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

COMMENTARY NUMBER 328
September Employment and Unemployment, M3

October 8, 2010

Outright Contraction in September Payrolls
Net of Temporary Census Workers

Current Payroll Level Overstated by Roughly 550,000
Based on Announced Benchmark Revision

Broad Unemployment Rates Soar

September Unemployment Rates:
U.3 at 9.6%, U.6 at 17.1%, SGS at 22.5%

M3 Annual Decline Narrows

PLEASE NOTE: The next regular Commentary *is scheduled for Friday, October 15th, following the release of the September CPI and Retail Sales releases, including analysis of September PPI and August Trade data, as well as a review of the inflation and systemic-liquidity outlooks.*

-- Best wishes to all, John Williams

September Payrolls Suggest Weaker Data Ahead. On its surface, the September employment report was miserable. Monthly payrolls showed an outright contraction both before and after consideration of the census-worker layoffs. With published revisions and the announcement of revisions to come, the report was horrendous, showing the economy to be in renewed contraction, and showing that economic activity has been overstated during the last year and a half. Consistent with today's reporting, weaker-than-expected data likely are ahead for other September reporting, such as retail sales, industrial production and housing starts.

As discussed in *Special Commentary No. 323*, this intensified downturn should lead to extreme stimulus and liquidity actions by the U.S. government and the Federal Reserve. Fear of same at least partially is driving market activity pushing the U.S. dollar towards historic lows and the price of gold to historic highs. Though possibly a little early for such, next week's inflation reporting could begin to offer some upside surprises. This will be discussed more fully in the next *Commentary*.

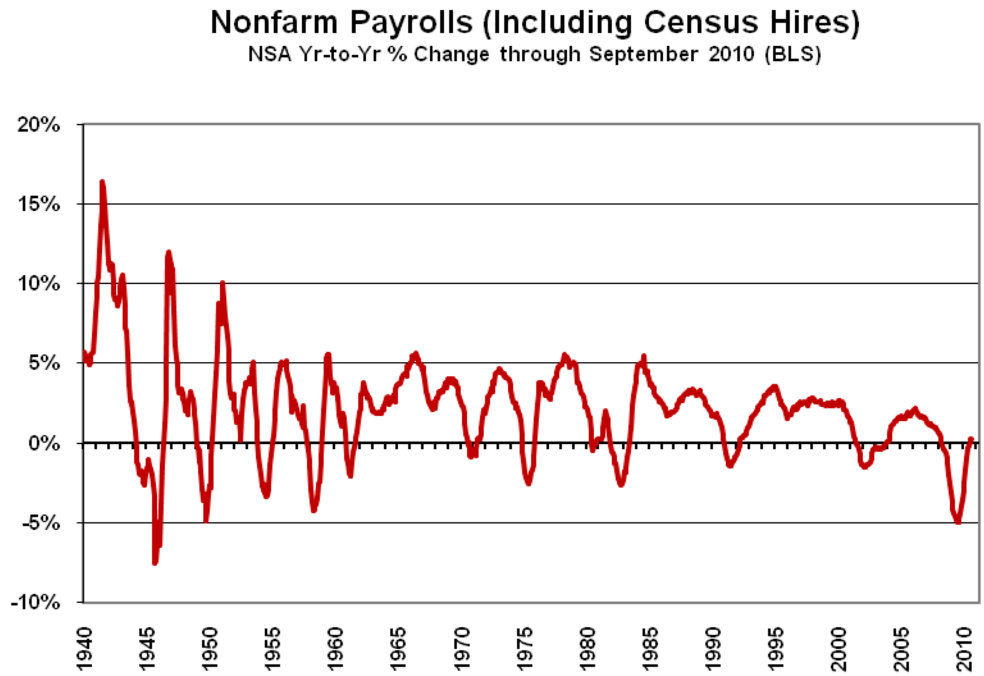
Payroll Survey. The BLS reported today (October 8th) a statistically-insignificant, seasonally-adjusted September 2010 jobs loss of 95,000 (a decline of 110,000 before prior-period revisions) +/- 129,000 (95% confidence interval). Net of the included layoffs of 77,000 intermittent and temporary census hires, September payrolls lost a statistically-insignificant 18,000 jobs. The Wall Street canard of looking just at private employment -- without considering regular gains and losses in the government sector -- showed a gain in private-sector payrolls of 64,000 for the month, which was swamped by 82,000 regular jobs lost at the government (76,000 lost at the local government level), leaving the total payroll decline at 18,000, net of census distortions.

