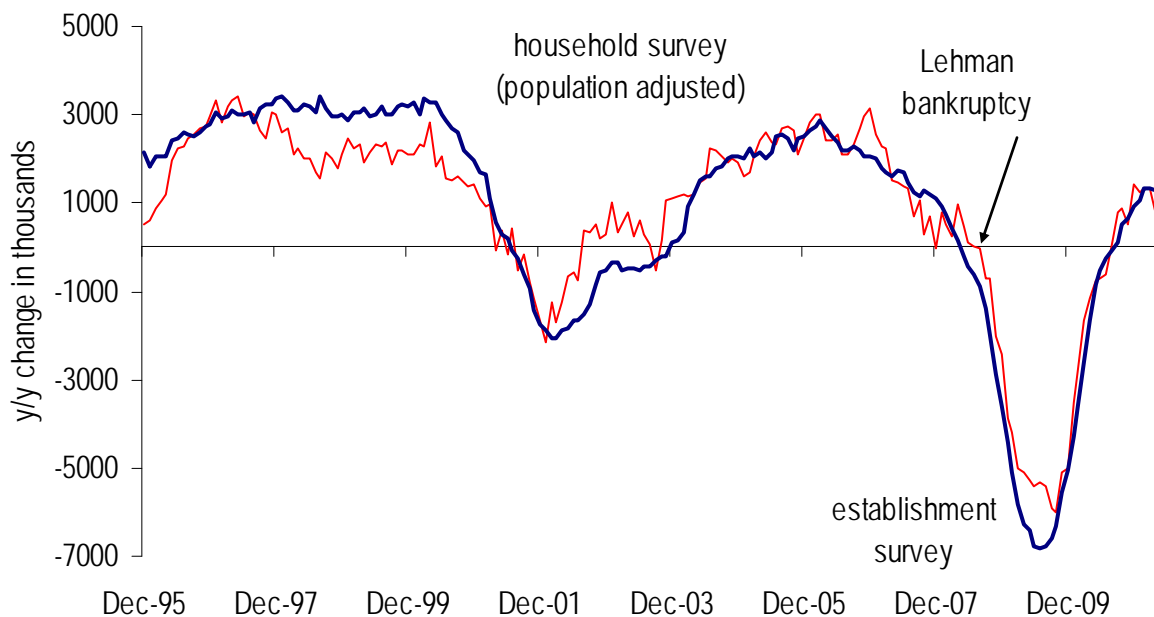


Job Growth Drops In May

The establishment survey showed a 54,000 net gain in May payrolls with a combined 39,000 downward revision to March and April payrolls. Private sector payrolls rose 83,000, offset by increasing job losses in the government sector (down 29,000 in May.)

- The household survey showed a gain of 105,000 jobs in May versus a 272,000 increase in the labor force. This pushed unemployment up to 13.9 million, a 9.1% rate, from 13.7M and a 9.0% rate in April. The household survey showed a job loss of 190,000 in April, ending four months of strong gains starting in December. **The same household survey weakness happened in 2010 with strong gains in January through April but then a sudden letdown in May, June and July of 2010 that accurately marked the soft patch as did jobless claims and auto sales.**

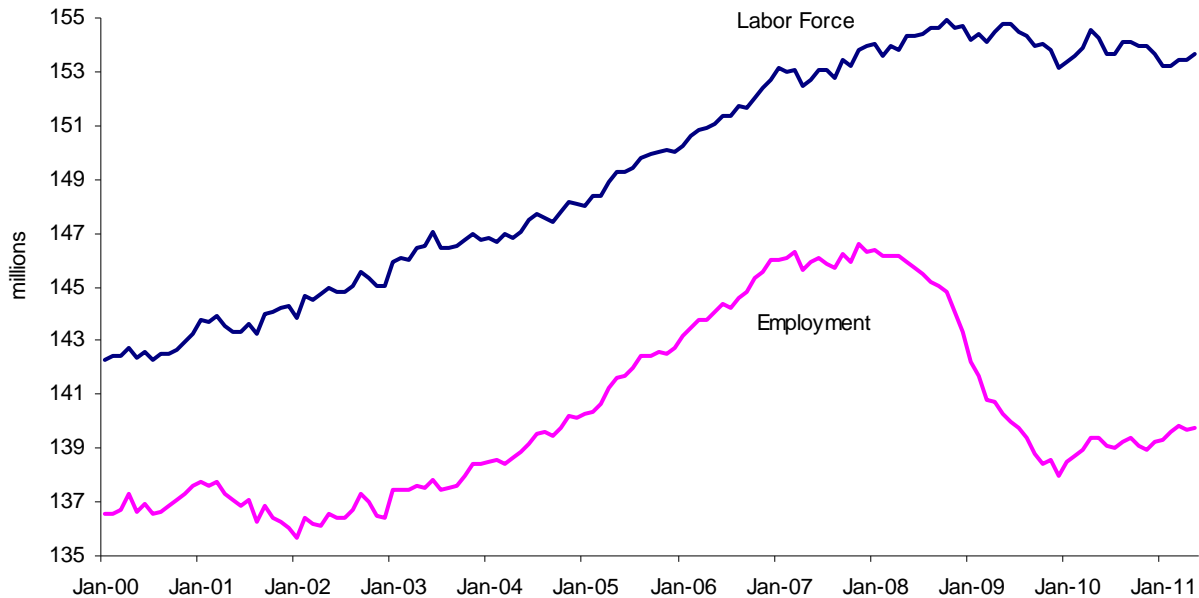
Annual Growth in Employment (last obs. May 2011)



