OBSERVATION

TD Economics

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WHY THE JANUARY PAYROLL REPORT WAS ACTUALLY PRETTY GOOD

Highlights

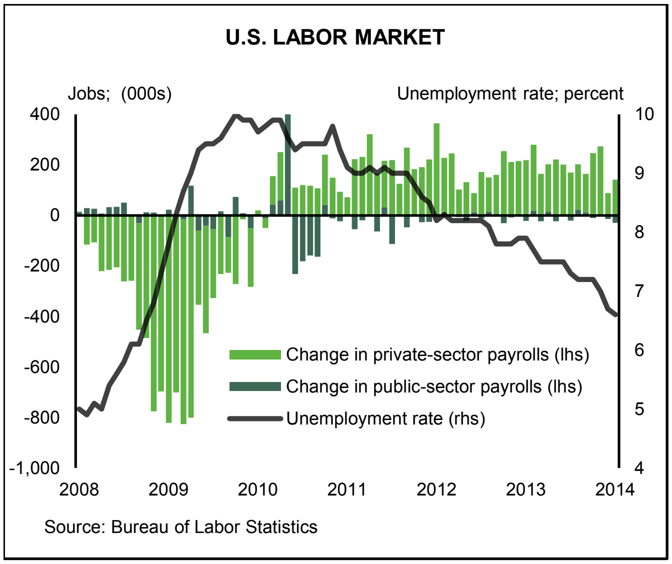
- On the surface, the pace of U.S. job growth in January was disappointing at just 113k. Following an even weaker outturn in December, this has led to concerns that America's job engine is stalling.
- Below the surface, the details look a lot better. In particular, the growth in household survey employment, especially among core working-age people and the strength in cyclical industries like construction and manufacturing alongside weakness in healthcare and government employment, suggest that the soft patch should prove temporary.

By the initial coverage of the U.S. employment report for January, one might think the U.S. job recovery is slowing down considerably. The headline number was disappointing with an estimated 113k jobs added to nonfarm payrolls in January, short of the 180k consensus call. This followed an even weaker month in December of just 75k jobs. However, there is more to the employment report than the change in nonfarm payrolls. A number of other details suggest that the recent weakness should be temporary and will give way to stronger growth in the months ahead.

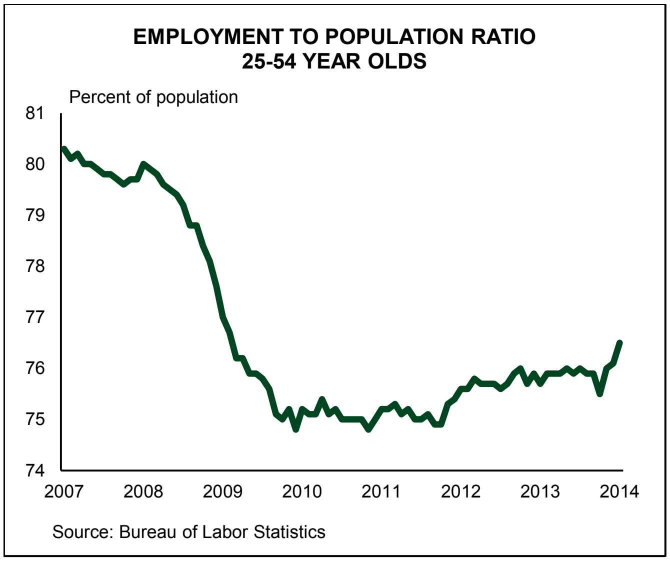
Household survey employment accelerated firmly in January. Moreover, job growth was particularly pronounced among prime-working age people. As a result, the employment-to-population ratio of 25-54 year olds rose 0.4 percentage points (pp) and is up 0.8 from a year ago. Other details such strong job creation in more cyclical industries like construction and manufacturing, and weakness in typically acyclical industries like healthcare, also suggest the weakness in the payroll number will be relatively short lived. Finally, weakness in the average seasonally adjusted number relative to the non-adjusted number over the last 12 months suggests some upside to headline payroll growth in the months ahead.

Signs of housing recovery are all over the jobs data

An important signal for a stronger cyclical recovery in the United States is the rebound in the U.S. housing sector. Recently, we wrote about the prospects for employment recovery in the construction industry (for more see our report). The bottom line is that the sector should add close 1 million jobs over the next three years – close to 30k a month. While not making too much of one month of data, the 48k gain in construction jobs in January is certainly consistent with this story. Just as important are signs of recovery in sectors related to housing. This too has been borne out in the data. Employment in wood manufacturing is up 4.0 % from a year ago. Other housing related sectors are also outperforming overall job growth. Furniture manufacturing is up 2.6% from a year ago, while building material and garden supply stores are up 2.9%.



