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

COMMENTARY NUMBER 397
October Employment and Unemployment

November 4, 2011

Monthly Payroll and Unemployment Changes Were Not Statistically Meaningful

October Payroll Employment Not Only Was 6.5 Million Below the Pre-2007 Recession High, But Also Was 1.0 Million Below the Pre-2001 Recession High

October Unemployment: 9.0% (U.3), 16.2% (U.6), 22.9% (SGS)

Annual Growth in October Money Supply M3 Held at About 2.6%

PLEASE NOTE: The next regular Commentary *is scheduled for Thursday, November 10th. It will cover reporting of the September 2011 trade balance.*

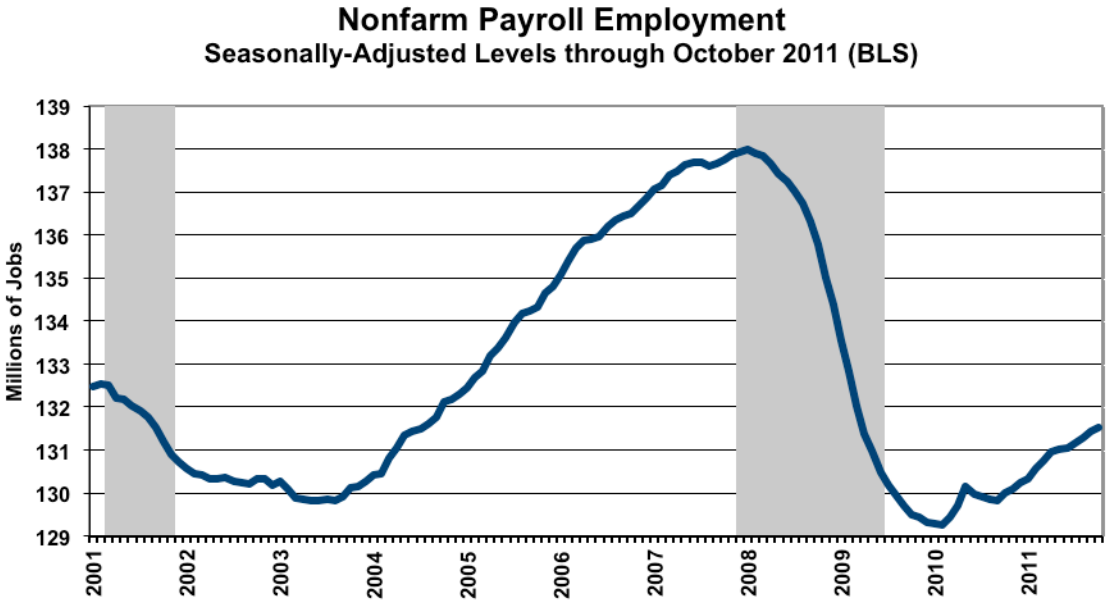
—Best wishes to all, John Williams

Opening Comments and Executive Summary. The U.S. economy remains deep in a severe contraction, experiencing a protracted period of bottom-bouncing that followed the sharpest decline in business activity seen since the Great Depression. Economic series that have shown any marked upside bounce reflect little more than understated inflation used in deflating such series (use of understated inflation results in overstated inflation-adjusted growth) and/or the transient effects of government stimulus efforts. As discussed in the prior *Commentary No. 396*, rather than using the heavily biased and politicized GDP numbers for guidance on broad economic activity, series such as payroll employment give a much more stable and meaningful picture of general business activity. This is despite numerous

problems with payroll employment reporting, which are discussed in the appropriate sections. How can the economy be healthy and expanding when current payrolls are below where they were coming into the 2001 recession?

Contrary to popular hype, employment is a coincident, not a lagging, economic indicator. Traditionally, it was deemed coincident in the government's leading, coincident and lagging indicator series, and it is used by the National Bureau of Economic Research (NBER) to time the monthly onset of a recession. Employment has been mislabeled as a lagging indicator in the last decade or two, because the NBER called ends to the last two recessions well before those downturns ended. Those miscalls resulted from evolving methodological understatement of inflation and resulting reporting distortions in various series.

