

DAILY GLOBAL
COMMENTARY

Northern Trust
Global Economic Research
50 South LaSalle
Chicago, Illinois 60603
northerntrust.com

Paul Kasriel
plk1@ntrs.com

Will the *Real* Private Nonfarm Payrolls Please Stand Up?

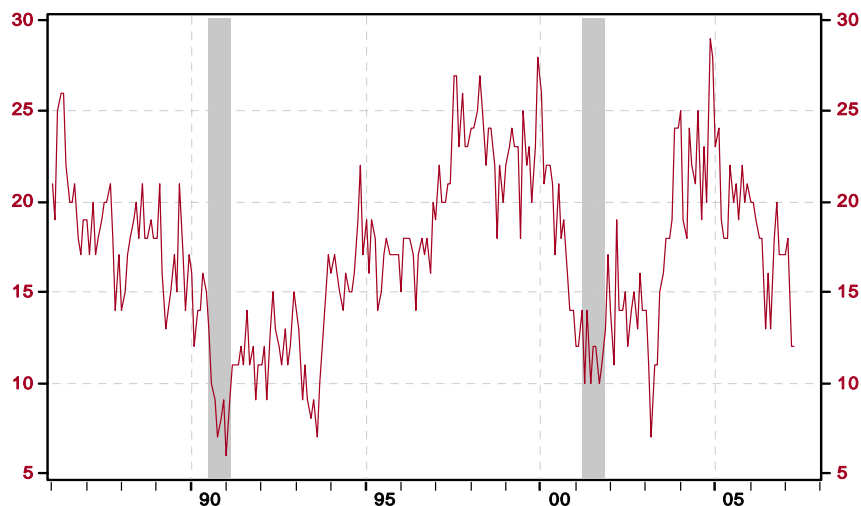
May 31, 2007

Each month the BLS heroically makes an adjustment to private nonfarm payrolls for the estimated hiring by new businesses not yet included in the BLS survey and the firing by closed-down businesses not captured in the BLS survey. This is called the “birth/death” adjustment. The birth/death adjustment does not take into account *cyclical* influences on business start-ups and failures. So, at a time when economic growth is slowing, there conceivably could be a slowdown in start-ups and an increase in failures that would not be incorporated in the birth/death adjustment. That is, late in a business cycle, the birth/death adjustment could bias upward the BLS estimate of private nonfarm payrolls. (This is what Justin Lahart was alluding to in his June 1 *WSJ* column “[Sometimes Jobs Numbers Don’t Work.](#)”) Chart 1 shows that small businesses currently do not think that now is a good time to be expanding their operations. If now is not a good time to expand the operations of an existing business, it would be reasonable to assume that now would not be a particularly good time to *start* a business either.