Source: Bureau of Labor Statistics; Encima Global

- The labor force grew an average 120,000 per month from 2000 through 2008 and has been in a decline since then. This reflects discouraged workers, a probable exodus of immigrant workers, especially in construction, and the sharp secular downshift in the prime labor force growth rate as the baby boom retires.

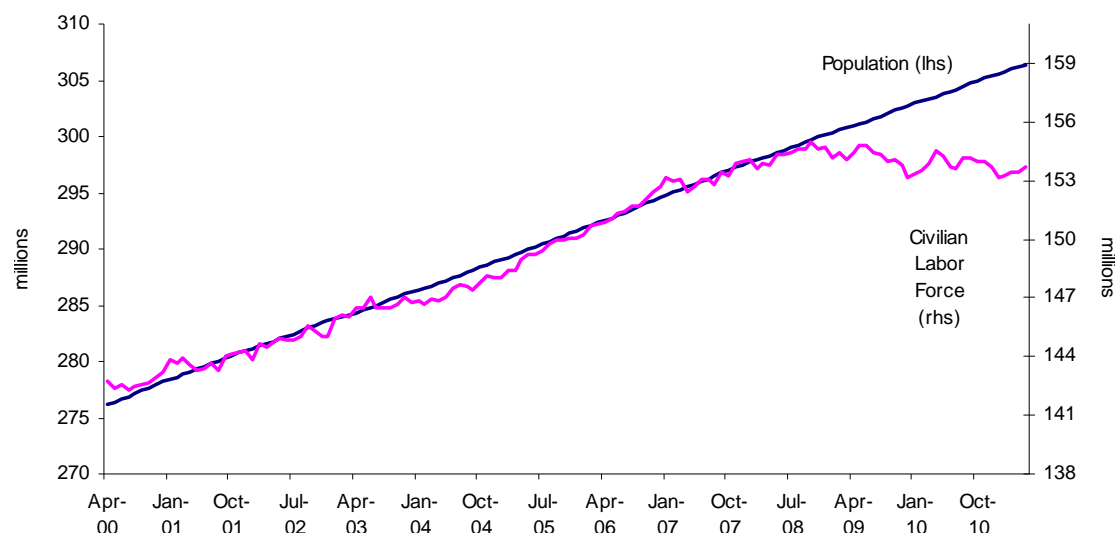
Civilian Labor Force and Employment (household survey, last obs. May 2011)



Source: Bureau of Labor Statistics; Encima Global

- The prime working age population (18-64) grew 167,000 per month (1% annual rate) from 2000-2010 but will slow by half to only 84,000 per month (0.5% growth) from 2011-2020. The slowdown in the growth of the prime working age population should help some on the unemployment rate as will workers dropping out of the labor force after their extended unemployment benefits expire due to the 99 week limit. With the baby boom entering retirement, we expect only slow labor force growth in coming decades. Japan has been seeing a decline in its labor force since the late 1990s, while China's labor force is expected to peak late this decade and decline sharply in the 2020s and 2030s. In contrast, the U.S. labor force is expected to grow slowly into the middle of the century (after a period of much slower growth over the next two decades.) This sets the U.S. apart from the declines in most other industrialized countries and China.

Civilian Labor Force and Total Population (last obs. May 2011)



Source: Bureau of Labor Statistics; Encima Global

- Over the last six months, the establishment survey shows that the economy added 935,000 total jobs and 1.1 million private sector jobs while the household survey shows 1.3 million total gains and ADP 1.1 million private sector gains. However, recent data in all three surveys shows a sharp slowdown from the pace earlier in the year.

