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IAN SHEPHERDSON, CHIEF ECONOMIST

Leading and coincident indicators point to May payrolls rising by at least 250K; we look for 280K.

The wild card this month is the birth/death model; we expect mean reversion after a 60K April hit.

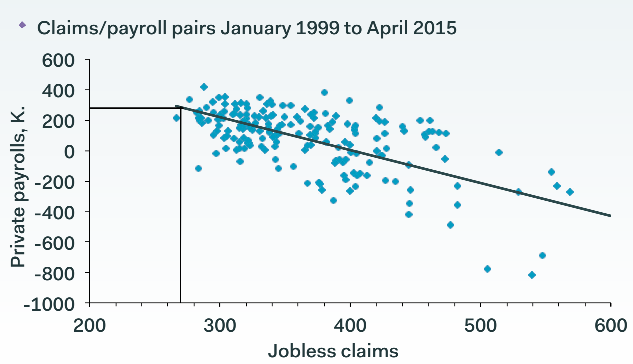
Unemployment likely to hit a new cycle a low, just a tenth above the top of the Fed's Nairu range.

Payroll Consensus Looks Low, but Watch Out for Birth/Death Model

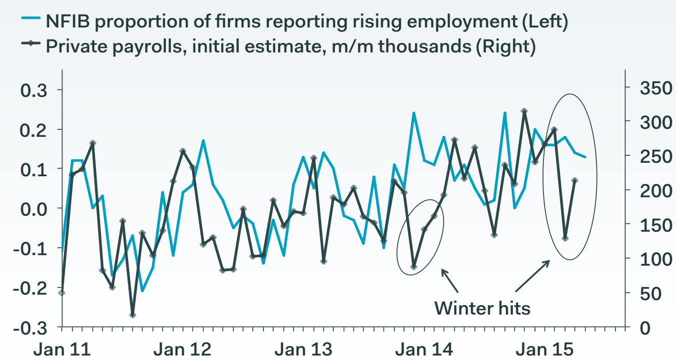
All the fundamentals point to a very strong payroll number for May. The NFIB hiring intentions index, the best single leading indicator of payrolls five months ahead, signalled back in December that May employment would rise by about 300K. The NFIB actual net hiring number, released yesterday, is a bit less bullish, implying 250K, but the extraordinarily low level of jobless claims, shown in our first chart, points to 300K. Finally, the ISM non-manufacturing employment index suggests we should be looking for payrolls to rise by about 260K. Our estimate is 280K.

The consensus forecast, however, is a rather less dramatic 227K. The implicit assumption of the consensus forecast is that the April payroll number,

CLAIMS POINT TO 300K...



...NFIB NET EMPLOYMENT PER FIRM IS CONSISTENT WITH 250K



223K, is a better guide to the underlying trend than all the leading and coincident indicators cited above. We understand the idea that mean-reversion in payrolls is a very powerful idea. Most of the time, the best unbiased forecast of each month's payroll number is whatever happened the previous month. *In April, however, payrolls were depressed by a sudden adverse swing in the birth/death model.* For May, we have assumed it will revert to its prior trend. If we believed it would repeat its April weakness, our payroll estimate would be 220K, close to the consensus.

The birth/death model is required because new businesses do not have to announce their arrival to the Bureau of Labor Statistics. They do have to tell the Internal Revenue Service, but the IRS only talks to the BLS once per year, when it submits social security data as part of the annual benchmarking process, in March. So, if a business starts up in April, the BLS doesn't know it exists until the following March. As start-ups are the biggest single source of job creation, their absence from the numbers would leave payrolls hugely under-reported every month; hence, the requirement for the birth/death model.

Each month, the model generates an unadjusted estimate of job creation by new firms, less job destruction by firms going out of business. The output of the birth/death model is then added to the unadjusted survey data collected from employers, and the resulting numbers are subject to seasonal adjustment. *This means that when you look at the birth/death model, you have to look at the data in year-over-terms, because the variation during the year is substantial.*