Chart 1

NFIB: Percent Reporting Now is a Good Time To Expand

SA, %

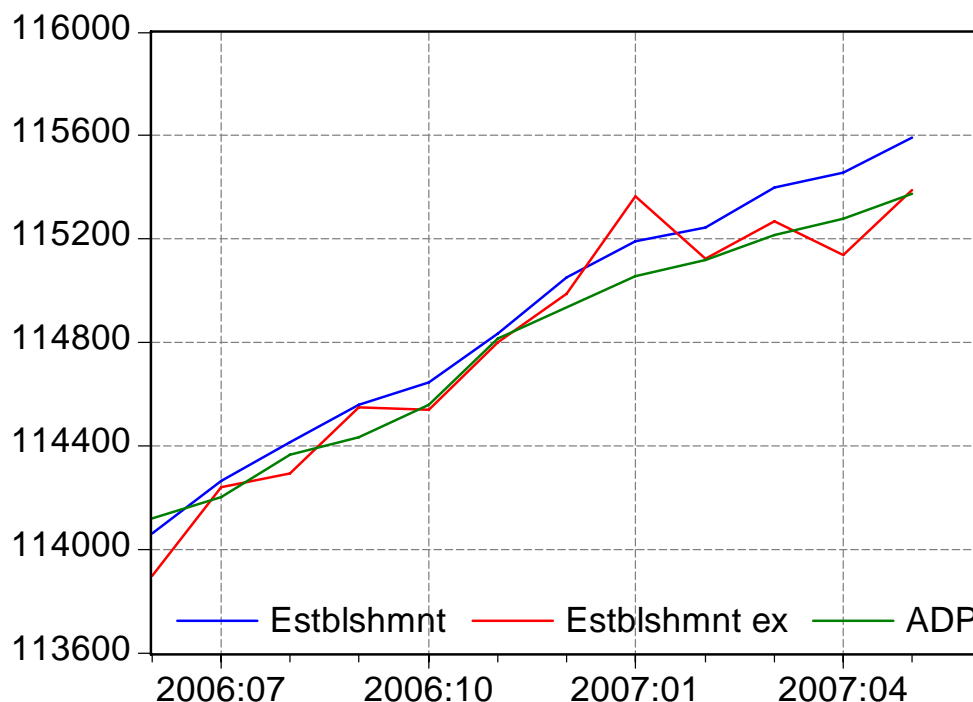


Source: National Federation of Independent Business /Haver Analytics

I was curious to see how private nonfarm payrolls *excluding* the birth/death adjustment compared with the published private nonfarm payrolls. I also was curious to see how the ADP estimate of private nonfarm payrolls, which does not include a birth/death adjustment compared with Establishment Survey private nonfarm payrolls excluding the birth/death adjustment. My curiosity resulted in Chart 2, in which three varieties of seasonally-adjusted private nonfarm payrolls are plotted – the published Establishment Survey payrolls, the Establishment Survey payrolls excluding the birth/death adjustment and the ADP estimate. In order to arrive at the Establishment Survey –ex measure, I had to subtract the birth/death adjustment from the not-seasonally-adjusted total and then apply the seasonal factor to this remainder.

Chart 2

**Private Nonfarm Payroll Totals (sa, thous.)
Establishment, Establishment ex Birth/Death, ADP**



Notice that the ADP estimate begins to diverge more from the official BLS estimate late in 2006 and into 2007. Notice that the payroll estimate using the Establishment Survey excluding the birth/death begins to diverge more from the official BLS estimate and conform more to the ADP estimate beginning early in 2007. The cumulative increase in private nonfarm payrolls in the five months ended May 2007 according to the official BLS estimate, the official BLS estimate excluding the birth/death adjustment and the ADP estimate are 538,000; 400,000; and 442,000, respectively.

The BLS reported that seasonally adjusted, residential construction employment was down only 1,300 in May. Given that home builders have cut back their production and that many are laying off staff, it is curious that such a small number of residential construction jobs were lost in May. The birth/death adjustment might have played a role in limiting this decrease inasmuch as the adjustment *added 40,000* construction jobs (both residential and nonresidential) to the total of not-seasonally-adjusted private nonfarm payrolls in May.

I am a big believer in the notion that the private sector can do most things more efficiently than can the government sector. And this extends to measuring economic activity. Perhaps the ADP estimate of payrolls, which is based on actual company payroll data processed by ADP and which is not adjusted for the birth and death of small businesses, presents a more accurate picture of employment growth in America than does the BLS Establishment and Household Surveys.

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May Employment Data Reinforce Expectations of Fed on Hold

Civilian Unemployment Rate: 4.5% in May, unchanged from April

Payroll Employment: +157,000 in May, after a net downward revision of 10,000 to earlier estimates of payrolls in March and April

Hourly earnings: +0.3% from prior month, year-to-year increase is 3.84%, up 17 bps from April but still down 42 bps from a 4.28% increase in December 2006

Household Survey – The unemployment rate held steady at 4.5% in May. The jobless rate has essentially moved between 4.4% and 4.6% for nine straight months (see Chart 3). After reaching a cycle peak of 2.1% year-over-year growth in November 2006, employment growth, as measured in the Household Survey, has decelerated sharply to only 1.3% as of May (see Chart 4).

