

M&B News Update

June 13, 2012

The Federal Reserve meets next week to discuss the current economic situation. Several policymakers have suggested that the Fed should engage in more quantitative easing (buying bonds in the open market) to move interest rates even lower than they already are. Those policymakers are concerned about slow economic growth in the United States and possible contagion from the financial problems in European countries.

How bad are the employment data? Evaluating data in real time is difficult because the numbers are based on preliminary and incomplete data and because seasonal factors change over time in unexpected ways. It takes years before we know how those seasonal factors may be changing. For example, many economists have expressed concern about the recent decline in the monthly change in payroll employment, shown in Chart 1.

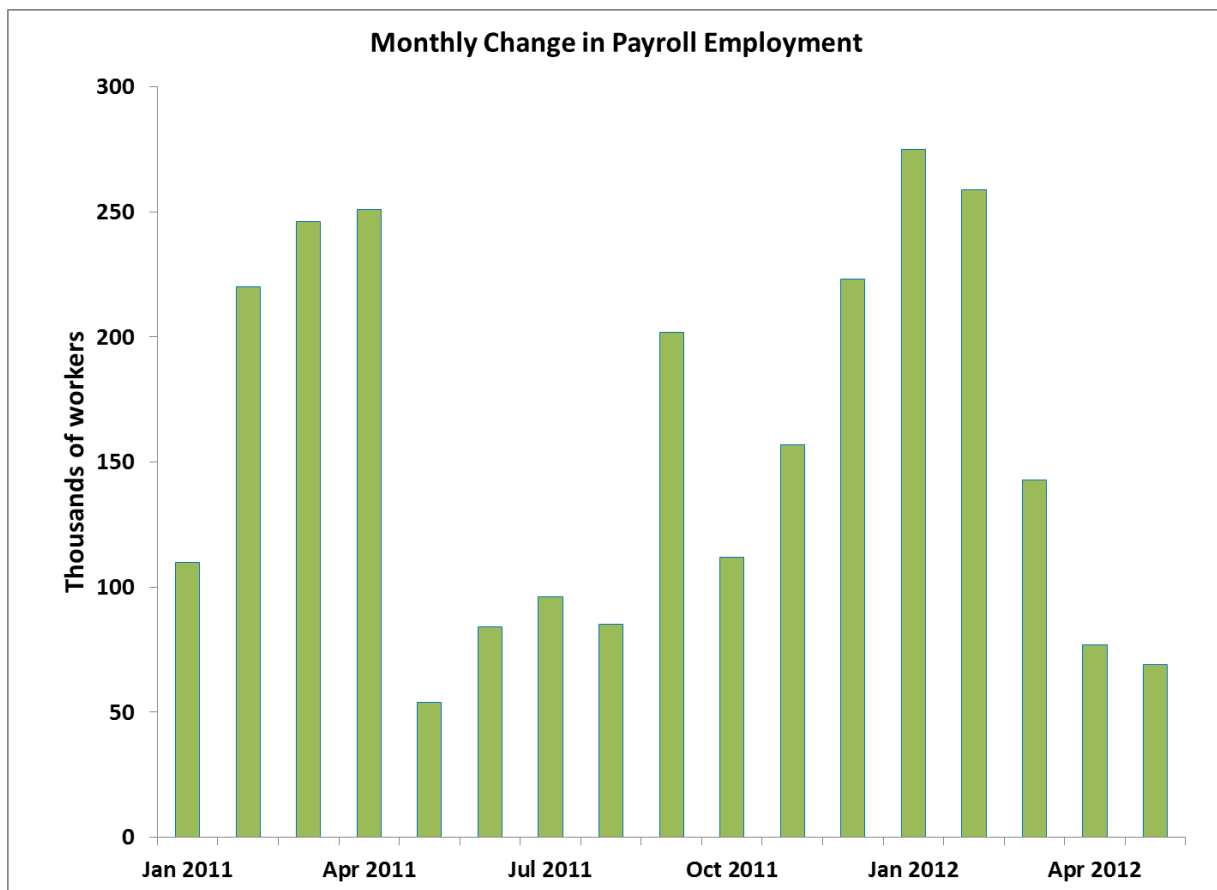


Chart 1: Change in payroll employment, monthly, in thousands, January 2011 to May 2012. Source: Federal Reserve Bank of St. Louis FRED database, original data from U.S. Bureau of Labor Statistics

As the chart suggests, in both of the past two years, employment has increased substantially in the winter but then tailed off substantially in the spring. The May 2012 increase in payrolls of 69,000

jobs is the lowest since May 2011; that may not be a coincidence. Analysts always become concerned about such a drop-off in a variable as important as payroll employment, but the fact is that these data may not be an accurate representation of what is really going on the economy because the seasonal pattern of employment may have shifted. If so, then our data for employment will ultimately be revised down for the winter months and revised up for the spring months and the overall pattern will look smoother and of less concern. Perhaps a better way to analyze the data is to look at a 12-month moving average of the employment data, as shown in Chart 2.