That said, consider that on a seasonally-adjusted basis, nonfarm payrolls for October 2011 stood at 131.516 million. That was 6.5 million below the pre-2007 recession high of 137.996 million (January 2008). It also was 1.0 million below the pre-2001 recession high of 132.530 million (February 2001). The series shows the economic plunge in 2008 and 2009 and the ongoing bottom-bouncing thereafter. Despite the 192,000 upside benchmark estimated by the Bureau of Labor Statistics (BLS) for March 2011, later revisions likely will eliminate the gentle upside slope seen in current reporting. The small spike in 2010 was due to temporary hiring (and reversal of same) related to conducting the 2010 census.



Employment and Unemployment (October 2011). Neither October's headline 80,000 monthly jobs gain, nor the headline decline in unemployment to 9.0% from September's 9.1%, were statistically meaningful. The reported 80,000 employment increase also is more than accounted for by what appears to have be an upside shift in the monthly Birth-Death Model add-factors of 50,000 jobs per month, on top of major job shifting between periods due to the ongoing concurrent seasonal factor distortions.

The headline seasonally-adjusted October U.3 unemployment rate of 9.0% was against 9.1% in September, and U.6 was 16.2% in October versus 16.5% in September. The SGS-Alternate Unemployment Measure was 22.9% in October versus 23.1% in September, declining less than U.6, as more unemployed continued rolling out of the short-term discouraged worker status in U.6 into the long-term discouraged worker status in the SGS estimate.

Hyperinflation Watch—Economic Woes Threaten Systemic Stability. With the economy in ongoing crisis and with no prospects of a turnaround in the foreseeable future, the implications for the federal budget deficit, U.S. Treasury funding needs and prospective banking-system stability, in the year and years ahead, are horrendous. The current, relatively happy forecasts for each of those areas are based on assumptions of solid economic growth going forward. That growth simply will not be forthcoming.

Money Supply M3 (October 2011). Bank lending remains impaired and broad money growth is not picking up as it would with a healthy banking system. Based on roughly three weeks of data, the preliminary estimate of the SGS Ongoing-M3 Estimate for October 2011 will be published in the Alternate Data section on November 5th. October M3 is on track to show year-to-year growth of about 2.6%, the same level as in September and still below the official rate of CPI inflation. These numbers reflect the latest 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 minus-side of unchanged, which would be the first monthly decline since January 2011. The estimated month-to-month M3 changes, however, remain less reliable than the estimates of annual growth.

A flattening in the relative monthly estimates of annual growth, and slowing month-to month gains, also are likely for the narrower M1 and M2 measures (M2 includes M1, M3 includes M2). M2 for October is on track to show year-to-year growth of about 9.9%, versus 10.0% in September, with month-to-month growth estimated at roughly 0.3% in October versus 0.5% in September. The early estimate on M1 for October shows year-to-year growth of roughly 20.6%, the same level as in September, with month-to-month growth estimated at roughly 0.5% in October, versus 1.2% in September. The relatively stronger annual growth rates in M1 and M2 still reflect the recent shifting of funds out of M3 accounts into M1 and M2 accounts.

Broad Systemic, Economic and Inflation Outlooks Are Unchanged. The markets remain unstable and highly volatile, with the financial system still vulnerable to potential negative surprises in areas ranging from economic data to domestic and global political instabilities.

Repeated from the prior *Commentaries*, there are no happy solutions available here to remedy the crises, only tools—devil's choices—for the Fed and the U.S. government to buy 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 crises in the euro-area 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 instability. For those living in a U.S. dollar-denominated world, regardless of any ongoing 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 may 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, spend, loan or guarantee whatever money is needed; with the U.S. dollar at increasing risk of losing its global reserve currency status; much higher inflation lies ahead, in a circumstance that rapidly could evolve into hyperinflation.

