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

COMMENTARY NUMBER 387
August Employment, Unemployment, M3

September 2, 2011

August Payrolls Were 58,000 Below the July Payroll Levels Reported One Month Ago

Concurrent Seasonal-Factor Adjustments Mute Bad News

August Unemployment Rates: 9.1% (U.3), 16.2% (U.6), 22.8% (SGS)

Money Supply M3 Growth Slowed in August

PLEASE NOTE: The next regular Commentary *is scheduled for Thursday, September 8th. It will cover the release of U.S. trade balance details for July 2011. A* Special Commentary *would be published, as appropriate, in response to any unusual market or economic developments.*

—Best wishes to all for an enjoyable holiday weekend, John Williams

Opening Comments and Executive Summary. The U.S. employment picture is much worse than reported, thanks partially to the Bureau of Labor Statistics' (BLS) use of gimmicked revisions, which are a natural fallout of the "concurrent" seasonal-factor adjustment concept used in the payroll survey (also used by other statistical bureaus in reporting series such as retail sales and new orders for durable goods). The effect has been to mute the reported impact of layoffs, with the result that today's (September 2nd) seasonally-adjusted downside revisions to recent employment levels were shy by at least 85,000 jobs.

Teacher Layoffs. Consider new teacher layoffs reported for July. Presumably better information led to today's 116,000 downside revision to July's not-seasonally-adjusted level of teacher payrolls. As of July 2011 reporting—with many teachers on regular seasonal holiday—seasonal factors added roughly 17% to aggregate unadjusted July teacher payroll numbers. The unadjusted 116,000 downside revision to those payrolls would have been translated into a seasonally-adjusted 135,000 reduction, based on the original July 2011 seasonal adjustments.

With old-line seasonal-adjustment approaches, monthly seasonal adjustments were stable and not constantly recalculated. Yet, with "concurrent" calculations, readjustments are made every month. The unusually large layoff revisions were recalculated in August's system as part of the "new normal," with the effect of upping July's seasonal adjustments for aggregate teacher payrolls and reducing the impact from the newly reported layoffs to an adjusted 50,000. Non-regular teacher layoffs of 135,000 based on July's initial adjustments were muted to 50,000 (a difference of 85,000 jobs) simply by the recalculation of seasonal factors in a system that treats current layoffs as part of the ongoing normal business cycle.

Prior-Period Revisions—Inaccurate Data Published in BLS Reporting. Other, related reporting issues for the headline jobs-growth number were evident in today's estimated monthly payroll change of 0 +/- 129,000 for August 2011. Consider that the headline number published last month reflected July 2011 payrolls at 131.190 million, a monthly gain of 117,000. With today's August payrolls at 131.132 million, one might think that payrolls contracted by 58,000 for the month, but with a fortuitous downside revision of July's payrolls to 131.132 million, the August number was unchanged.

Along with those revisions, July's initial gain of 117,000 jobs revised to 85,000, and June's gain of 46,000, as reported last month, revised to 20,000.

That June number, however, deliberately was misleading. The BLS recalculates the seasonally-adjusted payroll levels each month, but it only publishes the last two months of revised estimates, so as not to "confuse" users of the data. The recalculated level for May payrolls was about 131.003 million, not the published 131.027 million. So June's gain of 20,000 really was 44,000, but May was weaker than currently published. May's monthly gain now is 30,000, instead of the 51,000 indicated officially by the BLS (see the first section under *Employment and Unemployment (August 2011)* in the *Reporting Detail*.

August Employment and Unemployment Show Economic Bottom-Bouncing. Although the BLS might be signaling a toss-up between improving and deteriorating labor market conditions, the U.S. economy continues in a downtrending bottom-bounce, with the odds strongly favoring ongoing deterioration in employment and in the unemployment rate.

There is enough rounding and guesstimating made with the BLS estimate of payroll levels to bring in the monthly payroll change at a small gain or small contraction, as opposed to exactly unchanged. With a 95% confidence interval of +/- 129,000 around zero growth, the BLS is suggesting equal odds for employment growing or declining. Whatever employment is doing, though, it is doing such from a lower level (see revisions discussion) than it was last month.

