THE ECONOMIC OUTLOOK GROUP

475 Wall Street
PRINCETON, NEW JERSEY 08540 Tel: 609 - 529 - 1300
www.economicoutlookgroup.com

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

March 8, 2010

Jump in Hiring Reflects A Robust Private Economy

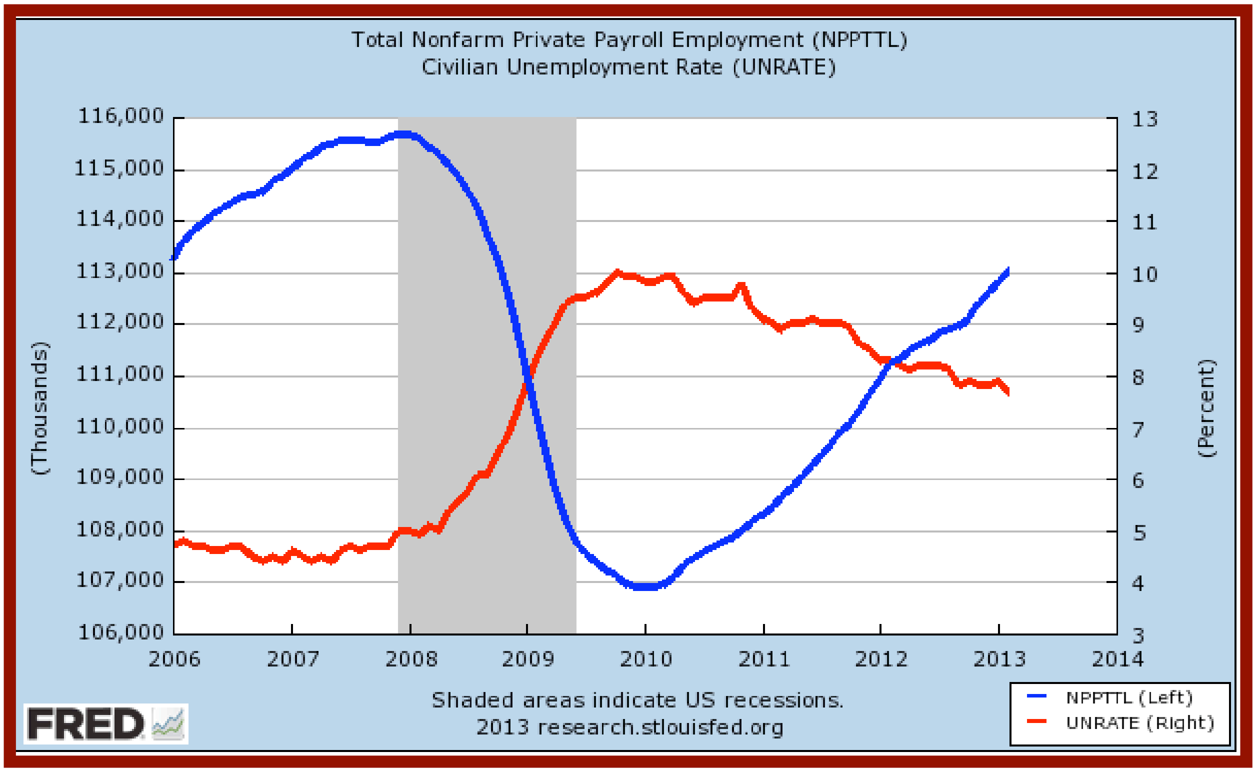
Certainly February's strong job numbers should not have surprised anyone listening to us. We have been arguing all along that the real story for 2013 will be the impressive vitality in the private sector. The perennial budget fights in Washington, while irksome to most Americans, have increasingly become background noise.

There is no better evidence of this than the fact companies went ahead and hired an impressive 246,000 employees in a month that preceded the implementation of the sequester, saw gasoline prices climb sharply, and had workers take home less income as a result of the payroll tax hike.

To understand what is behind the improvement in the labor market in the face of such headwinds, just focus on the **three Fs.**

