

A User's Guide to Unemployment Statistics

On the first Friday of every month, the markets get ready to process the latest Employment Situation Report. The report is released by the Bureau of Labor Statistics and details the state of the labour market in the United States (US). The first sentence of the report usually reads something like this:

"The unemployment rate rose to 4.3 percent in July, and nonfarm payroll employment edged up by 114,000, the U.S. Bureau of Labor Statistics reported today."

How Employment Figures Influence Economic Policies and Markets

Employment indicators are some of the timeliest measures of the state of the US economy. In the days, hours and minutes following their release, markets can react decisively if they miss expectations.

This is because the Federal Reserve (the Fed) uses the latest employment data to check whether its monetary policies are achieving their goals and what direction the economy is heading. For example, over the past 18 months, the Fed has raised rates and held them at their highest level for some time to combat inflation. Higher interest rates tend to slow down the economy, and a key sign of this slowdown is higher unemployment. Consequently, rising unemployment rates suggest to the Fed that its strategy to control inflation might be working, which in turn influences market reactions.

Where Unemployment Stats Fall Short

However, the unemployment rate is often revised after it is released because, like most economic data, it is subject to errors. While it gives us some details about the state of employment in the country, it doesn't tell us everything. This often results in the market forming distorted views about the state of the US labour market and the effectiveness of the Fed's monetary policy.

We'll break down what the unemployment rate is, its limitations, and why it's often revised after the fact.

1. Scope: The Mechanics of Unemployment Rates and Their Different Types

The Bureau of Labor Statistics (BLS) has been calculating unemployment statistics in largely the same way since 1940. The BLS follows the international guidelines for reporting labour statistics, which are set by the International Labour Organisation (ILO).

To be classified as unemployed, a person must be (1) without work, (2) available for work, and (3) have actively searched for work. Although that classification is relatively simple, the BLS recognises that employment dynamics are nuanced and no single measure holistically reflects the state of employment in the economy. To that end, the BLS publishes six different unemployment rates every month. They are colloquially known as U-1 to U-6, with U-3 being the official unemployment rate.

The first two measures, U-1 and U-2, define unemployment more narrowly than the official rate (U-3), meaning they include fewer people as unemployed. On the other hand, measures U-4 to U-6 have broader definitions of unemployment and usually show higher rates than the official U-3 rate.

The table below defines U-1 to U-6 and shows reported rates over the past year.

The BLS refers to each of these statistics as "alternative measures of labour underutilisation". For simplicity, they are best thought of as stricter and more lenient definitions of the official unemployment rate, or U-3.

Official Labour Underutilisation Statistics – July 2023 to July 2024 (%)

	July 2023	Mar 2024	Apr 2024	May 2024	Jun 2024	Jul 2024
U-1 Persons unemployed 15 weeks or longer, as a percent of the civilian labour force. <i>*This is the strictest definition of unemployment</i>	1.3	1.3	1.3	1.4	1.5	1.6
U-2 Job losers and persons who completed temporary jobs, as a percent of the civilian labour force. <i>*This measures the change in unemployment as it counts people who effectively fell out of the employed category</i>	1.6	1.8	1.9	1.9	1.9	2.1
U-3 Total unemployed persons, as a percent of the civilian labour force (the official unemployment rate). <i>*This rate includes U-1 as well as people who have been more recently unemployed but excludes discouraged workers</i>	3.5	3.8	3.9	4	4.1	4.3
U-4 Total unemployed persons plus discouraged workers, as a percent of the civilian labour force plus discouraged workers. <i>*This is U-3 but discouraged workers are also included</i>	3.7	4	4.1	4.2	4.3	4.5
U-5 Total unemployed persons, plus discouraged workers, plus all other “marginally attached” workers, as a percent of the civilian labour force plus all “marginally attached” workers. <i>*This is U-4 but the broader group of marginally attached and not only discouraged workers are included</i>	4.3	4.7	4.8	4.8	4.9	5.1
U-6 Total unemployed persons, plus all “marginally attached” workers, plus all persons employed part-time for economic reasons, as a percent of the civilian labour force plus all “marginally attached” workers. <i>*This is U-5 but also includes people who are employed part-time</i>	6.7	7.3	7.4	7.4	7.4	7.8

Source: Bureau of Labor Statistics, July 2024

This table shows significant differences between unemployment measures U-1 to U-6. Understanding these differences requires knowing some key terms.

Unemployment Terms Explained

- **Civilian Labour Force** – People aged 16 years or older and classified as employed or unemployed.
- **Marginally Attached to the Workforce** – Those persons who are not in the labour force, who want and are available for work, and who have looked for a job in the past 12 months but are not counted as employed because they haven’t looked for a job in the past four weeks preceding the employment survey.
- **Discouraged Worker** – A subset of the marginally attached but stopped looking for work because they believed no work was available for them, therefore not included as unemployed.