Not only was the monthly employment gain unchanged, but so too was headline unemployment rate, at the second decimal point, 9.09% +/- 0.23%. Again even-money is suggested as to actual improvement or deterioration, per the BLS.

With the biases and distortions built into the BLS reporting, ongoing actual deterioration remains a solid bet. There also are suggestions of weakening labor conditions, from ongoing monthly contractions in the Conference Board's still-nascent measure of online help-wanted advertising (the newspaper index has been discontinued), and from patterns of slowing employment (approaching contraction) in recent purchasing managers surveys.

Most important, though, the consumer's structural liquidity problems are ongoing. Actual income growth continues to lag rising inflation, while many consumers still lack the ability to expand their debt in order to make up shortfalls in maintaining standards of living. Without positive growth in real income and/or debt, chances remain nil of any meaningful uptick in business activity.

Hyperinflation Watch—Money Supply Growth Is Not Picking Up. As the U.S. economic crisis continues to deepen, so too does the U.S. solvency crisis. Aggregate bank lending is flat, likely much more heavily due to balance sheet issues with banks than due to a lack of credit-worthy borrowers.

Money Supply M3 (August 2011). Based on three weeks of data, the preliminary estimate of the SGS Ongoing-M3 Estimate for August 2011 will be published in the Alternate Data section on September 3rd. August M3 likely showed year-to-year growth of about 2.2%, down from 2.4% in July. Seasonally-adjusted month-to-month change in M3 likely will be around unchanged, after a 0.4% monthly gain in July. As discussed previously, declines in large time deposits and institutional money funds (M3 components) largely are offsetting surging growth reported for M2. The M2 growth is due to cash in M3 being shifted into M2 and M1 accounts. The estimated month-to-month M3 changes, however, remain less reliable than the estimates of annual growth.

An early estimate on M2 for August suggests year-to-year growth of about 10.1%, versus 8.2% in July. Month-to-month M2 growth is estimated at roughly 2.3% in August, versus 2.2% in July. The early estimate on M1 for August shows year-to-year growth of 20.2% versus 16.2% in July. Month-to-month M1 growth is estimated at roughly 4.6% in August, versus 3.0% in July.

Fed Easing Remains Likely. With ongoing economic and systemic solvency crises, the Fed remains likely to institute some new form of liquidity injection for the banking system, soon. That action, though, should continue under the guise of trying to stimulate the economy. Neither the Fed nor the Administration is in a position to put forth meaningful economic stimulation, although action by both entities increasingly is expected by the markets and/or the electorate. As a point of clarification, I am not advocating any actions, only offering my opinion as to what likely will unfold.

