

THE ECONOMIC OUTLOOK GROUP



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ECONOMIC TALKING POINTS

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What Is Needed To See More Jobs?

What is it going to take for employers to earnestly start hiring again? For this to occur, four developments need to take place.

The first is improved corporate profits. Not profits that are solely derived from slashing costs. Sure, that may please shareholders but it is inconsistent with generating more employment. If you want to slash costs, go for the greatest expense in your operating budget – your workforce.

Instead, we have to see earnings expand from a genuine increase in sales --- that is, greater top line growth to reflect an increase in demand for goods and services. Only with this backdrop will conditions improve for a resumption of permanent hiring. Has this criterion been met yet? No, at least not to the degree necessary to make a dent in the employment picture.

Second, the economy has to demonstrate it can finally stand on its own. Right now the US economy is being held together with scotch tape and glue supplied by the government. That hardly evokes much confidence among business leaders. The latest 3rd quarter spurt in GDP growth was largely fueled by a plethora of federal programs (the Obama stimulus, cash for clunkers, the homebuying tax credit and etc.) In fact, if you just strip out the cash for clunkers auto contribution to GDP, economic growth would

have registered about 1.7% instead of the headline 3.5%. In other words, the economy's underlying strength, while improving, still falls far short of what is needed to produce a net increase in payrolls. Economic activity will have to accelerate to a minimum of 3.5% on a sustained basis --- without excessive government aid --- before the unemployment rate ticks down in a meaningful way.

Third, banks must be willing to lend more to small and mid-size businesses. They account for 80% of all new hiring during a recovery and yet these companies are precisely the ones most hurt by the ongoing credit crunch. Banks and other lenders continue to deny them access to funds due, in part, to the uncertain economic outlook but also because so many small and midsize companies lack sufficient collateral or the necessary cash flow to service future loans in the event of another downturn. With so many notable forecasters still warning of a double dip recession, bankers have chosen to remain ultra cautious.

Fourth, we'll need to see a steeper yield curve. If the Federal Reserve keeps the Fed funds rate close to the current zero level, banks will be more motivated to lend because the net interest margins on those assets look more attractive. The cost of funds for banks would be at historic low levels, yet they can charge higher rates on longer maturity loans. Indeed, to encourage such lending, we expect the Federal Reserve will repeat the phrase of "keeping low levels of the federal funds rate for an extended period" in its FOMC statement this afternoon.

What's the score on all four? We're getting close on the fourth requirement but little progress has been made on the other three. In the meantime, the job numbers will lack any consistent pattern. Take the latest series of reports:

- The ISM manufacturing report showed producers were hiring more workers last month. Good news to be sure, but let's get real here. Manufacturing makes up only 12% of GDP.
- Today, we got the ISM results for the dominant service sector and the jobs picture turned ugly again. The October employment index for services utterly collapsed to 41.1, the lowest since last May. Just three industry groups within services said they were hiring more people: (1) Real Estate, Rental & Leasing; (2) Mining; (3) and Management of Companies & Support Services. The other another 11 industries reported a reduction in employment --- (1) Arts, Entertainment & Recreation; (2) Wholesale Trade; (3) Public Administration; (4) Accommodation & Food Services; (5) Professional, Scientific & Technical Services; (6) Retail Trade; (7) Educational Services; (8) Health Care & Social Assistance; (9) Transportation & Warehousing; (10) Information; and (11) Finance & Insurance.
- Adding to the mix of conflicting employment news today were two other reports. The ADP Employment survey showed the slowest number of job losses for October in more than a year. Private employers eliminated 203,000 jobs last month, the smallest since July 2008. However, consensus forecast called for an even better performance, a drop of 198,000.

- Challenger, Gray & Christmas also released its latest count on announced corporate layoffs and it fell to 55,679 in October, the third consecutive monthly decline.

Bottom line:

Here's our take away. The labor market is now at a critical turning point. With the 2008 – 2009 recession now over and a recovery underway, employers are beginning to reassess future staffing needs. Did they let too many people go? Should the layoffs continue or stop at this point? What if the economy rebounds more strongly? Is this a great time to pick and choose the most skilled workers? How about hiring temporary workers?

If economic indicators begin to show a rebound consumer and business spending and higher production, the pace of hiring will pick up as early as next spring or summer. We're assigning this as the most likely scenario (probability 50%).

But if the economy can't shake off its lethargy and shows just anemic growth, there will be little justification for companies to hire more workers (probability 30%). The darkest scenario for the labor market, of course, is if the economy slips back into recession next year, for that would lead to a new round of substantial job cuts. But we believe the latter is the least likely to materialize (probability 20%).

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