


Chart 2. Nonfarm payroll employment over-the-month change, seasonally adjusted, October 2011 – October 2013



Establishment Survey

Let's drill a little deeper into the establishment part of the report. Outside of the government, every major industry either ramped up hiring or kept their payrolls steady (except for "wholesale trade" which saw a slight loss). Employment in the goods producing sector (mining, logging, construction, manufacturing) rose 35,000 with all the key industries making a contribution. Payrolls in the much larger service sector was up 177,000 last month with all but one (wholesale trade) making a contribution.

Average weekly hours worked in October was 34.4, no different than September's and higher than the year ago pace of 34.3 hours. Moreover, both hourly and weekly earnings in the private sector rose in October!

Is the rebound in employment consistent with other economic reports that touch on jobs? Yes. We saw some very good stats on corporate hiring in the PMI series. Their well-correlated employment index for services showed hiring ***accelerated*** in October. The ISM employment index for manufacturing ***also expanded***, if at a slightly slower pace than September's.

Household Survey

Now, it is true the BLS household survey noted the jobless rate ticked up from 7.2% in September to 7.3% last month, but this is where the data suffers from some statistical noise. According to this survey, some 735,000 people were no longer employed last month, with 720,000 leaving the civilian labor force. Pretty alarming numbers. However, it is important to keep in mind that the BLS uses a ***different set of definitions and concepts*** with household survey.

What is different? In the establishment survey, federal employees on furlough during the government shutdown were ***still*** considered employed because they received pay for the period that included the week of the 12th last month. (The partial government shut down began October 1st and ended on October 16th.)

In contrast, the household survey takes a different approach in their methodology. Workers who indicated they were not working during the reference week due to the government shutdown and expected to be called back afterwards, were still classified as unemployed on temporary layoff, whether they were paid or not during their furlough. That greatly added to the rise in the overall number of persons unemployed.

The bottom line on the October employment report is that the results of private sector hiring in the establishment survey more accurately reflects the underlying strength in the labor market and economy. These results have been corroborated by the improvement in October's overall PMI reports and the boost in nominal and real disposable personal income the last two months.

Undoubtedly, there will be those who will point to the dismal numbers on **consumer confidence** of late. The University of Michigan's early read on November consumer sentiment, for example, plummeted to the lowest level in two years. And yesterday, the weekly Bloomberg Consumer Comfort Index fell to its yearly low. But we need to stress that there is no short-term correlation between confidence and consumer spending. Case in point: Americans still increased spending in September in nominal (up 0.2%) and in real (+0.1%) terms, though not as much as in August (+ 0.3% and +0.2%, respectively).

So what to make of the gallimaufry of recent economic data?

We doubt a convincing argument can be made that says the US will remain stuck with lackluster growth through next year. Consumers are not about to disappear; they are not about to enter the witness protection program. Moreover buisnesses are flush with cash and eager to put that money to work. When you combine the rise in private sector hiring, the healthy finances among households, businesses and banks, the low cost of capital, absence of inflation, and the emerging recovery of foreign economies, then the outlook for 2014 turns out to be a very positive one.

==============================