

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

COMMENTARY NUMBER 393
September Employment, Unemployment, M3, Special Commentary

October 7, 2011

September Payroll Gain Was Statistically Meaningless
Broadest Government Unemployment Rate Jumped by 0.3% to 16.5%
September Unemployment: 9.1% (U.3), 16.5% (U.6), 23.1% (SGS)
Annual Money Supply M3 Growth Inched Higher in September
Economic and Systemic-Solvency Crises Intensify

PLEASE NOTE: The next regular Commentary is scheduled for Friday, October 14th. It will cover September retail sales and the August trade deficit.

—Best wishes to all, John Williams

SPECIAL COMMENTARY

Do Not Blame Europe. Broad systemic and economic instabilities have been ongoing in the United States for more than three years, and the crises appear headed for a near-term crescendo. All the extreme monetary and fiscal measures taken by the Federal Reserve and the U.S. government in 2008, and later, aimed at preventing a collapse of the U.S. financial system, and ostensibly intended to stimulate the economy, have done little to fix either the banking system or the economy. Sovereign and systemic issues

in the euro area, however, are receiving heavy blame from the Obama administration and some market analysts both for mounting questions on systemic problems and for concerns of an intensifying U.S. economic downturn. The problems, however, always have been primarily U.S.-based and due to domestic economic, monetary and regulatory policies. Blaming the euro area for U.S. problems is little more than a foil aimed at distracting attention from the catastrophic fiscal and Fed-policy issues threatening long-term U.S. solvency and the U.S. dollar.

The U.S. markets have been extraordinarily violent and unstable since the U.S. government demonstrated its inability and unwillingness to control its sovereign finances in early-August 2011. As the dollar entered a tailspin, various actions by governments and financial regulators were undertaken, aimed at quelling the instabilities. The euro crisis suddenly intensified anew (distracting the markets from the great overhanging crisis with the U.S. dollar). Yet, the underlying negative U.S. dollar fundamentals persist and cannot be altered easily. Accordingly, near-term relative U.S. dollar strength against gold, silver and the stronger currencies should prove to be short-lived.

As was established with the 2008 crisis, central banks (primarily the Fed) and various governments (primarily the U.S. government—even though more politically splintered at present) will do whatever is necessary to prevent a collapse of the banking and financial systems. The Fed and the U.S. government still will provide whatever guarantees are needed, whatever money has to be created, spent or loaned out, in order to prevent systemic failure. This includes any sovereign or non-U.S.-bank bailouts required to prevent systemic collapse. The costs of such actions remain inflation or U.S. dollar debasement. They can continue only so long as the global markets allow them, until the U.S. dollar comes under massive, sustained selling pressure.

SYSTEMIC ISSUES. When the Treasury Secretary has to deny vehemently (in response to Congressional questioning) that any major U.S. banks are at risk of failure, systemic instability is beginning to break into the light of day. Per Dow Jones of October 6th: “When asked at a Senate Banking Committee whether the euro-zone sovereign debt crisis could bring down Morgan Stanley or another major financial institution, Geithner said, ‘Absolutely not.’”

Banks generally are not increasing lending. Per the Fed’s recent second-quarter *Flow of Funds* report, total bank credit issued by U.S chartered banks, seasonally-adjusted for second-quarter 2001, was down by 0.8% quarter-quarter, unchanged on an unadjusted basis, and down by 0.4% year-to-year. While there certainly are issues as to credit-worthy borrowers, I contend that the weakness in lending is due more to still-impaired bank balance sheets than to any other factor. As a result, broad money growth remains tepid.

Money Supply M3 (September 2011). Based on roughly three weeks of data, the preliminary estimate of the SGS Ongoing-M3 Estimate for September 2011 will be published in the [Alternate Data](#) section on October 8th. September M3 is on track to show year-to-year growth of about 2.6%, up from 2.4% in August and 2.5% in July. These numbers reflect the latest regular benchmark revisions by the Fed to its money and banking data. The seasonally-adjusted, month-to-month change estimate for M3 likely will be on the plus-side of unchanged, as it was in August and July. The estimated month-to-month M3 changes, however, remain less reliable than the estimates of annual growth.