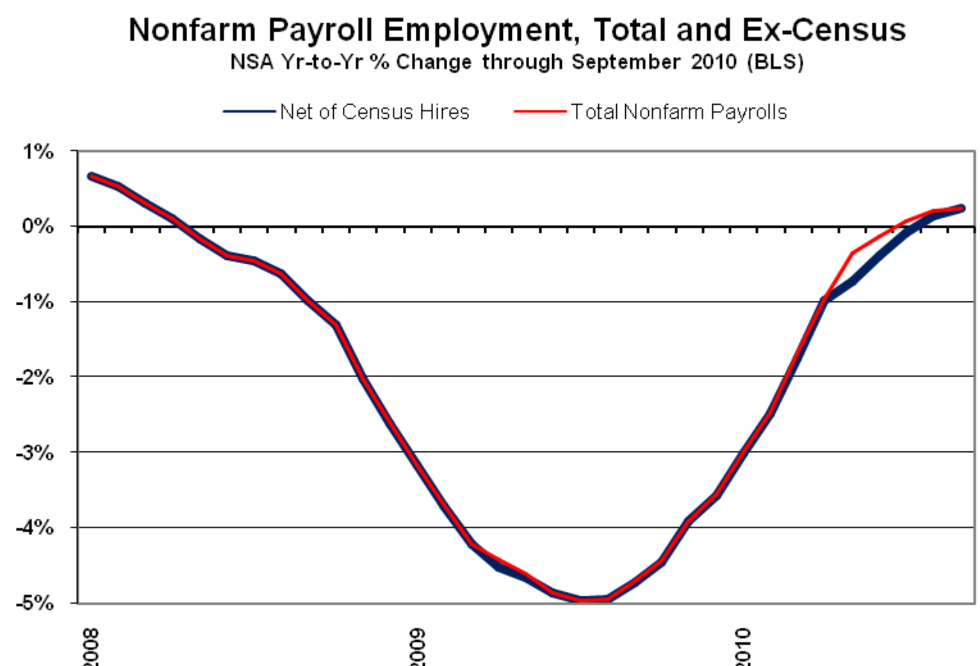
Against September's total jobs loss of 95,000, a jobs loss net of census impact of 18,000, a jobs gain of 64,000 in the private sector, and a jobs loss of 82,000 in the government sector (net of census), August showed a revised monthly total jobs loss of 57,000 (previously a loss of 54,000), a jobs gain net of census impact of 57,000 (previously a gain of 60,000), a jobs gain in the private sector of 97,000 (previously a 67,000 gain), and loss of 36,000 in government, ex-census (previously a 7,000 loss).

As of the September payroll survey, the number of temporary census workers still facing lay-offs was down to 6,000. This factor effectively has worked its way out of the employment data, with no likely further major impact in the months ahead.

From peak-to-trough (the peak month was December 2007; December 2009 is the short-lived trough of the current cycle), payroll employment declined by a seasonally-adjusted 8,363,000 jobs, or 6.1%. As of September 2010 reporting, net of temporary census hiring, payrolls have gained 0.5% or 613,000 jobs since the December 2009 trough. That trough, though, will shift into 2010 with the upcoming benchmark revision, discussed below.

In terms of annual change, year-to-year growth in September nonfarm payrolls was 0.25% (0.25% net of surviving census hires), up from August's revised 0.20% gain (previously a 0.21% gain), and a revised 0.14% (previously 0.15%) annual gain for August net of census effects. Net of likely benchmark revisions, annual change was a small contraction both before and after census effects.


