SL Sightlines
Tracking the American Economy

October 2013

IT'S STILL ALL ABOUT JOBS

September job growth was soft, but retail sales were decent. And with employment growth barely keeping up with population increase, and income gaps high and widening, there's still plenty to worry about—and it's really no wonder that the FOMC is not yet tapering.

- Job-market data remained weak in September. Not only were total payroll gains soft, but the BLS announced that job growth through March 2013 was a bit slower than reported, dashing hopes that job growth had been under-reported. There was some good news on unemployment. September's 0.1 point decline to 7.2% was clean, and there were signs of growing worker confidence in the labor market.

- September retail sales were negative because of a decline in auto sales. Take that out, and sales were up—more than September, though below the early-2013 pace. Slowing in spending and payroll growth are both corroborated in our surveys of tax receipts.

- No matter how you look at it, the gap between upper and lower incomes is widening, and no matter what you think about that ethically, it is hard to maintain a consumption-based economy when the incomes of those most likely to spend are shrinking.

- Some were surprised that the FOMC didn't slow asset purchases, but with employment data coming in on the weak side, and the federal shutdown imminent, staying on their current path is in line with their most recent guidance.

- September data underscored the fact that we're "not there yet," and still slogging through the aftermath of the financial crisis. It's tiresome, but it's certainly in line with past finaical crises around the world. Our new index of diesel fuel sales around the country is somewhat encouraging.

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STAGNATION, POLARIZATION, AND CONSUMPTION

Since this is our first issue, and since the policy-makers at the Federal Reserve have made it clear that they mean it when they say their position is dependant on underlying details in the labor market, this issue will be heavy on analysis of those details. We've sorted through a lot of data in order to highlight what we think is important in a coherent, if still mostly discouraging, story.

September was another grinding month in job-data world. The data for the month totaled out on the weaker side, once you take out computer-related fluctuations in weekly jobless claims, and job detail for the month of September showed a notable slowdown in momentum. The total gain in non-farm employment for the month, 148,000, was 18,000 below the average of the previous five months, and 60,000 below the average of the six months before that.

Our contacts in Midwestern manufacturing states continue to report solid growth in withheld tax receipts, broken out to isolate receipts coming from manufacturing itself when possible, and the goods producing sector was broadly positive in the official report on employment in establishments around the country. Manufacturing was up 2,000 (with durables up 9,000, and nondurables down 7,000). mining and logging up 4,000; construction, up 20,000 (with all subsectors up, though nonresidential was stronger than residential).

Private services were up 100,000, about 40% below its average over the last year. Wholesale trade rose a healthy 16,000; retail, +21,000 (a third below its average over the last year); transportation and warehousing, +23,000 (almost five times its recent average). Information rose 4,000, led by recently volatile motion-picture employment. Professional and business services rose 32,000 (two-thirds of it from temps); and education and health, +14,000 (all of it from health care, which was half its recent average).

