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# The Liscio Report

## On the Economy

For John Liscio 1949-2000

# Withholding steady; states question job growth

Seventy-six percent of the states in our survey made or exceeded their projected withholding tax collections in June. We had originally reported May's level as 85%, but that has been revised down to 75%. (April also stands lower than originally reported, 85% v. 90%.)

Comments from our contacts were in line with last month's. The states with concentrations of high-income individuals take special care to estimate the share of withheld taxes coming from these payers, and are generally convinced that their strong collections derive from them and not from an influx of jobs going to "ordinary guys" at lower income levels. The estimator at one large eastern state that, in fact, missed the June estimate commented that year-over-year growth of close to 4% was "pretty good considering we have no evidence of any real growth in employment." The economist at a large midatlantic state that is currently slowing after years of growth well above the national average believes that employment there remains "strong, or at least stable." And our contact in a southwestern state suggested that high royalties caused by strenuous oil and gas exploration efforts may have a hand in improved withholding collections. Withholding growth in most regions, though, outside the occasional monthly blip, is in a slowing trend. Underpinning this is the weakening housing market. We'll include more on this in our upcoming sales tax report, but this month some of the states that reported year-over-year drops in real estate transfer taxes were surprised to see collections actually going negative so soon.

***• parsing the ADP***

***• skills shortage***

***• income flattish, profits soar***

Several Midwestern states are "waiting for the next shoe to drop." Layoff announcements and buyouts don't stop at the auto industry. Maytag, Rubbermaid, Electrolux and other lower profile firms are also closing or consolidating factories. Some states pointed to an uptick in their initial claims in recent months, even before the plants have closed. One auto-heavy state said that although withholding recovered in June (although a large neighboring state missed their target by quite a bit) employment was still "looking bad, although wages are up."

*fidarsi é bene; non fidarsi é meglio*



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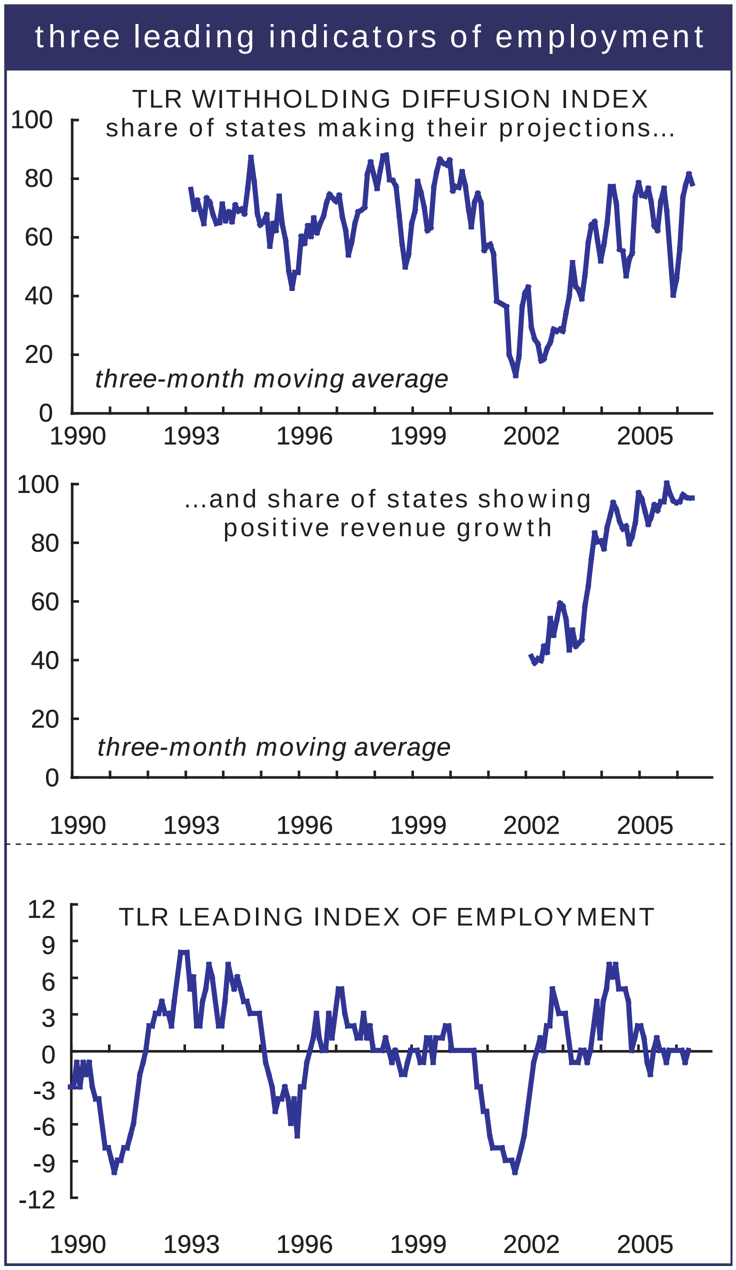
## That ADP report

