John Williams'
Shadow Government Statistics
Analysis Behind and Beyond Government Economic Reporting

COMMENTARY NUMBER 403
Labor Data, Consumer Confidence, M3, Systemic-Solvency and Euro Crises

December 3, 2011

There Is No Sudden Economic Recovery, Just Bad-Quality Numbers and Deteriorating Labor Conditions

Latest Jobs Level Still Well Below Pre-2007 and Pre-2001 Recession Levels

November Unemployment: 8.6% (U.3), 15.6% (U.6), 22.6% (SGS)

Money Supply M3 Annual Growth at 2.7% in November

Potential Euro Disintegration Is Nothing Like the Looming Dollar Collapse

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PLEASE NOTE: The next regular Commentary *is scheduled for Friday, December 9th, covering the October trade deficit.*

—Best wishes to all, John Williams

Opening Comments and Executive Summary. While the systemic solvency crisis appears to be intensifying, once again, the U.S. economy continues in severe and protracted downturn. There was no miraculous business recovery in November, despite a couple of positive surprises in recent reporting, specifically, yesterday's (December 2nd) 0.4 percentage-point decline in November's headline unemployment rate, and the 15-point surge in the Conference Board's November consumer confidence

index (reported November 29th). The drop in the headline unemployment rate actually signaled ongoing economic collapse, with swelling ranks of "discouraged" workers, not the ongoing economic recovery heralded by the Administration and some on Wall Street.

The jump in the Conference Board's volatile consumer confidence number likely was due at least partially to bad seasonal factors, with a much smaller gain seen in the unadjusted Michigan series. Even with the reported sharp monthly upturn, the November level of the Conference Board index still was so low that it has not been seen before, except at the lowest readings in the most severe economic contractions since World War II.

At work are here in recent economic reporting simply are some methodological issues and unusual seasonal-factor distortions, not a sudden turnaround in commercial activity.

In the still-unfolding systemic solvency crisis, coordinated huffing and puffing by major central banks, "assuring" liquidity in the global banking system, is a likely sign of rapid deterioration in that system. As discussed regularly in the *Hyperinflation Watch*, central banks and central governments, in general, and very specifically the Federal Reserve and U.S. Treasury, will continue to do whatever they have to do, in order to prevent banking system failures, irrespective of cost. The Fed, by itself, has the ability and the will to act—as it did in 2008—to prevent systemic collapse in the United States.

The eventual cost of continued systemic support remains much higher inflation, but the U.S. central bank is in a no-win circumstance and has little choice in the matter. In terms of its primary responsibility to the banking system, the Fed cannot let the system fail. It will do whatever it has to do, in conjunction with the U.S. Treasury wherever publicly possible, to guarantee, create, lend and/or spend whatever money is needed to prevent systemic collapse. The support process can continue so long as the central bank's machinations are accepted in the markets. That acceptance generally is reflected in rest-of-the-world willingness to hold U.S. dollars. Global confidence in the U.S. currency, however, has been shattered in recent months, where hopes of the United States addressing its long-range solvency issues have been shattered by the recent activities of the politicians controlling the White House and Congress.

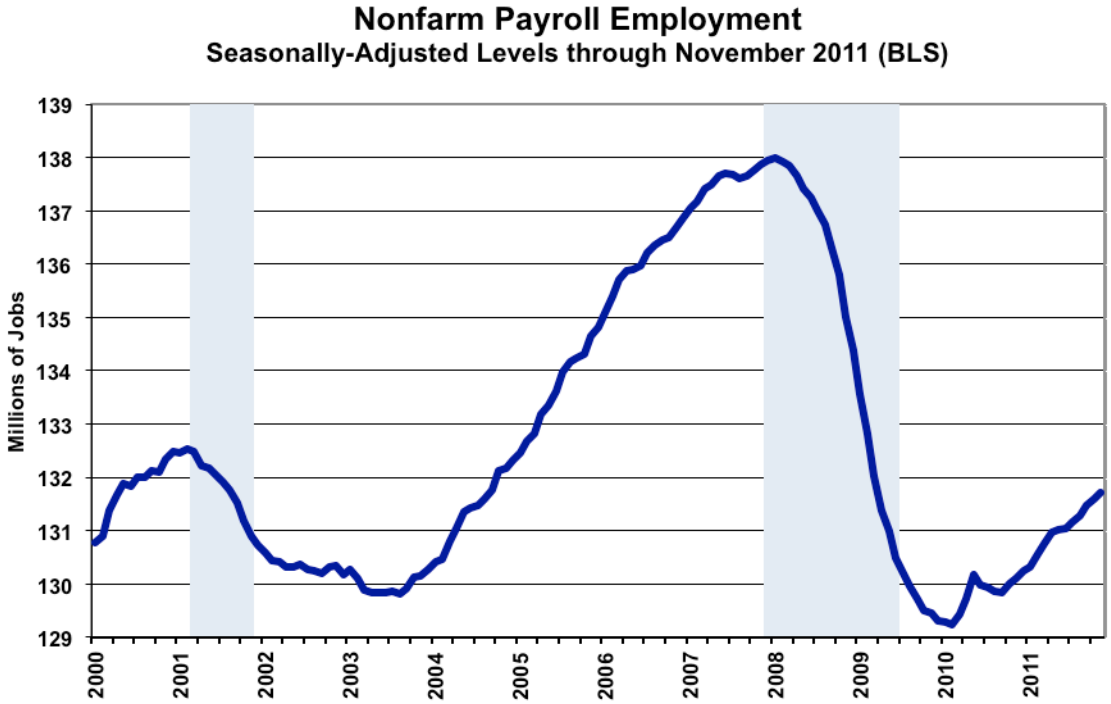
Employment and Unemployment. Online help-wanted advertising has been tumbling for six consecutive months. Until the Internet gained dominance over print media in help-wanted advertising, and the Conference Board ceased publishing its newspaper-based help-wanted advertising index, that newspaper index was one of the most reliable leading indicators of economic and employment activity. In the last several years, the Conference Board has introduced a measure of online help-wanted advertising activity. While the series still is nascent, it now has enough substance to be considered as a leading indicator of hiring activity, one measure of employment activity that otherwise is not addressed adequately in other employment measures.

The help-wanted on line (HWOL) seasonally-adjusted data for November 2011 (released November 30th) showed a monthly decline of 1.9%, which was the sixth straight monthly contraction. Since May 2011, the series has declined by 13.7% and the current HWOL pattern is suggestive of declining employment levels now, and in the near future, contrary to the gradual, but ever statistically-insignificant gains reported in the monthly payroll employment surveys.

