



## January Employment Report - The True Story is in the Details Not the Headlines

### Highlights of the Employment Report:

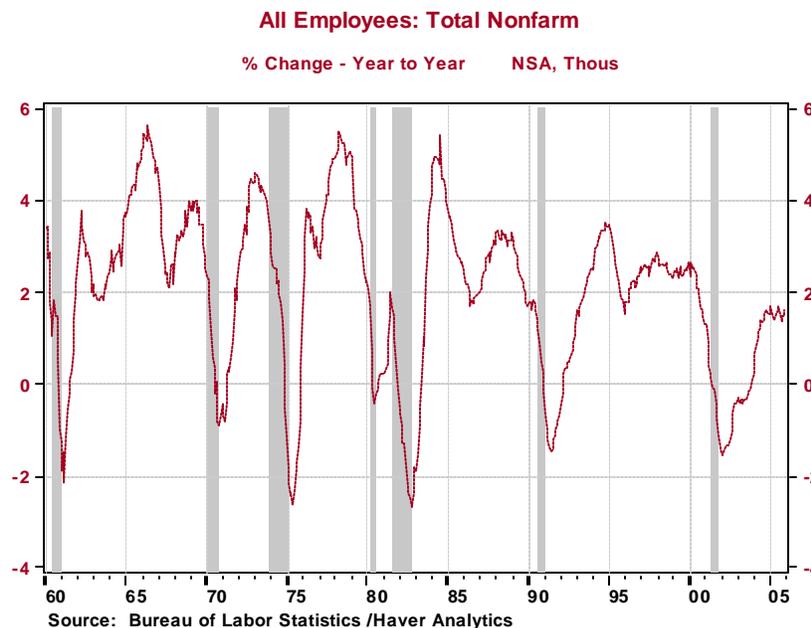
- Unemployment rate dropped to 4.7% in January from 4.9% in prior month. This is the lowest reading since July 2001.
- Payroll employment rose 193,000 in January, revisions added 85,000 more jobs in November and December.
- Construction employment rose 47,000, 7,000 new factory jobs were created, and service sector payroll employment increased 135,000. 2,000 retail jobs were lost, 21,000 more jobs in the financial sector, and payrolls rose 29,200 in the health sector.
- Hourly earnings increased 7cents to \$16.41, up 3.3% from a year ago.
- Manufacturing man-hours index rose 0.2% in January, supports moderate growth in industrial production.

### Analysis of the Employment Report:

We get excited about 193 thousand monthly increase in nonfarm payrolls only because employment growth has been so feeble in this business recovery/expansion.

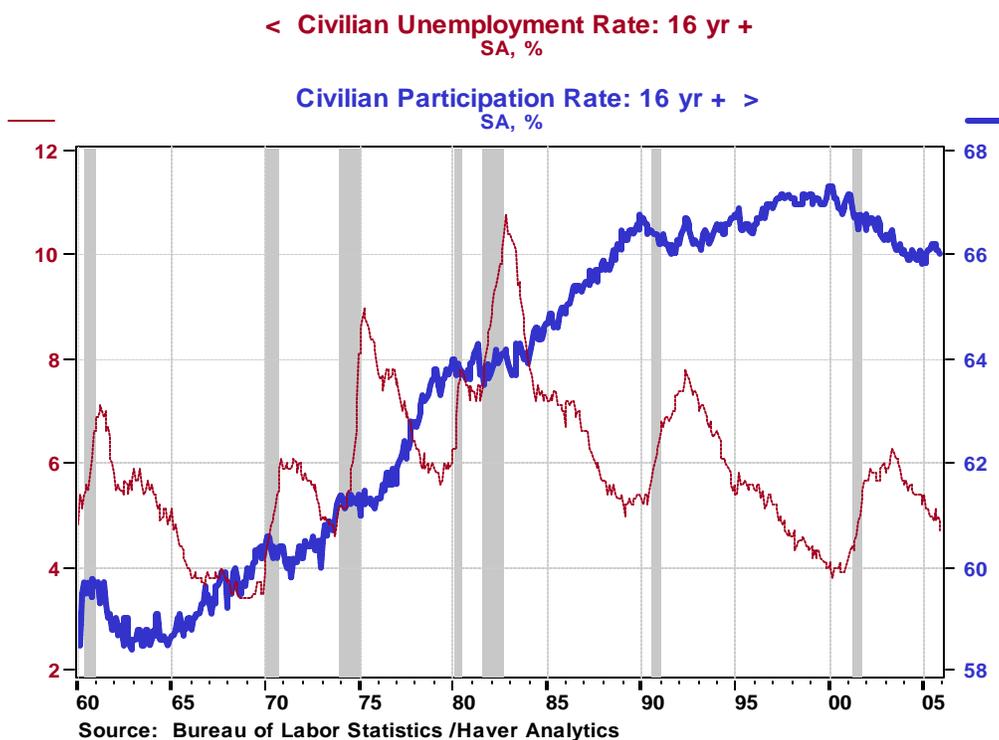
Chart 1 below illustrates just how feeble employment growth has been in this cycle. Year-over-year nonfarm payroll growth appears to be peaking out around 1.6% -- lower than any other cyclical peak in the past 45 years.