So, what about the ADP index that screamed through the bond market on Wednesday morning? Some traders suggested that market players were perhaps just doing what they had wanted to do, but since the index has an excellent correlation to the nonfarm payroll report, we do want to give it serious thought, especially since we are not significantly upping our own forecast based on ADP.

There are apparently some technical issues, e.g., they may have problems with the five-week span between the May and June survey weeks, which they do not adjust for. They suggest this isn't such a big problem because their June seasonal factors include a number of Junes with similar five-week spans, so the hurdle is there. The BLS, however, has a separate adjustment for the five-week spans. This brings us to broader point more structural than technical concerning long-term relationships and the historical performance of the US labor market.




We have often mentioned the current disconnect between many of the labor market model inputs that have performed extremely well over time and current growth in US employment. Familiar series are currently over-predicting job growth. This may be because in the past when the job market was improving we'd regularly see strings of monthly gains of 250,000 and even 300,000 payrolls. We just haven't had this kind of consistent monthly job growth in this recovery/expansion. Yet we hear repeatedly that, say, initial claims at some current level suggest job growth we might have seen back in the day. Over the long term, the employment component of the ISM manufacturing survey correlated quite reliably with factory job growth; when the index was over 50, payrolls expanded, and when it was under 50, they contracted. Not recently though; over the last 5 or 10 years, it's taken readings in the high 50s to get plus signs in factory employment. (The current level of 48.7 suggests further losses.) So, in addition to the fact that the ADP Index sometimes suffers outsized misses at extremes, as David Rosenberg of Merrill Lynch has argued, their model may be pegged to the monthly gains of the US labor market's more robust past. (Since their sample size is so large this would not be as significant an issue as it may be for proxy based forecasts.)

### Skills shortage

There's an ongoing debate on whether a shortage of skilled workers has lead to slower hiring recently, and we mentioned in last month's piece that recent college graduates with requisite skill sets are getting multiple job offers and signing bonuses. Some of these new workers certainly received paychecks by survey week, and may have allowed employers to hire at a level perhaps closer to their goals. But the BLS's seasonal factors anticipate this, and since there are a limited number of graduates (reckoned at about 1.5 million, not all likely to show up in one month) there is an upside limit.

Another bit of evidence for some shortage of skilled workers comes from a July 3 piece in the *Los Angeles Times*, "Access to Job Market in U.S. a Matter of Degrees," by Anna Gorman. Extracting actual facts from the highly political argument concerning H-1B visas is tough. Many firms argue that restricting access to these workers cuts into competition, and makes it impossible to fill job openings because there are not "enough US citizens pursuing degrees [in science and engineering]." An Intel spokesperson reported that 5% of their US-based workforce are on H-1B visas, and they need more such workers. Those who favor keeping stricter quotas (currently at 65,000 but slated to rise) argue that there are plenty of US citizens qualified for such work, but that companies prefer to hire less expensive workers from, for example, China and India. Whatever. We mention it because Gorman points out that applications for H-1B visas hit the current quota by the end of May this year, just 60 days after Immigration Services opened the process on April Fools' Day. Last year the cap was reached in August, and in 2004, in October. (There are an additional 20,000 visas available to foreign workers with master's degrees and higher; those are still being accepted.)

### Growth contrasts revisited

Though there's no shortage of analysts eager to dilate on the strength of this cyclical expansion, it's remarkable how poorly it stacks up historically, at least on some measures. It's pretty well known that employment growth is the weakest of all the post-World War II expansions. Less well known is the fact that broader measures are also underwhelming. GDP growth is also the weakest of all the post-World War II expansions, coming in a hair behind its 1990s predecessor. (Though everybody remembers the boomy years of the late 1990s, the first half of that expansion was torpid, which dragged down the average.) And income growth has been pretty disappointing as well.

