

COMMENTARY NUMBER 422
February Employment, Unemployment and M3, January Trade Balance

March 9, 2012

Payrolls Regain Pre-2001 (Not Pre-2007) Recession Levels

February Unemployment: 8.3% (U.3), 14.9% (U.6), 22.4% (SGS)

Trade Deficit Deteriorates in January Reporting and Prior-Period Revisions

Money Supply M3 Growth Stalls Anew

PLEASE NOTE: The next regular Commentary is scheduled for Tuesday, March 13th, covering February retail sales. A subsequent Commentary will be published on Friday, March 16th, covering February CPI, PPI and industrial production.

Best wishes to all — John Williams

Opening Comments and Executive Summary. The outlook for the broad economy remains bleak, despite relatively upbeat February payroll data. Deterioration in the January trade deficit and related revisions suggest negative impact on first-quarter 2012 GDP reporting, along with increasing downside pressure on the U.S. dollar from underlying economic and political fundamentals.

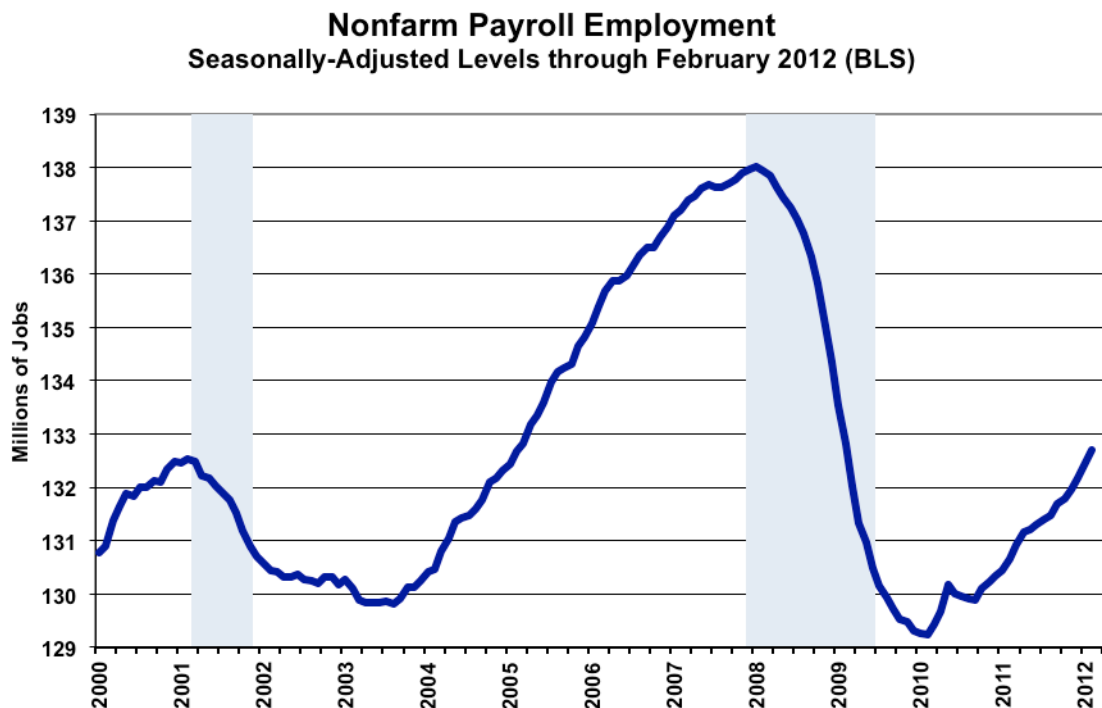
Systemic-solvency and liquidity issues continue to plague the Fed and to restrain U.S. economic activity. Bank lending remains impaired, while household income has taken a new hit, as indicated in recent

reporting. Separately, as detailed in the *Hyperinflation Watch*, annual and monthly growth in the broad money supply appears to be stalling, again. That likely is a further indication of mounting difficulties in the systemic-solvency crisis.

Payrolls and Unemployment. As with January, the February labor numbers involved massive seasonal adjustments. With heavy warping of the seasonal-adjustment process from the effects of the extreme nature of the current downturn, the resulting employment gain and unemployment rate level remain of questionable quality and significance. With the payroll benchmark revision in place, concurrent seasonal factor distortions have resurfaced, as discussed in *Concurrent Seasonal Factors* section in *Reporting Detail*.

The reporting pattern in recent monthly payroll changes has been running in parallel with the trend forecast (200,000 for February, 215,000 is the trend forecast for March) generated by the Bureau of Labor Statistics' (BLS) seasonal-adjustment model. That indicates that payroll activity is behaving as the BLS expects, but such "stability" in these unusual times is not likely to survive for long in the real world.

