

SPECIAL REPORT

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The State Of Employment

Over the past few months we have been talking about one of the real structural issues of the economy which is going to be the slow bleed to a longer term recovery – and that is employment.

In [last week's newsletter](#) we addressed the issue of savings being a key component to long term economic growth as savings generally lead to productive investment. However, in order to have savings one must have a job and therefore, as for the whole of the economy, employment is a key factor to long term sustainable growth.

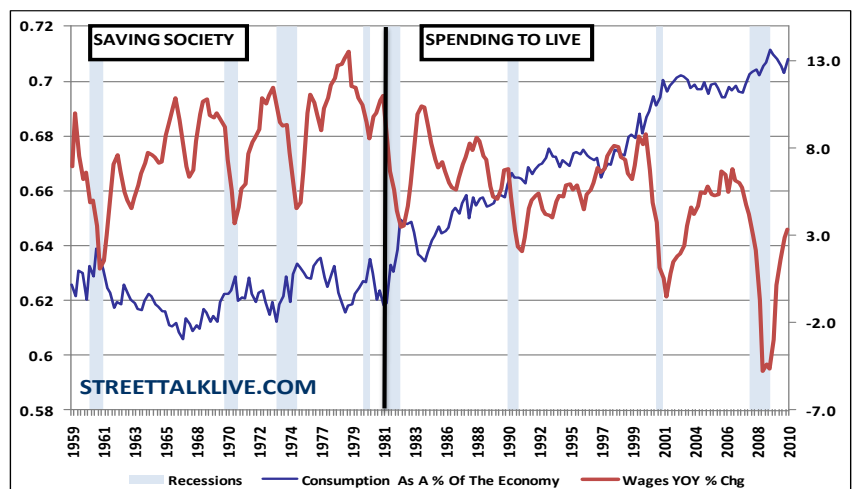
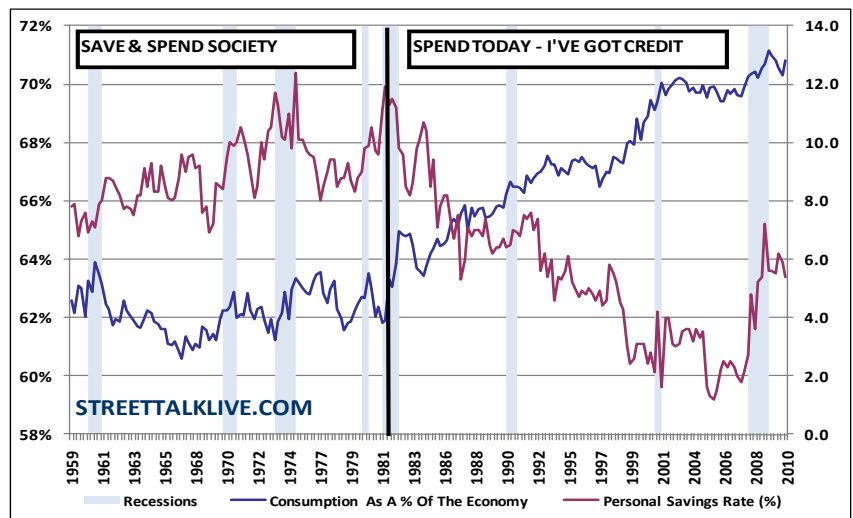
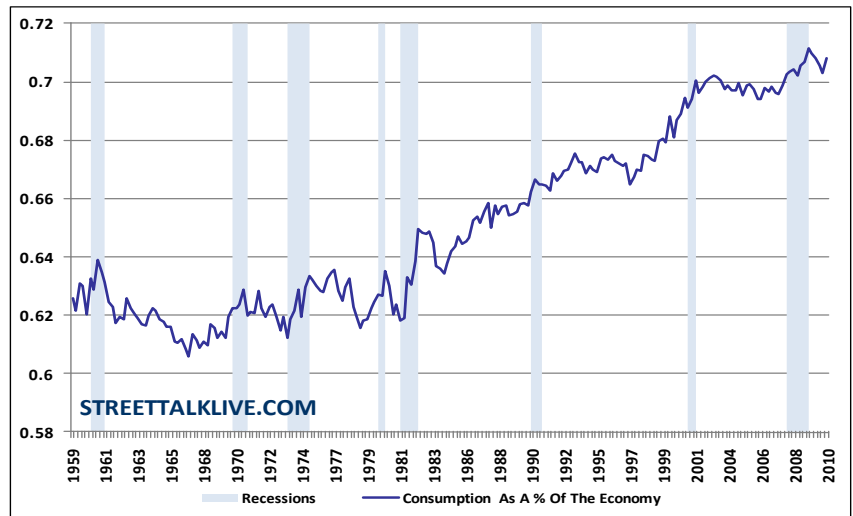
As was discussed last week the economic growth of the economy is currently made up of 70% consumer spending. This level has been on the rise since 1981 as the economy shifted from a strong production base to a financial services base.

