

# U.S. Economic Views

## Fed Focuses on Payrolls...up to a Point

- Payrolls may disappoint again in September with lower-than-expected prints that could raise doubts about the robustness of the expansion. Despite the heightened focus on payrolls, short run moves track poorly with other measures of economic activity.
- We believe the solid improvement in the labor market is continuing. However, a calendar bias and payback from the surprisingly strong start of the year point to another soft employment reading for September. Since 2000, initial summer payroll estimates contained some of the weakest gains reported for the year.
- September payrolls likely rose by just 175K after the disappointing 142K August gain. Both months have a tendency to be revised higher, with typical adjustments of about 40K and 60K, respectively.
- Weakness in summer payrolls is not reflected in other activity data, which indicate that solid above trend growth continues.

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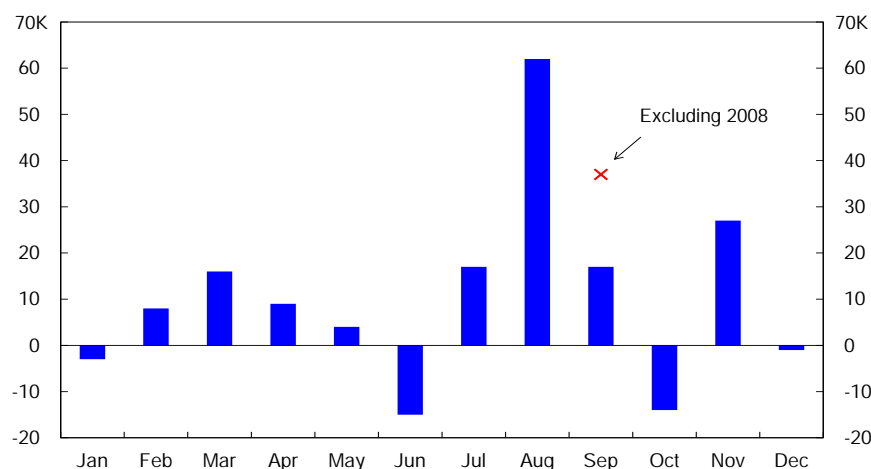
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### August Payroll Revisions Tend to be the Largest of the Year



Note: Figures are calculated from 2000-2013  
Sources: Bureau of Labor Statistics and Citi Research.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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## Fed Focuses on Payrolls...up to a Point

**With the Fed and markets focused on developments in the labor market, the September employment report is now taking center stage** (especially after the lackluster August reading). We think payroll employment may disappoint again in September, reflecting calendar quirks and payback from outsized early year gains. While the back-to-back soft readings may generate doubts about the pace of the expansion, they mean little for overall growth. Although payrolls are an important factor for the economy, monthly changes often are at odds with other broad measures of activity. Despite the anticipated soft payrolls, new data continue to imply solid, above-trend GDP growth in the third quarter and the coming year.

**We expect payrolls expanded at a below-trend 175K in September (Figure 1).** Nevertheless, we believe solid improvement in the labor market is continuing. We see the low print as an offset to the outsized gains in the winter and spring. Also, initial estimates for September payrolls tend to underestimate the final data.

Figure 1. Employment Statistics (Thousands Unless Indicated), Jun 14-Sep 14E

	Sep E	Aug	Jul	Jun
Total Employment	175	142	212	267
Private Payrolls	165	134	213	260
Goods Producing	25	22	67	34
Construction	10	20	31	8
Manufacturing	10	0	28	21
Service Producing	140	112	146	226
Retail Trade	25	-8	21	35
Business Services	40	47	36	70
Government	10	8	-1	7
Unemployment Rate (Percent)	6.0	6.1	6.2	6.1
Average Workweek (Hours)	34.5	34.5	34.5	34.5
Hours Worked Index (Percent)	0.1	0.1	0.2	0.2
Hourly Earnings (Percent)	0.2	0.2	0.1	0.3