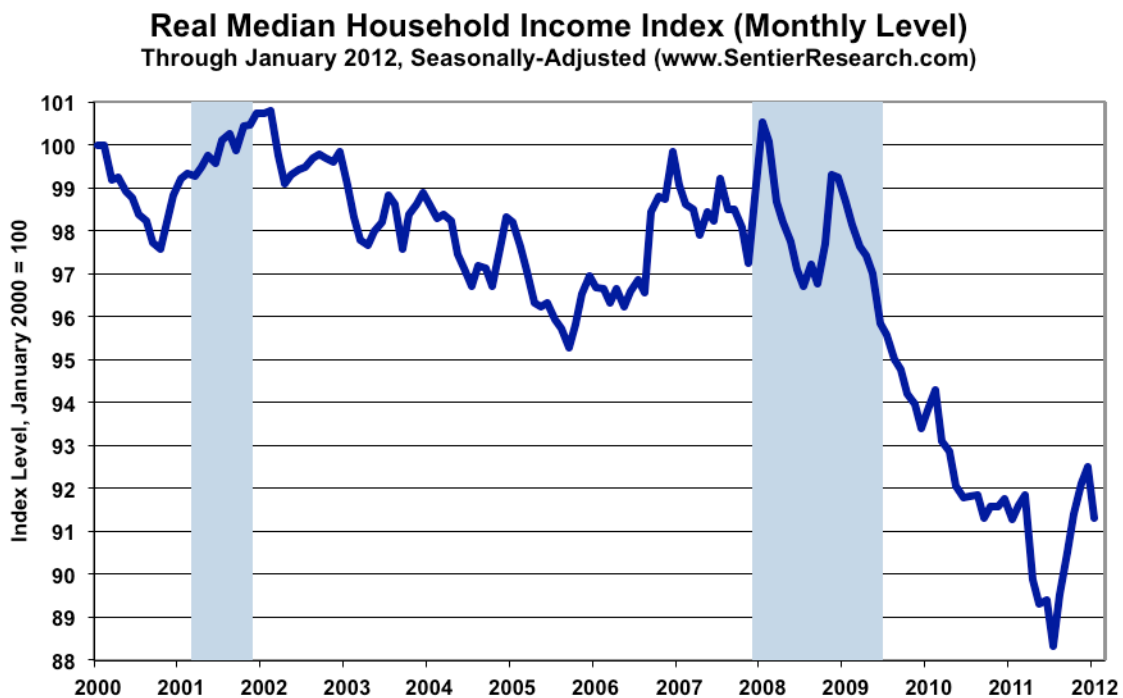
Nonetheless, with prior-period revisions and February's 227,000 monthly payroll gain, the seasonally-adjusted February 2012 payroll level now has regained/exceeded the pre-2001 recession peak, but it still remains well shy of the pre-2007 recession peak, as shown in the following graph.



The headline February unemployment rate held at 8.3%. The broader U.6 and SGS-Alternate Unemployment measures came in at 14.9% and 22.4%, respectively. Again, the stability indicated by the headline number is not likely to continue in real-world reporting.

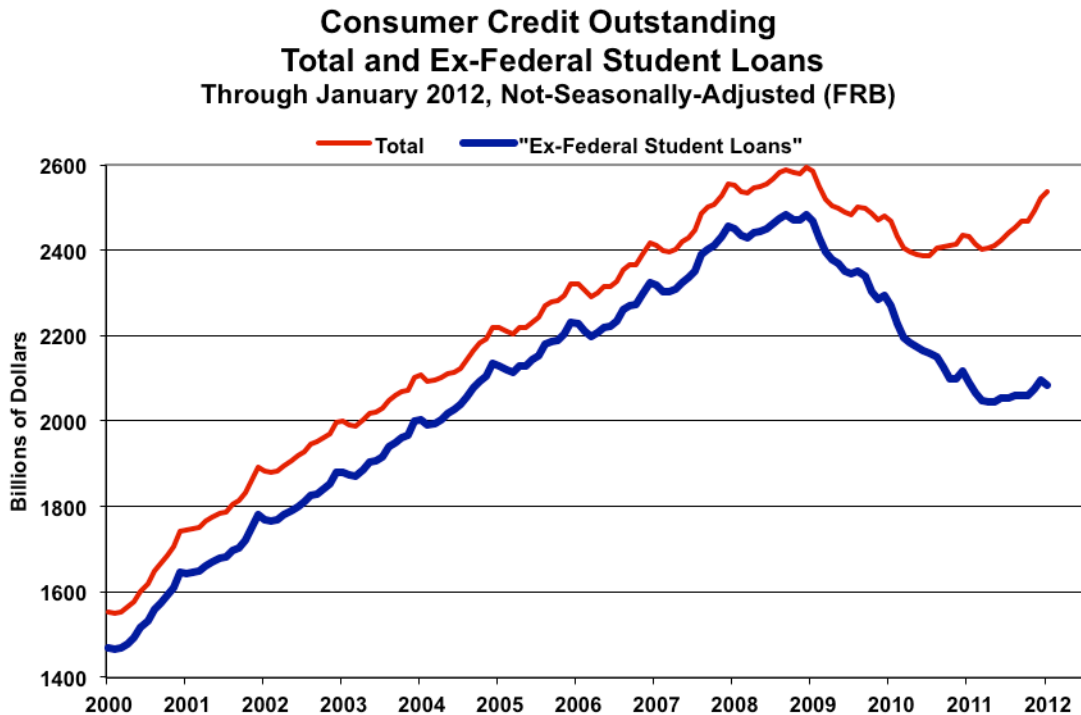
Trade Deficit. Generally, a deteriorating U.S. trade deficit is bad news for the U.S. dollar and U.S. GDP growth, and the January 2012 trade deficit widened sharply to a multi-year high of \$52.6 billion, up from an upwardly revised \$50.2 billion in December. The revised numbers included a revamping of the inflation-adjusted series, with the initial reporting of the real January shortfall suggestive of a first-quarter 2012 deterioration in the trade deficit, relative to the fourth-quarter. That would tend to mute respective reporting of GDP growth.