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

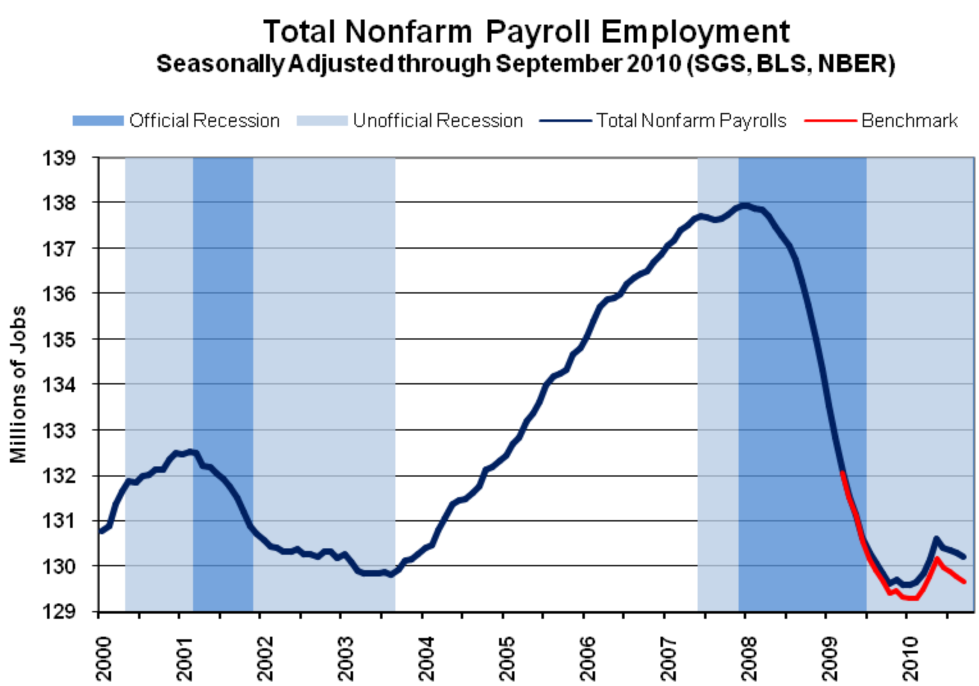

Nonfarm Payroll Employment, Total and Ex-Census
NSA Yr-to-Yr % Change through September 2010 (BLS)
Net of Census Hires
Total Nonfarm Payrolls
1%
0%
-1%
-2%
-3%
-4%
-5%
2008
2009
2010

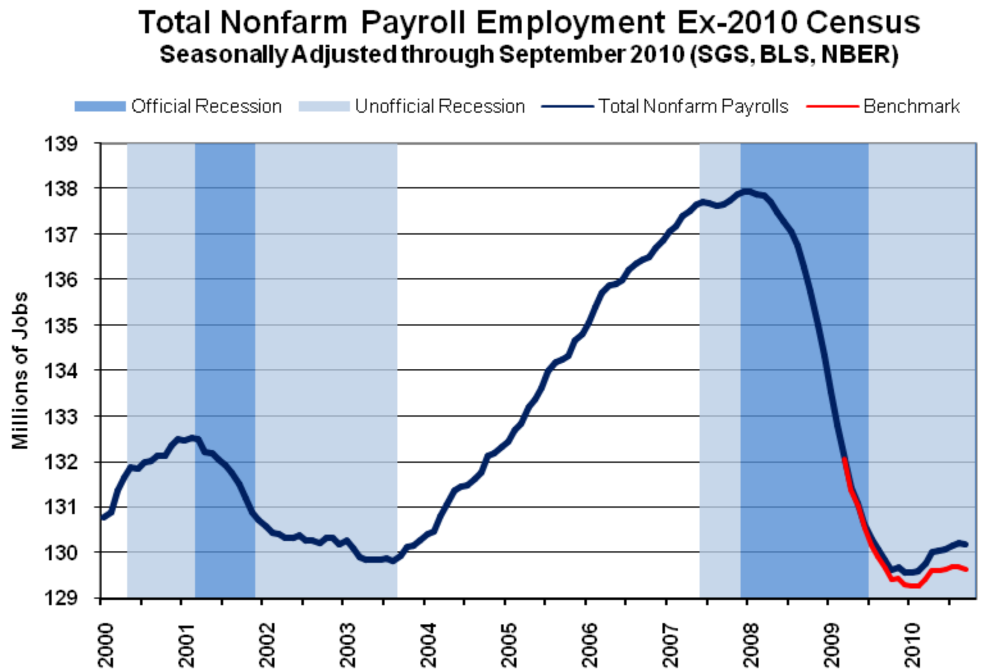
Thanks to recent, protracted bottom-bouncing in the payroll series (see the benchmark-level graphs that follow), current annual growth has recovered from the post-World War II record 4.96% decline in July 2009. The July 2009 decline was the most severe annual contraction seen since the production shutdown at the end of World War II, which reflected a trough of a 7.59% annual contraction in September 1945. Disallowing the post-war shutdown as a normal business cycle, the current annual decline remains the worst since the Great Depression, and should deepen further net of the pending benchmark revision.

