

The Employment Situation

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THE EMPLOYMENT SITUATION AS OF AUGUST 2007

LOOK BEFORE YOU LEAP

This morning's employment report was replete with surprises. Not only did the August figures come in well below expectations, downward revisions to the two prior estimates bumped the level of concern to near-panic levels. While the market spent the morning running around with its hair on fire, we waded through the details of the report to see if we could find out what caused the numbers to behave the way they did.

Let's start with the changes to total nonfarms seen on Chart 1. There you will note that in addition to the August drop of 4 thousand, there are revisions that cut the gains in June and July from the acceptable to the paltry. As a result, the bars on Chart 2 have taken on a decidedly negative track, suggesting that something happened in June to change the course of employment growth. Note also, that as a result of the June and July revisions, the net change in payroll employment was a drop of 85,000 from the level reported last month.

Whenever we see changes of this magnitude in these numbers we immediately head for the source data and bring out the old reports, which we carefully save, so as to be able to compare what is currently being reported with what was previously reported. While the Bureau of Labor Statistics (BLS) maintains what I think is the spiffiest of the on line data bases, they overwrite the files every month. So, if you want to see what the data were before revision, you have to go back to the paper copies of the report. Which we did to prepare Table 1 showing you the changes in the major categories of nonfarm payrolls as they appear this month and as they appeared last month. As you can see, and may not have been told by the massed punditry, the downward revisions were in service-providing employment, and not goods-producing employment. Most notably Government and Leisure and Hospitality (which we bolded to assist your reading). Government, you can see, went from being up 19 in June to down 2 and from being down 28 in July to down 52. Similarly, Leisure and Hospitality was first reported as being up 33 in June, and is now shown as being up only 17, while July went from being up 22 to only up 6.

Table 2 provides a closer look at the revisions (you knew we were going to this, didn't you) and shows that the BLS removed 57,000 jobs from their count in June and 81,000 from their count in July. The biggest declines (again, in bold) were Government and Leisure and Hospitality. Table 2 shows each of those categories in detail and I think it is interesting that the downward revisions to Local Government Education account for the bulk of the downward revision to the total. Last I looked; school boards were not basing their hiring decisions on the level and trend of Fed Funds rate. Nor, for that matter, did the level of local government education employment correlate very well with the level and trend of GDP growth.





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This brings us back to the level and trend of nonfarm payrolls seen in Chart 3. While the break to the downside of the line on the chart is worrisome, cooler heads will note that there are quite a few instances on that chart of the line hitting zero without it spending any time below zero. Also, this is the first estimate of the August number, and as we have just seen, significant revisions are common. Of greater moment is what has been going on on Chart 4, where the line continues to track ever closer to the 1% level. But, we have been saying for months that the Federal Open Market Committee (FOMC) should have been paying more attention to this chart than it has. You may recall from Table 1 that Goods Producing employment was down 64,000 in August – off virtually unrevised estimates for June and July – with a particularly severe drop in Manufacturing (-46,000). As a result, the line on Chart 5 moved down sharply, extending its reach into negative territory and bringing it very close to the limits of drops not associated with a recession. The level and trend of goods-producing employment does correlate with the level and trend of GDP. Service-providing employment (Chart 6), meanwhile, is still tracking sideways. But, with the full impact on employment of the shut down of the sub-prime lenders still to be measured, we can't be sure how much longer this will continue.

The debate over whether to cut the Fed Funds rate that will rage at the September 18th FOMC meeting will doubtlessly center over whether what is happening on Chart 4 is more important than what is happening on Chart 7. Will the inflation hawks be satisfied with the jagged downward trend in wage growth portrayed there, or will they cling to the view that the pace is still too high?

Another reason for adjusting monetary policy at this juncture is what has been happening on Chart 8, where the Unemployment Rate has been displaying the type of behavior associated with prior soft-landings. One of the goals of the FOMC's policy to this point was to keep the Unemployment Rate from falling too far too fast. This chart says they have accomplished that goal. We should note, however, that the latest reading of 4.6% was the result of declines in both the number of people employed and the number of people in the workforce. This is not the way you want to keep the Unemployment Rate unchanged. You should also note that it's very hard to reverse a rise in the Unemployment Rate. The FOMC does not want to let the economy soften to the point where the rate starts to rise.

So, having reviewed the statistics and learned that there is not as much weakness in the numbers as the headlines would suggest, but that there are a number of worrisome issues to be addressed, we can turn to the effects of all of this on our four major players.