Consumer Liquidity Remains Squeezed. Despite “improved” labor numbers, the consumer remains in an extraordinary liquidity bind. Updated data from SentierResearch.com showed a renewed decline in median household income as of January 2012 (adjusted for CPI-U inflation) per the accompanying graph.



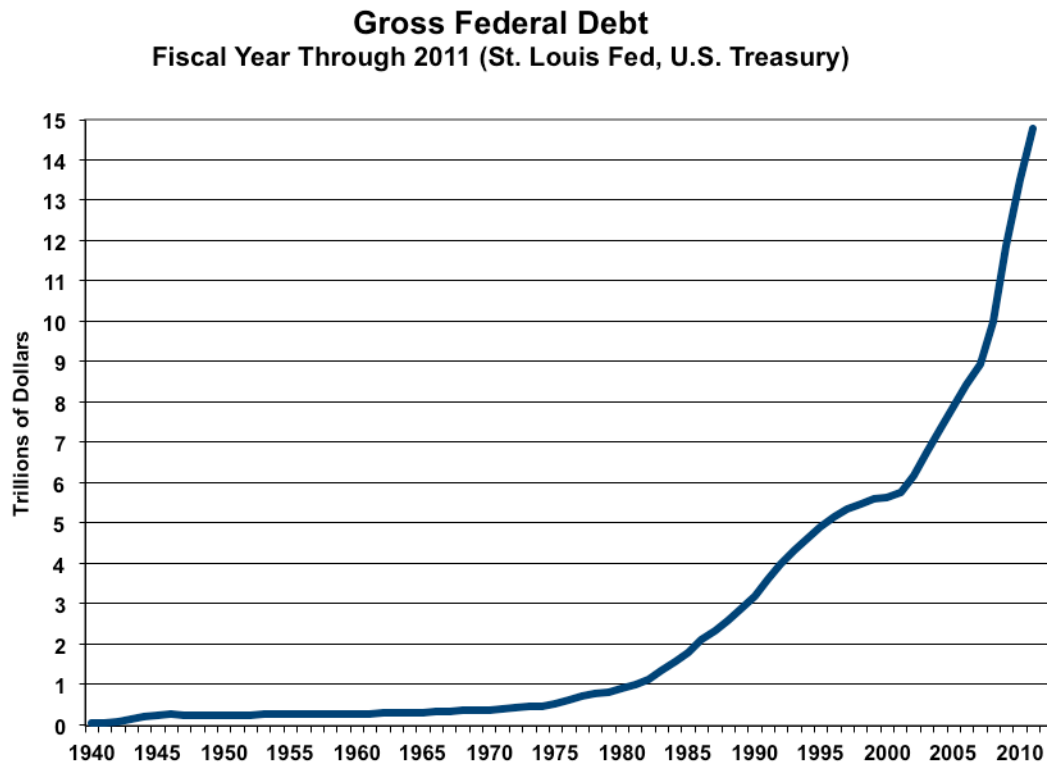
Unless income grows faster than inflation, there can be no sustained positive growth in real (inflation-adjusted) consumer spending, which accounts for more than 70% of GDP activity. As discussed in [Hyperinflation 2012](#), short-term consumption growth can be supported by debt expansion, but the average consumer does not have that credit availability, at present, to do so, despite the recent hoopla over recent levels of consumer credit outstanding approaching pre-2007 recession levels.

As shown in the following graph, virtually all of the growth in consumer credit outstanding has been in federal student loans, not in bank lending to consumers that could be used to make up the shortfall in declining living standards. Bank lending generally remains impaired, due largely to ongoing banking-system balance-sheet problems. Although there has been some pick-up in commercial and industrial loans, total credit market debt outstanding (net of Uncle Sam) has not been growing.



Symptomatic of the ongoing nature of the systemic-solvency crisis, in the just-released (March 8th) fourth-quarter 2011 flow-of-funds data, the Federal Reserve reported no growth in credit market debt outstanding, other than for the federal government. Net of federal government borrowings, total credit market debt contracted by 0.04% (not annualized) in fourth-quarter 2011, versus third-quarter 2011, with a year-to-year decline for fourth-quarter 2011 of 0.65%.

Gross federal debt level by fiscal year is shown in the next graph. Keep in mind that significant portion of the net lending to the U.S. Treasury in the last year was worked through the Federal Reserve.



Hyperinflation Watch. Beyond the economic and liquidity data covered in this *Commentary*, the broad economic, inflation and hyperinflation outlooks discussed in [Hyperinflation 2012](#) are not changed.

Money Supply M3 (February 2012). Based on more than three weeks of data, the preliminary estimate of annual growth for the February 2012 SGS Ongoing-M3 Estimate—to be published tomorrow (March 10th) in the [Alternate Data](#) section—is on track to hold at 3.9%, the same as estimated for January, with monthly growth stalled. Such follows a recent upturn in both annual and monthly growth.

The seasonally-adjusted, month-to-month change estimated for February 2012 M3 likely will be flat, following an unrevised estimate of 0.8% monthly growth in January. The estimated month-to-month M3 changes, however, remain less reliable than the estimates of annual growth.