The preceding graph of long-term year-to-year payroll change reflects the numbers as reported, with no adjustment for census hiring variations or the pending benchmark revision. The second graph shows the year-to-year detail both with and without the census hires, but also without benchmark considerations.

Benchmark Revision -- About Minus 550,000 and Counting. Announced along with today's payroll release was an early estimate for the 2010 benchmark revision, which indicated the not-seasonally-adjusted March 2010 payrolls were overstated by 366,000. As the data are re-worked for that estimate, changes will be carried back to the prior revision as of March 2009, as well as carried forward to present reporting. Such suggests that the overstatement of the level of payrolls as of September 2010 reporting is about 550,000 jobs. The formal benchmark revision and restated economic history will be published with the January 2011 employment report, due for release on February 4, 2011.

The following two graphs reflect the likely impact of the benchmark. The second graph, which also has the temporary effects of the census hires removed, shows the benchmarked economy turning lower, following a sharp plunge, bottom bouncing, and short-lived stimulus impact. It also helps to make the case that the National Bureau of Economic Research (NBER) was too early, again, in calling the end of a recession, as discussed in *Commentary No. 326*.





Birth-Death/Bias Factor Adjustment. Where the BLS cannot measure the impact of jobs loss and jobs creation from employers starting up or going out of business, on a timely basis (within at least five years, if ever), such information is estimated by the Birth-Death Model. Unusual birth-death activity continued in September 2010, with the monthly birth-death adjustment adding 11,000 more jobs than it did in September 2009, a pattern that continues to run contrary to the 2009 BLS reporting difficulties that understated declines in payroll employment, and by today's indications of still further downside benchmark revisions for 2010 data.

Based now on the unsupportable assumption of economic recovery, the bias factors used in the last six months of payroll reporting have been 28.0% ahead of what they were reset to after the most recent and disastrous 2009 benchmark revision. 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.

Historically, the Birth-Death Model biases have tended to overstate payroll employment levels -- to understate employment declines -- during recessions. The unsupportable premise that jobs created by start-up companies in this downturn have more than offset jobs lost by companies going out of business, continues. So, if a company fails to report its payrolls because it has gone out of business, the BLS assumes it still has its previously-reported employees and adjusts those numbers for the trend in the company's industry.

Further, presumed additional "surplus" jobs, created by start-up firms, get added on to the payroll estimates each month as a special add-factor. These add-factors are running at about 50,000 per month (seasonally-adjusted), at present. I still estimate this monthly bias should be negative by 200,000 or so, on average. Since it is not, the BLS continues regularly to overestimate monthly growth in payroll employment by roughly 250,000 jobs. Most of that misreporting, however, now will not be corrected until at least the benchmark revision to be published in February 2012.

That said, the unadjusted September 2010 bias was a monthly addition of 11,000 jobs, versus no addition in September 2009, and against a monthly addition of 115,000 jobs in August 2010.

