 Volume 20, Number 8

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The Liscio Report
On the Economy

For John Liscio 1949-2000

Crawling back to 2006, or 2004

• state sales tax collections working their way back to 2006 levels

• are there a few million uncounted jobs out there?

• what happened to business formation?

• commodity inflation: no pass through

In March, 83% of the states in our survey met or exceeded their sales tax collections, up from 73% in February. And 71% reported growth over the year, down from 91% in February—but some of this was related to tax rates on gasoline, rather than the economic trend, and was built into forecasts. Average over-the-year growth, weighted by state population, slipped to 4.8% from March's 5.4%, and forecasts were exceeded by an average margin of 3.1%, up from 0.7% in February.

Within those averages were wide variations. A few states reported growth in the high single and low double-digits, with little or no help from the calendar, while others reported only modest growth. Strongest growth was in states with large high-net-worth populations, and in some, but not all, of the Great Lakes manufacturing states, where there may be decades of pent-up demand finally unleashed by the uptick in manufacturing. A contact in a particularly hard-hit housing state says he is "cautiously optimistic," these days.

Weighted by population, in March 36% of the states in our survey collected more than they did in March 2006, and 56% more than they did in 2007, when sales receipts had already begun to fall. This is a bit of a sloppy exercise, since money slips around from month to month, but, to put current improvement in perspective, the graph on p. 3 shows total unadjusted dollars collected in the last six Marches in 4 states selected because they did not experience the sharpest real estate declines. (Unusual to see a classic Midwestern manufacturing state in the lead, but the factory recovery is impressive, at least for now.)

Not all states are in our survey, but among the ones that are, a few are up in the mid-to-high single digits since 2006, but most of the gains are more like 2–3%. So we are

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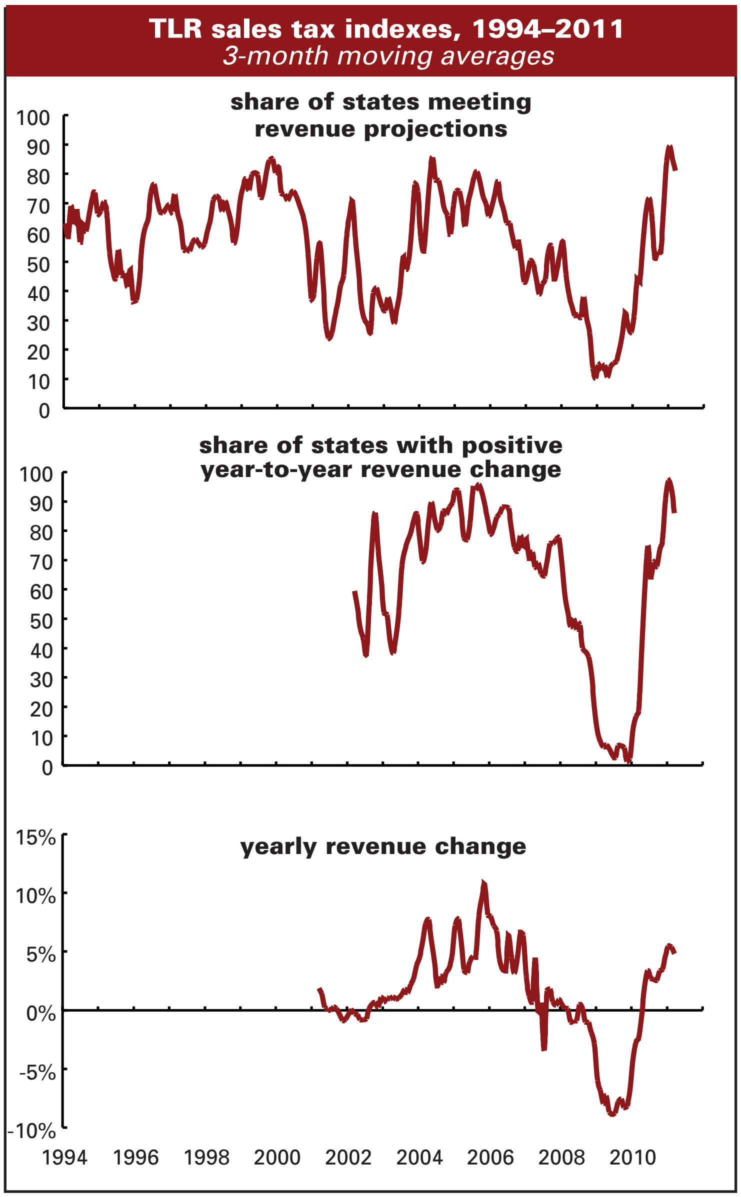
currently moving in the right direction, but have much ground to cover.

hidden job growth?

