WESTWOOD CAPITAL, LLC

RESEARCH

July 24, 2013

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The New Sick-onomy?

Examining the Entrails of the U.S. Employment Situation

If you can forgive the following gratuitous self-promotion of my upcoming book, I have a story to tell you about the U.S. employment picture. A story that you may find far more interesting than the media and government-led backslapping that has been forthcoming on "jobs days" in the first half of 2013:

> Economists are notorious for getting worked up by numbers, and these days no data dump triggers a sharper frisson of excitement than the two dozen or so tables of employment numbers released at exactly 8:30 a.m. on the first Friday of every month by the Bureau of Labor Statistics at the U.S. Department of Labor.
>
> It's not just economists who eagerly await—or dread—the U.S. "Jobs Day," as this Friday has become known in Washington. It's also politicians, stock analysts, policy wonks, and journalists. Amid the worst economic run of our lifetime—a crisis that keeps morphing and whacking us again—everyone is looking for signs of what's coming next.
>
> If you're waiting on Wall Street for the numbers, you're wondering whether you're about to make money or lose money. But if you're sipping coffee in Washington on Jobs Day or sitting in an editorial office or the faculty lounge of a place like Harvard or the University of Chicago, you're getting ready to spin the numbers to support your beliefs about how the economy works. No matter what the numbers, you'll have something authoritative to say on Jobs Day (even I always do)—an analysis of exactly what's going on with the economy and, most of all, a set of solutions designed to ensure growth and jobs. If Jobs Day is nothing else, it's a chance to make the same points you've made before and tout the same solutions you always tout.
>
> (from *The Age of Oversupply Overcoming the Greatest Challenge to the Global Economy*, forthcoming from Penguin Portfolio, September 26, 2013)

The headline jobs numbers—while still failing, five-and-a-half years later, to close the gap of 8.7 million jobs lost from the pre-Great Recession high of 138 million non-farm jobs (January 2008), have been very sprightly indeed, growing by just over an average of 200,000 jobs a month over the past six months. But notwithstanding the creation of some 1.2 million jobs this year, the pool of those eligible for work—the so-called Civilian Non-Institutional Population—has grown by a like amount. Thus, the employment-population ratio has languished at 58.7 percent (where is has been more or less stuck since September of last year), down sharply from its pre-recession high of 63.4 percent.

Nevertheless, 1.2 million more people are "working," even as the number of idle citizens and those working part time who would rather have a full time job, increased by over 750,000 during H1 2013.

"Yeah, yeah," you say. You've heard all the stuff about the low employment-population ratio before, and some say it's a merely structural phenomenon tied to retiring baby boomers and the like. Sure, we may not have recovered all of the jobs lost to the Great Recession, but we've made up for 75 percent of them over the past 40 months. The official (U-3) unemployment rate has fallen to 7.6 percent from a recession high 10 percent in October 2009. Clearly, America is on the mend . . . right?

I suppose if all you knew were the headline numbers and ignored the underlying components thereof, you would easily arrive at the foregoing conclusion. But the fact is that the U.S. employment situation is more of a wounded beast than a bull. And it is a wounded beast whose entrails tell a different story, indeed—one that ties far more convincingly into the anemic sub-2 percent GDP growth rate of the U.S. economy and the sluggish retail sales data we have seen of late. This recently led to the Federal Reserve's chairman, Ben Bernanke, conceding that he is puzzled by the lack of growth in an economy that is producing about 200,000 jobs per month.

Here, then, is a different set of "headlines" for you (and the chairman) to mull over:

- Over 69 percent of the jobs created in Q2 2013 and over 57 percent of all the jobs created in the first half of 2013 were created in the three lowest wage sub-sectors of the economy, Retail Trade, Administrative and Waste Services, and Leisure and Hospitality, that otherwise account for an aggregate of only 33 percent of all private sector jobs. These jobs, in the aggregate, pay an average of only $15.80 per hour, compared with the other two-thirds of private sector jobs, which pay $27.16 per hour. Relative to unemployment benefits and other assistance, jobs at $15.80 per hour put less than $3.00/hour more in the pockets of a newly working consumer.