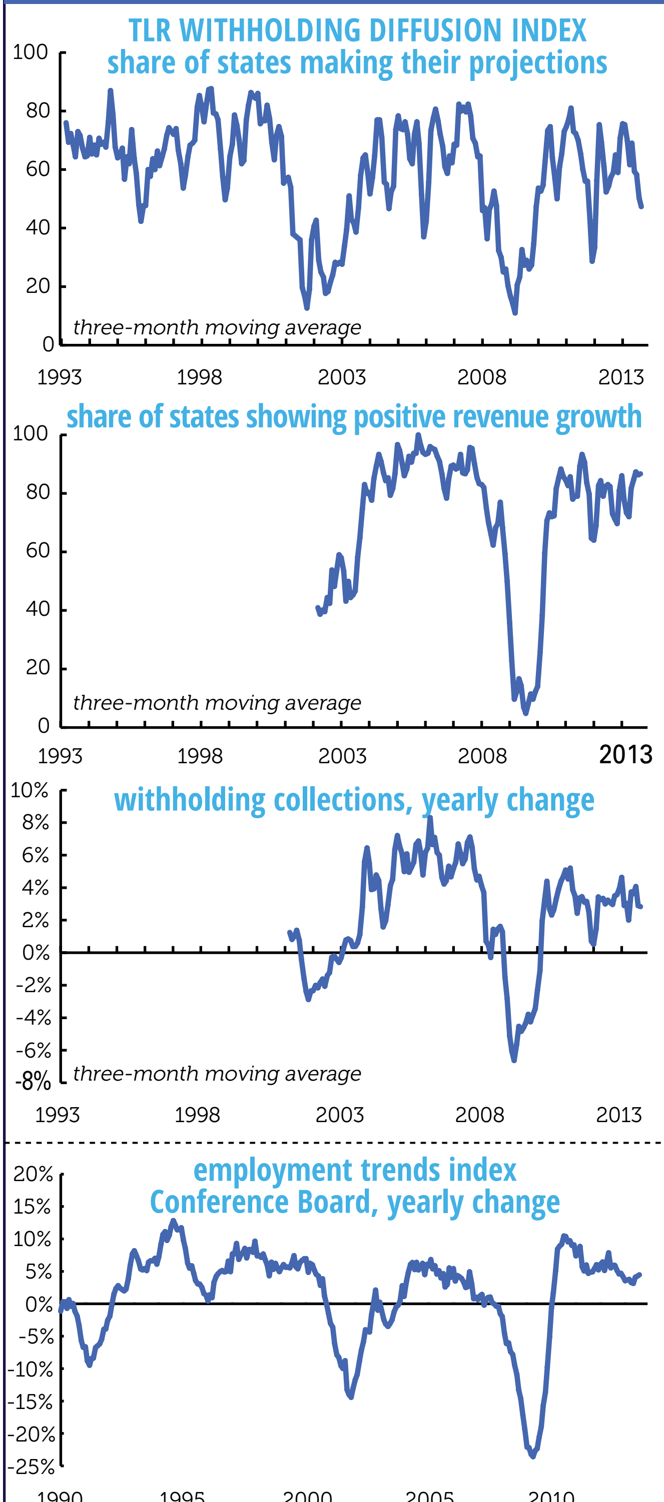
In the red were financial activities, off 2,000, and the previously mighty leisure and hospitality, off 13,000 (though the birth/death model (see text box p. 8) subtracted an unusually large 42,000 from the subsector). While state and local government were positive, federal employment was off 7,000, in line with its average over the last year. Federal civilian employment, off 3.1% over the last year, is now a hair under 2% of total employment - very close to an all-time low, and less than half its 1950s average.

Diffusion indexes, which measure the breadth of hiring, were little changed, except for the six-month index, which was down 3.2 percentage points from August. All are below their 2012 averages, and well below their 1995-2000 averages, indicating we remain in a narrow channel when it comes to hiring.

The average workweek was unchanged at 34.5 hours (where it's been for 11 of the last 21 months); both manufacturing and services hours were unchanged. The service week has been 33.3 hours for 15 of the last 21 months. Average hourly earnings were up 0.1%, and its three-month moving average was also 0.1%. Aggregate payrolls were up just 0.3%.

The Household Survey, derived from a series of interviews with individual households, performed pretty much in line with its establishment counterpart. Total employment was up 133,000 - though down 195,000 when adjusted to match the establishment concept. The adjusted household figure is very volatile from month to month, but its yearly gain is now 1.4%, compared with 1.7% for the establishment survey - a reversal of the re-

FOUR EMPLOYMENT INDICATORS



The Conference Board's ETI leads payroll growth by about three months. It appears here with permission.

cent trend in which the adjusted household gain was slightly ahead of the establishment survey. (This is good news: researchers at the National Bureau of Economic Research (NBER) have shown that the Household Survey tends to run ahead of its Establishment counterpart when the economy is weakening—see below). The participation rate and the employment/population ratio were both unchanged; the participation rate is actually 0.5 point lower than its 2012 average, while the EPR is the same as last year's average. This is, of course, not what one wants to see in an expansion.

We're all scouring the data to find information on the effects of recent health care legislation, and the place to look is part-time employment detail. The number working part-time in September fell by 164,000, though those on short hours for economic reasons was up 75,000. But that was entirely because of those reporting "slack work or business conditions"; those only capable of finding part-time work was down. And the number working full time was up a very strong 691,000. All these household numbers are volatile, and its reckless to draw any conclusions from one-month movements, but analysts blaming Obamacare for the weakness in overall employment would have a hard time finding support in those figures.

WITHHELD TAX RECEIPTS WEAK

The labor market is healing, but progress is ragged and slow. That raggedness is captured by monthly fluctuations, and now a slowing, in monthly withheld tax collections

