

Weekly Economic Commentary



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Labor Market Report Card Improving, but Still Unsatisfactory

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Highlights

Weather will still be a factor in the March employment data but not as big a factor as it was in the past few months.

The markets may give the economy another “free pass” for yet another potentially weak jobs report.

In our view, the Fed would have to see a sharp slowdown (less than 50,000 jobs per month) or ramp up (over 300,000 jobs per month) to slow down or speed up tapering before fall 2014.

Our view remains that the American economy may continue to create the most jobs where our exports are strongest, service sectors involving Good Old American Know-How.

If realized, the 200,000 forecast for private sector payrolls in March 2014 is still modestly below the 208,000 per month gain in private sector payrolls, on average, in the 12 months ending in November 2013, just prior to the onset of the poor weather.

As the end of the school year nears, we are inspired to take a look back and grade the efforts of the labor market. Markets are braced for a busy week of economic data with several key reports due out on the state of the labor market:

- Employment report for March (Friday, April 4, 2014);
- ADP employment report for March (Wednesday, April 2, 2014);
- Challenger Layoff Announcements for March (Thursday, April 3, 2014);
- Initial claims for unemployment insurance for week ending March 29 (Thursday, April 3, 2014); and
- The employment components of the Institute for Supply Management (ISM)—manufacturing and non-manufacturing—for March (Tuesday April 1 and Thursday April 3, 2014).

The unusually cold, snowy, and generally disruptive winter weather that gripped large portions of the United States in December 2013, January 2014, and February 2014, persisted into March 2014, but the severity waned a bit in March. While much colder-than-usual temperatures were present in six of the nine U.S. Census regions in early March, and several snowstorms hit the Midwest and eastern United States, fewer power outages and flight cancellations occurred nationwide than in a typical March—all of which suggests that weather will still be a factor in the March employment data, but not as big a factor as it was in the prior three months.

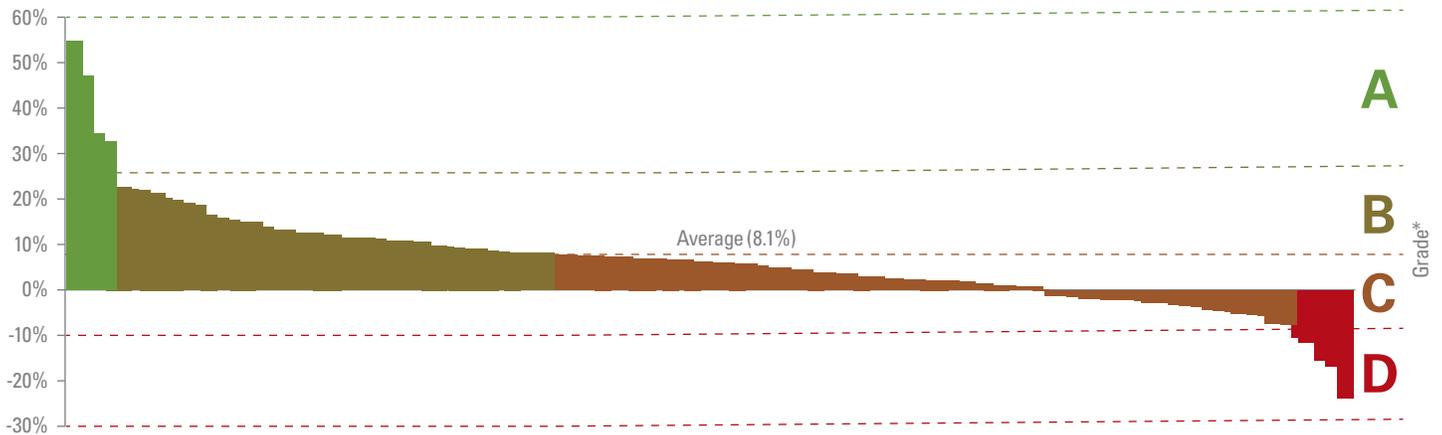
The consensus of economists, as polled by Bloomberg News, estimates that the private sector economy created a net new 200,000 jobs in March 2014. The economy created 162,000 private sector jobs in February 2014. The forecast of 200,000 is the highest since economists’ forecast of a 200,000 gain in the December 2013 payrolls, before the poor weather was on economic forecasters’ radar screens. The December 2013 reading (released in early January 2014) on private sector employment came in at just 87,000, and the weather (and its impact on the economic data) has been front page news ever since.

