

November 6, 2003

# *The Liscio Report*

## On the Economy

For John Liscio 1949-2000

### Continued Improvement in State Withholding Taxes

Our Withholding Diffusion Index, the percentage of states that made their withholding tax projections in October, came in at 74%, up a bit from September's revised reading of 70%. The number of states showing positive growth year over year was unchanged for the two months at 76%. (The three-month moving averages of these two measures, graphed on p. 2, also rose nicely.) Also, last month's levels were revised up substantially; the calendar forced the BLS to re-release their employment report on the early side, and our states did not have their final numbers. The September WDI was revised up from 57%, and the number of states reporting positive yearly growth was up from 64%. Another encouraging facet: a number of states in the positive growth column reported larger year-over-year revenue gains, and some big Midwestern states reported marginally better collections for the first time in months.

That the survey has held last month's gains is certainly good news and bodes well for continued improvement in the

national labor market. Our contacts believe that the services sectors in their states are likely to show the strongest growth, and the states with higher-paid service sectors are reporting the highest revenues, as are the tourist destinations at this time of year. The states with the weakest collections all are sensitive to continuing troubles in factory employment—though, encouragingly, three states suggested some improvement in manufacturing.

There are a number of factors that support the higher range of the consensus for Friday's payrolls. We're getting back to the time of year when weather is important, and survey week was unusually warm and

dry, excepting areas of the Gulf Coast soaked by torrential rains. With continuing strength in construction, the seasonal expectation of a drop in that sector may be a bit off. The strike in California may have pushed the number up as well. Employers were reportedly training replacement workers going into the strike, so workers on strike as well as their replacements may have been reported as em-

- ***indexes rise, labor market firming***
- ***how bad was the recession?***
- ***what moves bonds?***

*fidarsi é bene; non fidarsi é meglio*

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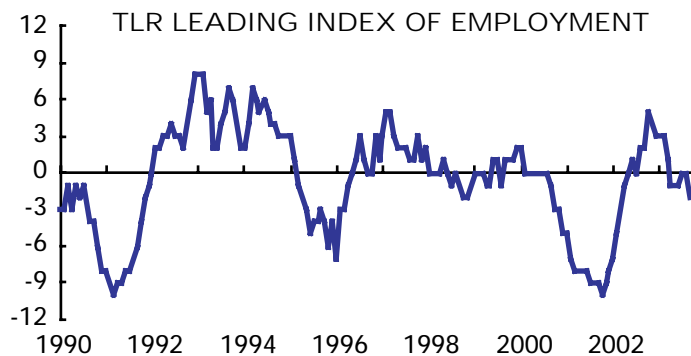
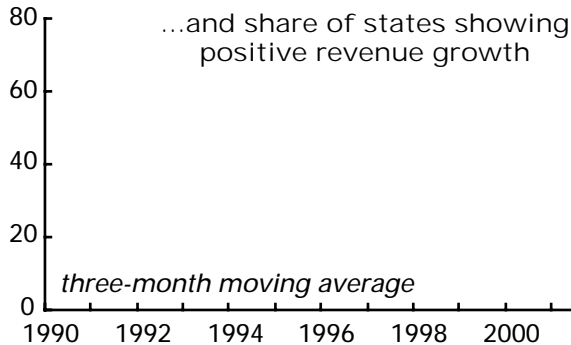
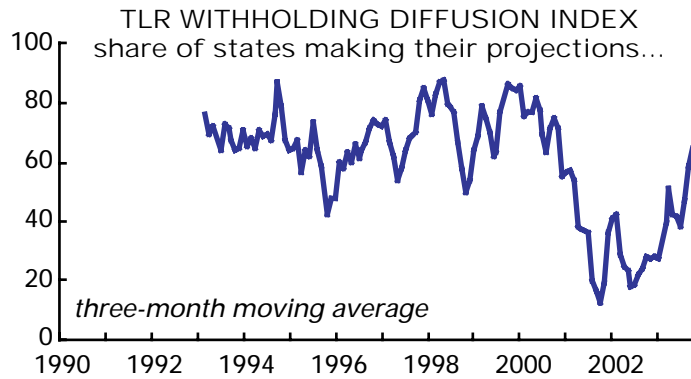
ployed in survey week, giving payrolls a temporary boost, especially as the strike's negative effect on collateral employment, like trucking, would not have been felt during survey week.

