

US EMPLOYMENT REPORT PREVIEW

28th Jan. 2010



Benchmark revision to reveal sharper falls in employment

Our econometric model, which incorporates a wide range of labour market indicators, suggests that payroll employment fell by around 30,000 in January. That would be roughly halfway between November's 4,000 gain and December's 85,000 decline, meaning that this economic recovery is still a jobless one. The annual benchmark revision to the back data on payrolls provides an additional wildcard this month. The gap between the payroll measure of employment and the household measure suggests the former may be revised down substantially.

Still a jobless recovery

Early indicators suggest that any improvement in labour market conditions in January was fairly modest. The downward trend in initial jobless claims appears to have slowed, with the four-week average falling only marginally in January. Meanwhile, the rises in the employment balances of the two ISM surveys in December merely reversed the falls of the previous two months. A 30,000 decline in payroll employment in January would confirm that the pace of the recovery in the labour market remains slow.

Large firm bias to lead to downward revisions

January's Employment Report will also incorporate the results of the annual benchmark revision to the historical payroll figures. The revision is based on unemployment insurance records, which all employers are required by law to file, so the new figures should be fairly accurate. It should therefore correct for any deficiencies in the normal monthly survey, such as the failure to accurately pick up the birth and death of firms or any distortions within the survey sample.

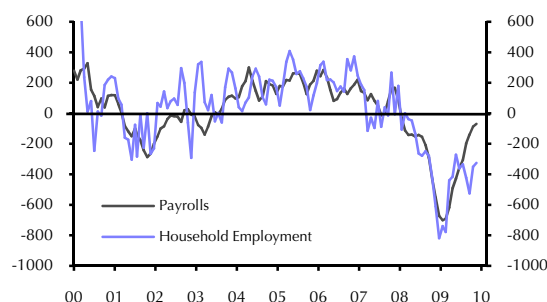
The preliminary estimates, issued by the BLS last October but not yet incorporated into the figures, suggested that the level of non-farm payrolls in the year to March 2009 needed to be revised down by 824,000, or about 69,000 per month over the

previous 12 months. That would be the largest downward benchmark revision in percentage terms since 1991.

The BLS has provided no information on how monthly changes in payrolls between April and December of last year are likely to be revised. **However, the large gap between the payroll measure of employment and the alternative household measure suggests to us that further downward revisions are likely.**

Chart 1 shows that, more often than not, payroll employment and household employment move in tandem. Since August, however, an unprecedented gap has developed. While payroll employment has fallen by an average of 100,000 per month, household employment has dropped by a much larger 405,000. **In other words, the payroll employment measure suggests that labour market conditions have improved, while the household employment measure indicates they have stagnated, if not actually deteriorated.**

CHART 1: CHANGE IN EMPLOYMENT (000s, 3 MTH AVERAGE)



Source – Thomson Datastream

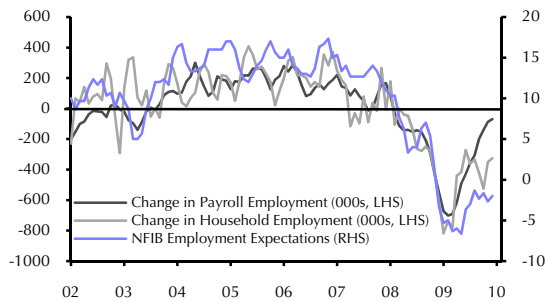
The smaller survey sample of the household measure, 60,000 households versus 400,000 business establishments, would normally lead us to suggest that it is the suspect one. **However, on this occasion we think the payroll measure may be overstating the extent of the recent improvement in labour market conditions**

because of its disproportionate coverage of large firms. Indeed, in its survey of 400,000 business establishments, the payroll employment measure includes "all firms with 1,000 employees or more", but just a "sample" of smaller firms.

