

THE ECONOMIC OUTLOOK GROUP



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ECONOMIC TALKING POINTS

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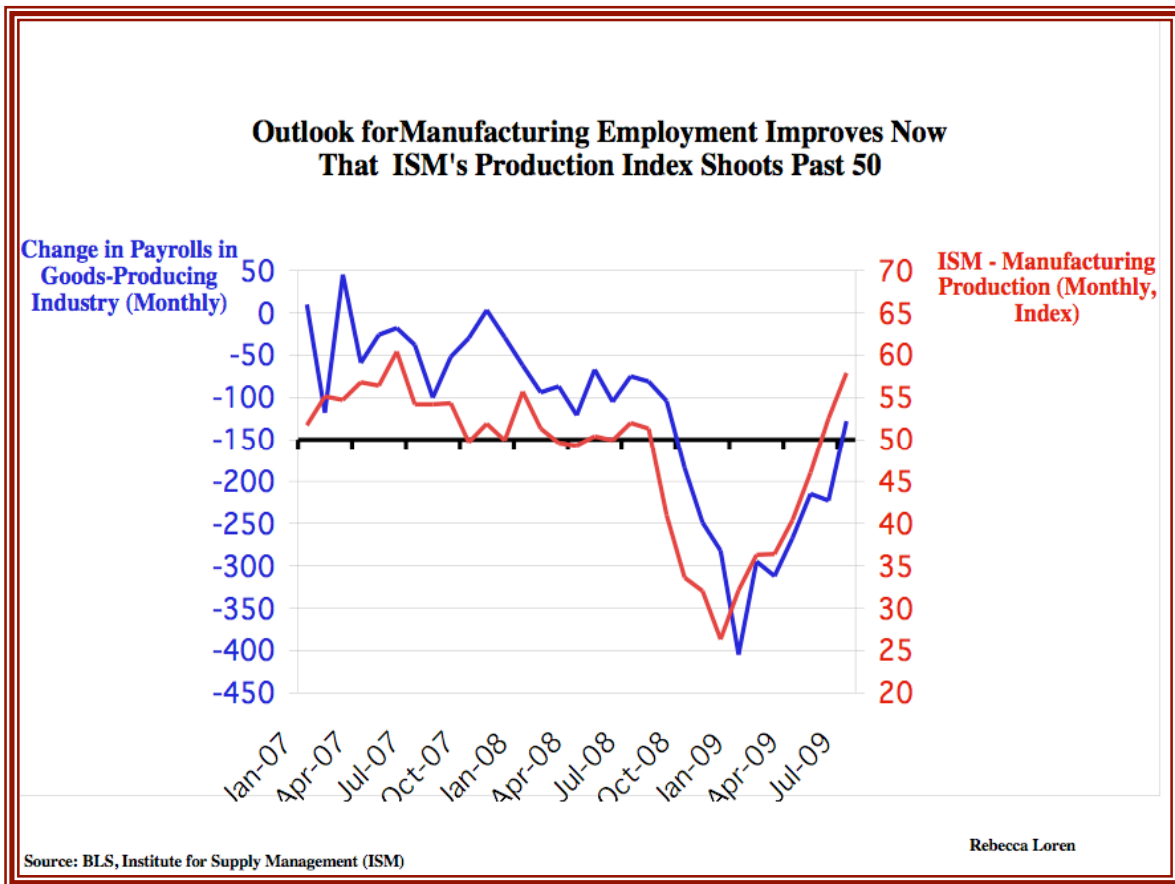
Good News on Employment Joins Other Upbeat Reports This Week

With the July jobs report, we add one more vital indicator to the growing list that suggests this economy has firmly pivoted from recession to recovery. Indeed, a close look at all the other indicators out this week produces a composite picture of an economy that may actually be way more resilient and agile than most observers would have thought given the severity of the global financial crises. Let's begin by highlighting some key data points in the latest employment report.

Good news. July payrolls saw a net loss of 247,000 jobs, which was well within our own forecast range of a 288,000 average in the third quarter. Last month's drop in payrolls was nearly half of June's 443,000 loss, and one-third the 741,000 peak in January. July's drop in payrolls turned out to be the smallest since August 2008.

Some will attribute the improvement last month to government hiring stemming from the Obama stimulus program and not really reflective of a genuine recovery in the private economy. We do not subscribe to that argument. Government employment increased only 7,000 last month. Even so, payrolls in the private business sector showed a drop of 254,000, which also happened to be the least since August of last year. In other words, while federal spending certainly helped the economy, private employers – many of whom already slashed payrolls to the bone --- are dramatically scaling back firings now that an economic recovery appears to be in progress.