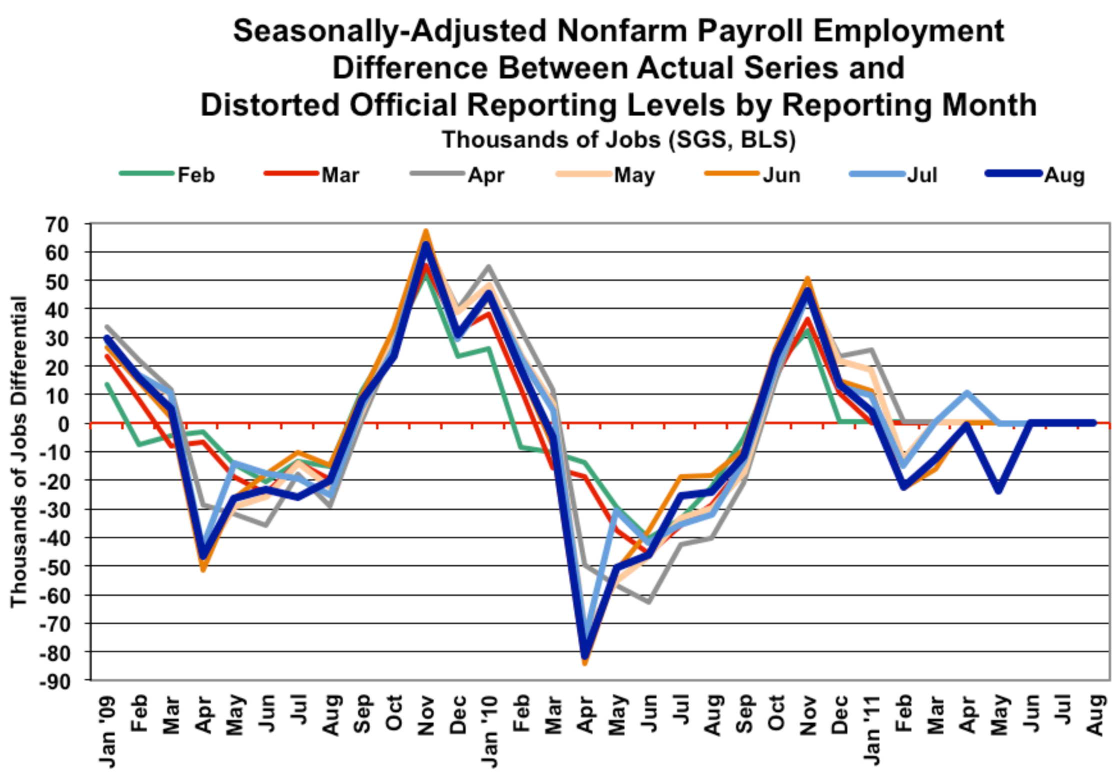
As discussed in the regular *Commentaries*, the broad inflation and economic outlooks detailed in the *Hyperinflation Special Report (2011)* continue to unfold and are unchanged. The financial markets still are unstable and extremely volatile, roiled by deepening crises of confidence in the U.S. dollar and in the long-term outlook for U.S. financial, economic, systemic and political stability. For those living in a U.S. dollar-denominated world, regardless of further 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 remain the fundamental hedges against what lies ahead.

Massive, fundamental dollar dumping and dumping of dollar-denominated assets could 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 and spend whatever money is needed; and with the U.S. dollar at risk of losing its global reserve currency status; much higher inflation lies ahead, in a circumstance that rapidly could evolve into hyperinflation.

REPORTING DETAIL

EMPLOYMENT AND UNEMPLOYMENT (AUGUST 2011)

Constant Recalculation of Payroll Seasonal Factors Boosts Adjusted Payrolls. As discussed in the *Opening Comments and Executive* Summary, and 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.



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 (June and July 2011 with the August 2011 report). Shown in the preceding graph, the latest "concurrent" seasonal factor changes upped July and August of 2010 (with implied stronger seasonals for the July and August 2011 reporting, beyond the opening discussion on teacher payrolls). With just two months of prior reporting shown as revised, the changes pre-June 2011 were not published by the BLS, so as to avoid "confusing" people who use the data.

