

COMMENTARY NUMBER 332
October Employment and Unemployment, Dollar Debasement, Election

November 5, 2010

**Baloney Payroll-Employment Data:
Seasonal Adjustments Become Primary Driver of Jobs Creation?**

October Household-Survey Employment Fell 330,000

October Unemployment Rates: 9.6% (U.3), 17.0% (U.6), 22.5% (SGS)

Fed Move to Debase U.S. Dollar Will Generate Higher Inflation But No Recovery

Election Results Do Not Alter Basic Economic or Inflation Outlooks

PLEASE NOTE: Today's Commentary focuses on the October labor report. A Special Commentary is planned for Tuesday, November 9th, updating the outlook for the U.S. economy, inflation, financial markets and systemic liquidity and stability. Although the broad outlook is unchanged, developments with the Federal Reserve's active debasement of the U.S. dollar and the impact of the mid-term elections will be assessed, well beyond the summary comments here.

-- Best wishes to all, John Williams

Double-Dip Continues Despite Best Gimmicks of the Bureau of Labor Statistics. The Federal Reserve's efforts at debasing the U.S. dollar already have triggered higher inflation, as seen in higher priced dollar-based commodities such as oil. The announced "quantitative easing," though, likely will have minimal impact in terms of stimulating economic activity. The mid-term election results and the shift in control of the House of Representatives should lead to more-open discussion of the structural U.S. economic problems and threats to the system from the actual federal deficit, but solutions to the economic issues will take years to have major impact, if they are addressed, while the issues with the actual federal deficit (not the cash-based shortfall Washington plays with) remain intractable.

As the double-dip recession and the federal deficit and related Treasury funding horrors get worse -- irrespective of today's (November 5th) happy report on payroll employment -- the Fed's monetization of Treasury debt will be increased out of necessity, as part of an ongoing effort at systemic salvation. These circumstances and the updated broad outlook will be more fully explored in the *Special Commentary* pending for Tuesday, November 9th. The preliminary estimate of the SGS-Ongoing M3 estimate for October will be posted over the weekend at the [Alternate Data page for M3](#). Annual growth appears headed for roughly a 3.3% year-to-year contraction, versus a 3.7% contraction in September.

Employment Was Demonstrably Gimmicked -- Seasonal-Factor Games Added 200,000 to October Payrolls. My predictions of a monthly decline in October nonfarm payrolls and an increase in the headline unemployment rate were wrong. Not only were October payrolls reported with a statistically-meaningful gain, but prior periods enjoyed upside revisions. Of the major significance, though, those large revisions and the October gain largely were the result of seasonal-adjustment gimmicks; they were not reflected in the underlying unadjusted numbers. As to the U.3 unemployment rate, it held once again at 9.6%, 8,700 unemployed shy of rounding up to 9.7%.

At issue with the payroll employment data is the use of "concurrent" seasonal-factor adjustments, where the current and recent seasonal adjustment factors are created and changed on a monthly basis. The use of this process enables the Bureau of Labor Statistics (BLS) to report almost anything desired in terms of monthly payroll change.

In general, seasonal adjustments are used to redistribute recurring patterns of employment activity, such as seen with the school-year or holiday-shopping periods, so that the adjusted monthly changes tend to reflect economic changes as opposed to just the regular variations in employment activity. Key to the entire seasonal-adjustment concept is that the total year's activity remains the same, whether adjusted or unadjusted; the adjustments just shift and rebalance activity between certain months. If the aggregated levels of adjusted and unadjusted activity were different over a year, then the adjustments inappropriately would be increasing or decreasing the reported level of actual annual activity.

Such no longer is the case. While touted by the BLS as the more-accurate approach to seasonally adjusting data, the concurrent adjustment process can distort the annual reporting and, as happened in today's payroll reporting, it can allow for jobs creation solely from seasonal-factor adjustments, without regard to underlying reporting.