THE EMPLOYMENT SITUATION AS OF AUGUST 2007

Federal Reserve: The moment of truth has arrived. For those of you who may not know the origin of that phrase, it comes from Spanish and it describes the point in a bullfight when the matador kills the bull. Only a strong and well-timed thrust will accomplish the task. Had this jobs report not come after several weeks of market turbulence, it would not have been enough to get the FOMC to consider acting. The number was too flakey and too fluky to support an easing decision. Worse still, the first easing decision of Dr. Bernanke's tenure. Under less-fraught circumstances the FOMC could have used some jawboning to allay market fears while awaiting a better read on conditions. It should be noted there was nothing in the latest Beige Book to support the kind of report we got from the BLS today. So, if the FOMC believes their own anecdotal evidence, they will heavily discount today's news. But, who else besides a geek like me reads the Beige Book? (Actually, I read it because I am in the sample of one of the District banks.) My feeling is that the FOMC is already working hard on the language of the next policy directive. I think it will contain a rate cut, but the words surrounding that instruction will be laden with qualifiers so as to remove any doubt that the actions were taken as part of the central bank's strategy to further the process of economic expansion while preventing inflation. They will be at pains to be sure that the markets understand the move was motivated by the need to address an uncertain economic situation and not the financial prospects of any institution.

Political: You can expect to see more of Secretary Paulson in the days ahead. The combination of market turbulence and scary headlines will force the Administration to take a more visible role in economic management, especially between now and the FOMC meeting. But, they will be walking a fine line. If they make too much noise, the FOMC could balk for fear of being seen as captive to the politicians.

Bond Market: This is one of those days that makes me glad I don't manage money anymore. The bond market is most treacherous right before a change in Fed policy. When they are about to tighten you run the risk of being too long. When they are about to ease you run the risk of being too short. But, that's why they pay those folks the big bucks.

Stock Market: For the past several months we have been telling our equity friends to be careful what they asked for. Calls for a Fed ease have been all over the equity press since the spring. But, as we have reminded them, Fed eases at this stage of business cycle are usually associated with some kind of unpleasantness, either in the form of stresses on the financial system such as those we just went through, or stresses on the economy like the one reported this morning. Neither of these sets of circumstances is associated with tranquil trading environments. And the market probably won't feel much better after its long-sought rate cut.



Chart 1

Change in Nonfarm Payroll Employment Thousands of Persons



Month:Year	As Reported	After 1st Revision	After 2nd Revision	After Benchmark Revision
8:06	128	188	230	186
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		
8:07	-4			

Chart 2 Change in Nonfarm Payroll Employment

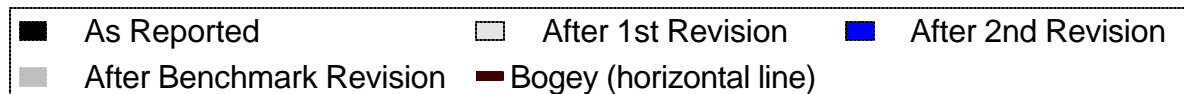
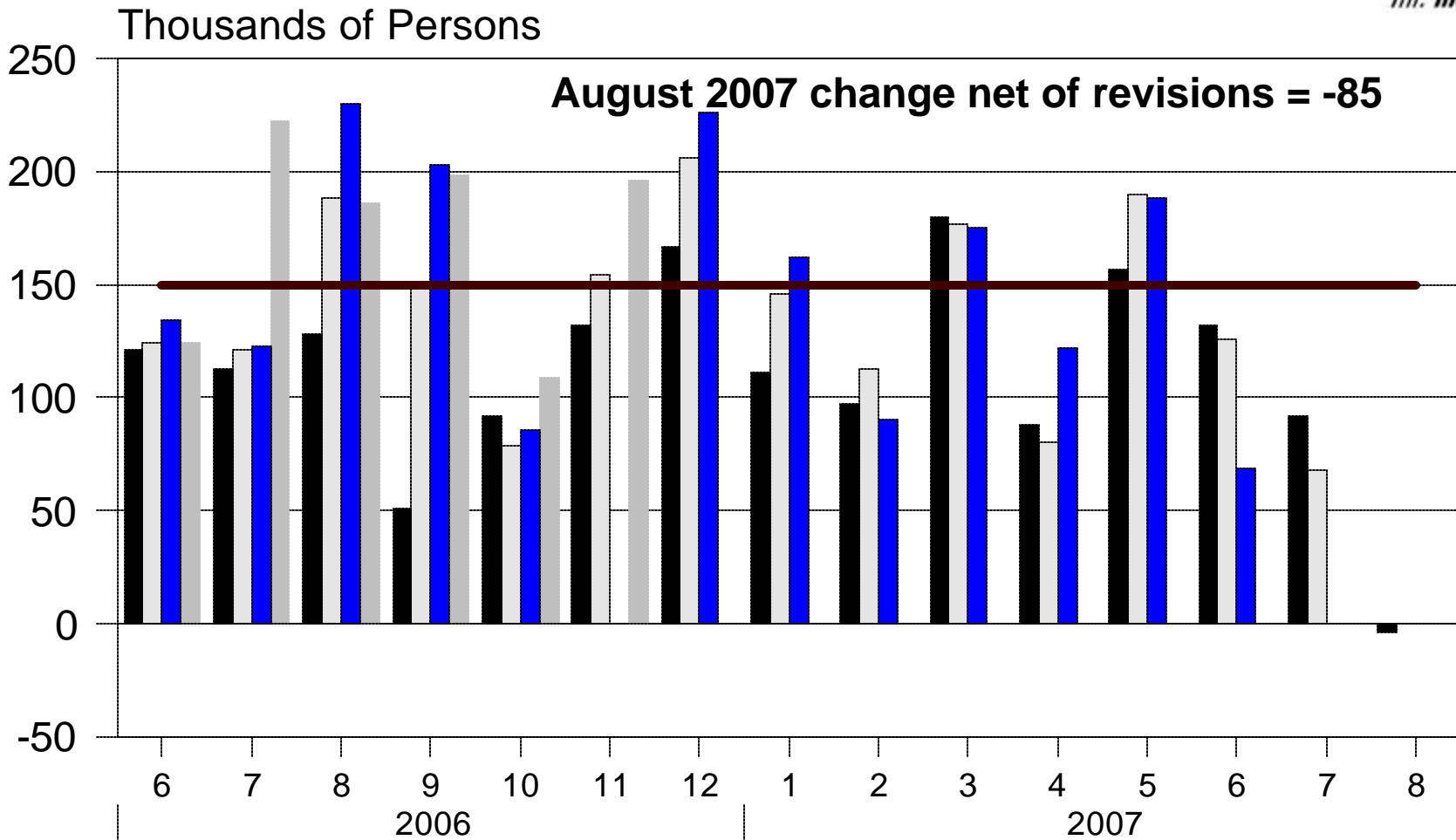