We showed last week that savings have been steadily declining since the deregulation of the financial markets began in 1980 as access to credit became ever easier as interest rates dropped and greed took over common sense.

However, there is one other factor that I did not include in last week's diatribe that might also be indicative of today's pervasive slump in personal savings which would be wages.

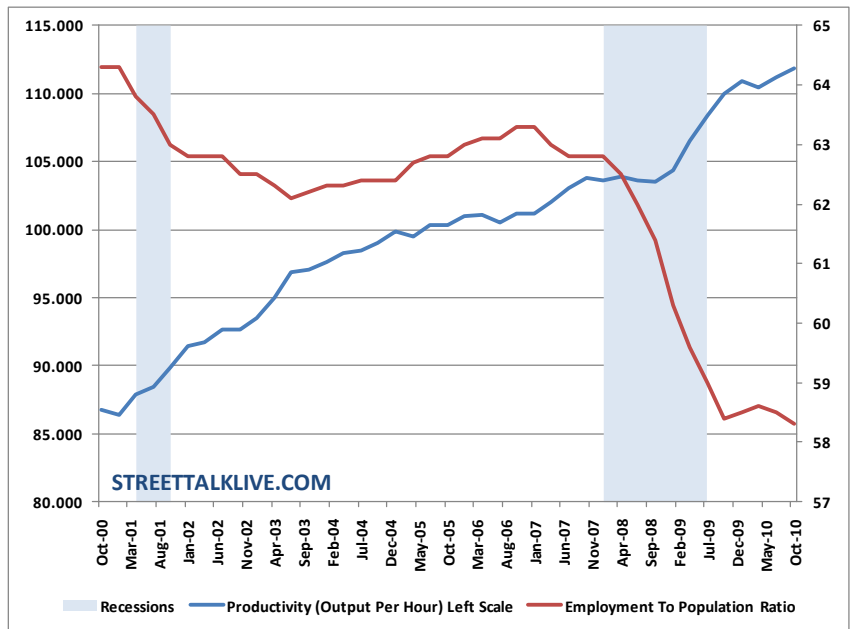
Over the past 30 years wages have declined steadily due to a couple of factors that we have already discussed previously. One is the increase in productivity which allows for fewer workers to produce more in hourly output; the other has been the real efforts to offset the decline in economic growth by keeping wages and benefits as low as possible.

This is clearly shown in the next chart which shows that on average wages on a year over year basis grew during the 1960's and 70's as consumer spending steadily made up about 62% of the economy. During this same period of time the economy was averaging a little of 6% GDP growth.



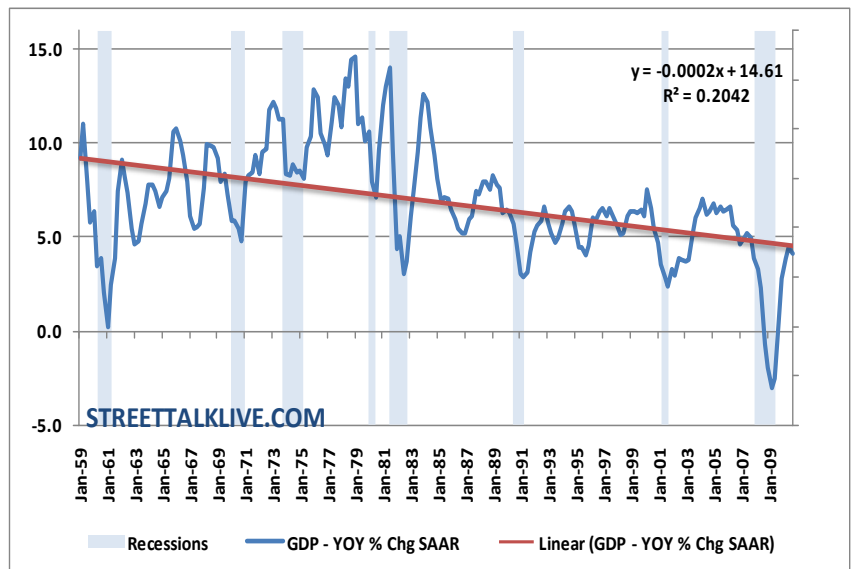
The shift came beginning in the early 1980's as technology really began to come of age – fax machines, microwaves for transmission, the internet and, most importantly, the semiconductor changed the landscape of American business as productivity was vastly increased.