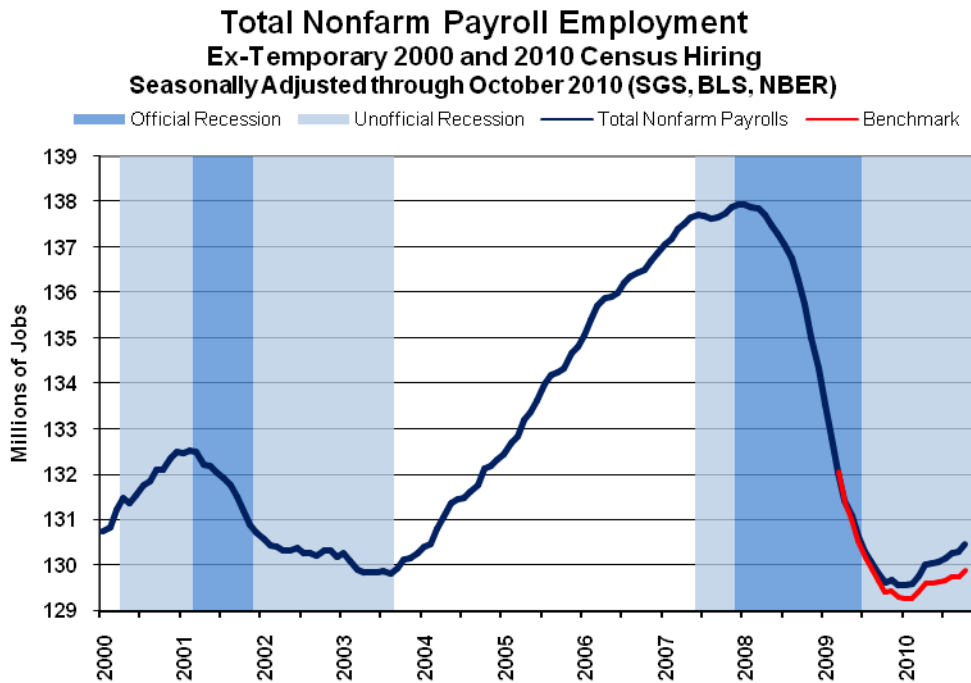
Current Seasonal Factors Created Roughly 200,000 Phantom Jobs. The "happy" news in the October jobs report was not just that seasonally-adjusted payrolls gained 151,000, but that the previously-reported seasonally-adjusted payrolls were revised higher by 110,000 in September, including an upside revision to August of 56,000. If the revisions were based on new jobs data, usually there would be parallel upside

revisions in the unadjusted numbers. Instead, the unadjusted September total was revised upward by 32,000 and the unadjusted August was revised lower by 1,000, far shy of the aggregate revisions, and suggestive of the new jobs coming largely from a recasting of the monthly seasonal-adjustment factors.