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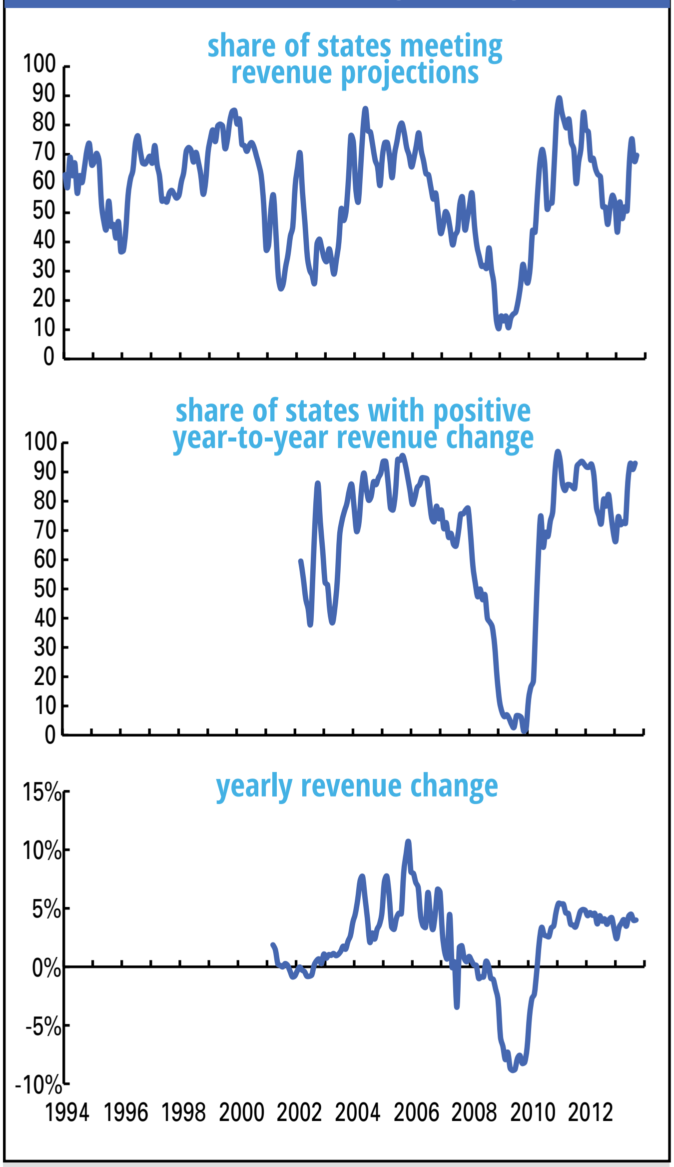
TLR sales tax indexes, 1994–2013
3-month moving averages



at the state level. As our longer term readers know, we survey states around the country to determine how their actual collected tax receipts compare to their forecasts, and to their collections a year earlier. In September, 43% of the states in our survey met or exceeded their forecasted withheld tax collections, down from August's downwardly revised 48%. Since July our index has been unusually stable, hovering around a weak 50%.

The share reporting growth over the year rose to 93% from August's 76%, and is in line with both June and July, and the average rate of change rose to 2.9% from August's weak 0.7%. We were averaging around 3.8% through July, so this represents a real slowdown. The margin from forecast sank to -0.3%, from August's +0.2%, and has had a volatile year.

BENCHMARK: ESTIMATES MEET REALITY

The Bureau of Labor Statistics released their preliminary benchmark adjustment at the end of September. When people don't like what they see in the Establishment Survey, or Non-Farm Payroll, they run for the far more volatile Household Survey, but that's never a good idea, for two central reasons. First, as noted above, NBER has demonstrated that relative strength in the Household Survey is counter-cyclical: when the economy is weakening and solid jobs are becoming scarce people move into self-employment, which inflates the Household Survey relative to the Establishment Survey.

And second, the Household Survey is never benchmarked to a more definitive source, so we can never know how accurate it is. On the other hand, every year the BLS effectively replaces their monthly estimates of establishment employment with hard data from unemployment insurance tax records, which cover close to the entire non-farm universe, non-agricultural workers drawing paychecks.

The official benchmark takes place in February with the release of January data, at which time the BLS computes the number of jobs they added in error or missed for the 12 months ending in March, and adjust the March level to reflect their new findings. In February 2014 we'll have the official information through March 2013, but the preliminary and the official benchmark have never been far apart.

Given the job the BLS is mandated to do, it's remarkable that the annual benchmark revisions of the last 10 years have averaged +/-0.3% of total employment, which works out to about 340,000-400,000 jobs at current levels. You hear a lot of complaining about the statisticians at the BLS, but many of the loudest complainers don't understand that in a given month there are millions of hires, separations, and jobs standing open: in August, for example, there were 4.4 million separations, 4.5 million hires, and 3.9 million openings. So to compute the foam caused by that underlying job churn, which is no doubt what the monthly job numbers are, and miss by an average of 33,000 a month is not too shabby.