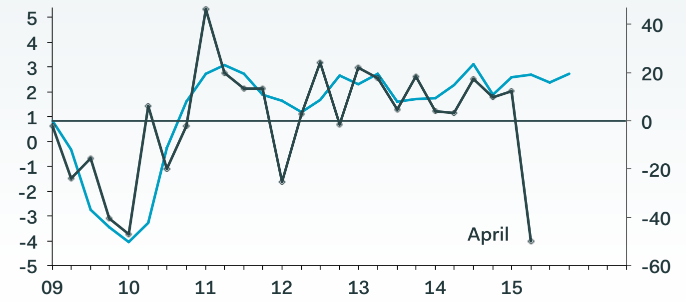
Before March, the trend in the birth death model was running at about +10K per month year-over-year, but the April reading was -50K. The BLS switched one of the inputs to the model to quarterly from annual-with-interpolation, and April was the first month with the new data. But officials were unable to pinpoint exactly to us why the seemingly-small switch in the input appears to have generated such a big swing in the birth/death model, and neither would they offer any views on whether subsequent numbers would be similarly depressed. *The April number was a huge outlier; sustained birth/death declines of 50K are consistent with GDP growth of about* minus *4%, rather than the* plus *2.7% recorded in third quarter of last year.* The birth/death model's output lags GDP growth by about three quarters.

History suggests that big swings in the birth/death model usually are followed by mean-reversion, as our next chart shows. But that's not a cast-iron rule, and the break in the inputs to the model in April makes us uneasy. *We assume mean-reversion in May, but if payrolls significantly undershoot our forecast, the birth/death model is the first place we'll look for the undershoot.* If the model continues to run at -50K, we would then expect a huge upward revision to payrolls after the March 2016 benchmark revision. But those numbers won't be published until late next year.

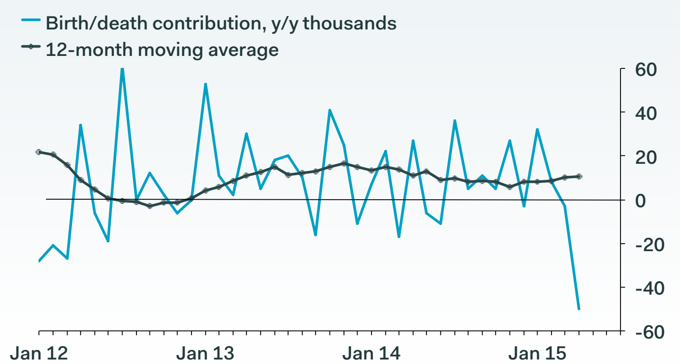
In the meantime, note that any sustained hit from the birth/death model will not slow the rate of decline of the unemployment rate, which is derived from the entirely separate household survey. It might even *boost* the rate of growth of hourly earnings, by artificially depressing the measure of aggregate hours worked used in the calculation. But an apparent sustained slowing in payroll growth might persuade the more dovish FOMC members to push harder for a further delay in policy action. *We're not sure they'll get much traction—a 225K trend in payrolls is still pretty strong—but they can be expected to try.*

Payrolls aside, it is prudent to expect the May unemployment rate to nudge down a tenth, in line with the underlying trend. ***That would put the headline rate at 5.3%, just one tenth above the Fed's latest estimate of the Nairu, 5.0-to-5.2%.*** The FOMC's March forecasts show unemployment at 5.1% in the fourth quarter, which means that they'll have to revise down their forecasts, for the sixth straight time, when they meet in June. Finally, we look for hourly earnings to rise 0.2%, leaving the year-over-year rate at 2.2%.

APRIL'S BIRTH/DEATH MODEL CONSISTENT WITH DEEP RECESSION



BIRT/DEATH SWINGS *USUALLY* FOLLOWED BY MEAN-REVERSION



Ian Shepherdson
+1 914 610 3830
ian@pantheonmacro.com

THIS WEEK IN BRIEF

Note: "**D**" prefix denotes Datanotes for these releases.

Monday, June 1

• D: Personal Income (4)/8:30 EDT
Incomes rose **0.4%,** while nominal spending was **unchanged.** Real spending was unchanged too, despite a 0.1% increase in the PCE deflator, thanks to favorable rounding. Spending was hit by another plunge in spending on energy services, reflecting the return of normal temperatures. The core deflator rose **0.1%.**

• D: ISM Manufacturing Survey (5)/10:00 EDT
Favorable seasonal factors lifted the index to **52.8** from 51.5, led by new orders, employment and inventories.

• D: Construction (4)/10:00 EDT
Spending rebounded by a hefty **2.2%** as the winter ended, and the prior data were revised up by a total of 1.8%.

