

The Employment Situation

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THE EMPLOYMENT SITUATION AS OF SEPTEMBER 2007

“Never Mind”

Back in the day when the show was at least semi-funny, there used to be a character on Saturday Night Live, played by the late great Gilda Radner, named Emily Latella. She appeared during the news segment and would launch into a fulminating rant about some subject (“what’s all this about sax and violins on TV”?) only to be told by the anchor: “Emily, its sex and violence on TV.” To which Emily would reply: “Never mind.” And so it is with this month’s employment report. Most of the analysis you have been reading on your screens, and will see in the papers, and will hear from the punditocracy this weekend, will be a long winded version of Emily’s “never mind” tag line.

After getting their shorts in a knot last month over the decline in nonfarm payrolls (Chart 1), most of the analysts now find themselves backtracking furiously. Had they taken the time, as we did, to look into the composition of the numbers that caused the unexpected droop in payrolls last month, they would have known that the number was likely to be revised away and would have, as we did, tempered their comments accordingly. But they did not. They fulminated and threw the R-word into the mix, implying that unless the Federal Open Market Committee (FOMC) soon cut the Fed Funds rate by 50 basis points the world would soon end. Well, they got their 50 basis points, but for the wrong reason, and probably at the wrong time. As we shall see as we go through the rest of the charts, if these had been the data used by the FOMC at their last meeting, they probably would not have cut rates by 50, and might not have cut them at all.

Consider the new configuration of Chart 2. (I reformatted this chart in hopes of ending the driver-induced glitches that some of you have reported. Please let me know if it is behaving itself.) There is nothing in the pattern we see there to justify a 50-basis-point cut in the Fed Funds rate. Consider the new configuration of Chart 3. Ditto. I have seen no further mention of the R-word in the commentaries that have so far crossed my screens this morning. Before we declare the matter closed, let’s remember that the August number gets one more revision, but given the nature of the source data involved (all of the turmoil can be attributed to what was being reported in seasonally-adjusted State and Local government hiring) it seems unlikely that the numbers we see now will move much in the next report.

This brings us to the number that really matters, the year-over-year change in total nonfarm payroll employment, plotted on Chart 4. There, we continue see the line drift down towards the 1% level and it is that drift that prompted us, several months ago, to say here, and in our other reports, that the FOMC had to start considering an adjustment to its policy stance to promote more stable employment growth.





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The reason for that is seen in Chart 5, where goods-producing employment continues to shrink. The decline here is the consequence both of the prolonged and severe decline in manufacturing employment – down another 18,000 for the month, bringing its 12-month decline to 223,000 – and the contraction of construction employment, which has dropped by 206,000 since February 2006. As a result, this chart has taken on a decidedly recession-like configuration. At -1.33% in September, the series is now within range of taking out the -1.39% reading posted in June, 1986 during the Volcker soft-landing.

Meanwhile, service-providing employment (Chart 6) continues to track sideways. The Bureau of Labor Statistics (BLS) noted in its report this morning that between June and September, employment growth in this sector averaged 90,000 persons per month, down from the 147,000 person per month pace of the first five months of the year. The BLS went on to say that the two largest contributors to service-providing employment over the past year have been health care (+396,000) and food services and drinking places (+355,000). Meanwhile, employment services (temp workers, for the most part) have seen job losses of 203,000 since the beginning of 2007 and credit intermediation services have shed 46,000 jobs since February.

In other words, the jobs report was a mixed bag, reflecting the changes that are occurring in an economy that until recently was subjected to monetary restraint and an argument for making some adjustments in monetary policy. Whether those adjustments will soon be made is going to depend on how things play out on Charts 7 and 8.

The inflation hawks on the FOMC did not like what they saw on Chart 7. They will fret mightily over whether the latest zig of the line marks the beginning of a trend reversal. Time will tell. At the same time, the entire Committee will not like what they saw on Chart 8. The uptick of the unemployment rate, even though it was entirely the result of an influx of people to the workforce (+573,000) outnumbering a large gain in those securing employment (+463,000). The horizontal lines on the chart are a reminder of what the series did in the last two soft landings; after flattening out at a level very close to that with which it entered the preceding recession, unemployment tracked steadily downward as the policy adjustments needed to secure the soft landing were made. It has been the behavior of this chart that has prompted our earlier, and repeated, statements that the FOMC needed to do something to insure that the economy would continue to expand at a pace sufficient to bring the unemployment rate down further.

Let's turn now to the effects of all of this on our four major players.





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Political: The latest news removes some of the froth that had begun to form in the political debates over the course of the economy. With no crisis to address, we suspect the politicians will return to their main task: chopping each other up.

Stock Market: As you can see on Chart 9, the S&P500 has been tracking upwards for the past two months. When last we looked at the screen this morning, the index had taken out its July high, suggesting that the equity traders are currently of the view that the economy will continue to expand. (A view, we hasten to add, that is subject to change without notice.) While this is good news, it also means that we are back to the eternal problem of how to value earnings.