- About half of the jobs created during H1 2013, and a large majority of the jobs created in Q2 2013, appear to have been part-time jobs that offer employees as little as one hour of work per week, and up to 35 hours of work. Moreover, after falling from a recession high of 9.2 million to a post-recession low of 7.6 million at the end of Q1 2013, the number of people saying they are working part time because they can't find full time work (part time for economic reasons) crept back up to 8.2 million, double pre-recession levels.

- The U-6 underemployment rate, incorporating those working part time for economic reasons, plus another 6.6 million folks who the Bureau of Labor Statistics does not count as part of the labor force, but who nevertheless say they want a job, as well as others, rose during Q2 2013 to 14.3 percent from the 13.8 percent it registered at the end of Q1. The U-6 rate topped out at 17.1 percent during the Great Recession, and has only declined by 16.4 percent from its peak, while the official U-3 unemployment rate has declined by 24 percent.

- Unsurprisingly, therefore, since the recession it turns out that the decline in the U-3 unemployment rate has been principally due to a reduction in the labor forces itself, which stood at 65.09 percent when unemployment hit its 10 percent peak (down already from the pre-recession high of 66.11 percent) to 63.46 at the end of Q2 2013. *If the unemployment rate were calculated at the 65.09 percent labor force participation level, U-3 would stand at 9.77 percent today.*

- Real wages, calculated after giving effect to inflation, have been falling for nearly fifteen years. But with inflation at or near all-time lows, U.S. families were beginning, on average, to scratch their way back—albeit slowly. But decidedly not so in the sectors in which most of the jobs are being created. On the whole—with hyper-low inflation (which is likely to continue)—U.S. wages are roughly keeping pace across the board (real wages are up 0.07 percent—tiny, but considering that they have been falling for so long, not so bad). But in the three low-wage sectors responsible for the creation of over 69 percent of jobs in Q2 2013, wages have fallen after inflation by -0.7 percent (seven tenths of 1 percent) year over year. In contrast, wages in the high-wages sectors which have generated less than a third of newly created jobs, have risen 0.44 percent after inflation.

Gains in employment, however welcome, are not transmitting into meaningful economic growth in this "sick-onomy." Not when the only folks engaging in meaningful hiring are doing so because labor is cheap and, on a real basis, getting cheaper. And not when we are stuck with, on a seasonally adjusted basis, a mere 116.8 million full time workers, plus an additional 27.3 million working between one and 34 hours a week, trying to support a population of 316.3 million people. In fact, on a non-seasonally adjusted basis, June 2013 showed the actual number of part-time workers at over 33 million. The math of recovery just doesn't work at these levels.

The Hamburger Flipper, the Barmaid, the Temp, the Garbage Man, and the Walmart "Associate"

Let's start with an examination of where the jobs are being created. For this purpose, I divide the job sectors into two categories. One could pull out additional low-ish wage sub-sectors from some of the super-sectors I am using below, but the following highlights the problem well enough in my view (all data in this report is sourced from the U.S. Bureau of Labor Statistics):

Table 1. High-Wage and Low-Wage Jobs

	Number of Employees (thousands)	Hourly Wages	Weighted Average Wages	Percent of Total Private Sector Jobs
HIGH WAGE JOBS				
Goods Producing	18,643	$ 25.22		16.35%
Wholesale Trade	5,761	$ 27.74		5.05%
Transportation and Warehousing	4,457	$ 22.19		3.91%
Utilities	559	$ 35.18		0.49%
Information	2,688	$ 32.94		2.36%
Financial Activities	7,896	$ 30.28		6.92%
Education and Health	20,662	$ 24.65		18.12%
Professional and Tech	8,111	$ 36.67		7.11%
Management of Companies	2,046	$ 35.42		1.79%
Other services	5,482	$ 21.29		4.81%
Totals and Weighted Averages	76,305		**$ 27.16**	66.90%
LOW WAGE JOBS				
Retail Trade	15,136	$ 16.64		13.27%
Administrative and Waste Services	8,380	$ 18.25		7.35%
Leisure and Hospitality	14,230	$ 13.46		12.48%
Totals and Weighted Averages	37,746		**$ 15.80**	33.10%