REPORTING DETAIL

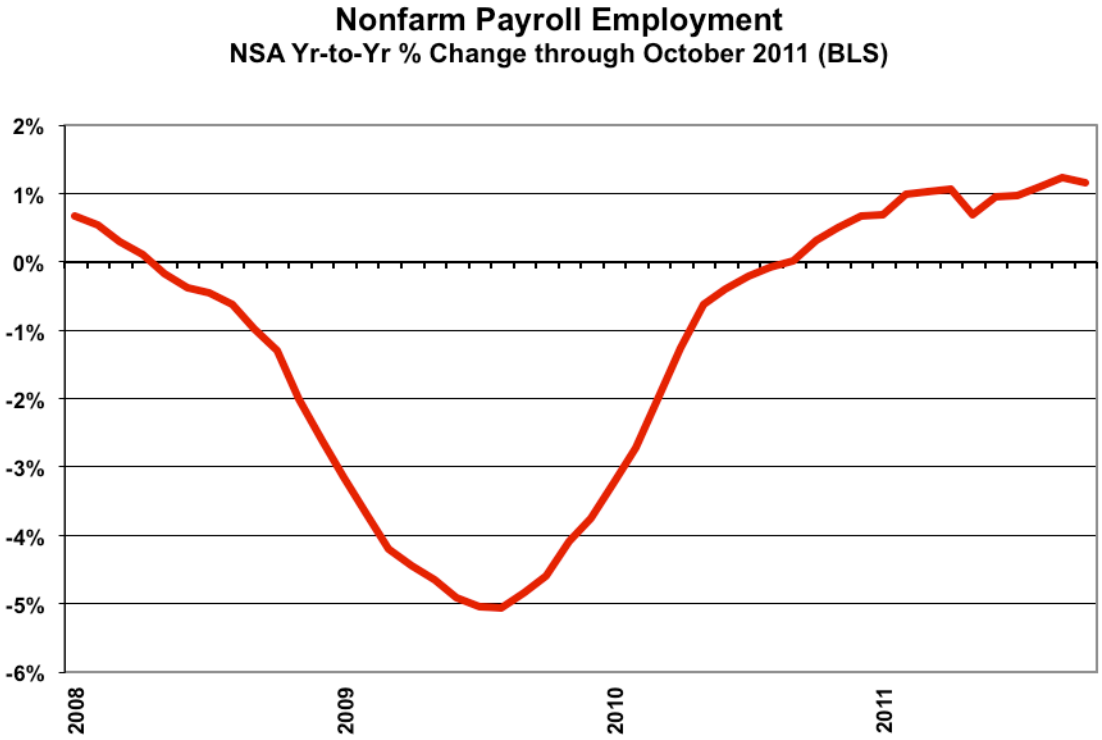
EMPLOYMENT AND UNEMPLOYMENT (October 2011)

Constant Recalculation of Payroll Seasonal Factors Is Boosting 2011 Payrolls. The Bureau of Labor Statistics' (BLS) practice of using "concurrent" seasonal-factor adjustments artificially shifted previously reported jobs into October 2011 and contributed to boosting the reported monthly gain versus September. Net of that and an upswing of 50,000 jobs in the adjusted monthly Birth-Death Model