Payroll Employment. Seasonally-adjusted payrolls were reported up by 120,000 in November, but, as usual, that level of change was not statistically meaningful. The November gain followed an upwardly

revised 100,000 jobs gain in October (previously reported as a gain of 80,000), yet a reasonable portion of the happy upside news was no more than shifting of previously reported employment activity from earlier periods to reporting of the last three months, through the magic of concurrent seasonal adjustments, where the monthly seasonal adjustments and the employment levels are recalculated each and every month. Those adjustments set the headline reporting of month-to-month payroll change. If the system were statistically stable, those monthly readjustments would be minimal. The system is far from stable.

As shown in the following graph of payroll employment levels over time (shaded areas are official recessions), the uptick in the last two years (the upside blip in 2010 was due to temporary hiring for the decennial census) does not reflect an economic recovery. Not only is November 2011 employment still well below the employment high seen going into the 2007 recession, it also is well below the employment high seen going into the 2001 recession. Where the U.S. population has grown by more than 10% since the onset of the 2001 downturn, the collapse of current payroll employment is symptomatic of the structural loss of U.S. jobs to offshore facilities, and of the resultant exploding population of "discouraged" workers, who still are unemployed. Although able and willing to work, they simply have given up looking for jobs where there are none available to them.



Unemployment. The big news from the November 2011 labor conditions release was a statistically-significant 0.37 percentage point decline in the headline U.3 unemployment rate to 8.64%, from 9.01% in October. The story, however, was not a happy one: an indication of deteriorating economic activity, not an economic rebound.

At least 0.30 percentage point of the unemployment rate decline was due to an unusual surge in discouraged workers and a corresponding decline in the headline labor force, which is the devisor in the unemployment rate calculation (unemployment rate = unemployed/labor force). Where discouraged workers are reported only on a not-seasonally-adjusted basis, the effect of discouraged workers on the unemployment rate was calculated on an unadjusted basis. There also remain basic issues for this series, given ongoing seasonal-factor distortions.

At the headline U.3 unemployment level, the unemployed become "discouraged" when they stop looking for work because there are no jobs to be had. When the unemployed have not looked for work actively in the last four weeks, they are dropped from U.3 unemployment and from the headline labor force estimate. Discouraged workers are tallied in the broader U.6 unemployment measure, until they have not looked actively for work in the last year.

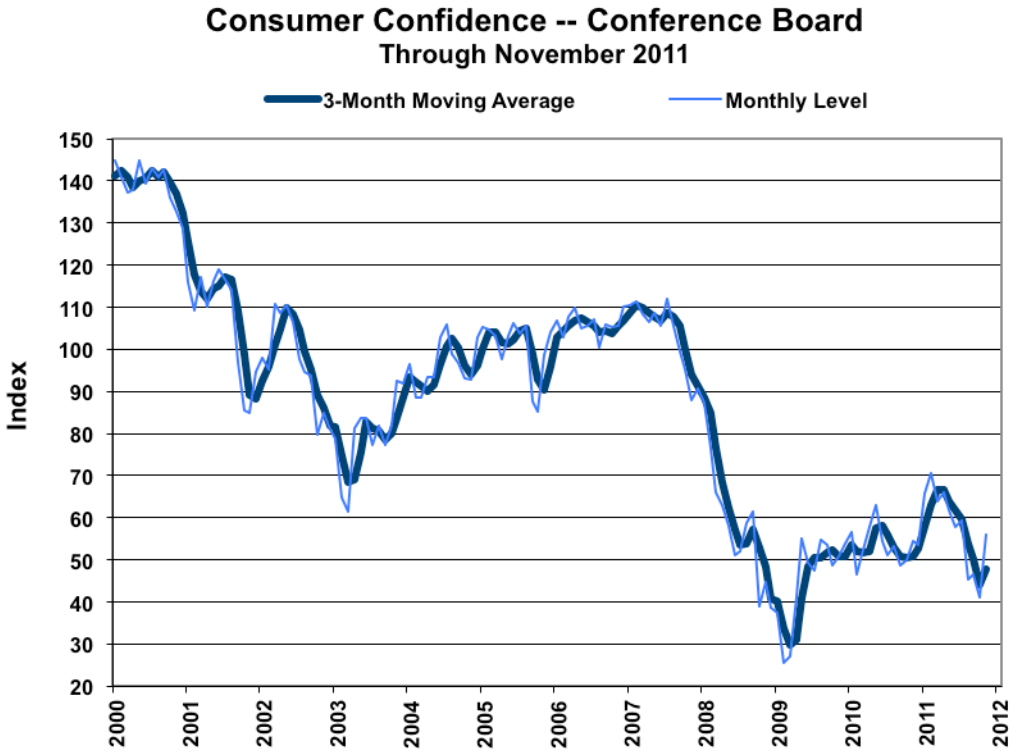
The government's broadest unemployment measure U.6, however, also declined on a seasonally-adjusted basis, to 15.6% from 16.2%. Again, though, that improvement was distorted by special factors, where a portion of short-term discouraged workers from October rolled out of government accounting, into the long-term discouraged worker category (included in the SGS-Alternate Unemployment Measure). The biggest factor, though, was a sharp decline in the seasonally-adjusted level of those employed part-time for economic reasons in November. Where that series usually increases on an unadjusted basis in November, with people taking on part-time holiday-season work, that did not happen this year (this could be argued either as good news or bad news). In any event, the seasonal factors converted the unusual unchanged level to a big drop.