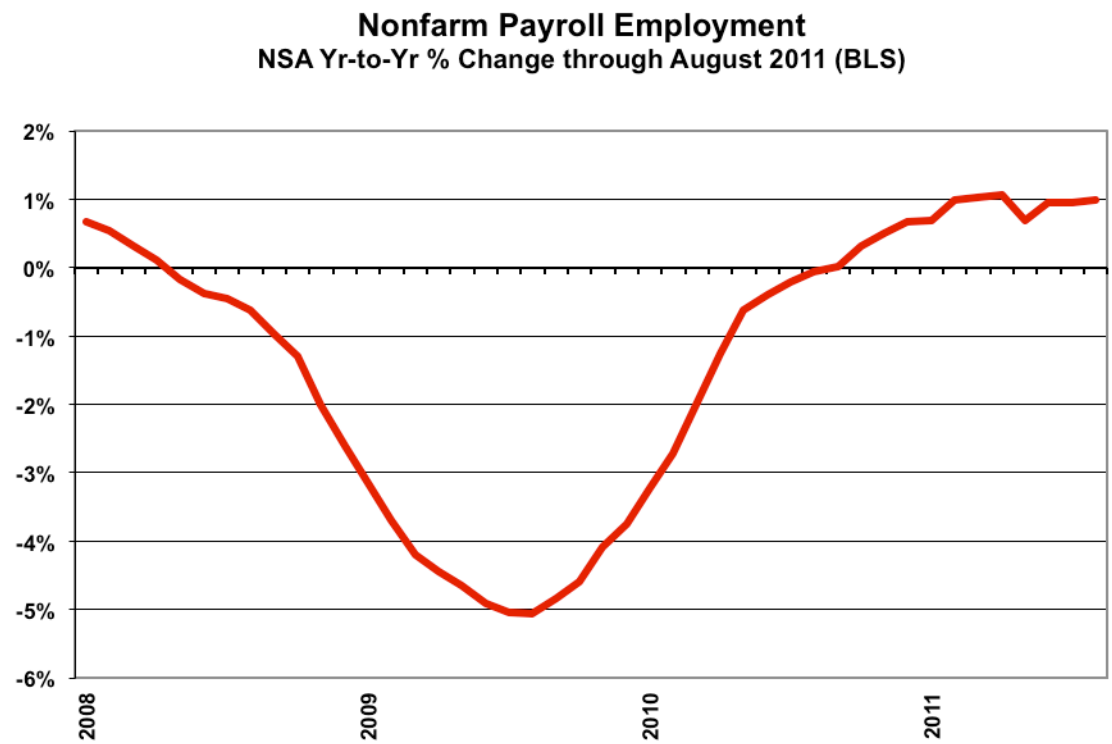
As discussed repeatedly in recent employment *Commentaries*, meaningful seasonal-adjustments tend to be stable over time, without wild fluctuations every time the seasonals are re-estimated. This is true particularly for series like payroll employment and retail sales, where the seasonal factors are concurrent—recalculated each month for the current month's raw data. If the payroll seasonals were stable, the lines in the preceding graph would be flat and coincident. Instead, the variations intensify with each successive month. The monthly recalculations of seasonally-adjusted payroll levels show irregular revisions, with monthly swings now of plus or minus 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.

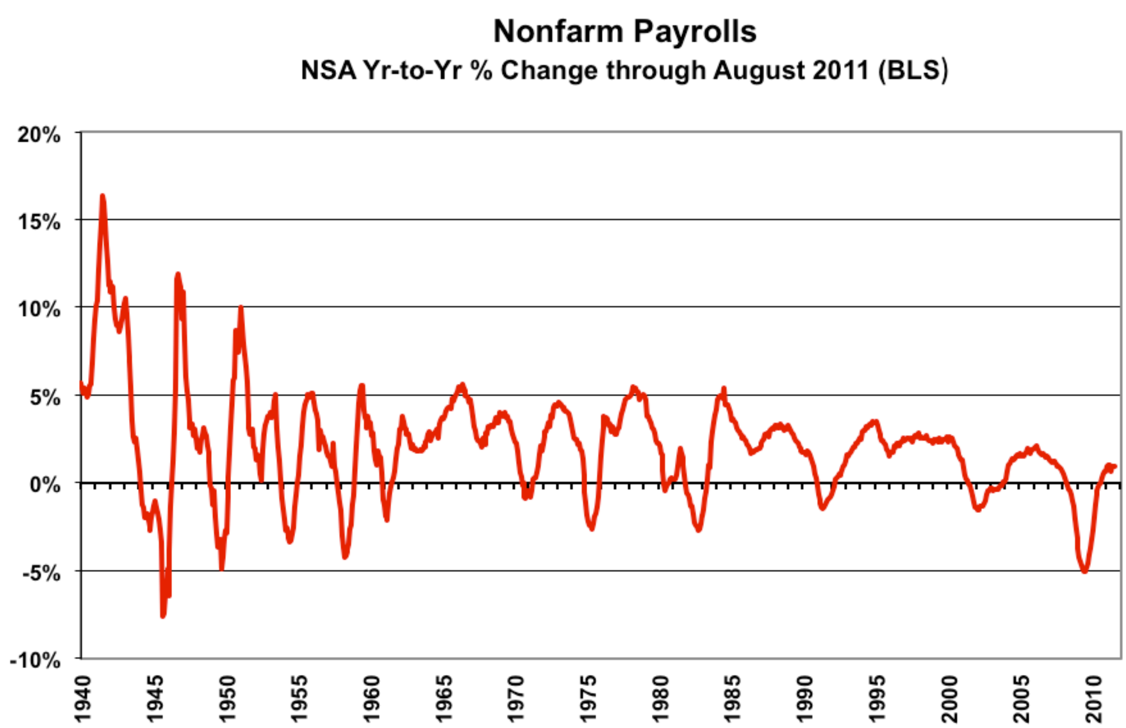
The big issue remains that the month-to-month seasonally-adjusted payroll data have become increasingly worthless, with reporting errors likely now well beyond the official 95% confidence interval of +/- 129,000 jobs in the reported monthly payroll change. Yet the media and the markets tout the data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