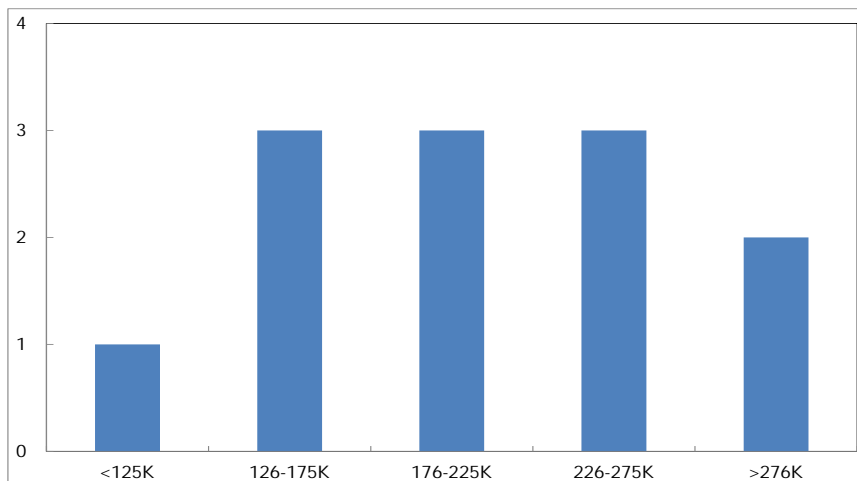
Source: Bureau of Labor Statistics and Citi Research.

**The payroll trend may not have changed materially.** Payroll gains did pick up to an average of 215K per month this year compared with about 190K in the previous two years. However, payrolls are very volatile on a month-to-month basis and the pickup in recent gains is well within the range that can be considered noise. According to the Bureau of Labor Statistics, the measurement error for payrolls is 90K. **Figure 2** shows the wide dispersion of payroll counts by month over the past year. How can we decipher a subtle 25K shift in trend when nine of the past 12 readings are not near the trend?

Keep in mind that if the payroll trend is around 200K, as we expect, it is equally likely that any given payroll gain will be above or below that level. So, we were not surprised by the August 142K reading. Payroll gains in the 100Ks could occur frequently even if the trend is gradually shifting higher.

**We have warned that August and September payroll reports were strong candidates for low prints to offset the big gains earlier in the year** ([U.S. Economic Views - Spending and Jobs Are Better Than You Think](#)). For more than a decade, we have found a bias toward low initial prints in the summer months, especially August and September. **Figure 3** indicates the number of initial payroll readings that were among the highest three or lowest three of the year for each month. The smallest reported initial estimates seem to be evenly distributed among the twelve months. However, the largest readings are clustered in the early part of the year, with none occurring in the summer months.

Figure 2. Wide Dispersion of Payroll Increases Masks Any Trend Changes



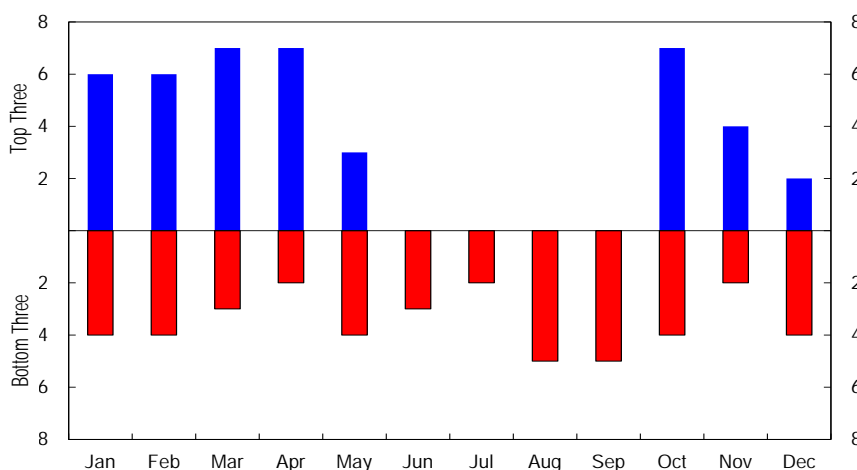
Source: Bureau of Labor Statistics.