Recently there's been talk of the likelihood of substantial upward revisions to payroll employment, because that's the way it's happened in the past. The argument is part of a case that the economy is stronger than it looks, so the Fed should think about tightening sooner rather than later.

To make this argument, analysts have been counting upward revisions for entire expansions, and not the 22 months of expansion we've experienced so far, which presumably has further to run. We went back and looked at the original and benchmarked employment performance for the first 22 months of an expansion going back to the early 1970s.

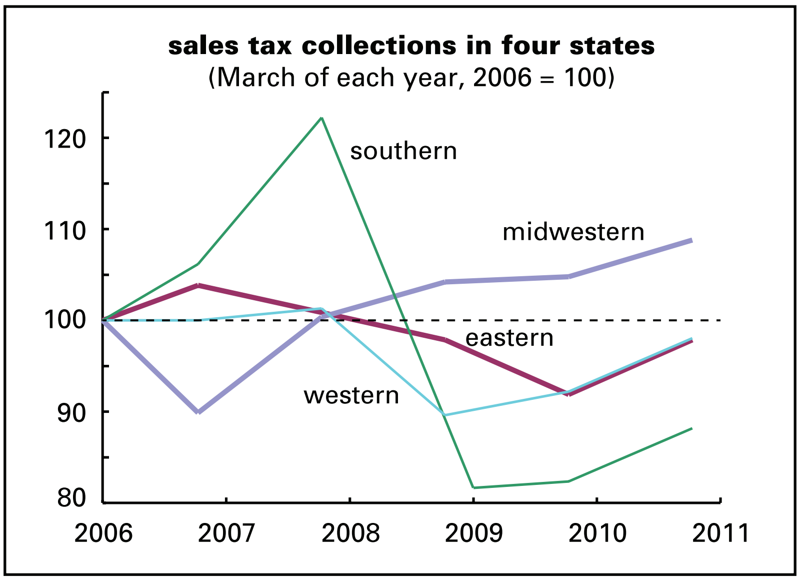


An important opening point: reported payroll growth was, in most earlier cases, substantially stronger than it's been in this cycle. In the first 22 months of the last five expansions (leaving aside the very brief 1980–81 episode, since the economy was back in recession just 12 months after the trough), average employment growth was 2.6% as originally reported; after benchmarking, that was revised up to 2.9%.

For the first 22 months of this expansion (that is, ending in March 2011), total growth was 0.2%—meaning total growth so far was far smaller, in percentage terms, than the average earlier revision. In other words, those upward revisions were on top of more-than-decent growth. Now, a proportionate revision might take us from 0.2% to 0.3% or 0.4%—meaning another 350,000 jobs or so, not the seven-figure historical averages that have been circulating.

And the employment/population ratio (EPR)—derived from the household survey, which some people tout as being more accurate at turning points than its establishment counterpart—rose an average of 0.5 point during the five earlier cycles. For the 22 months ending in March 2011, it's *down* 0.9 point.

Maybe things have accelerated more than we know over the last several months—even though the EPR has been flat for nearly a year. The Quarterly Census of Employment and Wages (QCEW), based on the same source, the unemployment insurance system, as the annual benchmarking, suggests that job growth for the year ending in September 2010 may have been understated by about 200,000, or 0.2 percentage points which, as we said a couple of paragraphs ago, would be in line with earlier cyclical experience. If something of that magnitude of underestimate has continued, that would mean we're 7.05 million jobs below where we were in December 2007, and not 7.25 million. That would bring us back to the employment level of 2004.



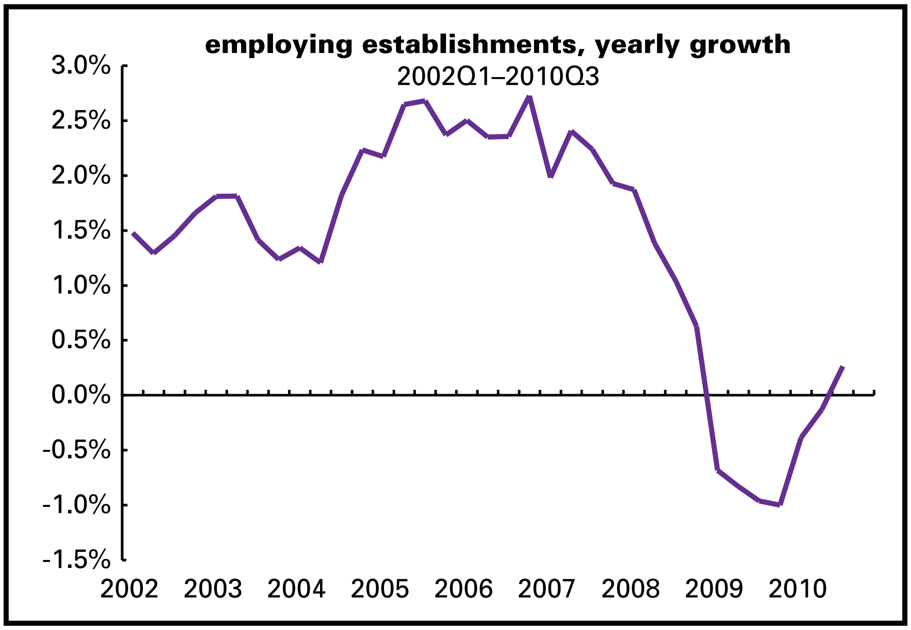
And that's probably a best-case scenario. Not only is the EPR flat for nearly a year, over the last six months, the household employment measure, adjusted to match the payroll concept, is up 804,000—*less* than the payroll survey itself, which is up 894,000. All household employment measures are volatile, so short-term comparisons can be misleading. For the year ending in March, the payroll survey is up 1.0%; the adjusted household, 0.9%.