The inconsistency differences in the graph were calculated based on the raw 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.

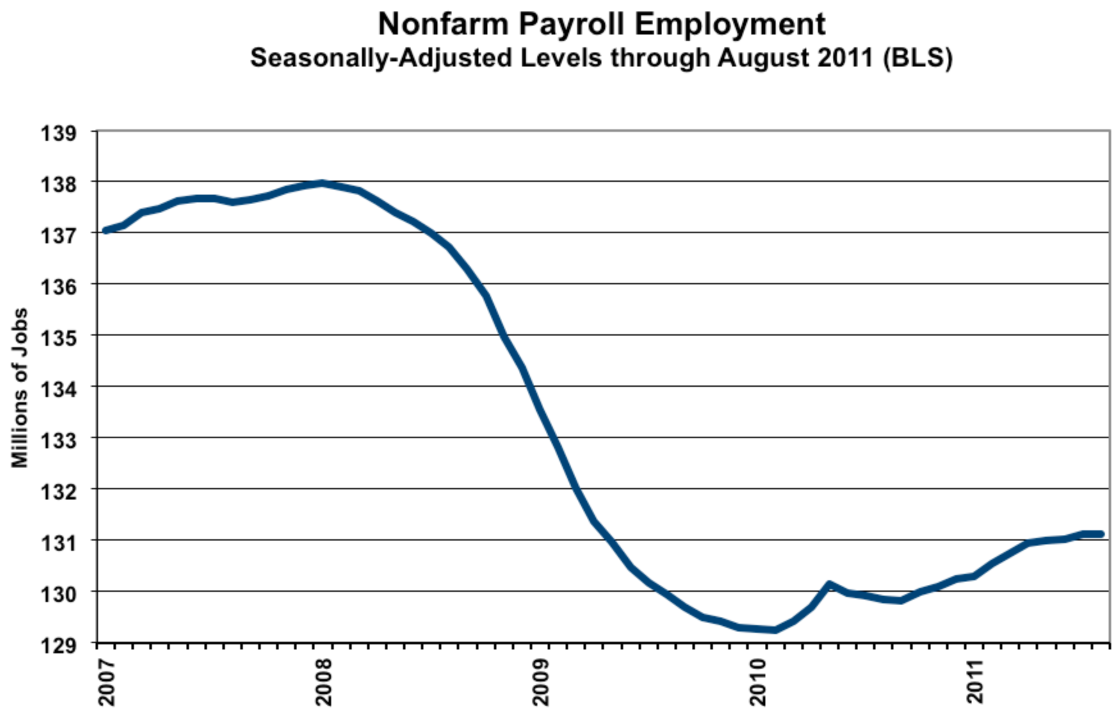
Payroll Survey Detail. The BLS reported a statistically-insignificant, seasonally-adjusted August 2011 month-to-month jobs change of zero (a loss of 58,000 jobs before prior-period revisions) +/- 129,000 (95% confidence interval). July payrolls showed a revised 85,000 (previously 117,000) gain while June's monthly gain also was reduced in revision to 20,000 (see *Opening Comments*), from last month's estimate of a 46,000 gain.