Chart 3

Civilian Unemployment Rate: 16 yr +

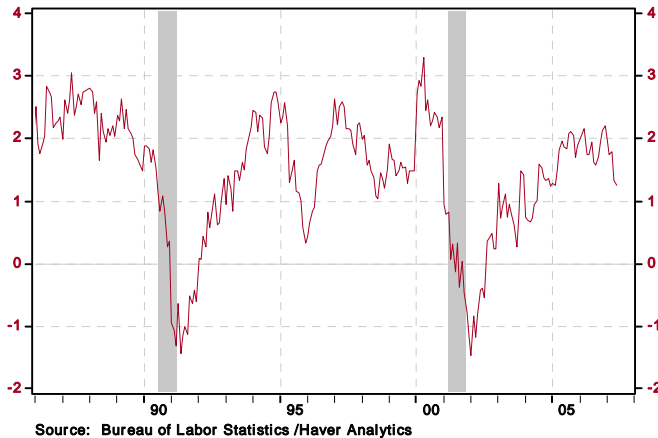
SA, %



Chart 4

Civilians Employed: 16 Years and Over

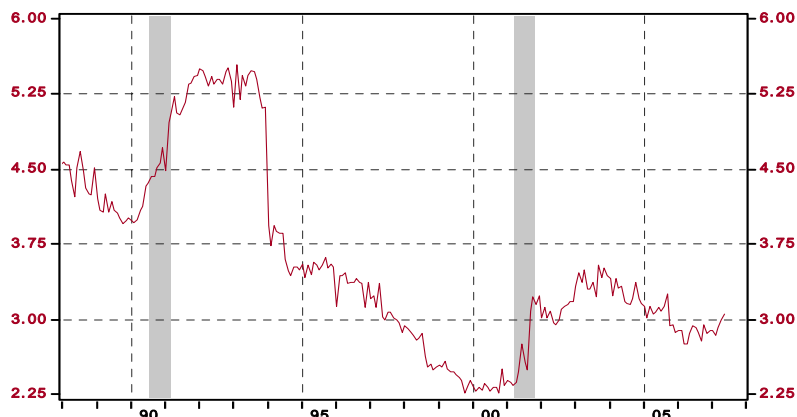
% Change - Year to Year NSA, Thous



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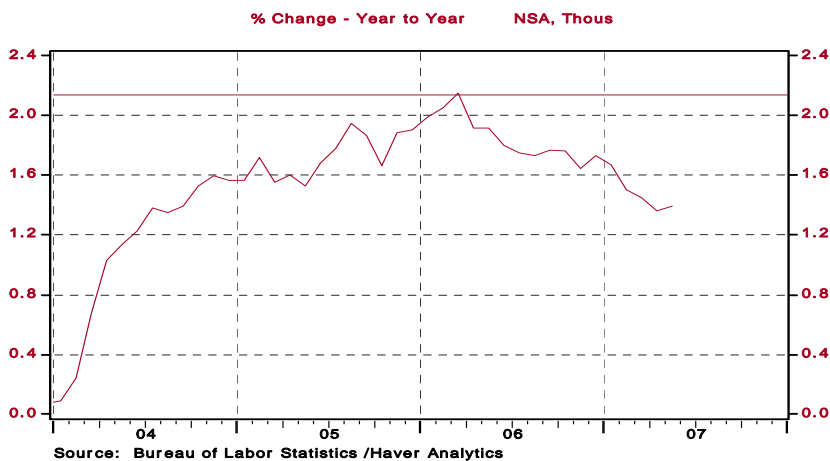
Part-time employment for economic reasons has risen in absolute terms and as a percentage of total employment in non-agricultural industries during the last three months. Historically, the availability of only part-time employment increases as a recession approaches (see chart 5).

Chart 5
Part-time employment of economic reasons as a % of total employment
percent (non-agricultural industries)



Establishment Survey – Payroll employment increased 157,000 in May, after a gain of only 80,000 in April. This is an impressive improvement in hiring. But on a year-to-year basis, payroll employment rose 1.39% from a year ago, which represents a decelerating trend. Year-to-date, hiring increased on average 132,800 each month compared with an average monthly increase of 200,400 jobs in the first five months of 2006. The birth/death of new businesses is incorporated each month via addition or subtraction of jobs. In May, the BLS reports a net addition of 203,000 jobs (not seasonally adjusted) vs. a gain of 201,000 a year ago. In particular, not-seasonally-adjusted construction employment was adjusted up 40,000 in May compared with an addition of 37,000 jobs a year ago. These estimates are suspect because fewer new jobs are created when the economy has shifted to a lower gear. Based on this information, the May payroll employment gain should be viewed with some degree of skepticism.