Oh, and withholding receipts do not suggest an unrecognized employment boom is underway.

animal dis-spirits

Another cautionary point: there doesn't seem to be a whole lot of business formation going on, which you'd need to have significant underestimates of employment growth. According to the QCEW, the shrinkage in employing establishments only came to an end in the second quarter of 2010. (See graph, p. 4. The numbers aren't seasonally adjusted, so we're using annual changes.) During earlier expansions, establishment growth was far more vigorous.

Speaking of establishment growth, as the Atlanta Fed pointed out recently on its Macroblog, the weakness in net business formations since 2007 is actually rather alarming. Even in 2002–2003, when employment was moving from solidly down to slightly up, the number of establishments was growing by around 1.5% a year. Last year, following a sharp contraction, it moved into slightly positive territory. As we've noted in reviewing the Business Employment Dynamics data in recent years, the U.S. labor market has lost a lot of its fizz; apparently the animal spirits of entrepreneurs have undergone a similar loss of gas. (Either that or they can't get startup financing: research done for the International Franchise Association found that of the $10.4 billion of lending necessary to keep the 3,500 "franchised concepts" moving forward, only $8.0 billion is currently available, which means that local franchises are putting off plans to expand, hire and remodel.)



Not only is this bad news in the short-term, cyclical sense—it looks like a major structural change for an economy that had been characterized for a couple of centuries by a world-changing dynamism.

commodities & core inflation

You read it here first: as we showed in our March 3 issue, over the last couple of decades there's been little or no pass through from commodity inflation to core inflation—either up or down.

Now the Chicago Fed is out with a paper making a similar argument—and it's co-authored by the Bank's president, Charles Evans, a voting member of the FOMC, along with his macro research chief, Jonas Fisher. "In the post-Volcker period, the core inflation response is virtually zero." They also find little change in the fed funds rate in response to commodity price shocks.

Their causal explanation is very similar to ours: the commodity share of firm costs has shrunk markedly since the 1970s, when the pass-through was much greater. Now, higher commodity prices are more likely to depress growth than stoke inflation.

Wednesday's retail numbers

A given month's sales tax collections include activity from the beginning of that month and the end of the prior month, so we suspect some of March's strength has already been reported in February's Retail Sales report. But we suspect consumer spending is holding up, bolstered by higher wages, bonuses, some gains in employment, and tourist dollars, and are looking for a 0.5% gain in total sales, and a 0.9% increase excluding automobiles.

It's *not* credit cards. With credit card charge-off rates continuing to decline—the fourth quarter pace was the slowest in two years—the weakness in consumer credit (outside auto finance) is real, and not an artifact of writing down bad debts.

But the high end is clearly leading the way: the ICSC's luxury segment was up 7.0% for the year ending in March, down from February's blistering 10.1%—but still 5.0 points ahead of the overall number, and 11.4 points ahead of the discounters, who had one of their worst months ever.

PS: something cool

Emory University's Ken Ono and his international team have found a formula for calculating the number of partitions, the integers that add up to a given number, a formula sought since the mid-1700s by mathematicians struggling to understand the relationship of partitions. Although there is not yet a practical application for this breakthrough, the formula should speed things up a bit: using the previously available method of calculation, it has taken 150 years to complete the first 200 numbers, a limitation Ono describes for the math world as akin to "not being able to see further than Mars." Ono and his team found that partitions are fractal, and "self-similar in a shocking way. Our 'zooming' procedure resolves several open conjectures...." Included in those is Srinivasa Ramanujan's statement, made toward the end of his pitiably short life, that the "simple properties" he unearthed for partitions involving prime numbers 5, 7, and 11 would not hold for the higher primes. Highly recommended story here: http://esciencecommons.blogspot.com/2011/01/new-theories-reveal-nature-of-numbers.html

—Philippa Dunne & Doug Henwood