Bond Market: Interest rates rose on the news of no new bread lines. But they have not risen enough to get the yield curve back to any semblance of a normal shape. The effects of the flight to quality are still being felt on the short end of the curve, while the long end is still trying to figure out whether the short-term threat of higher inflation is greater than the long-term threat of a stalled economy. Conditions here are going to be treacherous until the FOMC finds the right words to go with the right level of the Fed Funds rate.

Federal Reserve: We concluded last month's forecast reports with a comment that the FOMC was going to need every minute of their two day meeting at the end of the month to reach a policy decision. They may want to consider making it a three day meeting.

Today's report upped the ante by bringing back all of the issues the Committee was facing during the summer. To wit, sluggish employment growth, employment cost pressures, and a muddled inflation picture. But, unlike their debates during the summer, the FOMC now has to make a decision about what to next against the backdrop of having already cut rates once. While they may try to finesse the issue by saying they had no choice in the first rate cut – their responsibility to keep the financial system liquid having trumped their price stability and growth mandates – everything they do going forward will be measured against the additional constraints of consistency and credibility.

This Fed Chairman made much of the need for transparency during his campaign for the office. Yes, Fed Chairmen have to campaign for the office. The primaries are in held in the White House and the Senate Cloak Room. The major polling booths are on Wall Street, La Salle Street, and Massachusetts Avenue in Cambridge. How much weight the FOMC will give to the economic fundamentals and how much to the ebb and flow of market sentiment needs to be clearly stated in their policy actions and in their policy directive. Anything less leaves the Committee vulnerable to being seen as a creature of the punditocracy.



Chart 1 Change in Nonfarm Payroll Employment Thousands of Persons



Month:Year	As Reported	After 1st Revision	After 2nd Revision	After Benchmark Revision
9:06	51	148	203	198
10:06	92	79	86	109
11:06	132	154		196
12:06	167	206	226	
1:07	111	146	162	
2:07	97	113	90	
3:07	180	177	175	
4:07	88	80	122	
5:07	157	190	188	
6:07	132	126	69	
7:07	92	68	93	
8:07	-4	89		
9:07	110			

Chart 2 Change in Nonfarm Payroll Employment

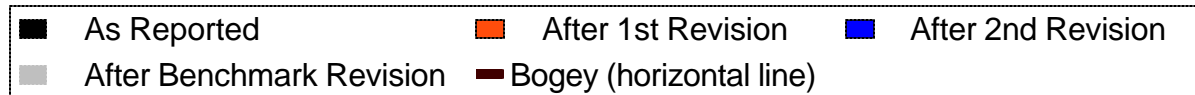
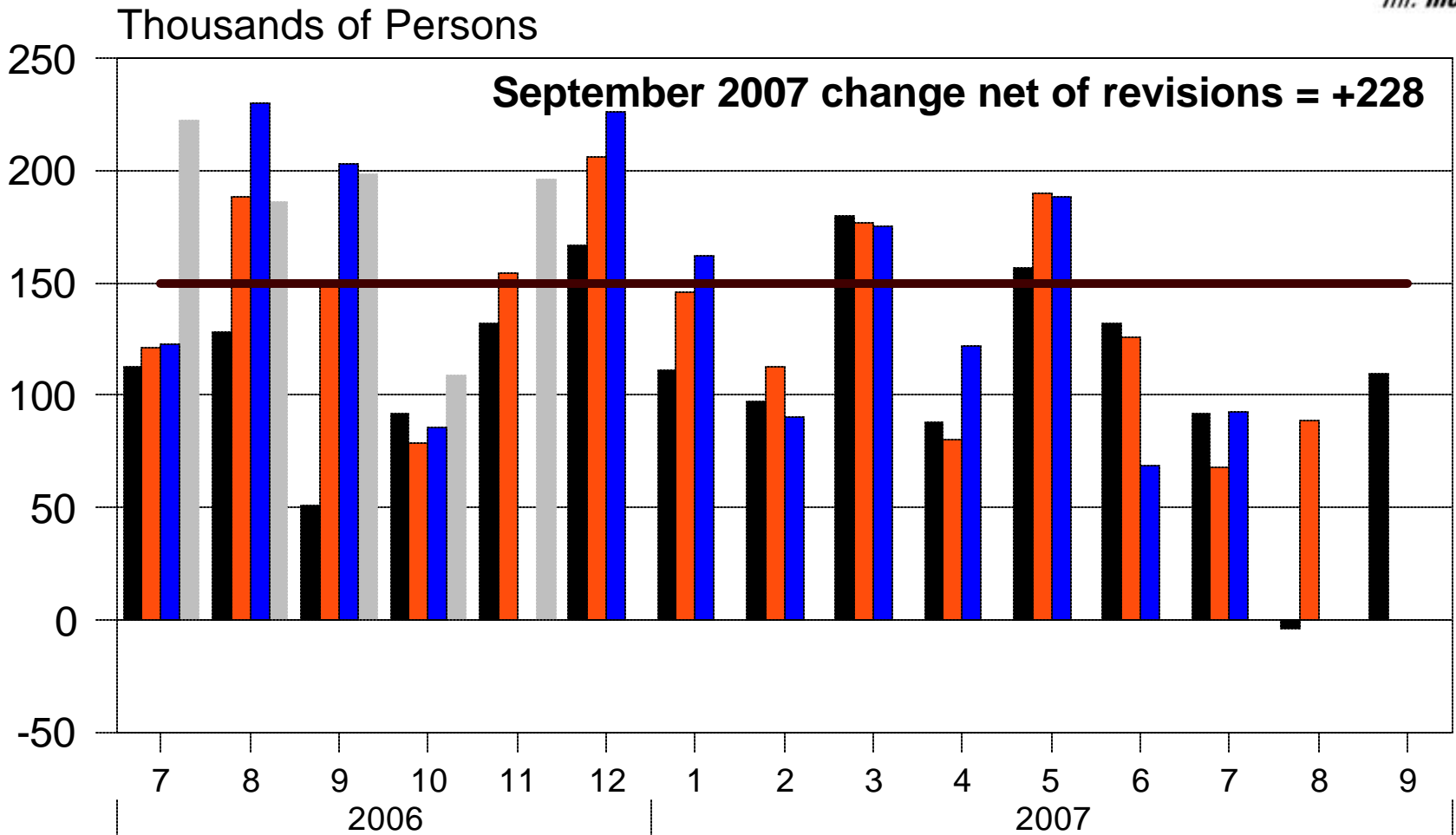