We must pass along that when asked point blank if the jobs situation is actually improving, our contacts in all regions but the Midatlantic paused for an uncomfortable few seconds. In general they answered yes, but concerns were that improvement in withholding receipts are over a couple of tough years, and are therefore in line with anecdotal evidence of, say, high-tech workers out of work for several years now finding three-month contract jobs without benefits. There is concern that the rising levels of home ownership are making it harder for workers

to relocate should their jobs move to a different state (several of our contacts had family members in this position), that a number of passing factors may have contributed to two months of improved growth, and that many manufacturing

jobs are now quite clearly lost. And the calendar demands a number of tricky adjustments. But, in any case, tax receipts are, on balance, looking up.

### three leading indicators of employment



### A backward glance

Memories of the recession are rightly fading, as the pace of recovery takes center stage, but an occasional look back is in order, especially since such memories are probably still shaping perceptions today. While the recession was mild by almost all measures, its impact on most Americans was probably stronger than conventional measures indicate.

Jared Bernstein of the Economic Policy Institute recently put together estimates of the number of annual hours worked by the average American family be-

tween 1979 and 2002. As the chart on p. 3 shows, the decline between the peak year 2000 and the apparent trough in 2002 was steeper than that of the early 1990s recession. The decline between 1979 and 1982 was deeper, but it was spread out over an

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additional year; at an annualized rate, the recent contraction was almost as harsh as that of twenty years earlier. This analysis also calls into question any lingering assertions that employment in the household survey has been significantly stronger than that in the payroll survey.

### Underlying trends

Our leading index of employment slipped two points, from 0 to -2, on continuing weakness in help wanted and a slow-down in temp employment growth.

We're skeptical about reading too much into this, especially since Friday's numbers could change the temp picture, and other leading indicators (like claims) are looking better. Still, it counsels against expecting a marked acceleration in job growth over the next couple of months.

There are other reasons to be cautious about letting bullishness get too far ahead of events. In a speech on Wednesday, Treasury Secretary John Snow, who is paid to be optimistic, said "though positive signs are emerging and the outlook is positive, it appears to be taking longer for labor markets to respond to the upturn in economic activity," which sounds like a retreat from his prediction of 200,000 monthly payroll gains just a few weeks ago. And the FOMC, which has a better eye for these things than most of us, said in its October 28 statement that the "labor market appears to be stabilizing." This week's ABC/*Money* consumer comfort figures were unchanged, despite the strong GDP report, and remain essentially unchanged since June. Other sentiment figures are creeping higher, but are also essentially unchanged

since June. And the jobs components of the Conference Board's confidence survey improved slightly in October, but as the chart on p. 4 shows, we need plenty more of that. Putting all these measures together supports a picture of a labor market that strengthening, but gradually.

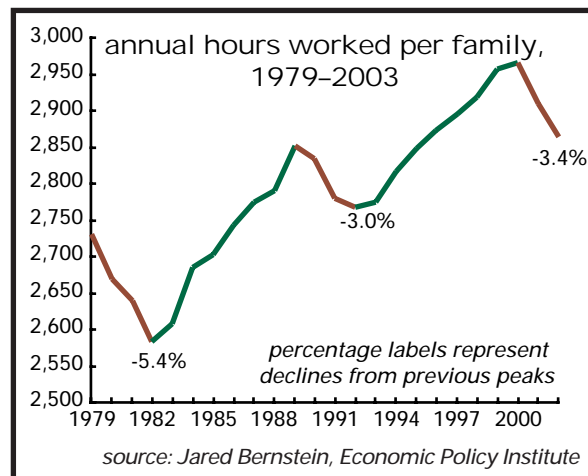
### Friday's Numbers

Taking our revised withholding index for September as being in line with the reported employment growth of about

50,000,

October's slightly higher reading would suggest a slightly larger job gain.