**In the fourteen years starting in 2000, there has not been a single instance of an initial summer-month payroll print that was among the three largest reported for the year.** If this were random, there would be more than a dozen times where summer months posted high readings (and lot fewer in the beginning of the year). September has the distinction of the lowest average ranking of any month.

We do not want to give the impression that summer payroll readings are all soft. These data go through the same seasonal adjustment process and therefore should have no consistent bias toward weak or strong readings. The problem is that seasonal adjustment is made on the final revised data, which are composed of a more complete reporting sample than the initial estimates. Evidently, initial payroll estimates with incomplete reporting appear to systematically dampen payroll gains in the summer months.

**The low initial prints in summer usually get revised up subsequently.** August payroll revisions have been the most extreme of any month. From the first to final prints, August job gains have been revised up in 12 of the past 14 years. Typically,

Figure 3. No Strong Initial Employment Estimates Reported in Summer Months for 2000-2013



Sources: Bureau of Labor Statistics and Citi Research.

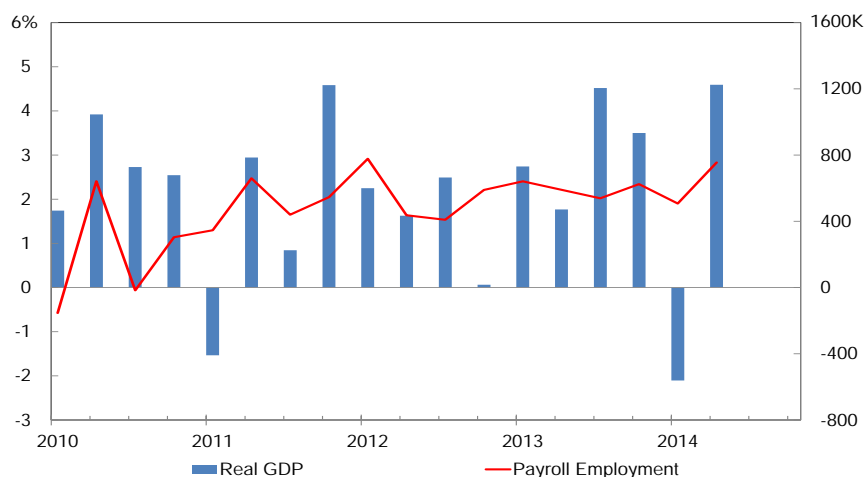
these revisions have been huge, averaging 63K, which is large enough to change the character of the headline print (**cover figure**). A similar claim can be made for September. If we excluded the massive recession-distorted downward revision in 2008, the average September revision would have been up about 40K.

**Light August and September payroll gains should not induce changes to monetary policy.** Fed officials are focused on a wide range of economic indicators and how their trends may change the overall outlook. Our employment forecast for September would keep the average gain over the past year right around 200K. And other data to be reported are likely to suggest continuing labor market improvement. In particular, we look for the unemployment rate to tick down to 6.0 percent.

## Outlook Is Bright Despite Summer Jobs Lull

**The expected temporary weakness in August and September employment has little bearing on the pace of activity in the overall economy.** Figure 4 shows that quarter-to-quarter swings in employment and GDP are rarely correlated. Our forecast for September would move the quarterly payroll change back toward the average gain from late 2012 to early 2014. Steady readings of that magnitude were associated with a wide range of GDP growth outcomes (from negative 2 percent to positive 4½ percent).

Figure 4. Real GDP Changes Are Not Tightly Correlated With Short Run Fluctuations in Payrolls



Note: Real GDP figures are annualized percent changes, and payroll are quarterly changes.  
Sources: Bureau of Economic Analysis and Bureau of Labor Statistics.

**Instead, growth is taking its cue from solid gains in domestic demand**, as was evident in the 4.6 percent rise in the final revision to second quarter GDP. Demand increased by 3.4%, which was the largest gain in four years. Investment soared in the quarter (up 9.5 percent) as did exports (up 11.1 percent). And third quarter GDP is tracking near 3½ percent.

