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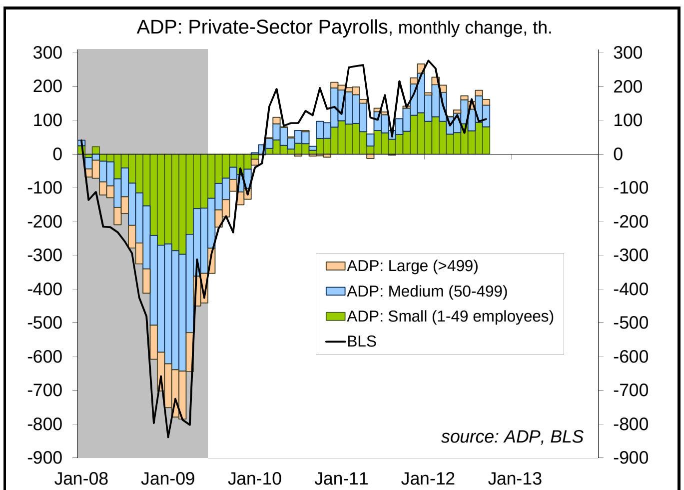
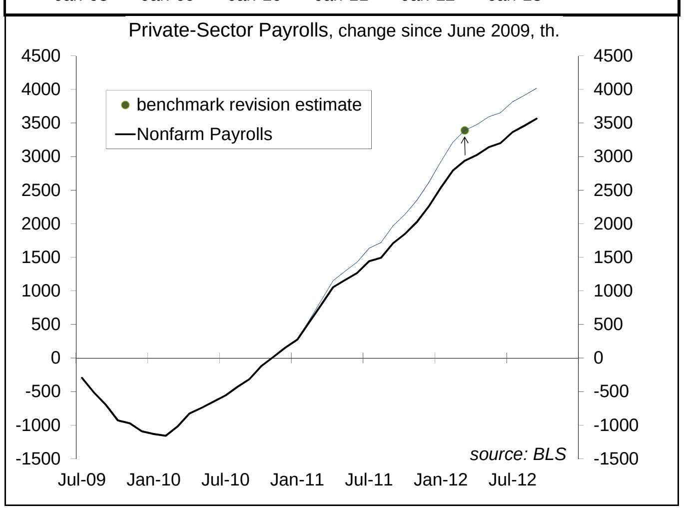
Monthly Economic Outlook

Some Job Market Gains, But Uncertainty Remains

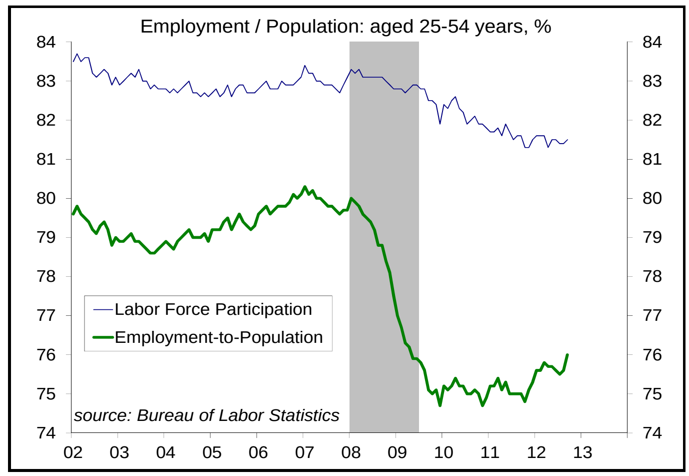
- *Recent economic reports continue to suggest a lackluster-to-moderate pace of growth in the near term.*
- *The recovery is still on track, restrained by a number of headwinds. Monetary policy will remain supportive, but fiscal policy is expected to be a moderate drag.*
- *Job growth appears to be a bit more than is needed to keep pace with the growth in the population, but is nowhere near enough to make up for the ground lost during the downturn.*

The monthly employment report is comprised of two separate surveys. The Establishment Survey, based on a sample of 400,000 worksites, generates estimates of nonfarm payrolls, hours, and earnings. As the baby-boom generation heads to retirement, labor force participation should edge lower. We now need about 100,000 jobs per month to be consistent with population growth. We averaged 151,000 additional private-sector jobs per month over the last year.