Similar flattening in the relative monthly estimates of annual growth, as well as in month-to month changes, also is likely for the narrower M1 and M2 measures (M2 includes M1, M3 includes M2). M2 for

September is on track to show year-to-year growth of about 10.1%, versus 10.3% in August, with month-to-month growth estimated at roughly 0.3% in September versus 2.5% in August. The early estimate on M1 for September shows year-to-year growth of roughly 20.0% versus 20.8% in August, with month-to-month growth estimated at roughly 0.6% in September, versus 5.1% in August. The relatively stronger annual growth rates in M1 and M2 reflect the recent shifting of funds out of M3 accounts into M1 and M2 accounts.

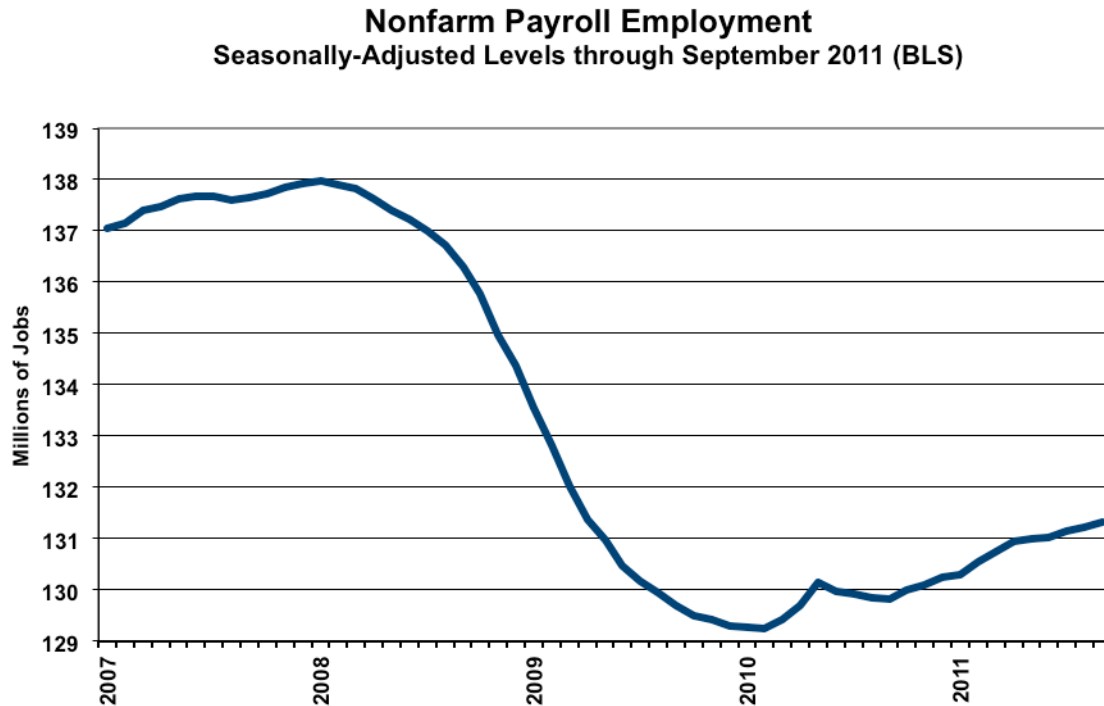
Fed Easing Remains Likely. With ongoing economic and systemic-solvency crises, the Fed remains likely to institute some new form of liquidity injection for the banking system, soon, despite protestations to the contrary. That action, though, should continue under the guise of trying to stimulate the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

U.S. ECONOMY: Employment and Unemployment (September 2011). The stronger-than-expected 103,000 gain reported in September payrolls was, as usual, statistically meaningless. Even with a 45,000 one-time boost from Verizon strikers returning, the 95% statistical confidence interval around the monthly jobs increase allowed for an outright monthly payroll contraction, as well as for monthly growth. Also, as commonly has been the case, changes in seasonal factors, which are recalculated each month, have shifted growth into the current period from revised prior reporting. Those revisions, however, are not published. The overall patterns in payroll employment were little changed, with current payroll levels below where they were 10 years ago.

