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A Tale of Two Employment Surveys Related

Financial markets were once again rocked by a weaker-than-expected gain (34,000) in payroll employment for July. This weak payroll number, moreover, comes at a time when other labor market indicators are painting a brighter picture, notably the household survey of employment, which showed an outsized gain of 627,000 for July. How is it possible for there to be such a large divergence between two measures of employment?

Payroll employment, like most economic series, is not a complete or final count. It is an estimate of non-farm industry employment based on information from approximately 400,000 establishments out of a nationwide total of 8.2 million. The initial estimate is based on information from 55% to 60% of the 400,000 establishments in the survey. The initial estimate is revised in each of the two subsequent payroll reports, and a more complete count becomes available six months later when the Quarterly Census Employment and Wage Data is published.

Because of the relatively small sample size, changes in payroll employment for a given month should thus not be either embraced or dismissed outright but viewed over three- and six-month periods, and in the context of other labor-market indicators. The same is also true of the household survey, which is also based on a small sample of total households.

July's gain in payroll employment was the smallest increase in the last six months, while the gain in household employment was the largest. Although both appear at odds with the basic underlying trend in labor markets, the weight of evidence favors the gains in household employment over the payroll figures.

There are two simple rules to follow when analyzing labor-market conditions. Look at the movement in the unemployment rate. And then look at the trend in withheld income-tax receipts.

In July, civilian unemployment fell 0.1% to 5.5%, the lowest rate this year. If job growth was as weak as the payroll figures suggest, the jobless rate would be rising, not falling. That's especially true in the current environment because labor-force growth (people entering or reentering the workforce) has been exceptionally strong. In fact, the civilian labor force grew by 577,000 in July and by 1.2 million over the past four months.

At the same time, federal withheld income-tax receipts (monies collected from workers' pay) has been relatively strong, increasing by roughly 7% in July, the fastest year-on-year gain of the year. Income-tax receipts are the "hardest" data series available, and although notorious for their volatility, they do provide an unambiguous and unbiased view of what is happening with worker income—and most likely employment as well.

Plainly, the results of both simple tests tend to support the job gains reported by the household survey, not the payroll survey.

Given those findings, is there a fundamental reason for the large divergence between the two surveys? None are readily apparent, but we can rule out a few things often cited:

First, the gains in the household measure of employment did not occur outside the scope of the payroll survey. Of the 627,000 increase in household employment, 407,000 were private-industry workers and thus included in the payroll survey.

Second, although the gains in household employment were largely bunched, these are workers also included in the payroll survey. In the household survey, a part-time worker is defined as someone who generally works less than 35 hours a week. Given that the nationwide average work week is 33.7 hours—and indeed almost an hour less in most service-providing industries—the vast majority of payroll workers would fall under the part-time category in the household employment survey.

In the final analysis, there is no easy explanation for the large gap. It might be nothing more than the "noise" of two partial and incomplete counts, and so we will likely see the two series move back into line in coming months. As best as we can determine, the payroll-employment series seems to be running at least 250,000 below the comparable measure in the household survey **(Display 1)**. Recall that an even larger gap developed in late 2003 and payroll employment eventually caught up, registering very large gains between February and May. We expect the payroll survey to move back in line with the household survey in the coming months.

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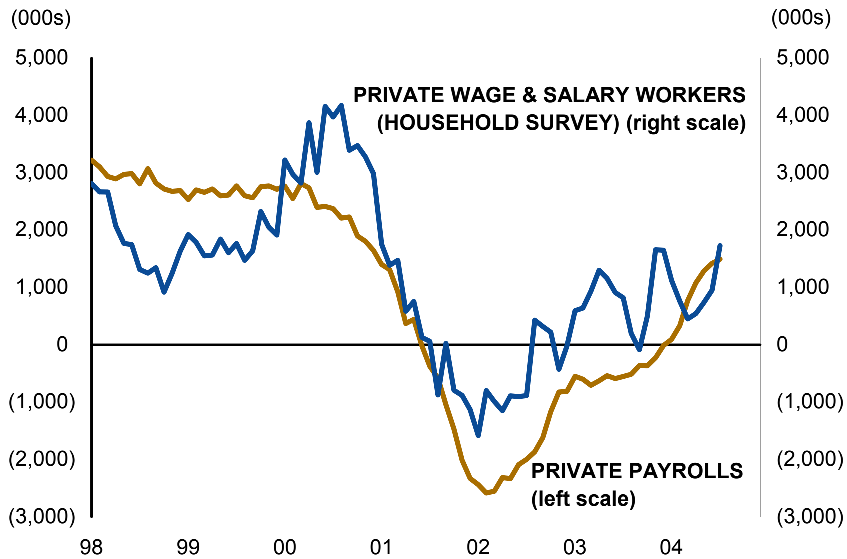
Display 1: Household and Payroll Employment Track One Another



Source: Haver Analytics and Alliance Fixed Income August 6, 2004

Payroll employment and the private wage and salary worker series in the household employment survey tend to track each other over time. At this writing, the level of payroll employment seems to be running at least 250,000 behind the comparable household employment series.