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Promises Promises

The stock market isn't the only thing that has been on a wild ride this spring and summer. So too has the BLS monthly jobs report.

On March 8 the Bureau of Labor Statistics (BLS) came out with a dismal jobs report for February, 2019 and then on March 20th the Fed announced that although the economy is "in a good place" and "economic fundamentals are still strong," growth is slowing from last year; therefore, the Fed will halt any planned rate increases for the foreseeable future.

Later in the summer the Fed changed course for the first time in 11 years and reduced the interest rate signaling that they had a concern about a potential economic slowdown.

The March jobs numbers came in at 189,000 (later revised downward by 75,000) and April followed suit coming in at 263,000 (and later revised downward by 75,000). The May jobs report was dismal, showing job growth of just 75,000 for non-farm payroll which was 100,000 shy of what economists were expecting. The June jobs numbers came in at a strong 224,000.

The jobs report for July (announced August 2) came in with growth of 164,000 jobs, just shy of the expected 165,000. This was right on the heels of the Federal Reserve cutting interest rates for the first time since 2008. That reduction of 25 basis points signaled that the Fed was concerned about a potential economic slowdown.

The real body blow might have come in late August 2019 when the BLS revised its jobs numbers DOWN by over 500,000 for the 12-month period ending March 2019.

Job gains for July and August were revised up by 45,000 in total adding a bit of hope to a fairly bleak picture. But then "[h]iring slowed in September as employers added 136,000 jobs, doing little to ease recession concerns and at least opening the door to another Federal Reserve rate cut as early as this month."

So, is this a turning point for the US economy?

Are we facing a recession?

Let's look first at the BLS jobs report.

As news outlets (fake or not) glom onto tidbits of the BLS jobs reports it might be worthwhile for us to ask, "Is that (or any) jobs number correct or ever correct?" No question jobs drive growth since it's that "circle of life" of working, getting a paycheck, and buying stuff with that money that fuels our (and every) economy. But it is pretty clear that with revisions both monthly and annually, the BLS jobs report might be no more than an indicator. And, of course we must be clear that one month isn't the issue, the real issue is what will happen longer term? That will help determine if this year's reports are an aberration or a forewarning of an economic slowdown, or worse, a recession.

Digging a little deeper,

how does the BLS come up with that monthly number?

A little secret is that the jobs data is essentially a best guess. The BLS "conducts the Current Employment Statistics (CES) survey, collecting data each month on employment, hours, and earnings from a sample of nonagricultural establishments. The sample includes about 140,000 businesses and government agencies, which cover approximately 440,000 individual worksites drawn from a sampling frame of roughly 9.0 million Unemployment Insurance tax accounts." That is the sample, and since, according to BLS, it represents 1/3rd of all non-farm employees, it's an adequate sample size. But it remains the statistical equivalent of a best guess. In fact, the BLS refers to these numbers, when first released, as a "preliminary estimate."

"According to the BLS, the actual monthly change in the number of jobs likely falls somewhere in the range of 120,000 more or 120,000 less than its estimate. That means you can be confident that job numbers grew in a given month only if the change in monthly hiring is 120,000 or greater."

Again according to the BLS, the jobs numbers are revised twice, at one month and at two months following the initial release of the preliminary estimate. These revisions are far less "hyped" by the media than are the initial announcements.

To make things even more confusing, with (maybe) only 20,000 jobs added last February, for example, the unemployment rate FELL to 3.8%. However, there are two measures of unemployment. This 3.8% number is called the U-3 rate, defined as "total unemployed, as a percent of the civilian labor force." A broader measure of unemployment is the U-6 rate (also called "real unemployment") which includes workers too discouraged to search for a job and those who are "under employed" such as part time or temporary workers who want full time jobs. That "real unemployment" rate plummeted by .8% to 7.3% in February 2019.

And not too surprisingly based on our low unemployment rates, the good news in the BLS report was on wages. The average hourly earnings rose $.11 in February 2019 making the year over year increase 3.4% which is the highest since April 2009.

But BLS jobs report, if it is a bellwether for the economy, could be impacted by things as diverse as the partial government shutdown (which increased unemployment figures in January 2019) and bad weather, including February 2019 records for heat, cold, snow, and rain (which impact construction employment). Or it could be other economic factors that are making businesses wary of hiring, such as the global economic slowdown - especially in China, Japan, and Germany, Trump's tariff war with China, and political uncertainly both here in the USA as well as in the EU the UK.