When you review the above, you may wonder why some sub-sectors in the education and health sector are not included under low wages. Certainly, some teachers and health care aides are not paid much more than waiters and checkout girls. But, for the most part, jobs in education and health earn more than $20 per hour and those that do not employ fewer people than the number that would be statistically material to this analysis.

Next, let's see how wages have changed in each sector over the past twelve months ending in June, relative to inflation:

Table 2. Wage Growth and Lack Thereof

	Percent Change from Year Ago Wages through June 2013
HIGH WAGE JOBS	
Goods Producing	2.02%
Wholesale Trade	3.35%
Transportation and Warehousing	0.77%
Utilities	1.71%
Information	3.52%
Financial Activities	3.63%
Education and Health	1.78%
Professional and Tech	2.20%
Management of Companies	1.72%
Other services	2.45%
Weighted Average Change	2.24%
Less Inflation (CPI)	1.80%
Real Change	**0.44%**
LOW WAGE JOBS	
Retail Trade	1.90%
Administrative and Waste Services	0.83%
Leisure and Hospitality	**0.45%**
Weighted Average Change	1.11%
Less Inflation	1.80%
Real Change	**-0.69%**
Weighted Average Change All Sectors	1.87%
Less Inflation (CPI)	1.80%
Real Change	**0.07%**

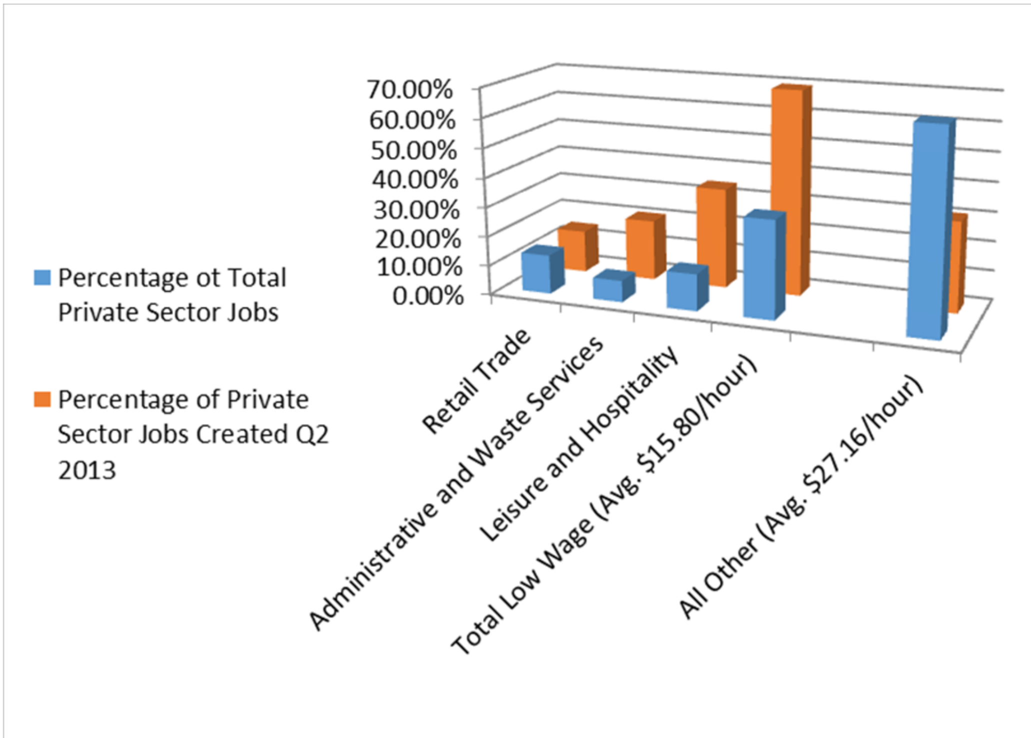
The low-wage jobs have gotten hammered after inflation, while most high-wage sectors have held their own or even gained some.