The preliminary benchmark revision for March 2013 is +0.3%, right in line with the average. But there's a very important technical note: the BLS reclassified approximately 469,000 home healthcare workers from Private Household workers into the Education and Health sector, or from beyond the scope of the survey to safely within. Without this non-economic change, the benchmark would have been an unusually small, but negative, 124,000. So the BLS has not been missing job creation, sad to say.

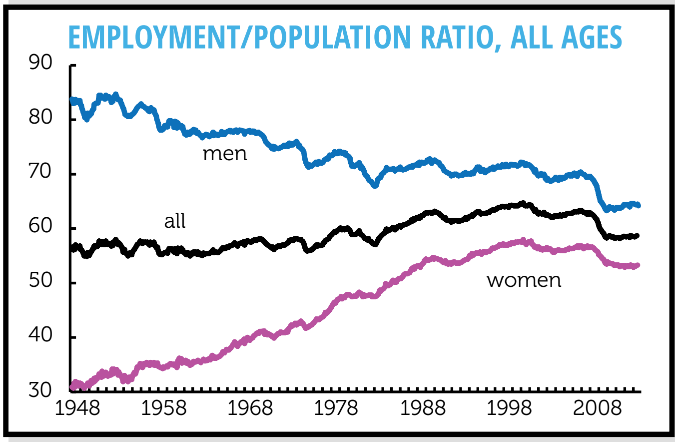
And here's some detail on another hurdle we face.

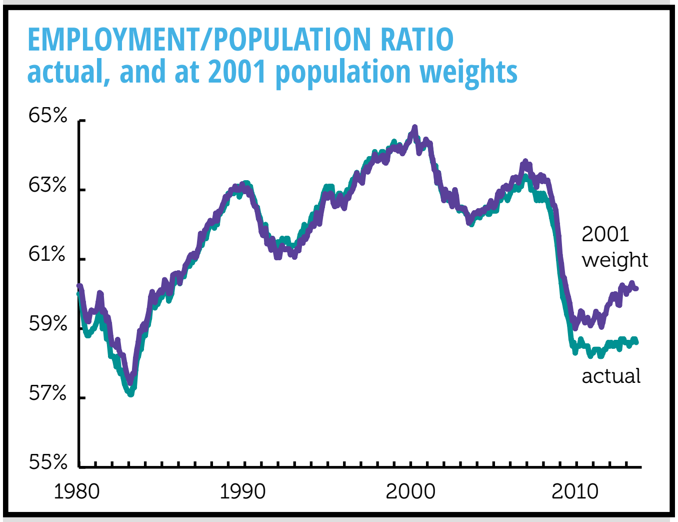
EMPLOYMENT/POP RATIO'S TORPOR

The Bureau of Labor Statistics publishes six unemployment rates each month, the U-1, the least inclusive, which includes only those unemployed for 15 weeks or longer, up to U-6, which includes discouraged workers, marginally attached workers, and those working part-time involuntarily. The U-3 is the "official" unemployment rate focused on in the media: one has to be looking for a job to be included in this series. (Since monetary policy-makers use the U-3 to gauge wage pressure, that makes sense.) In order to correctly assess changes in the U-3 unemployment rate, one must look at the Participation Rate, another BLS series that tells us what percentage of the population is working, or looking for a job. If U-3 falls because the unemployed drop out of the force, that's what's known as a "bad" decrease in unemployment, and if it rises because people joined the labor force, that's a "good" increase in unemployment, often characteristic of nascent recoveries.

For these reasons, Federal Reserve Chairman Ben Bernanke has often commented that the unemployment rate itself is not giving an accurate picture of the labor market these days, an idea underscored by the FOMC's recent decision to leave their current accommodative policy in place, we might add.

Nonetheless, you often hear these days that many of the workers currently sitting on the fence have withdrawn from the labor force to take care of aging relatives, or stay in school to improve their skills, and if we put them in brackets, then the alternative measures of employment look more normal. Part of this argument often includes the idea that currently idled workers have effectively taken early retirement and will never work again.

