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Payrolls and the 5-Week Gap

When the BLS reported June payrolls rose a sharp 379,000 most analysts, including some from the BLS, suggested that as much as 100,000 of the jump was related to the so-called "5-week survey gap" phenomenon. Using first-announced monthly payroll releases dating back to the late 1960's, we discovered that June's payroll jump was not an isolated event: indeed, at current levels of employment, a 5-week survey gap can add 50,000-70,000 to a current month's nonfarm payroll figure, above and beyond the prior month's change.

There is some dispute as to whether the 5-week survey gap effect exists or not, although top officials of the BLS have cited it as a source of noise in the data. The BLS asks over 350,000 businesses each month to report the size of their payrolls for the pay period that includes the 12th of the month. Based on the vagaries of the calendar and presuming company payrolls follow a Sunday-Saturday workweek, it is possible to have five weekly pay periods between the times the BLS surveys a given business. Particularly in periods of economic expansion, a growing business may be larger after five weeks than it might be after only four weeks. Since these 5-week survey gaps appear somewhat randomly on the calendar, even the BLS' normal processes of seasonal adjustment and bias factor adjustment cannot offset the noise of the 5-week gap. Only the once-a-year benchmark revisions, when BLS squares up their payroll data to state unemployment data, allow for correction of the survey gap.

To confirm that the survey gap impacts on the nonfarm payrolls release, we collected the first-announced payroll report for every month from Dec 68 to Aug 94. (Examining first-announced data is crucial, since the nonfarm payroll data that can be retrieved from most generally available data bases have undergone the annual benchmark revision process, which washes out the 5-week survey gap effect.) We looked to see whether the first-announced payroll gain/loss for a 5-week survey gap month was larger than the first-revised payroll gain/loss for the prior month. We also compared each 5-week survey gap month's gain/loss to the median gain/loss of the prior four months, to control for the then-current trend in employment growth.

The results were rather distinctive. Of the 107 survey gap months, 68 outperformed the prior month, while 67 outperformed the median of the preceding four months - roughly a 64% success rate. The average excess was 42,000 over the prior month, while the median excess was 49,000. Since total payrolls are considerably larger now than in the 1970s, percentage changes were also examined, and then applied to the current level of payrolls. This correction suggests that **at the current size of payroll employment, a 5-week survey gap contributes 50,000 to 70,000 over the prior month's release, or 45,000 to 55,000 over the median of the past four months.** When we isolate out just those 5-week survey gap months that occurred during economic booms, first-announced payroll gains in 5-week survey gap months outstrip the median gain of the prior four months by a stronger 75,000. Currently the median of the last four months is about 250,000, suggesting a 325,000 forecast for September payrolls is reasonable.



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BONDS INDEPTH:

Evaluating the Corporate Tax Hike

Given the gyrations in the stock market this week, it is clear that investors are having difficulty evaluating the ultimate impact of the Clinton plan on corporate profits. Part of the confusion is the difficulty of evaluating the tradeoff between the burden imposed by the increase in the corporate tax rate vs. the benefit received from falling rates on the cost of financing. If increased taxes successfully narrow the deficit and lower borrowing rates, the improved cost of capital might offset the cost of the increased taxation.

What needs to be weighed is the size of the reduction in interest rates that would be necessary to offset the burden of the corporate tax hike. In classic economic analysis of business investment, businesses are assumed to face an array of projects in which they can invest, choosing those projects whose after-tax returns exceed their cost of capital and rejecting those that do not. By increasing the corporate tax rate Clinton has effectively lowered the after-tax rate of return on investment projects that businesses face without necessarily increasing or improving the pre-tax returns of those projects. As a simple numerical example, assume that a business has the opportunity to receive a pre-tax rate of return of 15% on a project - at a 34% tax rate the after-tax return on this project is 9.90%. At the 36% rate the after-tax return falls to 9.60%. Thus, to be left whole by this tax rate change, this business would have to see at least a 30 bp decline in its cost of financing.

Has the cost of financing for businesses fallen since it became clear that Clinton would raise the corporate tax rate? One possible measure is the Fed's index of triple-A corporate bond yields, the rate at which the largest corporations turn to the markets to borrow. For the last half of 1992, that index averaged 8.00% - indeed, the averages in the last three months of 1992 were 7.99%, 8.10%, and 7.98%, indicating that the election did little to push corporate borrowing rates away from their longer run average. In January 1993 that average fell to about 7.90%, and is currently at about 7.80%. By these measures it is fair to say that corporate borrowing costs have not yet fallen enough to offset even the simple increase in the corporate tax rate, not even contemplating the additional hit corporate profits might take with the new BTU tax, or the possible loss of health premium deductibility. Ultimately, however, one only needs to listen to the businesspeople that make the types of decisions analyzed hypothetically above. In a survey of its members, the National Association of Manufacturers, which comprise 80% of the manufacturing capacity of the U.S., found that more than 93% of its members did not believe that a sufficient fall in interest rates would come from deficit reduction to offset their expected increase in their corporate tax bill.

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BONDS INDEPTH:

The Battle to Regulate the Treasury Market

As a result of the Treasury auction scandal last year, the Treasury, the Fed, and the SEC have been forced to work together to develop a new system for regulating the Treasury market. In particular, Congress is anxious to appear tough on the primary dealers, viewed as an old-boys club and as a perfect election year target. The Fed and the Treasury, comfortable with the system as is, have formed an uneasy alliance against the SEC, which has been maneuvering for years for complete regulatory authority over all financial markets. In this piece we will take a look at proposed changes and their ultimate impact on the Treasury market.

As far as the Fed is concerned, this scandal is just a minor aberration in an otherwise efficient operation. The Fed's solution to the scandal is threefold-- first, to accelerate the automation of the auction process, mainly to be able to experiment with new types of auction procedures. Second, to minimize the impression that the Fed actually regulates the primary dealers, so as to engender a *caveat emptor* attitude amongst those customers who would be overly trusting of the primary dealers. Third, to change the requirements for primary dealer status so as to encourage a larger number of firms to apply for the status. Such changes have included the dropping of a minimum market share and reducing the actual on-site dealer surveillance that firms used to face.

Ideally the Fed would like to have a large number of players, not just the primary dealers, participating in a more efficient, automated auction process. Although several different systems may be tried, the one favored by the NY Fed is as follows-- dealers would submit electronic bids at an opening price level. The Fed would quickly tabulate and reveal the total number of bids. The Fed would then raise the price, and new bids would be submitted. The Fed would again tabulate and reveal the size of the bids. This process would continue until a price was reached at which the Fed could sell just the amount of securities it intended. All bidders would then pay that single price. This is called an "open outcry, single price" auction, as opposed to the "sealed bid, multiple price" system in place now. Other options are also possible, and may be tried.

The SEC and Congress have a different agenda. Although they support the automation upgrades and auction changes in progress, they are fundamentally opposed to the primary dealer network, at least in its unregulated form. The SEC would propose that all primary dealers, and perhaps even all bond dealers, come under their regulatory sway. The SEC supports full reporting and disclosure of all trades, positions, and auction tenders by the primary dealers, in order to prevent fraud. Strong lobbying by the dealers, supported by the Fed and Treasury, is fueling a battle that is only now beginning.

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