Estimates of slowing annual gain, and relatively flat month-to-month change, appear to have been the circumstance in February for the narrower M1 and M2 measures (M2 includes M1, M3 includes M2). M2 for February is on track to show year-to-year growth of about 9.9%, versus 10.2% in January, with month-to-month growth estimated at roughly 0.2% versus 1.3% in January. The early estimate on M1 for February shows year-to-year growth of roughly 18.3%, versus 19.2% in January, with month-to-month change showing a likely contraction of 0.2% in February, versus a gain of 2.5% in January. The relatively stronger annual growth rates in M1 and M2 still reflect an earlier shifting of funds out of M3 accounts into M1 and M2 accounts.

Constrained broad money supply growth in an environment of massive Federal Reserve accommodation remains suggestive of an intensifying systemic-solvency crisis.

REPORTING DETAIL

EMPLOYMENT AND UNEMPLOYMENT (February 2012)

The Economy Is Not Recovering. Massive seasonal adjustments were used to generate the reported levels of the monthly payroll employment change and the unemployment rate in February. Unfortunately, the seasonal-adjustment process remains seriously marred by the unusual length and depth of the current economic downturn, and such leaves the resulting headline labor numbers of highly questionable quality.

That said, and as discussed in the *Opening Comments and Executive Summary*, irrespective of the nature of the factors that helped to generate today's labor data, the general outlook has not changed. With the upside trend in monthly payroll employment moving with the Bureau of Labor Statistics' (BLS) trend model (based on the not-so-stable BLS seasonal-adjustment model), February 2012 payrolls finally recovered the pre-2001 recession highs. Payrolls still remain well shy of recovering their pre-2007 recession highs.

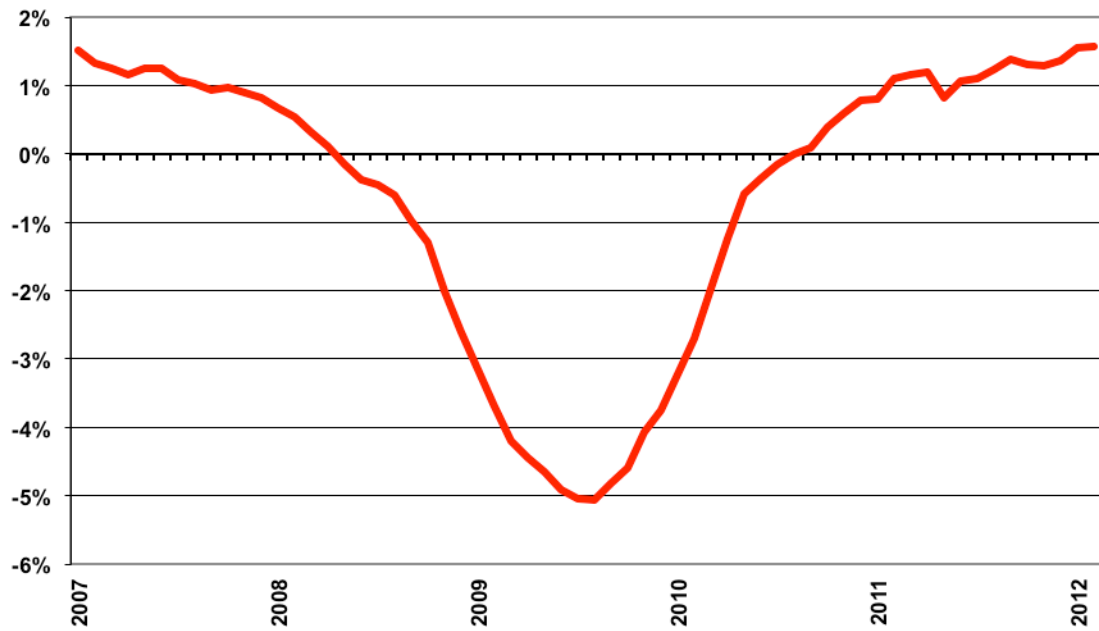
PAYROLL SURVEY DETAIL. The BLS reported today (March 9th) a statistically-significant, seasonally-adjusted February 2012 month-to-month payroll employment gain of 227,000 (a gain of 288,000 jobs before prior period revisions) +/- 129,000 (95% confidence interval). The January payroll gain was revised to 284,000 (previously 243,000).

In terms of year-to-year change, the unadjusted February 2012 annual growth rate was 1.56%, up versus a revised annual January growth rate of 1.55% (previously 1.51%).

