

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

COMMENTARY NUMBER 344
December Employment and Unemployment

January 7, 2011

December Jobs Increase Was Statistically Indistinguishable from Decline

December Unemployment: 9.4% (U.3), 16.7% (U.6), 22.4% (SGS)

Seasonal Factor Issues "Improved" Both Payroll and Unemployment Reporting

Watch Out for Next Month's Revisions

PLEASE NOTE: The next regular Commentary is planned for Friday, January 14th, following release of the December CPI, Retail Sales and Industrial Production, along with analysis of the prior day's release of the November Trade Deficit.

-- Best wishes to all, John Williams

Next Month's Revised Labor Data Should Confirm a Weaker Economy. The payroll employment data will go through major revisions in the next reporting (February 4th), with a weaker than previously recognized economy coming out of the revamped reporting. On the unemployment front -- separate from the seasonal-adjustment revisions published with today's (January 7th) December report -- next month's

data will reflect population re-estimates that will make the January household survey data inconsistent with and not comparable to previous reporting. While the new information will move the employment picture closer to reality, seasonal-factor distortions in the unemployment area did not undergo meaningful revisions in today's release, and next month's population changes likely will not affect reporting meaningfully. Accordingly, patterns of headline seasonally-adjusted U.3 number reporting likely will remain irregular in the year ahead.

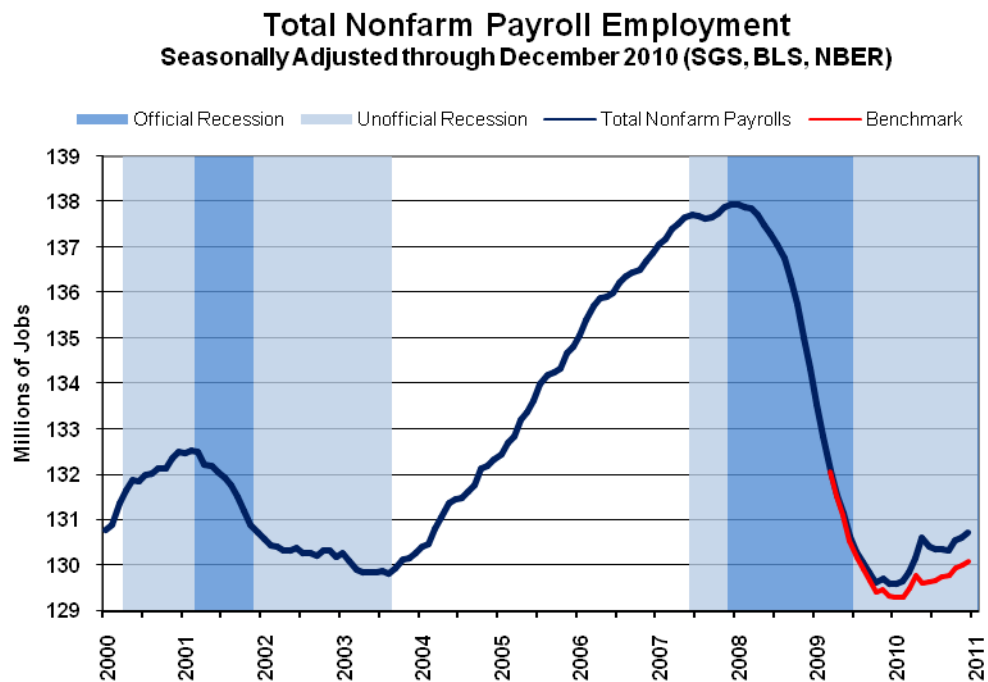
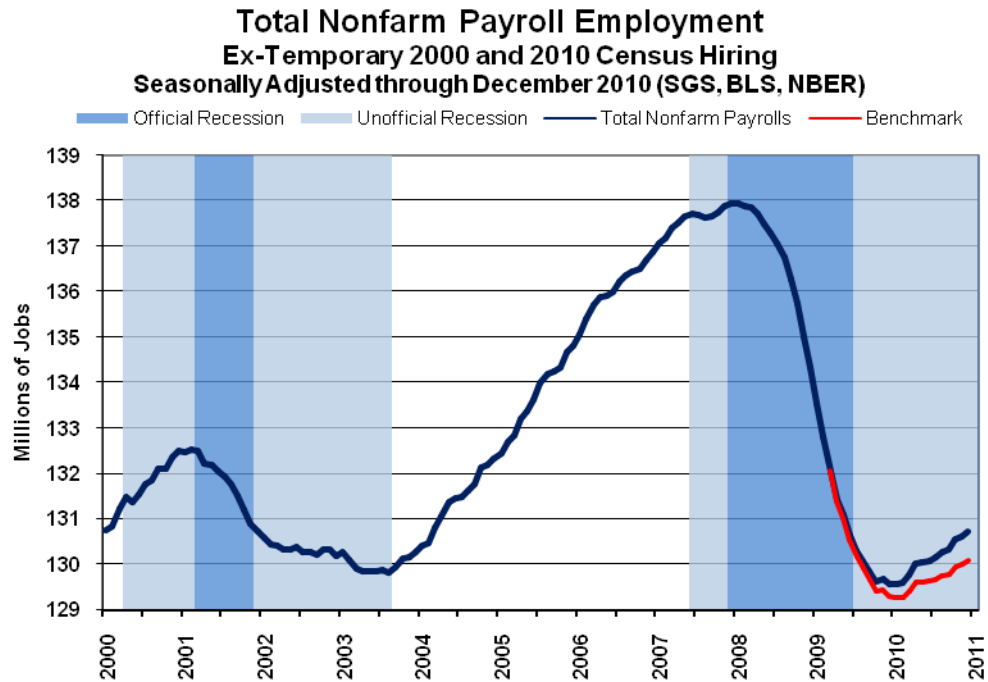
That said, the December numbers were mixed, with weaker payroll growth but a better unemployment rate than expected. Serious seasonal-adjustment problems again were exacerbated by the effects of the severe depth and length of the economic downturn, creating about 30,000 of phantom payrolls and knocking at least 0.1 percentages points off the headline unemployment rate. The issues are discussed below and were detailed last month (see [Commentary No. 337](#)).