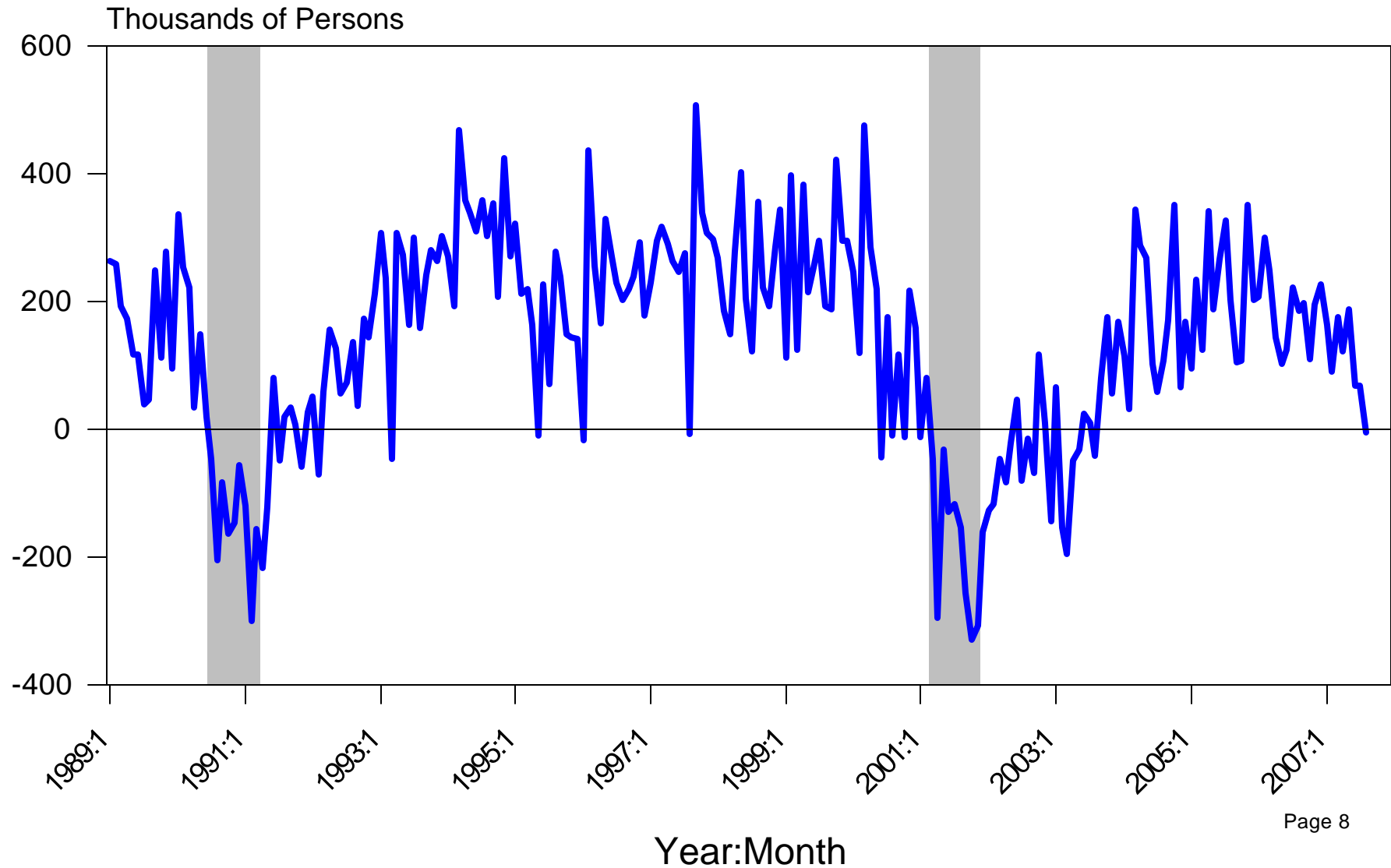
Table 1
Detail of Month-to-month Changes in Nonfarm Payrolls