In terms of year-to-year change, the unadjusted August 2011 growth rate was at 0.99%, versus the revised 0.94% (previously 1.04%) reported in July, and against 0.94% (previously 0.95%) annual growth reported in June. Although the graphs of long-term 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 the last several months, as shown in the first graph following of the near-term detail in year-to-year change. These numbers still reflect some short-lived year-to-year distortions as a result of the year-ago hiring surge and full layoffs of temporary census workers.


Nonfarm Payroll Employment
NSA Yr-to-Yr % Change through August 2011 (BLS)
2%
1%
0%
-1%
-2%
-3%
-4%
-5%
-6%
2008
2009
2010
2011


Nonfarm Payrolls
NSA Yr-to-Yr % Change through August 2011 (BLS)
20%
15%
10%
5%
0%
-5%
-10%
1940
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010

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, yet the current level of employment is far from any recovery.



In the above plot of seasonally-adjusted payroll levels (as reported by the BLS) the current level of nonfarm payrolls also shows a recent flattening and certainly no recovery to pre-recession highs. The data continue to bottom-bounce 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 more than 10% in the same period.

Birth-Death/Bias Factor Adjustment. Despite the ongoing and regular overstatement of monthly payroll employment—as evidenced by regular and massive, annual downward benchmark—the BLS generally has upped its monthly biases in post-benchmark reporting. For August 2011, however, the monthly bias used was an addition of 87,000 jobs, somewhat less than the 91,000 monthly upside bias used in August 2010. In July 2011, a downside bias of 18,000 was used.

The aggregated 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 reporting for 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.

