



The US jobs report came out this morning, and it was simply dismal. This week we look at not only the jobs report but also “what-if” proffers for the US and global economies. There’s a lot to cover, so let’s jump in.

First, there were only 18,000 jobs created in June, the lowest since September 2010. While private employment rose by 57,000, government workers dropped by 39,000, continuing a trend as governments at all levels work to cut their budgets. Long-time readers know I think it is important to look at the direction of the revisions, and we got no help. May was revised down by 29,000 jobs and April a further down 15,000.

I saw some headlines and talking heads in the mainstream media saying the poor number was due to “seasonals,” and I just shook my head. If you are that reflexively bullish when presented with what was clearly a bad report, how can you be taken seriously? You know who you are. And then Philippa Dunne of the *Liscio Report* sent the following note. She is one of the best data mavens there is on jobs and employment.

“After the release, some bulls turned to that old reliable excuse – bad seasonals. According to one analysis making the rounds, had the BLS used last year’s factor – computed, of course, using exactly the same concurrent technique as this year’s factor – the gain would have been 221,000! (Whoever did this made a mistake by comparing the NSA and SA levels for the two months – you have to compare the over-the-month changes.) Still, if you’re going to play this game, you should be consistent, and apply last year’s seasonals to several months, not just one. If you do that, May’s gain of 25,000 would turn into a loss of 19,000, and June’s gain would be a mere 73,000, all total payrolls. In any case, why should you do that? The seasonals are recomputed every month based on recent experience and calendar quirks, and should be more aggressive in a recovery. (Hope we won’t be using the trend set in the depth of the recession as the bar going forward.) Also, there is no adjustment to the headline number – the sectors are adjusted separately (96 different industries at the 3-digit NAICS level, to be precise) and the total is the sum of those components. The

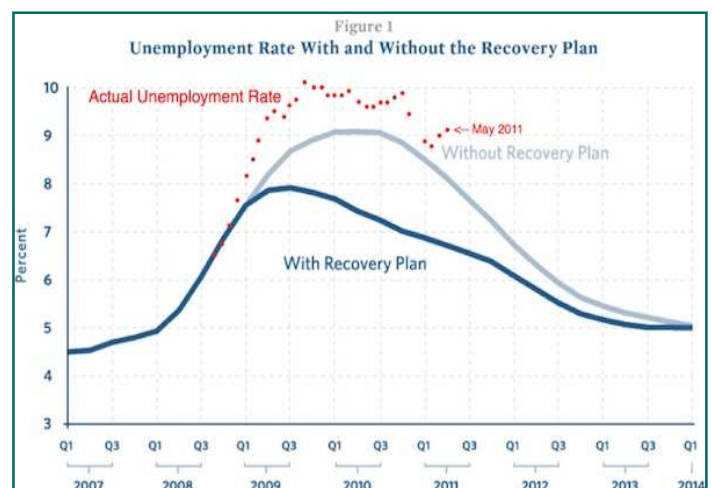
whole argument is bogus.”

The household survey was even worse. Total employment fell by 445,000. Full-time employment is down by 0.5% in the last year, while part-time is up 3%. David Rosenberg calls this the just-in-time labor market. The total number of unemployed rose to over 14 million. If you count the discouraged workers not in the official unemployed, the total number rises to 20.6 million, up 483,000 last month. This put the unemployment rate back up to 9.2%.

### So How’s That Stimulus Thing Working Out?

We were told that the stimulus would have us down to 6.5% unemployment by now. The team at [e21](#) has the real story:

“Back in January 2009, Christina Romer and Jared Bernstein of the Obama administration produced a [report](#) estimating future unemployment rates with and without a stimulus plan. Their estimates, which were widely circulated, projected that unemployment would approach 9% without a stimulus, but would never exceed 8% with the plan. The estimates, along with real unemployment rates, are posted below:



If you update the graph for today’s report, you find that there is another red dot higher than the last one. The last three months have seen the unemployment rate rise (chart from [e21](#)).