If realized, the 200,000 forecast for private sector payrolls in March 2014 is still modestly below the 208,000 per month gain in private sector payrolls, on average, in the 12 months ending in November 2013, just prior to the onset of the poor weather. This suggests that the market may grade on a curve and give the economy a “free pass” for yet another weak jobs report. The unusually large gap (190,000) between the highest estimate for the



1 Some Industry Groups Graded Better Than Others Over the Last Four Years of the Labor Market Recovery

■ Number of Jobs per Industry, Percent Change in the 48 Months Since February 2010



Best Graded Employment Industries	Goods/Services/ Government	% Change	Worst Graded Employment Industries	Goods/Services/ Government	% Change
Mining Support	Goods	54.6	Paper and Paper Products	Goods	-5.1
Other Information (Internet Publishing, Broadcasting, & Web Search Portals)	Services	47.0	Federal Government	Service	-5.3
Employment Services	Services	34.3	Grant Making/Giving	Service	-5.5
Oil & Gas Extraction	Goods	32.7	Telecomm	Service	-7.3
Art Schools, Sports and Rec Schools	Services	22.7	Textile Products	Goods	-7.4
Other Services (Pet/Photo, Parking Lots)	Services	22.1	Printing and Related Support	Services	-10.4
Mgmt. & Tech Consulting	Services	22.0	Monetary Authorities	Services	-11.6
Computer Systems Design	Services	21.4	Apparel	Goods	-15.3
Education Support	Services	20.3	Motion Pictures	Services	-16.6
Outpatient Care	Services	19.8	Jr. Colleges	Services	-23.7

Source: LPL Financial Research, 03/31/14

* **Definition of Grade:** On average, private sector payrolls increased by 8.1% between February 2010 and February 2014 (48 months). We ranked 116 industry groups by their 48 month percent change, and applied a letter grade to each

A: 25% and above

B: Between 10% and 24%

C: Between -10% and 9% (including 8.1%)

D: Less than -10%

March 2014 payroll gain (275,000) and the lowest forecast (85,000) also suggests that the market remains uncertain as to the impact of weather on the March jobs report. On average, the range of estimates for the December 2013, and the January 2014 and February 2014 reports was 150,000, well above the 125,000 difference between the high and low estimate on private sector payrolls seen since early 2010.

This week's report, as always, is crucial not just for financial market participants, but for policymakers at the Federal Reserve (Fed) as well. The Fed has indicated that there is a high hurdle for it to speed up, slow down, or stop the wind down of its quantitative easing (QE) program. The Fed has tapered its bond purchases by \$10 billion at each of its Federal Open Market Committee (FOMC) meetings since December 2013. We expect it to continue that pattern until QE has ended, likely in fall 2014. In our view, the Fed would have to see a sharp slowdown (less than 50,000



Closer Look: Participation Rate

- For years, the labor force participation rate has been an afterthought in the monthly employment report and received little attention from the market, the media, the public, or pundits. While the market continues to largely ignore the number, it gets a ton of attention each month from the other groups noted above. The participation rate (63.0% in February 2014) is calculated by dividing the labor force (155.7 million in February 2014) by the civilian population over the age of 16 (247.1 million in February 2014). This metric ran up sharply between the early 1960s (58%) and early 1990s (67%) as women entered the labor force like never before. The participation rate among women aged 20 and over was around 37% in the early 1960s and by the early 90s it was close to 60%. The overall participation rate plateaued in the 90s, peaked at just over 67% in the early 2000s, and has been falling ever since.
- According to the nonpartisan Congressional Budget Office (CBO), The sluggish economy, demographic trends, and the unusual nature of this recovery account for the three percentage point drop in the participation rate since 2007, with the aging of the population accounting for half of the drop. The oldest baby boomers began turning 65 in 2011. The participation rate of people 65 and above is less than 20%, so as a greater portion of the population turns 65, the participation rate will continue to decline. Indeed, the CBO projects the participation rate will continue to decline over the next 10 years (albeit at a slower pace than over the past few years) and hit 60.8 by 2024.

jobs per month) or ramp up (over 300,000 jobs per month) in order for it to slow down or speed up tapering. Please see our recent *Weekly Economic Commentaries* for our take on the Fed's view of the labor market: *Janet Yellen's Employment Report (3/3/14)* and *Guide to Q1: Global Growth, Jobs, and the Fed (1/6/14)*.

This week's reports are also crucial for the public, and especially for those still unemployed, or underemployed. Since February 2010, when the economy started to regularly create jobs again after the 2007–2009 Great Recession, the private sector has created 8.7 million net new jobs. At the end of February 2014, there were 115.8 million private sector jobs in the economy, just 129,000 below the all-time high set in January 2008. The unemployment rate—culled from a different survey than the payroll job count (please see “Closer Look: Labor Market Surveys” on page 4)—has dropped from a high of 10.0% in October 2009 to as low as 6.6% (January 2014) and stood at 6.7% in February 2014, the latest reading. The consensus expects the unemployment rate to tick back down to 6.6% in March.