Now, understand that this is not the first time this innovation has happened. It happened with the steam engine, the cotton gin, railroads, and automobiles. Productivity explosions have occurred repeatedly throughout history but this round of innovation failed to increase economic output, as it had previously, due to the shift from manufacturing and production which multiplied every \$1 input into the economy to a multiple of 2 or 3 times; to a base of service and financial engineering which effectively yielded less and less return of economic growth for each dollar input.



Let me explain what I mean. Productivity increases are great as long as it continues to facilitate more and more economic growth for each \$1 of input. For example: When the railroad was laid across America it allowed for products to be shipped farther and faster than had been previously available. Therefore, producers of goods, particularly perishable items like food stuffs, could be sold to a greater base of customers. Therefore, the producer had to hire more individuals to produce more products to meet a much greater base of demand. This in turn led to more economic growth as now all those individuals that now had jobs had money with which to save and spend. So, for every \$1 that was invested in building a railroad – the economic growth was multiplied many times over.

In today's world of financial engineering we are continuing to find more and more ways to increase productivity, however, in a financial transaction very little growth gets translated to the economy. For example: The banks currently have \$1.2 Trillion dollars with which to conduct business. The proprietary trading desks of the five major Wall Street firms can move this money through the financial markets with relatively very few individuals involved in the process. Hundreds of millions of dollars in profits are made from these transactions which wind up immediately back on the balance sheets of the banks. Effectively the \$1 of input through the system created \$0 of economic growth because it did not create more jobs or effect economic output in the system.



This is one of the many reasons why ever since 1981 we have watched a continual slide away from economic growth to economic malaise. This will continue as long as the U.S. is focused on financial and service based transactions that only affect a small number of individuals rather than more productive activities such as manufacturing which fosters stronger economic growth. Maybe this is why China and India are so widely viewed as booming economies as they absorb more and more of our outsourced manufacturing needs.

The Employment Report – Broken Down

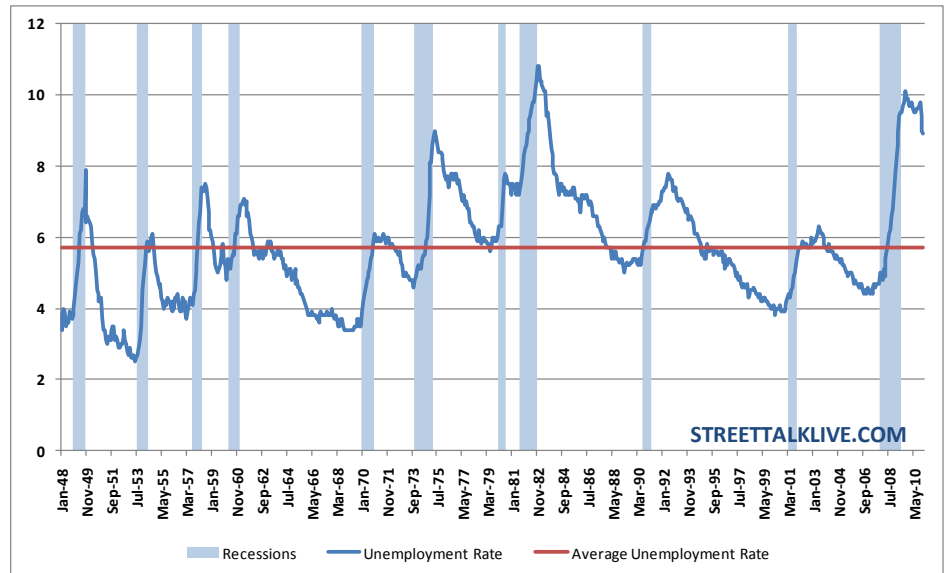
What does all of that have to do with the state of employment? Well, as we started off saying, if you want economic growth, you need consumption and savings. If you want to have consumption and savings; you need a job.

While the Whitehouse is focused on passing measures to write down mortgages for delinquent property owners and provide a quick pass resolution to get foreclosures through the system so the banks can be bailed out once again; the real issue that they should be focusing on is the situation with employment.