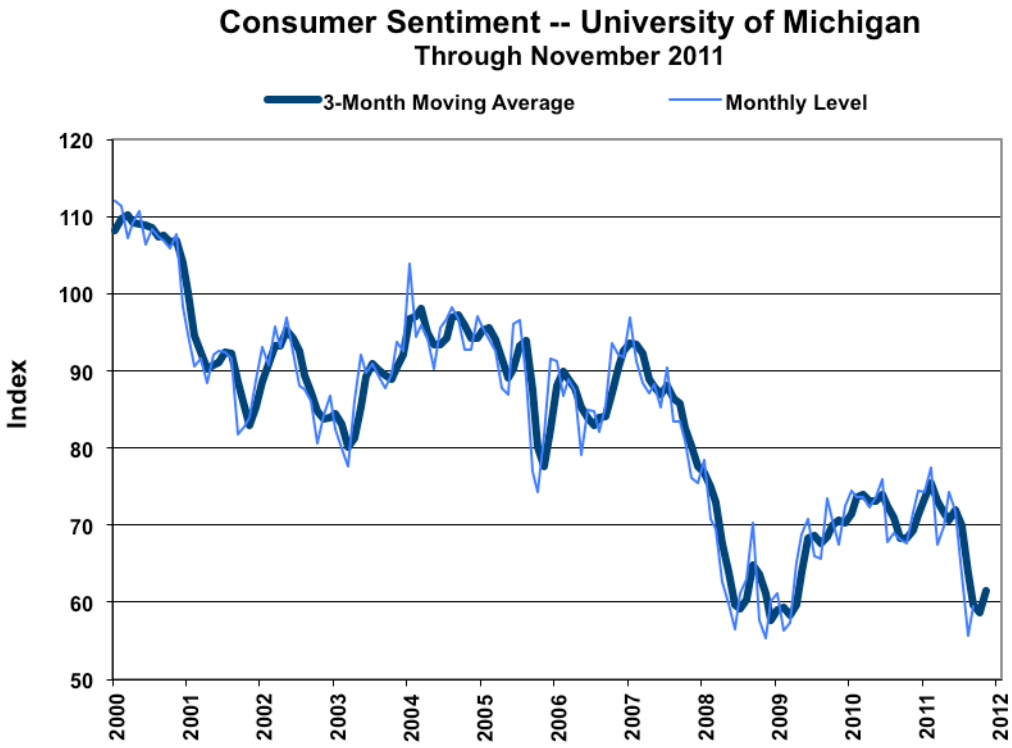
While that likely will reverse in the next several months of reporting, it had the effect of depressing the U.6 unemployment rate. Where the SGS-Alternate Unemployment Measure is built on top of U.6, the SGS measure also was depressed, at 22.6% unemployment in November, versus 22.9% in October.

Consumer Confidence, Sentiment and New Home Sales. 'Tis the season for happy consumer numbers. At least that was the tradition some years back, where ever-happy November consumer confidence numbers could be counted on by the popular media for a regular story to help encourage shoppers to part with their money in holiday shopping. On the rare occasion that November confidence numbers were down, the story usually ended up on the obituary page, instead of on the front page. Newspapers naturally were sensitive to the needs of their paying advertisers.

An unusual feature of the Conference Board's consumer confidence measure is that it is "seasonally adjusted." Whether such a series even should be adjusted is a major issue; the University of Michigan's consumer sentiment series is not. Further, the Conference Board does not release the unadjusted series for public consumption.

That said, adjusted consumer confidence jumped sharply in November, just in time to brighten the news for the holiday season. This series is highly volatile, although stable seasonal adjustments should tend to reduce month-to-month volatility. Smoothed by a three-month moving average, the November swing is not large. As reported in the single month surge, though, the level of confidence still is near the historic lows of the series, at a level never seen outside of the most severe contractions in the worst recessions of the post-World War II era.





Although the unadjusted University of Michigan consumer sentiment measure also rose in November, as with the confidence series, smoothed by a three-month moving average, the November uptick was not meaningful. As a standalone month, the November reading also is near the historic lows of the series, at a level never seen outside of the most severe contractions of the worst recessions in the post World War II era.

The new home sales series, which is tied to a certain extent to consumer confidence and sentiment, continued its long-term bottom-bouncing in October. The reported 1.3% monthly gain (November 28th) was an artifact of prior-period downside revisions and was, as usual for this series, statistically meaningless.

Hyperinflation Watch—A Euro Break-Up Would Not Be Like a U.S. Dollar Collapse. As market concerns continue to fluctuate around euro-area conditions, fears of a euro collapse or break-up keep surfacing in the press. It is worth noting that while such an event is unhappy news for aficionados of single currencies for regional trade or economic blocs, and it is a major complication for the European Union and related financial structures, the euro still is a fixed-exchange rate conglomeration of 16 currencies that include the dominant, and what still would the powerful German mark, as well as the troubled Greek drachma.

A complete break-up of the euro effectively would be the same as allowing the included sovereign currencies to float against each other again. The involved currencies would survive. Such is not a currency collapse, only a reorganization that also could result in partial break-up of the euro, with a new currency bloc or blocs resulting. In contrast, the deliberate debasement of the U.S. dollar, and the unwillingness or inability of the U.S. government to address its long-range insolvency, promise an ultimate collapse of the U.S. currency that will leave the U.S. dollar absolutely worthless to its holders.

The hoopla out of the major central banks, on November 30th, over renewed coordinated global efforts at maintaining banking-system liquidity, suggested a rapidly deteriorating circumstance. Further, the continued lack of meaningful growth in either the U.S. broad money supply measure, or in domestic bank lending, remains suggestive of deteriorating banking stability in the United States.

Money Supply M3 (November 2011). Bank lending remains impaired and broad money growth still is not picking up as it would with a healthy banking system. Based on roughly three weeks of data, the preliminary estimate of annual growth for the November 2011 SGS Ongoing-M3 Estimate was 2.7%, published today (December 3rd) in the Alternate Data section. That was at the same level as the revised 2.7% (previously 2.6%) annual growth estimated for October 2011. Revisions here reflect revisions to underlying Federal Reserve data. As with October, the seasonally-adjusted, month-to-month change estimated for November M3 likely will be unchanged, with the adjusted M3 monthly growth virtually stalled since September. The estimated month-to-month M3 changes, however, remain less reliable than the estimates of annual growth.

A flattening or softening in the relative monthly estimates of annual growth, and flat-to-slowing month-to-month gains, also likely continued for the narrower M1 and M2 measures (M2 includes M1, M3 includes M2). M2 for November is on track to show year-to-year growth of about 9.7%, versus 9.9% in October, with month-to-month growth estimated at roughly 0.3% in November, the same as in October.

The early estimate on M1 for November shows year-to-year growth of roughly 17.9%, down from 20.8% in October, with month-to-month change showing a likely 0.4% contraction in November, versus a 0.8% gain in October. The relatively stronger annual growth rates in M1 and M2 still reflect the recent shifting of funds out of M3 accounts into M1 and M2 accounts.

Reiterating Key Points of the Prior **Hyperinflation Watch.** An annual GAAP-based U.S. federal deficit running greater than five-trillion dollars is beyond control and containment within the sphere of the politicians controlling the White House and Congress (see *Commentary No. 400*), and underlying economic reality remains an ongoing protracted and deepening economic catastrophe (see *Commentary No. 401*). The lack of of political will in Washington to address the mortal threats to the U.S. financial system and economy effectively killed any remaining global confidence in the U.S. dollar by early August 2011, and the domestic and global markets have been highly unstable—in extreme turmoil—ever since. A new dollar-selling panic, and crisis reactions actions by the Fed, easily could bring the pending hyperinflation threat rapidly to a head.