Goods news. Total average weekly hours worked in the private sector rose to 33.1 in July, from its record low of 33.0 the month before. Contributing to that increase was a jump in weekly manufacturing hours from 39.5 to 39.8. This was the biggest one month increase since March of 2007. Evidently the sharp decline manufacturing, wholesale and retail inventories has led to new orders for goods, and this in turn caused manufacturers to rev up their assembly lines last month and increased working hours. This also helps explain why factory payrolls fell 52,000 last month, the fewest in a year. Given there's near .80 correlation (with 1.0 representing a perfect relationship) between the ISM's production index and changes in payrolls within the goods-producing sector, the outlook for jobs in manufacturing looks increasingly brighter.



Good news. Fewer Americans last month were forced to take part time work because they couldn't find more suitable full time employment. The number of part time workers who accepted such work for economic reasons fell to 8.79 million, the lowest since January.

Not necessarily good news! OK, here we have to be honest. In a real surprise, the unemployment rate fell to 9.4% last month, the first drop since April of 2008. But,

regretfully, we believe this dip in joblessness will prove to be temporary. With the summer in full swing, we assume a larger than usual number of unemployed Americans have decided to take a break from job hunting. It's been a horrible labor market so who could blame them. Of course, once these people stop looking for work, the government no longer counts them as officially unemployed. That probably explains the fall in joblessness.

We do expect the headline jobless rate to pick up again in the fall, as people resume their search for employment. That will add to the aggregate number of unemployed and drive the jobless rate higher. Thus our forecast remains that unemployment will surpass 10% in 2010, if not later this year.

The strong jobs reports matches up well with other upbeat economic news this week.

What is important here is that we do not look at the latest job numbers in isolation. When one combines the news on employment with all the other major economic indicators released this week, we see a very interesting pattern emerge. Time and time again forecasters appear to have *underestimated* the strength in the economy. Just look for yourself.

Factory orders for manufactured goods surprised many economists after it rose 0.4% in June, following an increase of 1.1% in May. (Forecasters called for a decline.) The June increase was the fourth in five months.

Pending Home Sales climbed 3.6% in June, which stunned observers who predicted a much more anemic 0.7% rise. June was the fifth straight increase for this series.

ISM's manufacturing index for July jumped to 48.9 from 44.8, again a bigger than the consensus forecast. New orders, production, and exports all showed an expansion in activity.

Initial claims for unemployment benefits last week dropped by 38,000 to 550,000, a larger drop than experts had predicted. The four-week moving average is down to 555,250, some 100,000 below the average pace in early April.

Construction spending surprised analysts as well when it increased 0.3% in June, thanks in part to a jump in residential construction.

Personal spending was up 0.4%, in June, the most since February. But look at the savings rate! Could the amount Americans stash away into savings accounts be slipping now that home prices and the stock market seems to have stabilized? The savings rate dropped from a recent high of 6.2% in March, when equity prices hit bottom, to 4.6% in June, following an upturn in both stock and residential real estate prices. Lower savings suggests rising confidence more consumer spending in the coming months.

Wait there's more.....

Auto sales climbed to an 11.3 million-unit rate in July, the highest level since last September. Some of the increase can be attributed to the "cash for clunkers" program, which got off the ground at the end of last month. As many as 300,000 vehicles have been bought under the program. Now that Congress approved an additional \$2 billion, we expect as many as 500,000 more Americans will take advantage of the program.

Will it steal sales from the future? Perhaps some. But remember: Every year we see about 2 million to 2.5 million new drivers buying cars for the first time. Then add the typical 12 million to 13 million sales a year just based on replacing older vehicles. Together we're talking about 14 to 16 million vehicles sold a year prior to the recession. So there's lots of pent up demand out there, and only a tiny amount of that will be absorbed by the "cash for clunkers" program.

Challenger Gray Christmas, the outplacement firm, announced that July had 5.7% fewer announced job cuts than a year ago. Moreover, that followed a 9% decline in planned job eliminations during June. This is the first time we have seen two back-to-back drops in scheduled firings since the recession began.

What does it all mean? The reason we're mentioning these assorted data points is because the central question being asked right now is not whether the recession has ended. It's fair to say it has. The critical issue now is whether the recovery now underway is sustainable, or will the economy slip back into recession again in 2010? A lot rides on the answer to this question. It will influence the risk appetite of investors, affect the hiring decisions of employers, and determine what kind of policies we'll see coming out of Washington.

Our take? Based on all available evidence, we remain confident this recovery will achieve sufficient critical mass over the next few quarters to avoid another downturn. We're going to be looking at next week's industrial production, retail sales, and initial claims to further reinforce this view.