COMMENTARY NUMBER 367
April Labor Numbers, Money Supply, Dollar and Precious Metals

May 6, 2011

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Increasingly Misleading Seasonal-Factors
Continued to Pummel Accuracy of Jobs Data

April Household Survey Showed 190,000 Employment Drop

April Unemployment Rates: 9.0% (U.3), 15.9% (U.6), 22.3% (SGS)

Broad Money Supply Gains in April

Underlying Inflation, Dollar and Precious Metals Fundamentals Unchanged

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PLEASE NOTE: The next regularly scheduled Commentary *is for Friday, May 13th. It will cover April inflation (CPI and PPI) and retail sales, and the March trade deficit.*

—Best wishes to all, John Williams

Opening Comments and Executive Summary. The extreme volatility seen in the price of silver—exacerbated by tightened margin requirements—and the large swings in the price of gold, price of oil and in certain U.S. dollar exchange rates, do not in any way change the long-term outlooks for the U.S. dollar or for the long-term hedges against a collapse in U.S. dollar purchasing power. The current markets leave

open the potential for near-term jawboning (official or through market intermediaries) and government intervention (overt or covert) to encourage relative U.S. dollar strength. Despite whatever volatility there may be, the U.S. dollar remains on track for an eventual complete collapse in a hyperinflation, and the roots of that hyperinflation remain imbedded in the system. The primary hedge against losing U.S. dollar purchasing power remains physical gold (and silver), with some funds outside the U.S. dollar. As discussed in the *Hyperinflation Special Report (2011)*, I still like the Swiss franc, Canadian dollar and Australian dollar.

Labor Data. On the economic front, the broad outlook is unchanged. The nonsensical market gyrations and hype around yesterday's (May 5th) jump in jobless claims speaks to the manipulations, ignorance or insanity in the current markets. As I have discussed frequently and as is recognized fairly widely, big weekly swings in jobless claims commonly reflect nothing other than the Department of Labor's demonstrated inability to seasonally-adjust these numbers around holidays. The period in question encompassed Easter and followed Good Friday.

Today (May 6th), stocks are soaring as we go to press, purportedly due to an upside surprise in April nonfarm payroll growth, a gain of 244,000. As has been the case for months, though, reported changes in the monthly labor data usually are not statistically significant, and they were not so today.

Given the increasing level of concurrent seasonal-factor adjustment distortions, and the sharp upside adjustment to April's birth-death model bias-factor, the reported payroll gain was not meaningful. Following the plunge in payrolls in the early part of the economic downturn, a protracted period of bottom-bouncing commenced. Year-to-year change in the reported bottom-bouncing now has flattened out at about one-percent, and nonfarm payrolls still are below where they were ten years ago.

In contrast to the 244,000 gain in payrolls, the household (unemployment) survey showed a 190,000 decline in monthly employment, but that also was not meaningful.

Heavily warped by its own poor-quality seasonal adjustments, the headline U.3 unemployment rate rose to 8.96% in April, from 8.83% in March, an increase that was not statistically significant. The adjusted broader U.6 unemployment rate rose to 15.9% in April, versus March, while the SGS-Alternate Unemployment Measure picked up some disappearing short-term discouraged workers, rising to 22.3% from 22.0% in March.

Hyperinflation Watch—QE2 and M3. In Federal Reserve Chairman Ben Bernanke's April 27th news conference, he confirmed the FOMC announcement of the same date that the Fed would cease QE2— buying U.S. Treasury securities—as planned in June. Shown in the accompanying graph, thanks to QE2, the Fed effectively has monetized more than the entire net issuance of U.S. Treasury debt (to be held by the public) during the last five months. Ostensibly, the Fed has done this in an effort to stimulate the economy and to debase the U.S. dollar (create inflation). While the Fed has little chance of turning the economy to sustainable economic growth, it has been successful in triggering an upturn in consumer inflation. That has been seen in recent months and likely will be reconfirmed in the week ahead.