The economic collapse that began in 2006 or 2007 is ongoing and is worse than popularly is recognized. With no relief in sight for the structural income and credit problems facing consumers, there is no near-term prospect for broad economic recovery in the United States. An ongoing economic downturn has severely negative implications for the projected U.S. federal budget deficit, for projected U.S. Treasury funding needs and for banking-system stress tests and systemic stability. It also promises a volatile political environment coming into the 2012 election, where pocket-book issues historically have dominated national election results more than any other single issue.

There remain no happy solutions available here to remedy the crises, only tools—devil's choices—for the Fed and the U.S. government to buy a little extra time. Domestic systemic instabilities, and possibly instabilities outside the United States, make substantial, expanded "easing" actions of some form likely by the Federal Reserve, sooner rather than later. From the Fed's standpoint, keeping the banking system afloat remains its primary concern, not expanding the economy or containing inflation. The ultimate cost in propping the system, however, remains inflation.

The root source of current global systemic instabilities primarily has been the financially-dominant United States, and it is against the U.S. dollar that the global markets ultimately should turn, massively. The Fed and the U.S. Treasury likely will do whatever has to be done to prevent ongoing crises in the euro-area from triggering a systemic collapse in the United States. That precedent was established in 2008. Accordingly, it is not from a euro-related crisis, but rather from within the U.S. financial system and financial-authority actions that an eventual U.S. systemic failure likely will be triggered, seen initially in a rapidly accelerating pace of domestic inflation—ultimately hyperinflation.

The financial markets remain extremely volatile and unstable. Underlying the various market upheavals fundamentally is the deepening crisis of confidence in the U.S. dollar and in the long-term doubts of U.S. financial, economic, systemic and political stability. For those living in a U.S. dollar-denominated world, regardless of any ongoing near-term extreme volatility in the U.S. dollar—in either direction—versus the stronger major currencies and gold, the stronger currencies and precious metals, again, remain the fundamental, long-range hedges against what lies ahead.

Massive, fundamental dollar dumping and dumping of dollar-denominated assets may start at anytime, with little or no further warning. With a U.S. government unwilling to balance or even to address its

uncontainable fiscal condition; with the federal government and Federal Reserve standing ready to prevent a systemic collapse, so long as it is possible to print, spend, loan or guarantee whatever money is needed; with the U.S. dollar at increasing risk of losing its global reserve currency status; much higher inflation lies ahead, in a circumstance that, again, could evolve rapidly into hyperinflation.

The economic and systemic-solvency crises and the broad inflation and economic issues detailed in the *Hyperinflation Special Report (2011)* and in recent *Commentaries*, continue to unfold with outlooks that remain unchanged. A fully updated *Hyperinflation Report* is planned in later this month, shortly after the December 15th scheduled publication of the 2011 GAAP-based financial statements for the U.S. government.

REPORTING DETAIL

EMPLOYMENT AND UNEMPLOYMENT (November 2011)

Poor-Quality Seasonal Adjustments and Growing Ranks of Discouraged Workers Give False Luster to November's Headline Labor Numbers. While the 120,000 gain reported for November payrolls was not statistically meaningful, the significance of the headline jobs gain was marred further by serious distortions in seasonal-adjustment factors that have resulted from the impact of the ongoing extreme depth and duration of the economic turmoil of recent years. Further complicating the data is the Bureau of Labor Statistics' (BLS) practice of using "concurrent" seasonal-factor adjustments. Monthly seasonal factors are recalculated each month, for every month going back a number of years, but the BLS only reports the revised payroll data for the two months prior to headline reporting. The effect recently has been to shift previously reported employment from prior periods to the present, adding 20,000 to 30,000 jobs artificially to recent payroll reporting.

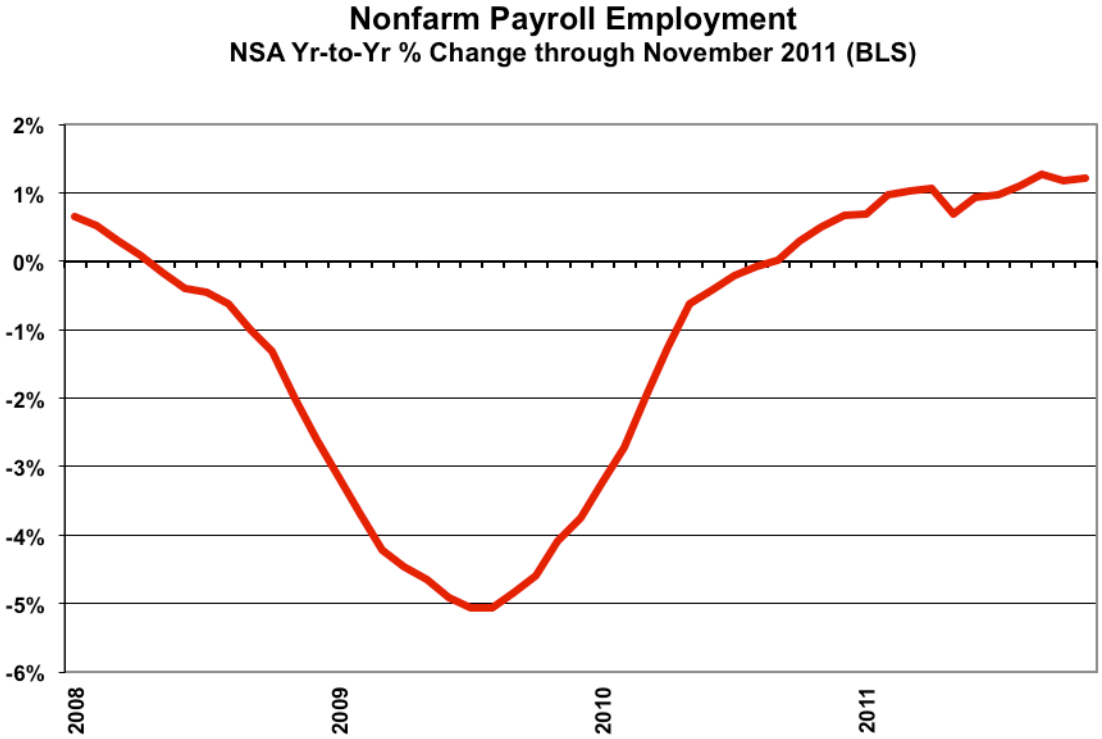
The 0.4 percentage point decline in the headline U.3 unemployment rate to 8.6% was statistically meaningful, but most of the reported improvement in the jobless rate was due to an increasing number of unemployed falling into the "discouraged" worker category and being viewed by the BLS as out of the headline labor force. These individuals would consider themselves to be unemployed, but they have given up looking for work because there are no jobs to be had.

