

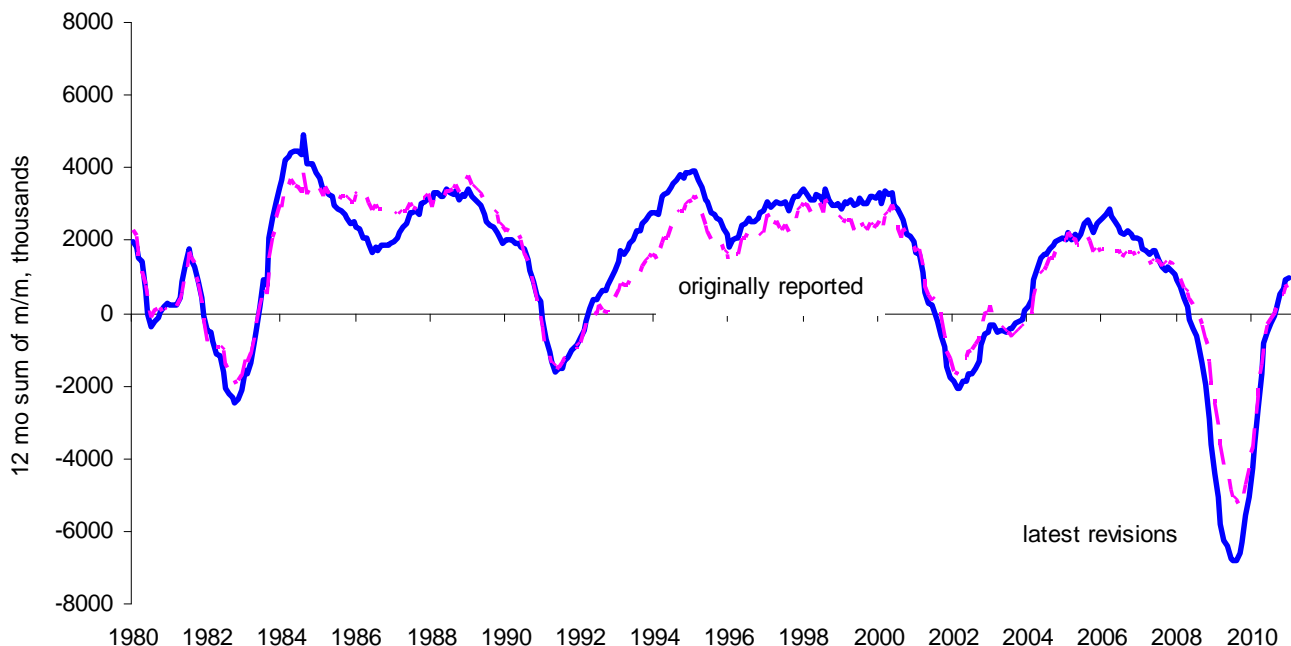
Job Growth or Conspiracy?

We've gotten lots of questions on the employment data. There's substantial complexity, so we thought it would be worth an addendum to our February 4 piece, *Weak Payrolls, But Recovery In Other Indicators*.

1. Why was the establishment survey so weak (at 36,000 in January)?

- By its definition, the establishment survey doesn't pick up gains in self-employment. It also has trouble picking up new businesses and growth in small businesses. As a result, **the establishment survey doesn't do well at turning points and is subject to big revisions later**. Both the establishment survey and the household surveys are small compared to the labor force, with wide statistical confidence intervals, meaning neither is very precise on a month-to-month basis.