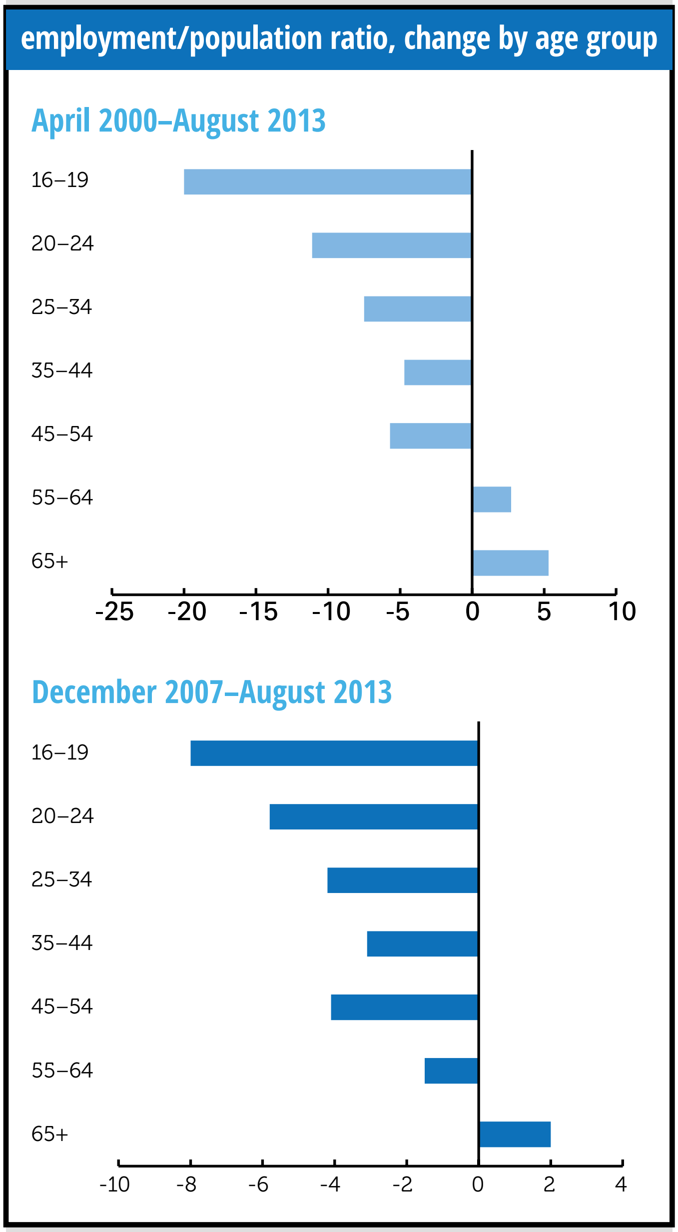




We'd better hope that's not true. Contrary to popular wisdom, the decline in both the labor force participation rate (LFPR), and the employment/population ratio (EPR) are largely due to withdrawal of young and prime age workers. Official projections published over the last few years for a decline in the participation rate were posited on baby boomers retiring, but currently the only cohort increasing their presence in the labor force are those 55 years old and older. As the graph on the bottom of the left column shows, had the population remained at 2001's age composition, the EPR wouldn't have declined as much as it has, but it still would have declined.

We're focusing on the Employment/Population Ratio here because it's a clean measure of the number of people working, broken out by age. The graph at top left shows that the EPR for all ages is back at 1977 levels. The EPR has been in a long downtrend for men, with a steep drop during the Great Recession, with a modest recovery since. For women, the long uptrend in the EPR peaked in 2000 and has been working its way lower since. It's actually fallen a hair since employment troughed in February 2010.

There's a great variation in performance by age group in the EPR, though. As the graph on p. 7 shows, younger cohorts have been hammered, whether you take the all-time EPR peak in 2000 as your base, or the pre-Great Recession high as your base. Teens have fared the worst, but those aged 20–34 have done quite poorly too. Older cohorts have done much better, with the over-55 set's EPR actually exceeding 2000's. Many studies correlate under- and un-employment among younger workers with long-term problems, including lower wage rates for life, and loss of skills gained in college, at major expense. Investors who specialize in real estate tend to be much more aware of these



issues than generalists because of the negative impact on household formation, as evidenced by recent increases in multi-generational households. (Recent college grads are probably the least likely group to want to live with their parents, so the economy is surely to blame.) Household formation is a major driver of our economy, and the decline in the work force is something we need to realign, not explain away. All this also means, of course, that there are a lot of experienced workers out there waiting to get back in the labor force.

RETAIL AND SALES TAXES

The monthly Advance Retail Sales report is extremely noisy—sometimes your best guess is a change in direction from the prior month, and there was some of that in August. A 2.2% decline in auto sales pulled the monthly total below zero, but stripping out auto sales produced a 0.4% gain.(Gas was flat, so no need to remove its effect.)

The relationship between state sales tax receipts and withheld receipts has been keeping revenue officials awake at night since 2005. During the housing boom we heard from our contacts around the country that sales tax receipts were consistently running ahead of withheld tax receipts—what are they spending?—and that could not be sustained, as indeed it was not. After the recession, withheld tax receipts did relatively better than sales tax receipts, but both were making record lows. In 2011/12 sales receipts were again picking up relative to withheld receipts, which caused some concern, but then withheld taxes got a big boost from accelerated bonus payments spurred by concerns about tax hikes at the turn of the year. Now sales receipts are running ahead of withheld receipts. Monthly data are erratic, so we'll be watching this, but the ongoing weakening in retail spending as measured by over-the-year growth rates is not surprising.