I contend that the Fed's liquidity actions are tied more banking system solvency concerns than to the economy, which continues to stagnate, where elements such as construction are showing renewed economic contraction, after a period of extensive bottom-bouncing. Disappointing economic activity

likely will provide the public excuse for QE3, although, again, systemic solvency likely will continue as the Fed's primary concern. From a monetization standpoint, a hiatus in net Treasury issuance could be in place for the next five months or so, so long as action is forestalled on raising the federal debt ceiling.

Net Fed Monetization of U.S. Treasuries versus Net Treasury Issuance of Debt Held By Public
Cumulative Dollars and Monetization as % of Issuance
In December 2010 to April 2011 (FRB, U.S. Treasury)
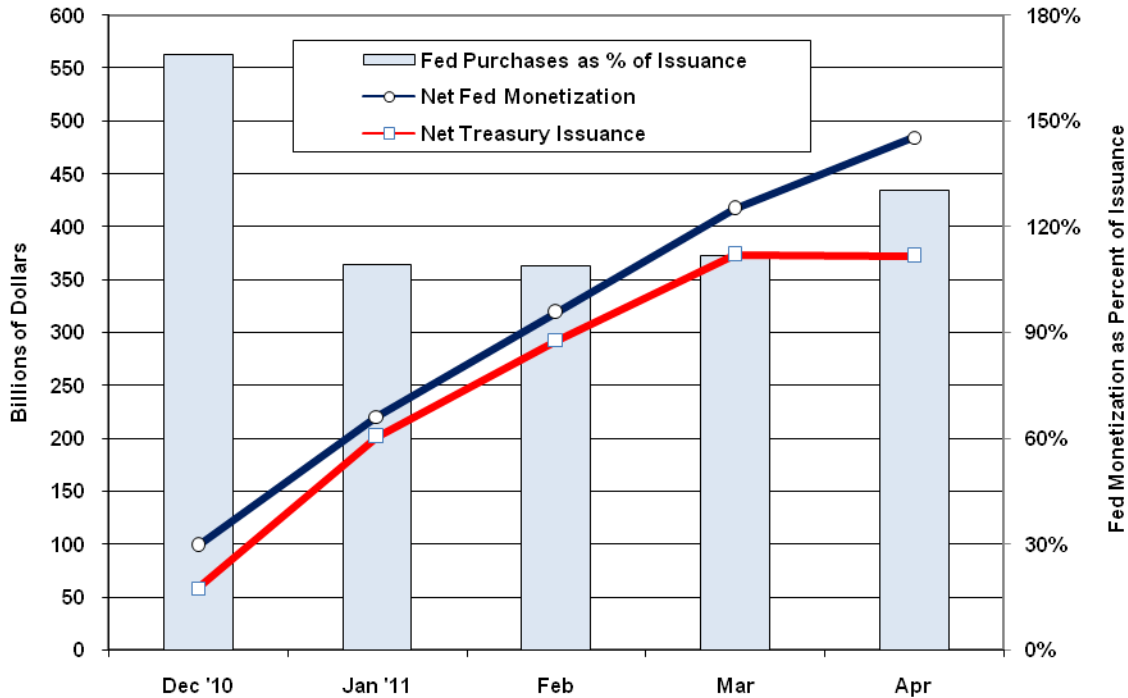
The Fed's effective full monetization of U.S. Treasury debt could be expected to trigger some increase in broad money supply (M3) growth. Whether the Treasuries are bought directly from the Treasury or from holding institutions, the effective cash flows through the Treasury to the public and generally are deposited in the banking system. Whether or not the banking system increases lending in response to the deposits, however, is another issue. In any event, the SGS Ongoing-M3 Estimate has started to grow.

The general outlooks on inflation, systemic solvency and the broad economy, as discussed in *Hyperinflation Special Report (2011)* continue unabated.

SGS Ongoing-M3 April Estimate on Track to Show Annual and Monthly Gains. The preliminary estimate for the SGS Ongoing-M3 Estimate for April will be published tomorrow (May 7th) in the Alternate Data section. At present, the series is on track for year-to-year growth of about 0.5%, versus a 0.9% annual decline in March. The April result would be the first annual increase since November 2009. Monthly change also is headed for a likely gain, possibly the strongest monthly pick-up since May 2009.