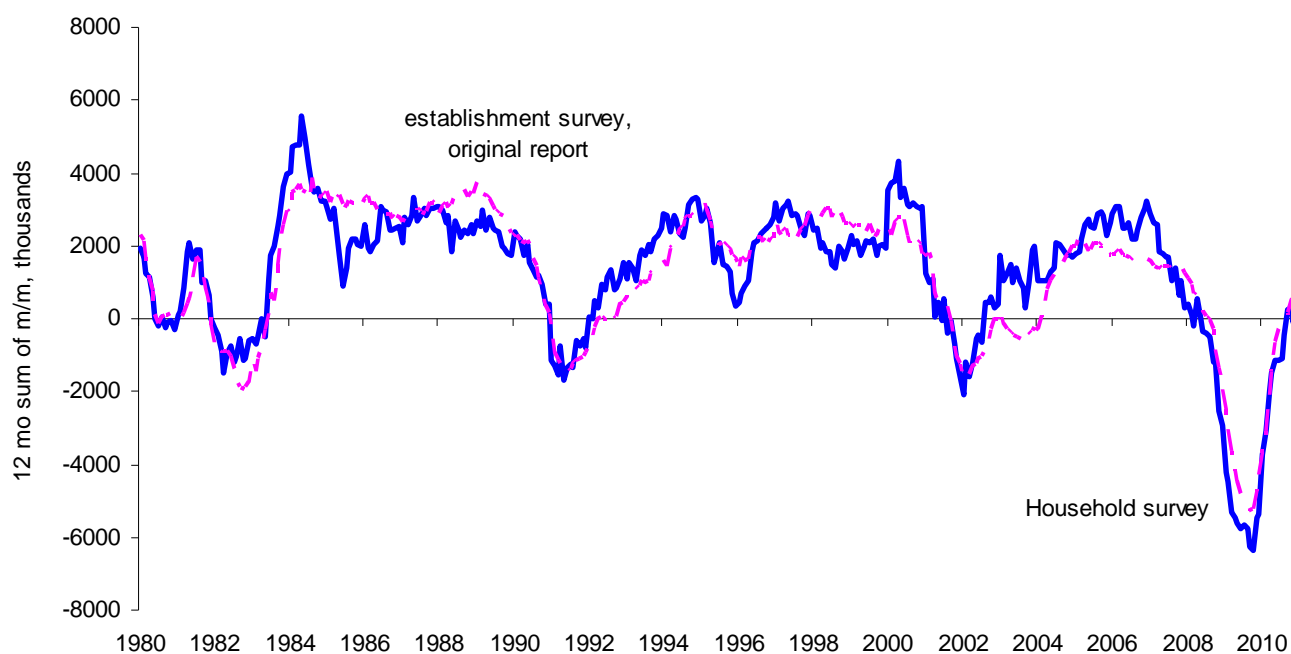
Employment: Original Establishment Vs. Revised (last obs. January 2011)



Source: Bureau of Labor Statistics; Encima Global

- At this point in the business cycle, we rely more on the household survey. It pointed correctly to weakness in 2010, when small businesses were struggling badly and few new businesses were being created. We wrote extensively on the contrast in 2003 and 2004 when the economy was beginning a boom yet the establishment survey was still weak and the Fed was keeping interest rates at 1% based on the “jobless recovery” story. The establishment survey was subsequently revised up substantially toward the more meaningful data being picked up in the household survey.

Employment: Original Establishment vs household (last obs. January 2011)



Source: Bureau of Labor Statistics; Encima Global

2. Was weakness in the establishment survey caused by weather? Will it be reversed?

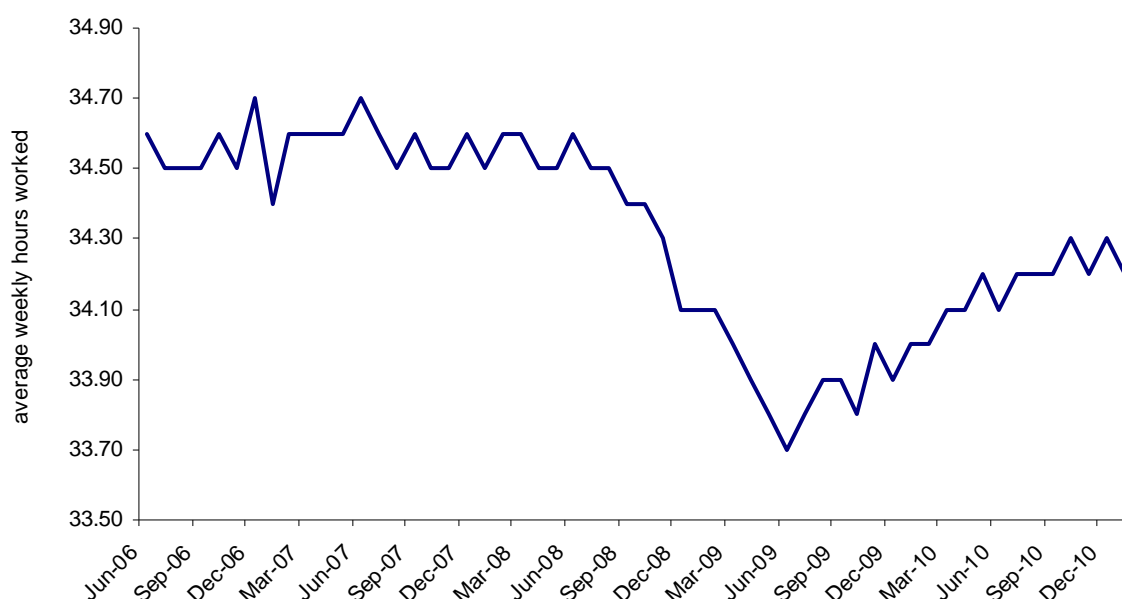
- **Only some of the weakness was weather related. The construction industry lost 32,000 jobs and transportation 38,000 jobs in the January establishment survey, many of which were due to forecasts of bad weather on its way. This suggests some strength in the February or March payroll data when weather improves.**
- The widely cited January statistic about 866,000 workers “not at work due to bad weather” should not have caused weakness in the establishment survey. The survey counts people as employed if they were paid or worked even one day during the five-day sample week.