Change from Prior Month (000)	As Reported In September			As Reported in August	
	June	July	August	June	July
Total	69	68	-4	126	92
Goods-producing	-10	-10	-64	-7	-12
Natural resources and mining	3	5	4	3	2
Construction	6	-14	-22	3	-12
Manufacturing	-19	-1	-46	-13	-2
Service-providing	79	78	60	133	104
Trade, transportation and utilities	6	21	12	10	19
Information	-4	-4	-7	-1	-5
Financial activities	-4	24	0	-2	27
Professional and business services	-7	25	6	7	26
Education and health services	71	50	63	64	39
Leisure and Hospitality	17	6	12	33	22
Other services	2	8	2	3	4
Government	-2	-52	-28	19	-28

Table 2
Analysis of Revisions to Nonfarm Payrolls
(Thousands)

Category	Revision to June	Revision to July
Total nonfarm	-57	-81
Goods-producing	-3	-1
Natural resources and mining	0	3
Construction	3	1
Manufacturing	-6	-5
Service - providing	-54	-80
Trade, transportation and utilities	-4	-2
Information	-3	-2
Financial activities	-2	-5
Professional and business services	-14	-15
Education and health services	7	18
Leisure and Hospitality	-16	-32
Other services	-1	3
Government	-21	-45
Leisure and Hospitality	-16	-32
Arts, entertainment and recreation	-5	-9
Accommodations and food service	-11	-23
Accommodations	-5	-11
Food services and drinking places	-6	-13
Government	-21	-45
Federal	1	9
State Government	0	2
Local Government	-22	-56
Local government education	-24	-59
Local government excluding education	2	3
Totals may not add due to rounding		

Chart 3 Total Nonfarm Payroll Employment Change from Prior Month



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Chart 4 Nonfarm Payroll Employment Change from Year-Ago Month