Each February, the Bureau of Labor Statistics benchmarks payroll data to unemployment insurance tax receipts and, in early September, presents an estimate of the upcoming revision. The BLS expects that the March 2012 level of private-sector payrolls will be revised 453,000 (0.3%) higher, while the March 2012 level of government payrolls is expected to be revised down 67,000 (0.3%). So, job growth was stronger (into March) than we thought, and the drag from state and local government was a bit more severe. Note that ADP estimates of job growth have been stronger than the BLS figures.



The Household Survey, based on a telephone sample of 60,000, does not generate good estimates of levels, such as employment. However, it does yield reasonable estimates of ratios, such as labor force participation and the unemployment rate (although the unemployment rate is only accurate to ±0.2%). The unemployment rate plunged to 7.8% last month, from 8.1% in August and 8.3% in July, leading to some charges of "conspiracy." However, BLS employees are not political appointees; they are very dedicated, and the process is highly secure. The reported figures often bounce around and that's especially so at the start of the school year. So take them with a grain of salt. However, if we concentrate on the broad swath of adults, those aged 25 to 54 years, labor force participation appears to have leveled out (individuals have stopped dropping out of the labor force) and the employment/population ratio seems to be trending higher. That's good.

That doesn't mean that everything is great in the labor market. Underemployment remains elevated and long-term unemployment is very high. Unemployed workers lose skills over time and new entrants do not acquire the skills they would normally get – hence, the Federal Reserve's haste in getting a more rapid job market recovery. Unfortunately, uncertainties may restrain the pace of hiring in the near term.

The U.S. economic recovery continues to face a number of headwinds, including the overhang in housing, tight credit for some borrowers, contractionary fiscal policy, and slower growth abroad, which should prevent a more substantial pickup in momentum through the end of the year. In addition, uncertainty about the election, the fiscal cliff, and Europe may restrain firms' willingness to expand. Reports on manufacturing have been mixed, with a softening trend in capital goods orders and shipments. The Fed's most recent Beige Book, the anecdotal summary of economic conditions from each of the 12 Federal Reserve districts, noted that *"economic activity generally expanded modestly"* since the previous assessment and five Fed districts cited restraint on new hiring due to uncertainties about the presidential election, fiscal policy, and European debt issues.

Lawmakers have continued to discuss the fiscal cliff (primarily the expiration of the Bush-era tax cuts, the end of the 2% reduction in payroll taxes, and automatic spending cuts, but some would include the fix for the Alternative Minimum tax and a few other issues). Still, no action appears likely until after the election. Note that when the Bush-era tax cuts were extended two years ago, an agreement wasn't reached until mid-December. Remember, it's not just the winner of the presidential election that matters. The composition of the House and Senate are also at stake. However, without a 60-seat super majority in the Senate, one party is not going to be able to dictate terms. The two parties will have to come together, which is not an encouraging thought.

Meanwhile, the housing sector has continued to improve, with solid year-over-year gains in home sales and residential construction. We still have a long way to go for a full recovery in housing. However, the Fed's actions have contributed to a further decline in residential mortgage rates.

The consumer spending outlook is mixed. Replacement needs should continue to support an improving trend in motor vehicle sales and the recovering housing sector should lift sales of home-related items. Job growth, while not spectacular, is likely to contribute to gains in aggregate income. Gasoline prices remain a key wildcard, and have failed to fully reflect the decline in crude oil prices in recent weeks.

The outlook for global economic growth has continued to soften. The IMF lowered its projection of world output to 3.3% in 2012 and 3.6% in 2013 (the IMF defines a "global recession" as anything less than 3%). That's still a far cry from the global contraction seen a few years ago, but it's not a promising outlook. In its recent World Economic Outlook, the IMF has re-thought its view on fiscal multipliers. While smaller budget deficits are an important long-term goal, too much austerity has undermined recovery prospects in many countries. Sharp reductions in planned deficits have not boosted confidence. Rather, they have weakened economies further, resulting in less-than-expected budget improvement.