Payroll Survey Detail. The BLS reported a statistically-insignificant, seasonally-adjusted December 2010 jobs gain of 103,000 (a gain of 173,000 before prior-period revisions) +/- 129,000 (95% confidence interval). November payrolls showed a revised 71,000 increase (previously 39,000) with October payrolls up a phony 210,000 in revision (previously 172,000). The October revision would have been reported as a gain of 190,000, if the BLS consistently reported its monthly recasting of seasonal factors. While the BLS readjusts all the data from recent years, each month, with the unstable monthly seasonal factor recalculations, it only reports the current and two prior months on the revised basis.

Doing this "concurrent" monthly seasonal factor adjustment, the BLS created something over 30,000 phantom jobs in today's report, simply by shifting them into the current period from the second-quarter 2010, without publishing the downside revisions to the second-quarter's jobs. All these data should be recast in next month's benchmark reporting, with relative aggregate employment strength being reduced in the February to April 2010 period, and with shifts into third-quarter 2010 reporting already in place. All that is before benchmark corrections to the unadjusted data.

As shown in the following 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 continue to constrain normal commercial activity, preventing any meaningful recovery in business activity, as discussed in [Special Commentary No. 342](#).

The first of the graphs reflects payrolls net of temporary census hires, with the red line reflecting the likely benchmark revision due for publication on February 4th. Such shows no meaningful recovery or upturn in the economy. Current housing, industrial production, consumer confidence numbers and the likely revisions to the payroll data suggest that the onset of timing for an official double-dip in this contraction will be in the August/October 2010 timeframe. The second graph is similar to the first one, except it includes the census hires, as officially reported.

