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ECONOMIC TALKING POINTS

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Is The Upturn In Job Growth Sustainable?

The better than expected payroll numbers for February and March are certainly heartening, and one hopes the pace of hiring will continue to improve. We know the US economy entered the year with a fairly strong head of steam. But it is also true some of that steam has begun to dissipate in recent weeks in the face of escalating food and energy prices, and because of growing concerns that the turmoil in the Middle East and North Africa will fester for months, if not years.

Therein lies our main concern with today's employment report. As good as the numbers were, we cannot view them in isolation of the multiple crises in a strategically important part of the world. So we have to get back to the basics. Will employers remain in a hiring mood if the price of oil, gasoline, food, and other critical commodities keep escalating? Will they keep adding to payrolls if consumers retrench or if profit margins get squeezed?

We know that households are already feeling pain. Both the Conference Board and the University of Michigan have registered steep declines in consumer confidence last month. The low confidence numbers are showing up even though the recession ended nearly two years ago! This will certainly translate into less discretionary spending.

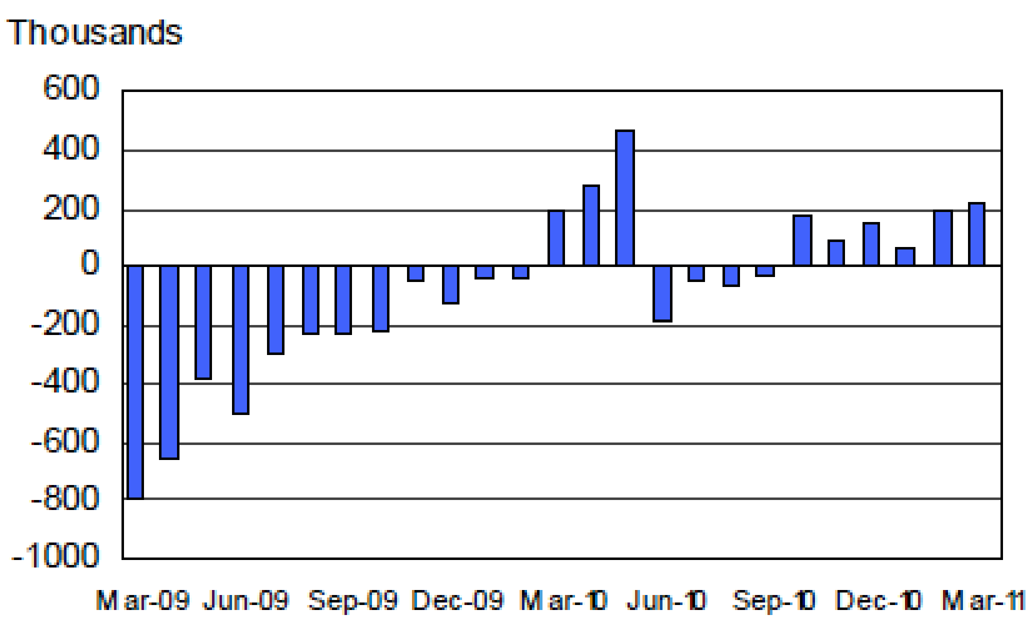
We also know that corporate margins are under pressure, with many firms now forced to pass those higher costs on to customers. The latest ISM survey, for example, reported that manufacturers have seen their prices jump for 21 straight months, driving the price index in March to its highest level since July 2008. The result: Manufacturers are hiking their prices too. The pass through to finished products is showing up in producer price inflation, which surged in February by the most in nearly two years. The jump in wholesale prices has led retailers to reluctantly lift their prices as well. Wal-Mart this week made it clear it has no choice but to charge more at its stores. (Wal-Mart's head of

US operations warned that consumers will end up seeing “serious” inflation.)

Given all these dynamics, we’re not yet convinced the recovery is --- as the Fed put it recently--- “on a firmer footing.” If anything, we’re seeing incipient signs the economy is beginning to lose some horsepower and that means the increase in private payrolls may not be sustainable.

Yes, the headline numbers for March were a pleasant surprise. Companies added 230,000 net new jobs last month, and that followed a hefty 240,000 gain in February. The unemployment rate slipped down to 8.8%, the lowest level in two years, while the underemployment rate dropped to 15.7%, from 15.9% the month before (and a high of 17% last November). Virtually every major industry category saw more hiring --- manufacturing, financial services, leisure and hospitality, temporary employment, health care and education.

Change in non-farm monthly payroll, seasonally adjusted, past 12 months



Source: US Labor Department

But our job is to see what’s coming around the corner and so we also monitor closely those statistics in this report that may provide fresh clues on future trends in the labor market. Here are a few worth tracking.

First, take a look at the change in the number of newly unemployed, those out of work in just the last four weeks. They have been declining every month since December, a good sign. But it suddenly ticked up in March by 59,000. Is it a temporary blip, or something more ominous?

Second, Americans who were forced to accept part-time work because they couldn’t locate suitable full time employment, jumped in March to its highest level this year, 8.43 million. Not a good sign.

Third, average hourly earnings of production workers, a measure highly sensitive to turning points in manufacturing, slipped to $19.30, the lowest of the year.

Fourth, the little known, but relevant, statistic known as the diffusion index measures how widespread hiring has been across 267 different industries. An index score of 50 means an equal number of industries gained as lost jobs. Thus, a measure above 50 indicates that more industries added jobs than lost them. The March index came in at 62.4, which means most industries were still hiring --- though the number was fewer than February's 68.7. March also saw the first decline in four months. Historically, when this index starts to drop, it foreshadows a deceleration in hiring in the months ahead. Again, it's something we need to monitor.