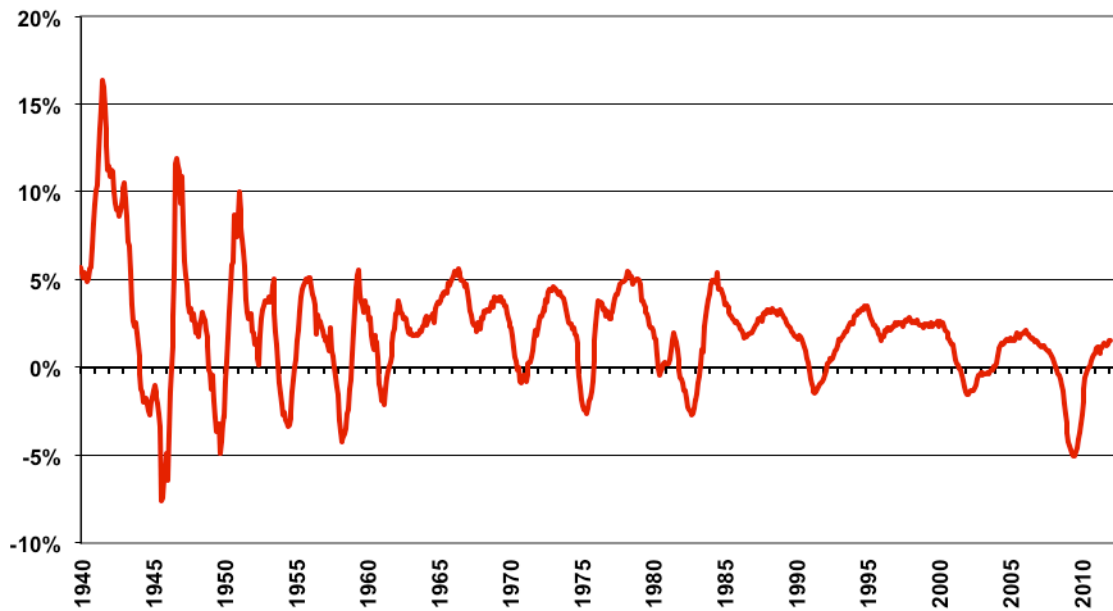
The following graphs of year-to-year unadjusted payroll change had shown a rising trend in annual growth through 2010, which primarily reflected the still-protracted bottom-bouncing in the payroll series. That pattern of growth flattened out in 2011, as shown in the first graph of the near-term detail in year-to-year change. The January and February 2012 numbers have shown somewhat higher relative growth, a circumstance that likely will be short-lived.

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

Nonfarm Payroll Employment
NSA Yr-to-Yr % Change through February 2012 (BLS)



Nonfarm Payrolls
NSA Yr-to-Yr % Change through February 2012 (BLS)

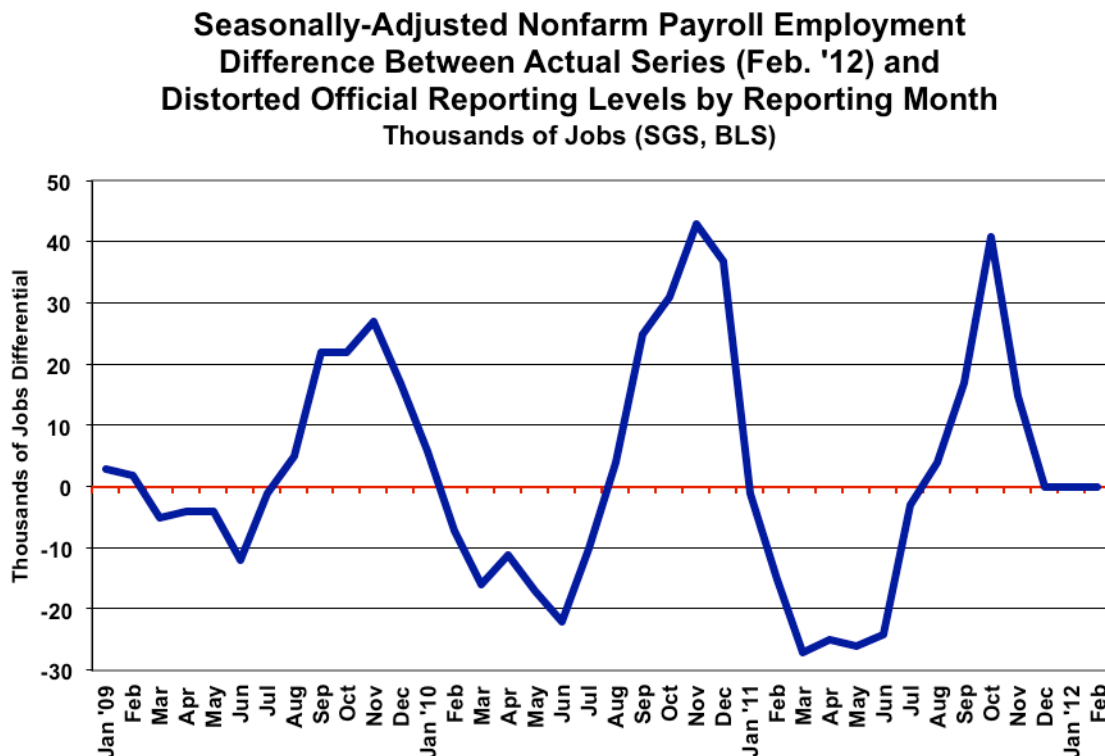


The regular graph of seasonally-adjusted payroll levels, which shows the current employment level breaking its pre-2001 recession peak, is located in the *Opening Comments and Executive Summary* section.

Concurrent Seasonal Factor Distortions. A month has passed since the annual benchmark revisions to payroll employment, and the latest concurrent seasonal factors show renewed misreporting of the BLS's own historical payroll levels, as well as ongoing instabilities in the BLS's seasonal factors.