Net of inflation adjustment, annual growth will remain negative at present, and the early pick-up here does not change the economic outlook whatsoever. If nominal (not adjusted for inflation) growth accelerates in the months ahead, however, that could raise a caution signal on inflation, depending on what is happening with the U.S. dollar.

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REPORTING DETAIL

Increasingly Distorted Seasonal Factors Shift Jobs from 2nd- and 3rd-Quarter 2010 to More-Current Reporting. As discussed in the *Hyperinflation Special Report (2011)*, the extreme severity of the current economic downturn—both in terms of depth and duration—distorted regular month-to-month reporting of seasonally-adjusted series, including the headline U.3 unemployment rate and particularly the nonfarm payroll employment, which is adjusted using concurrent seasonal-factor calculations.

Seasonally-Adjusted Nonfarm Payroll Employment
Difference Between Actual Series and
Distorted Official Reporting Levels by Reporting Month
Thousands of Jobs (SGS, BLS)
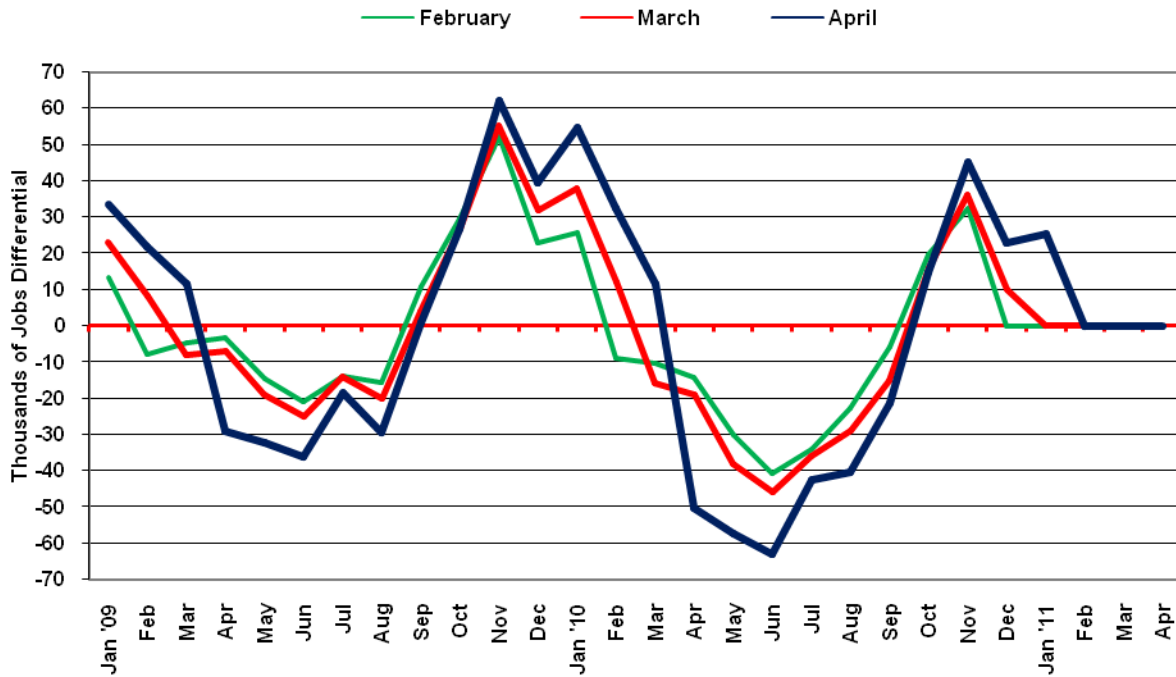
While the BLS recalculates the monthly seasonal factors each month for payroll employment, going back a number of years, it only publishes revised data for the last two months of reporting (February and March 2011 with the April 2011 report). What is shown in the preceding graph is that these concurrent seasonal factor changes increasingly have reduced levels of payrolls in the second- and third- quarter of 2010, shifting adjusted jobs to the most recent period. The most recent boosted number gets reported as the base for current reporting, while the downward revisions to mid-2010 are not published, so as to avoid "confusing" people who use the data.