Chart 1



Aha! But what about that 4.7% unemployment rate? Although there have been cycle lows in the unemployment rate beneath 4.7%, there have been a number of unemployment rate nadirs above 4.7%. Yes, but. But there has never been an expansion cycle in the past 45 years in which the participation rate (those actually in the labor force as a percent of those that *could* be in the labor force) trended lower save for the current one (see Chart 2). Had the labor participation rate risen in a normal cyclical fashion, today's unemployment rate would be considerably higher. Katherine Bradbury, an economist at the Boston Fed, discussed this unique cyclical behavior of the participation rate only to have the big guns of Federal Reserve *Board* economists discredit her "politically-incorrect" study. Kind of makes you wonder why the 12 Fed District Banks even have economic research departments given that the font of all knowledge resides with Board economists.

Chart 2

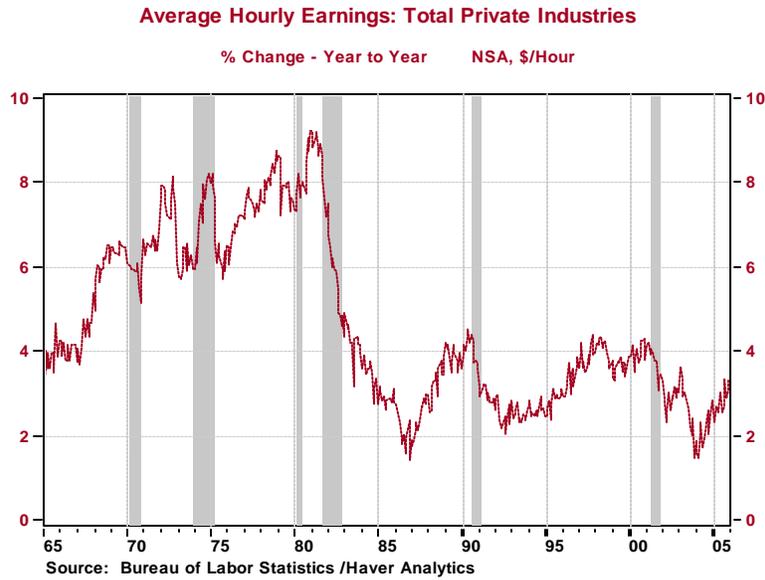


We also get excited about the rising trend in the growth of average hourly earnings. On a year-over-year basis, average hourly earnings of nonsupervisory private sector workers increased 3.3% in January. This is well below the peaks of over 4% in the prior two economic expansions (see Chart 3). Average hourly earnings are a relatively crude measure of employment costs. They do not include compensation of supervisory workers. They do not include compensation in the form of employee benefits. And, as important, there is no control for the mix of jobs being created. For example, suppose that a lot of higher-paying construction jobs are being created relative to lower-paying hamburger helpers. This will bias upward gains in average hourly earnings.