- We think most of the weakness in the establishment survey was not weather, but because many new jobs aren't reported to the Labor Department, especially in the first data release.

3. Were there other weather effects?

- Yes. Page 11 of the Labor Department report specifically addresses severe weather. It says the impact will have more of an effect on hours than employment. **The average weekly hours fell by 0.1 in both all private workers and non-supervisory workers.**

Average Weekly Hours, Total Private Industries (last obs. January 2011)



Source: Bureau of Labor Statistics; Encima Global

4. Why did the unemployment rate go down to 9% even though the establishment survey was weak? Is it a conspiracy to make the data look good?

- **Job growth in the household survey was much stronger than job growth in the establishment survey.** This explains the divergence. We think new businesses, self-employment and small businesses are improving significantly, a change not being picked up in the establishment survey. We've noted several reasons for improvement – the tax bill, bank credit, auto financing, passage of time from the Lehman bankruptcy, pent-up demand for innovations, auto production. The positive interpretation is consistent with the data coming from ADP, withholding taxes and ISM surveys. NFIB surveys haven't been as strong, but we think they reflect more established small businesses (and therefore not as job-rich.)

5. Didn't the labor force decline, causing the unemployment rate to go down artificially?

- No. To get to 9% unemployment, the household survey showed **589,000 new jobs and no reduction in the labor force in population-controlled data**, compared to only 36,000 jobs in the establishment survey. Many commentators are citing unadjusted household survey data showing shrinkage in the labor force and only 117,000 new jobs. However, per the Labor Department on page 2 of its release: "the number of unemployed persons decreased by about 600,000 in January to 13.9 million, while the labor force was unchanged (based on data adjusted for updated population controls.)" Here is the BLS link: <http://www.bls.gov/news.release/pdf/empsit.pdf>. There's a BLS table on page 7. It shows the results of the population-adjusted household survey with and without the population control effect. The population adjustment is a standard BLS adjustment. **Bloomberg is still showing the non-adjusted data** (117,000 new jobs in January and a reduction in the labor force of 504,000), but **it is clear from the BLS release that its interpretation is the right-hand column -- that 589,000 jobs were created and will become the official data.**

Selected labor force measures, adjusted for population control effects (January 2011 compared to December 2010)

Category	Dec - Jan change as published	2011 population control effect	Dec - Jan change after removing pop control effect
Civilian noninstitutional population	-185	-347	162
Civilian labor force	-504	-504	0
Employed	117	-472	589
Unemployed	-622	-32	-590
Unemployment Rate	-0.4	0.0	-0.4
Not in Labor Force	319	157	162

Source: Bureau of Labor Statistics; Encima Global

6. How many people many are unemployed?

- About 14 million (9%) are unemployed. Of those, 8.9M were collecting unemployment insurance in federal and state programs in December. U6 under-employment is 25.2M or 16.1%. It includes people who are working part-time because of the economy and people who stopped looking within the last four weeks (the marginally attached). Another measure occasionally cited is the available labor pool which comes to 20.3M. This includes the unemployed (14M) plus marginally attached (2.8M) plus others who are not in the labor force but want a job (3.5 million).