We have pointed out before that large firms' greater access to the capital markets means they are enjoying a decent rebound in activity. In contrast, because small firms are reliant on bank credit that is in short supply, they are still struggling. (See *US Economics Weekly* "The plight of small businesses", 30th November 2009.)

In other words, the payroll employment measure may be putting too much weight on the improvement at large firms and not enough weight on the still tough conditions at small firms. Chart 2 provides further support for this idea. It shows that the household measure of employment is more closely aligned with the employment index of the small business NFIB survey.

CHART 2: EMPLOYMENT & NFIB EMPLOYMENT BALANCE



Source – Thomson Datastream

Of course, the household employment measure may not be perfect either. Nonetheless, if the benchmark revisions were to reveal that payroll employment evolved more like household employment has done, payroll employment from April to December of last year would be revised down by 108,000 per month, or 972,000 in total.

Together with the preliminary estimate of a 824,000 downward revision in the year to March, January's Employment Report could reveal that payroll employment is actually 1.8 million lower

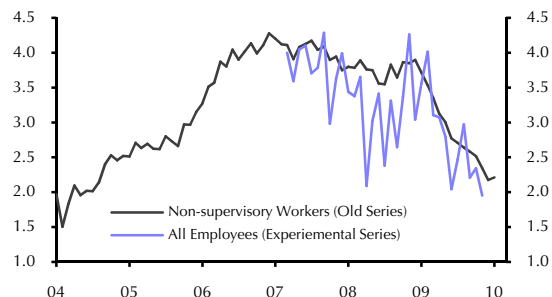
than current figures suggest. Since the recession began, employment may therefore have fallen by 9.0 million, or 6.5%, compared with the current estimate of a 7.2 million, or 5.2%, decline.

The benchmark revision does not affect the unemployment rate. Accordingly, it will not suggest there is more spare capacity than previously thought. Nonetheless, sharper falls in employment last year would show that the recovery in the labour market is lagging even further behind that in the wider economy. **Accordingly, it would reinforce our view that the Fed will not increase interest rates any time soon, and perhaps not even until 2012.**

New earnings series

Finally, January's Employment Report will include a new average hourly earnings series that covers all private employees and not just non-supervisory workers. This series will receive little attention at first, but will eventually become the main measure of earnings watched by the markets and the Fed. As Chart 3 shows, an experimental series of this measure previously released by the BLS followed the same broad trends as the existing earnings series, but was much more volatile. This presumably reflects the larger discretionary elements in the relatively high pay of (more senior) supervisory workers.

CHART 3: AVERAGE HOURLY EARNINGS (%/Y)



Sources – Thomson Datastream & Bureau of Labor Statistics

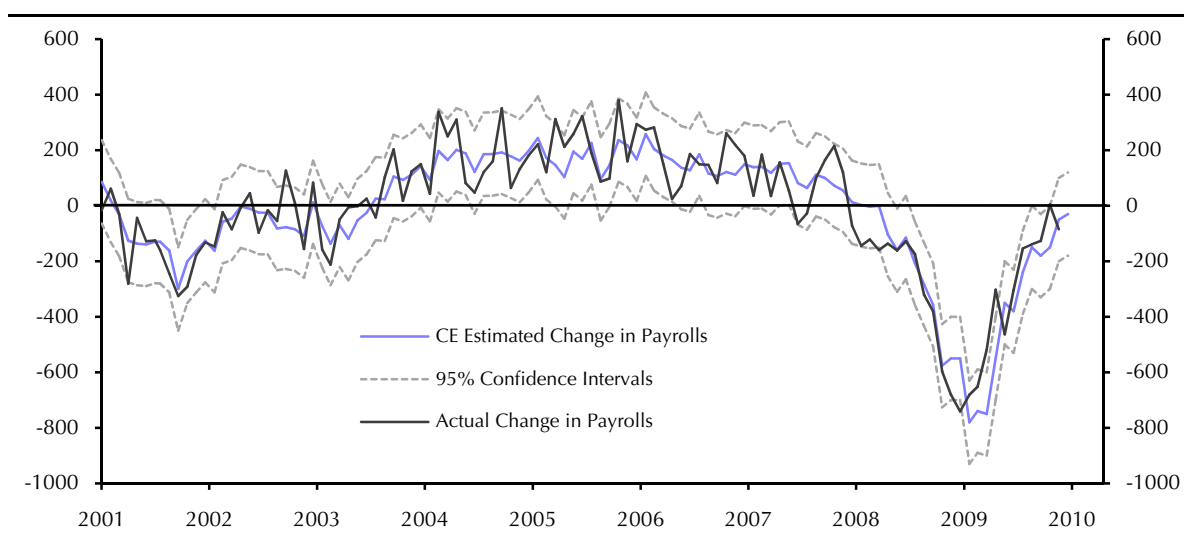
Paul Dales
Tel: +1 416 413 0428
E-mail: paul.dales@capitaleconomics.com