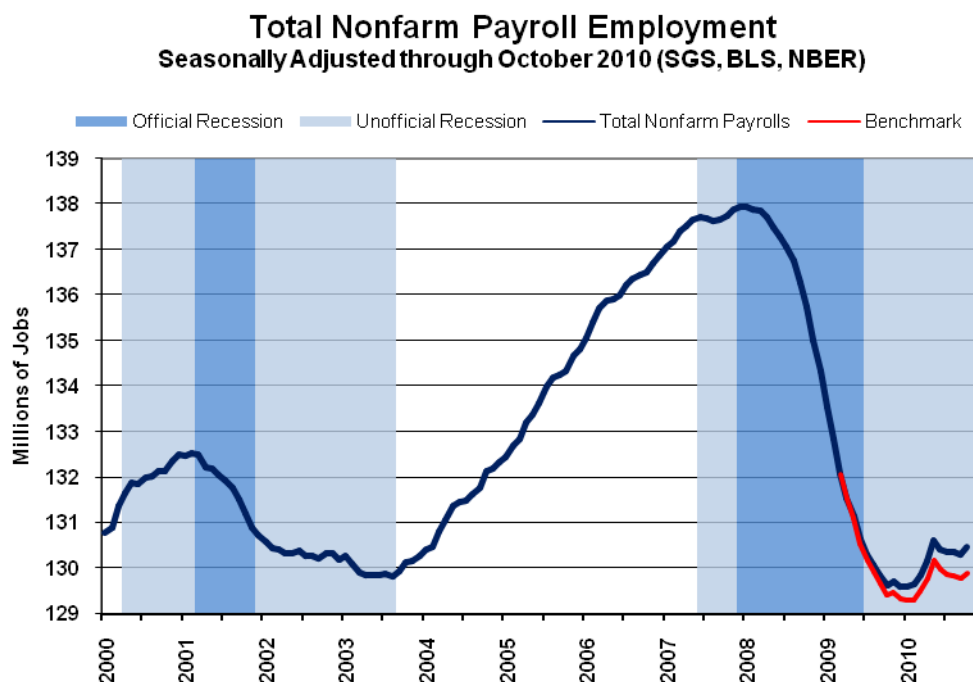
Even with concurrent adjustments, the adjusted and unadjusted changes usually are reasonably consistent. In the period October 2008 to October 2009, for example, adjusted payrolls fell by 6,096,000 versus an unadjusted loss of 6,084,000. In last month's reporting for the period of September 2009 to September 2010, the adjusted gain was 344,000 versus an unadjusted gain of 321,000. As of the October reporting, those September numbers changed respectively to an adjusted gain of 454,000 versus an unadjusted 353,000, while the period from October 2009 to October 2010 reflected an adjusted 829,000 gain versus an unadjusted 626,000 gain, a creation of roughly 200,000 reported jobs from nothing more than the tweaking of seasonal-adjustment factors.

Payroll Survey Detail. The BLS reported a statistically-significant, seasonally-adjusted October 2010 jobs gain of 151,000 (a gain of 261,000 before prior-period revisions) +/- 129,000 (95% confidence interval). September payrolls showed a revised 41,000 (was 95,000) jobs loss, of which 77,000 was tied to the layoff of temporary census workers. One thousand census workers still will lose their jobs following the October payroll survey, which reflected census layoffs of 5,000.

As shown in the next two graphs, the level of payroll employment still stands below where it was a decade ago, despite the U.S. population growing by more than 10% in the same period. The structural impairments to U.S. economic activity will be reviewed in the upcoming *Special Commentary*.



The preceding graph reflects payrolls net of temporary census hires, with the red line reflecting the likely benchmark revision due for publication with the January data in February 2011. The magnitude of the revision was estimated along with September reporting. The following graph similar, except it includes the census hires, as officially reported. I expect that the upside blips seen in the most recent reporting eventually will revise away.



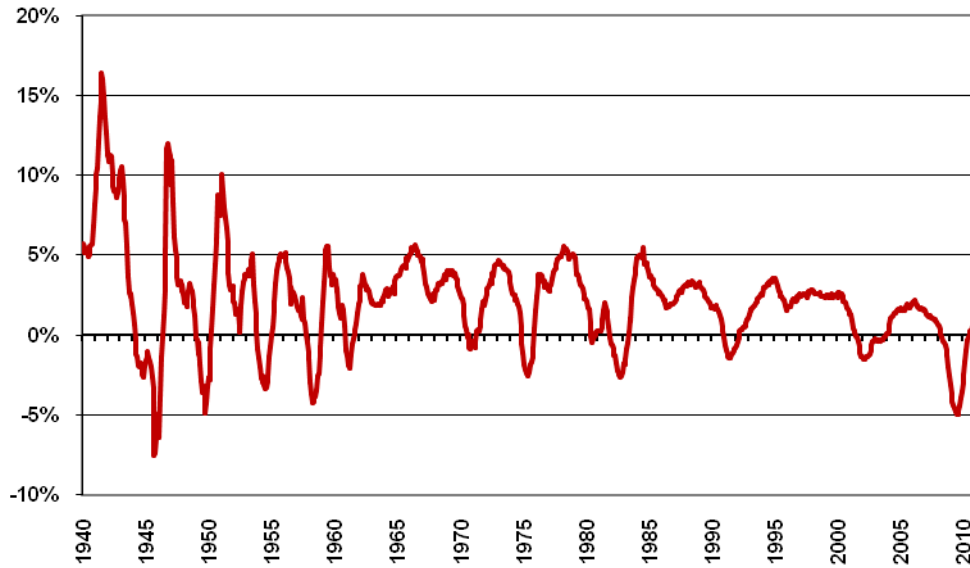
From peak-to-trough (the peak month was December 2007; December 2009 is the short-lived trough of the current cycle), payroll employment declined by a seasonally-adjusted 8,363,000 jobs, or 6.1%. As of October 2010 reporting, payrolls purportedly have gained 0.7% or 874,000 jobs since the December 2009 trough. That trough, though, will shift into 2010 with the upcoming benchmark revision, along with a reduction in current employment levels by more than 500,000.