**Next week's report on August consumer spending is likely to show solid consumer demand as well (Figure 5).** Moreover, we would not be surprised by an upward revision to July mirroring the retail sales report. Industry reports indicated that back-to-school sales were up substantially from a year earlier. We view these sales as largely discretionary and therefore a harbinger of healthy demand around Christmas. In addition, consumers are benefiting from the drop in energy prices, which already has added an estimated \$25 billion to consumers' discretionary income. Further declines in crude prices suggest there will be more savings in coming months.

Figure 5. Personal Income and Spending (Percent Change)

	Aug	E	Jul	Jun	May
Personal Income	0.3	%	0.2	0.5	0.5
Wages and Salaries	0.3		0.2	0.4	0.4
Disposable Personal Income, 2009 \$	0.4		0.1	0.3	0.3
Personal Spending	0.5		-0.1	0.4	0.3
Personal Spending, 2009 \$	0.6		-0.2	0.2	0.1
Savings Rate	5.2		5.7	5.4	5.4
Core PCE Chain Price Index	0.0		0.1	0.1	0.2
Core PCE (12-Month Percent Change)	1.4		1.5	1.5	1.5

Sources: Bureau of Economic Analysis and Citi Research

**Auto sales normally would be the first indication of the state of September demand, but not this time.** We think the data were distorted by an early Labor Day this year, which shifted some holiday promotion sales into August. As a result, autos posted a cycle-high annual sales pace of 17.4 million units. In the previous three times that Labor Day was this early, unit sales jumped in August only to reverse the gains in September (**Figure 6**). We suspect this time was no different. September sales probably were in line with the previous trend at 16.5 million.

Figure 6. Early Labor Day Weekend Raises Doubts for September Auto Sales

	August Sales	Change from July	September Sales	Change from August
1997	15.7	0.6	14.7	-1.1
2003	17.9	1.2	16.9	-1.0
2008	13.8	1.1	12.7	-1.1
2014	17.4	1.0	16.5F	-0.9

Source: Bureau of Economic Analysis.

**In addition, we expect net exports to contribute nearly a half percentage point to third quarter GDP.** The August trade report is likely to show another small deficit, largely reflecting lower petroleum prices. Our forecast would put the average of July and August \$38 billion above (less negative than) the second quarter average. Even in real terms, the trade deficit has narrowed sharply in recent months mainly due to faster paced exports (**Figure 7**). However, if the dollar continues to strengthen, we expect this source of growth to be dampened.

Figure 7. Trade in Goods and Services (Billions of Dollars)

	Aug E	Jul	Jun	May	Apr	Mar
Trade Balance	-40.0	-40.5	-40.8	-43.5	-46.0	-43.1
Exports	197.5	198.0	196.2	196.2	193.9	193.9
Goods	138.0	138.6	136.8	137.0	135.0	135.6
Services	59.5	59.4	59.4	59.2	58.9	58.3
Imports	237.5	238.6	237.0	239.6	239.9	237.1
Goods	197.5	198.8	197.2	200.0	200.7	198.2
Oil	27.0	28.3	27.4	28.3	29.8	30.5
Services	40.0	39.8	39.8	39.6	39.2	38.9

Source: Bureau of Economic Analysis and Citi Research.

