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ECONOMIC TALKING POINTS

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Economic Whiplash:
A Big Drop in the Unemployment Rate...Yet Only a Modest Rise in Payrolls

It's unfortunate we invest so much time pouring over the headline numbers on the initial monthly jobs report. The first draft on employment often ends up creating more confusion than anything else. It is typically based on incomplete data and the government routinely comes back a month later to say, in effect, "never mind," here's what *really* happened! Yet, many investors, analysts and the media assign it way too much credence. That can be dangerous for a report that is unequalled in its impact on the financial markets and on economic policy.

So here we go again.

This time confusion began after ADP came out with its shocker that private payrolls exploded in December; it surged by 297,000, the most that group ever recorded! Many analysts reflexively jumped to revise their own forecasts up so they can look good when the government releases the official numbers two days later. What followed, though, was akin to economic whiplash. When the government published the latest job numbers, private payrolls turned out to be just **one-third** of ADP's estimate! Disappointing to be sure.

But don't despair because the December report also allowed you dwell on the more cheerful news regarding the unemployment rate, which plunged from 9.8% in November to 9.4% last month, the biggest single drop in more than a decade. So you can frown or smile at the employment news, whichever is your fancy. Simply put, the December employment proved to look more like a classic Rorschach test. You see whatever you want to see.

Still, is there anything we can comfortably take away from the latest employment figures that is meaningful? Yes, there is.

First, make no mistake; we have turned the corner on job creation. Employers are more optimistic that the economic recovery is on solid ground and worry less about the prospect of a double dip recession. (See results from the last Business Roundtable survey and that by the National Federation of Independent Business.)

Second, don't despair over the modest rise in December's payrolls. If there is one pattern emerging with the employment releases it is that during a recovery government economists routinely make upward revisions on earlier months. For instance, the increase in October's private payrolls went from 160,000 to 193,000, the second biggest jump in 2010. They also crossed out November's preliminary figure of 50,000 and lifted it to 79,000 (a 60% revision!). December's first release showed private payrolls rose an estimated 113,000, but it is highly probable they will bump up that number as well, though it still may still fall short of the ADP figures.

What does count is that the overall employment trend has been improving. Private payrolls grew on a quarterly basis all year. Here's the average monthly breakdown by quarter in 2010.

IQ = 79,000
IIQ = 118,000
III Q = 124,000
IV Q = 128,000

The pace of employment is bound to pick up more markedly this year. That is because companies so radically slimmed payrolls during the recession, many are now in anorexic staffing shock. With demand increasing from domestic and foreign sources, U.S. firms will now move more quickly to add workers. Not doing so risks falling behind in filling orders and angering customers.

Third, the big drop in joblessness to 9.4% last month may have produced smiles and a few high-fives by analysts and policymakers. But let's get real here. While we're up quite upbeat on the outlook for jobs, we are highly skeptical of December's improvement. It is highly suspect. The latest release noted that 434,000 people left the labor force last month, the largest exodus in six months. That certainly helped pull down the jobless rate. Why did so many people suddenly leave? Are they so disgruntled and exasperated that they simply gave up seeking work? Not really. Let's keep in mind that some simply stop looking for a job during the holiday season. It's not unusual for this time of year. In December 2009, for example, the labor force shrunk by 805,000, the most that year. Most came back a few months later. We expect the same phenomenon will occur this time. Many who left the labor force in December will return fairly soon and resume their search. In other words, don't be stunned if the jobless rate kicks up again this quarter when the pool of active unemployed are counted back in the official numbers.

Fourth, to better understand the dynamics in the job market, we really have to look to data points that have demonstrated their predictive validity in the past. Below are some markers that are especially worth monitoring.

A. Temporary workers

Now that there is a growing conviction among employers that the economic expansion will endure, we should see a shift away from temporary hiring to permanent employment. That process appears to be underway. Temporary employment rose by 15,900 in December, the slowest in four months. Except for a one month drop in temporary workers last July, December's increase was the smallest increase of the year.

In a separate employment survey by the BLS, staffing at employment agencies charged with placing workers in ***permanent*** jobs has jumped to its highest level since January 2009! So business is clearly picking up to staff workers on a long term basis. (This BLS series lags by one month so it reflects data as of November.)

B. Overtime in Manufacturing

Overtime has been rising throughout 2010 and peaked out at 3.1 hours every month the last quarter, which happens to be the highest level we have seen in more than two years. Interestingly, the last time companies asked their employees to put in as many overtime hours was in May 2008 when the jobless rate stood at….5.4%! Rising OT is a reliable indicator of future employment gains. After all, at some point workers become fatigued which can reduce the quality of their work.

C. Working Part-time For Economic Reasons

The number of Americans forced to accept part time employment because of dismal economic conditions has now fallen for three straight months, and now stands at 8.93 million.
This group consists largely of those who were asked to downshift from full time to part time because of weak business conditions. The good news is their numbers have declined to 6.01 million in December, the smallest in eleven months. As expected, with the economy picking up more steam, employers are asking an increasing number of workers to return to full time work.

D. Average Weekly Earnings

Worker pay also has also been rising in the private sector. The December jobs report showed that average weekly earnings increased 3.3% over the last 12 months, **TRIPLE** the rate of consumer price inflation. With inflation still dormant, working Americans are seeing an increase in real earnings and that typically translates into more consumer spending.

E. Other Important Job Gauges in the December Report.

1. Employment in the **trucking industry** jumped by 2,600 last month. Trucking is a critical part of the nation's supply chain system. It carries freight to manufacturers, wholesalers and retailers around the country, and transports goods to and from ports. Needless to say, a jump in demand for truckers underscores the vitality of this recovery. Total employment in the truck transportation sector rose to 1.25 million in December, the most we have seen in more than a year.

2. Are Americans comfortable enough about the economy that they are spending more time and money at restaurants and bars? It appears so since these venues are hiring more people to service customers. Employment at **"food services and drinking places"** climbed another 24,500 in December to 9.56 million, the largest since the summer of 2008!!

3. Another less well-known but highly sensitive barometer of economic conditions is employment in the field of **couriers and messengers,** those who typically travel within a local area and pick-up or deliver legal or financial documents, passports, and airline tickets. Employment nationwide of couriers and messengers swelled to 536,400 in

December, a high for 2010.

Bottom line:

Today's employment news has to be viewed in conjunction with numerous other economic indicators, including the frothy ADP report. No single indicator --- not even today's BLS "preliminary" jobs release ---- should be seen in isolation. What we look for is corroboration among different data sets. Virtually all the reports agree that both the economy and job creation are accelerating. New orders at manufacturers are arriving at the fastest pace since May, according to the Institute for Supply Management. Orders in the service sector, which makes up nearly 90% of the economy, just jumped to its highest level since 2005!! The increase means factories and service firms will be under pressure to hire more workers in coming months. We also have evidence that firms are scaling back layoffs. The BLS reported yesterday that applications for new unemployment insurance fell to the lowest in more than two and half years, based on the four-week moving average. The Challenger Gray & Christmas group largely confirmed that trend when they said that announced corporate layoffs in December dropped to the fewest in more than a decade.

Does all this mean the economy is finally running on all six cylinders? No. There's one cylinder that is still sputtering --- housing. Nevertheless, we should begin to see even that sector, specifically housing starts, show signs of life again later this year and contribute to jobs and economic growth.

While December's first glance on payroll numbers turned out to be less than expected, there is a body of supporting economic evidence suggesting the tide has finally turned for employment and this will be substantiated in the coming months.