Now this situation might be tolerable if it were not for the fact that it is the low-wage sectors—which suffer from significant real wage deflation—where employers are most willing to take on new hires. And it might even be seen as normal in a cyclical recovery for temporary help, food and beverage workers, and retail employees to be at the vanguard of a robust expansion in job creation across all categories. A pump-primer. Such has been the case in the past.

The problem is that matters seem to be operating in reverse this time around. The job growth in the higher wage-paying sectors was substantially more robust in Q4 2012 and Q1 2013, than it was in Q2 2013. In the high-wage goods producing part of the economy, the six months preceding the most recent quarter saw the creation of 247,000 new jobs. In the last quarter, the Bureau of Labor Statistics said America *lost* 9,000 good producing jobs. The pump apparently failed to prime.

Instead, nearly 70 percent of total job growth in Q2 2013 came from the lowest paying sectors of the U.S. economy, as shown in Figure 1 on the following page, well in excess of those sectors' relative percentage of the employment base:

Figure 1. Where Is the Job Growth Happening?



One final, but important, point: jobs in the low-wage-paying sector offer the smallest bump up in economic activity not only because of their nominal wage levels. They also provide a correspondingly smaller net benefit to the economy in terms of the spread between the unemployment benefits being received by a formerly out of work individual and the compensation being received for working. For example, the unemployment compensation received by a worker receiving the maximum benefit is about $400 per week on average, nationally. Based on a 35 hour a week fulltime job, that equates to $11.42 per hour. Throw in another $50/week for food stamps and you are up to the equivalent of a job paying $12.86 per hour.

While there is a fiscal benefit to government not being required to pay out assistance to a previously unemployed individual, just how much additional consumption is spurred by the 70 percent of those gaining employment in the second quarter of 2013 at wages that average $15.80/hour versus the $12.86 received in benefits? That would be less than $3.00 per hour, about $100 gross per week if the job is full time—less taxes say about $80—or the paltry sum of $4,160 per year of additional consumption. In the second quarter, some 414,000 jobs were created in the foregoing low-wage sectors (of a total of 597,000 created). Based on the forgoing math, that would be an increment of $1.7 billion in additional annual consumption (versus public assistance), at best a rounding error in a $15 trillion economy. And that is if the job is full time . . . which leads to the next part of the story.

