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ECONOMIC TALKING POINTS

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Employment, Jobless Benefits, and Factory Orders
Bottom line: Recovery Still On Track

We're going to say it plain and simple. The June jobs report, along with the latest weekly filings for unemployment benefits and monthly factory orders are consistent with an economy that is now turning the corner away recession and toward a recovery. It's not an easy case to make to skeptics, since the headline employment numbers were disappointing. So let's state up front that we're not drinking any strange cool-aid. We would have preferred to see a more significant improvement in the labor markets. But we should not ignore several other noteworthy trends inside the June employment report --- as well as in the other two releases --- that tell us we are still on track to see economic growth in the second half of the year. Indeed, we're expecting to see a steeper yield curve in the weeks ahead as evidence mounts that the 2008 -2009 recession is history and that business activity will accelerate the next six months.

Here are the hopeful signs we found in the three reports released today:

The June Employment Release:

- The 467,000 drop in payrolls last month was higher than most forecasts. A significant contributor to that loss, however, were the 52,000 government jobs that were eliminated. Most of the pink slips occurred at the federal level and was largely due to the layoff of workers temporarily hired to prepare for 2010 census.

What we prefer to focus on are changes in job market, ex-government. In other words, what is really going on in the private business sector? Here payrolls declined by 415,000, which means the average monthly drop in payrolls in the second quarter declined to 440,000, compared with 695,000 in the first quarter and 552,000 during the final the three months of 2008.

Would we have preferred to see businesses hand out far fewer pink slips? Of course. With the recession winding down and a recovery in progress, further substantial downsizing by business is just dumbsizing. Employers can cut their workforce to the bone, but at some point they could unwittingly end up amputating entire limbs. For this reason, we expect to see payrolls shrink by much smaller margins by fall.

- The 9.5% unemployment rate in June is just 0.1 percentage point above the 9.4% for May. That increase in the jobless rate was the smallest we have seen in a year.

- It's true that manufacturing employment suffered another big blow last month, as factory payrolls fell by 136,000. But at this juncture in the business cycle, what we're looking at more closely is manufacturing overtime hours. Here's why. Once demand begins to pick up, employers will begin to scale down layoffs and typically ask their *existing workforce* to put in extra hours. That's precisely what we are seeing now. Payrolls at manufacturing dropped by 136,000 in June, which happens to be the smallest cut since last November. At the same time, average weekly overtime held at 2.8 hours in June, the same as May – but a pick up from the recession low of 2.6 hours in March. History has shown that once overtime begins to move up from its cyclical low, it's a strong signal the economy is pivoting from recession to recovery. Manufacturing overtime hours is one of the best leading indicators to monitor if you want to understand where the economy stands in the business cycle.

- What does the employment report say about worker earnings in the latest month? Average hourly earnings increased by 2.7 percent over the past 12 months, which, admittedly, is the smallest annual increase since 2005. But bear in mind we have had several months of deflation. Over the past year, consumer prices have declined by the largest amount since 1950! When you combine the nominal increase in average hourly earnings with the fact that consumer prices have fallen, real average hourly earnings for the year ending in June jumped by 4%. According to the Bureau of Labor Statistics, real annual average hourly earnings have climbed by 4% or higher every month since December. <u>This represents the biggest jump in purchasing power for Americans in nearly 40 years!!!</u> --- and sets the stage for more consumer spending in the months ahead.

- The composition on the duration of unemployment has also changed. The percentage of those recently laid off (5 weeks or less) has dropped back to 21.1% of all the unemployed, compared with 22.4% in May and 31% in January. This tells us that employers are beginning to wind down job cuts. Unfortunately, companies are still in no mood to hire many back which is why the average number of weeks people remain out of work continues to edge higher. It stood at 24.5 weeks in June, compared with 22.5 weeks the previous month and 17.6 weeks a year ago. So while fewer jobs have been eliminated this quarter, all those without work continue to experience great difficulty finding employment.

Claims for Unemployment Insurance:

For the week ending June 27, 614,000 new applications have been filed for unemployment benefits, down 16,000 from the previous month. The one clear trend that has emerged in recent weeks is that the number of first time claims has come off its highs. It averaged 658,000 filings a week in March, but has since edged down to an average of 615,000 at the end of the second quarter. Look, these are still fairly high numbers. But it is starting to slip downwards and this is what we expect to see once a recession hits its trough.

Factory Orders

Yet another important indicator released today fell in line with our general outlook that the economy appears to have shaken off recession. Orders sent to factories jumped 1.2% in May, the third such increase in four months. That pick-up in orders, the biggest in a year, will lead to future increases in production and employment. Durable goods orders, which consists of big-ticket items like machinery and computers, jumped 1.8% in the month and suggests that companies are increasing capital spending and replenishing depleted inventories. Booking for non-durable goods rose 0.7% in May.

The rise in factory orders matches up well with the recent increase in manufacturing overtime hours seen in the jobs report. This is the sort of corroborative pattern helps us put the all the pieces of the economic puzzle together, and the picture that is emerging with increasing clarity is of an economy that has undergone a wrenching recession the last 18 months but is now gradually transitioning into recovery.

This shift from economic contraction to growth should manifest itself more clearly during the summer and fall months.