Chart 3 Total Nonfarm Payroll Employment Change from Prior Month

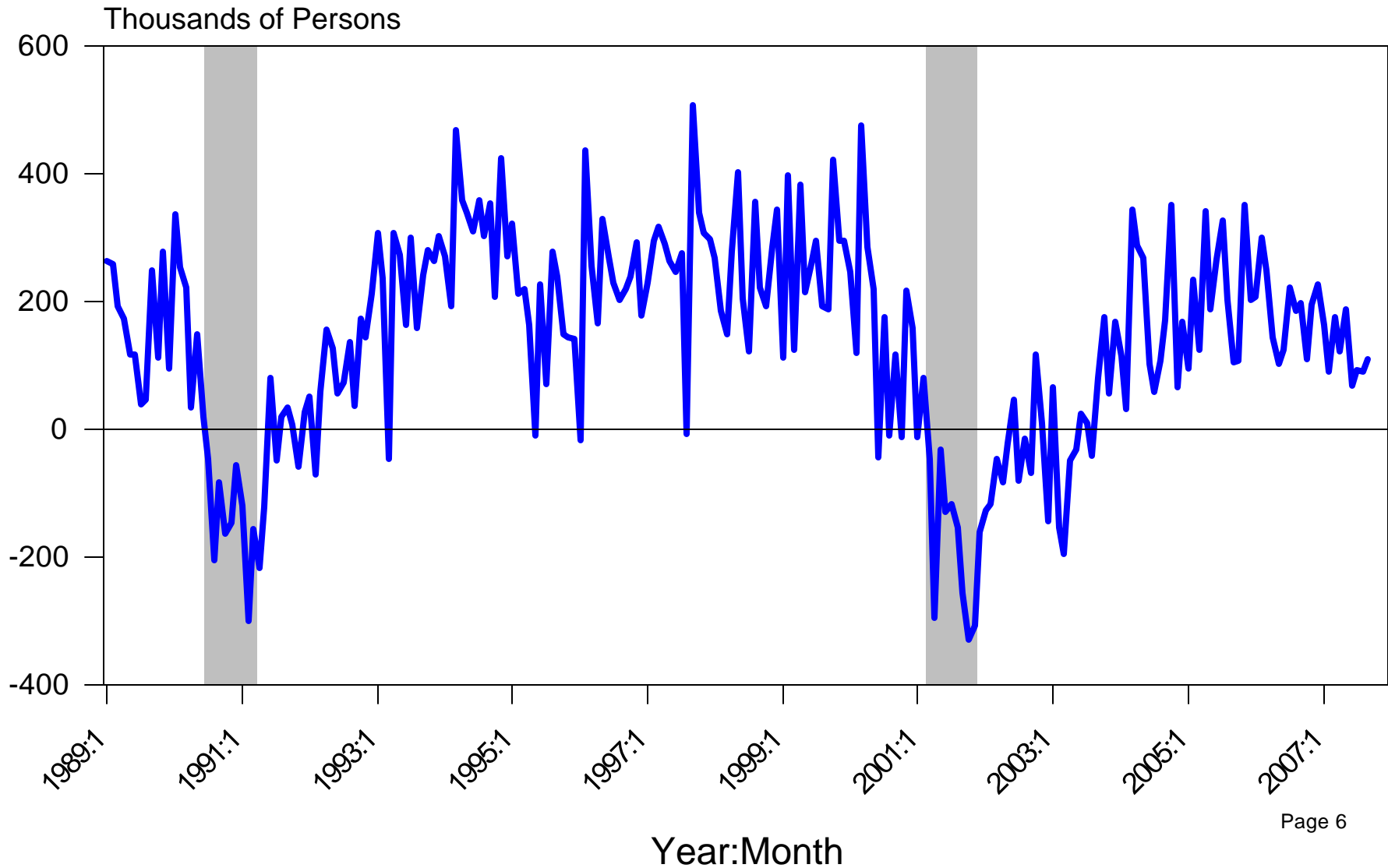
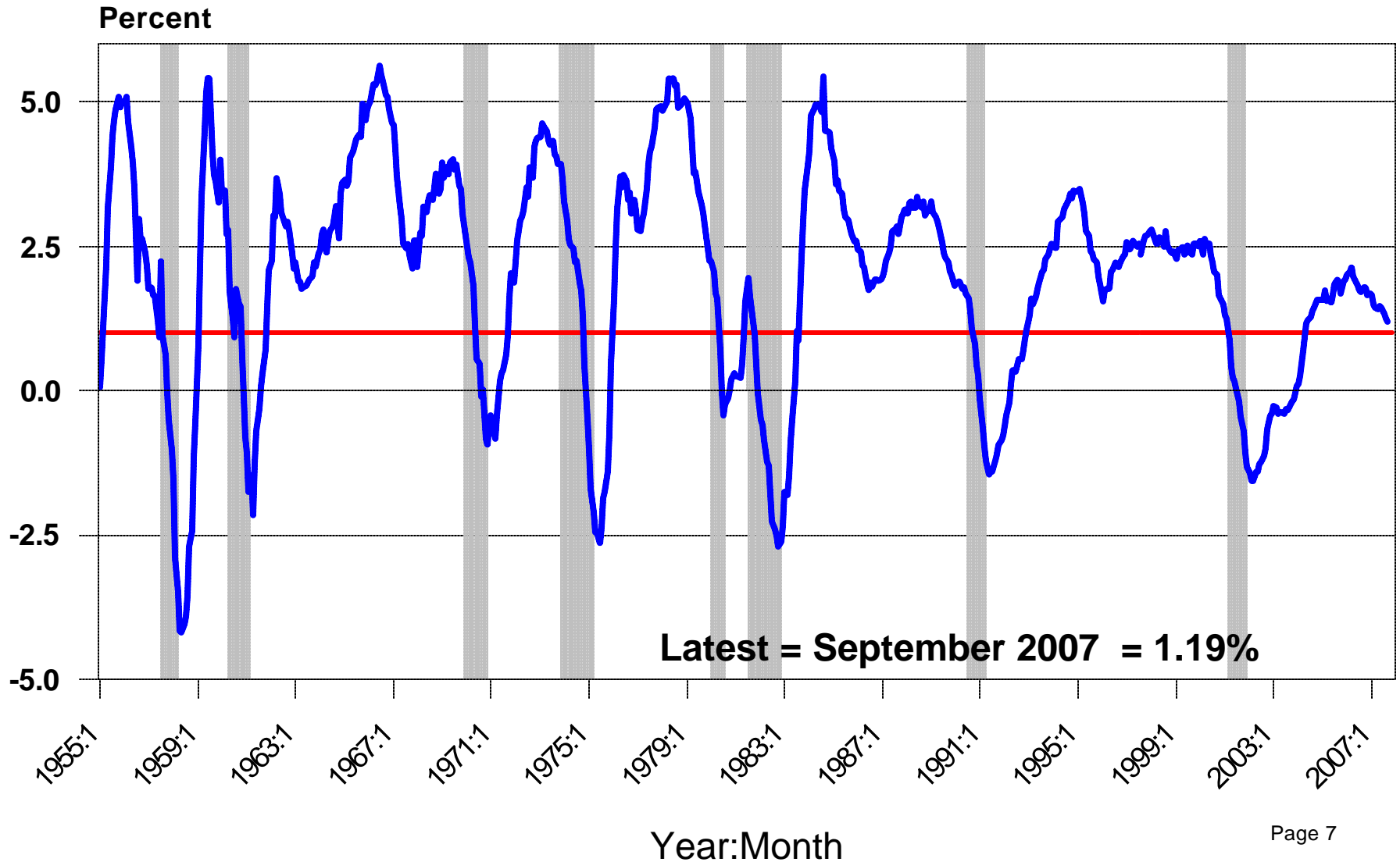


Chart 4 Nonfarm Payroll Employment Change from Year-Ago Month



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Chart 5 Goods-Producing Payrolls Change from Year-Ago Month