As discussed in prior writings (see [Hyperinflation 2012](#), 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, outside of benchmarks, it only publishes the revised data for the last two months of reporting. Last month's benchmark revision, in theory, included a full update of the revised concurrent seasonally-adjusted data (actually it is off by a month or two). As plotted below, though, the latest revised (but not published) adjusted payroll data already is showing monthly seasonal-adjustment distortions that top 40,000 jobs per month, with previously-reported payroll employment being shifted from the first-half to the second-half of the year. If seasonal-adjustment factors were stable in month-to-month reporting, which they should be, then the graph of differences would be flat at zero.



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.

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 (2011 excepted)—the BLS generally ups its monthly biases in post-benchmark reportings. Based on the just-published benchmark revision, the BLS appears to have upped the annual upside fudge factor for the twelve months ended February 2012, to about 520,000 as of the latest reporting. The February 2012 bias was a positive 91,000, versus a minus 367,000 in January 2012.

The aggregated upside annual bias still reflects an ongoing assumption of a net positive jobs creation by new companies versus those going out of 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 prophecies, 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 are set now to add an average of about 44,000 jobs per month in the current year. With the underlying economy continuing to falter, however, I expect a significant downside benchmark revision for 2012 (based on the upcoming March 2012 benchmark), given current details of the BLS’s overly positive estimates.

HOUSEHOLD SURVEY DETAILS. The once 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 monthly employment gain in February 2012 of 428,000. The January 2012 data were not comparable with the December 2011 numbers.

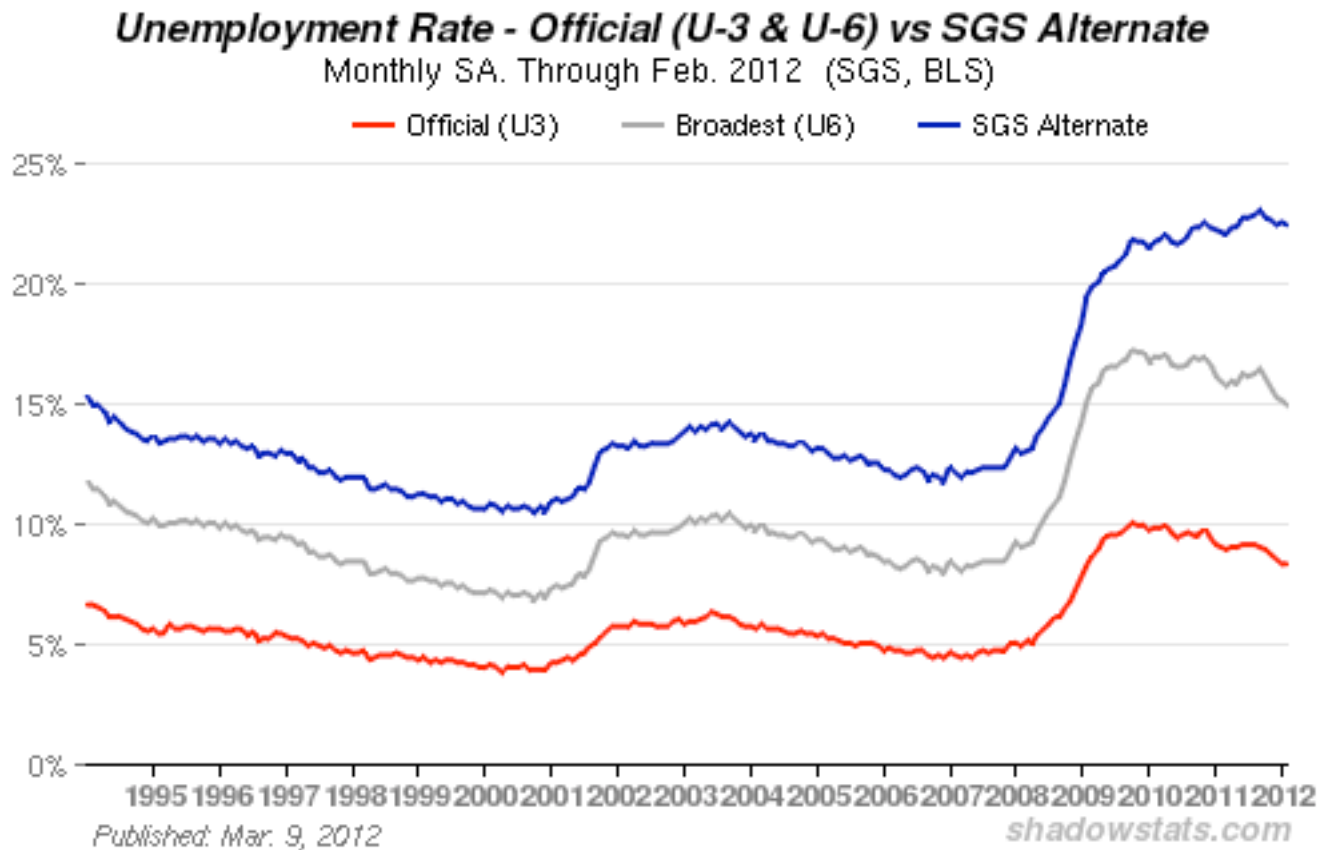
Severe issues with monthly seasonal factors are ongoing and meaningfully cloud the significance of the reported monthly levels in the adjusted headline U.3 unemployment rate and other adjusted household-survey numbers. The data have been shifted by highly unstable seasonal factors that are artifacts of the

severe and extraordinarily protracted downturn in U.S. economic activity (as well as distortions created by 2010'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.