US EMPLOYMENT DATABANK

	2009								2010	Implication for Payroll Growth
	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan ⁽¹⁾	
Labour Market Indicators										
Jobless Claims (Monthly Ave.)	627	616	560	573	549	527	481	460	456	Better
Jobless Claims (for week including the 12 th)	636	612	559	580	534	531	501	480	478	Worse
Challenger Job Cut Announcements (SA)	112	80	127	86	67	54	41	42	-	Worse
Help Wanted Online New Ads Index	1.26	1.26	1.28	1.41	1.31	1.30	1.29	1.45	-	Better
Monster Employment Index	118	117	114	121	119	120	119	115	-	Worse
ISM Manufacturing Employment Index	34.3	40.7	45.6	46.4	46.2	53.1	50.8	52.0	-	Better
ISM Non-Manufacturing Employment Index	39	43.4	41.5	43.5	44.3	41.1	41.6	44.0	-	Better
ADP Private Payroll Employment Survey	-461	-433	-347	-267	-220	-178	-145	-84	-	Better
CE Estimated Change in Payrolls⁽²⁾	-550	-350	-380	-240	-150	-180	-150	-50	-30	-
Consensus Forecast	-520	-350	-345	-230	-188	-165	-150	-5	-25	-
Actual Change in Payrolls	-303	-463	-304	-154	-139	-127	4	-85	-	-
Other Employment Report Data										Consen. Fore.
Unemployment Rate	9.4	9.5	9.4	9.7	9.8	10.1	10.0	10.0	10.2	10.0
Change in Household Employment	-464	-400	-221	-384	-665	-526	139	-50	-30	-
Hours Worked	33.1	33.0	33.1	33.1	33.1	33.0	33.2	33.2	33.2	33.2
Average Earnings (%m/m)	0.2	0.1	0.3	0.4	0.1	0.3	0.3	0.2	0.2	0.2
Average Earnings (%y/y)	3.0	2.8	2.7	2.6	2.6	2.5	2.3	2.2	2.2	2.2

(1) Figures in blue are forecasts (2) Based on the CE econometric model of payroll growth that includes effects from jobless claims, Challenger job cuts, changes in temporary employment and the ISM employment indices. Between 2001 and 2008, the CE model error was 66,000 compared to the Bloomberg consensus error of 90,000 and the ADP employment survey error of 67,000. During that time, on average the model has been more accurate than the consensus forecast in eight of every 12 months.

ACTUAL & ESTIMATED CHANGE IN PAYROLLS (000s)



Sources – Thomson Datastream, Capital Economics

Capital Economics

North America: 2 Bloor Street West, Suite 1740, Toronto, ON, M4W 3E2, Canada, Tel: +1 416 413 0428

Europe: 150 Buckingham Palace Road, London SW1W 9TR, United Kingdom, Tel: +44 (0)20 7823 5000

Asia: #26-03 Hitachi Tower, 16 Collyer Quay, Singapore 049318, Tel: +65 6595 5190