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Reconciling Jobs and GDP

The Bureau of Labor Statistics (BLS) released preliminary data for January's employment situation. The BLS estimated that payrolls grew by 112,000 (seasonally adjusted) from December; estimates had ranged from 150,000 – 175,000 new jobs. Most of the increase (105,000) came in the service sector, and most of this in retail.

Even these modest gains are exaggerated because of seasonal adjustments. To quote from the BLS release: "Weak holiday hiring in general merchandise, sporting goods, and miscellaneous stores meant that there were fewer workers to lay off in January, resulting in seasonally adjusted employment gains for the month."

With job creation once again below expectations, it's beginning to look like the optimistic picture of this recovery has some blotches on it. We think the problem stems from a misunderstanding of what caused the spurt in GDP growth last year.

Confusion over GDP

In the third quarter of 2003, the economy expanded at an annualized rate of 8.2% yet showed a loss of 3,000 jobs. In the fourth quarter it expanded at an annualized rate of 4.0% and created 187,000 jobs. Now, 187,000 jobs is certainly better than a loss of 3,000, but job creation is well below what we expect from such a burst in GDP two years after a recession ended.

Most economists and analysts accept the GDP numbers at face value. They explain the weak jobs numbers by supposing that employment will eventually accelerate, probably some time this year, and eventually catch up with GDP.

We, on the other hand, think the jobs number (specifically what is called Nonfarm Payroll) more correctly represents the actual condition of the economy at this time. We'll spend the rest of this article showing that job creation is seriously below the pace of a normal recovery, and that the big jump in GDP last year had nothing to do with jobs but a lot to do with unusual sources of consumer spending.

Job Growth: Then and Now

If GDP is really as strong as reported in the last two quarters, then job creation should be much stronger than reported. To get an idea of the number of jobs that should have been created, we can look at job expansion after past recessions. We'll look specifically at the 1991 recession and mention briefly the 1982 data.

In the 12 months after the 1991 recession, jobs fell at an average rate of about 20,000 a month. Obviously, job growth can lag the turnaround in GDP (though it did not in 1983). However, the situation reversed dramatically during the second 12 months after the end of the 1991 recession; in that period, jobs were added at an average rate of 135,000 a month. At the same time, GDP grew at an estimated annual rate of about 3.3%.

How does this compare with our most recent experience? The last recession ended (according to the National Bureau of Economic Research which decides these dates) in the fourth quarter of 2001, just after the 9/11 attack. Yet it is impossible to separate the effects of the recession from the negative effects of the attack (almost a million jobs were lost between the attack and the end of 2001). So we will ignore the last quarter of 2001 and use data from the beginning of 2002.

On this basis, the U.S. lost an average of about 47,000 jobs a month for all of 2002, more than twice the rate during the previous recovery. But, surprisingly, during the next 12 months employment didn't follow the 1992 pattern at all. During 2003, jobs were lost at a rate of about 26,600 a month, even though GDP grew at an annual rate of 4.3%.

Let's summarize. In the two years after the 1991 recession, 1.4 million jobs were created. In the two years after the 2001 recession ended (skipping the last quarter of 2001), over 1 million jobs were lost. Compared to 1992-93, the latest recovery is about 2.4 million jobs in arrears. Economists used the phrase 'jobless recovery' to describe the post 1991 recovery. If that was a jobless recovery, what should we call this one?

There is little point in going into the same detail for a comparison with the recovery starting in 1983. If we had used these data, then the job shortfall for this recovery would look even worse. Throughout 1983 and 1984, an average of over 310,000 jobs were being added every month. Let's not even do the math on this one.

Lending Consumers a Hand

The current situation seems to defy understanding. The economy has reportedly grown faster after the 2001 recession than after the 1991 recession, but has not produced any jobs. Without a doubt, we are in the midst of a very curious kind of recovery. Normally,

job creation and GDP expansion should go hand in hand. But if jobs aren't growing while the economy is, what's driving this expansion?

Before answering, we want to digress for a moment. GDP expands because spending expands: business spending, consumer spending and, of course, government spending. Indeed, that is exactly what is happening: consumer spending is going up, business is investing and producing more, and the federal government is spending a good bit more because of the Iraqi conflict. But two-thirds of the economy is consumer related, so most of the push is coming here.

The fallacy in the optimistic picture of this recovery stems from assuming that consumer spending is growing because jobs are growing. In a normal recovery, this is exactly what happens, but it really doesn't matter how the increase in spending comes about. In the third quarter of 2003, we saw a big jump in consumer spending not associated with jobs but with the federal government.

That's right. The federal government provided some very strong fiscal stimulus during the third quarter of 2003 in the form of tax rebates to American families and lower withholding rates. As a result, personal income and spending rose substantially. At seasonally adjusted annual rates (how the numbers are reported), disposable personal income increased \$193 billion in the third quarter, almost three times the increase seen in the second quarter. Most of this \$193 billion was spent since the savings rate increased only \$24 billion. This huge increase accounts for most of the jump in GDP growth in the third quarter. The other source of recent strength is a recovery in manufacturing driven by economic growth, mainly in Asia.

Consumer Spending by Any Other Name...

All consumer spending is not equal. The kind that grows out of new job creation generates self-sustaining economic growth. On the other hand, spending that comes from a one time stimulus is just that: one time. It does not plant the seeds for future growth. In fact, a good part of GDP growth last year came from one time events. In the second quarter, increased defense spending for the Iraqi war almost doubled GDP from what it would have been otherwise, but again didn't create any job growth.

In fact, without more fiscal stimulus from the federal government, economic growth this year will trend back downward. We saw the backsliding in the fourth quarter's growth estimate of 4% (which will likely be revised downward), and we expect to see it in the first quarter of this year. The key to recovery is still jobs. We cannot count on a solid recovery until payrolls expand, probably at a rate of around 200,000 jobs per month. Until that happens, any big jump in GDP should be analyzed carefully.