

October 7, 2004

The Liscio Report

On the Economy

For John Liscio 1949-2000

Withholding weakness spreads beyond Midwest

The number of states that made their projected withholding collections in September fell from August's upwardly revised reading of 67% to 33%. (The three-month moving average, graphed on p. 2, fell from 55% to 48%.) In 2003, however, September receipts were considerably stronger than August's, so this year's drop may not be as bad for September payrolls as it appears. The number of states reporting positive growth year over year held steady at 85%.

With the exception of a few states scattered around the country, strength was concentrated in the Midatlantic region, where revenue collections continue to hold steady or even strengthen month by month. But elsewhere weakness moved beyond the classic rust belt states, with states on both coasts missing their projections, and mixed-economy states in the Midwest concerned about underlying weakening as well.

Just after survey week, several articles cropped up in the press detailing threats to hiring. For example, Reuters' Anupama Chandrasekaran reported that executives at their September Autos and Manufacturing

Summit cited rising health-care costs and "economic prospects" as the reasons they are hiring permanent employees judiciously, and relying on temp workers and overtime to meet increased demand. Separately, Reuters' Karen Pierog reported that cash-strapped school districts throughout the Midwest are starting the new year with thousands of fewer teachers. The majority of new hires anticipated by the BLS's seasonal adjustment factors in recent Septembers have been in education at the local government level. In recent years the seasonal factors have trimmed close to a million "local education" jobs from the August to September

seasonally adjusted job change. Below trend educational hiring, which is likely owing to state budget woes, poses a potentially serious but under-appreciated downside risk.

A real icebreaker

Ain't it grand to be sought out at cocktail parties to pontificate on the upcoming benchmark revisions? Ordinarily you feel like such a geek, but don't try it next year, when the upcoming elections will be relegated to the past. We'll probably see the benchmark revi-

- ***will weak WDI & Ivan et al. blow payrolls down?***
- ***CEOs less optimistic than economists***
- ***benchmarks coming***

fidarsi é bene; non fidarsi é meglio

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sions make rare front-page appearances in fish-wrappers across the nation on Saturday, and they could play a starring role in Friday night's presidential debate. (We'd like to offer a prize to the spin-doctor of either side who can keep the American populace focused on revisions to data already 6 months old. What would Rodney Dangerfield say?)

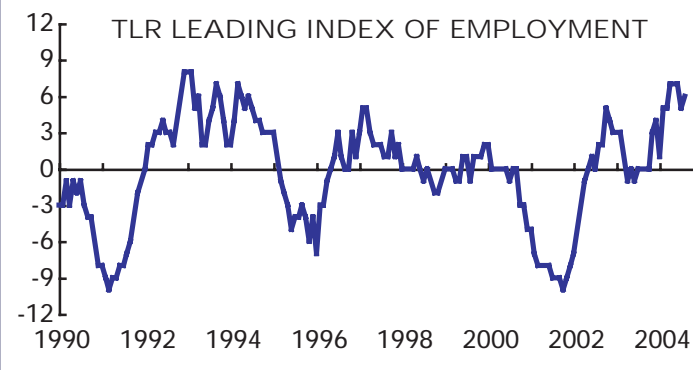
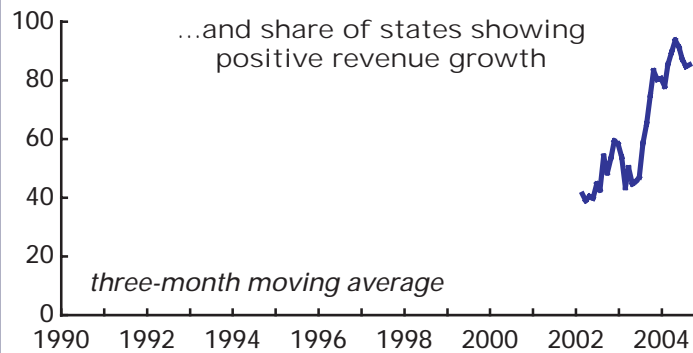
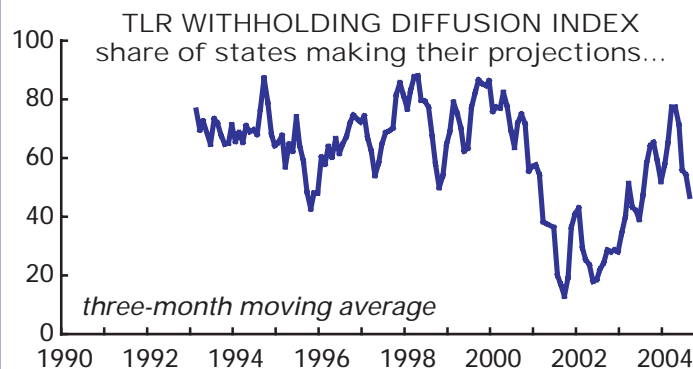
We are confident that the estimated benchmark, despite all recent speculation, will come in a bit below the 0.03% historical average, hitting the mark at 0.02 percent. There are two camps on the BLS error deriving from the birth/death model: Is it an actual bias in one direction or is it random? Our research on BLS revisions, carried out in moldy library basements, leads us to believe it's random. Anecdotal evidence suggests that payrolls were a bit stronger than reported through March 2004, which seems to be the month of strongest payroll growth, so we're leaning toward a plus sign. Still that doesn't rule out a negatively revised standard error.