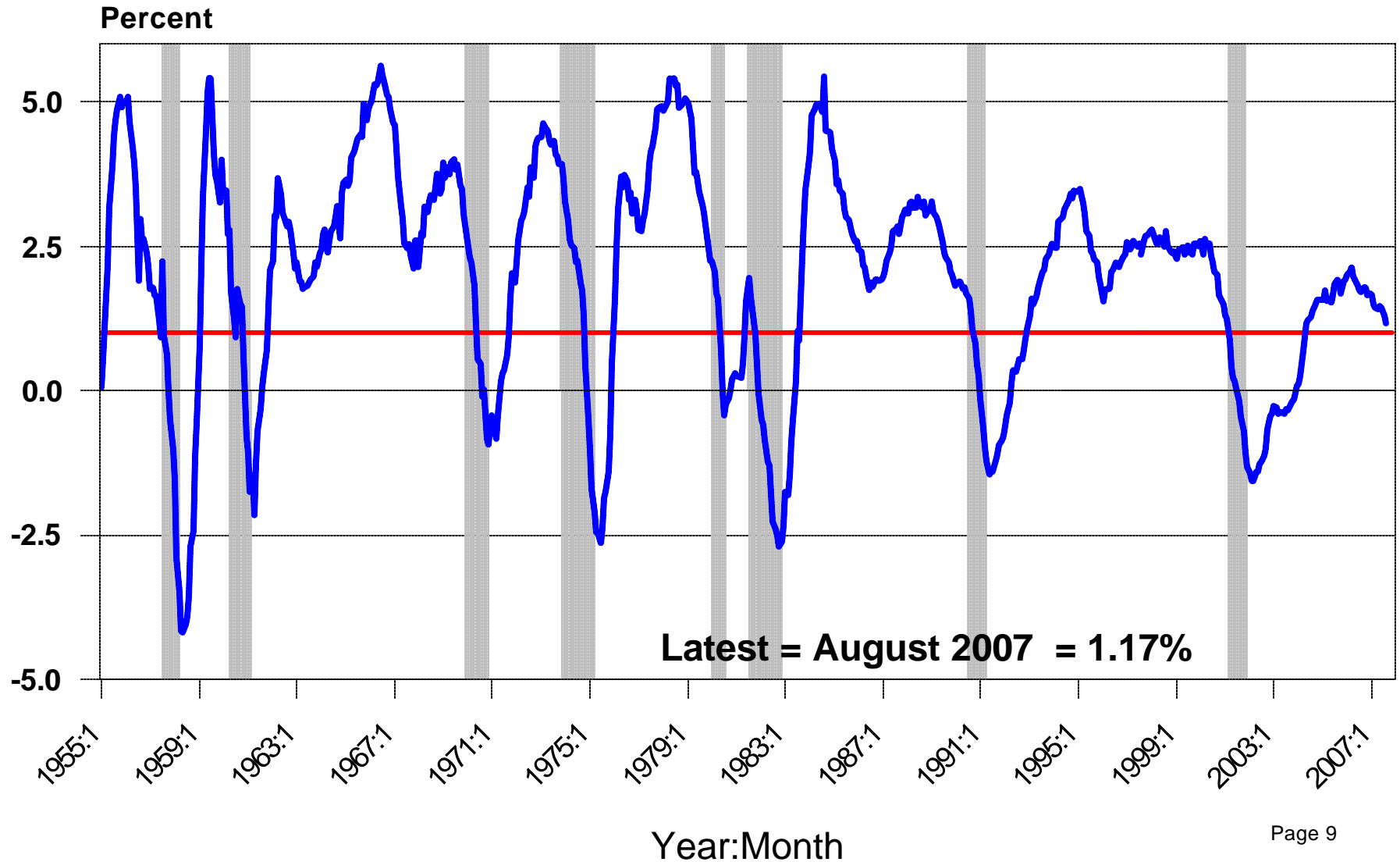


Chart 5 Goods-Producing Payrolls Change from Year-Ago Month

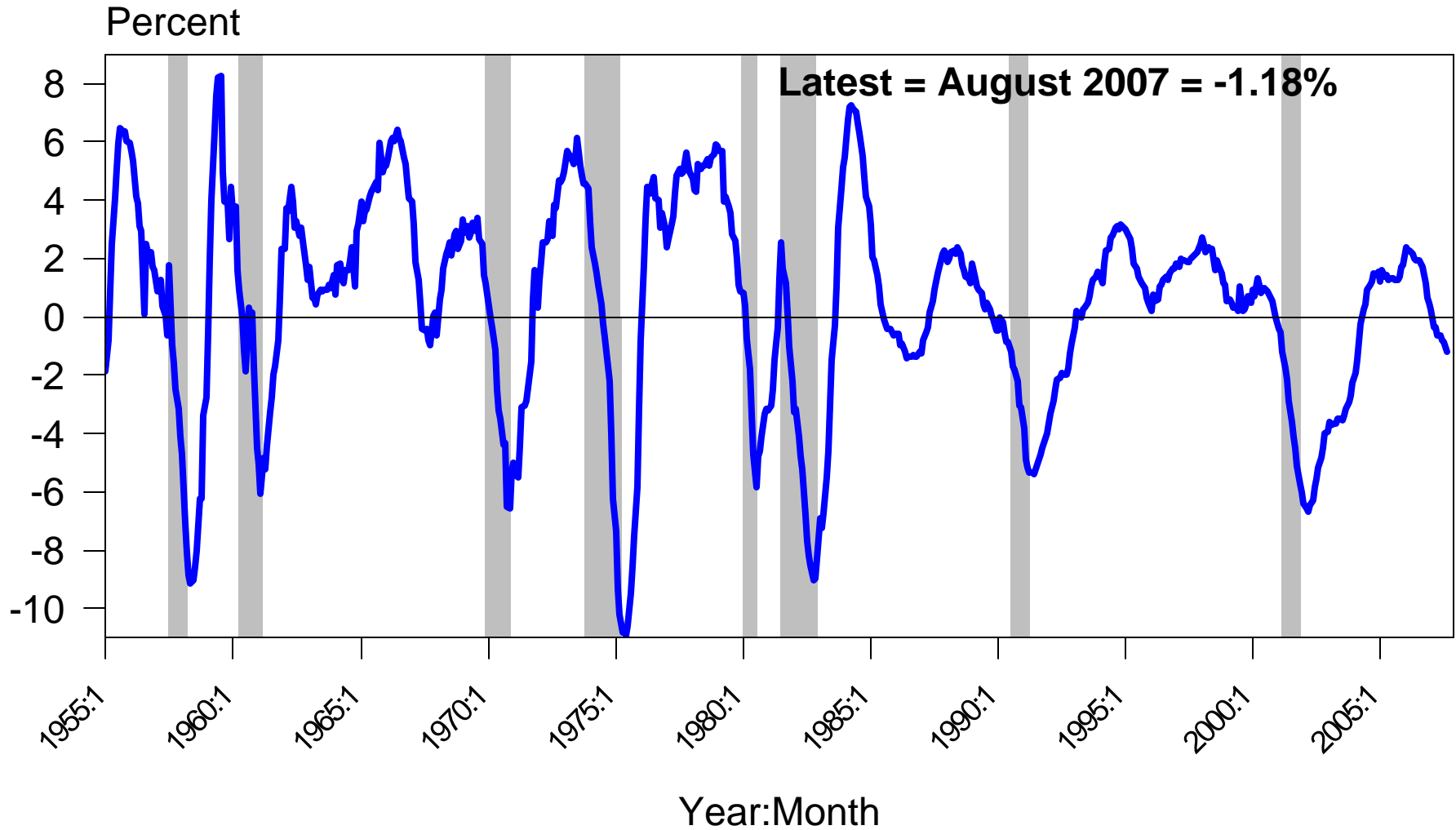