add-factor for October, monthly payroll change would have been on the downside of "unchanged," instead of plus 80,000, but that still would have had a 95% confidence interval around it of plus-or-minus 129,000 jobs.

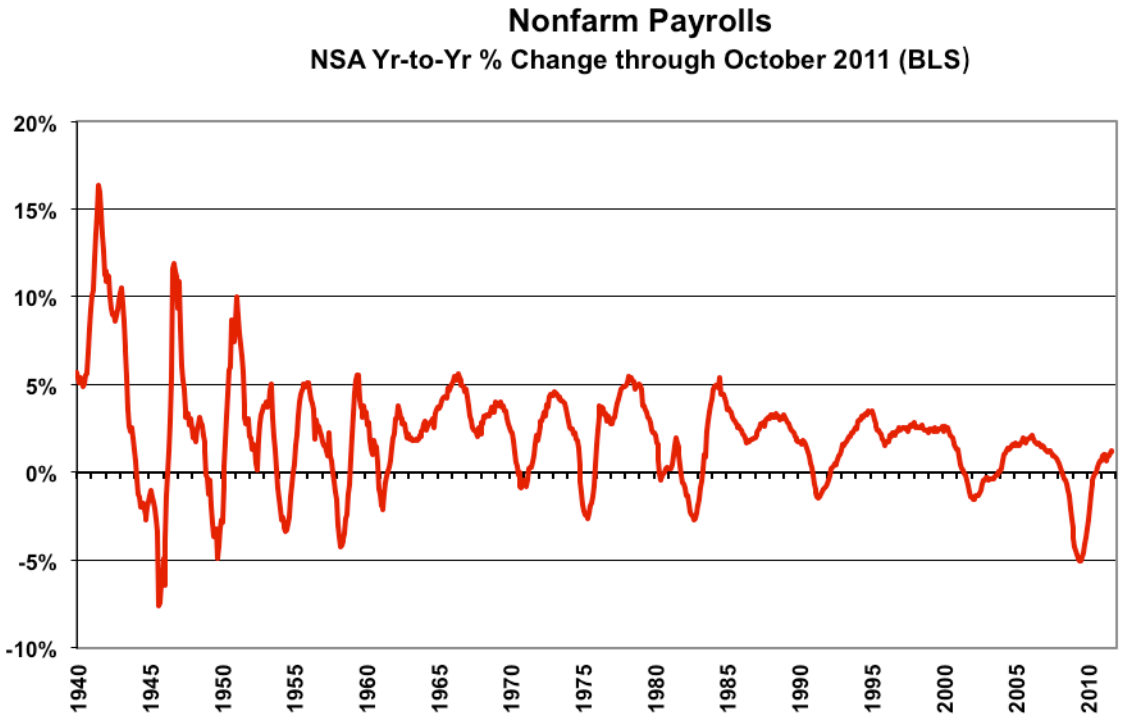
Heavily distorted seasonal factors, and the plus-or-minus 0.23% confidence interval around the 0.07% easing in the unemployment rate, left the rounded 0.1% headline drop in unemployment as meaningless as the reported 80,000 jobs gain in October.