The Formula Behind the Unemployment Rate

If we think of the basic unemployment rate calculation, across all six measures, the numerator is an estimate of the number of unemployed people that varies depending on how unemployment is defined. Likewise, the denominator is an estimate of the labour force, which is the number of people in a country who are available to work.

Formulaically, U-3, which is the official unemployment rate, is defined as follows: U-1 to 2 and U-4 to 6 either expand or reduce the size of the numerator and/or the denominator.

$$\text{Official Unemployment Rate (\%)} = \frac{\text{Total Number of Unemployed Persons}}{\text{Civilian Labour Force}}$$

The market focuses almost exclusively on U-3, the official unemployment rate. However, the mere existence of the above classification tells us that U-3 only provides us with a narrow view of the labour market.

The fact that discouraged workers and marginally employed people are excluded from this statistic has a meaningful impact on the reported numbers. This can be seen by the change in the numbers from U-3 to U-5 above.

2. Context – Uncovering the Limitations in U-3 Unemployment Data

In addition to the varied definitions of the labour force and unemployment, U-3 has several limitations.

- **Limited Information on Job Quality:** The unemployment rate tells us if people have a job but nothing about the quality of that job. For example, it doesn't distinguish between someone working a single-hour week and someone working 60 hours a week. According to the ILO, a person is classified as employed if they worked at least one hour during the reference week in paid employment, regardless of job type or hours worked. Employment statistics also don't tell us if people are working in jobs that they are overqualified for, known as underemployment.
- **Limited Information on the Unemployed:** Information like the education level of the unemployed as well as whether or not people are recently discouraged workers is important to understand. For example, if most of the unemployed are skilled workers, that may lead to different conclusions about the state of the economy than if most of the unemployed are unskilled workers. Likewise, to be classified as unemployed you need to have actively looked for work in the past four weeks. So technically, if a person last looked for a job five weeks ago they are classified as discouraged, but they may not in fact be a discouraged worker. Therefore, the official unemployment rate may actually be higher as a result.

Ultimately, these factors all have a meaningful effect on the makeup of the labour market and having sufficient information on each may help us to better judge the state of the economy.

3: The Lag Effect of Unemployment Data

Unemployment statistics are classified as a lagging economic indicator because they reflect past economic activity. That is, employment activity reacts to the state of the economy.

In addition, employment statistics take some time to gather. In the US, it typically takes the BLS around two weeks to conduct employment surveys and then another two weeks to report labour statistics. That means that the most recent employment statistics report on the state of the labour market four weeks earlier.

Short-term abnormalities in the labour market like strikes, natural disasters and temporary lay-offs may also distort labour market dynamics, especially if they coincide with the weeks over which the BLS surveys the economy.

4: How Data Errors Impact Employment Statistics

Unemployment statistics are typically prone to four kinds of data errors:

- **Measurement Errors** – These tend to occur when survey data is misinterpreted due to incorrect reporting by survey respondents.
- **Sample Size Errors** – When the size of the sample which is surveyed is too small, this leads to a distorted view of the labour market.

- **Classification Errors** – When data reported through the surveys is misinterpreted and not classified correctly.
- **Lack of Data** – Ultimately, employment data is only useful if survey respondents respond and the size of the sample is sufficient enough to make broad-based conclusions about the state of the labour market.

While these may seem like relatively trivial errors, they can have a substantial impact and ultimately lead to data revisions.

A Practical Example of a Measurement Error – Nonfarm Payroll Revisions

One of the most reported statistics in the Employment Situation Report is the Nonfarm Payroll (NFP) number. It measures the total amount of employed people (on a company's payroll) working in goods, construction and manufacturing. It represents about 80% of the US workforce and monthly changes in the NFP number are closely followed by the market.

The number usually reported is the difference between the latest and the previous month's NFP number, which indicates the total jobs in those sectors that the economy added or lost over the last month. However, NFP numbers are often revised because of some of the data errors we highlighted above. Most recently, the BLS preliminarily revised the March 2024 NFP figure down by 818 000 jobs.

That means that in March, the BLS over-reported the total number of jobs in the goods, construction and manufacturing sectors by 818 000 (i.e. there were 818 000 fewer jobs than originally thought). That is a material overestimation and has led many analysts to believe that the unemployment situation in the US is worse than originally estimated.

Conclusion: Navigating the Complexities of Employment Data

Employment statistics provide the market with important information about the state of the US labour market, the effectiveness of the Fed's monetary policy and ultimately the direction of the US economy.

However, they also provide us with less information than we need to properly characterise the state of employment in the US.

Crucial data like NFP numbers, which the market uses to form expectations, is often revised. Understanding these shortcomings may help us form a more balanced economic view and ultimately lead to better investment decisions.

Moreover, although the Fed's rate-hiking regime has been effective in bringing down inflation, the latest revised employment data suggests it might have been too effective. It remains to be seen whether or not the Fed can still keep the US economy out of recession like the market expects.

