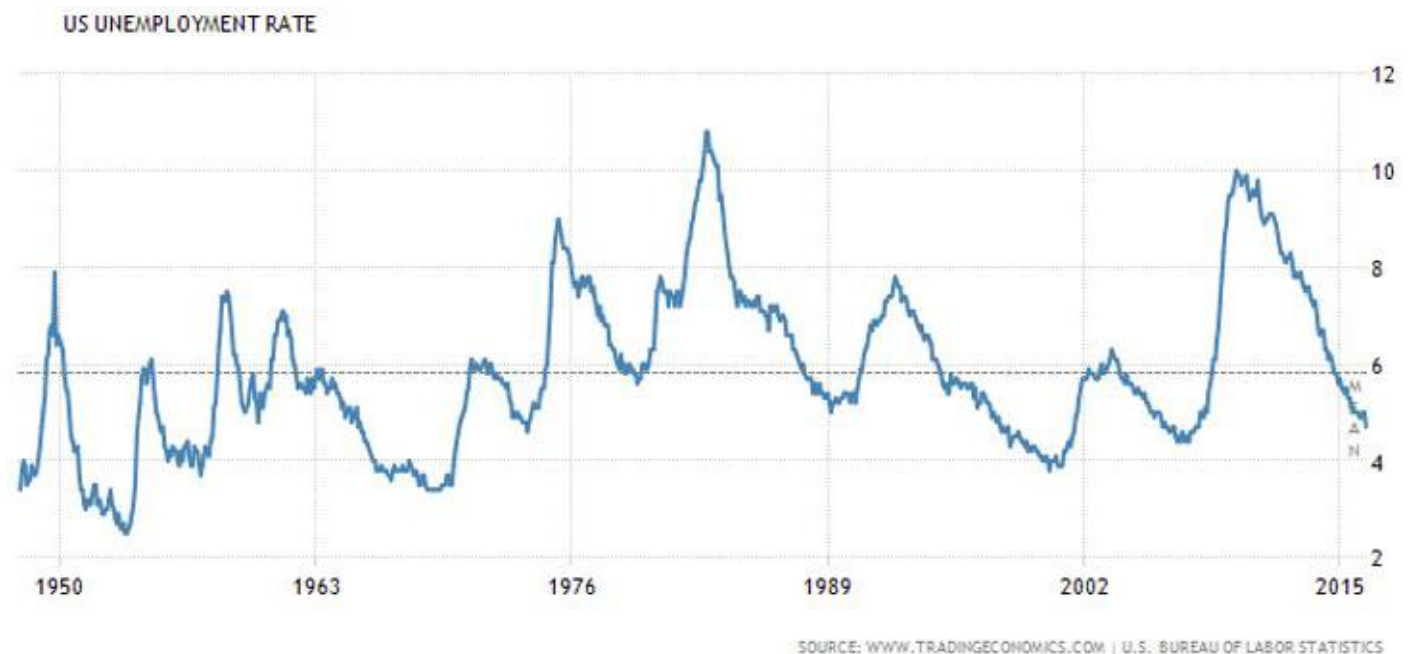


The Hidden Realities behind the US unemployment rate

It seems that many investors globally wait impatiently for the first Friday of each month for the latest US employment update. Any update provided on US unemployment is greeted with what appears to be an extreme reaction by the market. Any slight disappointment in employment figures relative to what was expected or forecast raises broad concerns about the US economy which leads to weak equity markets and a weakening US dollar. This article takes a closer look at US unemployment rates, how they are calculated and why many regard the figure as so crucial to the future direction of markets.

US unemployment rates

The official unemployment rate has fallen dramatically from around 10% following the global financial crisis in 2008/9 to around 5% (which is in line with pre crisis levels as shown in the graph).



This fall to below the long term mean should provide an indication that the US economy is in a healthy state and that the US economic recovery is in full swing. However, as with most statistics, the devil often hides in the detail and many commentators in the market are not as convinced that US unemployment is a good news story.

How is US unemployment calculated?

The U.S. Bureau of Labor Statistics (who calculate the monthly unemployment figures for the US) define the basic employment concepts as follows:

- People with jobs are employed.
- People who are jobless, looking for jobs, and available for work are unemployed.
- The labor force is made up of the employed and the unemployed.
- People who are neither employed nor unemployed are not in the labor force.

Seems simple. The monthly calculation of unemployment is the total number of people unemployed ("the unemployed") as a % of the total number of people who are able to be employed (known as the "civilian labor force").

But the key is how do you define the unemployed, employed and thereby the labor force?

Who is counted as unemployed?

For a person to be included as unemployed, they need to meet 3 criteria:

- they do not currently have a job,
- they have actively looked for work in the prior 4 weeks, and
- they are currently available for work.