The graphs on p. 6 recount the history of growth in real wage and salary incomes and in disposable (after-tax) personal income (DPI) per capita. Although both series have picked up over the last quarter or two, they're still at the lower end of their historical ranges—and the trend on the DPI remains down, as if we were just crawling out of a recession. Nominal wage and salary income was unchanged in May, a pretty rare occurrence.

The table immediately below shows the

**real disposable income per capita**
*18 quarters after trough*

| trough | growth | constant tax rates |
|---|---|---|
| 49Q4 | 11.9% | |
| 54Q2 | 10.1 | |
| 58Q2 | 10.1 | |
| 61Q1 | 20.3 | |
| 70Q4 | 14.3 | |
| 75Q1 | 13.3 | |
| 80Q3 | 14.5 | |
| 82Q4 | 13.5 | |
| 91Q1 | 5.2 | 5.7 |
| 01Q4 | 7.4 | 5.4 |

gains in real DPI eighteen quarters after a trough: note that the current reading is the second-lowest on record. (These are totals, not annual averages.) But recent experience was given a substantial lift by the tax cuts of the early 2000s—a contrast with the 1990s expansion, which saw significant tax increases. The second column of the chart shows what recent gains would look like without any tax changes: with that adjustment, the current expansion falls behind its predecessor.

But there's one area where the current expansion is almost unprecedentedly strong: profits. The second table on this page makes that clear. Total real profits for nonfinancial corporations (deflated by the price index for nonresidential fixed investment) is up at a 28% average annual rate (these are *not* cumulative numbers—they're annual averages), and real unit profits (from the productivity series) are up almost 21% a year. The only near-precedent for this kind of performance is the brief expansion of 1980–81, which lasted only a year. Nothing else comes close. Whatever one's social philosophy, it doesn't seem as if this sort of thing can go on forever.

## Friday's numbers

Aside from the ADP report, other job market indicators show few signs of acceleration. Our own leading index of employment rose a notch, from –1 to 0, but its graph on p. 2 has a distinctly meandering feel over recent months. The Conference Board's help wanted index declined in May, with every region of the country showing negative signs. Though it's undoubtedly the case that newspaper ads don't mean what they once did, the Board's online index, launched in April 2005, increased 4% in May, but remains below its March level. And just 24% of markets saw rising online want-ad vol-

**nonfinancial corporate profits**
*average annual growth rates*

| | total | unit |
|---|---|---|
| 49Q4 | 9.0% | |
| 54Q2 | 3.9 | |
| 58Q2 | 15.2 | 6.0% |
| 61Q1 | 5.3 | -1.2 |
| 70Q4 | 11.6 | 4.0 |
| 75Q1 | 5.1 | 0.1 |
| 80Q3 | 31.2 | 23.4 |
| 82Q4 | 7.5 | 1.4 |
| 91Q1 | 4.5 | -1.7 |
| 01Q4 | 28.0 | 20.6 |

ume in May, compared with 41% in April, and 51% a year ago. It's hard to square this with a strengthening job market. And another Conference Board series softened slightly—the gap between those describing jobs as plentiful vs. those describing them as hard to get in the confidence survey.