### Upcoming Releases of Economic Indicators

Date	Time	Report	Citi	Median	Low	High	Prior Report	2 Periods Ago
9/29	8:30	Personal Income (Aug)	0.3%	0.3%	0.2%	0.4%	0.2%	0.5%
		Consumption	0.5%	0.4%	0.2%	0.6%	-0.1%	-0.1%
9/30	9:45	Chicago Business Barometer (Sep)	58.0	62.0	58.0	65.0	64.3	52.6
	10:00	Consumer Confidence (Sep)	92.0	92.5	88.7	95.0	92.4	90.3
10/1	10:00	ISM Mfg. Activity Index (Sep)	59.0	58.3	57.0	59.5	59.0	57.1
		Construction PIP (Aug)	0.4%	0.5%	-0.8%	1.0%	1.8%	-0.9%
	NA	Total Motor Vehicle Sales (Sep)	16.5M	16.9M	16.5M	17.1M	17.4M	16.4M
		Domestic Vehicle Sales		13.6M	13.1M	13.7M	13.9M	13.0M
10/2	8:30	Initial Jobless Claims (Sep 27)	300K	297K	285K	320K	293K	281K
		Beneficiaries (Sep 20)	2.42M	2.43M	2.38M	2.45M	2.44M	2.43M
	10:00	Factory Orders (Aug)	-10.5%	-9.3%	-11.0%	-7.0%	10.5%	1.5%
10/3	8:30	Nonfarm Payrolls (Sep)	175K	215K	155K	265K	142K	212K
		Unemployment Rate	6.0%	6.1%	6.0%	6.2%	6.1%	6.2%
		Average Hourly Earnings	0.2%	0.2%	0.1%	0.3%	0.2%	0.1%
		Private Workweek	34.5H	34.5H	34.5H	34.5H	34.5H	34.5H
		International Trade (Aug)	-40.0B	-41.0B	-44.7B	-39.0B	-40.5B	-40.8B
	10:00	ISM Non-Manufacturing Index (Sep)	59.0	58.5	56.0	59.5	59.6	58.7

### Events

9/28	12:15	Former Fed Chairman Bernanke to speak to the National Association for Business Economics in Chicago.
9/29	9:00	Chicago Fed President Evans to speak to the National Association for Business Economics in Chicago.
9/30	10:45	Fed Governor Powell to speak on a panel about "Government Debt Management at the Zero Lower Bound" in DC.
10/2	13:00	Atlanta Fed President Lockhart to give opening remarks to a conference on Employment and Social Insurance in Atlanta.
	19:45	St. Louis Fed President Bullard to speak on the U.S. economy and monetary policy in Mississippi.

Sources: Bloomberg and Citi Research.

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*For Informational Purposes Only*

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## U.S. Economics Weekly: Market and Policy Comments — Previous Essays

	Publication Date
<a href="#">Wanted by the Fed: Above-Trend Growth</a>	19 September 2014
<a href="#">FOMC Stands Pat But Reveals Its "Tell"</a>	18 September 2014
<a href="#">Stronger Q2 GDP May Not Shift Fed Timing</a>	12 September 2014
<a href="#">Spending and Jobs Are Better Than You Think</a>	5 September 2014
<a href="#">Our Fed Call: Fed Poised For On-Time Or Early Liftoff?</a>	15 August 2014
<a href="#">The Impending Acceleration in U.S. Business Investment</a>	8 August 2014
<a href="#">GDP 4 Point 0 Reassures Fed Is On Track</a>	1 August 2014
<a href="#">Fed Creates Maginot Line to Defend Against Financial Instability</a>	25 July 2014
<a href="#">Potential Growth Slump Is Likely Temporary</a>	18 July 2014
<a href="#">Fed Chiefs Debate Monetary Normalization While Yellen Passes Off Financial Stability</a>	11 July 2014
<a href="#">Bright Outlook Leaves Fed On Schedule Despite Dark Q1</a>	27 June 2014
<a href="#">Gradual Fed Exit Discounted By Markets</a>	20 June 2014
<a href="#">Pick Your Horse: Fed Prognostication or Investment Stagnation</a>	13 June 2014
<a href="#">Receding Turbulence Clears Way for Growth Without Inflation</a>	6 June 2014
<a href="#">No Pressure From Wages</a>	30 May 2014
<a href="#">NY Fed Views On Revised Exit Strategy and Long-term Unemployed</a>	23 May 2014
<a href="#">Housing Worries May be Policy Induced</a>	16 May 2014
<a href="#">Fed's Employment Mandate: Cyclical and Structural Forces Clash</a>	9 May 2014
<a href="#">Shifting Focus to Rebounding Growth</a>	2 May 2014
<a href="#">Strong Economic Bounce Sets Stage For Future Fed Moves</a>	25 April 2014
<a href="#">Labor Costs Put a Floor Under Inflation</a>	11 April 2014
<a href="#">Back On Track, No More Excuses</a>	4 April 2014
<a href="#">The Coming Thaw</a>	28 March 2014
<a href="#">Transparency ≠ Clarity</a>	21 March 2014
<a href="#">Different Words, Same Message</a>	14 March 2014
<a href="#">Looking for Clarity After the Storms</a>	7 March 2014
<a href="#">Winter's Stall May Be Spring's Gain</a>	28 February 2014

