TrendMacrolytics

Donald Luskin, Chief Investment Officer
David Gitlitz, Chief Economist
Thomas Demas, Managing Director

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Job Market Myth vs. Reality

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David Gitlitz

Jobs numbers can't prop up bonds -- but they may inspire the Fed to overshoot.

Friday's below-expectations **payroll number** gave determined skeptics of this **expansion's** staying power another chance to attempt to breathe life into their case, but the pessimists are finding little traction to sustain their story. "High Prices for Energy Hold Down Job Growth," the ***New York Times'*** headline proclaimed, with its news story offering that the growth of 56,000 payroll **jobs** last month -- versus expectations of about 100,000 -- was a sign that "the economic damage from high energy prices might be growing." The ***Wall Street Journal*** averred that the apparently subdued pace of hiring raised "questions about the current strength of economic growth," citing economists who pointed to energy prices as a source of business caution amid "developing signs of weaker consumer spending."

These assertions, however, suffer from a dearth of empirical support. While "everyone knows" that higher **energy costs** should take a bite out **non-energy consumption**, leading to a **slowing in growth** with an inevitable impact on **job creation**, the fact is there is virtually no data available to corroborate the supposition. As we have explained, while the rising energy bill is not to be dismissed as a negative economic factor, it has to date been handily overcome by substantially stronger growth of **disposable income** and **wealth** (see "High Anxiety" October 10, 2005). As the naysayers await confirmation of their scenario, the news offers them little sustenance. Just a day before Friday's release of the October jobs report, for example, **chain stores** reported their best **sales growth** in six months.

As is frequently the case, the latest payroll report gives rise to at least as many questions about the reliability of the **establishment survey** data as about the labor market it is attempting to measure. The report found that **softness** in **new hiring** last month was focused on the **service sector**, for example. But the **ISM non-manufacturing index** for October, also released last week, showed a strong bounce higher to 60, indicating vigorous growth. At the same time, the reported weakness in job growth is inconsistent with the more frequently updated data on **jobless claims**. After spiking as high as 435,000 in the aftermath of the hurricanes in September, initial claims fell to 323,000 in the most recent week, back to pre-storm levels and consistent with a healthy job market. In addition, the purported softness would seem anomalous with a solid increase in **hourly wages**, which are now up nearly 3% year-on year, the best gain since mid-2003.

Lingering effects of **Katrina** and **Rita** appear to be affecting the data. The **household survey** showed the total of respondents "not at work due to bad weather" about a third higher than usual, accounting for a reduction of more than 30,000 in the count of people employed. At the same time, though, this survey -- which is much more sensitive to job creation by entrepreneurial, grassroots enterprise -- showed growth of 214,000 jobs last month. While economists generally consider the payroll report a more accurate measure due to its much larger **sample size**, there is good reason to question whether the establishment data is picking

http://www.trendmacro.com
don@trendmacro.com
dgitlitz@trendmacro.com
tdemas@trendmacro.com

Offices:
Menlo Park CA
Parsippany NJ
Charlotte NC

Phone:
650 429 2112
973 335 5079
704 552 3625

up current labor market dynamics as well as the household survey. Over the first 10 months of the year, the establishment survey reports **total payroll growth** of some 1.6 million, while the household survey shows creation of some 2.5 million **new jobs**. On a year-on-year basis, moreover, the establishment survey has shown no acceleration in the **rate of job growth** since mid-2004, at a rate of about 1.9 million jobs per year. Over the same period, **employment growth** rose from about 2 million per year to more than 2.8 million, according to the household data. Given the sustained robust economic performance throughout these months, a case can certainly be made that the household data has been more representative of underlying conditions than has the establishment survey.

This issue of the relative merits of the establishment versus the household survey is also relevant to the **Fed policy** outlook. While most policymakers and the senior Fed **staff** subscribe to the mainstream view that the establishment survey is superior, the **unemployment rate** is based on household data, and remains a significant consideration in policy deliberations. At 5% -- down from 5.5% a year ago -- the rate is now approaching levels approximating "full employment" in the flawed **Phillips Curve/output-gap** analytical model. If the Fed follows past practice, further declines in unemployment could compel the central bank to overshoot its present course, moving from a **rate "normalization"** paradigm to one inspired by a perceived need for a more **restrictive policy** stance. It may well be that those considerations played no small part in the **gold** market Friday. After initially spiking some $5 higher to the mid-$460s in knee-jerk response to the weak-looking headline payroll data, gold did a quick u-turn, falling by nearly $10 and closing the session at about $456, the lowest since mid-September. While less volatile, **bonds** followed a similar course, initially rallying on the headlines only to turn lower with the **10-year Treasury** finishing with a yield approaching 4.67%, the highest year-to-date. As the likely shape of the policy outlook comes into clearer focus, we'd expect those market prices to continue on a downward trend.

Bottom Line: The disappointing payroll report was seen representing the toll of higher energy prices, but there is little evidence available to sustain that view. Consumer spending remains strong and the service sector, where the labor market weakness was reportedly concentrated, is currently showing impressive vitality. As far as the Fed is concerned, the most significant element of the jobs report was likely the unemployment rate dropping to 5%, a level suggesting troublesome labor market tightness in its rigid neo-Keynesian model. That potentially sets the stage for a shift into a restrictive policy mode. TM