Chart 6
All Employees: Total Nonfarm



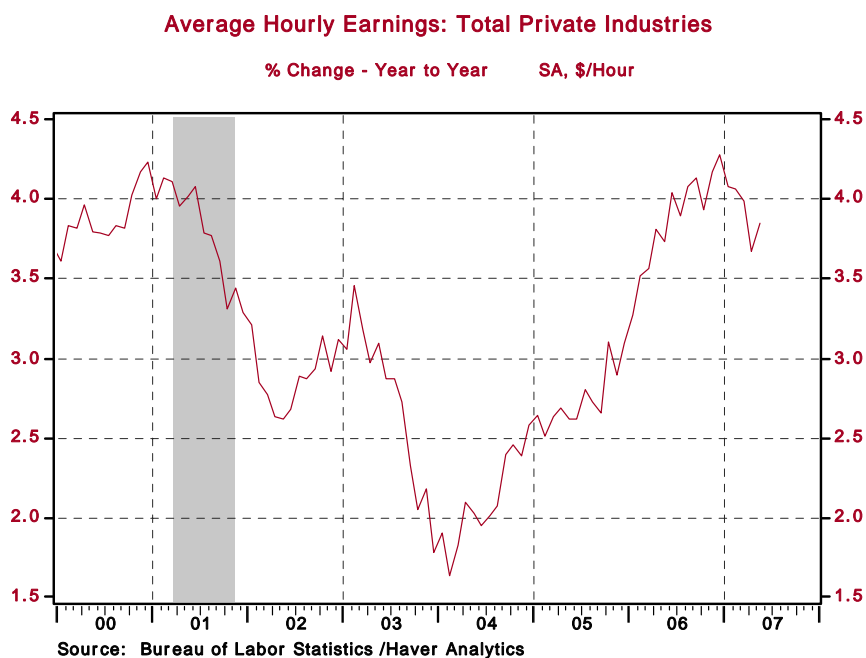
Source: Bureau of Labor Statistics /Haver Analytics

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During May, construction employment was unchanged, 19,000 factory jobs were lost, with about half the decline concentrated in the auto sector. The 176,000 increase in service sector jobs reflects a drop 5,000 retail jobs and gains of 32,000 professional services and 25,000 health care jobs.

Hourly earnings rose 6 cents to \$17.30, putting the year-to-year increase at 3.84% vs. a 3.67% in April. The cycle peak for the year-to-year change in hourly earnings appears to be at 4.28%, set in December 2006. Payroll and earnings data point to a moderate increase in personal income during May.

Chart 7



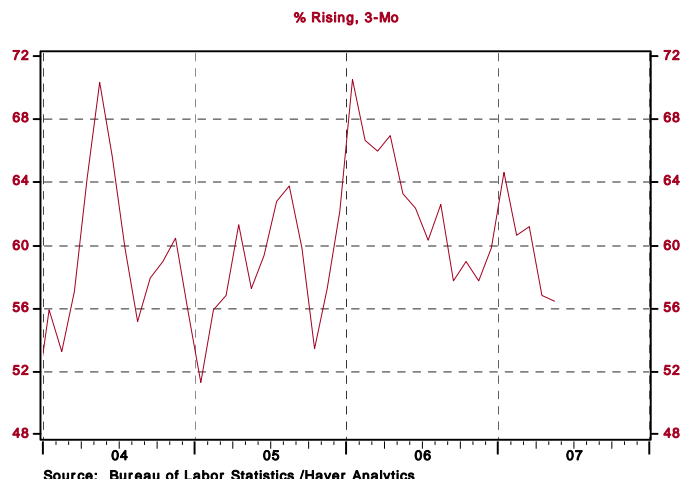
The overall workweek was longer by one 0.1 hours to 33.9 hours. The total man-hours index increased 0.5% and the manufacturing man-hours index dropped 0.3%. The decline in factory man-hours index suggests a decline in industrial production during May. The three-month diffusion index of private sector payroll employment (56.5) is the lowest since October 2005.

The headlines of the May employment report point to an improvement in labor market conditions but there are several questionable aspects such as the birth/death adjustment and the inconsistency of construction employment during a severe downturn in activity that reduce the credibility of the message sent by the headlines.

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Chart 8

Diffusion Index: Employees On Private Nonag Payrolls



Conclusion – The string of economic numbers released this morning contain many elements of an economic recovery, following near economic stagnation in the first quarter, which is consistent with the Fed’s forecast. Thus, the FOMC has little incentive to change the fed funds rate one way or another. The less credible elements of the employment report and the fact that consumer spending in April got a lift from non-discretionary spending items such as household utilities in the face of a colder-than-seasonal April make a less- than- air-tight case for a sustainable re-acceleration of growth over the remainder of the year. That said, the latest economic reports have reduced the probability of an August cut in the federal funds rate.