PAYROLL SURVEY DETAIL. The BLS reported today (November 4th) a statistically-insignificant, seasonally-adjusted October 2011 month-to-month jobs gain of 80,000 (a gain of 182,000 jobs before prior-period revisions) +/- 129,000 (95% confidence interval). September payrolls showed a revised 158,000 gain (previously a gain of 103,000), while August's monthly gain revised to 104,000, versus last month's estimate of a 57,000 gain. Monthly changes for July 2011 and before also were revised, but those revisions were not reported by the BLS so as to avoid confusing payroll employment data users.

In terms of year-to-year change, the unadjusted October 2011 growth rate slowed minimally to 1.15% versus the revised 1.23% (previously 1.12%) reported for September, and against 1.11% (previously 1.09%) annual growth reported for August. 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.

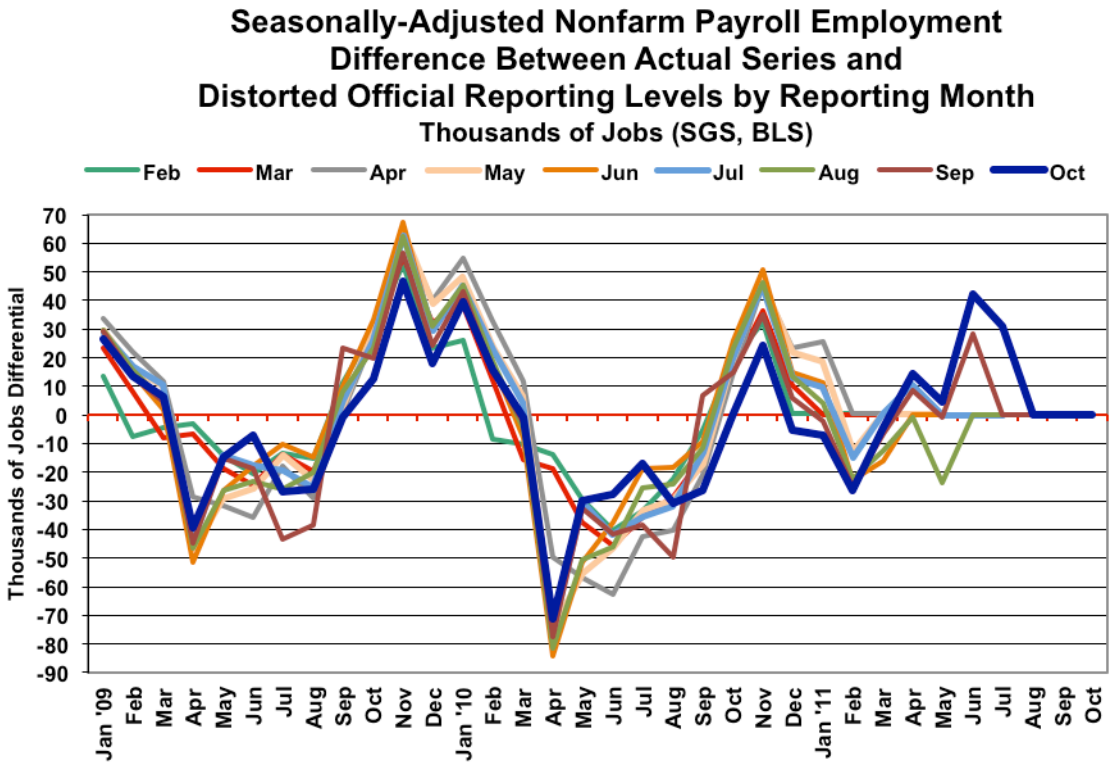


The regular graph of seasonally-adjusted payroll levels is shown in the *Opening Comments and Executive Summary* section.

Concurrent Seasonal Factor Distortions. 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.

Where 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 (August and September 2011 with the October 2011 report). Shown in the following graph, the latest "concurrent" seasonal factor changes upped October 2010 relative to September 2010, with implied greater adjusted gain for October 2011.

Clearly seen in the most recent plot (heavy blue line) is a shifting of reported seasonally-adjusted jobs from 2010 into 2011. With just two months of prior reporting shown as revised in the official BLS release, pre-August 2011 revisions were not published so as to avoid "confusing" people using 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.

A further 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 Benchmark Revision and Gimmicked Upside Biases. Where, traditionally, the BLS does not adjust payroll reporting for the annual benchmark revisions before the January release of the following

year, the Birth-Death Model appears to have been adjusted for the quarter beginning October 2011, so as to add an additional 50,000 jobs per month (600,000) per year to compensate for the pending 192,000 annual benchmark revision (see next section). On September 29th, the BLS published a preliminary upside benchmark estimate for March 2011 unadjusted nonfarm payrolls. The announced192,000 positive revision suggested there had been a monthly-average understatement of 16,000 jobs in the period from April 2010 to March 2011. Official reporting history will not be revised until the February 2012 release of the January 2012 payrolls.

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 nonetheless generally upped its monthly biases in post-benchmark reportings of recent years. In the wake of the purported upside benchmark preliminary revision for March 2011 (see previous section), the monthly bias factor used in October 2011—the first month of fourth-quarter reporting—was revamped to a more-positive monthly add-factor of 102,000 than the 71,000 used in October 2010. That followed a more-negative subtraction of of 43,000 jobs for September 2011, versus a 25,000 subtraction in September 2010. The resulting monthly swing of 50,000 jobs—an upswing of 600,000 annual jobs—substantially over-compensates for the purported 192,000 upside benchmark revision.

The aggregated upside annual bias reflects 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 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 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, 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 and appear now to have been upped to about 90,000 jobs per month. With the economy continuing to falter, I expect a significant downside benchmark revision for next year (March 2012), given current details of the BLS's happy estimates.