ISM Manufacturing

Another yellow flag can be found in the March ISM report. Manufacturing activity has been expanding for seven consecutive months, before slowing last month. The PMI eased back to 61.2, from 61.4 the month before. New orders, a harbinger of future factory output, took a more significant tumble when it dropped to 63.3, the lowest this year. It was 68 in February. The manufacturing employment index declined as well, to 63, from 64.5 the previous month. Another concern for us was the sharp decline in exports, a sector that has contributed significantly to US GDP growth in this recovery. Here, too, the ISM export index declined to 56 in March, a low for this year.

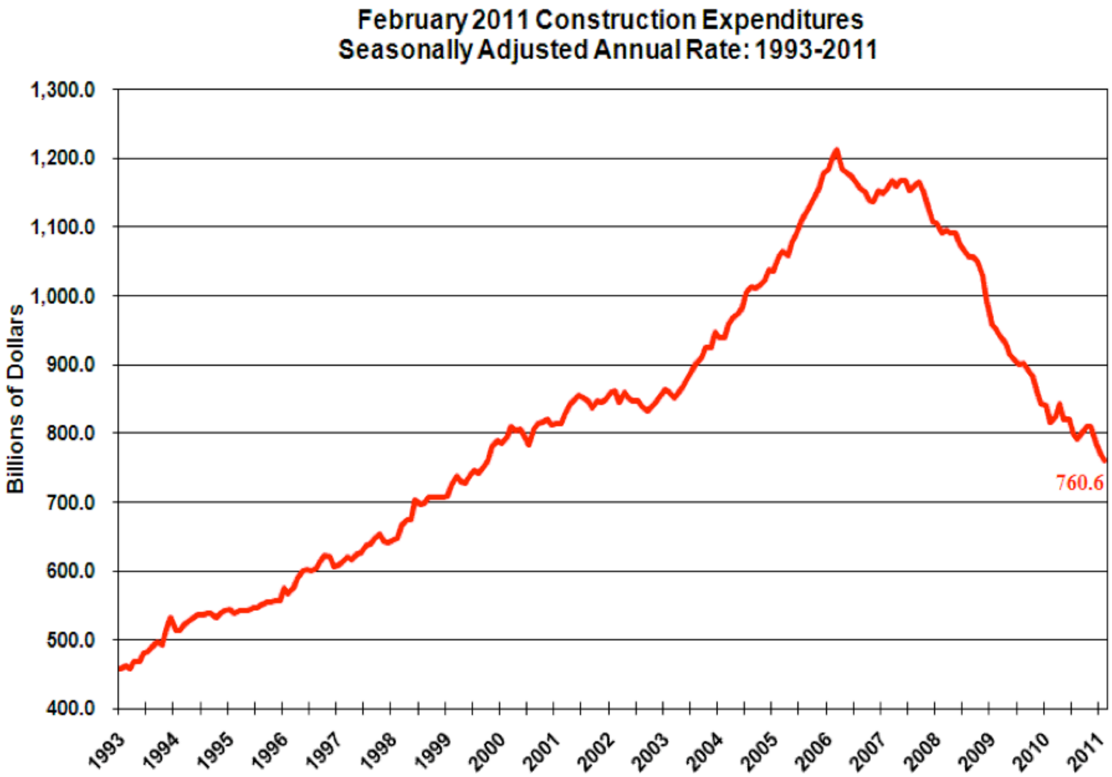
MANUFACTURING AT A GLANCE MARCH 2011						
Index	Series Index March	Series Index February	Percentage Point Change	Direction	Rate of Change	Trend* (Months)
PMI	61.2	61.4	-0.2	Growing	Slower	20
New Orders	63.3	68.0	-4.7	Growing	Slower	21
Production	69.0	66.3	+2.7	Growing	Faster	22
Employment	63.0	64.5	-1.5	Growing	Slower	18
Supplier Deliveries	63.1	59.4	+3.7	Slowing	Faster	22
Inventories	47.4	48.8	-1.4	Contracting	Faster	2
Customers' Inventories	39.5	40.0	-0.5	Too Low	Faster	24
Prices	85.0	82.0	+3.0	Increasing	Faster	21
Backlog of Orders	52.5	59.0	-6.5	Growing	Slower	3
Exports	56.0	62.5	-6.5	Growing	Slower	21
Imports	56.5	55.0	+1.5	Growing	Faster	19
OVERALL ECONOMY				Growing	Slower	22
Manufacturing Sector				Growing	Slower	20

*Number of months moving in current direction.

Source: Institute for Supply Management

Construction Spending

Nor were the latest numbers on construction spending encouraging. In fact, they were plain awful. The February report showed expenditures in free fall, dropping to $760.6 billion annual rate, the slowest pace in more than a decade! That's right, there is less spending on construction now than anytime during the last two recessions!



Source: Census Bureau

Bottom line:

The employment numbers certainly looked a lot better the last two months. But it is way too premature to say the long awaited turn-around in the job market has arrived. The headwinds slowing economic growth are in fact getting more formidable. Companies are turning cautious. New orders for U.S. manufactured goods showed an unexpected drop in February, the first such fall since last October. Moreover, the AAA just noted the price of regular gasoline at the pump shot up to $3.62, six cents more than just a week ago. Over the past year, Americans have had to shell out an additional $80 billion to drive their vehicles. These numbers are bound to climb even higher. Today, WTI oil climbed above $108 a barrel and Brent exceeded $118. People are also seeing sticker shock on food prices as the rise in global demand outpaces supplies --- and because higher energy costs are making their way into the food production chain as well.

If evidence continues to build showing a recovery losing momentum, it's likely jobs growth will slow as well.