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 preceding graph would be flat and coincident.

Instead, the monthly recalculations of seasonally-adjusted payroll levels show irregular revisions, with monthly swings of plus or minus 60,000 jobs shifting over time. To the extent the numbers affect current reporting, the differences are enough potentially to alter financial-market perceptions and reactions.

Again, what has happened here is largely a distortion created by the extreme severity of the economic downturn, which disrupted regular seasonal patterns and calculations of related seasonal adjustments. The big issue remains that the month-to-month seasonally-adjusted payroll data have become increasingly worthless, with errors likely now well beyond the 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 (see *Commentary No. 355* for greater detail).

The inconsistency differences in the graph were calculated based on the raw 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 Survey Detail. The Bureau of Labor Statistics (BLS) reported a statistically-significant, seasonally-adjusted April 2011 jobs gain of 244,000 (an increase of 290,000 jobs before prior-period revisions) +/- 129,000 (95% confidence interval). March payrolls showed a revised 221,000 (previously 216,000) gain. Yet, as discussed earlier, much of the gain and upside revision was only to a recasting of seasonal adjustment factors that borrowed seasonally-adjusted jobs from earlier months, where the downside monthly revisions were not published by the BLS.

In terms of year-to-year change, the unadjusted April 2011 number was reported up by 1.07% from the year before, little changed from the revised 1.04% (previously 1.03%) year-to-year change reported for March.

Although the graphs of long-term year-to-year unadjusted payroll change had shown a recent rising increase in annual growth, which primarily reflected the still-protracted bottom-bouncing in the payroll series, that pattern has flattened out in the last several months, as shown in the first graph following of the near-term detail in year-to-year change.