Also, as usual, the unchanged 9.1% headline U.3 unemployment rate could have reflected a 0.2% increase or decrease, within the official statistical confidence interval. The government's broader U.6 rate, however, jumped to 16.5% in September from 16.3% in August, and the SGS Alternate Unemployment rate rose in tandem to 23.1% from 20.8%. The unemployment rates are heavily skewed by seasonal-adjustment issues, with the resulting adjusted data currently of little meaning.

As can be seen with the U.S. payroll employment data, shown below, the U.S. economy entered a free-fall in late-2007 and then began to flatten-out—bottom-bounce—by late-2009, early-2010. The plot of seasonally-adjusted payroll levels shows a recent slowing of growth 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.

The economic downturn is worsening, fueled as it was in 2007 by structural problems in consumer income, where the average household could not keep its income growing fast enough to cover inflation, and where consumer credit quickly dried up, preventing the use of debt expansion to cover the shortfall in income (see the [Hyperinflation Special Report \(2011\)](#) and [Commentary No. 389](#) for greater detail).



Hyperinflation Watch—Economic and Systemic Solvency Crises Continue to Unfold. Repeated from the prior *Commentaries*, there are no happy solutions available here, only tools—devil’s choices—for the Fed and the U.S. government buying a little extra time. From the Fed’s standpoint, keeping the banking system afloat remains its primary concern, although needs for economic growth and contained inflation will be given as the rationale behind any overt change in policy. The ultimate cost in propping the system, however, remains inflation. The economic and systemic-solvency crises and the broad inflation and economic issues detailed in the [Hyperinflation Special Report \(2011\)](#) and in recent *Commentaries*, continue to unfold with outlooks that remain unchanged.

The root source of current global systemic instabilities largely has been the financially-dominant United States, and it is against the U.S. dollar that the global markets ultimately should turn, massively. The Fed and the U.S. Treasury likely will do whatever has to be done to prevent a euro-area crisis from triggering a systemic collapse in the United States. Accordingly, it is not from a euro-related crisis, but rather from within the U.S. financial system and financial-authority actions that an eventual U.S. systemic failure likely will be triggered, seen initially in a rapidly accelerating pace of domestic inflation—ultimately hyperinflation.

The financial markets still are 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 uncontrollable 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 (SEPTEMBER 2011)

Constant Recalculation of Payroll Seasonal Factors Boosted September Payrolls. The BLS practice of using “concurrent” seasonal-factor adjustments artificially shifted previously reported jobs growth into September 2011, and that resulted in boosting the reported September monthly gain. Also the revised July month-to-month payroll gain was inflated to 107,000, from the 99,000 that would have been seen with consistent reporting.

