

An employment & market chat

Written by Jeff Thredgold, CSP, President, Thredgold Economic Associates

During the past 31 years of writing a weekly economic & financial newsletter, I have periodically tried to present information in an unusual format so as to make “the dismal science” less intimidating and more interesting. Over the years, we have occasionally run a discussion between two old friends—Mrs. Smith and Mr. Jones—regarding a variety of issues. Their topic of discussion today is employment, inflation, markets, the dollar, and the Fed...

While sitting on a park bench...

“I am really confused by all this stuff I hear and read about job growth, inflation, Federal Reserve policy, interest rates and stock prices moving up and down, the dollar, etc.” stated Mr. Jones. “How do you keep all this stuff straight?”

“Well, it can be very confusing,” stated Mrs. Smith. “But once you understand the basic relationships, and how things might affect you, it isn’t all that hard.”

“I hope that’s the case,” said Mr. Jones. “For instance, the latest U.S. employment data released on June 2 indicated that American job creation was less than expected in May. However, the nation’s unemployment rate went down.”

“How is that possible?” he continued. “It makes more sense that if job growth was less than expected, the unemployment rate would stay the same or even move a bit higher.”

“Your logic is sound,” stated Mrs. Smith. “But keep in mind, American employment data comes from two different surveys...and one survey doesn’t always agree with the other.”

Mrs. Smith continued, “In this case, the U.S. economy added an estimated 75,000 net new jobs in May. While that sounds pretty good, the gain was expected by economists and financial market players to be closer to 175,000 net new jobs.”

“Please keep in mind that the ‘official’ employment data comes from a monthly survey of nearly 400,000 medium- and large-sized businesses,” Mrs. Smith noted. “The unemployment rate, on the other hand, comes from a monthly survey of 60,000 households. The household survey also has an employment component.”

“When the most recent household survey was conducted,” she continued, “an estimated 180,000 more people were seeking jobs in May, and thus were considered part of the labor force...now estimated at just under 151 million people. Also during May, an estimated 288,000 members of households reported that they had found jobs last month, many more than the ‘official’ 75,000 job rise. As a result, the number of people considered unemployed actually fell by 108,000 to 7,015,000 people. That total, divided by the total labor force of 150,991,000 people gets you to the 4.6% unemployment rate, versus 4.7% in April.”

“That’s kind of confusing,” stated Mr. Jones.

“It gets worse,” laughed Mrs. Smith. “The differences over time between the two employment surveys can be enormous. For example, the ‘official’ monthly survey of businesses notes that total non-farm employment has risen by 2,929,000 net new jobs during the five years from May 2001 through May 2006, a period that included recession and recovery.”

“However,” she continued, “the household survey during the same five-year period notes the net addition of 6,884,000 jobs, a difference of nearly four million jobs...and more than twice as many. Many labor market watchers...including the gentleman (term used loosely) writing our dialogue... argue that newly created and/or expanded small businesses, more consultants, more contract and 1099 workers, etc. are the basis of a rising share of job creation today.”



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“These jobs are counted in the household survey,” she added, “and are NOT counted in the larger business survey. Most of these jobs will ultimately be counted in coming years as additional sources of information are measured.”

“So the reference the national media constantly makes about ‘the jobless recovery’ taking place in the economy is wrong?” asked Mr. Jones.

“Precisely,” noted Mrs. Smith.

The Fed

“So is that Federal Reserve group doing whatever it is they do?” asked a puzzled Mr. Jones.

“That, my good friend, is today’s \$64 question,” chuckled Mrs. Smith. “The Fed’s Open Market Committee (FOMC), a voting group of 12 people drawn from Federal Reserve Board members and District presidents, has to make that determination on June 29.”

“The members are well aware,” she continued, “that they have already tightened monetary policy following 16 consecutive meetings of the Committee since June 2004. The members also know that the impact of monetary tightening actions does not show up in the economy for 12 to 24 months,” she continued.

“To make things more complicated,” she added, “the Federal Reserve’s new Chairman, Ben Bernanke, has suggested that the FOMC might pause from doing any additional tightening for a meeting or two. He also noted that such a pause would not preclude additional tightening later. He then talked very tough about inflation on June 5, raising the odds that the Fed would tighten again on June 29.”

The Markets

“It seems that stock prices have been on a roller coaster in recent weeks, with the Dow up or down sharply,” complained Mr. Jones. “Why is that happening?”

“American stock market traders and investors, in addition to players in the U.S. bond market, are keeping a close eye on what the Fed might do and what happens with inflation,” she explained patiently. “Each of these markets is fearful of the damage that higher inflation can do

to asset prices. However, investors and traders in both markets are also worried that the Fed could tighten too much, and hurt the economy. The Fed is walking a very fine line.”

“Is inflation going to moderate?” asked Mr. Jones. “After all, we are paying much more for energy and other stuff than we used to.”

“Another \$64 question, my friend,” she answered. “The Fed wants and expects the U.S. economy to slow somewhat from the strong 5.3% real (after inflation) annual growth pace during 2006’s first quarter. However, the Fed doesn’t want growth to slow too much. The Fed would be happy to see the economy grow at around a 3.0% real annual pace over the next 18 months.”

The Dollar

“I have also heard that the dollar is weak,” stated a confused Mr. Jones. “I thought a dollar was a dollar.”

“The American dollar has weakened in recent months when considering its purchasing power versus a number of other major currencies around the world,” she stated. “Such a weakening versus the European Union’s euro, the Japanese yen, and the Canadian dollar, for example, can be viewed as a positive development, as long as it takes place in an orderly fashion.”

She added, “A weaker dollar is perhaps the easiest way to help reduce the enormous trade imbalance the U.S. runs with the rest of the world. A weaker dollar makes foreign-made goods and services more expensive to Americans (in theory)... hence we buy less. At the same time, the weaker U.S. dollar makes U.S.-made goods and services more affordable around the world, hence foreigners (in theory) buy more. Both developments can lessen our trade imbalance with other nations.”

“OK...final question,” stated a flustered Mr. Jones. “Is the Fed going to tighten again on June 29?”

“My friend,” she laughed. “Even Ben Bernanke can’t answer that question right now. It all depends on the data the Fed sees in coming weeks.”

“I’m still confused,” moaned Mr. Jones.

“TEA”sers

More Deep Thoughts on Golf:

- A golf match is a test of your skill versus your opponent’s luck
- It is surprisingly easy to hole a 50-foot putt for an 8
- It’s not a gimme if you’re still away



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