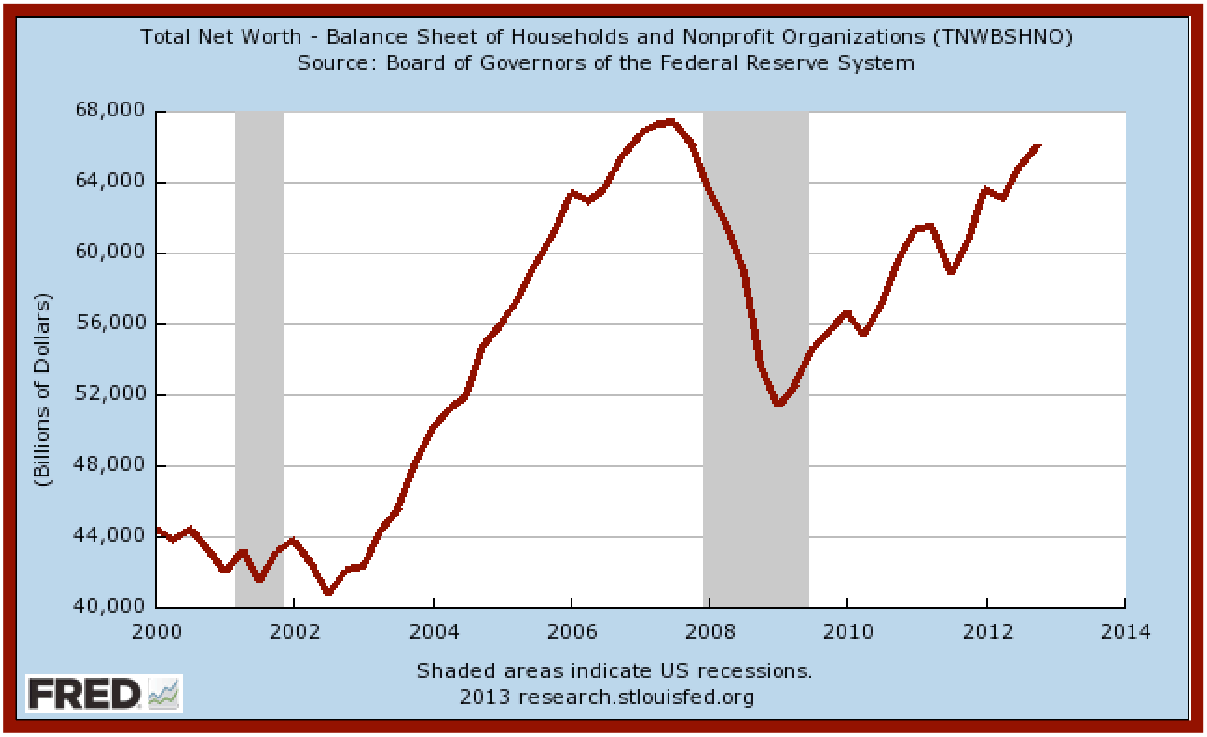
The first F is the Federal Reserve, which has undoubtedly been the main driver of the economic expansion. Ben Bernanke, Janet Yellen and others on the FOMC have repeatedly stated that the Fed will continue to pursue its extremely accommodative monetary policy at least through the end of this year. The goal is the have the economy grow fast enough to achieve "escape velocity," a point where it can generate more investments, employment, and consumption on its own with less assistance from the Fed. We are not there yet, but the cheap cost of credit has certainly worked its magic over the economy, especially with the interest-rate sensitive sectors like autos and housing.

Does this mean the Fed may reassess its current strategy and consider pulling back on quantitative easing sooner? No. The unemployment rate even at 7.7% is still more than a full point above the Fed's stated goal. The growth in payrolls needs to accelerate toward 300,000 a month to bring joblessness down in a meaningful way. Nor does the Fed worry about inflation at this time. The cost of living (PCE price index) rose by just at 1.2% for the year in January, the smallest pace since October 2009. No change is thus seen on the monetary front.



The second F deals with the fundamentals, and here one need go no further than yesterday's release of the Flow of Funds (FoF) data. Household and corporate finances are much healthier. So much so that both sectors appear ready and eager to unleash years of pent-up demand in the months ahead.

Perhaps one of the biggest stories from the FoF report is that by the end of last year, households have successfully recovered more than 90% of the $16 trillion in wealth they lost during the great recession when real estate and stock prices utterly collapsed. And with stock and real estate values continuing their climb so far this year, it is likely Americans will recoup it all this quarter. Household wealth has officially risen to $66.07 trillion at the end 2012, the most since before the recession. **This rebound in wealth and the improvement in the job market have fired up consumer confidence.**



The same FoF report showed that US corporations have amassed a record $1.8 trillion in cash reserves at the end of last year --- and there is now economic data showing companies are finally tapping those funds to help finance more capital spending projects.

Let's not stop here. There are other important fundamentals to consider. US banks are much healthier and more willing to finance economic growth too. The FDIC reported that US banks in 2012 had the second best earnings ever! Moreover, given their stronger balance sheets and high capitalization, regulators yesterday announced that all but one of the 18 largest commercial banks are better able to withstand future economic and financial shocks. That has made banks more comfortable about lending. Commercial and industrial loans jumped by 11.4% in 2012, the most since 2008. That double-digit pace has continued into 2013. All have contributed to the best underlying economic fundamentals in more then half a decade.

The third F represents the ongoing follies in the nation's capital. While Americans are exasperated by the political trench warfare over taxes and spending, there is also a growing sense that Washington's antics will ***not*** derail the expansion. There was lots of hand wringing late last year over the fiscal cliff and the recession it would cause in 2013. But the New Year's Eve agreement not only averted that cliff, it also changed the mindset of most Americans. Fatigued by all the brinksmanship, consumers are now ready to get on with their lives and business leaders are happily paying more attention to satisfying the growing demand for products from domestic and foreign customers. In other words, the spotlight has shifted away from the melodrama in Congress to the emerging strength in the private sector, which so dominates US economic activity.

Certainly, the sequester will cause some pain, specifically in the defense department but also among other federal and civilian workers. Our expectation is that the sequester will be resolved this quarter or next and that Congress will shortly pass a continuing resolution to keep the government functioning for the rest of the fiscal year. We also doubt the Republicans will raise the debt ceiling threat in the spring as a way to force more spending cuts from the White House. The GOP is well aware of the polls that show the majority of Americans believe that economic growth and employment should be the most immediate goals of government, while budget cuts, important as they are, should be the medium term objectives.

Bottom line:

All the economic metrics are moving in the right direction.

In the February jobs report, our primary focus has been on the leading data points**:** **trucking employment** (up 5,600), **construction** (up 48,000), **employment agency services** (up 21,100), **leisure and hospitality** (up 24,000), **child care services** (up 1,600), **average weekly hours** (up to 34.5), **manufacturing overtime** (up to 3.4 hours --- highest since June 2007). Now add to these a slew of other macroeconomic data points moving higher: ISM orders, consumer spending, housing, auto sales, initial jobless claims, the stock market, to name a few.

Our forecast for growth remains at 3.2% this year (2.7% should the sequester continue the rest of the year). The unemployment rate will drop to 7% by year's end with payrolls edging closer to 300,000 a month in the last quarter. The Fed will begin to scale purchases of Treasuries and MBS paper during the first half of 2014, and start to inch the Fed funds rate higher in the second half of that year.

==============================