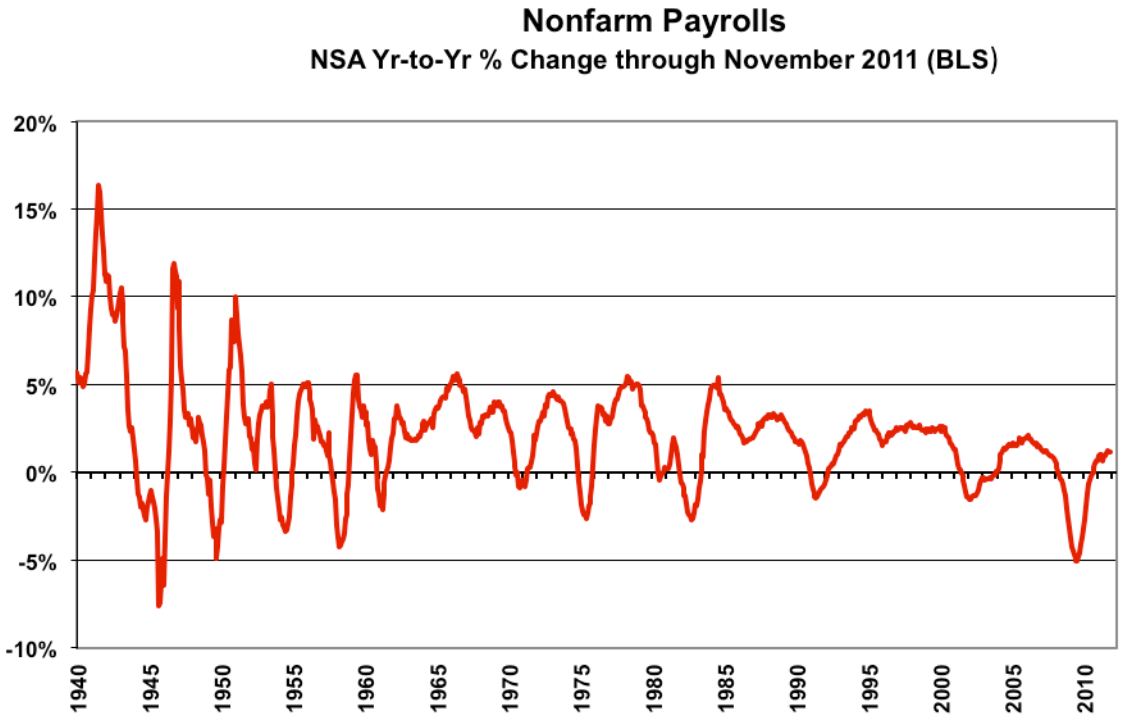
By BLS definition, individuals not actively looking for work are not counted in the headline unemployment measure. Although the BLS tracks "discouraged" workers for one year in the broader U.6 unemployment measure, the discouraged disappear from government surveys after one year. An accelerating flow of unemployed from the headline category, to the discouraged category, to off the books (still counted in the SGS Alternate Unemployment Measure) may reduce the headline unemployment rate, but it is a sign of a collapsing, not rebounding economy.

PAYROLL SURVEY DETAIL. The BLS reported yesterday (December 2nd) a statistically-insignificant, seasonally-adjusted November 2011 month-to-month payroll employment gain of 120,000 (a gain of 192,000 jobs before prior-period revisions) +/- 129,000 (95% confidence interval). October payrolls showed a revised 100,000 gain (previously a gain of 80,000), while September's monthly gain revised to 210,000 (previous reporting of 158,000).

Out of the public eye and scrutiny, though, the revised September gain actually was 20,000 less, at 190,000, but the BLS did not report that, officially. August's gain of 104,000 was revised to 84,000, also not reported. Monthly changes for July and earlier were revised back for years, as happens each month with the concurrent seasonal adjustment process, but those revisions also were not reported by the BLS, so as to "avoid confusing" payroll employment data users. The reporting gets partially corrected each year with the annual benchmark revision (the 2011 revisions are due for release with the January 2012 data in February 2012).

In terms of year-to-year change, the unadjusted November 2011 growth rate was 1.27%, up versus the revised 1.18% (previously 1.15%) reported for October, and against a revised 1.21% (previously 1.23%) annual growth reported for September. Although the graphs of year-to-year unadjusted payroll change had shown a rising trend in annual growth, which primarily reflected the still-protracted bottom-bouncing in the payroll series, that pattern has flattened out in recent months, as shown in the first graph following of the near-term detail in year-to-year change. These numbers recently have reflected short-lived year-to-year distortions as a result of the year-ago hiring surge and full layoffs of temporary census workers.





As shown in the longer-term graph (historical detail back to World War II), with the bottom-bouncing of recent years, current annual growth has recovered from the post-World War II record 5.06% decline in August 2009, which was the most severe annual contraction seen since the production shutdown at the end of World War II (a trough of a 7.59% annual contraction in September 1945). Disallowing the post-war shutdown as a normal business cycle, the August 2009 annual decline remains the worst since the Great Depression, yet the current level of employment is far from any recovery.

