ECONOMIC UPDATE

REGIONS

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August Employment Report: Don't Depend On These Data . . .

- Nonfarm employment rose by 151,000 jobs in August; prior estimates for June/July were revised down by a net 1,000 jobs.
- Average hourly earnings rose by 0.1 percent, with aggregate private sector earnings down 0.1 percent (up 3.47 percent year-on-year).
- The unemployment rate was unchanged at 4.9 percent (4.922 percent unrounded); the broader U6 measure was unchanged at 9.7 percent.

Anyone who had depended on the August employment report to settle anything for a data dependent FOMC when they meet later this month will be disappointed. Then again, given some what by now should be well-known issues with the initial August data, we can't imagine why anyone would have looked for clarity in today's report. Total nonfarm employment rose by 151,000 jobs in August according to the initial estimate, with private sector payrolls up by 126,000 jobs and public sector payrolls up by 25,000 jobs, almost all of which came in the local government sector. The unemployment rate was unchanged, the result of paltry increases in both the labor force and household employment.

Historically, the August employment report has been plagued by low response rates to the BLS's establishment survey and a host of seasonal adjustment issues. As a result, the initial August data have been prone to sizeable revisions, typically though not always to the good. This August, the 76.3 percent response rate would seem to be less of an issue, not only is this higher than the year-to-date average for 2016, it is the second highest August response rate in the data that go back to 1981. A higher response rate to the initial survey would suggest smaller revisions in subsequent months as more data filter in, but we'll note the highest ever August response rate came in 2014 and the initial estimate of August job growth was revised higher by 61,000 jobs that year.

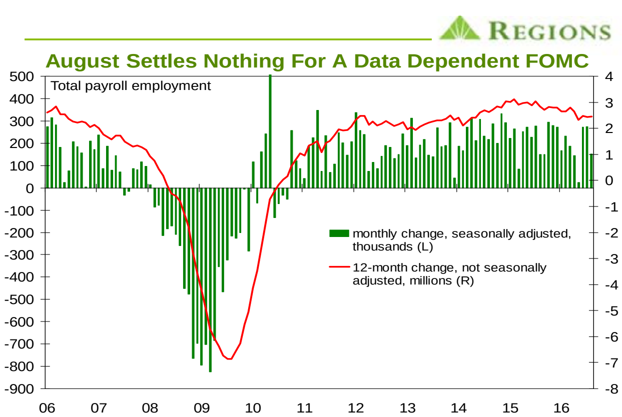
There is, however, evidence of ongoing seasonal adjustment issues. For instance, the annual flows of younger adults in to and out of the labor force are impacted by the timing of the school year. This year, far fewer young adults left the labor force in August than is normal for the month. As a result, the increases in participation and employment for the 16-to-24 year-old age cohort reported in the seasonally adjusted data are considerably overstated. We also see seasonal adjustment noise in the data on local government payrolls in the education sector, as well as in the data on manufacturing payrolls. As we thought was the case with the reported jump in employment amongst motor vehicle producers in July, we see the reported decline in August as nothing more than noise.

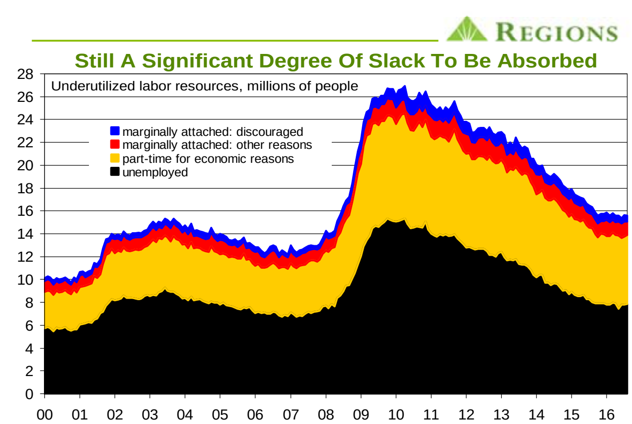
So, in short, don't get too attached to today's numbers, as they will surely be revised, potentially significantly so. Still, that doesn't mean you should simply dismiss the report out of hand, and there is a lot not to like about the data we do have today. First, the breadth of hiring narrowed in August, with the one-month hiring diffusion index dipping to 58.0 percent while the hiring diffusion index for the manufacturing index fell to 45.6 percent – affirming the weak print in the August ISM Manufacturing Index's measure of the change in factory payrolls.

Additionally, the earnings details in the August data, again as they now stand, are flat-out lousy. Average hourly earnings were up just 0.1 percent – while there are some who attribute this to a calendar quirk, we are by no means sold on that argument. On top of the meager gain in hourly earnings, there was a decline in average hours worked while the reported increase for July was revised away, as we noted would likely be the case. Average hours worked fell to 34.3 hours in August, which is alarmingly weak, and the decline was broad based as almost every major industry category reported a shorter workweek. The combination of a smaller gain in employment, a paltry increase in hourly earnings, and a decline in hours worked yields a decline in aggregate private sector wage and salary earnings and an over-the-year gain of just 3.5 percent, the smallest such gain since August 2010.

The details of the household survey are also cause for concern, with an increase in the number of those working part-time for economic reasons and the number of long-term unemployed still at over 2 million. This year has seen little headway in paring down the degree of labor market slack, as seen in the chart below. While some, including some FOMC members argue we're at full employment, it's hard to buy this argument based on the number of underutilized labor resources still in the market.

While no one should be surprised by the slowing pace of job growth, the August employment report raises many red flags. Coming months will reveal whether those are noise in the data or genuine cause for concern.





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