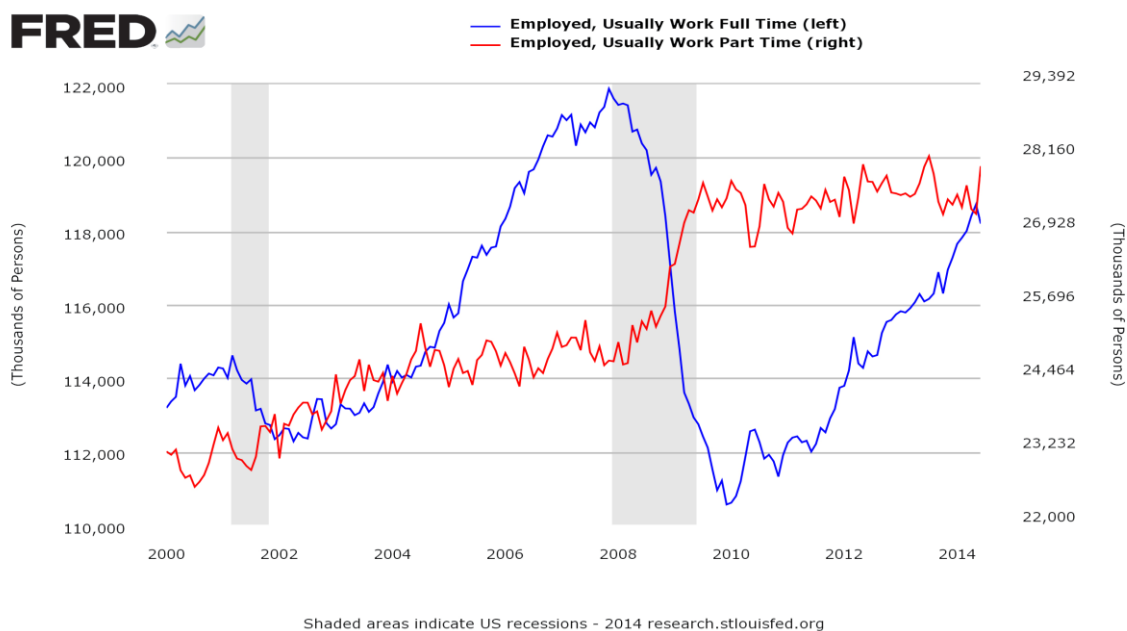
Many regard the official definition of unemployment as being too narrow, missing out on two groups:

- “Underemployed” individuals are defined as those who are working part-time because they can’t find a full-time job. They are included in the employed number but as this figure increases, the economic impact on the individuals and their families is material.
- “Marginally attached workers” are defined as those unemployed people who had looked for work at some point in the last 12 months, but not in the last 4 weeks. They are excluded from the unemployment figure. “Discouraged workers” are a subset of this and they are defined as those who haven’t looked for a job in the last 4 weeks because they believe there are no jobs available or there are none for which they would qualify. So by definition if an individual becomes a discouraged worker, they are excluded from the unemployment number and the unemployment rate improves. The economic reality is different from the statistic.

Who is counted as employed?

Individuals are considered employed if they did any work at all for pay or profit. Both full-time employed (working 35 hours or more per week) and part-time employed (working between 1 and 34 hours per week) are included in the employed figure for the calculation of the unemployment rate which does make sense from a pure calculation point of view. However, the impact on the economy of a shift from full-time to part-time is material.

The graph below shows how the full-time employed decreased materially during the global financial crisis in 2008/09, while the number of part-time employees increased. The increase in part-time was less than the fall in full-time employees resulting in an increase in the unemployment rate



However, the challenge is that while the unemployment rate may have recovered back to pre-crisis levels, the number of full time employees is still well below the figure pre-crisis and the number of part time employees has remained fairly steady since the crisis. The result (which is hidden by the simple unemployment figure) is that the number of paid working hours has fallen fairly materially in the US, with a corresponding fall in total wages paid. The knock on impact is that the economic recovery resulting from improving unemployment will take longer.

Many economists and market commentators in the US argue that the way the unemployment figure is being calculated hides a significant issue in the US labor market, and that the actual unemployment rate could be as high as 9% depending on how the employed and unemployed are defined.

Why is the US unemployment number important?

Many consider the US unemployment as the key driver and indicator of recovery in the US economy. An increase in employment should mean that businesses are either growing and are hiring to meet that need, or that they are generally positive about the future of the economy so are happy to employ people to build the business. It also means that more individuals will be receiving an income and spending that money which further helps businesses and stimulates the economy.

The unemployment figure also has important consequences for US monetary planners. The Fed uses the unemployment rate as an important indicator of how and when it should stimulate the economy so that over time it can guide the US economy to stable inflation and growth. A big part of this is how and when the Fed raises interest rates to avoid over-heating the economy which would result in inflation. The timing and magnitude of US interest rate increases will significantly impact the US bond and equity markets, as well as global bond and equity markets, and have a significant impact on the US Dollar and currencies the world over.