They further note:

“For example, there is new [research](#) that suggests that the stimulus may actually have resulted in a net loss of jobs. Regardless of the exact number of jobs lost or created, however, the fact that some economists are even arguing that it had a negative impact tells you that the stimulus may very well have been a [wash](#) overall.

“Larry Lindsey offered his own [review](#) of the stimulus this week, arguing that it failed what’s colloquially known as the *Sharp Pencil Test*. As he explains, ‘if you sit down and do a back of the envelope calculation of the [stimulus] program’s costs and benefits, there is no way to conjure up numbers that allow it to make sense.’ Here is more on how Lindsey applies this test to the stimulus:

“ ‘[E]ven if you buy the White House’s argument that the \$800 billion package created 3 million jobs, that works out to \$266,000 per job. Taxing or borrowing \$266,000 from the private sector to create a single job is simply not a cost effective way of putting America back to work. The long-term debt burden of that \$266,000 swamps any benefit that the single job created might provide.’

“At minimum, the public now deserves a response from policymakers about what they have learned from 2009 and 2010 – about what actually does and does not help get the economy growing and producing more jobs.”

The small businesses that are the real drivers of employment are not participating the way they do in a normal recovery. Bill Dunkelberg, fishing buddy and the chief economist for the National Federation of Independent Business, writes me this afternoon:

“Writing about our current weak economy (*Philadelphia Inquirer Currents*, June 26), Mark Zandi argued that employment will improve because ‘...U.S. companies are in great

financial shape’. Dr. Zandi must be referring to companies like GE which just posted profits of \$17 billion (and paid no income taxes) and whose CEO is the head of President Obama’s job creation committee. This is the view in Washington and Wall Street that only thinks in terms of the “biggies” (that make large donations to re-election committees). For perspective, GE employs about 150,000 people in the U.S. Last week, over 400,000 people filed initial claims for unemployment (e.g. lost their jobs). There are 6 million firms in the U.S. that employ 1 or more workers. This includes GE, but 90% of them have fewer than 20 employees. These firms are not ‘in great financial shape’ as Dr. Zandi asserts. In a recent survey of a sample of 350,000 of them, 46% reported that profits were still falling two years into the ‘recovery’ compared to 18% reporting that earnings were improving. Firms like GE might hire more due to their good fortune, but there aren’t many of them and they don’t employ many workers anyway. It’s the small businesses that Treasury Secretary Geithner said must be taxed more to support government that provide the needed jobs, not ‘tax-free’ GE. Regulations such as the new mandatory sick leave passed by City Council are detrimental to the job creation needed by making labor more expensive to hire, a bad idea.

“Dr. Zandi also suggests that state and local governments be given more funding to prevent the predicted loss of 250,000 public sector jobs over the next 12 months, funded I guess by more debt, since the Federal government is a bit short of cash (like \$1.5 trillion in deficit). ‘Ending this job loss would go a long way to lifting the job market,’ he asserts. My math says that would reduce job loss by about 5,000 per week. With monthly job loss over 400,000, this hardly makes a difference. Government employment has become bloated because governments don’t have to worry about profitability. When faced with budget problems, politicians tend to make cuts in services like libraries or police protection that hurt voters to show taxpayers why the government can’t live with less instead of cutting patronage jobs and the like whose efforts would not be missed. Government can’t create jobs, but it can create a lot of policies and taxes that prevent jobs from being created.”



I wrote last year about the studies that show that on a net job-creation basis, large businesses educated their employment over the last two decades. Of course, there are exceptions; but on average, large businesses are not where you get new jobs.

And many of the jobs we got this last month, as few as they were, were not of the high-paying variety. Leisure and hospitality were up 34,000. The average work week was down, and earnings dropped a penny an hour. After inflation, workers are behind, year over year.

By the way, I get the unemployment thing. Today we found out that my daughter Amanda has lost her job. Sales at the place she worked were down a lot. Another two of my kids can't get enough hours. At 17, Trey is looking for a job, but so far no luck. It's tough out there. Let's look at a few charts from David Rosenberg. First is the average duration of unemployment, which has risen to an all-time high.



Even worse, 44% of those unemployed have been so for at least six months, again close to an all-time high.