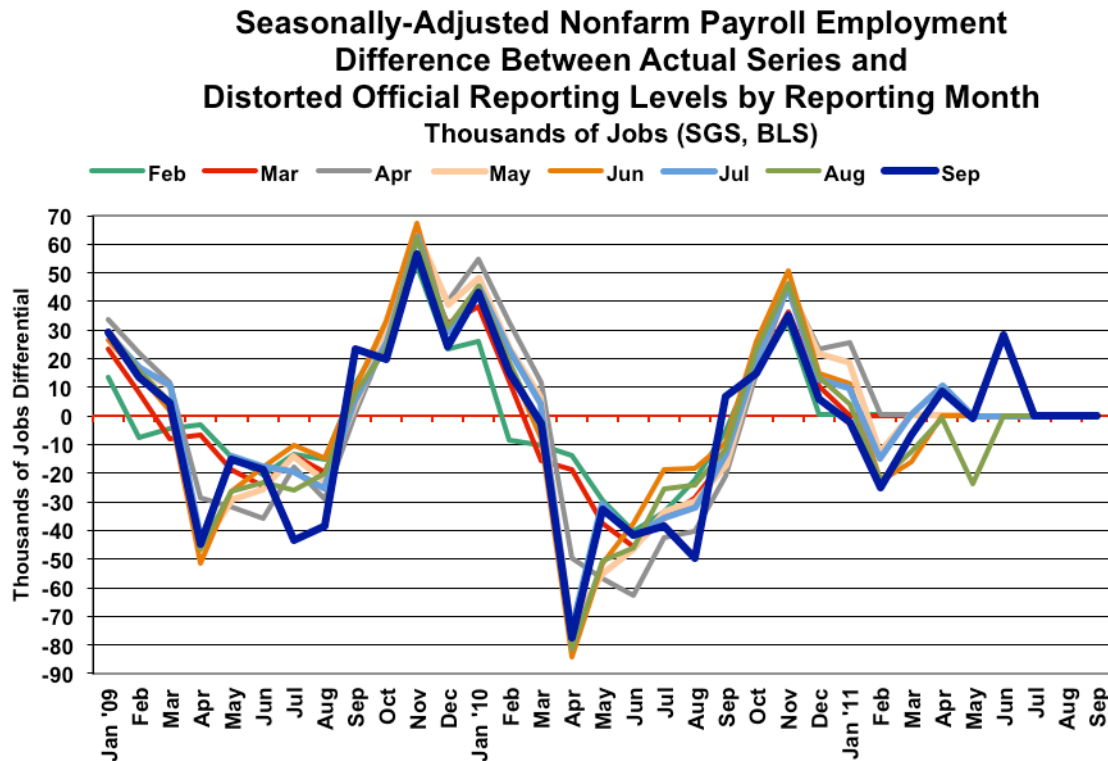
As discussed in prior writings (see the [Hyperinflation Special Report \(2011\)](#), for example), seasonal-factor estimation for most economic series has been distorted severely by the extreme depth and duration of the economic contraction. These distortions are exacerbated for payroll employment data 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 (July and August 2011 with the September 2011 report). Shown in the following graph, the latest “concurrent” seasonal factor changes upped September 2010 (with implied stronger seasonals and a boost for the September 2011 reporting). With just two months of prior reporting shown as revised, the changes pre-July 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 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.