This week I am going to take the press release from the WallStreet Journal so that you can see the release as it was reported and break it down so that it will make more sense in the future when see these reports. Hopefully, at the end of this you will have a much better understanding of what is “real” and what is “not”. Let’s get started.

Wall Street Journal; *“Private-sector job creation in the U.S. accelerated in February and unemployment fell below 9% for the first time in nearly two years, the latest signs of an improving economy. The U.S. unemployment rate slipped to 8.9% in February, the lowest rate in nearly two years.”*

While the unemployment rate did drop to 8.9% the first thing to notice is that we have a LONG way to go just to get back to the average unemployment rate of 5.7% since 1948.



The last time we were at these levels was just after the recession in 1982 and

it took almost 6 years to get back towards full employment. However, a key difference between then and now was that interest rates and inflation were falling steadily which fostered a recovery in economic growth. This time, however, we will not have that tailwind behind the recovery when interest rates and reported inflation are already near zero.

When we talk about the unemployment rate it is important that you understand that there are several measures of being unemployed according to the government. There are the U-3 reports which are those individuals that are unemployed and collecting unemployment. Then there is the U-6 report which is a combination of the unemployed collecting benefits and those working part-time that really want a full time job. Then there are those who are not working part time AND have run out of benefits; these individuals are no longer counted and are figured to have “given up looking for work.” I am sure if you ask one those many people if they would like a job I am sure they would tell you yes. This showed up in the following statement from the WSJ:

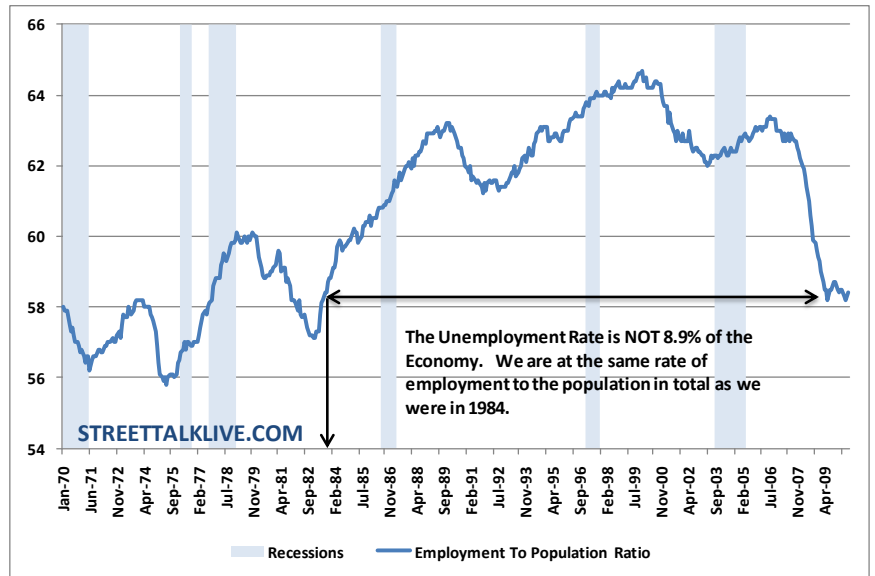
“Still, there are about 13.67 million people who would like to work can't get a job.”

There are a lot of issues with the way that jobs are counted by the Bureau of Labor Statistics from both the way job creation is estimated to the seasonal adjustments that are used to account for things like Christmas season hiring and summer employment of teenagers, etc. However, what you and I really want to know from the data is what is REALLY going on within the job market because ultimately that affects the economy and the markets.

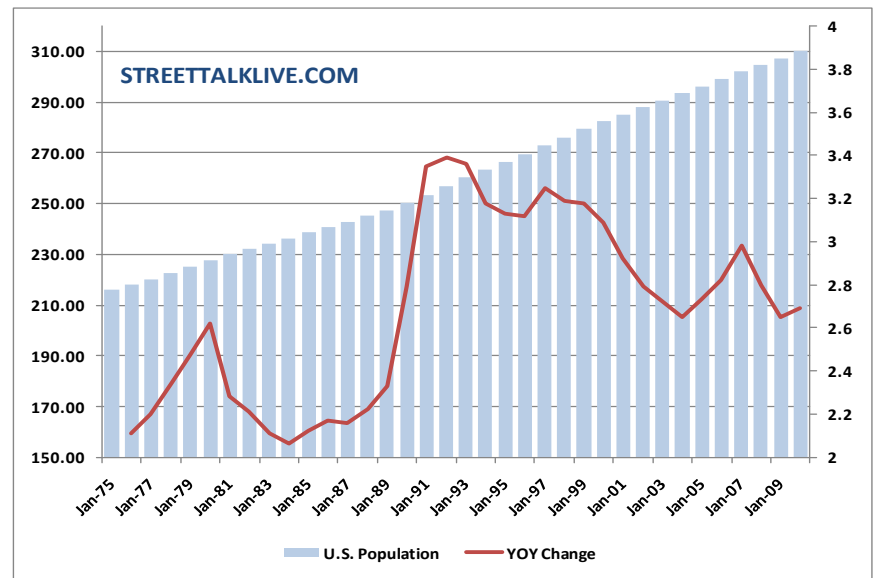
Got Job?