MARKET REPORT
31 08 2024

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investment clarity

		3m	YTD	1yr	3yr pa	5yr pa	10yr pa	5yr Vol1	10yr Vol1
LOCAL MARKET INDICES									
SA Equity	ZAR	9.4%	10.9%	15.3%	11.3%	12.0%	7.8%	16.8%	14.3%
SA Listed Property	ZAR	19.5%	23.3%	37.4%	13.1%	3.9%	3.5%	27.2%	21.5%
SA Bonds	ZAR	11.8%	12.0%	17.9%	8.4%	8.5%	7.8%	8.8%	8.3%
SA Cash	ZAR	2.1%	5.6%	8.5%	6.7%	6.1%	6.6%	0.5%	0.4%
Balanced Benchmark	ZAR	7.8%	10.5%	15.3%	10.7%	10.9%	8.7%	11.6%	9.8%
SA Inflation (1 month lag)	ZAR	0.7%	2.8%	4.6%	5.7%	5.0%	5.0%	1.4%	1.4%
GLOBAL MARKET INDICES BASED TO USD									
Global Equity	USD	6.6%	16.5%	24.5%	7.0%	13.2%	9.7%	17.7%	15.1%
Emerging Markets Equity	USD	5.4%	9.0%	13.9%	-3.4%	4.4%	2.3%	18.4%	17.4%
Global Property	USD	13.0%	7.4%	17.4%	-2.6%	1.2%	3.0%	21.1%	17.0%
Global Bonds	USD	5.3%	1.8%	6.8%	-4.2%	-1.4%	0.1%	7.6%	6.3%
US Cash	USD	1.4%	3.7%	5.6%	3.5%	2.3%	1.7%	0.7%	0.5%
MAJOR INDICES BASED TO RANDS									
SA Equity	ZAR	9.4%	10.9%	15.3%	11.3%	12.0%	7.8%	16.8%	14.3%
Global Equity	ZAR	0.5%	12.0%	16.8%	14.6%	16.8%	15.5%	15.8%	15.8%
Emerging Markets Equity	ZAR	-0.6%	5.8%	6.8%	3.4%	7.7%	7.6%	13.9%	13.7%
Global Property	ZAR	6.6%	3.3%	10.1%	4.3%	4.5%	8.5%	18.6%	17.3%
SA Bonds	ZAR	11.8%	12.0%	17.9%	8.4%	8.5%	7.8%	8.8%	8.3%
Global Bonds	ZAR	-0.7%	-1.2%	0.1%	2.6%	1.7%	5.3%	12.8%	13.8%
COMMODITIES									
Gold (US Dollars)	USD	7.0%	21.8%	29.2%	11.3%	10.3%	6.7%	14.2%	13.6%
Gold (Rands)	ZAR	0.9%	18.2%	21.2%	19.2%	13.8%	12.3%	17.0%	16.9%
CURRENCIES									
Rand / Dollar	ZAR	5.3%	2.5%	5.5%	-7.1%	-3.3%	-5.3%	13.9%	14.8%
Rand / GBP Pound	ZAR	2.3%	-0.6%	2.1%	-5.5%	-4.8%	-2.9%	11.9%	14.2%
Rand / Euro	ZAR	3.4%	2.3%	3.6%	-4.8%	-3.4%	-3.5%	11.5%	13.0%

KEY

Asset Class	Represented By:
SA Bonds	Satrix Bond Index Tracker
SA Cash	STeFi
SA Equity	Satrix ALSI Index Tracker
SA Listed Property	Satrix Property Index Tracker
Emerging Markets Equity	iShares Emerging Markets Equity Index Tracker
US Cash	Fidelity Institutional Liquidity The United States Dollar
Global Bonds	iShares Core Global Aggregate Bond ETF
Global Equity	iShares Developed World Index Tracker
Global Property	iShares Developed Real Estate Index Tracker

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INVESTMENT - RETIREMENT - FINANCIAL PLANNERS

August 2024

Spot Rates		30-Aug-24	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
CURRENCIES							
Rand/US\$	Rand	17.8	18.3	18.9	15.2	10.6	6.7
Rand/GBP	Rand	23.3	23.1	24.0	18.5	17.7	12.0
Rand/EUR	Rand	19.7	19.6	20.6	16.7	14.0	8.1
RATES							
SOFR 6m \$	US\$	5.1	5.7	5.9	2.0	0.3	2.0
Repo Rate	Rand	8.25	8.25	8.25	6.50	5.75	7.50
Prime	Rand	11.75	11.75	11.75	10.00	9.00	11.50
All Bond Index Yield	Rand	9.8	10.3	11.6	9.4	8.1	9.7
COMMODITIES							
Gold (\$/oz)	US\$	2,505.3	2,326.3	1,942.5	1,529.3	1,287.9	410.2
Platinum	US\$	940.0	1,012.0	980.0	939.0	1,424.0	864.0
Oil (Brent Crude) \$	US\$	78.9	86.4	86.9	60.5	102.5	39.7
INFLATION							
SA Inflation	%	4.6	5.2	4.8	4.4	6.5	9.4

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Email: adviser@fundhouse.co.za | Web: www.fundhouse.co.za

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