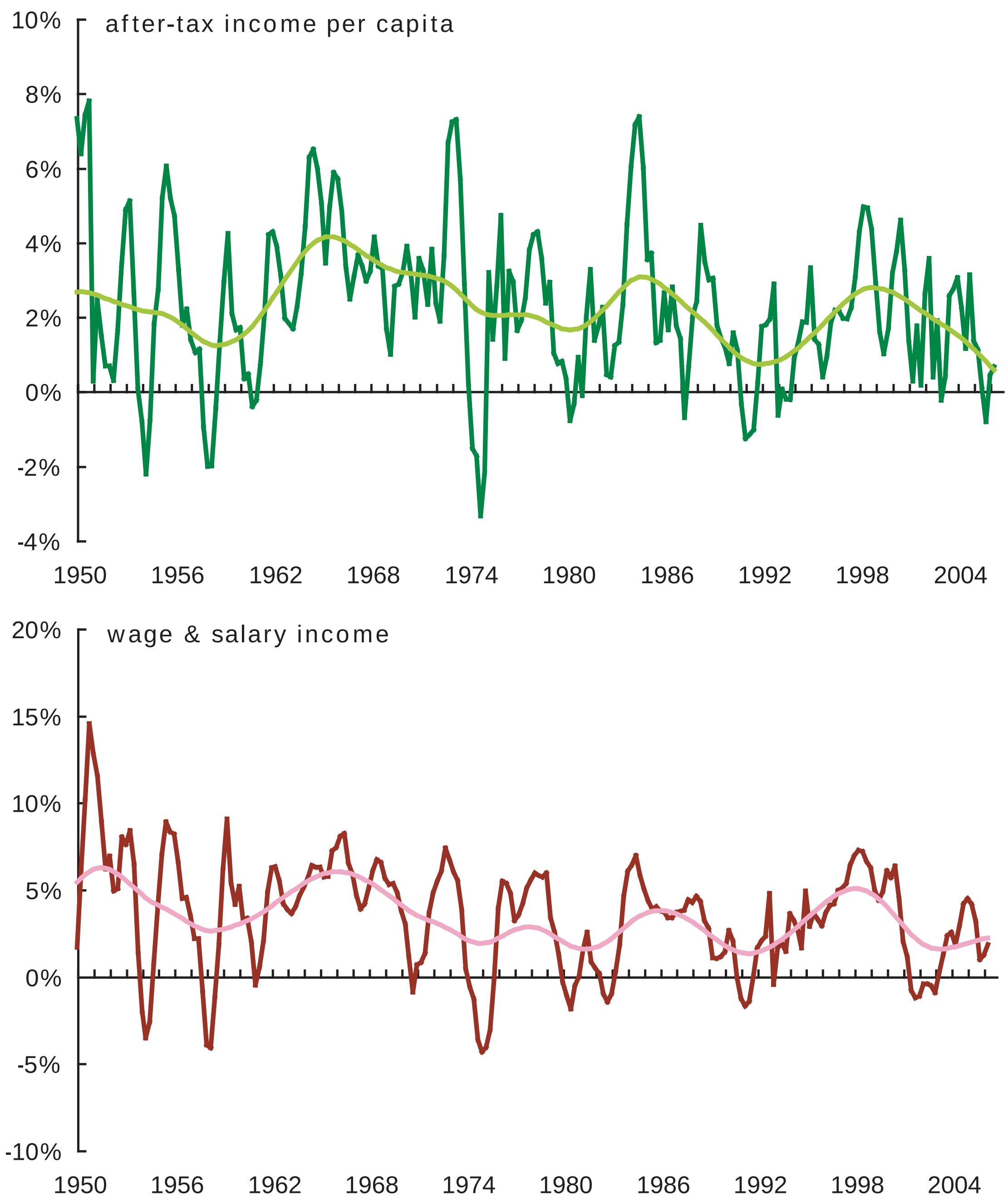
The Hudson Employment Index, which measures worker confidence, held steady in June after May's decline, but it's still below its year-ago levels. And the share of workers reporting their personal finances to be deteriorating rose to a surprisingly high 43%, the third consecutive monthly increase. According to the firm, perceptions of hiring have not risen to offset the effects of higher interest rates and energy prices. So even if the ADP figure is prescient for the month of June, it doesn't look like the beginning of a new trend.

We believe nonfarm payrolls grew 150,000 in June. This is slightly above recent trend, and takes into account some stabilization after two disappointing months. Although we think the unemployment rate will hold steady, we see the danger as being to an increase. (The unrounded unemployment rate was 4.646% last month, and so needs to rise only 0.004% to get to 4.7%.) Earnings were well below trend last month, and we expect them to return to +0.3%, and the workweek to hold steady at 33.8, especially with the weakness in current indicators of good old manufacturing activity.

***income growth***

**by Philippa Dunne and Doug Henwood**

## INCOME MEASURES, REAL YEARLY CHANGE




Year-to-year changes in disposable personal income per capita and total wage and salary income, both deflated by the PCE deflator. Figures for the second quarter of 2006 are based on April and May monthly data. Lighter lines are Hodrick–Prescott trendlines.