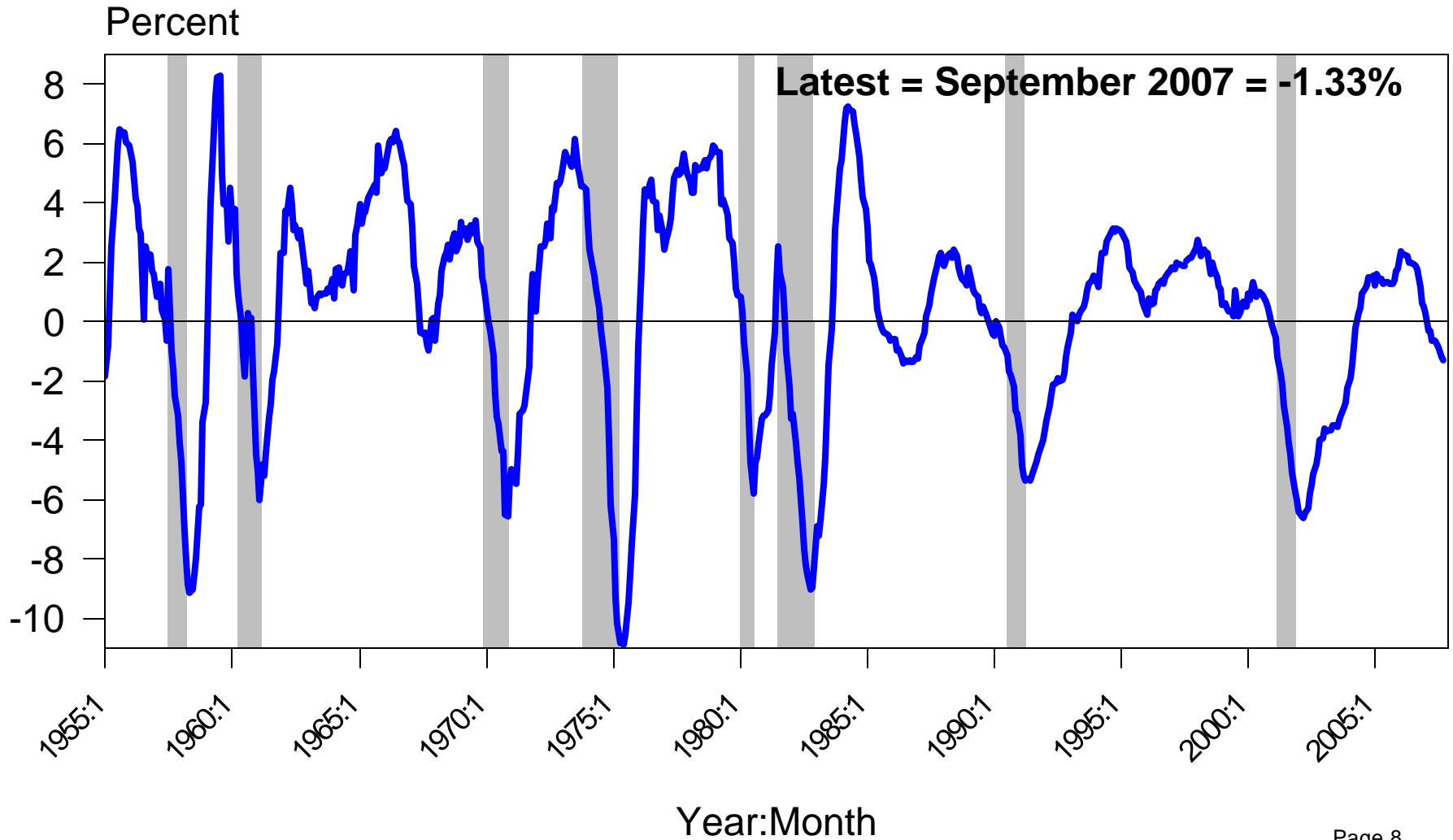


Chart 6 Service-Providing Payrolls Change from Year-Ago Month