James Marple, Senior Economist



While these cyclical sectors continued to show strength in January, the weakness in job growth was in areas not typically associated with business cycle slowdowns. Employment in hospitals and nursing care facilities fell 9.4k in the month. This is unusual. Indeed, healthcare continued to add jobs on a trend basis through the Great Recession. Given population aging, this weakness is also unlikely to be sustained.

Government employment also surprised on the downside, especially state and local employment, which fell 17k in the month. Given the improvement in state revenues and reinvestment that has been committed to in recent state budgets, this job shedding is likely more of an anomaly than the start of a new trend. We expect state and local governments to contribute positively to both economic and job growth over the next year (for more see our report).

Especially strong job growth among core-working age people

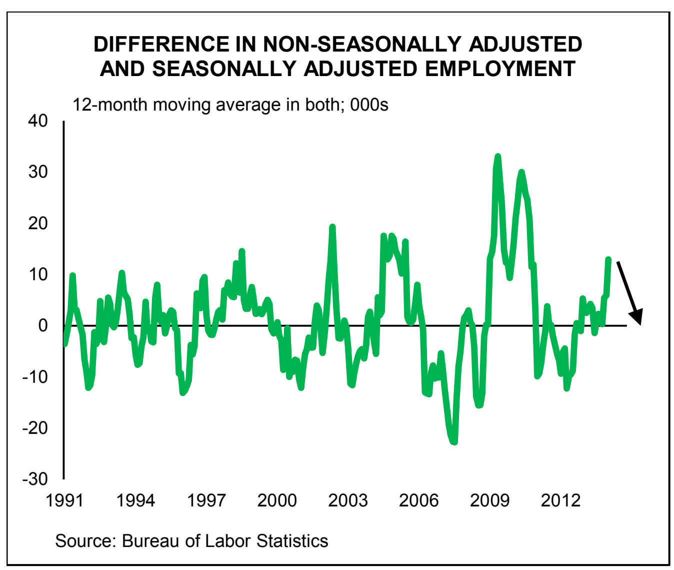
One of the more concerning trends of the post-recession recovery has been the lack of improvement in the level of employment relative to the population. While some of this is due to an aging population and to a lesser extent younger people leaving the work force to attain higher education, the real cause for concern is the lack of improvement among core-working age people aged 25 through 54. This appears to be changing course. Job growth among 25-54 year olds rose 552k in the month, making up 86.5% of the total employment growth registered in the household survey. Given the volatility in the survey, one should be cautious about making too much of one month. However, looking on a year-over-year basis, core-working age employment is up 1.2%, while growth in the population rose just 0.1%. As a result, the employment to population ratio is up 0.8 percentage points relative to a year ago.

The improvement in the core-working age employment rate also gives credence to the improvement in the unemployment rate that many have written off as driven by discouraged workers and declining labor force participation. Abstracting away from the aging of the baby boomers, there is evidence of a real headway in the pace of job growth relative to the population.

A quick note on seasonal adjustment

One final point with respect to the January jobs report is the issue of seasonal adjustment. This is a particular issue in January. Employment rises substantially in the months leading up to Christmas and then falls off in January. One way of getting around the seasonal adjustment issue is to simply look at the average level of employment over the last 12 months. Since there is no seasonal pattern over a whole year, the difference between the seasonally adjusted (SA) number and the non-seasonally adjusted (NSA) number should be relatively close to zero. Over time, this is exactly what happens; there are discrepancies in a given month, but they average close to zero over time.

Since July of last year, the 12-month average of the NSA number has been running higher than the SA number. The gap grew even larger in January with the SA number 12k higher than the NSA, the largest gap since September 2010. This gap will close over the near future, implying modestly stronger seasonally adjusted job growth relative



to the unadjusted number.

Bottom Line

The bottom line is that reading beyond the weak headline number there are lots of reason for optimism about the state of the U.S. labor market recovery. The strength in cyclical sectors of the economy and in job growth among core working age people (and especially prime first-time homebuyers) are supportive of an economy that should gain speed as fiscal drag diminishes.

James Marple
Senior Economist