Monthly Change in Jobs (last obs. May 2011)

	<u>ADP</u>	<u>Establishment Private Payrolls</u>	<u>Households Survey</u>
January 2010	-50	-42	789
February 2010	4	-21	183
March 2010	49	144	250
April 2010	113	229	425
May 2010	42	48	-33
June 2010	50	65	-263
July 2010	31	93	-105
August 2010	63	110	272
September 2010	32	109	107
October 2010	79	143	-297
November 2010	122	128	-178
December 2010	246	167	293
January 2011	190	94	589
February 2011	205	261	250
March 2011	203	219	291
April 2011	177	251	-190
May 2011	38	83	105

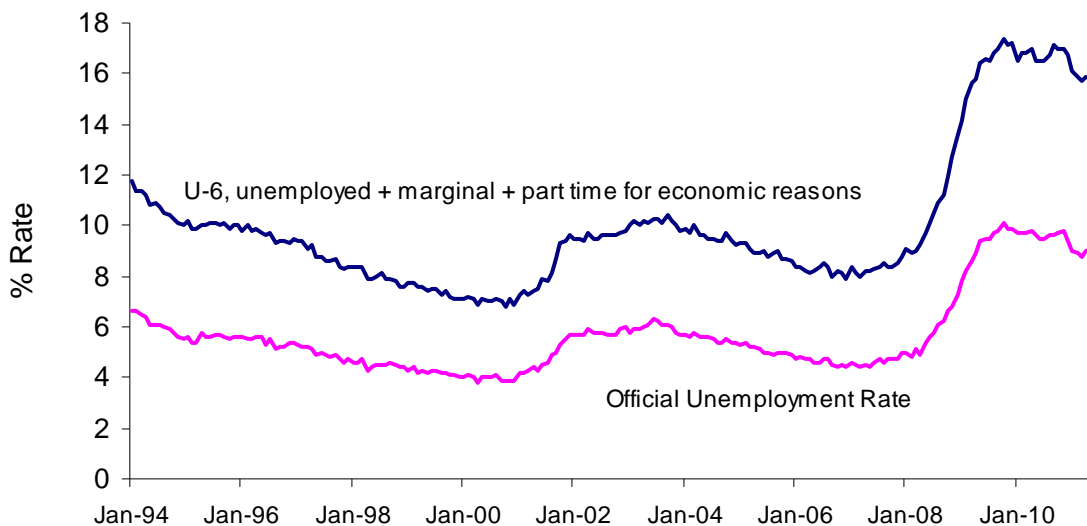
Source: ADP; Bureau of Labor Statistics (population-adjusted series); Encima Global

- Some of the job weakness in the three surveys is weather-related, late-Easter seasonality (which strengthened retail employment in April and weakened it in May), and a response to Japanese production cuts, but there's also a clear pause in other hiring elsewhere in the economy. We lowered our Q2 GDP forecast to 1.8% on Wednesday and looked for 100,000 job gains and a 9.1% unemployment rate (see Weak ADP and ISM Data: Employment Preview on June 1). We put emphasis on ADP, jobless claims and auto sales because they are relatively hard raw data, not surveys that get revised. We prefer the household survey to the establishment survey because, though volatile due to small sample size, it picks up trends in small and new businesses (today's WSJ has a good story on this preference on page C1).

Changes in the Labor Force

Unemployment rose to 9.1% in May, up 0.1% from April. Underemployment fell to 15.8%, down 0.1%.

Unemployment and Underemployment Rate (last obs. May 2011)