Tuesday, June 2

• Redbook Chain Store Sales (5/23)/9:00 EDT
Sales growth nudged up trivially to **1.7%** year-over-year from 1.6% last week. The numbers are nominal, and are being held down by falling prices, especially for electronics.

• Factory Orders (4)/10:00 EDT
Orders fell **0.4%,** depressed by the 1% drop in durable orders.

• Auto Sales (5)/Late afternoon EDT
Sales surged to a nine-year high of **17.7M**, after 16.5M in April.

Wednesday, June 3

• Mortgage Applications (5/22)/7:00 EDT
The purchase index fell 3.0% to a nine-week low of **195.4**.

• D: ADP Employment (5)/8:15 EDT
ADP reported a **201K** increase in private payrolls, lagging the official data by a month.

• D: International Trade (4)/8:30 EDT
The deficit dropped to **$40.9B** from $50.6B, thanks to a plunge in core imports; exports remain depressed after the port strike.

• D: ISM Non-manufacturing Survey (5)/10:00 EDT
The headline index fell to **55.7** from 57.8, but employment is still very strong and exports are holding up well.

Thursday, June 4

• D: Initial Jobless Claims (5/23)/8:30 EDT
Claims dipped, surprisingly, to **276K** from 284K, despite relatively unfavorable seasonals.

• Productivity and Unit Labor Costs (Q1r)/8:30 EDT
Productivity growth was revised down to **-3.1%** from -1.9%, following the downward revision to GDP growth. Unit labor costs were revised up to **6.7%** from 5.0%. **Consensus: Productivity -2.9%, unit labor costs 6.0%.**

Friday, June 5

• D: Employment (5)/8:30 EDT
Surveys and claims point to very strong payrolls, around 300K. But the May numbers are usually under-reported initially, so we look for a **275K** increase. Unemployment should dip a tenth to **5.3%,** and hourly earnings should rise **0.2%. Consensus: Payrolls 225K, unemployment 5.4%, earnings 0.2%.**

• Consumer Credit (4)/15:00 EDT
We look for a **$16B** increase, a bit slower than in March but in line with the underlying trend. **Consensus: $16.0B.**

THIS WEEK'S FUNDING

Monday 1	Announcement: 4-week bills (June 2) Auction: $24B 3-month, $24B 6-month bills
Tuesday 2	Auction: 4-week bills
Wednesday 3	Nothing
Thursday 4	Announcement: 3-month, 6-month bills (June 8) Announcement: 3-year notes (June 9) Announcement: 10-year notes (June 10) Announcement: 30-year bonds (June 11)
Friday 5	Nothing

PANTHEON'S FINANCIAL FORECASTS

		End-month:			
	4:00pm Thur.	**Jun**	**Sep**	**Dec**	**Mar**
Fed funds target	0-to-¼	0-to-¼	0.25	0.50	1.25
2-yr	0.66	0.80	1.50	2.00	2.50
10-yr	2.31	2.40	2.60	2.80	3.00
30-yr	3.04	3.10	3.20	3.30	3.40
Curve 10-2	165	160	110	80	50
Curve 30-2	238	230	170	130	90
S&P 500	2,096	2,100	2,050	2,075	2,100
Yen/Dollar	124.3	123	128	135	140
Dollar/Euro	1.12	1.10	1.03	0.95	0.95
Dollar/Sterling	1.54	1.53	1.47	1.44	1.43

PANTHEON'S ECONOMIC FORECASTS

GDP	Q2 third	4.6%	2012 year:	2.3%
	Q3 third	5.0%	2013 year:	2.2%
	Q4 third	2.2%	2014 year:	2.4%
	Q1 second	-0.7%	*2015 year:*	*2¾%*
	Q2 forecast	*>3%*	*2016 year:*	*3¼%*
	Q3 forecast	*>4%*		

CPI	Apr. 0.1% (-0.2% y/y); core 0.3% (1.8% y/y)
	September 2015 forecast: 0.5% y/y; core 1.9% y/y
	March 2016 forecast: 2.2% y/y; core 2.1% y/y

Unemployment: Sep. 2015, 4.9%; March 2016, 4.5%

Federal budget: FY 15 forecast: -$400B (2.3% of GDP)