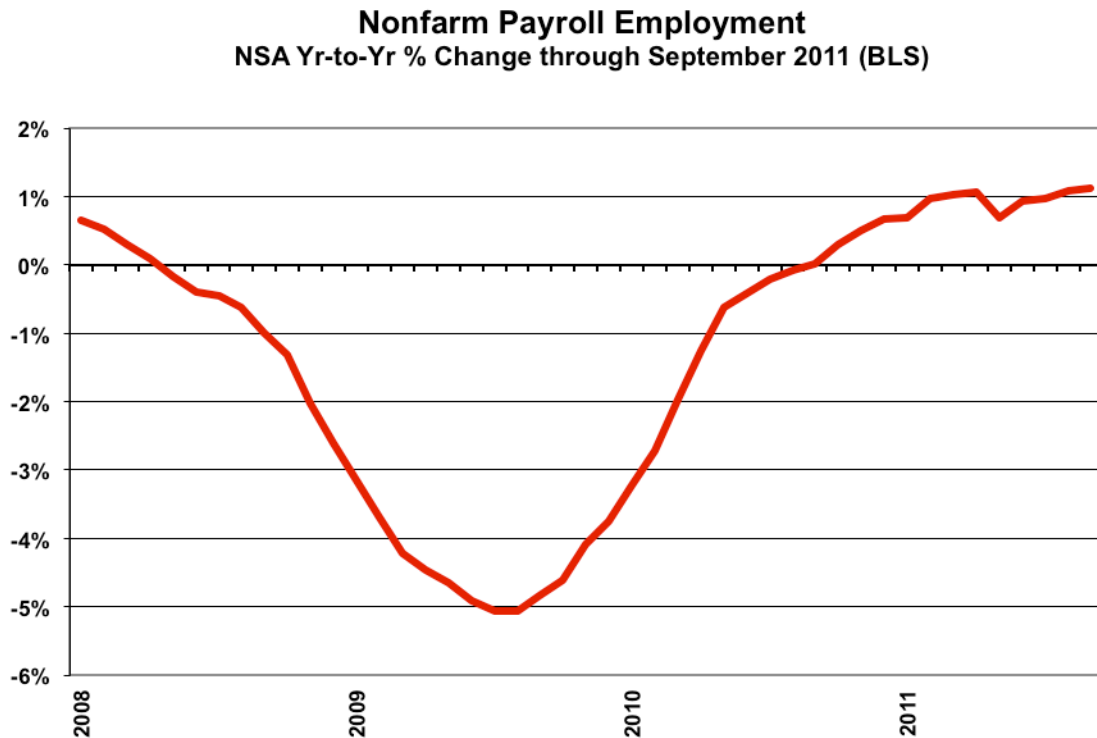


The inconsistency differences in the graph were calculated based on the raw unadjusted data and the seasonal-adjustment program available to the public on the BLS Web site. Using the BLS data, we have calculated the seasonally-adjusted numbers as the BLS should be showing them, as of the current reporting, and the differences between official reporting and the consistent seasonally-adjusted series.

Payroll Survey Detail. The Bureau of Labor Statistics (BLS) reported today (October 7th) a statistically-insignificant, seasonally-adjusted September 2011 month-to-month jobs gain of 103,000 (a gain of 202,000 jobs before prior-period revisions) +/- 129,000 (95% confidence interval). August payrolls showed a revised 57,000 gain (previously unchanged), while July's monthly gain also increased in revision, to 107,000, versus last month's estimate of an 85,000 gain. As noted in the comments on concurrent seasonal adjustment, the revised monthly gain for July really was 99,000, based on the BLS seasonal-factor detail, but revisions for June 2011 and before are not reported by the BLS. Accordingly, the revised "official" July monthly gain was against an unrevised and inconsistent June number.

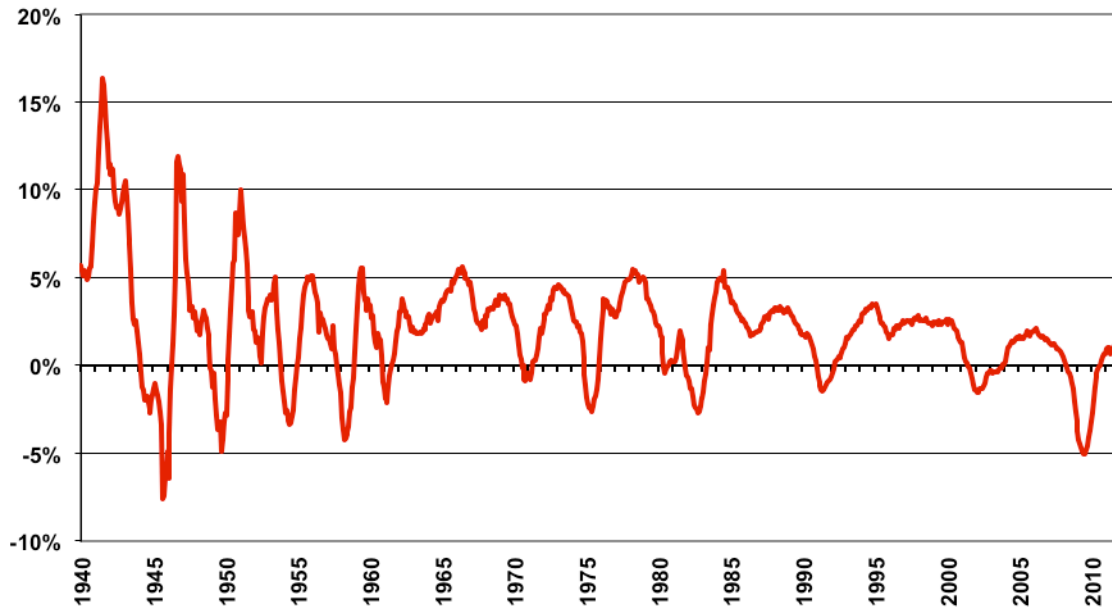
September's monthly gain of 103,000 reflected the return to work of 45,000 striking Verizon workers, reversing downside pressures of same on prior reporting. The estimated level of September's payroll employment still was below the level reported 10 years ago.