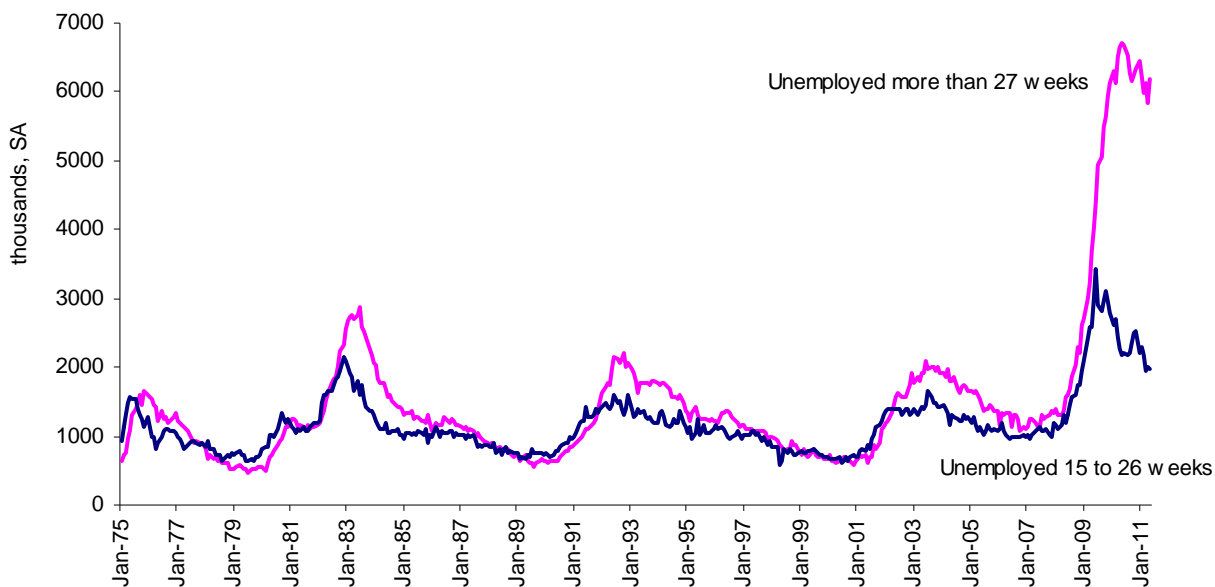


Source: Bureau of Labor Statistics; Encima Global

- **Even if job growth becomes fast, the unemployment rate is likely to stay higher than could be considered “full employment” under the Fed’s dual mandate. This has implications for the conduct of monetary policy and the value of the dollar (which is not taken into consideration in the Fed’s current interpretation of its price stability mandate). The Fed has a mandate to achieve full employment, which will be hard to accomplish given the overhang of unemployment. And in pursuing its price stability mandate, the Fed watches out for red flags in labor inflation which may be delayed well into the expansion because of the overhang of unemployed workers and the normal long lag between dollar weakness and general price inflation.**

- The average duration of unemployment is particularly long at 39.7 weeks, while the median duration of unemployment rose to 22 weeks. This shows a bifurcation – long-term unemployed are not finding jobs as readily as those who lost their jobs more recently. Given this dynamic, many longer-term unemployed will receive unemployment benefits through the 99 week limit at which point some will find work and many will drop out of the labor force, reducing the unemployment rate. Roughly 3.6 million long-term unemployed will reach the 99 week limit during 2011, with roughly another million losing federal unemployment benefits in January 2012 assuming federal benefits are discontinued then, creating substantial downward pressure on the unemployment rate partially offset by the overhang in the labor force discussed below.
- There are now 6.2 million workers unemployed for more than 27 weeks (peak was 6.7M in May 2010). The number of unemployed between 15 and 26 weeks stands at 2.0 million, well below the peak of 3.4 million in June 2009. There is clear improvement, but from very high levels.

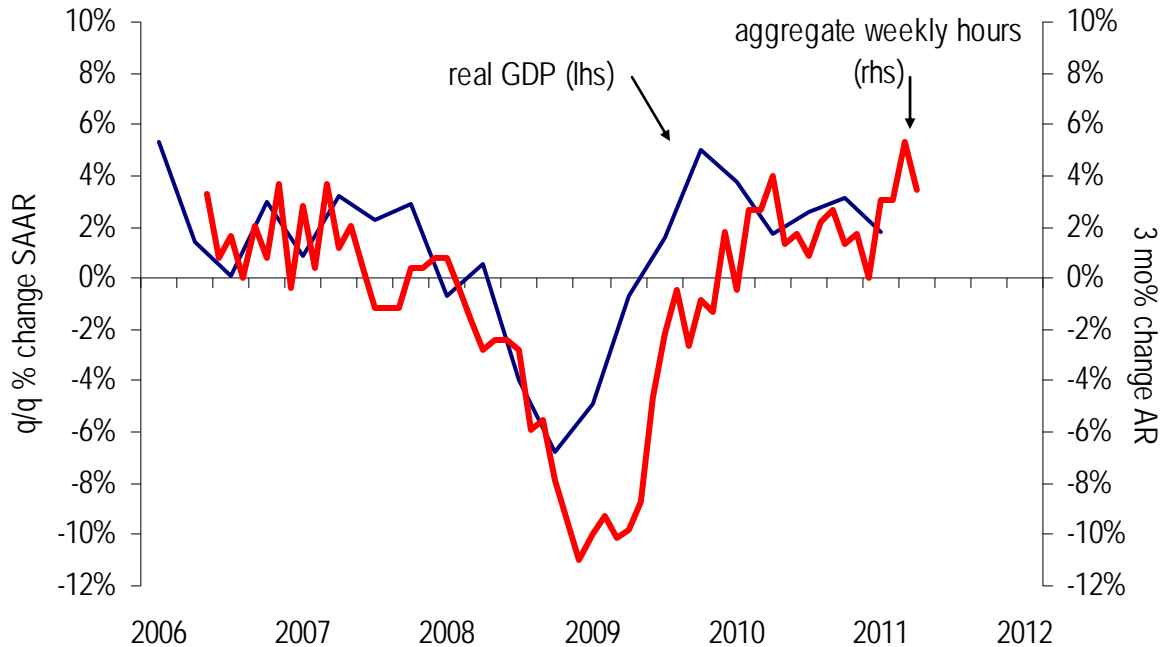
Unemployed Longer than 27 Weeks (last obs. May 2011)