## Global Economics View — Previous Essays

<a href="#">How Will The New Fed Exit Strategy Work?</a>	16 June 2014
<a href="#">The Long-Run Decline in Advanced-Economy Investment</a>	12 June 2014
<a href="#">How Could The EM Turmoil Affect The Advanced Economies?</a>	17 March 2014
<a href="#">Policy Uncertainty and Investment—How Much Lower Must Real Interest Rates Go?</a>	3 February 2014
<a href="#">Secular Stagnation: Only If We Really Ask For It</a>	13 January 2014
<a href="#">Debt Limit—Indecision Raises Long-Term Risks</a>	10 October 2013

September-October 2014

Monday	Tuesday	Wednesday	Thursday	Friday
<p>22</p> <p><b>Existing Home Sales</b> Jul 5.14M, Aug 5.05M</p> <p>Auction 3 &amp; 6 Mth. Bills: \$48.0B</p>	<p>23</p> <p><b>FHFA (Jun)</b></p> <p>Auction 2-Yr. Note: \$29.0B Auction 1 Mth. Bill: \$40.0B</p>	<p>24</p> <p><b>Mortgage Applications</b></p> <p><b>New Home Sales</b> Jul 427K, Aug 504K</p> <p>Auction 2-Yr. FRN: \$13.0B Auction 5-Yr. Note: \$35.0B</p>	<p>25</p> <p><b>Jobless Claims 9/20</b> 293 Thous</p> <p><b>Durable Goods</b> Total: Jul 22.5%, Aug -18.2% ExTrans: Jul -0.5%, Aug 0.7%</p> <p>Auction 7-Yr. Note: \$29.0B</p>	<p>26</p> <p><b>GDP</b> 2Q14P 4.2%, 2Q14F 4.6%</p> <p><b>Chain Price Index</b> 2Q14P 2.1%, 2Q14F 2.1%</p> <p>Corporate Profits (2QR)</p> <p>Reuters/Michigan Sentiment SepP 84.6; SepF 84.6</p>
<p>29</p> <p><b>Personal Income</b> Jul 0.2%; Aug(E) 0.3%</p> <p><b>Consumption</b> Jul -0.1%; Aug(E) 0.5%</p> <p>Pending Home Sales (Jul)</p> <p>Farm Prices (Sep)</p> <p>Auction 3 &amp; 6 Mth. Bills: \$48.0B</p>	<p>30</p> <p><b>S&amp;P/CaseShiller (Jul)</b></p> <p><b>Chicago Barometer</b> PMI: Aug 64.3; Sep(E) 58.0 Prices: Aug 60.2; Sep(E)</p> <p><b>Consumer Confidence</b> Aug 92.4; Sep(E) 92.0</p> <p>Auction 1 Mth. Bill: \$40.0B</p>	<p>Oct 1</p> <p><b>Mortgage Applications</b> ADP Employment (Sep)</p> <p><b>ISM Manufacturing</b> PMI: Aug 59.0; Sep(E) 59.0 Prices: Aug 58.0; Sep(E)</p> <p><b>Construction PIP</b> Jul 1.8%; Aug(E) 0.4%</p> <p><b>Total Vehicle Sales</b> Aug 17.5M; Sep(E) 16.5M</p>	<p>2</p> <p><b>Jobless Claims 9/27</b> 300 Thous(E)</p> <p><b>Factory Orders</b> Ord: Jul 10.5%; Aug(E) -10.5% Inv: Jul 0.1%; Aug(E) 0.2%</p> <p>Ann. 3-Yr. Note: \$27.0B(E) Ann. 