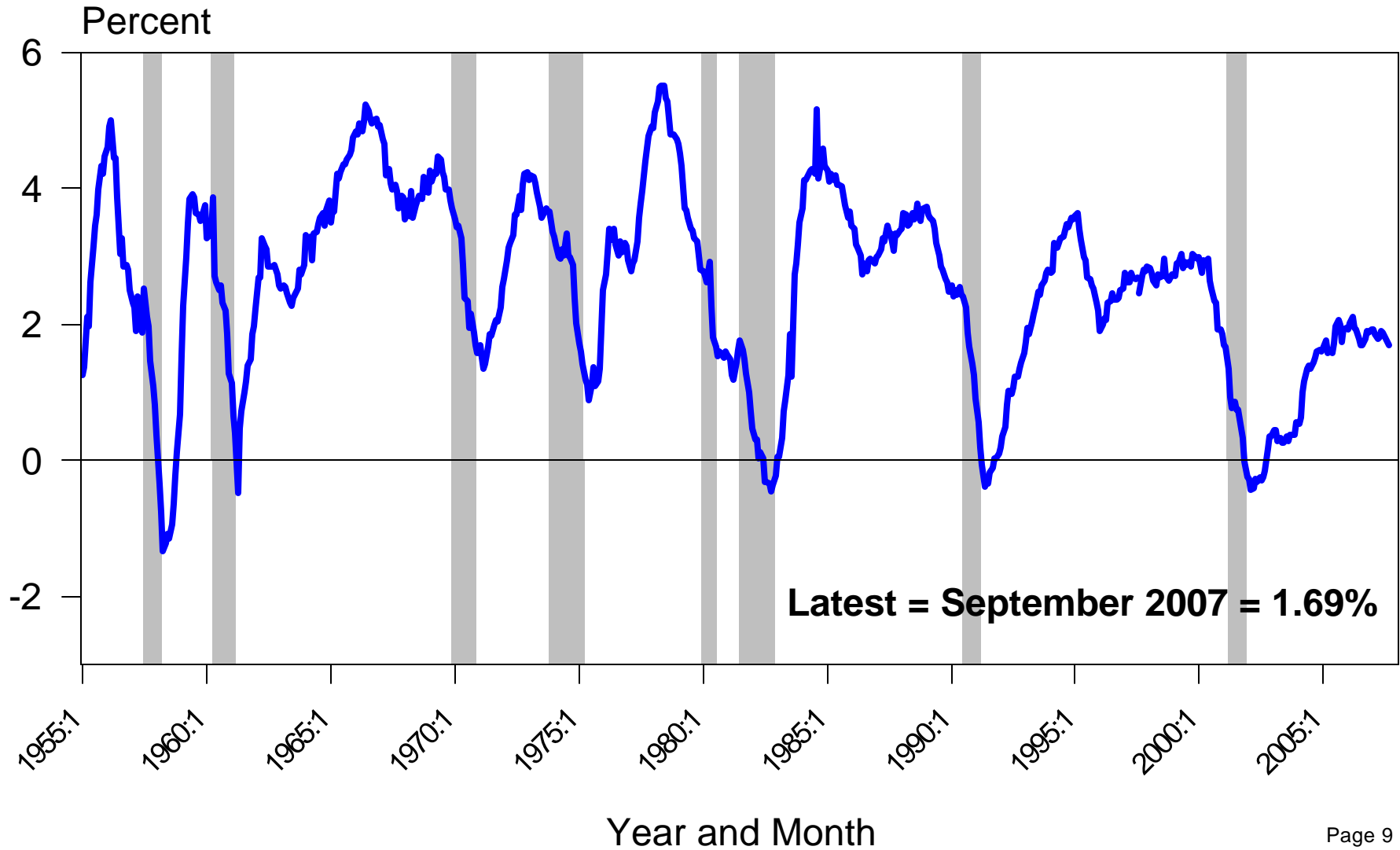


Chart 7
Average Weekly Earnings (AWE)
Seasonally Adjusted Change from Year-Ago Month