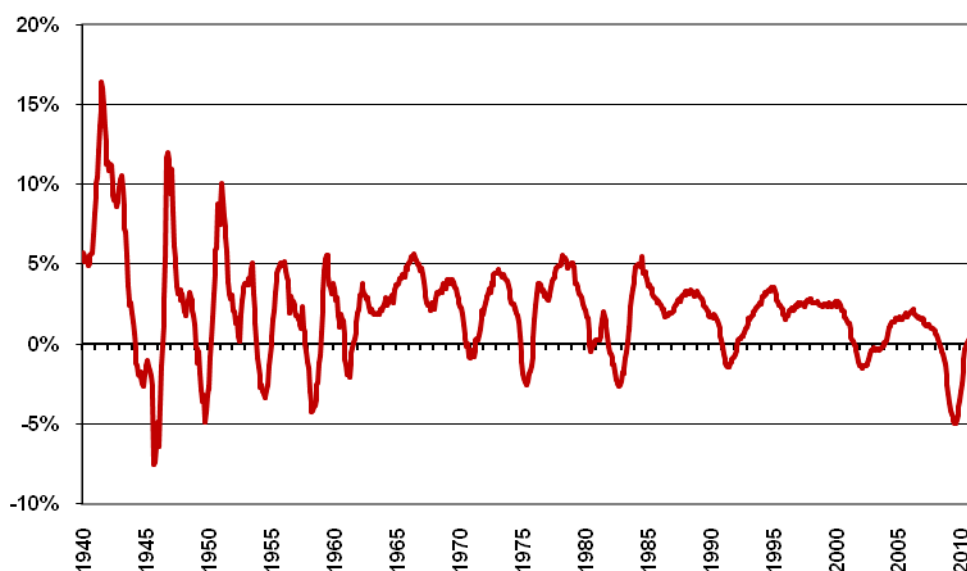


From peak-to-trough (the peak month was December 2007; December 2009 is the short-lived official trough of the current cycle), payroll employment declined by a seasonally-adjusted 8,363,000 jobs, or 6.1%. As of December 2010 reporting, payrolls purportedly had regained 0.9% or 1,124,000 jobs since the December 2009 trough, if one uses the published seasonally-adjusted payroll estimate for December 2009. Those numbers, however, are politically happy data that likely will not survive the benchmark revision. The current December 2009 trough should shift into 2010 with the upcoming revisions, along with a reduction in current employment levels by more than 600,000.

In terms of year-to-year change, the unadjusted December 2010 number was up by 0.82% versus November's revised 0.69%, (initially 0.64%). Net of likely benchmark revisions, annual change was about 0.5%.

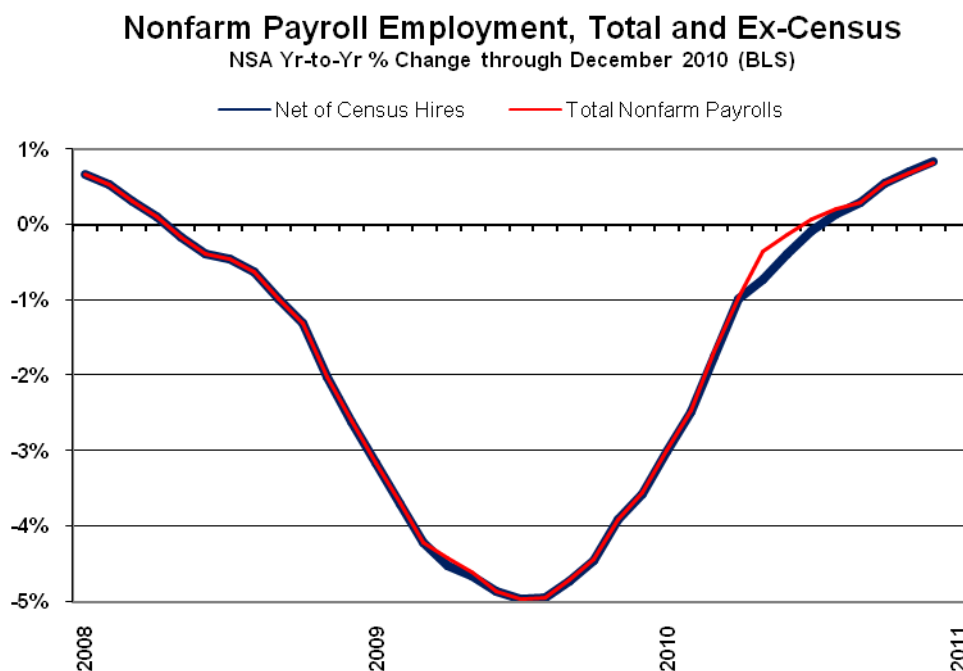
Nonfarm Payrolls (Including Census Hires)

NSA Yr-to-Yr % Change through December 2010 (BLS)



The preceding 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. Thanks to recent, protracted bottom-bouncing in the payroll series, 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 next graph shows the year-to-year detail both with and without the census hires, but still without benchmark considerations.



Again, while the patterns of year-to-year change have recovered their pre-collapse levels, such is due only to the particularly protracted nature of the downturn, with year-ago comparisons against the bottom-bouncing. In the above graph, keep in mind that the level of payrolls in December 2010 still was 4.3% below the level seen when annual growth in payrolls began to tumble.