Source: Bureau of Labor Statistics; Encima Global

- In May, average weekly hours worked were flat at 34.4. The March-May aggregate hours index (which includes hours worked times number of workers) grew at a 3.5% annualized rate, down from a peak 5.3% rate in February-April. This measure gives a rough indication of real growth and implies a soft patch but not a double dip into recession.

Aggregate Weekly Hours suggests stronger real GDP (last obs. April 2011)



Source: Bureau of Economic Analysis; Bureau of Labor Statistics; Encima Global

- An indication of stronger nominal growth comes from the combination of the aggregate weekly hours index times average hourly earnings which rose 0.3% in May to \$22.98. The three-month annualized growth for this nominal measure is 5.2%, an improvement on the 3.8% first quarter annualized nominal GDP growth rate.
- Still, average hourly earnings remain weak. This is partly due to the 9.1% unemployment rate. Over the last year, this measure of earnings increased only 1.8% (graphed below), lagging behind the inflation rate of 3.2% and the growth in broader personal income which includes job growth, dividend increases and the bulge in transfer payments. **While the economy as a whole is generating gradually more income and taxes, some of it is coming through partly through the increase in federal debt, an individual worker earning average wages isn't keeping up with inflation.**

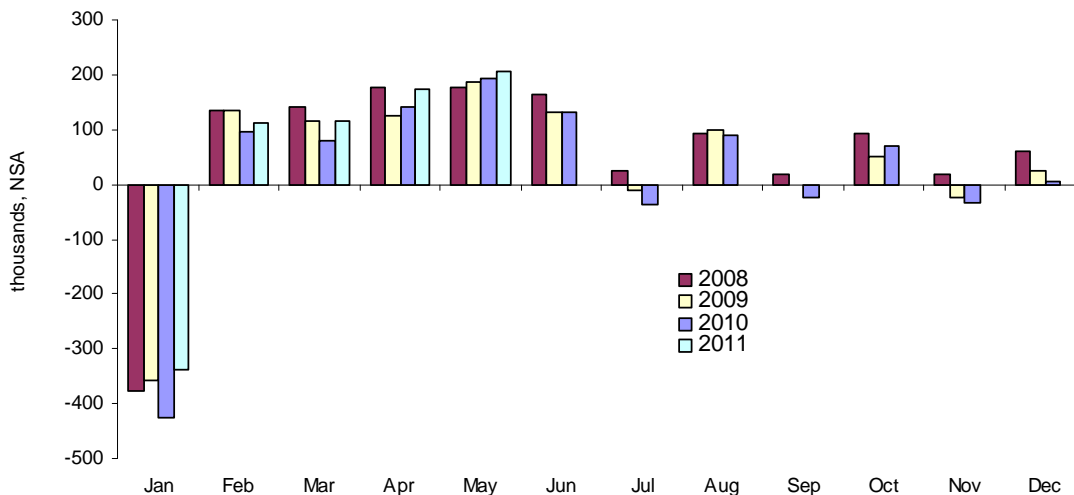
Average Hourly Earnings y/y (last obs. May 2011)



Source: Bureau of Labor Statistics; Encima Global

- In May, the net birth death model added 206,000 jobs on a not seasonally adjusted basis bringing the NSA payroll gain to 682,000 and the SA gain to 54,000. **This month's birth death model, basically a plug figure for assumed net job growth by new and small businesses, was the biggest single-month birth-death model increase in at least the last four years.**

Net Birth / Death Model (last obs. May 2011)



Source: Bureau of Labor Statistics; Encima Global

- Given the turbulence in the business climate, it's quite possible that the birth-death model is over-optimistic on new and small-business job gains, as it has been in recent years. This will get resolved in coming years through revisions to the establishment survey.

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