The next couple of charts will tell you a lot about the current state of the job market. The chart to the right is simply the number of people that have a job relative to the population as a whole. The employment to population level is at the same level as it was in 1984.

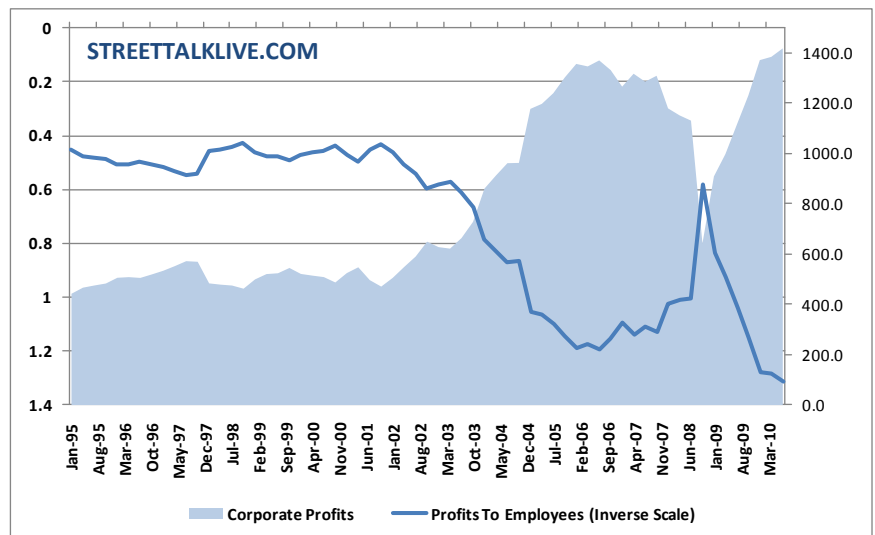
This is important to understand when you read headlines talking about the unemployment rate dropping. IF the unemployment rate was truly dropping then the unemployment to population ratio would be rising. It isn't.



The reason that it isn't is that simply we add about 220,000 or so NEW people to the job seeking pool each month. This is from individuals coming of age and wanting work, legally immigrating into the country and individuals that were not working beginning to re-enter the workforce. That is roughly 2.6 million new workers entering the workforce each year that need jobs. In 2010, the economy, according to the BLS, created 1 million new jobs. This sounds great until you realize that it actually left a deficit of 1,600,000 jobs that need to be created. **This is just to keep the unemployment rate stable.**



Population growth is a very important factor when we talk about the job market and job creation. Remember, for every job that is available there is more and more competition for that work. The higher the level of competition for a job the lower the wage has to be to find a "buyer" for that job. This is especially true in an economic environment such as we are faced with today. This also showed up in the report from the WSJ: *"Businesses remain cautious, often increasing hours worked by existing employees rather than hiring new workers."*



There has been a lot of talk about getting corporations involved in a "shared responsibility" to create jobs. In a capitalistic system, unfortunately, this is just not the case as corporations hire ONLY when they need to. Corporations still act on a profit motive and the one thing they learned well during the "Great Recession" was to increase productivity and reduce the number of employees needed to create profits. As a result profits have soared relative to the number of employees needed to produce them.

The Two Evils

Increased productivity and the ever increasing population are two issues that cannot be avoided in the coming future. Our population will continue to grow though immigration and births and inventive individuals will continue to innovate and create higher levels of productivity. These are two reasons why the current employment situation is unlikely to be resolved at any time in the near future and we may well be talking about high unemployment for longer than anyone can possibly imagine right now.

"We do see some grounds for optimism about the job market over the next few quarters, including notable declines in the unemployment rate in December and January, a drop in new claims for unemployment insurance, and an improvement in firms' hiring plans," Fed Chairman Ben Bernanke told lawmakers this week.