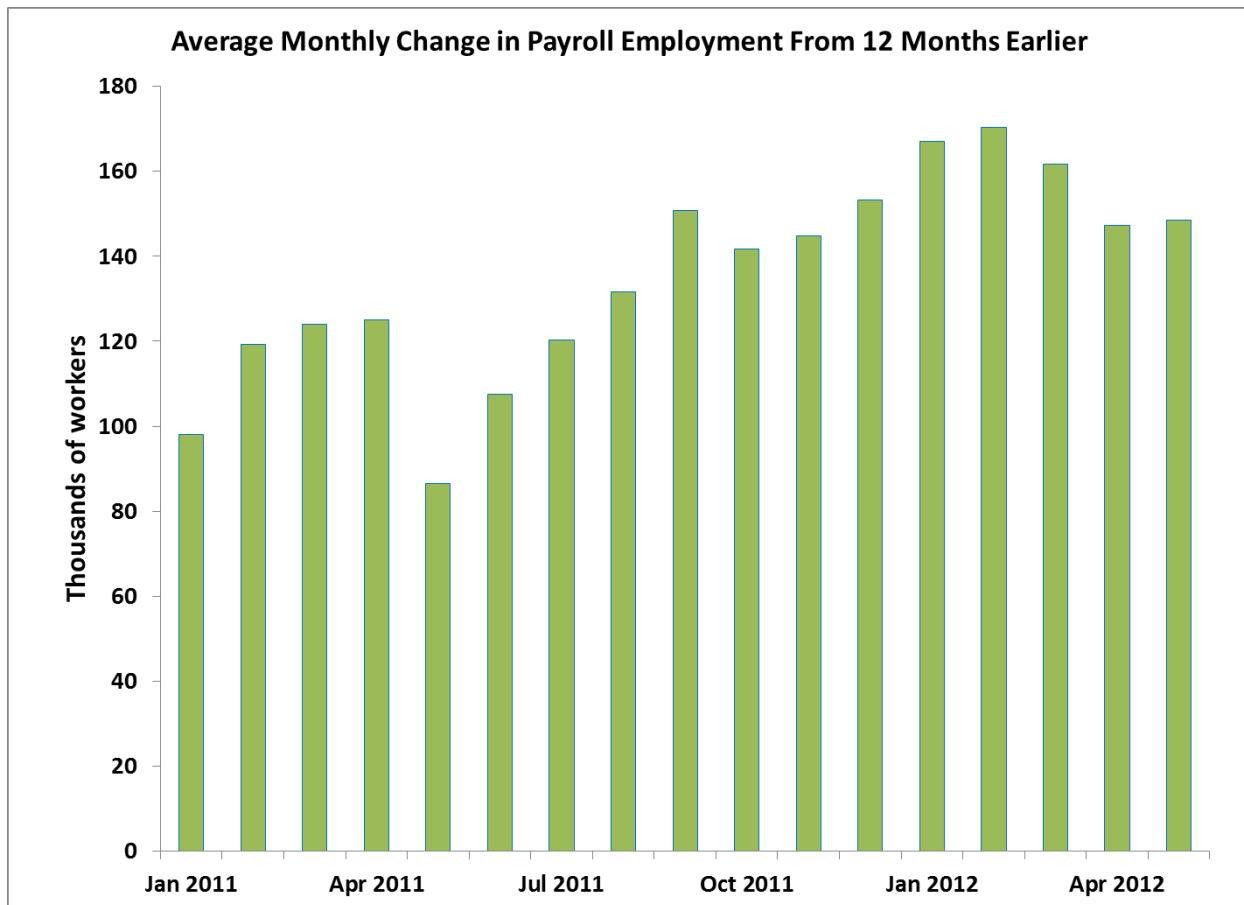


Chart 2: Average monthly change in payroll employment from 12 months earlier, monthly, in thousands, January 2011 to May 2012. Source: same as Chart 1

Taking a moving average, as Chart 2 does, obviously smooths the data compared to the data in Chart 1. Because we won't know until several more years if the seasonal factors affecting employment have changed, it may be a superior way to look at things. We do observe in Chart 2 a small decline in the average change in payrolls in May 2012 from the peak in February 2012, but the overall trend in employment growth remains positive. So, the data in Chart 1 may be making the economy look worse than it really is.

The technique of using a one-year moving average for data is often useful, especially for extremely volatile series such as inflation. For example, it is used in M&B, Chapter 17, Figure 17.8 on

page 366 to show the long-run movements of the inflation rate. If we had not taken a one-year moving average of the inflation rate, but just shown the monthly inflation rate, the graph would have been much more difficult to understand.

Policymakers at the Fed understand the vagaries of the data very well and the sentiment among the policymakers for further easing of monetary policy does not seem strong enough for the Fed to act. But if data other than employment show signs of weakness and if the problems in Europe begin to threaten world financial stability, the Fed might ultimately increase the money supply further. No action is likely at the June FOMC meeting, however.