So on the surface, the labor market has improved—in some cases improved markedly—but for many, the labor market recovery is less than satisfactory. [Figure 1](#) shows industries where jobs have been growing and where job growth has been slowing over the past four years. Overall, private sector payrolls have increased by 8.1% since early 2010, with the service sector up 8.3% and goods-producing jobs up 7.1%. Government jobs—not a part of total private jobs—have dropped by 2.8%.

Ten industry groups have seen employment grow by 20% or more since early 2010; eight of the 10 are in the service sector. The two industries in the goods sector that have seen the fastest growth in jobs in the past four years are, not surprisingly, in the mining sector, where anecdotal reports (in places like the *Beige Book*) suggest labor shortages and wage pressures are emerging. Employment services (workers on payrolls at temporary help firms) is among the fastest-growing industry for employment, which reflects the big shift toward part-time jobs and away from full-time jobs in this recovery. Health care (outpatient care) and Good Old American Know-How (Internet publishing, art schools, other services, management and technical consulting, computer systems design, and education support) are at the root of the other industries in the top 10. Our view remains that the American economy may continue to create the most jobs where our exports are strongest—service sectors involving Good Old American Know-How (see *Weekly Economic Commentary: Exporting Good Old American Know-How*, August 19, 2013).

At the other end of the spectrum, 27 industries have seen their employment drop over the past four years. Some surprises are at the very bottom of the list, populated by junior colleges, motion picture and sound recording, and monetary authorities, i.e., the Fed—all service areas of the economy. Five of the 27 industries are government related. As we noted in our *Outlook 2014: The Investor's Almanac*, we expect the government sector to have little impact on overall economic growth in 2014, after hundreds of thousands of



job cuts, along with tax increases and spending cuts weighed on the overall economy over much of the past four years.

Six of the 27 industries with losses in employment over the past four years are in the goods sector, with long-struggling industries like apparel and textile manufacturing, along with paper and paper product manufacturing seeing the largest declines. Although we expect the manufacturing sector as a whole to add jobs this year (and in the coming years) thanks in part to the energy renaissance, not all industries will benefit equally, if it all. Employment at coal and petroleum-producing industries is one of the six goods producing industries to have lost jobs over the past four years, partially thanks to the recent discoveries of significant amounts of natural gas within U.S. borders.

On balance, while the labor market has improved over the past four years, the improvement has been slow and uneven, with certain industries grading higher than others. Looking ahead, we continue to expect a pickup in the pace of job creation once the weather warms up. At that point, the Fed will be evaluating the pace of improvement in the broad labor market as it considers the next appropriate track for monetary policy. ■

Closer Look: Labor Market Surveys

- A survey of 60,000 households nationwide—an incredibly large sample size for a national survey—generates the data set used to calculate the unemployment rate, the size of the labor force, part-time and full-time employment, the reasons for and duration of unemployment, and employment status by age, educational attainment, and race. The “household survey” has been conducted essentially the same way since 1940, and although it has been “modified” over the years, the basic framework of the data set has stayed the same. The last major modification to the data set (and to how the data is collected) came in 1994. To put a sample size of 60,000 households into perspective, nationwide polling firms typically poll around 1,000 people for their opinion on presidential races.
- The headline unemployment rate (6.7% in February 2014) is calculated by dividing the number of unemployed (10.5 million in February 2014) by the number of people in the labor force (155.7 million). The civilian population over the age of 16 stood at 247.1 million in February 2014. A person is identified as being part of the labor force if they are over 16, have a job (employed), or do not have a job (unemployed) but are actively looking for work. A person is not in the labor force if they are neither employed nor unemployed. This category includes retired persons, students, those taking care of children or other family members, and others who are neither working nor seeking work.
- In February 2014, the labor force was 155.7 million, which consisted of 145.2 million employed people and 10.5 million unemployed people. Another 91.4 million people over the age of 16 were classified as not in the labor force. The 155.7 million people in the labor force plus the 91.4 million people not in the labor force is equal to the over 16 civilian population, 247.1 million.
- The payroll job count data are culled from a survey of 440,000 business establishments across the country. The sample includes about 141,000 businesses and government agencies, which covers approximately 486,000 individual worksites drawn from a sampling frame of Unemployment Insurance (UI) tax accounts covering roughly 9 million establishments. The sample includes approximately one-third of all nonfarm payroll employees. From these data, a large number of employment, hours, and earnings series in considerable industry and geographic detail are prepared and published each month.



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