HIGHLIGHTS OF MAY 2007 EMPLOYMENT REPORT

	Dec-06	Jan-07	Feb-07	Mar-07	Apr-07	May-07
Household Survey						
Chg. in Civilian Labor Force (000)	326	199	-190	195	-392	175
Chg. in Civilian Employed (000)	303	31	-38	335	-468	157
Civilian Unemployment Rate	4.5	4.6	4.5	4.4	4.5	4.5
Participation Rate	66.4	66.3	66.2	66.2	66.0	66.0
Establishment Survey						
Chg. in Total Nonfarm Payrolls (000)	226	162	90	175	80	157
Chg. in Manufacturing Payrolls (000)	-12	-1	-17	-23	-20	-19
Chg. in Services Ex. Government (000)	223	102	145	120	98	154
Total Workweek (Hours)						
Manufacturing Workweek (Hours)	41.0	40.9	40.9	41.2	41.1	41.0
Manufacturing Overtime (Hours)	4.2	4.1	4.1	4.3	4.2	4.1
Average Hourly Earnings						
	17.07	17.10	17.16	17.21	17.24	17.30
Chg. from prior month	0.5%	0.2%	0.4%	0.3%	0.2%	0.3%
Chg. from year ago	4.3%	4.1%	4.1%	4.0%	3.7%	3.8%
Average Weekly Earnings						
	578.67	577.98	578.29	583.42	582.71	586.47
Chg. from prior month	0.8%	-0.1%	0.1%	0.9%	-0.1%	0.6%
Chg. from year ago	4.6%	4.1%	3.8%	4.3%	3.4%	4.1%
Index of Aggregate Weekly Hours:						
Chg. from prior month in Total Index	0.6%	-0.2%	-0.3%	0.8%	-0.3%	0.5%
Chg. from prior month in Mfg. Index	0.1%	-0.3%	-0.1%	0.6%	-0.3%	-0.3%

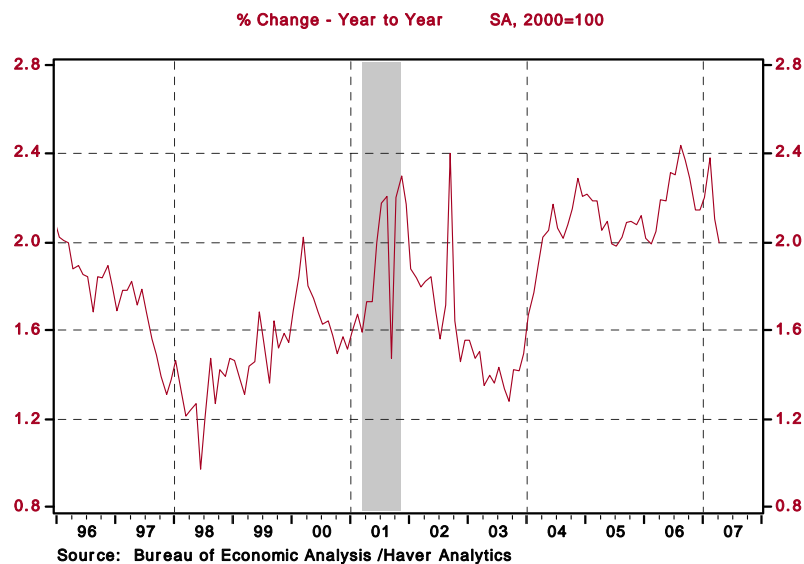
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Deceleration of Core Inflation Is Noteworthy

The personal consumption expenditure price index advanced 0.3% in April, following increases of 0.4% in each of the two prior months. The personal consumption expenditure price index excluding food and energy (also known as core inflation) increased 0.1% in April, putting the year-to-year gain at 2.0%. This is at the far end of the FOMC's comfort zone of core inflation (1%-2%). The year-to-year change in core inflation has shown significant deceleration from a 2.44% increase in August 2006. In light of this moderation in core inflation, the FOMC can reduce the emphasis it has been placing on inflation in the past few months and focus on economic growth.