In terms of year-to-year change, the unadjusted September 2011 growth rate was at 1.12%, versus the revised 1.09% (previously 0.99%) reported in August, and against 0.97% (previously 0.94%) annual growth reported for July. 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 recent 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.



As shown in the next, 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 Payrolls
NSA Yr-to-Yr % Change through September 2011 (BLS)



The regular graph of seasonally-adjusted payroll levels is shown in the *Special Commentary* section.

Payroll Benchmark Revision. On September 29th, the BLS published a preliminary upside benchmark revision to March 2011 unadjusted nonfarm payrolls. The estimated 192,000 positive revision suggests there was a monthly-average understatement of 16,000 jobs in the period from April 2010 to March 2011. Reporting history will not be revised until the February 2012 release of the January 2012 payrolls. The relatively small preliminary upside revision follows three consecutive larger downside annual revisions, and it should not affect current reporting. In the final accounting, the BLS will distribute the revision going back a year from the March 2011, as well as carrying forward a relatively more positive monthly reporting through January 2012.

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—the BLS generally has upped its monthly biases in post-benchmark reporting. Reversing patterns, in the wake of the upside benchmark preliminary revision for March 2011 (see previous section), however, the monthly bias used in September 2011 was a more-negative subtraction of 43,000 jobs, versus a 25,000 subtraction in September 2010. That followed an add factor for August 2011 of 87,000 jobs, somewhat less positive than the 91,000 monthly upside bias used in August 2010. The net aggregate annual upside biases used at present, however, still well exceed the 192,000 tentative upside benchmark revision and remain suggestive of ongoing instabilities in the Birth-Death Model.

The aggregated upside annual bias 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 have averaged 40,000 jobs per month over the last 12 months. I still estimate this monthly bias should be significantly on the negative side, on average, but I am re-assessing the 200,000 negative bias estimate based on updated survey information. I do not expect a significant change in the estimate and will update it in a future *Commentary*. I do expect a significant downside benchmark revision for next year (March 2012), given current details of the BLS's happy estimates.

