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The Liscio Report

On the Economy

For John Liscio 1949-2000

Withholding in line with "modest" job growth

Our survey of state withholding tax receipts held its own in January; 46% of the states in our survey made their projected collections, down marginally from 51% in December. The number of states reporting positive growth year over year rose to 79% from December's level of 67%. But in January 2003 only 30% of states made their projected collections and two thirds were in negative territory, so the improvement this year is likely not as strong as it seems at first glance. And, as the charts on p. 2 show, the three-month moving averages have even turned down a bit. We don't take that to mean the labor market is weakening, or even going into reverse; it just counsels against getting carried away with bullish expectations.

- ***landscape improving***
- ***Midwest: "disappointed but not totally discouraged"***
- ***retail seasonals: how important?***
- ***acceleration coming?***

The Waiting Game

There is a strong sense at the majority of our states that the economic landscape is indeed improving and that the labor market is gaining ground. The Midatlantic region continues to report genuine improvement in withholding collections. One of the big states there has a history of leading out in past recessions, and has been looking strong for some time now. The problem is the rest of the country isn't following as quickly as it has in the past. Our Midwestern states have yet to report sustained strength, and states on both coasts and in the Southwest continue on a yawing tack. "We've seen this all before," said one. "On several occasions withholding has suddenly come in strong, and then is gone away the next month." Or, "We keep thinking we see the beginnings of a recovery, but it is just so tentative. We assume we will lag the rest of the country because of our manufacturing base so we're just going to watch."

As is always the case at the turn of the year, there are a number of headache-makers for our contacts this month. Some states have shifted due dates, some have lowered or raised taxes on capital gains and other income streams, so there is a lot of adjusting going on. Also, it appears

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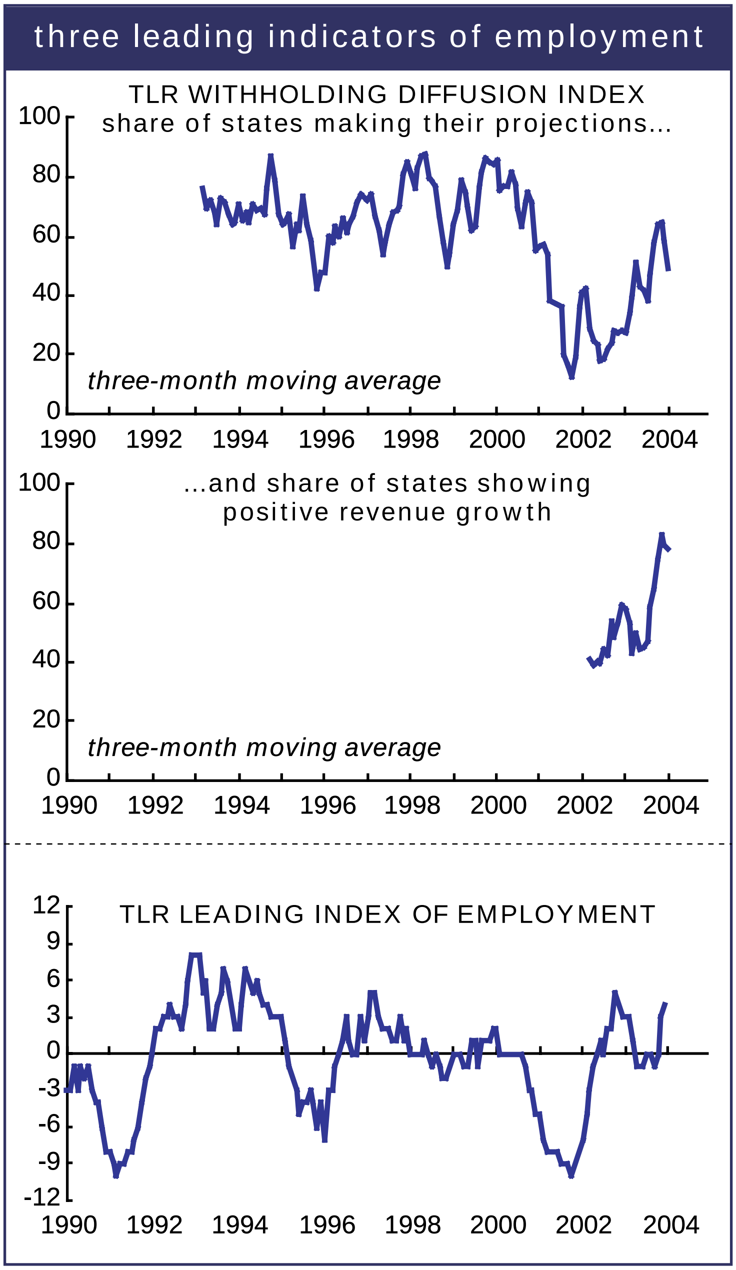
that bonus payments are showing up in collections this year, after being absent last. States that can back out bonuses say they look pretty good, and some states that can't separate them out believe they are contributing to moderate acceleration in withholding receipts. For example, one Midwestern state, unable to separate out bonuses, reported quite strong withholding although his department of labor reports they are still losing jobs, a trend supported by local news reports of heavy layoffs and plants moving out of the country.