Enthusiasts for a large upward revision are

once again pointing to the allegedly greater strength of the household survey over the last year or two. We say "allegedly" because on

close examination, the strength disappears. Shown on p. 5 are two comparisons of the establishment and household surveys since 1995—on the top panel, the level of employment, and on the bottom, the year-to-year change. The numbers in the household survey have been adjusted by the BLS to eliminate the periodic changes in the population controls, which can falsely inflate comparisons over time, and for differences in definitions and coverage. Some analysts choose not to use the adjusted numbers, even though the BLS publishes the series. But if you use the unadjusted household numbers, you are surely playing inappropriate games with apples and oranges.

three leading indicators of employment



anges.

A couple of things are notable about the charts. First, the establishment survey ran well ahead of the household count during the last years of the boom. In that context, the underperformance of the establishment series

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over the last few years can be read as the two surveys merely coming back into whack. Second, their courses since 2002 have been remarkably parallel—something you'd never know from the chatter about their supposed discrepancies.

Another way of making this point can be seen in the graph on p. 3, which compares the behavior of the establishment survey with the

employment/population ratio (EPR) from the beginning of the 2001 recession to the present. There are problems in transforming the raw household survey numbers into national estimates; for example, it's likely that immigration since 9/11 has been overestimated, meaning that population, labor force, and employment figures are inflated. But using the EPR—the share of the adult population working—largely eliminates this problem, since both the numerator and denominator are about equally affected by any problems with the population estimates. Note that establishment payroll growth over the last year or so has actually run ahead of the EPR. From this perspective, it's the household survey underperforming its establishment counterpart.