Really, Ben. You don't have to go very far to see that the number of people that are no longer in the labor force due to running out of benefits, or according to the government, have just "given up looking for work" is rapidly increasing as their ability to draw 99 weeks of unemployment rapidly comes to an end.

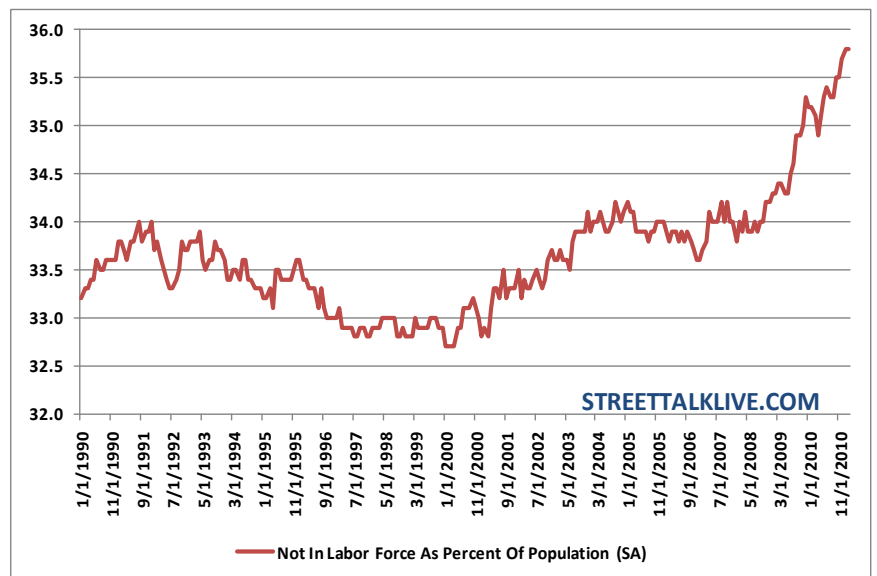
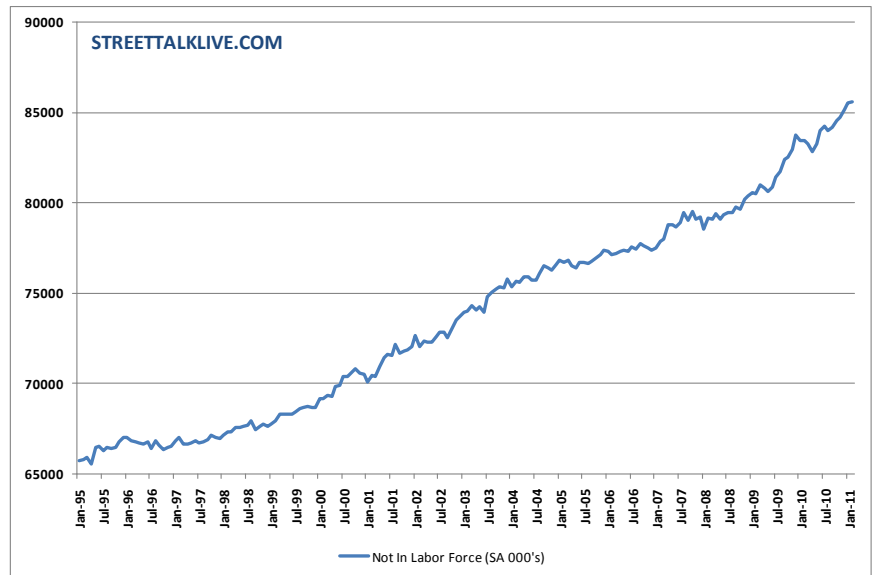
While the unemployment rate may look better on the surface the impact to economic growth is going to be much more severe. With further cuts to discretionary spending and a rapid rise in commodity prices acting as a tax on the consumer the result impact to corporate profits and economic growth could be much more severe than analysts currently predict.

Conclusion

I have lots of issues with the way that the government reports a lot of things from inflation to employment. There are too many "guesses" that go on that aren't adjusted until a year or two later. However, I hope that this week by showing you some of the numbers in graphical form you can come to appreciate a more, in what I believe to be, common sense approach to understanding the data.

There is a real, long term, structural problem with unemployment going forward. No matter how much money you throw at the problem it will not be corrected until you resolve the deleveraging process with individuals so that they can replace their savings and begin to make productive investments again. The banks need to go back to banking and moving money through the system rather than recycling it through the financial markets which only increases profits but doesn't produce economic growth or jobs.

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