Looking Ahead

One of the reasons many analysts—us included—have been expecting an acceleration in employment growth is the improvement in the unemployment claims stats, both initial and continuing. Though we still expect this (and other measures in our leading index of employment are also pointing up), it's striking how few of the old relationships are working in this cycle. It's quite possible that some of the improvement in the continuing claims figures are the result of the jobless exhausting their benefits rather than finding work. A new study by the Center on Budget and Policy Priorities finds a record level of the unemployed exhausting their regular benefits without being eligible for additional aid.

Measures of future hiring plans present a mixed picture. Surprisingly, the Conference Board's help wanted index fell in December. But a more hopeful view comes from the new Gallup/Wells Fargo small business survey (taken in December), which shows the general level of optimism up considerably from the previous survey (done in August). Hiring plans are looking better, with 21% of firms planning to add to staffing levels this year, compared with 6% planning to shrink, a decided improvement over last year's performance, when the figures were almost equally divided. With large firms seemingly preferring to hire in India rather than the U.S., employment growth is unusually dependent on small businesses. Commenting on the survey, Gallup economist Dennis Jacobe points out that the improvement is still less than what might have been expected, given the strengthening in so many economic stats in the second half of 2003. So we'd take this all to mean a slowly improving employment situation, but nothing too dramatic.

Revision Notes

Friday brings the annual benchmark revisions in the establishment survey. (This used to occur in June; faster data processing at the state levels means the task can be accomplished in February.) The BLS has already announced that it will mark down March 2003 employment levels by approximately 145,000, so there's not much news there.

It's important to emphasize, however, that the annual benchmarking process is different from the normal monthly revisions of the payroll data. Although November payrolls were revised downward, the previous three months were revised up. It's often said that the direction of these revisions can be a tipoff to shifting trends—though these common Wall Street nostrums often dissolve upon factchecking. How about this one?

We looked at upturns in employment in 1970, 1975, 1982, and 1992, and found that there's something to this. It's not a dead certainty, but it's still a tendency. In earlier cycles, about two-thirds of the revisions in the three months following an employment trough have been upward. The record is less impressive the further out you go; revisions in the six, nine, and twelve months following a trough are roughly fifty-fifty. But based on this indicator, the fact that revisions in the three months following the July 2003 employment trough were all upwards suggests that there are grounds for hope that the trend change is real.

Retail Seasonals

There has been much discussion of a January bounce-back in the retail sector owing to seasonal adjustment factors that anticipate heavy layoffs. While it is true that January is the month with far and away the most forgiving seasonal factors (millions of jobs are expected to be lost), it is also true that the BLS has been working to smooth out the problem inherent in the old system, namely that it did not take into account weaker-than-expected hiring when adjusting for layoffs in later months, with their new concurrent seasonal adjustment technique. Last year, the retail sector fell 99,000 in December only to bounce-back by about the same amount in January. There are two differences this year that need to be pointed out. First, that flipflop was largely in the eating and drinking establishments, which have been moved out of the retail sector under the new classification system, NAICS. In December 2002 eating and drinking establishments showed their first drop BEFORE adjustment in many years, and the seasonal factor for December 2003, accordingly, actually boosted the sector by 40,000 jobs. The retail sector did fall this December after adjustment, but it fell far less than it did last year, giving it little room to bounce. And if we combine the retail sector with eating and drinking, it looks like the concurrent technique would have reduced last January's anomalous bounce considerably.

And speaking of seasons, although those

living in the Northeast may think weather should be a negative factor on payrolls, those subzero temperatures were not widespread. For abnormally cold weather to pound payrolls, it needs to extend from the Midwest down to the Eastern seaboard, and it didn't.

Friday's Numbers

We're looking for a headline payroll number of +100,000. Projections based on the claims figures suggest something like 127,000. The ISM employment numbers suggest a gain of 19,000 in manufacturing and almost 200,000 in services. But the actual numbers in recent months have badly lagged these projections, especially the ISM-based ones, so we're marking them down—a caution supported by the moderate tone of our withholding survey. With such tepid growth, we're expecting earnings growth to stay weak at around 0.2%, and hours to pop back 0.1 from last month's very low 33.7. Our unemployment model projects an 0.1 point drop to 5.6%, though no change is a reasonable possibility should new entrants and reentrants reverse recent weakness in labor force growth.

But what if there is finally some catch-up? What if we see a payroll figure over 250,000? Does that mean the Fed tightens in three months? Only if they forgot to review their history books; it will take months of payroll gains before we are in line with the historical trend in recoveries (we've got a payroll deficit, based on historical experience, of some 8 million jobs). And it's unlikely that the Fed, especially in an election year, will take a cavalier approach to an anomalous labor market.

(Richard Luebbe's irrepressible scouring of the news wires provided valuable material for this report. Thanks, Dick.)

by Philippa Dunne and Doug Henwood