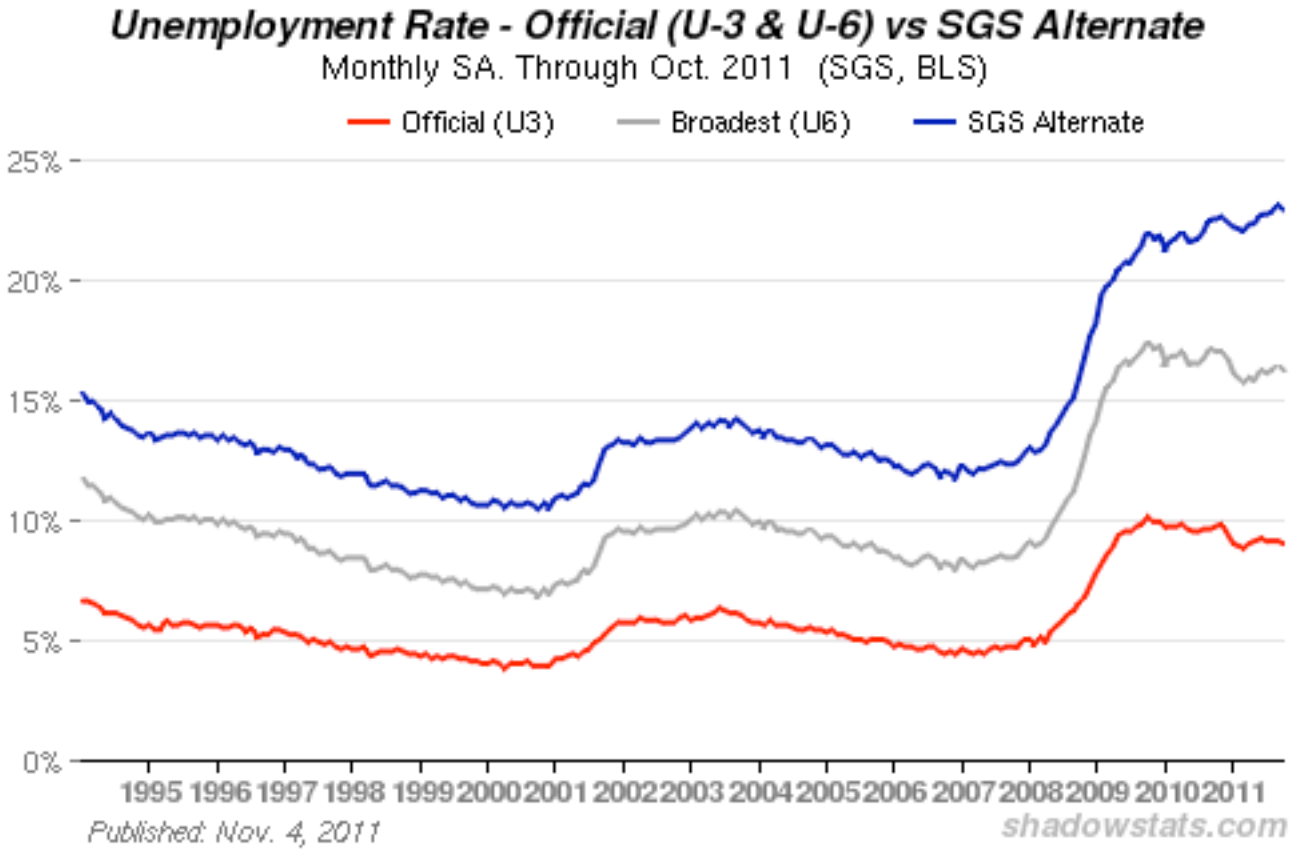
HOUSEHOLD SURVEY DETAILS. The usually statistically-sounder household survey, which counts the number of people with jobs, as opposed to the payroll survey that counts the number of jobs (counting multiple job holders more than once), showed a October 2011 employment gain of 277,000 versus a 398,000 gain in September. Severe issues with monthly 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 reported October 2011 seasonally-adjusted headline (U.3) unemployment rate was little changed, with a statistically-insignificant 0.07 percentage point decline to 9.01% +/- 0.23% (95% confidence interval), from 9.08% in September. Not-seasonally-adjusted, October's U.3 unemployment rate was 8.5%, down from 8.8% in September.

Also heavily skewed by the seasonals, the October U.6 unemployment rate fell to a seasonally-adjusted 16.2% from 16.5% in September. The unadjusted U.6 rate declined to 15.3% in October from 15.7% 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 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—eased to 22.9% in October from 23.1% in September. 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.

Nonetheless, there has been a noticeable divergence in the SGS series versus U.6. The reason for this is that U.6, again, only includes discouraged workers who have been discouraged for less than a year. As the discouraged worker status ages, those that go beyond one year fall off the government counting, as new workers enter "discouraged" status. Accordingly, with the continual rollover, the discouraged workers counted in U.6 continue are not changing much in aggregate, at present, but the long-term discouraged worker component in the SGS estimate continues to increase, as few of those that have dropped out of U.6 are gaining active employment. 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 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. 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 (September). The September monthly trade deficit is due for release on Thursday, November 10th. The general trend here should remain one of deterioration, with reporting risk favoring greater trade deficit widening than likely will be estimated by consensus forecasters. A significant variation against consensus expectation would have implications for the first-revision to third-quarter GDP (due for release on November 22nd), since the September numbers will complete the otherwise guesstimated third-quarter trade data currently used in the GDP estimate. A much worse-than-expected deterioration in the deficit, for example would be indicative of a downward revision to estimated third-quarter GDP growth, and vice versa.

