

THE ECONOMIC OUTLOOK GROUP



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ECONOMIC TALKING POINTS

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More Evidence of Recovery, While Inflation Sleeps

Skeptics of the recovery found no friendly economic indicators today. The government released no less than five different reports and they all point to an economy that is starting to grow again while inflation remains dormant.

(1) Claims for Unemployment Benefits

New applications for unemployment benefits slipped to 514,000 during the week ending October 10th. That's 10,000 less than the previous week and edges this series closer to breaking below the symbolic half a million threshold. Reinforcing the decline in layoffs is the four-week moving average, which fell to 531,500, from 540,000 the week before. Yes, the numbers are moving in the right direction, but let's also keep in mind that even these figures are disturbingly high. A year ago, the weekly pace of new applications averaged 480,500 --- and even then economic activity was contracting! If we're to have any sustainable growth in GDP, new claims for jobless benefits must drop (and remain) below 450,000.

One other sobering data point in this release. Continuing claims --- the total number of Americans now collecting unemployment benefits --- dropped to 5.99 million from 6.07 million. The new figure is the lowest since March. However, we believe this decline is more symptomatic of unemployed Americans running out of benefits than of any improvement in the labor market. In other words, while the economy is awakening from

its record long stupor, the job market still appears lifeless. Our overall assessment is that employers are more confident the recession is over and have consequently scaled back layoffs. But given the widely held view that economic growth will likely be weak next year, few are rushing to hire new workers and take on additional employment costs at this point. This bifurcation of stronger economic growth but very subdued job growth will be characteristic of the economy in 2010.

(2) New York Federal Reserve Empire State Manufacturing Survey

The New York Federal Reserve Bank released a report pointing to greater factory output in the state this month. Its General Business Conditions Index, which measures changes in manufacturing activity in New York, rocketed to 34.6 in October, the highest level since mid-2004, and nearly double what it was just last month. This is the third straight monthly increase! Digging deeper into the report we found a rare hopeful sign that employment conditions could improve a bit. Along with higher new orders and shipments, there was an upturn in local manufacturing employment this month.

(3) Philadelphia Federal Reserve Bank's Business Outlook Survey

A second regional report, this time by the Federal Reserve of Philadelphia, noted that factory activity in an area that covered eastern Pennsylvania, southern New Jersey and the state of Delaware continued to expand if at a slightly slower pace in October. Its general economic index fell to 11.5, after touching a two and half year high of 14.1 in September. Interestingly, it, too, showed employment conditions slightly better this month than in September.

(4) Consumer Prices

Even as manufacturers in the northeast ramped up production, inflation stood quiescent. The CPI climbed only 0.2% last month, less than the 0.4% increase in August. Over the last 12 months, consumer prices FELL 1.3%, helped in part by a 30% plunge in gasoline prices. With inflation still well behaved, the Federal Reserve is in no rush to increase rates. Our forecast calls for the Fed to begin lifting the fed funds rate by next fall.

(5) Real Earnings

Alongside the CPI came a fifth report, Real Earnings. This is a release that gets little attention and yet could hold an important key to future consumer spending. Average weekly earnings over the year, adjusted for inflation, rose 2.5% in September. Thanks to the current deflationary environment, September marks the 11th consecutive month of year over year increases in real pay for production and nonsupervisory employees, which

make up 80% of the working population. As people grow more confident that the economy is on a recovery path, we expect this year-long increase in purchasing power will translate into greater spending by households over the coming months.

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