THE MALIGNED BIRTH/DEATH MODEL

There are a number of bloggers and reporters who make their livings unearthing nefarious activity at the government data houses. We want it to be clear that we are not among them: most of the accusations depend on data collection weaknesses the statisticians themselves discuss openly. We follow the same aberrations closely, but with the intention of providing a better understanding of what the various official stats are telling us, not to point fingers.

The Bureau of Labor Statistics takes a number of measures to smooth out monthly gyrations in the data it collects, and among the most maligned and misunderstood is the birth death model. The bulk of job creation comes from young, although not necessarily small, firms, and it takes those firms a while to work their way into the monthly surveys of employment. The BLS statisticians take 2 steps to impute jobs at those businesses: first they use the number of businesses that did not respond to their survey to calculate how many jobs were created at new businesses that arose to take their place, and they add in a smaller correction based on a standard error in their own series.

The Great Recession broke down the relationship between business deaths and births, leading to an unusually large downward benchmark revision, but outside that period the relationship has been remarkably stable through expansions and contractions, and the birth/death model has done a reliable, if not perfect, job of adjusting for firms too young to be in the survey.

And if the BLS didn't employ their model, their data would be largely worthless: we'd all be trying to build our own B/D model.

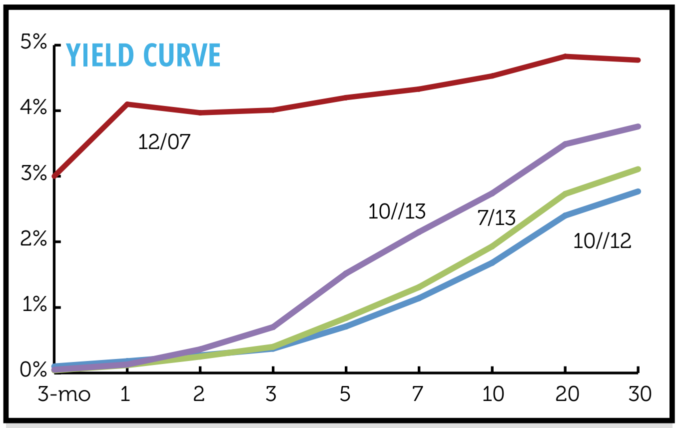
Especially considering the most recent updates from economists Thomas Piketty and Emmanuel Saez, who report that real incomes of the bottom 99% of the population grew by just 1% in 2012, compared with a gain of almost 20% for the top 1%. That top 1% claimed 95% of all the income gains between 2009 and 2012. That figure may be inflated by the taking of capital gains in 2012 to avoid a feared 2013 tax increase, but still, the skew is amazing. Whatever you think of it ethically or politically, it does make you wonder how a mass consumption economy can be sustained on such numbers.