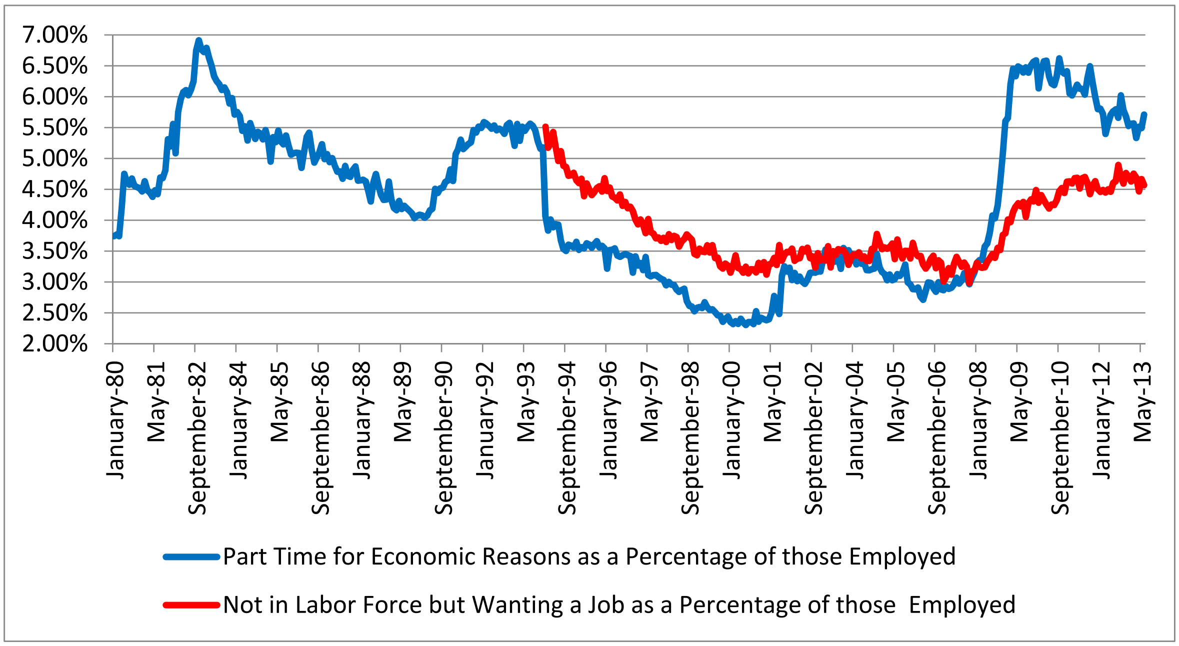
Part Time and Marginally Attached

We move now from the establishment survey portion of the U.S. employment situation reports, to the population survey. One caveat for the uninitiated: While the two data series typically converge over long term trends, they are certainly not relatable in the short term. But the independent trends of each series are useful in interpreting general directions.

One phenomenon that would typically be expected in a recovery from a recession is the steady decline in the number of people working part time involuntarily and those who have been discouraged from actively looking for a job, even though they want one, because they believe there are none to be had for them. While the number of those working part time for economic reasons has declined from its crisis peak, it has not declined anywhere near to post-recession levels, nor has the pace of decline emulated patterns in the recessions of the early 1980s and 1990s.

Disturbingly, over the just-ended quarter, the number of those working part time for economic reasons, as a percentage of the total number of workers employed, has moved higher on a seasonally adjusted basis. While it is difficult to make direct comparisons as explained above, it seems not unlikely that not only are the jobs that have been created over the first half of 2013 (and particularly Q2) low-wage jobs, but are part-time jobs as well. That may be explainable early in a recovery, but coming at this stage it is concerning. Note, in Figure 2, the quick fall-off in involuntary part-time employment following the two previous recessions in comparison to the stubborn pattern indicated this time around.

Figure 2. Part-time Workers and Job-Seekers as Percentage of Labor Force



A second phenomenon, more evidencing disease than economic vibrancy, is the percentage of people who are marginally attached to the labor force and not counted as being in it. These are people who want to work but have given up looking. Instead of declining, as the red line in the above figure shows, the number of people in this category remains at the highest levels (calculated relative to those employed); higher than during the Great Recession and its immediate aftermath.

The cause of this elevated level of marginally attached unemployed (who are not counted as unemployed) is undoubtedly the extremely long periods of unemployment for many workers who were terminated (or, in the case of the young, never hired) during the Great Recession. These workers, some 6.6 million of them at last count, have lost skills, never acquired them, and/or suffer the stigma, in the eyes of potential employers, of having been unemployed for extraordinarily long periods.

Some have surmised that this year's increase in part-time workers is related to employer concerns about being forced to provide health care benefits for full time workers under the Patient Protection and Affordable Care Act (Obamacare). That might be a more plausible argument if newly created jobs were more evenly spread among low-wage and high-wage sectors. Anecdotal Obamacare-scare stories abound, but they seem pretty specious at best. After all, when 70 percent of the jobs created in Q2 2013 were in low-wage sectors in which casual and limited-hours hiring is not atypical (restaurants, temporary services and retail sales, for example), what else could be expected? There is no empirical evidence that hiring practices relate to concerns over benefits, and a heck of a lot of evidence that the people being hired for new jobs are earning less than workers already employed and that the jobs that a significant proportion of jobs being created are not full time because of the sectors they are in. If the Obamacare hiring meme were accurate, the tendency game the law would be to game the system by hiring people to work just under the 30 hour "full time" cut off under the act. But that does not appear to be the case either (see the next section). It's the nature of the jobs, not the fears of the employer.