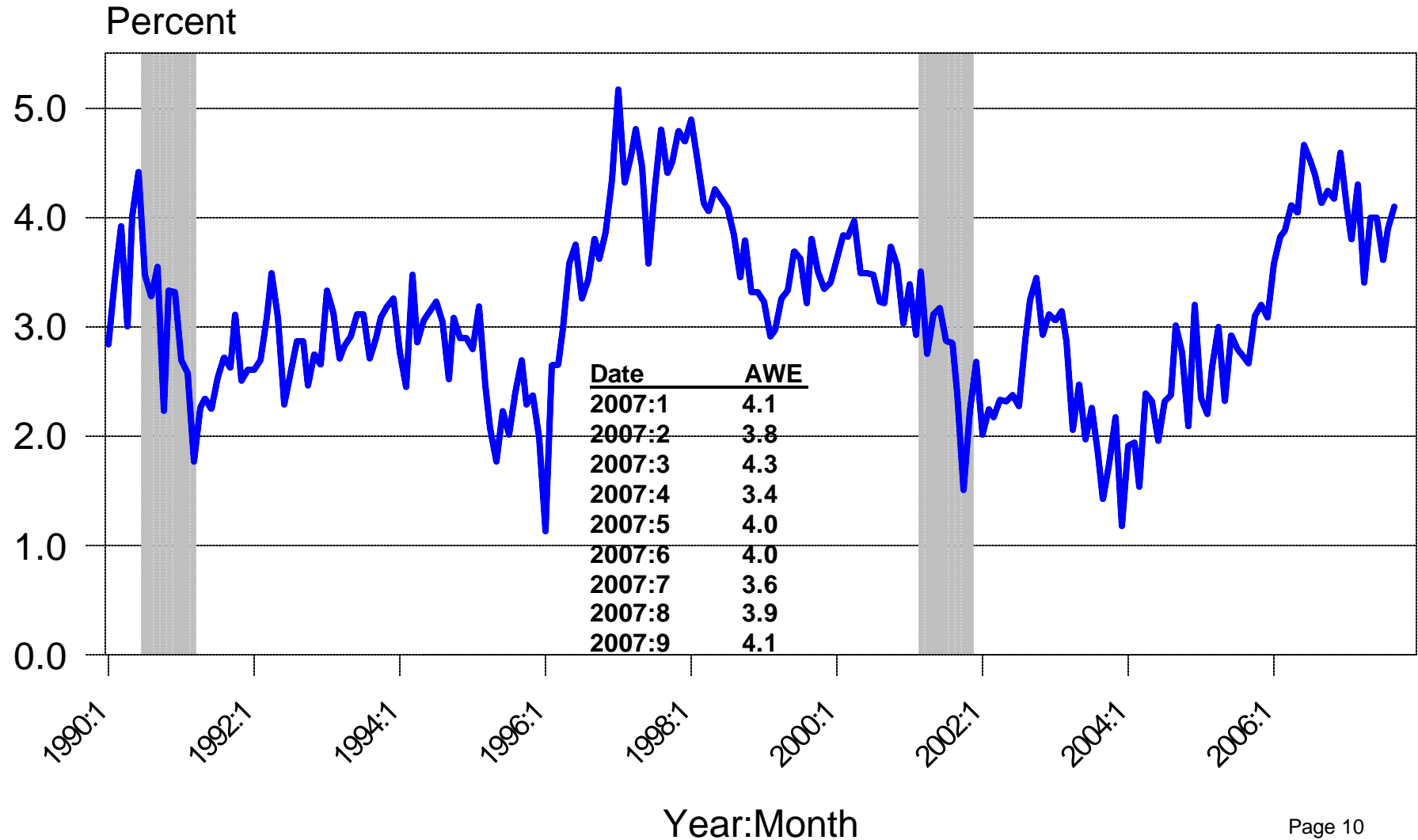


Chart 8 Civilian Unemployment Rate

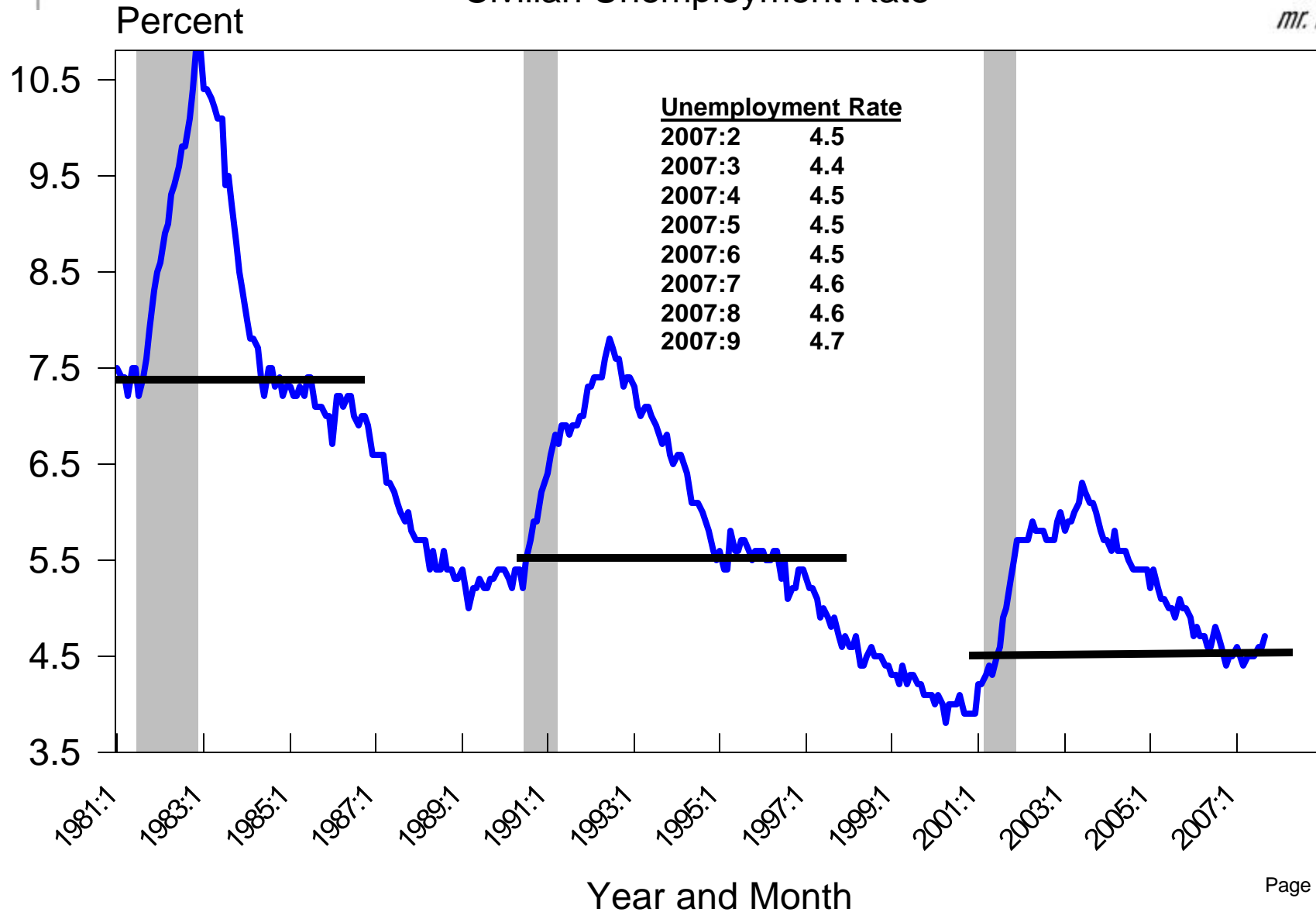
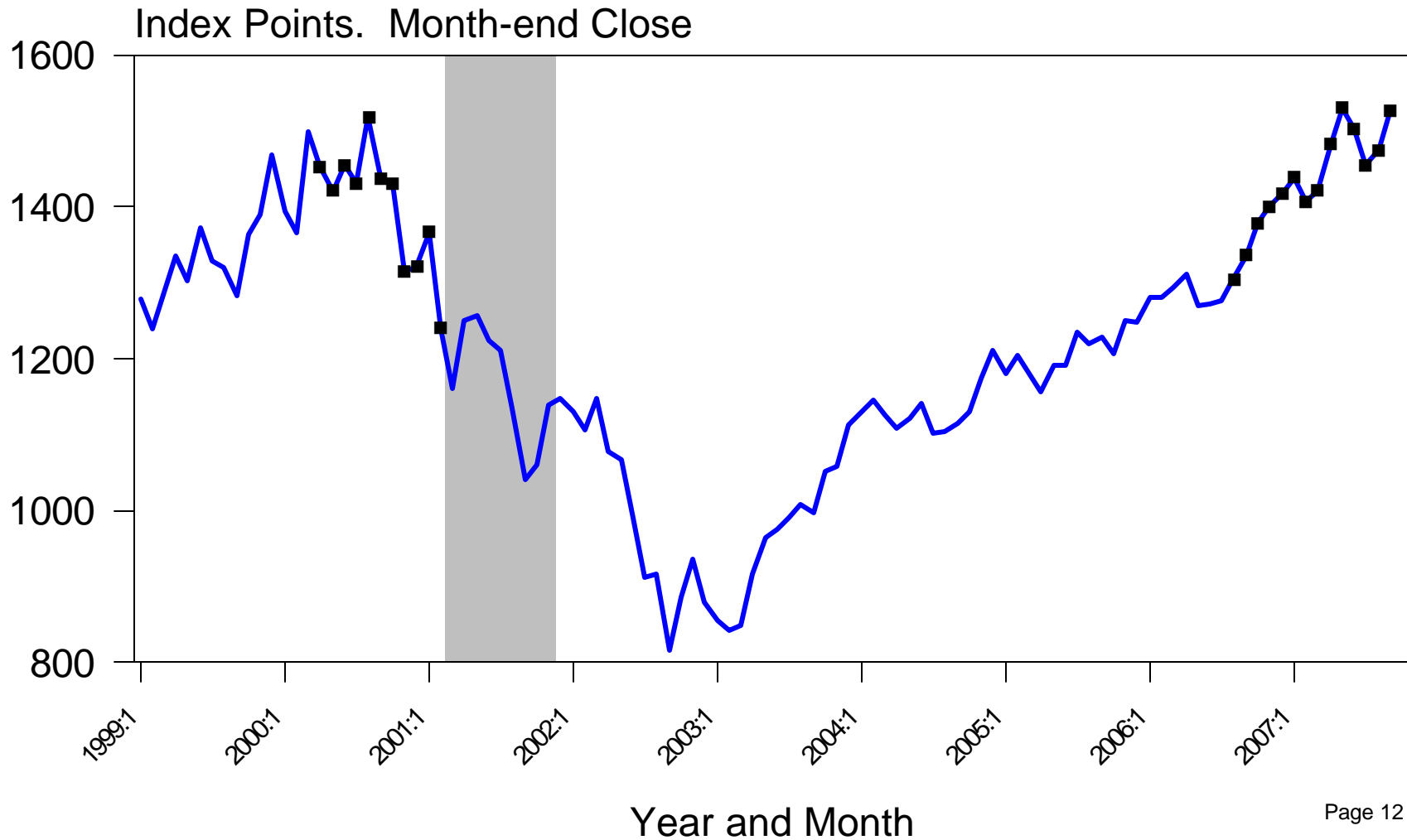


Chart 9 S&P 500 Stock Index

— SP 500 ■ Recession ■ Inverted Yield Curve



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October 5, 2007

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