Chart 6 Service-Providing Payrolls Change from Year-Ago Month

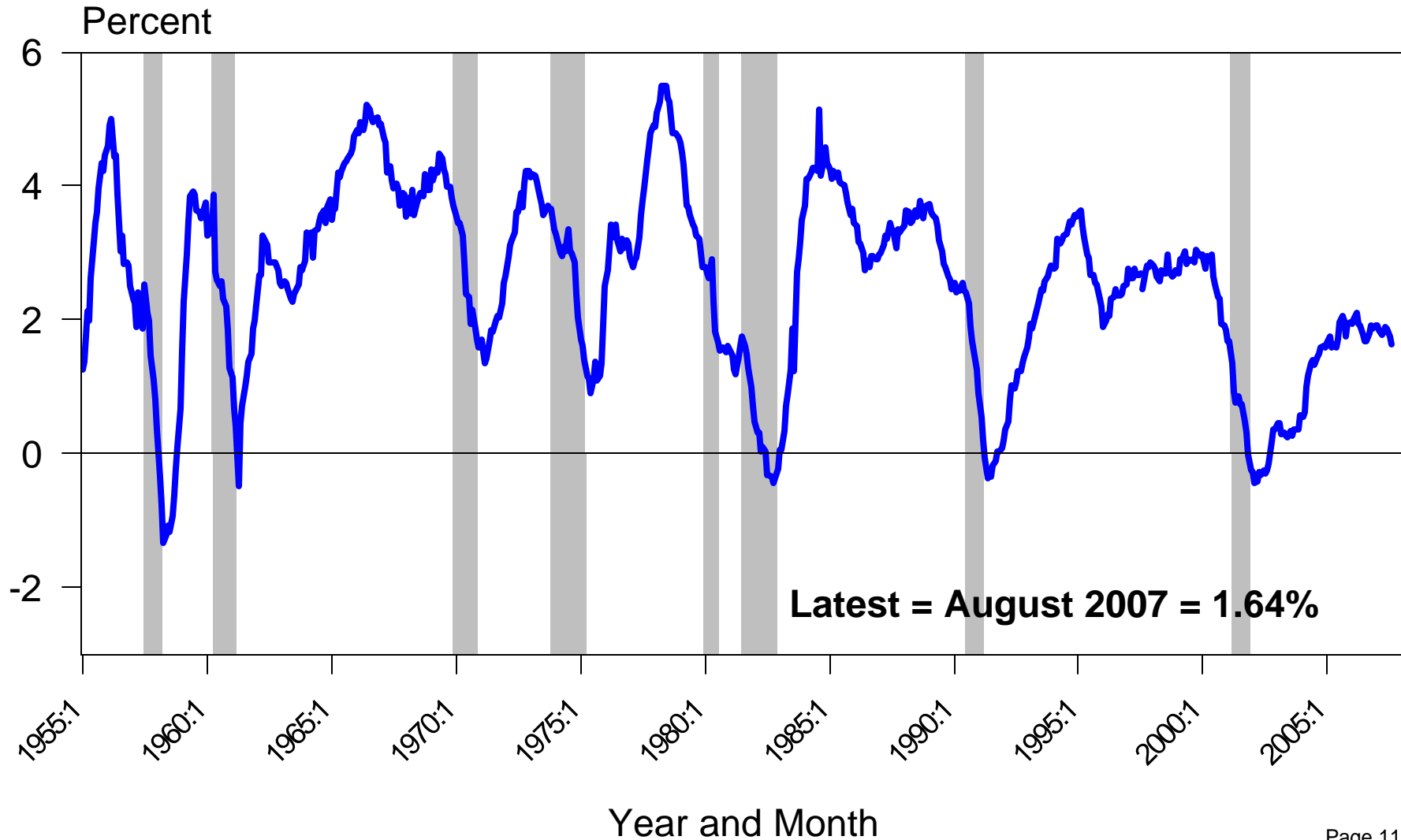


Chart 7
Average Weekly Earnings (AWE)
Seasonally Adjusted Change from Year-Ago Month