The U.S. faces a tradeoff with the fiscal cliff. If the full effect of the cliff hits, economic growth would be significantly slower in 2013 (with a likely recession in 1H13), but the federal budget deficit (about $1.1 trillion in FY12) would be substantially less in FY13 ($585 billion) and FY14 ($345 billion).

Economic projections have most, but not all, of the fiscal cliff hitting in 2013. At this point, no one seems to be advocating for an extension of the payroll tax reduction – if not extended, take-home pay from the typical middle class worker would fall next year, dampening growth in consumer spending. Changes to other tax policies are unclear. Congress may work to avoid scheduled budget cuts. While the fiscal cliff would be a negative for growth in 2013, the uncertainty could dampen growth to some extent in the remainder of 2012.

	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	2011	2012	2013
GDP (↓ *contributions*)	1.3	4.1	2.0	1.3	1.9	1.6	1.3	2.0	2.7	2.9	1.8	2.1	1.8
consumer durables	0.4	1.0	0.9	0.0	0.3	0.3	0.2	0.2	0.3	0.3	0.5	0.5	0.3
nondurables & services	0.8	0.5	0.9	1.1	1.0	1.2	1.1	1.2	1.4	1.4	1.3	0.9	1.2
bus. fixed investment	1.7	0.9	0.7	0.4	0.2	0.4	0.4	0.5	0.8	0.8	0.8	0.8	0.5
residential investment	0.0	0.3	0.4	0.2	0.4	0.3	0.2	0.2	0.2	0.3	0.0	0.3	0.3
government	-0.6	-0.4	-0.6	-0.1	-0.1	-0.2	-0.5	-0.2	0.0	0.0	-0.7	-0.4	-0.2
Domestic Final Sales	2.2	2.1	2.2	1.4	1.9	2.0	1.4	2.0	2.8	2.9	1.9	2.0	2.0
exports	0.8	0.2	0.6	0.7	-0.2	0.1	0.2	0.3	0.4	0.5	0.9	0.4	0.2
imports	-0.8	-0.9	-0.5	-0.5	0.0	-0.2	-0.3	-0.4	-0.5	-0.6	-0.8	-0.5	-0.3
Final Sales	2.3	1.5	2.4	1.7	1.7	2.0	1.3	1.9	2.7	2.8	1.9	1.9	1.8
ch. in bus. inventories	-1.1	2.5	-0.4	-0.5	0.2	-0.4	0.0	0.0	0.0	0.0	-0.2	0.2	0.0
Unemployment, %	9.1	8.7	8.2	8.2	8.1	7.8	7.7	7.6	7.4	7.3	9.0	8.1	7.5
NF Payrolls, monthly, th.	128	164	226	67	146	135	110	135	170	175	153	143	148
Cons. Price Index (q/q)	3.1	1.3	2.5	0.8	2.0	3.1	1.8	1.9	1.9	2.0	3.1	2.1	2.0
excl. food & energy	2.5	1.9	2.1	2.6	1.5	1.6	1.8	1.8	1.9	2.0	1.7	2.1	1.8
PCE Price Index (q/q)	2.3	1.1	2.5	0.7	1.7	2.4	1.6	1.8	1.8	1.9	2.4	1.8	1.8
excl. food & energy	1.9	1.3	2.2	1.7	1.3	1.6	1.7	1.8	1.8	1.8	1.4	1.8	1.7
Fed Funds Rate, %	0.08	0.08	0.10	0.16	0.15	0.15	0.15	0.15	0.16	0.17	0.10	0.14	0.16
3-month T-Bill, (bond-eq.)	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
2-year Treasury Note	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.5	0.5	0.3	0.4
10-year Treasury Note	2.4	2.0	2.0	1.8	1.6	1.6	1.6	1.7	1.8	2.0	2.8	1.8	1.8

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