Outmoded Statistics

The headline unemployment number (U-3) has, over the past several years, taken a back seat to the pace of job formation in terms of the focus given to the U.S. employment situation. There are some sensible reasons for this being the case. First of all, all measures of unemployment are derived from a monthly survey of households which, despite decades of advanced statistical development, is really more useful in detecting trends over broader periods than a single month.
Secondly, the survey of business enterprises measures hard data (although that data itself goes through a statistical meat grinder for adjustment) that seems more reliable in a month-to-month context, inasmuch as it does not ask respondents to characterize things like their own employment status, their level of dedication to finding a job if they are unemployed, and the number of hours they work if they are working (as does the population survey).

Nevertheless, the notion of a "job created" is a very mushy one itself if one fails to understand that the attributes of each job created can vary widely and therefor the measure itself can be very misleading if one is using it to forecast growth or contraction in other economic metrics. In fact, this essay argues that the job creation number, which is generally the first to be uttered on "jobs day" each month, is nearly as ambiguous as the headline unemployment rate.

But the U-3 measure is even more misleading, and here's why.

- *The U-3 Numerator*. The U-3 numerator is essentially anyone who is not regarded as employed. But the definition of "employed" for this purpose includes all part-time workers (all 27.3 million of them, seasonally adjusted—33.5 million, unadjusted—in June 2013). And among those who work part time (between one and 34 hours per week) are employees who are casual workers working as little as an hour or two a week—each and every one of them regarded as "employed." In fact, with respect to all part-time workers, the average number of weekly hours worked in June 2013 was 22—four hours and 24 minutes a day. On an hourly basis, when compared to classic 35 hour/week full time jobs, such part-time workers would yield 12.5 million fewer people employed using last June's unadjusted number as a base. One other curiosity (not particularly statistically significant) is that those working 15 hours or more as <u>unpaid</u> workers in an enterprise operated by a member of their family, are counted as employed for the purpose of the U-3 calculation.

- *The U-3 Denominator*. The denominator in the U-3 calculation is a number known as the Civilian Labor Force. This is a highly engineered and value-judgment inspired number that is substantially lower than the adult population itself, a figure the BLS calls the Civilian Non-Institutional Population (CNIP). CNIP itself is snipped of the population under 16 years of age, those in the military, incarcerated individuals and the aged and disabled who have been institutionalized. The CNIP is then reduced further to exclude any person who had not actively looked for a job within the four week period covered by each monthly survey, even if they are available for—and say they would like to—work. In the present environment, with an enormous cohort of long term unemployed discouraged about finding work, or who might seek work only from time-to-time, this constitutes a large number of people (old and young alike) who simply do not exist in the calculation of the U-3 headline unemployment rate.