OK, I have to use just one more chart, which shows how bad things really are.



### This Time Is Different

I have quoted at length in past letters from Ken Rogoff and Carmen Reinhart's masterful work, *This Time is Different*. While the market may have been surprised by such a low jobs number, it is PRECISELY what is typical following a credit crisis, as they demonstrate in their book.

And now the Fed is done with QE2 (except that they will take the mortgage roll-off from their portfolio and use it to buy treasuries), and the fiscal authorities are



going to put the brakes on government spending, or at least slow things down.

Everything is very fluid, but the headlines in today's *Wall Street Journal* suggest a deal on the order of \$4 trillion in on the table. I assume it will be back-loaded, but it is a start. But assume that the first year sees real spending cuts of \$200 billion. That is a reduction of 1.5% in GDP. It's that pesky old equation I keep using:

$$\text{GDP} = \text{C (total consumption)} + \text{I (Investments)} + \text{G (government Spending)} + \text{net exports}$$

Now, the literature suggests that the effect on the economy from a reduction in G should be over within about 4 quarters, on average. But then we reduce "G" again the next year. Maybe not by as much overall, but at least by another \$50-100 billion. This is going to put a real headwind in the face of economic growth for years, but we simply have to do it or we become Greece.

The economy will already be slowing down. A recession in 2012 is a real possibility if there is any type of shock coming from Europe, and what will happen there is anyone's guess. I think most European leaders are basing their thinking more on hope than on reality. When Greece defaults there will be a domino effect; you can count on it. And you could actually see a banking crisis before we get actual sovereign defaults.

Gentle reader, you need to understand that *the market does not get it*. Neither in Europe nor in the US. When someone says the market has already priced in a default, go back and ask them how well the market priced in a crisis in the spring of 2008. The market doesn't know jack.

I got a lot of internet buzz from a throwaway line in an interview on CNBC in London. I said that if the market knew what Bernanke and the leadership of the central banks talked about after their third glass of wine, the market would wet its pants. That is not to suggest I don't think Bernanke or Trichet can hold their liquor. It means that they get the problem more than they

let on in public and are simply trying to stem as much damage as they can.

Banking crises are followed by credit crises by 2-3 years. It is getting close to that time. We need 3-3.5% GDP growth in the US to really make a dent in jobs. We are not going to get it. There is nothing we can do other than Muddle Through as best we can. Prepare accordingly.

### Vancouver, New York, and Maine

I am home for a few weeks. In late July I head for Vancouver to speak at the Agora Wealth Symposium. Then the next week I go to New York for a few days, before heading up with my youngest son, Trey, to Maine for the annual Shadow Fed fish fest organized by David Kotok. It is one of the highlights of my year. So many friends are there. More on that in coming weeks.

In New York I'll be meeting with Barry Habib. We will soon be announcing a joint venture that we are both excited about. Barry launched the *Mortgage Market Guide* and sold it a few years ago and is ready for a new venture. As an aside, Barry is the producer of *Rock of Ages*, a major Broadway hit that is now being done as a movie with Tom Cruise, Catherine Zeta-Jones, Paul Giamatti, Russell Brand, and a lot of other stars. (Barry, how do I get invited to the set?)

If you want Barry's take on housing and mortgages, he was on CNBC this morning for an in-depth interview. I am proud to be his friend and look forward to working with him. You can see it at <http://video.cnbc.com/gallery/?video=3000031675>.

That's it for this week. I have to say, this has been one of the roughest weeks emotionally and personally for me in a very long time. Nothing that is world-ending, but sometimes being Dad is tough. This is the first week in many years that I did not get my usual 30-40 hours of reading and research in. I am so far behind, but I will catch up.

And a huge thanks to Louis and Kelli Gave, who let 14 of us invade their vacation lake home in Oklahoma with 6 of my kids and their families and friends. It was

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THOUGHTS FROM THE FRONTLINE



a great 4<sup>th</sup> of July. And to see some of the tornado damage up close was amazing. We are so fragile; we have no idea.

Have a great week. Enjoy your friends and families this summer.

Your thinking more about the important things in life analyst,

**John Mauldin**

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