In terms of annual change, October 2010 was up by 0.48%, versus September's revised 0.27% (previously 0.25%) gain. Net of likely benchmark revisions, annual change was virtually flat.

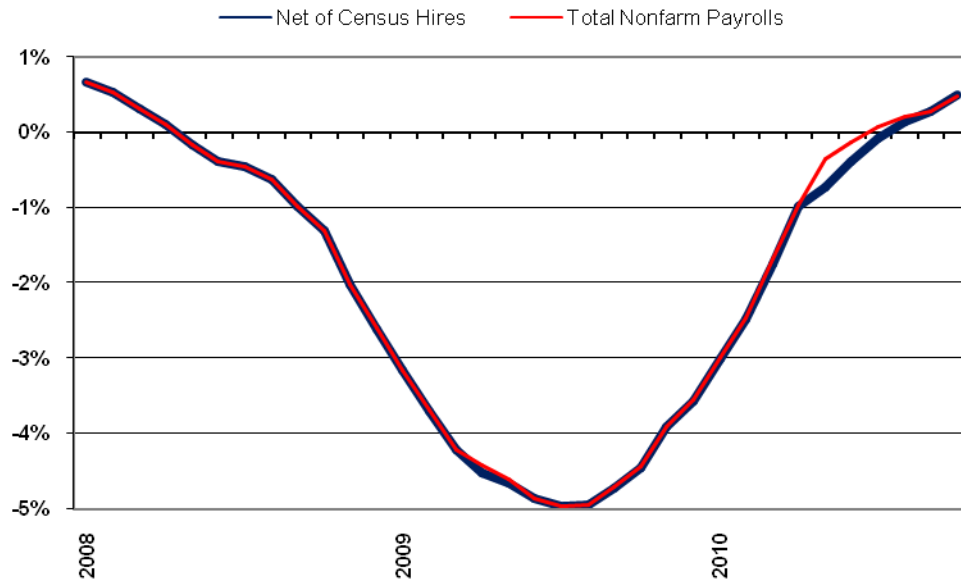
Thanks to recent, protracted bottom-bouncing in the payroll series (see benchmark-lines in the preceding graphs), current annual growth has recovered from the post-World War II record 4.96% decline in July 2009. The July 2009 decline was the most severe annual contraction seen since the production shutdown at the end of World War II, which reflected a trough of a 7.59% annual contraction in September 1945. Disallowing the post-war shutdown as a normal business cycle, the current annual decline remains the worst since the Great Depression, and should deepen further, net of the pending benchmark revision.

The following graph of long-term year-to-year payroll change reflects the numbers as reported, with no adjustment for census hiring variations or the pending benchmark revision. The next graph shows the year-to-year detail both with and without the census hires, but also without benchmark considerations.