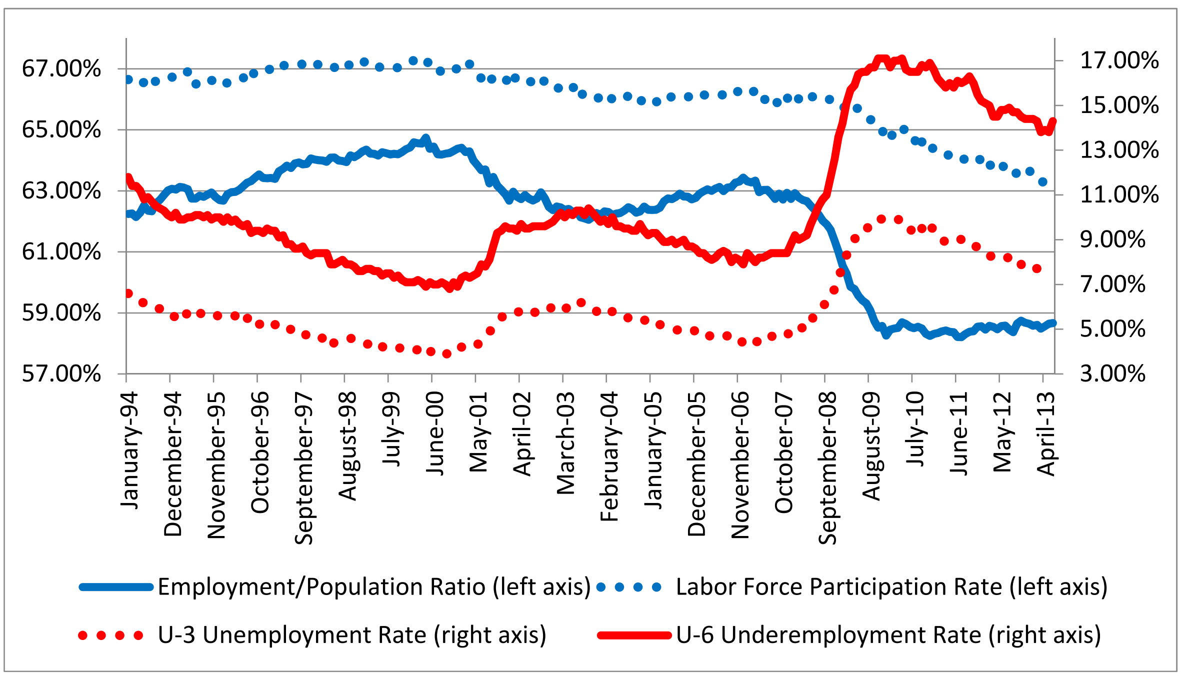
The foregoing peculiarities in the calculation of U.S. unemployment lead to some discomfiting results when observed as changes in the percentages of the overall population (CNIP) that is actually employed—the so-called Employment-Population Ratio—and the percentage of the CNIP that are considered to be in the labor force—the Labor Force Participation Rate (LFPR).

If you are reading this report, there is a very good chance that you're already aware that the Great Recession saw the Employment-Population ratio plummet from its average level of around 63 percent during the 15 prior year to now hover at a level of around 58 percent, a level not seen previously since the early 1980's when women were just beginning to come into the labor force in larger numbers. And there it has remained since, showing little sign of budging.

The Labor Force Participation Rate has also declined and is, more or less, continuing to decline—but its downward trend began well before the Great Recession. There is therefore a correlation between the falling LFPR and certain ongoing demographic changes in the CNIP.

Chiefly, such demographic changes arise from an aging U.S. population with growing longevity—typified by the ongoing aging-out of the enormous baby boom cadre from the labor force. But as real as those changes may be, the fact remains that the LFPR declined by all of 1 percent—to 66 percent from around 67 percent between 2000 and the beginning of the Great Recession. Since 2009, however, the LFPR has fallen nearly an additional 3 percent. This acceleration of the earlier trend is unlikely to merely be a demographic phenomenon. Figure 3, on the following page, shows the accelerated decline of the LFPR, the dramatic fall in the Employment-Population Ratio, and an overlay of the U-3 and U-6 unemployment/underemployment rates.