Unemployment Rates. The February 2012 seasonally-adjusted headline (U.3) unemployment rate was reported at 8.27% +/- 0.23%, which was statistically indistinguishable from January's reported 8.26%. On an unadjusted basis, February's U.3 unemployment rate was 9.3%, versus January's 9.4%.

Still heavily skewed by bad seasonal factors, the February U.6 unemployment rate eased to to a seasonally-adjusted 14.9%, from 15.1% in January. The unadjusted February U.6 rate declined to 15.6% from 16.2% in January.

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—notched lower to 22.4% in February from 22.5% in January. 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 recent distortions in adjusted reporting of part-time employment for economic reasons. There still should be catch-up reporting the months ahead, since the series do not use the concurrent-seasonal-factor methodology that is used with the payroll employment series.

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 headline workers flow into the short-term discouraged workers counted in U.6 continue, and from U.6 into long-term discouraged worker status (SGS Measure) at what appears to be an accelerating pace. See the [Alternate Data](#) tab for more detail.

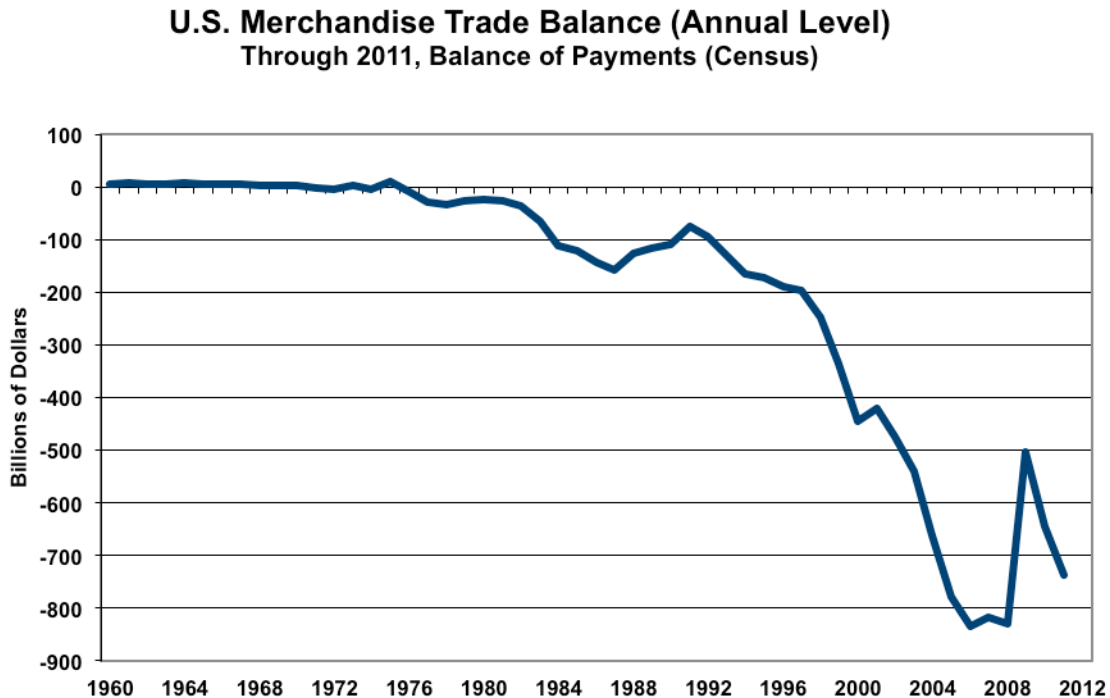
As discussed in previous writings, an unemployment rate above 22% might raise questions in terms of a comparison with the purported peak unemployment in the Great Depression (1933) of 25%. The SGS level likely is about as bad as the peak unemployment seen in the 1973 to 1975 recession. The Great Depression unemployment rate was estimated well after the fact, with 27% of those employed working on farms. Today, less than 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%.

U.S. TRADE BALANCE (January 2012)

January Trade Deterioration Has Negative Implications for First-Quarter 2012 Headline GDP Growth. Both adjusted and not adjusted for inflation, the U.S. trade deficit deteriorated in January 2012, in the context of further trade deterioration as revised in the annual and quarterly deficits in 2011. The first of two readings on the first-quarter trade deficit, which will be used in estimating initial headline growth for first-quarter 2012 GDP at the end of April, is suggestive of a negative trade contribution to the upcoming “advance” GDP growth estimate.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. In the context of major revisions to nominal and real trade data, the Bureau of Economic Analysis (BEA) and the Census Bureau reported today (March 9th) that the 2011 the annual trade shortfall in goods and services, on a balance of payments basis, widened to a revised to \$560.0 (previously \$558.0 billion), from \$500.0 billion in 2010, and from \$381.3 billion in 2009. On the goods side, the 2011 merchandise trade deficit widened to a revised \$738.3 (previously \$737.1) billion, from \$645.9 billion in 2010, and from \$505.9 trillion in 2009. The

merchandise detail has a relatively hard paper trail behind its reporting. On the services side, the 2011 surplus was reduced to a revised \$178.3 (previously \$179.0 billion), but up from \$145.8 billion in 2010, and from \$124.6 billion in 2009. The services series largely is guessed at, with supporting documentation of limited accuracy. The revised details on an annual basis for the merchandise trade deficit are graphed.