Nonfarm Payroll Employment
NSA Yr-to-Yr % Change through April 2011 (BLS)
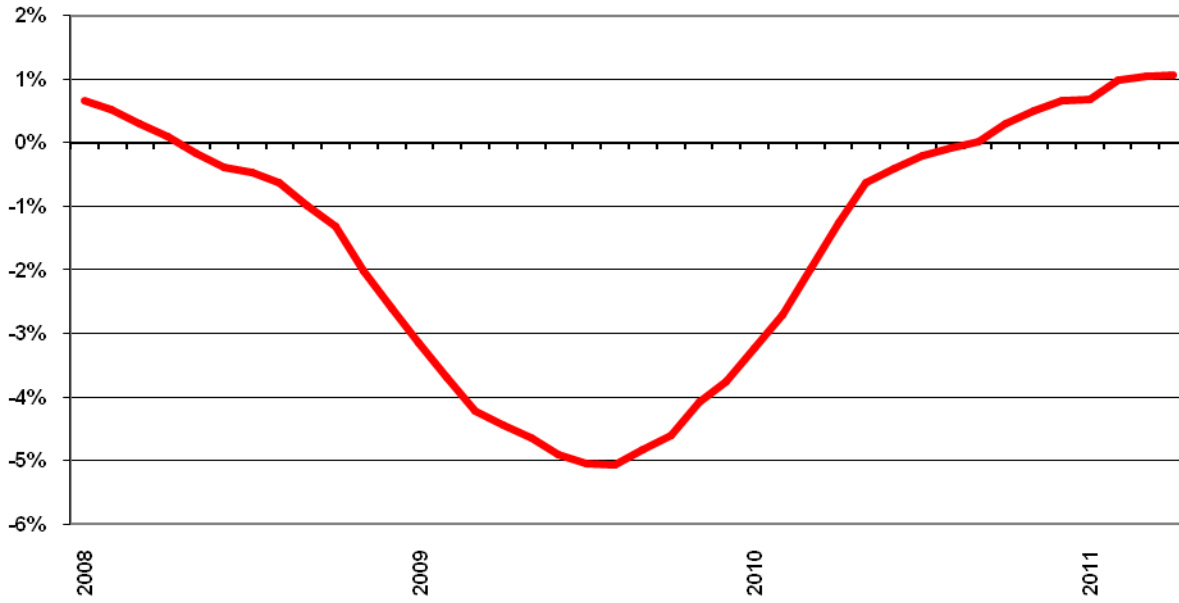
Nonfarm Payrolls
NSA Yr-to-Yr % Change through April 2011 (BLS)
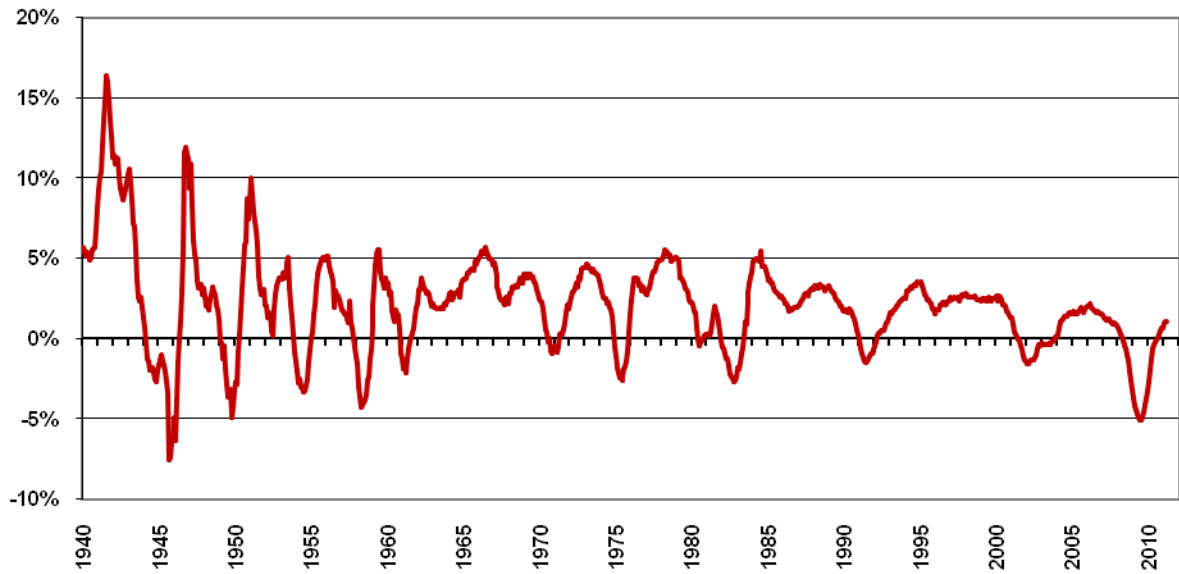
As shown in the preceding longer-term graph (historical detail back to World War II), with the bottom-bouncing of recent years, current annual growth has recovered from the post-World War II record 5.06% decline in August 2009, which was the most severe annual contraction seen since the production shutdown 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, and the current level of employment is far from any recovery.