Nonfarm Payrolls (Including Census Hires) NSA Yr-to-Yr % Change through October 2010 (BLS)



Nonfarm Payroll Employment, Total and Ex-Census NSA Yr-to-Yr % Change through October 2010 (BLS)



Benchmark Revision -- About Minus 580,000 and Counting. Announced along with the September 2010 payroll release was an early estimate for the 2010 benchmark revision, which indicated the not-

seasonally-adjusted March 2010 payrolls were overstated by 366,000. As the data are re-worked for that estimate, changes will be carried back to the prior revision as of March 2009, as well as carried forward to present reporting. Such suggests that the overstatement of the level of payrolls as of October 2010 reporting is about 580,000 jobs. The formal benchmark revision and restated economic history will be published with the January 2011 employment report, due for release on February 4, 2011.

Birth-Death/Bias Factor Adjustment -- Model Change. 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 new business creation and old business bankruptcies). The unadjusted October 2010 bias factor was a monthly addition of 61,000 jobs, versus 50,000 jobs in October 2009, and against a monthly addition of 11,000 jobs in September 2010.

The BLS announced in today's release that it would begin estimating its monthly bias factors on a quarterly basis, instead of on an annual basis, along with the publication of the 2010 benchmark revision in February. This appears to be intended to provide more frequent and accurate adjustments to the biases, reflecting data from the BLS Quarterly Census of Employment and Wages. While such has to be taken as a positive move, it does not appear to address the fundamental flaws of the Birth-Death Model, discussed as usual in the ensuing paragraphs, and it does not improve the quality of current reporting.

Based now on the unsupportable assumption of economic recovery, the bias factors used in the last six months of payroll reporting have been 27.4% ahead of what they were reset to after the most recent and disastrous 2009 benchmark revision. 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.

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, presumed 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 running at about 50,000 per month (seasonally-adjusted), at present. I still estimate this monthly bias should be negative by 200,000 or so, on average. Since it is not, the BLS continues regularly to overestimate monthly growth in payroll employment by roughly 250,000 jobs. Most of that misreporting, however, now will not be corrected until at least the 2011 benchmark revision to be published in February 2012.

Household Survey. 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 (counting multiple job holders more than once), showed a seasonally-adjusted monthly employment loss of 330,000 in October, following a reported gain of 141,000 in September, and an unchanged headline unemployment rate.

The October 2010 seasonally-adjusted headline (U.3) unemployment rate increased by a statistically-insignificant 0.06 percentage point to 9.64% +/- 0.23% (95% confidence interval), a level just shy of

rounding up to 9.7%. Such was up from the 9.58% U.3 in September. Not seasonally adjusted, October's U.3 unemployment rate eased to 9.0% from 9.2% in September.

October U.6 unemployment notched lower to a seasonally-adjusted 17.0% (eased to 15.9% unadjusted) from 17.1% (16.2% unadjusted) in September. 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 my estimate of the 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 -- held at about 22.5% in October, remaining at the highest reading of the current cycle. The SGS estimate generally is built on top of the official U.6 reporting and tends to follow its relative monthly movements. See the [Alternate Data](#) tab for a graph and more detail.

As discussed in earlier writings, while 22.5% unemployment 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 a Great Depression comparison, I would look at the estimated peak nonfarm unemployment rate in 1933 of 34% to 35%.

Week Ahead. Given the unfolding reality of an intensifying double-dip recession and more-serious inflation problems than generally are expected by the financial markets, risks to reporting will tend towards higher-than-expected inflation and weaker-than-expected economic reporting in the months ahead. Increasingly, previously unreported economic weakness will show up in prior-period revisions.

Trade Balance (September 2010). The September trade deficit is due for release on Wednesday, November 10th. While expectations are for no meaningful change (per Briefing.com), any major movement in the monthly data would impact the upcoming second-estimate (first-revision) of third-quarter 2010 GDP due for release on November 23rd. My betting would be on monthly deterioration, with a corresponding downward revision to the GDP estimate.