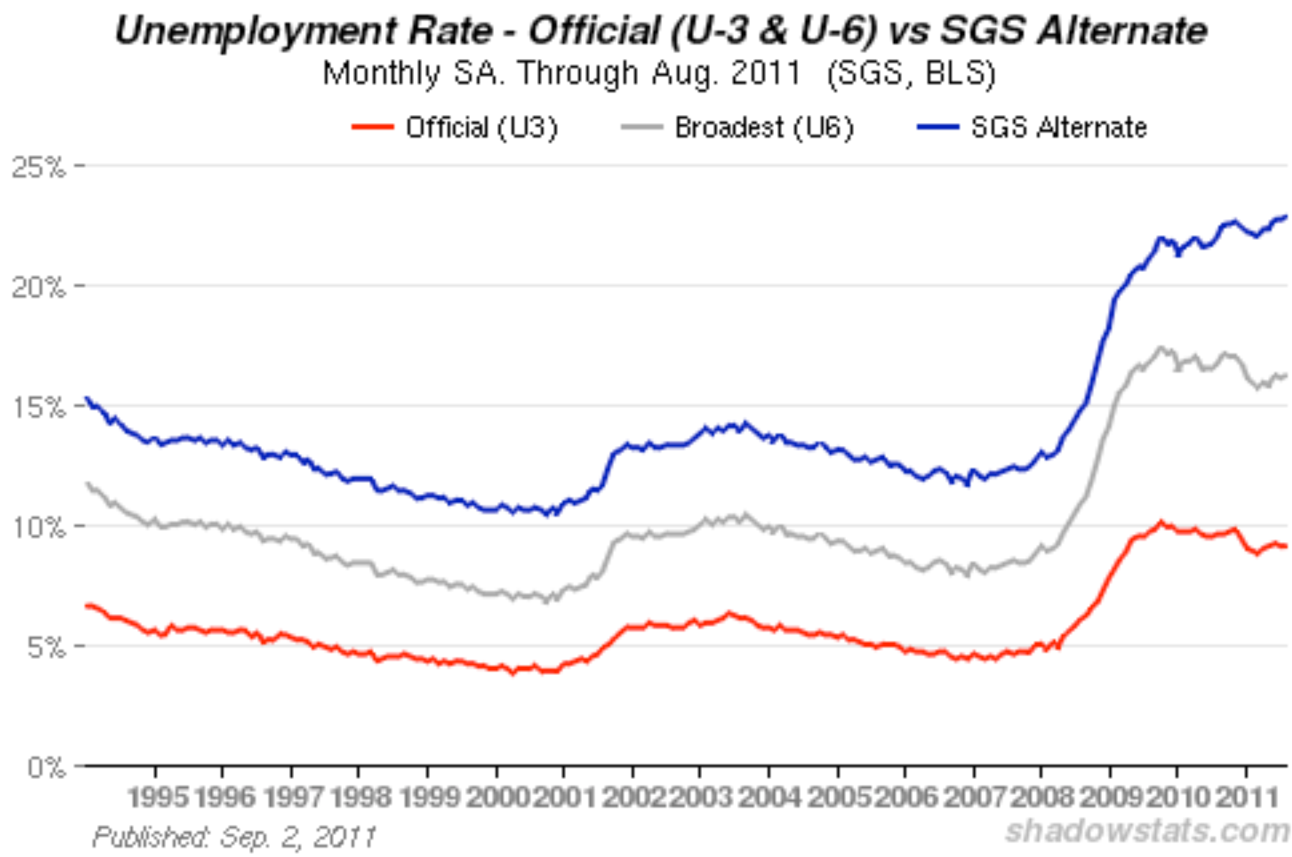
Further, presumed additional "surplus" jobs, created by start-up firms, get added on to the payroll estimates each month as a special add-factor. These add-factors have averaged 40,000 jobs per month over the last 12 months. I still estimate this monthly bias should be negative by roughly 200,000 or so, on average. Since it is not, the BLS overestimates monthly growth in payroll employment by roughly 240,000 jobs. Much of that misreporting was not picked up in the 2010 benchmarking, and now will not be corrected until at least the 2011 benchmark revision. In theory, the pending benchmark revision for March 2011 data (preliminary results to be announced on September 29th, with full details in February 2012) should correct for some of the current, regular monthly overstatement in jobs growth.

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 August 2011 employment gain of 331,000 versus a 38,000 employment drop in July. Issues with seasonal factors still 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 (and particularly of distortions created by census hiring and firing effects from last year), not by the regular and stable seasonal patterns that were in place before the current economic crisis.

The August 2011 seasonally-adjusted headline (U.3) unemployment rate was unchanged, with a statistically-insignificant 0.00 percentage point difference versus July, holding at 9.09% +/- 0.23% (95% confidence interval). Not-seasonally-adjusted, August's U.3 unemployment rate was 9.1%, down from 9.3% in July.

The August U.6 unemployment rate notched higher to a seasonally-adjusted 16.2%, from 16.1% in July. The unadjusted U.6 rate eased to 16.1% in August, from 16.3% in July. 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 higher to 22.8% in August, up from 22.7% in July. 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, an unemployment rate nearing 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%.

Week Ahead. Though still not widely acknowledged, there is both an intensifying double-dip recession and a rapidly escalating inflation problem. Until such time as financial-market expectations fully 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. Generally, previously unreported economic weakness should show up in prior-period revisions.

Trade Balance (July 2011). Due for release on Thursday, September 8th, the July 2011 monthly trade deficit likely continued to widen in both real (inflation-adjusted) and nominal (not adjusted for inflation).

A meaningful swing either way versus second-quarter 2011 reporting would provide some suggestion of the direction of the trade deficit's impact on the third-quarter gross domestic product (GDP) growth estimate (through the net exports account), due for release the end of October. A deteriorating real trade deficit reduces estimated GDP activity.