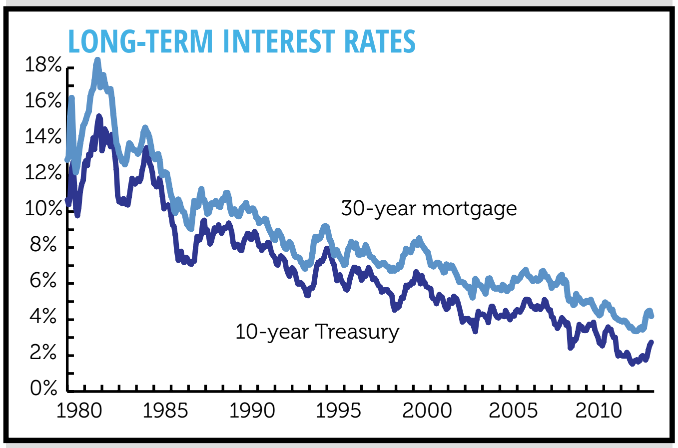
PUTTING IT ALL TOGETHER

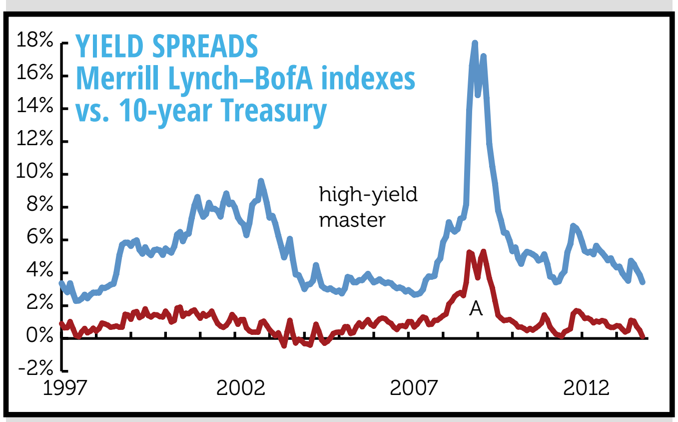
We're now 5 years out from the onset of the financial crisis, and tiresome as the slow pace of recovery is, we're still well in line with historical patterns following these nasty animals. In fact, even at current levels employment is doing a bit better than average. We're not sure what it is going to take to get hiring moving again, but one would guess we'd need clear indicators that demand is picking up, and we don't have those yet. We have some tentative signals that worker confidence is moving in the right direction, with a long way to go, that credit is loosening up a bit, as well as some anecdotal evidence that would-be entrepreneurs are willing to take the risk of starting or expanding their businesses.

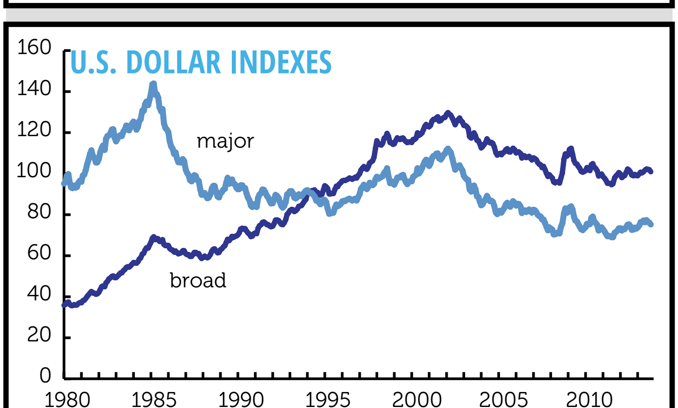
The FOMC is unlikely to do anything until they see sturdier signs of job creation. And they are in a real bind. We've been losing manufacturing jobs for decades, and the trend accelerated in 2000, well before the crisis. Job multipliers are much higher in manufacturing than in other sectors, so the loss of manufacturing jobs makes job creation trickier than it was in the past, especially with consumers buying goods produced outside the country with the fruits of easy money.

FINANCIAL INDICATORS









While interest rates at the long end—anything longer than two years, basically—have certainly risen since the Fed started talking taper, they remain extraordinarily low.

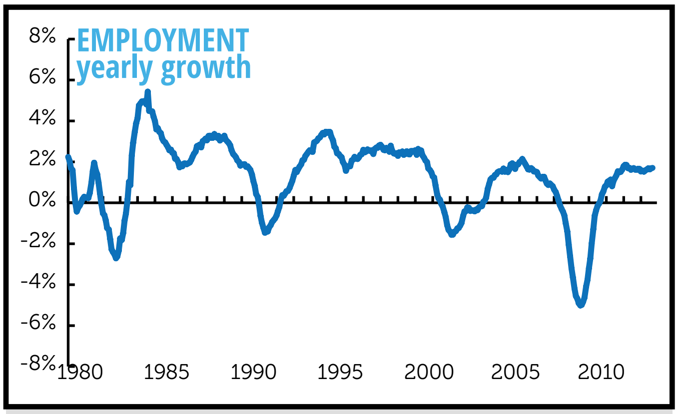
The yield curve shifted modestly upward between October 2012 and July 2013—and more dramatically so in the subsequent three months. But despite that, the whole curve, especially the short end, is still markedly below where it was before the recession hit in December 2007.

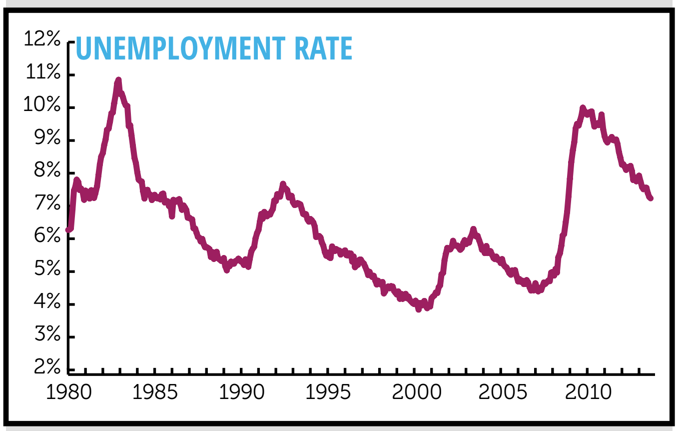
And, in historical context, long-term rates remain extraordinarily low. In fact, since our graph only begins in 1980, you can't tell that (excluding the latest cycle) you'd have to go back to 1954 to find 10-year Treasuries as low as they were in October, even after the taper tremors drove them off their April lows.