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 seasonally-adjusted monthly employment gain of 141,000 in September, following a reported gain of 290,000 in August. As has been discussed in the last several months of household reporting, the series still appears to be experiencing distortions from inappropriate seasonal-adjustments for temporary census worker employment. In the payroll survey, the census impact is quantified and properly is not seasonally adjusted.

Broad Unemployment Measures Surge. The September 2010 seasonally-adjusted headline (U.3) unemployment rate eased by a statistically-insignificant 0.06 percentage point to 9.58% +/- 0.23% (95% confidence interval), from 9.64% in August. Not seasonally adjusted, September's U.3 unemployment rate declined to 9.2% from 9.5% in August.

Increasing numbers of longer-term unemployed, previously counted in U.3 unemployment, appear to be rolling into the short-term discouraged worker category, with a portion of the short-term discouraged workers rolling into the long-term discouraged worker category. Also increasing numbers of "employed" can get only part-time work, despite wanting full-time jobs.

September U.6 unemployment soared to a seasonally-adjusted 17.1% (eased to 16.2% unadjusted) versus 16.7% (16.4% unadjusted) in August.

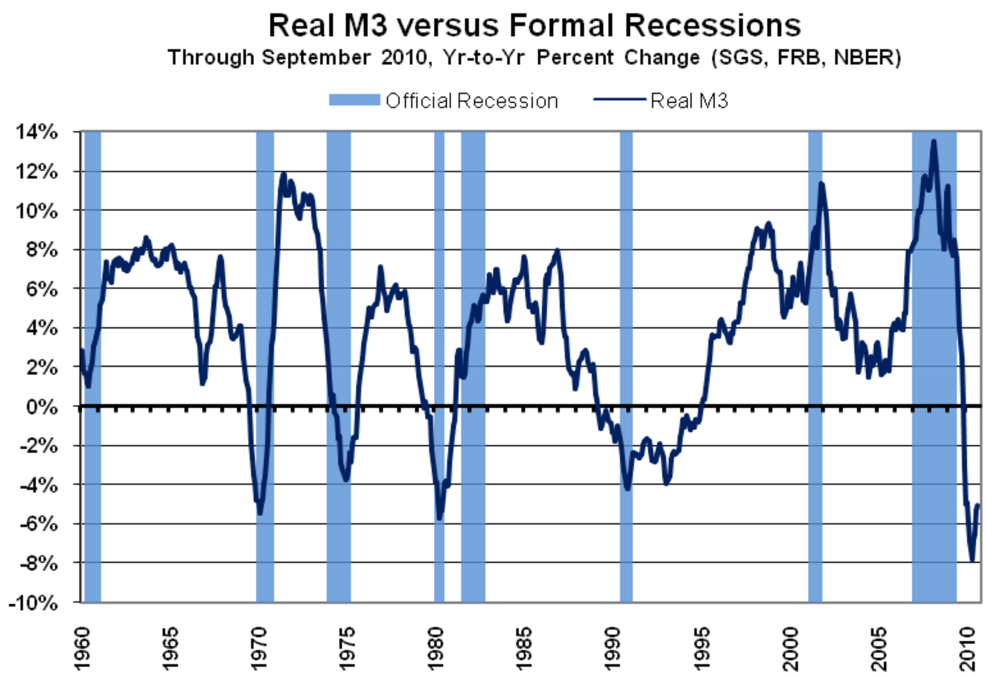
In 1994, during the Clinton Administration, "discouraged workers" -- those who had given up looking for a job because there were no jobs to be had -- were redefined so as to be counted only if they had been "discouraged" for less than a year. This time qualification defined away the long-term discouraged workers. The remaining short-term discouraged workers (less than one year) are included in U.6.

Adding my estimate of the excluded long-term discouraged workers back into the total unemployed and labor force, unemployment -- more in line with common experience as estimated by the SGS-Alternate Unemployment Measure -- rose in September to about 22.5%, from about 22.0% in August, the highest reading of the current cycle. The SGS estimate generally is built on top of the official U.6 reporting and tends to follow its relative monthly movements. See the Alternate Data tab for a graph and more detail.