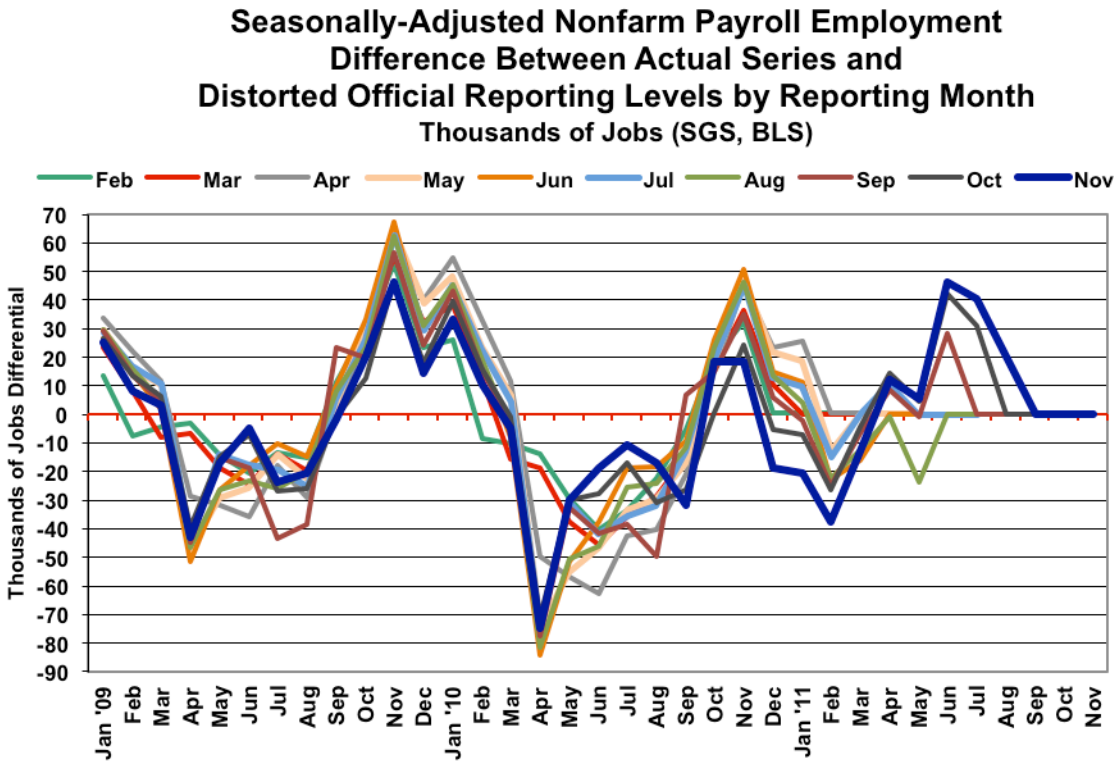
The regular graph of seasonally-adjusted payroll levels, showing that current employment still is below where it was pre-2001 and pre-2007 recessions is located in the *Opening Comments and Executive Summary* section.

Concurrent Seasonal Factor Distortions. As discussed in prior writings (see the *Hyperinflation Special Report (2011)*, for example), seasonal-factor estimation for most economic series has been distorted severely by the extreme depth and duration of the economic contraction. These distortions are exacerbated for payroll employment data based on the BLS's monthly seasonal-factor re-estimations and lack of full reporting.

Where the BLS recalculates the monthly seasonal factors each month for payroll employment, going back a number of years, it only publishes revised data for the last two months of reporting (September and

October 2011 with the November 2011 report). Shown in the following graph, the latest "concurrent" seasonal factor changes.

Clearly seen in the November plot (heavy blue line) is a shifting of reported seasonally-adjusted jobs from 2010 into 2011. With late-2010 losing previously reported jobs and the current reporting picking them up (see second paragraph under *PAYROLL SURVEY DETAIL* heading preceding). Again, just two months of prior reporting are shown as revised in the official BLS release, pre-September 2011 revisions were not published so as to avoid "confusing" people using the data.



As discussed repeatedly in recent employment *Commentaries*, meaningful seasonal-adjustments tend to be stable over time, without wild fluctuations every time the seasonals are re-estimated. This is true particularly for series like payroll employment and retail sales, where the seasonal factors are concurrent—recalculated each month for the current month's raw data. If the payroll seasonals were stable, the lines in the graph would be flat and coincident. Instead, the variations shift and intensify with each successive month. The monthly recalculations of seasonally-adjusted payroll levels show irregular revisions, with monthly swings now of plus or minus 70,000 to 90,000 jobs shifting over time. To the extent the numbers affect current reporting, the differences are enough potentially to alter financial-market perceptions and reactions.

A further big issue remains that the month-to-month seasonally-adjusted payroll data have become increasingly worthless, with reporting errors likely now well beyond the official 95% confidence interval of +/- 129,000 jobs in the reported monthly payroll change. Yet the media and the markets tout the data as meaningful, usually without question or qualification.

The inconsistency differences in the graph were calculated based on the raw unadjusted data and the seasonal-adjustment program available to the public on the BLS Web site. Using the BLS data, we have calculated the seasonally-adjusted numbers as the BLS should be showing them, as of the current reporting, and the differences between official reporting and the consistent seasonally-adjusted series.

Payroll Benchmark Revision and Gimmicked Upside Biases. Where, traditionally, the BLS does not adjust payroll reporting for the annual benchmark revisions before the January data release of the following year, the Birth-Death Model appeared to have been adjusted for the quarter beginning October 2011, so as to add an additional 50,000 jobs per month (600,000) per year to compensate for the pending 192,000 annual benchmark revision, although the change was not repeated in November (see next section). On September 29th, the BLS published a preliminary upside benchmark estimate for March 2011 unadjusted nonfarm payrolls. The announced 192,000 positive revision suggested there had been a monthly-average understatement of 16,000 jobs in the period from April 2010 to March 2011. Official reporting history will not be revised until the February 3, 2012 release of the January 2012 payrolls.

Birth-Death/Bias Factor Adjustment. Despite the ongoing and regular overstatement of monthly payroll employment—as evidenced usually by regular and massive, annual downward benchmark revisions—the BLS generally upped its monthly biases in post-benchmark reportings of recent years. In the wake of the purported upside benchmark preliminary revision for March 2011 (see previous section), the monthly bias factor used in October 2011—the first month of fourth-quarter reporting—was revamped to a more-positive monthly add-factor of 102,000 than the 71,000 used in October 2010. That followed a more-negative subtraction of 43,000 jobs for September 2011, versus a 25,000 subtraction in September 2010. The resulting monthly swing of 50,000 jobs—an upswing of 600,000 annual jobs—substantially over-compensated for the purported 192,000 upside benchmark revision. The November 2011 bias, however, was a 29,000 subtraction, only minimally narrower than the 32,000 subtraction used in November 2010.

The aggregated upside annual bias reflects an ongoing assumption of a net positive jobs creation by new companies versus those going out business. Such becomes a self-fulfilling system, as the upside biases boost reporting for financial-market and political needs, with relatively good headline data, while often also setting downside benchmark revisions for the next year, which traditionally are ignored by the media and the politicians. Where the BLS cannot measure the impact of jobs loss and jobs creation from employers starting up or going out of business, on a timely basis (within at least five years, if ever), such information is estimated by the addition of a bias-factor generated by the Birth-Death Model (a model of the effects of new business creation and old business bankruptcies). The fundamental defects of the Birth-Death Model are discussed as usual in the ensuing paragraphs.

Positive assumptions—commonly built into government statistical reporting and modeling—can become self-fulfilling prophesies, with "stronger" economic data being reported as a result of happy guesstimates, or underlying assumptions of ongoing economic recovery. Indeed, historically, the Birth-Death Model biases have tended to overstate payroll employment levels—to understate employment declines—during recessions. There is a faulty underlying premise here that jobs created by start-up companies in this downturn have more than offset jobs lost by companies going out of business. So, if a company fails to

report its payrolls because it has gone out of business, the BLS assumes it still has its previously-reported employees and adjusts those numbers for the trend in the company's industry.