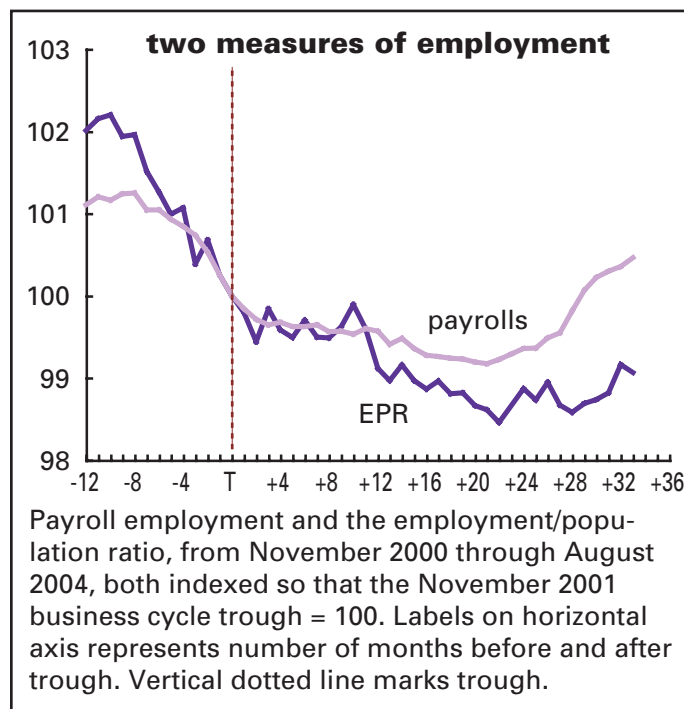
Job prospects

Our leading index of employment ticked up a notch for the month, from 5 to 6 (on a scale of -12 to +12). This is encouraging for the out-

look several months ahead, but the recent drop probably has yet to play itself out fully. The ECRI weekly leading index is also showing signs of stabilizing, but it's also likely that the weakening it's been forecasting hasn't fully played itself out either. Another bright spot is states reporting strong estimated payments for Q3/04.

While most economists are fairly upbeat in their outlook—the latest Blue Chip survey projects 2005 growth at 3.6%, a hair above the long-term average—a just-released survey of CEOs by the Business Council sees 0–2% growth next year. Top execs expect to see a modest drop in the jobless rate, but don't see any acceleration in the pace of hiring from this year's subpar levels. Nor do they expect a burst of capital spending; 42% expect to increase investment modestly, and 40% expect a continuation of this year's levels. Of course, intentions can always be altered, but you'd hope for something better if the soft patch were to turn out to be just a patch.

Even if the future is not boomy, the job picture is hardly bleak. A payroll processor for small businesses nationwide whom we talk to from time to time reports a pickup in hiring for the third quarter—accompanied, sad to say, by a fall in average pay. The Manpower hiring survey for the fourth quarter sits at a healthy 20, nearly 4 points above the series' long-term average, and where it's been since



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the second quarter. That suggests no acceleration in job growth as we approach yearend, but no retrenchment either. (The Challenger survey for September showed a big spike in layoffs and a sharp decline in hiring intentions, but we're not convinced that these numbers are all that useful.)

Andrew, Fran, Bonnie, and Floyd

Just as palm trees slap the pavement, initial payroll prints during the last five major September hurricanes have come in well below both trend and consensus—sometimes in the hundreds of thousands—only to rebound right back to trend in subsequent revisions. Intended partially to alleviate this kind of monthly gyration, the new concurrent seasonal adjustment factors employed by the BLS should distribute any horrific payroll drops caused by Ivan et al. to the surrounding 12 months, need we say both past and future? And, since the hurricane effect was largely absent from the initially reported August payroll, this is probably as it should be. This though is the first set of major hurricanes to be reckoned under the new factors so, like its predecessors, it remains a wildcard. Another way the hurricanes could hit payrolls is through delayed reporting. Florida has been generally a strong state. If the Florida “like businesses” used to impute non-responders in the BLS's imputing process themselves become non-responders because of the hurricanes, those that remain could impute behavior considerably weaker than the Florida averages, hence dragging the overall numbers down.

Friday's numbers

We're sticking to a below-consensus projection of +80,000, in line with our assessment of the true state of the labor market. In the words of a state contact at a relatively strong

Midatlantic state: “We ain't gaining, we ain't falling, we're just hanging in.” But it may well be that a confluence of factors will come together to hammer September payrolls. Given the initial prints of payrolls under the last five major hurricanes, the degeneration in our survey of state withholding receipts, and drops in confidence, we would not be surprised if the September payroll flashes across the screen close to flat, a result that will be quickly understood to be upwardly revised in October.

We're also looking for an uptick in the unemployment rate to 5.5% (not a big leap, since August's unrounded figure was 5.431%). Since labor markets remain pretty slack, earnings should rise a modest 0.2%. Hurricanes have historically taken a bite out of hours, so we're looking for the workweek to fall back to 33.7, supported by weakness in withholding collections in the Midwest.

by **Philippa Dunne and Doug Henwood**

comparing the surveys



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