

A tale of two surveys

Economist Insights

Anybody hoping that the latest batch of economic data will provide a clear insight into the state of the US economy could find themselves sorely disappointed. Take the US labor market report: not only do the findings from the non-farm payrolls and household survey conflict, so too does the wage data. The Fed may have declared that any future moves in interest rates will be data dependent, but with the data supporting both the hawks and the doves, debate among members of the FOMC could well be lively.



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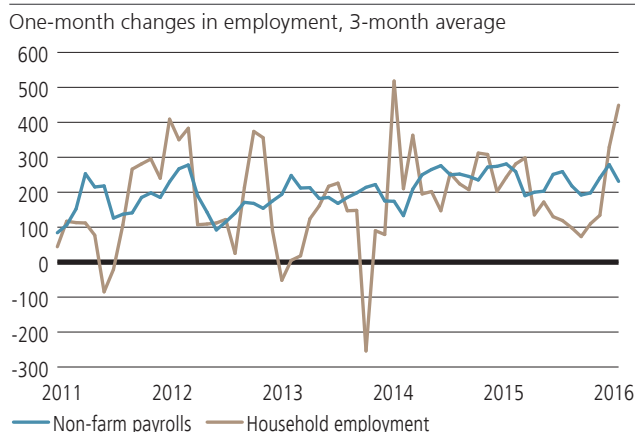


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You would think that more information is a good thing, but sometimes it just ends up bringing confusion. The US labor market report is a good example. There are two surveys: the establishment survey, which gives the familiar non-farm payrolls (NFP) measure of job growth, and the household survey, which is used to calculate the unemployment rate. In the most recent publication, the two surveys are giving conflicting messages.

The establishment survey, as its name suggests, asks non-farm businesses how many people they employ. The household survey asks a sample of households about the employment situation. The big difference is obviously that the household survey will include farms (inconsequential) and the self-employed (pretty big). The NFP number slowed down this month, and has decelerated over the last three months (chart 1), but the household survey is showing more and more employment growth. Its increase has actually been enough to push down the unemployment rate despite more people joining the labour force.

Chart 1: Entirely volatile



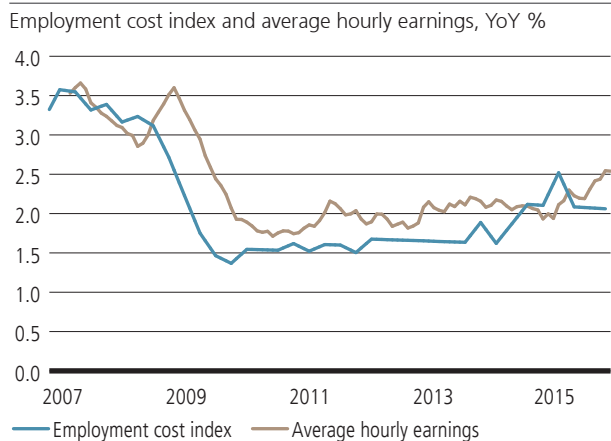
Source : BLS

The problem is which survey to believe? As volatile as the NFP number is, the household employment survey makes it look almost stationary. For example, through most of 2015 the NFP was strong but the household survey was weak. There are also some curious components. Despite the widely acknowledged contraction in manufacturing, manufacturing actually added more jobs than expected (close to the upper range of the last decade).

Some have argued that the employment data has been flattered by the mild weather. That may have been true in December, but hardly applies in January. Luckily the survey gives us an idea by asking workers if they have been off work due to bad weather. Mild weather should have pushed this number down. And although it is below the long run average, that average is driven by some very big spikes (for example, in 1996, almost 2 million people could not work due to bad weather). In fact, the number for January was the highest since 2011, so if anything the weather was probably holding payrolls back, not flattering them.

We face the same data puzzle with wages. Average hourly earnings (from the establishment survey) were stronger than expected, and are now clearly showing an uptrend over the last year (chart 2). But the employment cost index (based on yet another survey) has reversed its previous show of strength and remains moderate. The more worrying aspect of this divergence is that the employment cost index appears to lead average wages. If that is so, then the recent strength in wages could fade.

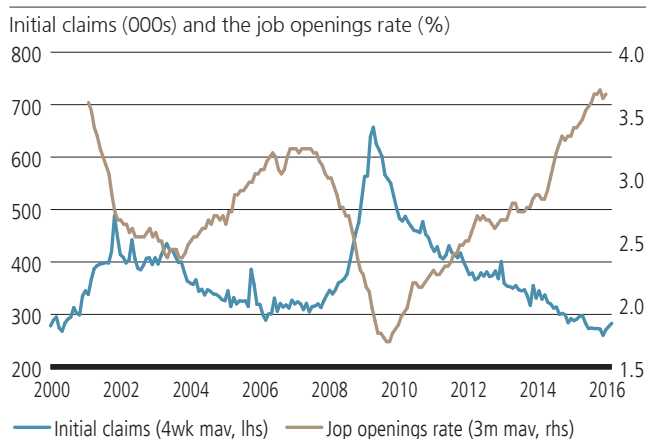
Chart 2: Not together now



Source: BLS

For those looking for bad news there are a couple of other indicators that suggest the strength of the labor market may be on the wane. Initial claims for unemployment benefits, which had reached a never before recorded low rate (relative to the labor force), have been trending up since the summer (chart 3). If more people are claiming unemployment benefits it suggests that firms are starting to lay off workers. And to add to the gloom for those claiming benefits it looks like it will be harder to get a job: the number of job openings appears to have stopped rising and is even falling.

Chart 3: Risk of inflection



Source: BLS, Department of Labor

Now both of these changes are fairly preliminary, and hardly conclusive. Job openings have paused several times already in this cycle, for example in 2012. Initial claims are volatile, and in the last cycle they rose from their trough in 2006 but then remained steady for over a year. But then again, recessions have tended to be preceded by a sharp increase in people getting laid off. But it is at best a necessary but not a sufficient condition.

This is a classic problem: the economic data cannot tell you that you are in a recession until you are already in a recession. The market thinks this data is enough to keep the Fed on hold, and the market is probably right. If the Fed means it when it says that it is data dependent, then they should prove it. Financial conditions tightened so much in response to the first rate hike possibly because the market expected the Fed to hike once a quarter almost regardless. Demonstrating a flexible approach could allay those fears and actually make later tightening less shocking to the markets.

But there will still be a lively debate at the next Fed meeting, as some will point to strong earnings while others point to slowing non-farm payrolls. The labor market report, combined with other indicators, has something for the hawks and something for the doves on the FOMC. It has the best of data, it has the worst of data.

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