Further, the presumed net additional "surplus" jobs created by start-up firms, get added on to the payroll estimates each month as a special add-factor. These add-factors have averaged 40,000 jobs per month over the last 12 months and appear may have been upped to about 90,000 jobs per month. With the economy continuing to falter, I expect a significant downside benchmark revision for next year (March 2012), given current details of the BLS's happy estimates.

HOUSEHOLD SURVEY DETAILS. The usually statistically-sounder household survey, which counts the number of people with jobs, as opposed to the payroll survey that counts the number of jobs (including multiple job holders more than once), showed a November 2011 employment gain of 278,000 versus a 277,000 gain in October. Severe issues with monthly seasonal factors still meaningfully cloud the significance of the reported monthly levels in the adjusted headline U.3 unemployment rate and other adjusted household-survey numbers.

Again, adjusted data have been shifted by highly unstable seasonal factors that are artifacts of the severe and extraordinarily protracted downturn in U.S. economic activity (as well as distortions created by last year's census hiring and firing effects), not by the regular and stable seasonal patterns that were in place before the current economic crisis. Unlike the payroll or establishment series, the household survey does not use the concurrent seasonal factor adjustment series. The household series, however, does go through other revisions and distortions.

As a heads up to regular annual revisions, the BLS confirmed that the household survey release for December 2011, on January 6, 2012, "will incorporate annual revisions in seasonally adjusted unemployment and other labor force series from the household survey. Seasonally adjusted data for the most recent 5 years are subject to revision."

Also, "Effective with the release of The Employment Situation for January 2012, scheduled for February 3, 2012, population controls that reflect the results of Census 2010 will be used in the monthly household survey estimation process. Historical data will not be revised to incorporate the new controls; consequently, household survey data for January 2012 will not be directly comparable with that for December 2011 or earlier periods."

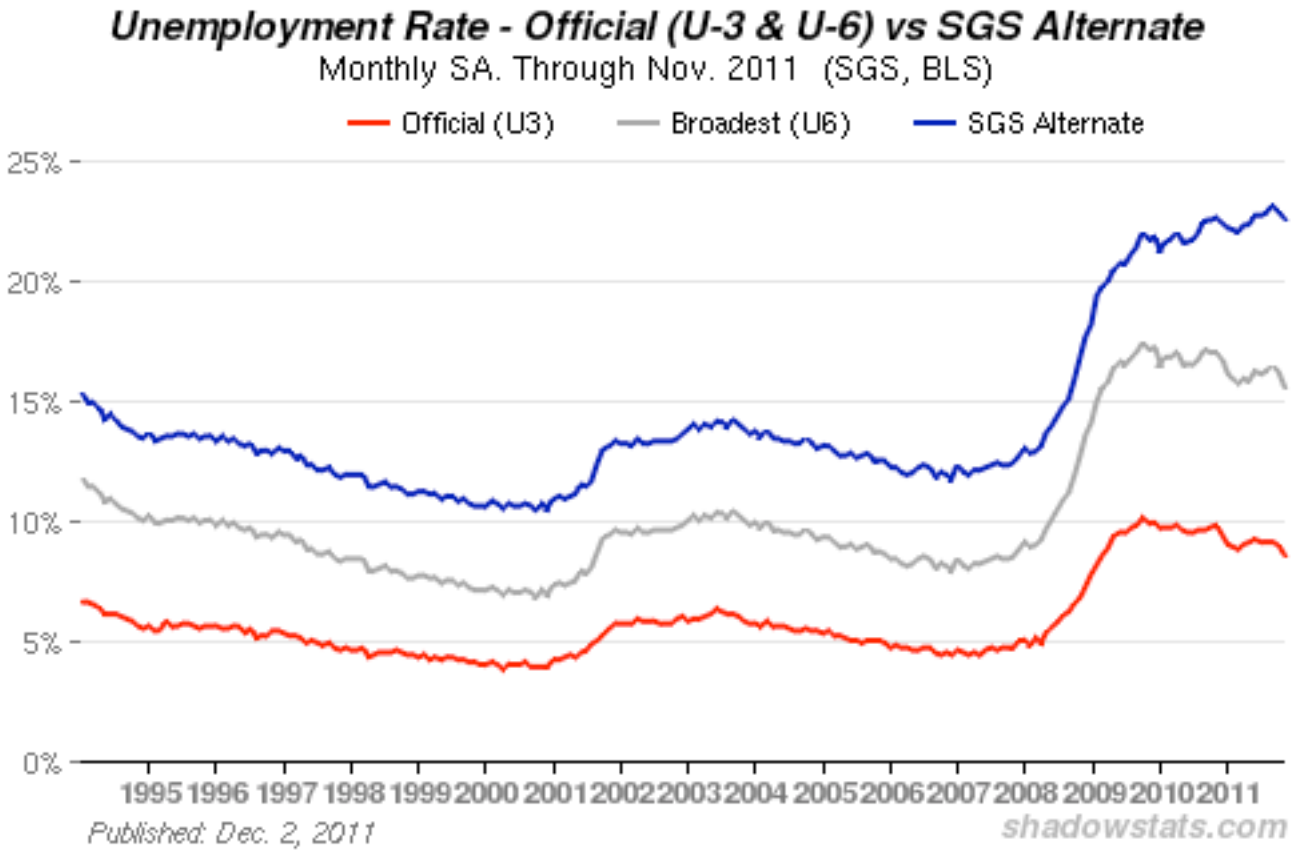
Lack of direct comparability is a major flaw in the household data and is why current unemployment series generally cannot be compared meaningfully with BLS series that pre-date the 1994 overhaul of the survey's methodology.

The December 2nd release showed November 2011 seasonally-adjusted headline (U.3) unemployment rate dropped sharply, with a statistically-significant 0.37 percentage point decline to 8.64% +/- 0.23% (95% confidence interval), from 9.01% in October and 9.08% in September. The adjusted November unemployment rate of 8.6% was shy just 8,000 unemployed from rounding to 8.7%. Not-seasonally-adjusted, November's U.3 unemployment rate was 8.2%, down from 8.5% in October. The bulk of the decline in November U.3 was do to a large surge in unemployed workers moving to discouraged-worker status and moving out of the headline labor force.

Seasonal-factor and discouraged-worker complications and issues with the various November unemployment rates are discussed in the *Opening Comments and Executive Summary*.