Chart 9

PCE less Food & Energy: Chain Price Index



Inflation adjusted personal consumption spending rose 0.2% in April after holding steady in the prior month. The April gain and conservative assumptions for May and June suggest a 2.0% increase in consumer spending in the second quarter after a 4.4% gain in the first quarter. Outlays on utilities helped to lift consumer spending in colder-than-typical April. Going forward, the positive contribution from utilities is unlikely. Expenditures on durable goods were virtually steady, while purchases of non-durable goods declined in April. Personal income dropped 0.1% in April, following hefty gains in the first three months of the year to account for bonuses and stock options. Personal saving as a percentage of disposal income was negative 1.3% in April compared with a negative 0.7% in March.

May ISM Manufacturing Survey - Surprising Strength In Factory Sector

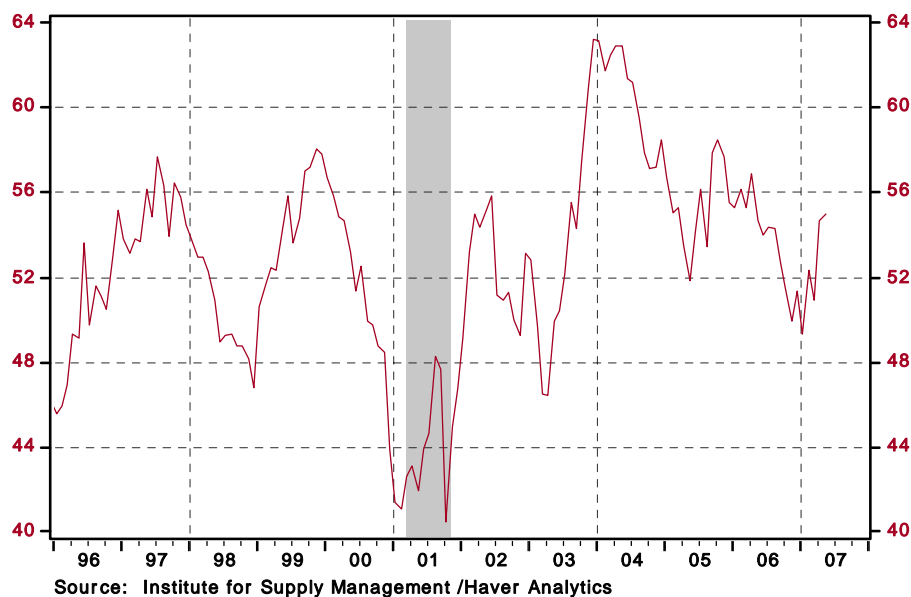
The ISM manufacturing survey for May shows a recovery in the factory sector. The composite index rose slightly to 55.0 from 54.7 in April. The composite index has held above 50.0 for four straight months after a cycle low reading of 49.3 in January. The factory sector recovery is being watched to ascertain whether it is a temporary event or a meaningful improvement.

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Chart 10

ISM Manufacturing: PMI Composite Index

SA, 50+=Increasing



Indexes tracking new orders (59.6, up 1.1 point), production (58.3, up 1.0 point), and exports (59.0, up 2.0 points) moved up noticeably in May. The employment index fell to 51.9 from 53.1 in April. The strength in export orders could possibly continue in months ahead given the current strength of the dollar and the health of trading partners of the U.S. economy.

ISM manufacturing – May 2007

	<u>Dec-2006</u>	<u>Jan-2007</u>	<u>Feb-2007</u>	<u>Mar-2007</u>	<u>Apr-2007</u>	<u>May-2007</u>
Composite Index	51.4	49.3	52.3	50.9	54.7	55.0
New Orders	51.9	50.3	54.9	51.6	58.5	59.6
Production	52.4	49.6	54.1	53.0	57.3	58.3
Employment	49.4	49.5	51.1	48.7	53.1	51.9
Vendor Deliveries	53.3	52.7	50.8	51.3	50.2	50.3
Inventories	48.5	39.9	44.6	47.5	46.3	46.1
Prices	47.5	53.0	59.0	65.5	73.0	71.0
Backlog of Orders	45.0	43.5	51.5	47.0	54.5	52.5
New Export Orders	54.3	52.5	54.0	55.5	57.0	59.0
Imports	55.5	54.5	61.5	57.5	58.0	57.5

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