Double-counting related to the strike could add another



30,000, and construction another 10,000 or so. That gets us into the 90,000s, an upbeat expectation supported by the strength in the ISM service employment figure, which finally poked its head well above 50 (though the corresponding reading for manufacturing failed to join in, suggesting a decline of 10,000-20,000 in that sector). And that's close to where we think the number will come in—between 75,000 and 90,000. Whatever signs of improvement we've seen recently, if the headline number powers interest rates up, that could be a dangerous thing for the still fragile recovery. Remember we need monthly job gains of 250,000 for a "historically correct" recovery. (For more on

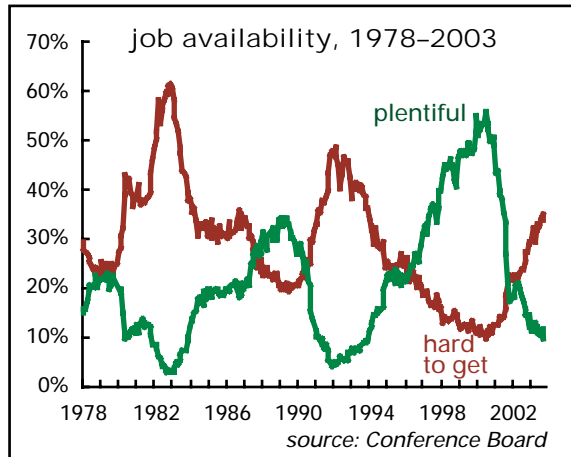
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what data moves the markets, see the box on p. 5.)

The workweek has been at or near record lows for several months. If there is anything to the recovery, it will surely rebound to 33.8

hours. And nominal wages came in at a very rare negative last month. With the growing disparity between high and low income levels, and our contacts' concern

that much of the improvement in withholding is coming from wages rather than job growth, a relatively strong hourly wage gain of +0.3% looks reasonable. The unemployment rates looks likely to be steady or down 0.1 point to 6.0%, with that heavily dependent on what happens to the labor force.



**what moves the bond market?**



by Philippa Dunne and Doug Henwood

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### What moves the bond market?

We're all familiar with how releases of economic stats can move markets, especially when they surprise, but which ones move markets the most? A recent study by Linda Goldberg and Deborah Leonard of the New York Fed

[www.newyorkfed.org/research/current\\_issues/ci9-9.html](http://www.newyorkfed.org/research/current_issues/ci9-9.html) answers that question for the U.S. and German bond markets.

Goldberg and Leonard studied hourly two- and ten-year yields from January 2000 through June 2002. Perhaps most importantly, since sometimes the things we "know" are wrong, they did confirm that news moves the credit markets. The most powerful movers of the U.S. bond markets are the payroll numbers, the unemployment rate, initial claims, and the advance (first) reading of GDP; surprises of one standard deviation or more resulted in moves of at least 3 bp in two-year yields and 2 bp in ten-year. Similar surprises in the Michigan and Conference Board confidence surveys, the employment cost index, the purchasing managers surveys, retail sales, and the unemployment rate produced moves of 2-3 bp in the two-year and 1-2 bp in the ten-year. Surprises in the PPI moved both maturities about 1 bp, while surprises in the CPI had a minor effect on the two-year and none on the ten. Initial claims surprises moved the two year a bit more than 1 bp,

while they had only a marginal effect on the ten-year. Releases that had no statistically significant effect included inventories, capacity utilization, construction spending, durable goods, factory orders, the leading indicators, consumption expenditures, and revisions to GDP.

Most of the market-moving U.S. releases spilled over into the German bond markets, while German data had almost no effect on U.S. markets. The most important German data for the German markets were the trade and current account balances, manufacturing output, and producer prices. Surprises in Euro area business confidence, consumer prices, and preliminary GDP also moved German yields.

All the yield movements were in the expected direction, with downside surprises lowering yields, and upside surprises raising them.

One surprise from the study, however: unexpected changes in the Fed funds rates produced changes in the *opposite direction* for ten-year Treasury yields. That is, surprise increases in the Fed funds rate lead to lower bond yields. Such surprises proved rare, however; it appears that the Fed has been quite skillful in telegraphing its intentions to the markets.