Heavily skewed by bad seasonal factors that sharply cut the adjusted count of those working part-time for economic reasons, and reflecting a surge in short-term discouraged workers moving into long-term discouraged worker status, the November U.6 unemployment rate fell to a seasonally-adjusted 15.6% from 16.2% in October. The unadjusted U.6 rate declined to 15.0% in November from 15.3% in October. The broadest unemployment rate published by the BLS, U.6 includes accounting for those marginally attached to the labor force (including short-term discouraged workers) and those who are employed part-time for economic reasons (they cannot find a full-time job).

In 1994, during the Clinton Administration, "discouraged workers"—those who had given up looking for a job because there were no jobs to be had—were redefined so as to be counted only if they had been "discouraged" for less than a year. This time qualification defined away the long-term discouraged workers. The remaining short-term discouraged workers (less than one year) are included in U.6.



Adding the SGS estimate of excluded long-term discouraged workers back into the total unemployed and labor force, unemployment—more in line with common experience as estimated by the SGS-Alternate Unemployment Measure—eased to 22.6% in November from 22.9% in October. The SGS estimate

generally is built on top of the official U.6 reporting, and tends to follow its relative monthly movements. Accordingly, it will suffer some of the current seasonal-adjustment woes afflicting the base series, such as the November distortions in part-time employment for economic reasons. Beyond next month's annual revisions, there should be catch-up reporting the months ahead, since the series does not use the concurrent-seasonal-factor methodology.

Nonetheless, there continues to be a noticeable divergence in the SGS series versus U.6. The reason for this is that U.6, again, only includes discouraged workers who have been discouraged for less than a year. As the discouraged-worker status ages, those that go beyond one year, fall off the government counting, and new workers enter "discouraged" status. Accordingly, with the continual rollover, the discouraged workers counted in U.6 continue had not been changing much in aggregate recently, but the November number showed an ominous net surge. Further, the long-term discouraged worker component in the SGS estimate continued to increase, as few of those that have dropped out of U.6 are gaining active employment. See the Alternate Data tab for more detail.

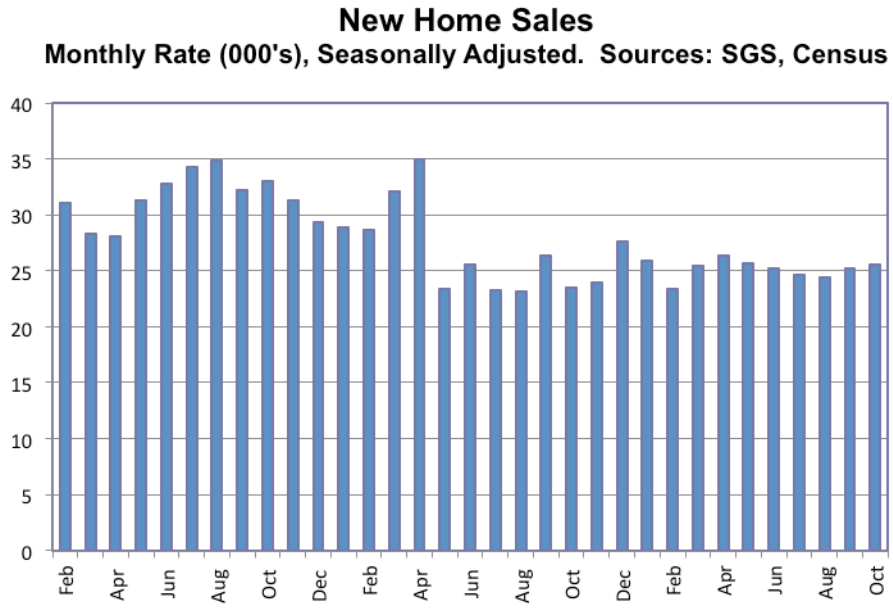
As discussed in previous writings, an unemployment rate near 23% might raise questions in terms of a comparison with the purported peak unemployment in the Great Depression (1933) of 25%. The SGS level likely is about as bad as the peak unemployment seen in the 1973 to 1975 recession. The Great Depression unemployment rate was estimated well after the fact, with 27% of those employed working on farms. Today, less that 2% work on farms. Accordingly, for purposes of Great Depression comparison, I would look at the estimated peak nonfarm unemployment rate in 1933 of 34% to 35%.

NEW HOME SALES (October 2011)

October New Home Sales Continued to Bottom-Bounce. Thrown into a week beyond its normal reporting by the Thanksgiving holiday, October new home sales continued bottom-bouncing with a slight downside trend. This was in line with reporting of October existing home sales (*Commentary No. 402*) and housing starts (*Commentary No. 401*), and in the context of downside revisions to the prior three months of reporting new home sales reporting.

The November 28th release of October new-home sales (counted based on contract signings, Census Bureau) showed an ongoing pattern of bottom-bouncing, along with downside revisions to prior months' data. October's 1.3% monthly gain (a decline of 1.9% before prior-period revisions) +/- 23.0% (95% confidence interval) versus September was statistically meaningless. In turn, September's monthly gain was revised to 3.4% (previously a 5.7% increase) versus August. The year-to-year change in October 2011 new-home sales was a statistically-insignificant gain of 8.9% +/- 20.1% (95% confidence interval). September's annual decline was revised to a 4.1% (previously a 0.9% contraction).

As with existing homes sales, volatility in annual change is due to the effects of the lapsing of housing stimulus efforts a year ago. Also, as with existing home sales, part of the new sales volume is due to foreclosure activity, but the Census Bureau does not provide an estimate of foreclosure volume.



Week Ahead. Although receiving sporadic bursts of attention, an intensifying double-dip recession (it will be classified as a double-dip, because the first dip already has been called), as well as an escalating inflation problem still are not are widely recognized. The political system would like to see the issues disappear until after the 2012 election, and the financial markets will do their best to avoid recognition of the problems that have horrendous implications for the markets and for systemic stability. Until such time as financial-market expectations move to catch up fully with underlying reality, or underlying reality catches up with the markets, reporting generally will continue to show higher-than-expected inflation and weaker-than-expected economic results in the months and year ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions.

Trade Balance (October 2011). The October monthly trade deficit is due for release on Friday, December 9th. The general trend here should remain one of deterioration, with reporting risk favoring greater trade deficit widening than likely will be estimated by consensus forecasters. This will be the first monthly estimate of trade data in the fourth-quarter and will contribute to fourth-quarter GDP reporting. Inflation-adjusted deterioration in the trade deficit relative to the third-quarter average would suggest a negative contribution to the fourth-quarter GDP, and vice versa.

