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ECONOMIC TALKING POINTS

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December's employment report: What is the *real* story about jobs?

Surprised at the meek 74,000 gain nonfarm payrolls and the unemployment rate dropping to 6.7% in December? So were many others. The question is what should we make of this report? To be brutally honest, the latest employment release deserves to be dismissed on the spot. The critical question is whether the Federal Reserve will do the same.

Why ignore December's job numbers? Simple. To better understand current and future business conditions, economists look for some consistency in the statistics that gauge the economy's health. The dismal rise in payroll, however, is an outlier; it has the feel of measuring a different universe light years away. The BLS report deviates dramatically from half a dozen other recent gauges that uniformly show a marked improvement in labor market conditions last month. So this time, one has to give much greater weight to the group in agreement, rather than the government's report which is completely at variance.

What then accounts for this morning's worse than expected job numbers? We suspect a combination of factors were involved: Weather, the holidays and insofar as the household survey is concerned, some significant changes to their seasonal adjustment factors last month. It will take time to sort out what was behind this anomaly. In any event, we do expect to see December's job figures revised higher when the January report is released.

Nevertheless, let's drill down into the December employment report. The BLS stated in its household survey that 347,000 people left the labor force last month. This was the result of 143,000 who claim they found work, but those numbers paled in comparison to the 490,000 jump in December's unemployed. As a result, the labor force participation rate plummeted to 62.8%, the lowest in 35 years--- and drove down the jobless rate to 6.7%, the smallest percentage since October 2008. While we all want to see the unemployment rate drop --- and it did for all demographic groups last month----it should be based on a genuine increase in hiring and not due to people who quit looking for work. Apparently, government statisticians surveyed 60,000 households in December and found a lot of snow-bound individuals across the country who understandably found it difficult, if not risky, to get on the road and actively seek work.

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

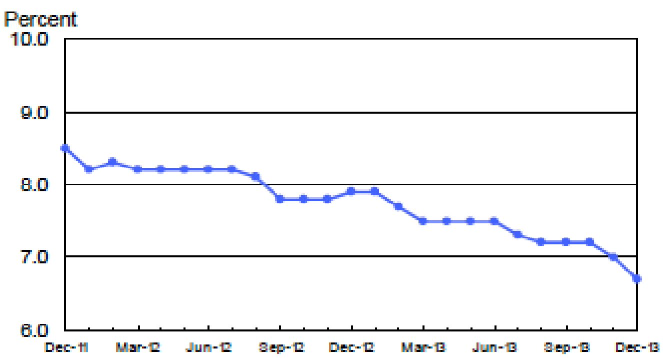
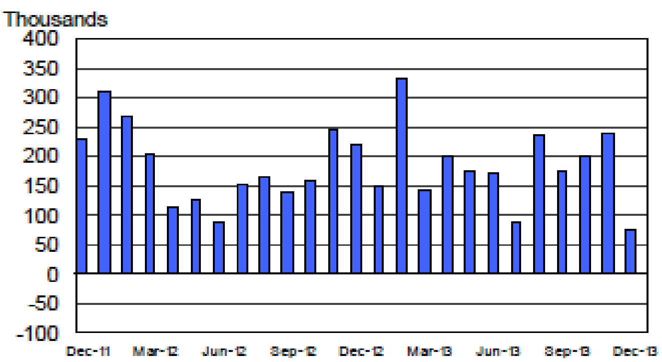


Chart 2. Nonfarm payroll employment over-the-month change, seasonally adjusted, December 2011 – December 2013



Also baffling was the miniscule gain in total nonfarm and private payrolls. They were up 74,000 and 87,000, respectively. Again, these numbers are very likely to be revised up in the next release. What undermines the integrity of the latest set of payroll numbers are the mixed messages seen in the details.

For example, in sharp contrast to the meager gains in nonfarm payrolls, there was a significant jump in hiring at employment agencies. Apparently demand for workers in the economy was so high, these agencies had to hire another 34,000 employees to help out. That is the biggest jump since September and the third largest of the year. The number of people now working at executive recruiting firms and general employment agencies is the highest since August 2007, months before the onset of the last recession!