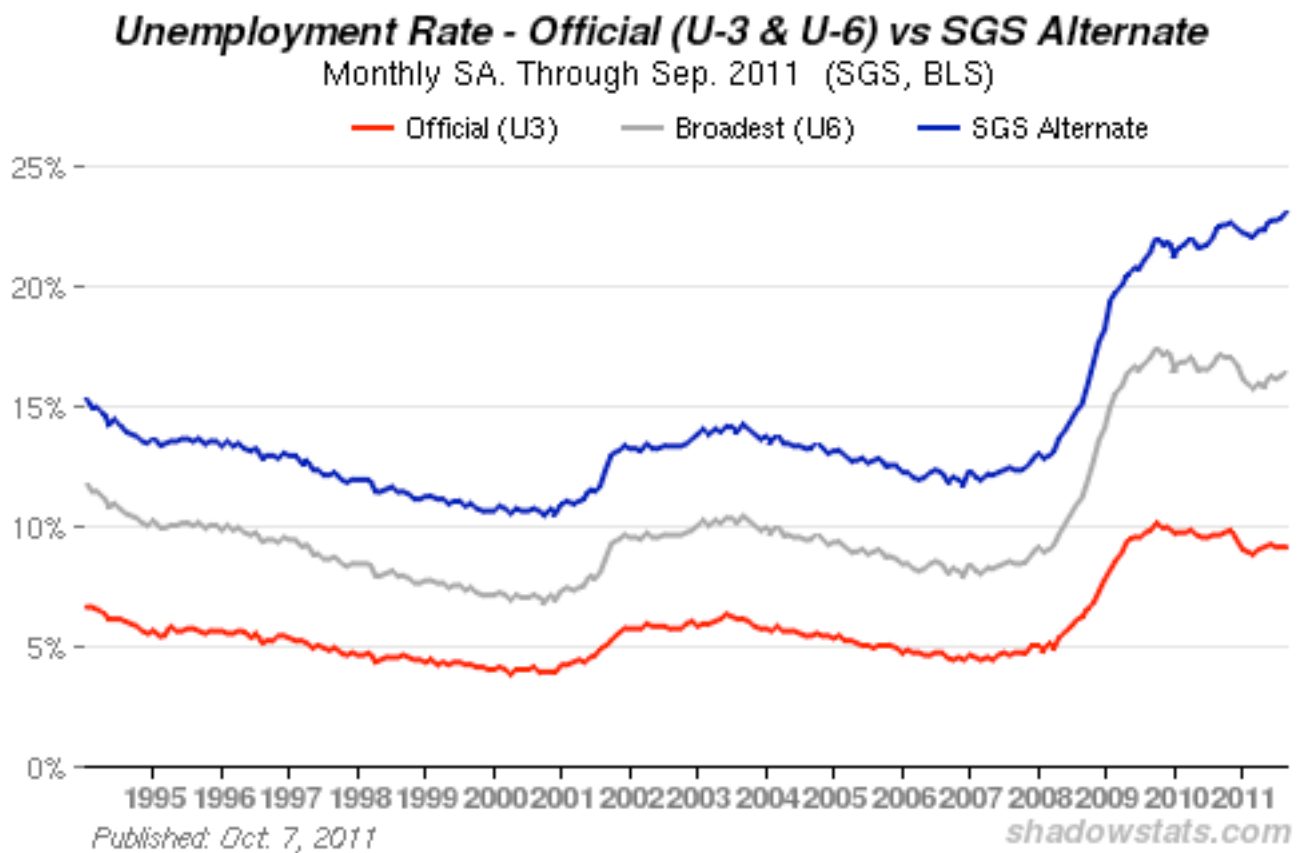
Household Survey. The usually statistically-sounder household survey, which counts the number of people with jobs, as opposed to the payroll survey that counts the number of jobs (counting multiple job holders more than once), showed a September 2011 employment gain of 398,000 versus a 331,000 gain in August and a 38,000 decline in July. Issues with seasonal factors still meaningfully 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 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 last year's census hiring and firing effects), not by the regular and stable seasonal patterns that were in place before the current economic crisis.

The September 2011 seasonally-adjusted headline (U.3) unemployment rate was virtually unchanged for a second month, with a statistically-insignificant 0.01 percentage point decline to 9.08% +/- 0.23% (95% confidence interval), versus 9.09% both August and July. Not-seasonally-adjusted, September's U.3 unemployment rate was 8.8%, down from 9.1% in August and 9.3% in July.

The September U.6 unemployment rate jumped to a seasonally-adjusted 16.5%, from 16.2% in August and 16.1% in July. The unadjusted U.6 rate eased to 15.7% in September, down from 16.1% in August and 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—rose to 23.1% in September, up from 22.8% in August and 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 near 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 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%.

Week Ahead. Although still not fully acknowledged, there is both an intensifying double-dip recession and an 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.

U.S. Trade Balance (August). The August trade deficit is due for release on Thursday, October 13th. The general trend here should remain one of general deterioration against recent month-to-month volatility, with reporting risk favoring greater trade deficit widening than likely will be estimated by consensus. The August report will be the last one available to the Bureau of Economic Analysis (BEA) for its first guess at third-quarter GDP. Accordingly, a much worse-than-expected deterioration in the deficit would be suggestive of weaker third-quarter growth than had been suggested by initial improved July trade reporting, and vice versa.

Retail Sales (September). The first estimate of September retail is scheduled for Friday, October 14th. Risk remains to the downside of a likely positive consensus outlook. As generally has been the case year-to-date, any reported monthly growth likely will be flat-to-negative after accounting for September's consumer price inflation.