Nonfarm Payroll Employment
Seasonally-Adjusted Levels through April 2011 (BLS)
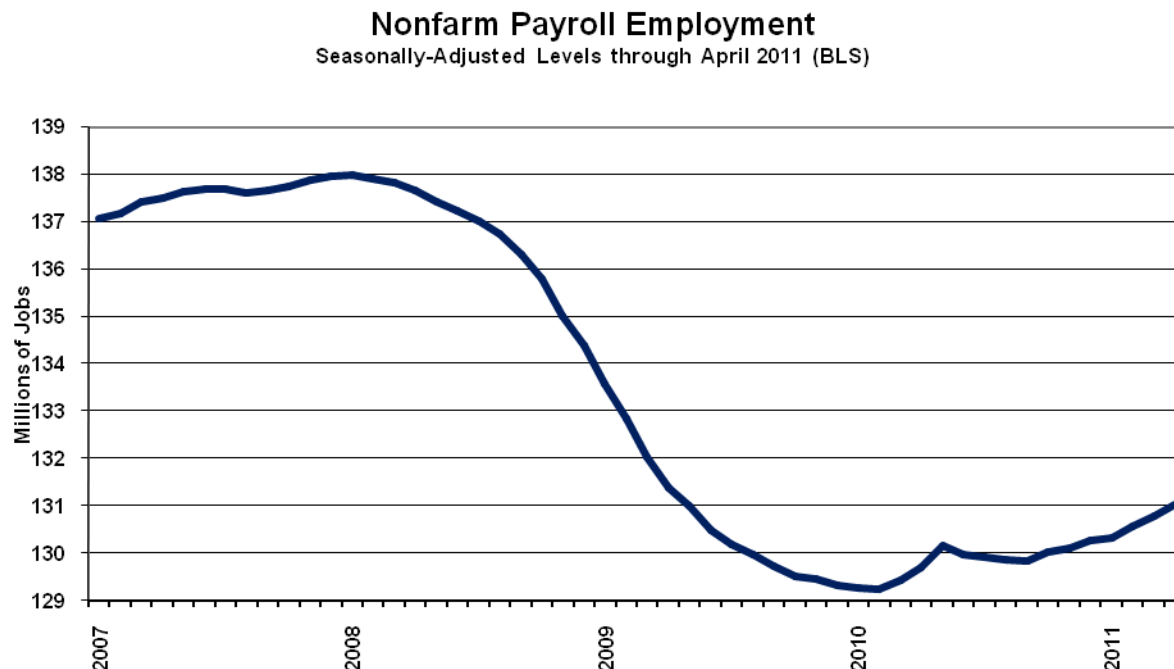
In the above plot of seasonally-adjusted payroll levels (as reported by the BLS) the current level of nonfarm payrolls shows no recovery to pre-recession highs. The data continue to reflect bouncing along a plateau of low-level activity, with the latest payroll level still well below where it was a decade ago, even though the U.S. population has increased by 10% in the same period.

Birth-Death/Bias Factor Adjustment. Despite the ongoing and regular overstatement of monthly payroll employment—as evidenced by the regular and massive, annual downward benchmark revisions to the reported payroll numbers—the BLS keeps upping its monthly biases in post-benchmark reporting. For April 2011, there was a positive monthly bias used of 175,000 jobs, up from the revised estimate of 141,000 used in April 2010. In March, the net bias was a boost of 119,000 jobs. These upside biases reflect 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 financial-market and political needs with relatively good headline data, while also setting up the next year's downside benchmark revisions, 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, 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 likely are running now above 30,000 per month (seasonally-adjusted). 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 230,000 jobs. Much of that misreporting, which was 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), showed an April 2011 employment decline of 190,000 from March. In turn, March had been reported up by 291,000 from February. Nonetheless, issues with seasonal factors also 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 moved by highly unstable seasonal factors that are artifacts of the severe and extraordinarily protracted downturn in U.S. economic activity, not by the regular and stable seasonal patterns that were in place before the current economic crisis.

The April 2011 seasonally-adjusted headline (U.3) unemployment rate rose by a statistically-insignificant 0.14 percentage point to 8.96% +/- 0.23% (95% confidence interval), from 8.83% in March. Not-seasonally-adjusted, April's U.3 unemployment fell to 8.7% from 9.2% in March.