Another sign of economic vitality buried in the report was the increase in hiring of truck drivers. It's a key statistic that reflects how busy the supply chain transportation network is in the US. As domestic and foreign demand for American-made goods rises, trucking firms respond by hiring more drivers. Employment in this sector has now been accelerating for six straight months and now stands at 1.40 million, the most in nearly five years.

Our main point is that we should not form any general conclusions on the overall job market or the economy on the basis of a single government report ---especially when it blatantly contravenes so many other barometers of the job market. Let's list a sample of them below:

1. The ADP Employment Report showed private payrolls jumped by 238,000 last month (nearly three times more than the BLS reported). According to ADP, hiring has been increasing in each of the last four months with December's pace being the best since November 2012.

2. ISM's manufacturing employment index in December rose to 56.9, the highest reading since June 2011.

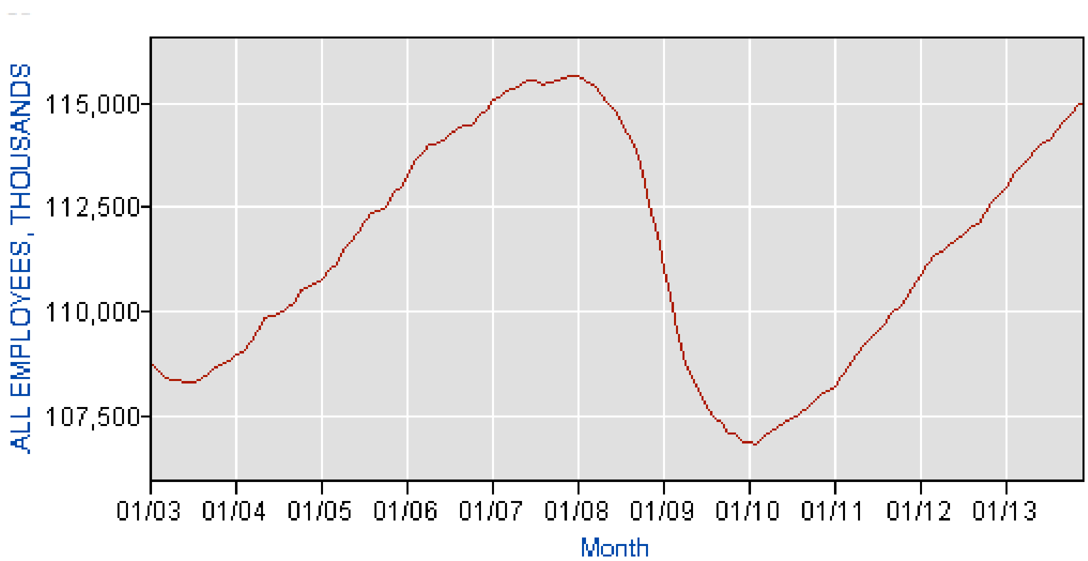
3. ISM's non-manufacturing employment grew last month for the 17th consecutive increase.

4. The Conference Board just reported that online job postings have been growing for the last six months. In December alone, the number of vacancies advertised increased in 36 of the 50 states.

5. The National Federation of Independent Business, a trade group that represents small firms, announced their members increased employment in December by the most since February 2006!

We'll even save the last intriguing factoid right out of the government's own internal stats: In spite of the anemic rise in the private nonfarm payrolls last month, total employment in the private sector now stands at a 115.03 million, a stones throw of its all time high of 115.67 million reached in January of 2008. We should surpass that record by March.

Total private employment in the U.S.



Bottom line:

The preliminary December employment report by the BLS should really be brushed off. Their numbers just do not offer much new insight about the underlying strength in the economy and labor markets, and they certainly should not be the basis for any change in monetary policy.

The US economic recovery is not in the process of slowing. Consumer and business confidence levels have been on the rise, as have their expenditures. The Federal Reserve should not waver in its strategy of further scaling back purchases of Treasuries and mortgage-back securities. While today's employment news did cause yields on 10 yr Treasuries to drop back to 2.88%, and drove equity prices down, we expect both will boomerang back to their pre-Friday levels within a week or so. In any event, regardless of the December employment release, we are not changing a decimal point in our macro forecasts, which projects economic activity in 2014 and 2015 to be the strongest back-to-back in a decade.