MAY INVESTMENT 2016 REVIEW

31 May 2016

Sector		1m	3m	6m	YTD	1yr	3yr pa	5yr pa	10yr pa	10yr Vol
LOCAL MARKET INDICES (In Rands)										
FTSE/JSE All Share Index (ALSI)	ZAR	1.8%	10.2%	5.7%	7.6%	6.3%	12.0%	14.0%	13.3%	15.1%
FTSE/JSE SA Listed Property	ZAR	-3.5%	7.8%	1.7%	8.4%	9.4%	15.5%	18.5%	16.9%	16.8%
SA All Bond Index (ALBI)	ZAR	-1.5%	3.0%	-0.2%	6.9%	1.0%	4.4%	7.1%	7.6%	7.5%
SA Cash Index (SteFI)	ZAR	0.6%	1.8%	3.4%	2.9%	6.8%	6.1%	5.9%	7.3%	0.6%
Balanced Benchmark ²	ZAR	2.8%	7.7%	6.0%	6.9%	10.3%	12.7%	14.8%	13.0%	6.7%
SA Inflation (1 month lag)	ZAR	0.8%	3.0%	4.1%	3.8%	6.2%	5.6%	5.8%	6.3%	1.4%
GLOBAL MARKET INDICES (in USD)										
Global Equity (MSCI World)	USD	0.2%	8.2%	-1.2%	0.7%	-5.9%	4.4%	4.3%	2.4%	16.6%
Emerging Markets Equity (MSCI EM)	USD	-3.7%	9.6%	0.0%	2.3%	-17.6%	-4.9%	-4.8%	3.1%	23.5%
Global Bonds (Barclays Global Bond Index)	USD	-1.3%	2.7%	6.4%	5.9%	5.3%	1.4%	1.2%	4.0%	5.7%
Global Cash	USD	0.0%	0.1%	0.2%	0.2%	0.3%	0.2%	0.2%	1.4%	0.6%
MAJOR INDICES BASED TO RANDS										
FTSE/JSE All Share Index (ALSI)	ZAR	1.8%	10.2%	5.7%	7.6%	6.3%	12.0%	14.0%	13.3%	15.1%
Global Equity (MSCI World)	ZAR	11.2%	7.8%	7.8%	2.2%	21.7%	21.2%	23.3%	11.5%	13.8%
Emerging Markets Equity (MSCI EM)	ZAR	6.8%	9.2%	9.1%	3.9%	6.5%	10.3%	12.5%	12.3%	15.7%
COMMODITIES										
Gold (US Dollars)	USD	-5.7%	-2.8%	14.0%	14.3%	1.6%	-5.0%	-4.7%	6.4%	19.3%
Gold (Rands)	ZAR	4.6%	-3.2%	24.4%	16.0%	31.3%	10.3%	12.6%	15.8%	21.6%
Currencies (positive return = Rand weakening)										
Rand / Dollar	ZAR	10.1%	3.9%	5.3%	-0.1%	22.3%	14.4%	15.2%	6.2%	14.2%
Rand / GBP Pound	ZAR	10.2%	4.1%	5.5%	0.2%	23.3%	14.5%	15.3%	6.2%	14.2%
Rand / Euro	ZAR	9.9%	3.9%	5.3%	-0.2%	22.2%	14.4%	15.2%	6.2%	14.1%

Source: FE Analytics

Spot Rates

31-May-16		5-Jun-16	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
Rand/US\$	Rand	15.08	14.65	12.13	6.75	6.13	3.98
Rand/GBP	Rand	21.68	21.09	17.97	10.84	10.64	6.08
Rand/EUR	Rand	17.15	16.70	13.14	9.58	7.46	4.73
Rand/Aus \$	Rand	11.10	11.26	9.29	6.99	4.41	3.11
Libor 6m \$	US\$	0.99	0.90	0.40	0.46	5.14	N/a
Prime	Rand	10.50	10.50	9.25	9.00	10.50	18.50
Repo Rate	Rand	7.00	7.00	5.75	5.50	7.00	N/a
All Bond Index Yield	Rand	9.03	9.01	8.15	8.89	9.44	13.86
Gold (\$/oz)	US\$	1,244.28	1,232.65	1,183.24	1,432.36	583.65	395.35
Palladium	US\$	554.00	569.00	729.00	766.00	332.00	139.00
Platinum	US\$	988.00	977.50	1,142.50	1,766.50	1,060.00	408.25
Oil (Brent Crude) \$	US\$	49.83	40.05	55.84	117.38	66.17	19.14
SA Inflation	Rand	6.20	6.30	4.00	4.10	3.40	6.30

data provided by Profile Data Analytics and INET BFA