10-Yr. Note(r): \$21.0B(E) Ann. 30-Yr. Bond(r): \$13.0B(E)</p>	<p>3</p> <p><b>Employment</b> Payrolls: Aug 142K; Sep(E) 175K Unem. Rate: Aug 6.1%; Sep(E) 6.0% Avg Hrlly Earn: Aug 0.2%; Sep(E) 0.2% Priv. Wrkww: Aug 34.5H; Sep(E) 34.5H</p> <p><b>International Trade Balance</b> Jul -\$40.5B; Aug(E) -40.0%</p> <p><b>ISM Non-Manufacturing</b> PMI: Aug 59.6; Sep(E) 59.0 Prices: Aug 57.7; Sep(E)</p>
<p>6</p> <p><b>Strips Data (Sep)</b></p> <p>Auction 3 &amp; 6 Mth. Bills: \$48.0B(E)</p>	<p>7</p> <p><b>Consumer Credit</b> Jul \$26.0B, Aug(E)</p> <p>Auction 3-Yr. Note: \$27.0B(E) Auction 1 Mth. Bill: \$35.0B(E)</p>	<p>8</p> <p><b>Mortgage Applications</b></p> <p><b>FOMC Minutes Released</b></p> <p>Auction 10-Yr. Note: \$21.0B(E)</p>	<p>9</p> <p><b>Jobless Claims 10/4</b></p> <p><b>Wholesale Inventories</b> Jul 0.1%, Aug(E)</p> <p>Auction 30-Yr. Bond(r): \$13.0B(E)</p>	<p>10</p> <p><b>Import Price Index</b> Total: Aug -0.9%, Sep(E) ExPetro: Aug -0.1%, Sep(E)</p> <p><b>Federal Budget Balance</b> Sep 13 \$75.1B; Sep 14(E)</p>
<p>13</p> <p><b>Columbus Day</b> <b>Federal Gov't Holiday</b></p>	<p>14</p> <p><b>Small Business (Sep)</b></p> <p>Auction 3 &amp; 6 Mth. Bills: \$48.0B(E)</p>	<p>15</p> <p><b>Mortgage Applications</b></p> <p><b>Empire State Manufacturing</b> Sep 27.5, Oct(E)</p> <p><b>Retail Sales</b> Total: Aug 0.6%, Sep(E) ExAuto: Aug 0.3%, Sep(E)</p> <p><b>Producer Price Index</b> Final Demand: Aug 0.0%, Sep(E) ExF&amp;E: Aug 0.1%, Sep(E)</p> <p><b>Business Inventories</b> Jul 04%, Aug(E)</p> <p><b>Beige Book</b> Auction 1 Mth. Bill: \$35.0B(E)</p>	<p>16</p> <p><b>Jobless Claims 10/11</b></p> <p><b>Industrial Production</b> Aug -0.1%, Sep(E)</p> <p><b>Capacity Utilization</b> Aug 78.8%, Sep(E)</p> <p><b>Philly Outlook Survey</b> Sep(E) 22.5%, Oct(E)</p> <p>Housing Market Index (Oct)</p> <p>Ann. 30-Yr. TIPS(r): \$13.0B(E)</p>	<p>17</p> <p><b>Housing Starts</b> Aug 956K, Sep(E) <b>Permits</b> Aug 998K, Sep(E)</p> <p>Reuters/Michigan Sentiment SepF 84.6, OctP(E)</p>

(E) Indicates Citigroup estimates. (A) Advance. (P) Preliminary. (F) Final. (UNCH) Unchanged. (R) Revised. Contributors: Martha Berasain and Cathy Gaeta.



## Appendix A-1

### Analyst Certification

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