Unemployment (last obs. January 2011)

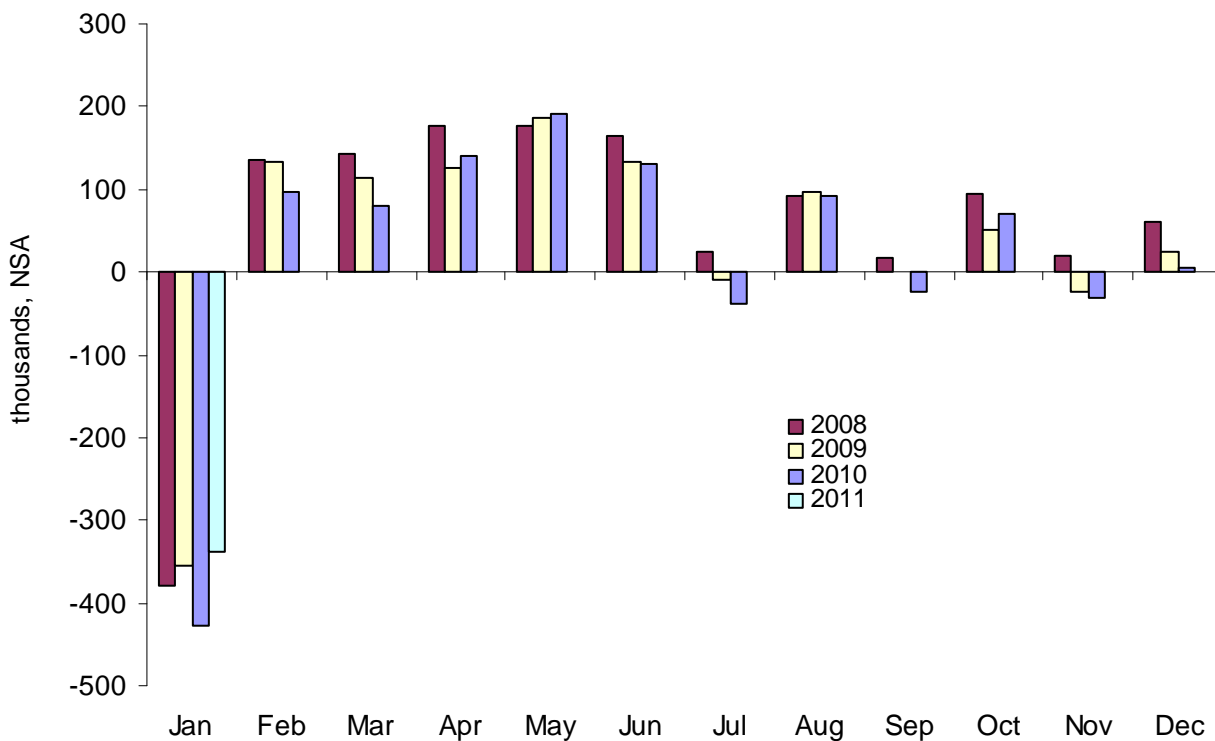
	Millions
Regular State Unemployment	4.3
Federal Unemployment	<u>4.6</u>
All Programs continuing claims	8.9
Unemployed not collecting UI	<u>5.1</u>
Total Unemployed (NSA)	14.0 (9% of labor force)
Marginally Attached (stopped looking in last four weeks)	2.8
Working part-Time for Economic Reasons	8.4
Total underemployment (U6)	25.2 (16.1% of labor force including marginally attached)
Labor force	153.2

Source: Bureau of Labor Statistics; Department of Labor; Encima Global

7. Does the birth-death model play a role?

- No. Over the year, the birth-death model adds jobs to the establishment survey to factor in the growth (and shrinkage) of new and small businesses that wouldn't otherwise get picked up in the survey. It's a plug factor that's added to the non-seasonally adjusted monthly survey data. We think it is one of several factors that cause the establishment survey to lag during turning points. We don't think it is a major factor distorting the data. On a monthly basis it's volatile like the non-seasonally adjusted payroll data. The total net additions by year have been declining sharply, from 1.06 million in 2006 to 288,000 in 2010 reflecting the deterioration in the new business climate. The full list: in 2010 288,000; 2009 477,000; 2008 724,000; 2007 954,000; 2006 1,060,000; 2005 816,000. If the economy continues accelerating, the birth-death model will probably begin to understate the job growth from new firms, compounding the other lagging factors in the establishment survey.

Net Birth Death Model (last obs. January 2011)



Source: Bureau of Labor Statistics; Encima Global

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