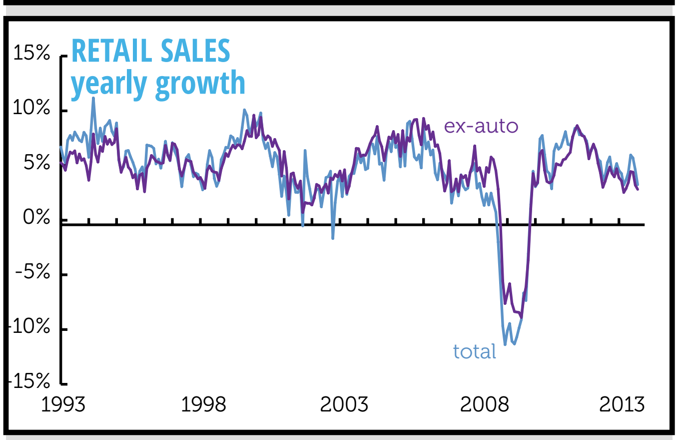
Risk premia are at the low end of their historical range (though that's a history that only goes back to 1997). The recovery from the panic highs of 2008 and 2009 has been very dramatic. Corporate yields bucked the rising Treasury trend, and in October, interest rates on A-rated bonds were just 0.1 point above 10-year Treasuries, well below the series average of 1.1 point. High-yield bonds were yielding just 3.4 point more than 10-year Treasuries in October, down a point from earlier in the year, and 2 points below their long-term average. Is this maybe just a bit complacent?

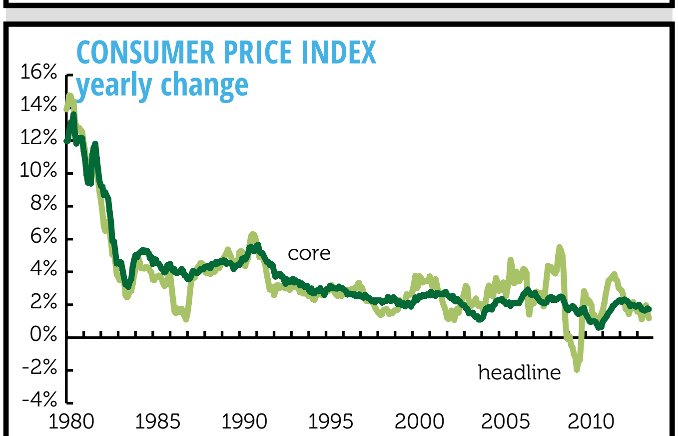
The U.S. dollar indexes have remained remarkably stable for nearly a decade, despite all the financial and real gyrations over the period. The broad dollar index, which includes all important trading partners, is up 1.4% since December 2007; the major currencies index, which covers only liquid, traded ones, is up 1.9%.

REAL INDICATORS









Employment growth has been averaging about 1.7% a year since the spring, which is where it was for most of 2012. Private sector growth, which isn't shown in the graph, has been averaging around 2.1%, also in line with 2012's performance. As you can see, that's about the rate that prevailed in the mid-2000s expansion, but below the highs of the 1980s and 1990s, and not really enough to offset the deep losses of 2008 and 2009.

The unemployment rate, though coming down (and at the lowest rate since late 2008), remains quite high. Although it never reached the peak of the 1981–82 recession, the recovery from that downturn was much sharper and quicker. But as we write elsewhere in this issue, the decline in the rate has been flattered by labor force withdrawal; the employment/population ratio remains in a funk (see pp. 6–7).

Retail sales were up 3.2% for the year ending in September 2013, or 2.8% ex-auto. Both measures are about 2 points below their 2012 average, and even further below their 1980–2007 averages (both of which were 5.5%). Though everyone always quotes retail sales in nominal terms, here's an arresting factoid: in real (CPI) terms, overall retail sales are just 2.5% above where they were in December 2007, when the recession hit. That's more than you can say for employment, which remains 1.1% below its December 2007 level.

Inflation remains very well-behaved, worrywarts to the contrary. Headline consumer prices were up 1.2% for the year ending in September, and core prices were up 1.7%—both below the Fed's all-but-formal target of 2.0%. While both measures are up from the depths of 2009, they're below where they were in 2011 and 2012.