Benchmark Revision -- About Minus 640,000 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 December 2010 reporting was around 640,000 jobs, along with a full restatement of seasonal-factor adjustments. The formal benchmark revision and restated economic history will be published on February 4, 2011, along with the January 2011 employment report.

Birth-Death/Bias Factor Adjustment. 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 unadjusted December 2010 bias factor was a monthly addition of 24,000 jobs, versus 25,000 jobs added in December 2009, and against a monthly subtraction of 8,000 jobs in November 2010.

Such was the first time in this survey year (beginning April 2010) that the monthly bias adjustment was weaker than in the prior year. Such could reflect changes pending with the upcoming benchmark.

The BLS announced recently 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 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 is not likely to improve the quality of current reporting meaningfully.

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, 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. Much of that misreporting -- not picked up in the 2010 benchmarking -- now will not be corrected until at least the 2011 benchmark revision (based on the upcoming March 2011 benchmarking) 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), went through annual revisions to its seasonally-adjusted data, and it faces further revisions next month, as the population data are tweaked. While no monthly unemployment rate was revised by more than 0.1 percentage point (to the first decimal point) in the five-year revision period, the new seasonal patterns did tend to lower slightly the reported December headline unemployment rates, contributing to the reported decline in the December 2010 headline number. For example, the U.3 unemployment rate in December 2009 initially was reported at 10.0%; after the revised seasonal factors, it now stands at 9.9%.

From the household survey, December showed a seasonally-adjusted monthly employment gain of 297,000, following a revised employment loss of 175,000 (previously 173,000) in November.

The December 2010 seasonally-adjusted headline (U.3) unemployment rate declined by a statistically-significant 0.34 percentage point to 9.43% +/- 0.23% (95% confidence interval), from a revised 9.77% (previously 9.82%) U.3 in November. Not seasonally adjusted, December's U.3 unemployment eased to 9.1% from 9.3% in November.

The December U.6 unemployment rate dropped to a seasonally-adjusted 16.7% from 17.0% in November, but the unadjusted rate rose to 16.6% in December from 16.3% in November. 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 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 -- declined to about 22.4% in December from 22.6% in November. The November reading was the highest 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 22.4% 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 anticipated 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 should show up in prior-period revisions.

SGS Ongoing M3 Estimate (December 2010). A preliminary M3 estimate for December 2010 will be published over this weekend (January 8th) on the [Alternate Data Tab](#). The series appears to be on track to show a 2.9% year-to-year contraction for the month, the same as in November, with the narrowing of annual decline flattening out. The M3 series also appears to have contracted month-to-month for the second month. The monthly gain in M2 -- the Fed's current broadest money supply measure -- has been more than offset by monthly contractions in the larger non-M2 components of M3: institutional money funds and large time deposits. An update of liquidity conditions will be included in the next *Commentary*.

Trade Balance (November 2010). The November trade deficit is due for release on Thursday, January 13th. I expect the monthly deficit to widen enough to push the "net export" component of the upcoming "advance" estimate of fourth-quarter 2010 GDP (due for release on January 28th) into the minus column as a contributor to fourth-quarter economic activity. Such would require a reported November deficit deterioration beyond likely consensus expectations.

Consumer Price Index (December 2010). Due for release on Friday, January 14th, the December 2010 CPI should begin to tick upwards, reflecting the effects of higher oil, food and other commodity prices, and offering some possible upside surprise to likely consensus forecasts. Gasoline prices rose by 4.6% in the month, and the impact of that should be enhanced by seasonal adjustments in reporting. At work here is the Fed's effort at debasing the U.S. dollar.

Year-to-year inflation would increase or decrease in December 2010 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.17% adjusted monthly gain seen in December 2009. I

use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual inflation rate for December 2010, the difference in December's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from November 2010's reported annual inflation rate of 1.14%. A result of 0.3% to 0.4% reported in monthly inflation would push year-to-year December 2010 inflation to roughly 1.3% to 1.4%.

Retail Sales (December 2010). Due for release on Friday, January 14th, December retail sales should show much less in holiday sales than has been touted by the recovery-at-hand cheerleaders. Assuming an upturn in inflation, real (inflation-adjusted) sales well could be negative on a monthly basis.

Industrial Production (December 2010). Due for release on Friday, January 14th, December industrial production -- aside from the effects of unseasonably bad weather spiking utility usage -- should be down for the month, increasing the odds that production peaked in September/October, subject to upcoming revisions. This likely also would be a negative surprise for consensus forecasts.