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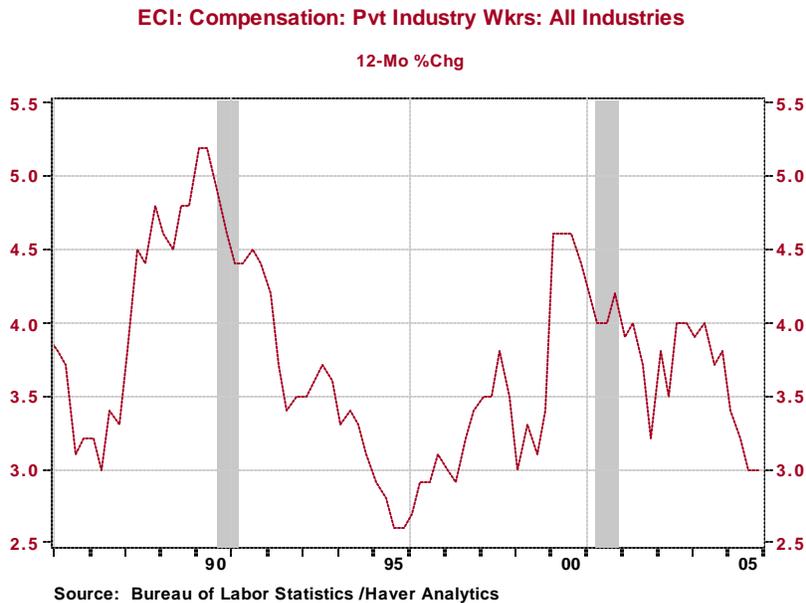
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Chart 3



There is a more refined measure of employee compensation that takes into consideration most of the deficiencies of average hourly earnings. This measure is the Employment Cost Index (ECI). As shown in Chart 4, growth in this measure of employee compensation is currently trending lower. The fact ECI growth is slowing at the same time that the unemployment rate is falling adds credence to the notion that the relatively low level of the unemployment rate is related to the upward trend in the participation rate. In plain English, the level of the unemployment overstates the degree of "tightness" in the labor market.

Chart 4



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We trust that some of our analysis of the less-than-robust current state of the labor market is similar to that being done by Fed Chairman Bernanke. We also trust that Fed Chairman Bernanke remembers the speech he gave in Chicago back on March 8, 2005 when he stated: "The funds rate will have reached an appropriate and sustainable level when, first, the outlook is consistent with the Committee's economic goals and, second, *the slope of the term structure of interest rates is approximately normal*, as best as can be determined [emphasis added]." The current slope of the yield curve is flat. Although a flat yield curve might be "normal" in an anchored monetary regime, in a fiat money regime, a flat yield curve is abnormal – it reflects monetary policy restrictiveness. With inflation contained, inflationary expectations contained and the slope of the yield curve suggesting that aggregate demand growth is about to trend lower, we suspect that Fed Chairman Bernanke is not as inclined to raise the fed funds rate another 25 basis points on March 28 as the traders in the CBOT fed funds futures pit think he is.

### HIGHLIGHTS OF JANUARY EMPLOYMENT REPORT

	<u>Aug-05</u>	<u>Sep-05</u>	<u>Oct-05</u>	<u>Nov-05</u>	<u>Dec-05</u>	<u>Jan-06</u>
<b>Household Survey</b>						
Chg. in Civilian Labor Force (000)	187	291	-40	140	-30	-39
Chg. in Civilian Employed (000)	314	10	190	-14	168	295
Civilian Unemployment Rate	4.9	5.1	4.9	5.0	4.9	4.7
Participation Rate	66.2	66.2	66.1	66.1	66.0	66.0
<b>Establishment Survey</b>						
Chg. in Total Nonfarm Payrolls (000)	175	48	37	354	140	193
Chg. in Manufacturing Payrolls (000)	-11	-26	9	18	-1	7
Chg. in Services Ex. Government (000)	131	47	4	241	136	136
<b>Total Workweek (Hours)</b>						
Manufacturing Workweek (Hours)	40.6	40.7	41.0	40.8	40.8	40.8
Manufacturing Overtime (Hours)	4.6	4.5	4.6	4.6	4.5	4.5
<b>Average Hourly Earnings</b>						
Average Hourly Earnings	16.16	16.19	16.28	16.28	16.34	16.41
Chg. from prior month	0.1%	0.2%	0.6%	0.0%	0.4%	0.4%
Chg. from year ago	2.7%	2.7%	3.1%	3.0%	3.2%	3.3%
<b>Average Weekly Earnings</b>						
Average Weekly Earnings	544.59	547.22	550.26	550.26	552.29	554.66
Chg. from prior month	-0.2%	0.5%	0.6%	0.0%	0.4%	0.4%
Chg. from year ago	2.7%	2.7%	3.4%	3.3%	3.2%	3.6%
<b>Index of Aggregate Weekly Hours:</b>						
Chg. from prior month in Total Index	-0.2%	0.4%	0.0%	0.4%	0.2%	0.2%
Chg. from prior month in Mfg. Index	0.3%	0.2%	0.9%	-0.1%	0.1%	0.2%

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