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Understanding March's "Unemployment" Report

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Friday morning at 8:30, the U.S. Department of Labor (DOL) will release "The Employment Situation" for March. Bond traders around the world will be glued to their seats to catch the report's headlines flashing on their screens. Within seconds, billions of dollars of bonds will be traded as investors react to the news.

Such a collective focus on one release occurs every month when the so-called Unemployment report is published, generally on the first Friday of the month.

In "normal" times, the Unemployment report is closely watched for a number of reasons. To start, it is the first official look at the prior month's economy. The report also contains significant data that can be used to help predict other economic indicators.

However, another reason this month's report will be thoroughly scrutinized is that the Federal Reserve's new Fed Chairman, Benjamin Bernanke, has told investors future decisions will be based, in part, on what current economic reports reveal about our economy.

In simple terms, the Fed said if the economy is strong and inflation shows signs of picking up, it will continue to push short-term interest rates higher. If the economy cools and levels off without inflation, rates will be steady. The Fed's clear spotlight on current economic indicators is a shift from recent years when its policy was somewhat disconnected from month-to-month and quarterly economic reports.

Paradoxically, most professionals will skip over the report's headline unemployment rate and go straight to the number of new jobs created in March. While the unemployment rate and the number of new jobs created are obviously related, the report uses different methods to calculate these statistics and in the short term, they are not always in sync.

To calculate our unemployment rate the Labor Department conducts a survey of households called the Current Population Survey to determine how many people are working or looking for work. Unfortunately, the number of people looking for work can significantly influence the unemployment rate without giving us much insight into the strength of the economy. For example, the unemployment rate falls if job seekers get discouraged and stop looking for work. In that case, a lower unemployment rate is not necessarily reflective of a stronger economy.

To deal with this issue the DOL conducts a survey of employers (business and government) called Current Employment Statistics to determine the number of workers on a payroll. The change in this statistic, the number of jobs created or lost by non-farm employers is the most carefully watched number in this report. Often called the "Payrolls

Number” it was reported as up 243,000 in February and the expectation for March is up 185,000 - 190,000.

When analyzing payroll numbers, it is critical to check for revisions to the previous month’s data, as they occur with regularity. For instance, if Friday’s payroll number is plus 140,000 for March, 50,000 below forecast; and February’s number of 243,000 is revised up 50,000, overall employment is still around where we expected. Due to the volatility of this statistic and its frequent revisions, many economists use a 3-month rolling average when analyzing longer-term trends.

Another data point occupying center stage is the Average Hourly Earnings. Earnings were up 0.3% from January to February and forecasters expect another 0.3% increase in March. A 0.3% monthly rate implies an annual growth rate of 3.7%, which is probably O.K. for the Fed. A 0.4% or 0.5% reading, which implies annual rates of 4.9% and 6.2% respectively, would be problematic.

The Fed watches Average Hourly Earnings for a several reasons. Large increases can be a sign that employers are being forced into offering higher wages to attract a dwindling number of available workers. Another explanation for strong Hourly Earnings could be more distressing if the Fed thinks inflationary expectations are becoming embedded in our wages. The Fed has indicated it will move aggressively to raise rates if it reaches this conclusion.

This report contains many other numbers including statistics on Average Workweek and overtime. February’s average workweek was 33.7 hours and the number is expected to tick up to 33.8 hours in March. Just for an example, large increases in hours worked coupled with slow overall job growth could indicate employers are increasing production but holding off on hiring additional workers.

I mentioned that The Employment Situation report is used to forecast other economic releases. For example, taking the number of people working and their average workweek gives analysts insight into how much the Gross Domestic Product (GDP) rose or fell in a particular period. Another example is using the earning figures to help predict changes in Personal Income.

In summary, I expect the bond and stock markets to be more volatile on the first Friday of every month as participants react to the latest employment report. This report has always been very important to the market, but the Fed over the past few months has willingly increased its significance. After a break of a few years, we are now reentering a phase in which Wall Street’s favorite parlor game will be to determine how the Fed will react to the latest economic report.

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