As discussed previously, while 22.5% unemployment might raise questions in terms of a comparison with the purported peak unemployment in the Great Depression (1933) of 25%, the SGS level likely is about as bad as the peak unemployment seen in the 1973 to 1975 recession. The Great Depression unemployment rate was estimated well after the fact, with 27% of those employed working on farms. Today, less 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%.

Updated Real-M3 Signal for Intensifying Downturn. As discussed in numerous *Commentaries* this year (see *Commentaries No. 323 and 326*, for example), declining year-to-year change in real (inflation-adjusted) M3 signals a pending economic downturn or pending intensification of an existing economic contraction, with contracting broad liquidity invariably constraining broad economic activity. The signal is generated when real M3 first turns negative year-to-year, which occurred in December 2009 in the current economic cycle. The signal is not generated by, nor dependent on, either the length or the depth of the M3 downturn. The downside shift in business activity usually follows within six to nine months, which encompasses the current period. Due to the NBER's current business cycle timing, the current downturn will be classified as a double-dip recession.

The following updated graph plots annual real M3 growth versus periods of recession formally recognized by the NBER. It includes an approximate annual real contraction in the SGS Ongoing-M3 Estimate as of September 2010. The inflation-adjusted September M3 estimate used here is an annual contraction of roughly 5.1% versus a 5.3% contraction in August. The formal preliminary estimate for the SGS Ongoing M3 Measure for September will be posted this weekend of October 9th on the Alternate Data page for M3. At present, the nominal annual change in M3 for September is on track for a 3.8% decline, versus a 4.2% drop in August. Such will be addressed in next Friday's (October 15th) *Commentary* on inflation and systemic liquidity.



Week Ahead. Given the unfolding reality of an intensifying double-dip recession and more-serious inflation problems than generally are expected by the financial markets, risks to reporting will tend towards higher-than-expected inflation and weaker-than-expected economic reporting in the months ahead. Increasingly, previously unreported economic weakness is showing up in prior-period revisions.

Trade Balance (August 2010). Due for release on Thursday, October 14th, reporting of the August trade deficit will be the key determinant in how the change in net exports will add to or subtract from the "advance" estimate of third-quarter GDP growth to be released on October 29th. With July trade reporting relatively neutral versus the second-quarter, a large deterioration in the August deficit would push trade activity into negative territory for reported GDP growth. Such is my expectation. A sharply improved monthly number would tend to boost GDP reporting.

Producer Price Index -- PPI (September 2010). Due for release on Thursday, October 14th, the September PPI has a fair shot of surprising expectations on the upside (0.3% expected per Briefing.com), given the regular volatility of the series, and as suggested by reporting such as the purchasing managers September survey of manufacturers.

Consumer Price Index -- CPI (September 2010). Due for release on Friday, October 15th, the September CPI-U likely will show higher seasonally-adjusted monthly inflation than the consensus 0.2% indicated by Briefing.com, against the 0.3% reported for August. Although seasonally-unadjusted gasoline prices were down 0.9% in September versus August (Department of Energy), the seasonal adjustments remain positive, and other elements, including food, should she some upside movement.

Year-to-year inflation would increase or decrease in the September 2010 CPI-U reporting, dependent on the seasonally-adjusted monthly change, versus the 0.06% adjusted monthly gain seen in September 2009. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual inflation rate for September 2010, the difference in September's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from August 2010's reported annual inflation rate of 1.15%. A consensus report of 0.2% monthly inflation would yield an annual inflation rate of about 1.3%.

Retail Sales (September 2010). Due for release on Friday, October 15th, September retail sales are expected to increase by 0.3%, after a 0.4% increase in August, per Briefing.com. Downside revisions to August reporting are a fair bet, with general downside reporting risk likely due to market underestimation of the intensifying economic downturn. Importantly, the monthly data likely will be in contraction, net of inflation, the same way the GDP levels of activity is viewed (that is net of inflation effects).