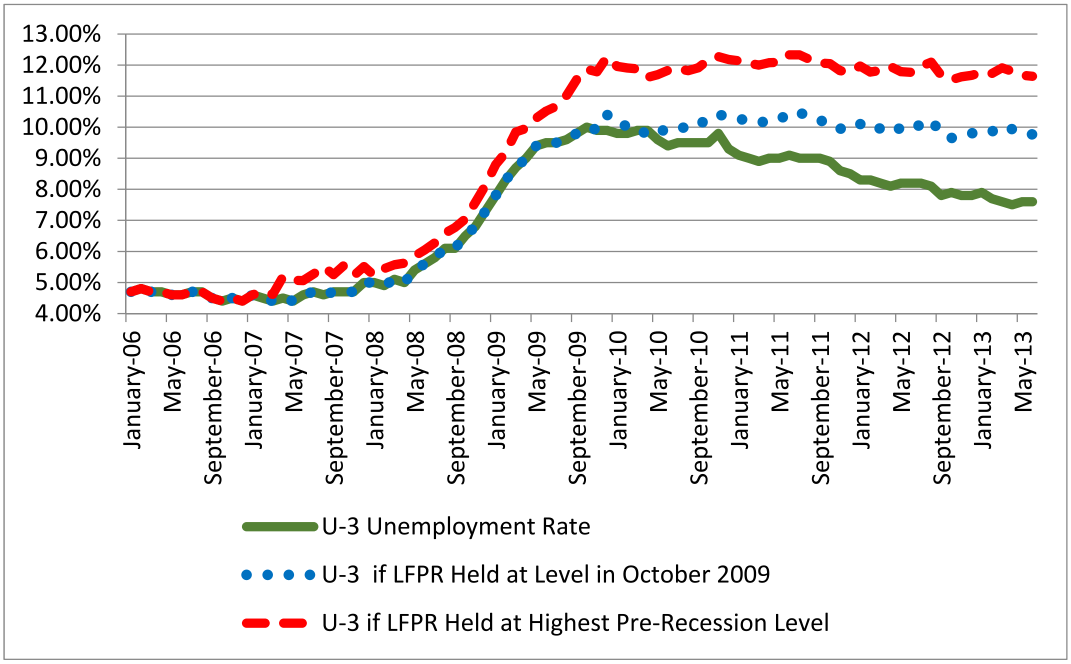
Figure 3. The Labor Force Participation Rate Takes a Plunge



And that brings us to the heart of the matter: Nearly 100 percent of the decline in the U-3 unemployment rate has been the result of there being fewer workers in the labor force as a percentage of the employable population (the CNIP). If the Labor Force Participation Rate had not fallen from October 2009, when unemployment hit its Great Recession peak of 10 percent, unemployment would today still be around 10 percent. Moreover, if the LFPR were held constant from its highest pre-recession level of 66.40 percent in January 2007 (when unemployment was 4.6

percent), the U-3 unemployment rate would be nearly 12 percent today. Figure 4, on the following page, illustrates the foregoing.

Figure 4. Labor Force Participation Rate: Different Scenarios



Conclusion

It would be nice be able to conclude that the job market has improved considerably and bodes well for a thorough recovery. I was hoping earlier in the year that the elevated levels of low-wage hiring we were experiencing were just temporary and that the modest additional demand this created would translate into momentum towards new hiring spread more evenly across the board. The real wage deflation, and nominal wage disinflation, trends in the low-wage sectors seemed inevitable to me—given the enormous oversupply of global labor in the tradable sectors that has led to a surplus of domestic labor needing to take service jobs.

But when the percentage of low-wage sector job creation accelerated sharply from the first quarter into the second quarter of 2013, elevated hopes turned to elevated concerns. The job creation this year may not evidence of a curing trend, but rather continued sickness. I am beginning to believe that we may be seeing workers accepting jobs at wages only marginally above the assistance benefits they were receiving, because their benefits have run out. Employers—seeing a bit more demand (not much, however, given the poor final reading for the growth of Q1 2013 GDP), seeing confidence build from monetary policy-led asset inflation in the housing sectors, and perhaps reacting to the deceptive jobs numbers themselves—have been willing to take on a little extra help here and there after years of cutting back to the bone, as long as that extra help comes dirt cheap and isn't looking for anything in the way of a raise.

I am concerned also by the fact that an expansion in revolving consumer credit has accompanied this rise in confidence. Credit card growth led by rising incomes is a great thing. Consumer credit growth resulting from people having jobs paying little more than the assistance they were previously receiving (after all, you can't get credit when you're on the dole) is not a good sign—it shows people still can't make ends meet. It is possible that may be some of what we are seeing. Regardless, I know that what we are taking for a jobs recovery is not the "real thing."