The April U.6 unemployment rate rose to a seasonally-adjusted 15.9% from 15.7% in March, still suffering from seasonal-maladjustment, with some of the unadjusted short-term discouraged workers in U.6 rolling into the long-term discouraged worker category in the SGS measure. The unadjusted U.6 rate fell to 15.5% in April, from 16.2% in March. 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—moved higher to about 22.3% in April, from 22.0% in March. 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. See the Alternate Data tab for more detail.
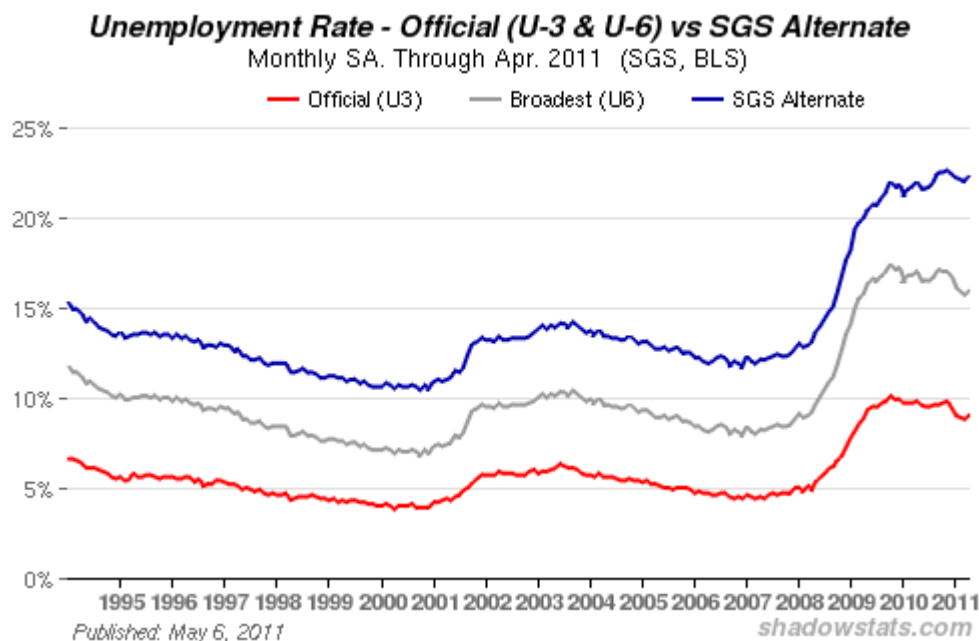
As discussed in previous writings, while an unemployment rate around 22% might raise questions in terms of a comparison with the purported peak unemployment in the Great Depression (1933) of 25%, the SGS level likely is about as bad as the peak unemployment seen in the 1973 to 1975 recession. The Great Depression unemployment rate was estimated well after the fact, with 27% of those employed working on farms. Today, less that 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. Though not yet commonly recognized, there is both an intensifying double-dip recession and a rapidly escalating inflation problem. Until such time as financial-market expectations catch up with underlying reality, reporting generally will continue to show higher-than-expected inflation and weaker-than-expected economic results in the month and months ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions, benchmark or otherwise.

SGS Ongoing M3 Estimate (April 2011). The preliminary estimate of the April 2011 SGS-Ongoing M3 Estimate will be posted in the Alternate Data section, tomorrow, May 7th. As discussed earlier, year-to-year and month-to-month gains are likely.

Trade Balance (March 2011). Due for release on Wednesday, May 11th, any unexpected improvement or deterioration in the March trade deficit should impact the first revision to first-quarter 2011 GDP scheduled for May 26th. I expect a possible widening deficit (negative GDP implications) for this highly volatile series.

Retail Sales (April 2011). Due for release on Thursday, May 12th, reporting risk is to the downside of what likely will be reasonably strong expectations. A fair bet is that whatever gain may be reported will be more than offset by CPI-U inflation in the month.

Producer Price Index—PPI (April 2011). Due for release on Thursday, May 12th, this volatile series once again is due to have reported energy inflation muted by seasonal factors. Nonetheless there is some risk for an upside surprise versus what likely will be somewhat tepid expectations.

Consumer Price Index—CPI (April 2011). Due for release on Friday, May 13th, the series is at risk of surprising likely muted expectations on the upside. In April 2010, seasonal adjustments turned an unadjusted 2.9% monthly gain in gasoline prices to a 2.4% adjusted monthly decline. With gasoline prices up about 7% for the month of April 2011, that likely still will be a gain after seasonal adjustment. The spreading effects of higher oil and food prices should be picking up in reported "core" (net of food and energy) inflation, which is where an upside surprise is a fair bet.

Year-to-year CPI-U inflation would increase or decrease in April 2011 reporting, dependent on the seasonally-adjusted monthly change, versus the unchanged adjusted monthly level seen in April 2010. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual inflation rate for April 2011, the difference in April's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from March 2011's reported annual inflation rate of 2.68%. A monthly gain of 0.3% in monthly CPI-U, for example, would push annual CPI-U inflation to 3%.

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