Monthly Detail. As has become the standard caution here for the monthly detail, heavy distortions likely continued in the seasonal adjustments, much as has been seen in other economic releases, such as retail sales and payrolls, where the headline number reflects month-to-month change. As has been discussed frequently (see [Hyperinflation 2012](#) for example), the extraordinary length and depth of the current business downturn have disrupted regular seasonality patterns. Accordingly, the markets still should not be relying heavily on the accuracy of monthly headline data.

That said, the nominal, seasonally-adjusted monthly trade deficit in goods and services for January 2012, on a balance of payments basis, widened to \$52.6 billion from a revised \$50.4 billion (previously \$48.8 billion) in December. That reporting was in the general context of revisions, once again, to all months in 2011, with a bias towards deficit deterioration evident in those revisions.

Against the revised December numbers, the seasonally-adjusted January 2012 trade balance reflected higher levels of both exports and imports, but the volume of imports increased by a greater amount. Oil prices and monthly physical oil import volume were not factors in the import increase.

Crude Oil and Energy-Related Petroleum Products. For the month of January 2012, the not-seasonally-adjusted average price of imported oil eased to \$103.81 per barrel, from \$104.13 in December, but it was up from \$84.34 in January 2011.

In terms of not-seasonally-adjusted physical oil imports, January 2012 volume averaged 8.773 million barrels per day, down from 8.998 million in December 2011 and down from 9.376 million in January 2011.

Real (Inflation-Adjusted) Trade Deficit. Trade data adjusted for seasonal factors and net of oil price swings and other inflation (2005 chain-weighted dollars as used in reporting real GDP) were revamped completely.

The reported January merchandise trade deficit came in at \$49.1 billion, a larger deficit than the revised \$48.3 (previously \$47.7) billion reported for December. On an annual basis, the real merchandise trade deficit was larger, at a revised \$571.1 (previously \$566.4 billion) in 2011, versus a revised \$566.3 (previously \$556.9 billion) in 2010. The impact of that revision on GDP should be a downside contribution to the annual benchmark revision to 2011 activity, due for release at the end of July.

Based on today's reporting, the first cut of an annualized first-quarter 2012 real trade deficit—used as a base for the GDP's net export account—was at a pace of \$589.3. That would be significantly worse than the revised annualized fourth-quarter 2011 real trade deficit of \$563.7 (previously \$554.4 billion). In turn, that was up from a revised third-quarter estimate of \$558.0 (previously \$548.2) billion. To the extent that the current data are reflected in the second revision to the fourth-quarter GDP on March 28th, the trade number revisions should be neutral on a relative basis in terms of revised growth. Again, there is an early suggestion of possible net damage to first-quarter 2012 GDP reporting.

Week Ahead. Recognition of an intensifying double-dip recession as well as an escalating inflation problem remains sporadic. The political system would like to see the issues disappear until after the election; the media does its best to avoid publicizing unhappy economic news; and the financial markets will do their best to avoid recognition of the problems for as long as possible, 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.

Retail Sales (February 2012). Due for release on Tuesday, March 13th, February retail sales again are a fair bet to show weaker growth than market expectations, net of revisions. The bulk of any month-to-month gain should be in rising prices, not in rising physical activity in the consumption of goods and services. The structural consumer income and credit issues discussed in the *Opening Comments and Executive Summary* remain major constraints on consumer spending.

Seasonal-adjustment distortions continue as a major factor in the reporting of questionable month-to-month changes. The real (inflation-adjusted) numbers on February sales activity will be published along with the March 16th release of the February CPI-U.

Producer Price Index—PPI (February 2012). The February PPI is due for release on Thursday, March 15th. With higher monthly-average oil prices in place and historically minimal distortion from oil-price seasonal adjustments in February, with catch-up from January's seasonally-adjusted understatement of PPI inflation, and with spreading inflation outside the energy area, monthly inflation in this regularly-volatile series should be on the upside of market expectations.

Consumer Price Index—CPI (February 2012). Due for release on Friday, March 16th, the February CPI-U could see an upside surprise to consensus estimates (0.5% per MarketWatch.com). Gasoline prices rose month-to-month by 5.8% in February 2012, versus January, per the Department of Energy, and seasonal-adjustments to gasoline prices should be a boost to the reported inflation. In February 2011, a 2.2% increase in monthly gasoline prices was inflated to 4.7%, after seasonal adjustments. Those adjustments, however, reverse direction March. Inflationary pressures also likely continued to spread outside the energy area.

Year-to-year total CPI-U inflation would increase or decrease in February 2012 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.44% gain in the adjusted monthly level reported for February 2011. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for February 2012, the difference in February's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from January 2012's reported annual inflation rate of 2.93%. A consensus 0.5% monthly gain would leave annual CPI-U inflation for February at about 3.0%.

Industrial Production (February 2012). Due for release on Friday, March 16th, industrial production reporting easily could be surprised on the downside of expectations, net of revisions. With production being cut back in an effort to balance excess inventories, production could show an actual monthly contraction, net of prior-period revisions.