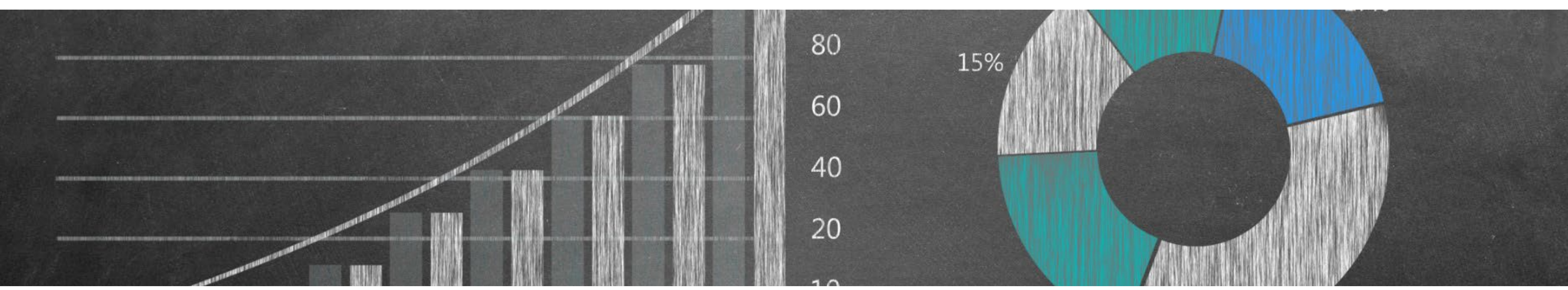
On March 20th, the Federal Reserve announced that the US economy was "slowing more than it had previously thought" particularly due to a decline in consumer spending and slowing business investment. And by July 2019 it had decided that the slowdown was enough to warrant the first rate cut in 11 years. The Fed expects that 2019 growth will be just north of 2% (and predict a number south of 2% for 2020). This is far less than the 3+ % growth promised by Trump when he and the Republicans ramrodded the Tax Cuts & Jobs Act through Congress in late 2017. While the tax cuts boosted the economy in the short term, the effects are fading, possibly quite quickly.

Growth requires either increase in productivity or job creation. Job creation requires workers. With unemployment currently at 3.7%, finding workers will be a challenge.

And what's all this about slowing business investment? Wasn't that what the reduction in the corporate tax rate was supposed to encourage? Well in part business investment did grow in 2018 to 7%, but in the first half of 2018 the growth was 10%, by the second half the growth was down to 4% which was about the same as the mid-2016 numbers.

"Businesses turned cautious for a number of reasons: Trump's saber-rattling on trade rattled executives' confidence in their return on investment. Slower global growth magnified those worries."

According to a December 20, 2018 blog by the Brookings Institute "companies have spent much of their tax savings on a stock buy-back spree totaling some $1.1 trillion in 2018..." Brookings Institute goes on to say that business investment might reach $550 billion in 2018, only half what they are spending on stock buy-backs. "



Because average families gained little from the tax changes, their purchases of houses and durable consumer goods continued to slide through 2018."

A Flattening Yield Curve?

Is the US heading for a recession in 2019? The jury is still out on that. But a weakening economy isn't helpful. Even more troubling is the yield curve as it has been "flattening" for over 18 months. According to the Federal Reserve Bank of San Francisco, with one false positive in 1966, an inverted yield curve has preceded by about one year every U.S. recession since 1960.

So, is a recession likely in 2019? Probably not since we are more than half-way through the year. But a recent survey of business economists reported that 42% of survey respondents believe the US will enter a recession in 2020, and another 25% believe the US will enter a recession in 2021. The next decade looks like it may start with some economic challenges for the United States. And as a final note, according to a recent article in Forbes, wouldn't we all have to agree that "[i]f the job market was on fire, college-educated professionals from a white-collar background would not be driving Ubers, bringing you lunch or serving you artisan coffee. They would be working in their chosen fields and earning a decent living." Yes, yes they would.

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What is difficult to understand when it comes to the unemployment numbers is what we refer to as the "matching issue." If unemployment is at, say, 3% that doesn't necessarily mean job seekers have the skills needed for the open positions. Many clients have told us that they simply can't find the right employees for certain positions such as software, sales, finance, and others with specific requirements pertaining to education or experience. The fact is, we would guess that the unemployment rate for individuals who are able to fill these positions is closer to *negative* 10%. There are far more openings than there are qualified candidates. Without the right potential employees, business is bound to slow down.

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The simple choice many of our clients are facing is to slow growth or hire less qualified employees and commit to training and development time or, alternatively, go "overseas" where there may be more qualified employees often willing to work for lower pay. However smaller organizations (which represent the bulk of the U.S. economy) really don't have that as a practical option. Of course some positions such as customer service, accounting and finance, and even some programming can be successfully outsourced to India or South Korea (for example) but outsourcing has its challenges as well.

It is not just the technical positions that are difficult to fill. Some of our fast food clients have confided in us saying that the one thing that is keeping them from expanding is the server staff, which is not available to support the expansion.

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Ultimately low unemployment will raise wages and costs which will lead to some inflation, unless a second event occurs. That second event is the automation. Yes, robots aren't just coming, they are here! We recommend to anyone who doubts it, go to the internet and take a look at the factory designed to build Tesla cars. It is estimated to be over 80% automated. (It was supposed to be 100% automated but not everything can be automated yet.) These robots are making 10's of thousands of cars per month.

It is difficult to look at this multitude of data pertaining to these inter-related issues of unemployment, GDP growth, wage and price inflation, and automation and determine the correct approach over either the short or long term.

However, today's organizations have to "make a bet" now even though it may be some years before we understand the impact. ■■■