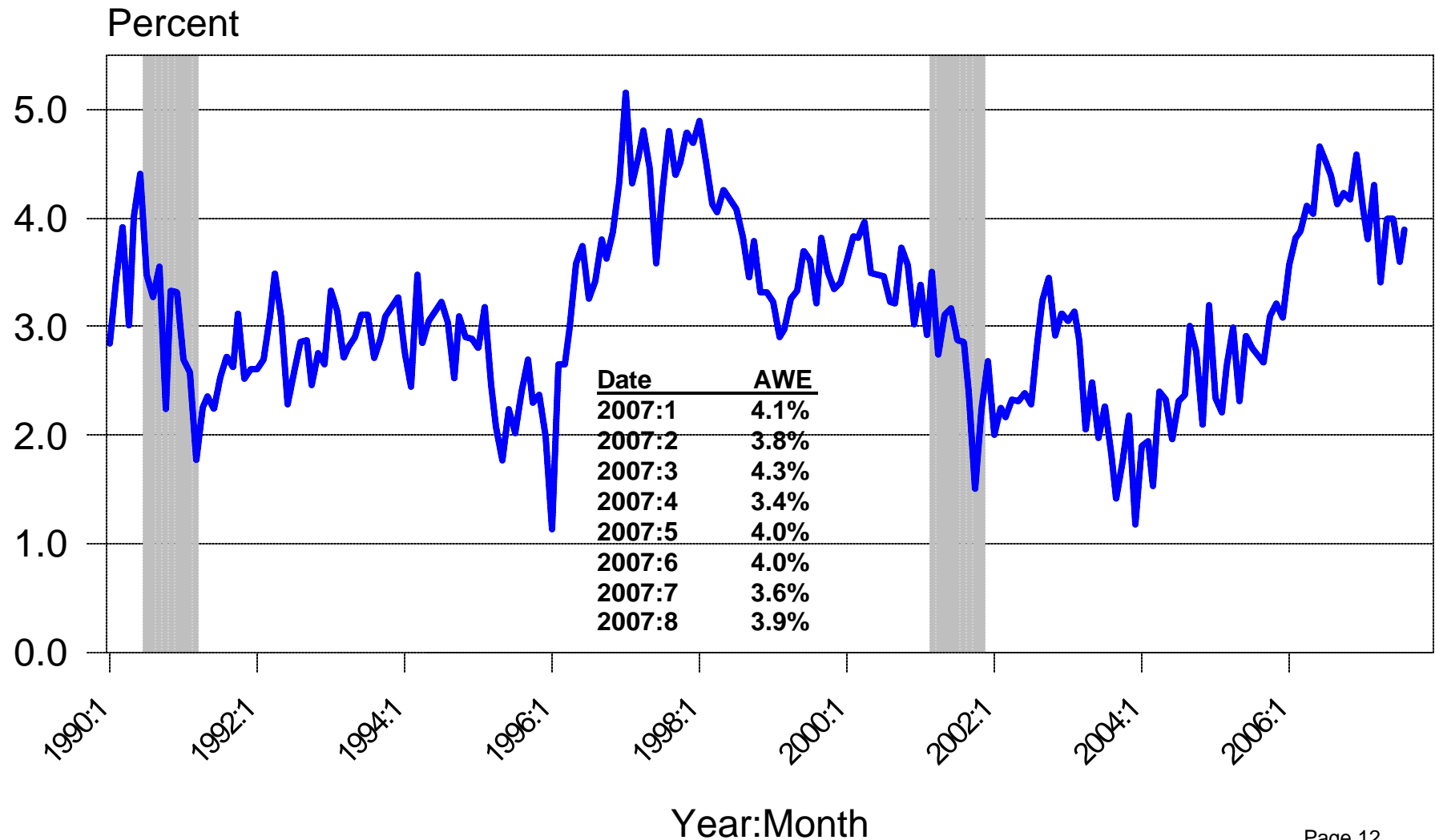
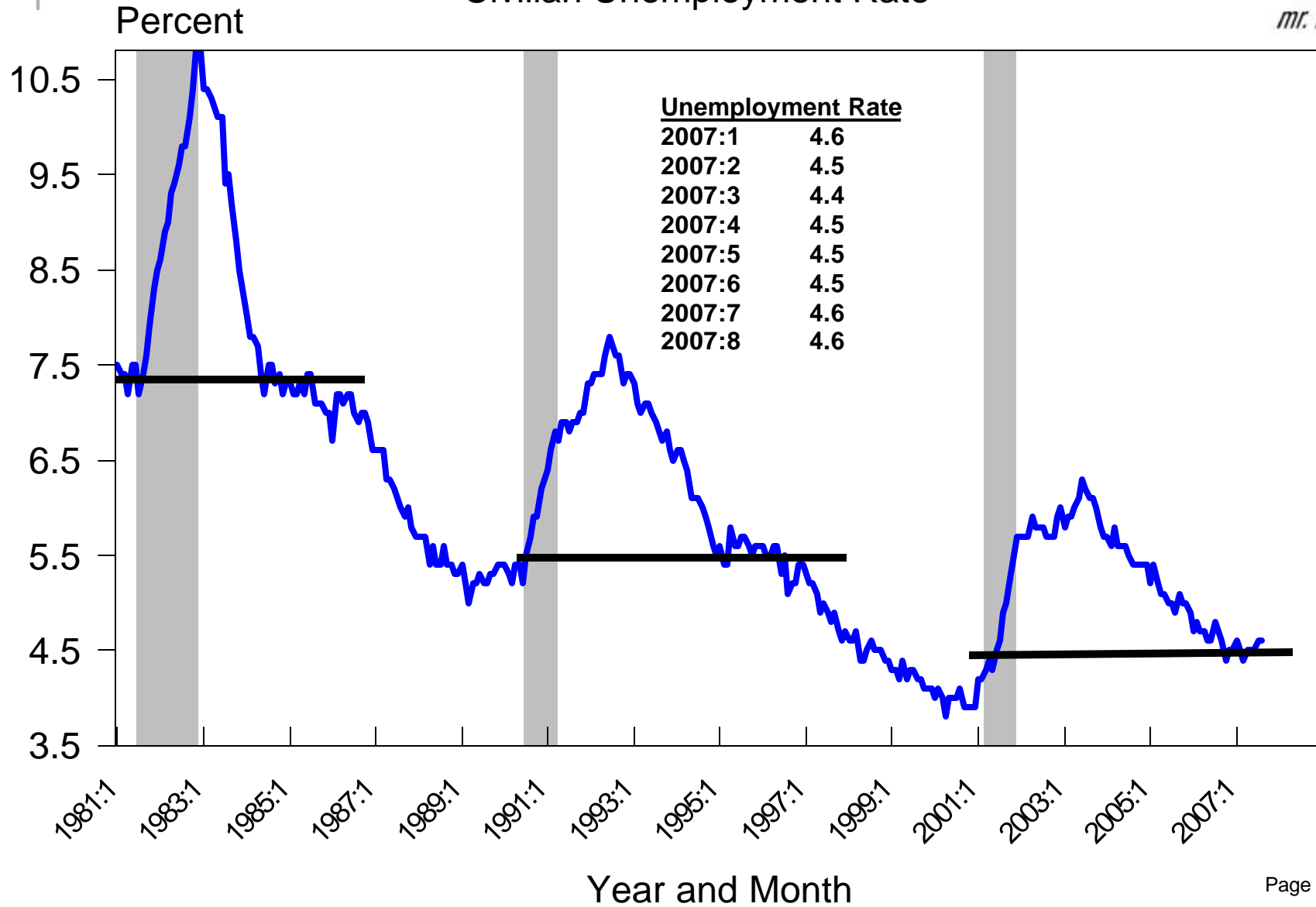


Chart 8 Civilian Unemployment Rate





September 7, 2007

THE EMPLOYMENT SITUATION AS OF AUGUST 2007

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Page 14



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