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ECONOMIC TALKING POINTS

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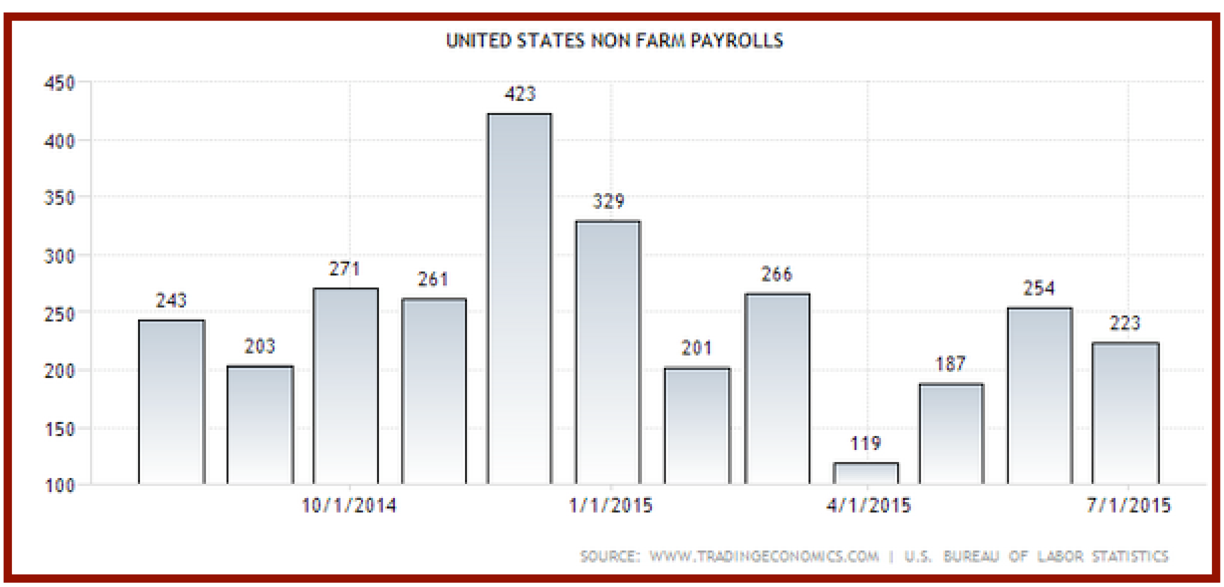
July 2, 2015

June Payrolls: Has the Relationship Between Economic Growth and Employment Broken Down?

Last month's increase of 223,000 in payrolls was a disappointment because it appeared so out of sync with the cascade of other indicators showing an economy that has re-energized in the second quarter. You would expect that with economic activity shifting into faster gear, job vacancies at their highest since the BLS has kept such records (15 years!) and with confidence in the outlook improving, the pace of hiring would be closer to 300,000. Instead, June's employment came in even below consensus forecasts, which was a fairly conservative 240,000.



Frankly, something appears askew with the June employment numbers, especially the "Establishment" survey in the report. This is where Labor Department communicates directly with businesses on the number of people hired, how many hours they worked on average per week, changes in hourly and weekly pay, and much more ---again, all from the perspective of employers. (In contrast, the household survey relies on answers given by individuals, whether they are employed our not.)

Here, briefly, is what struck us as strange about the June employment release and quickly raised questions about its validity.

1. The number new constructions workers hired last month was ZERO! That simply defies logic since overall construction spending and new home sales are both at seven year highs. Moreover, builders were filing permits for future home construction at the fastest rate in eight years! Pending home sales (which counts the number of contracts signed to purchase an existing home) just jumped to a near decade high. And finally, homebuilders in June were the most confident they have been all year about the prospects for new home sales. How could it be, with housing showing so much forward momentum, that not a single net new person was hired in the construction industry in June? Quite strange.

2. Though auto sales this year are on track to reach 17.4 million units, the strongest in 15 years, the jobs report noted that the industry added a mere 500 auto workers last month nationwide. Another suspicious figure.

3. Average hourly and weekly earnings were identical *to the penny* in both June and May. Yet manufacturing overtime jumped to a four-month high last month! Again, we have a dissonant combination.

These soft employment and income numbers simply lack credibility given the sturdy performance of the broad economy. What could account for this divergence?

There can be two explanations. First, Labor Department statisticians did not get an adequate number of firms to report on hiring, hours worked and pay in time for the June report. In fact, the collection rate last month was just 74.3%, the lowest in more than a year!

Or, two, the traditional relationship between economic growth and employment has broken down. That is, stronger economic activity may no longer translate into stronger job numbers.

What might account for that? Consider a number of possible reasons:

- The US is now more integrated into the world economy than ever before and that exposes American companies to more severe competition. The resulting lack of pricing power means firms are still struggling to protect their margins and that has constrained hiring and pay increases.

- The lack of productivity growth this past year can also hurt earnings, which further discourages boosting payrolls.

- And let's not forget how much technology itself has transformed the labor market, making some jobs extinct and others hard to fill because of inadequate skills.

If payrolls appear stuck at an average of 230,000 a month the rest of the year, even as the economy expands at a hefty 3% pace —a growth rate we expect to see — then the evidence only gets stronger that the calculus employers use to determine how many people to hire, when to hire and whom to hire has undergone a fundamental change.

We will need to wait a few more months to see whether June's soft employment report was largely the result of inadequate data collection — or –— symbolic of a deeper structural change in the labor market. If it's the latter, then we are in the midst of an historic paradigm shift in the dynamics that affect employment in this country, a change that will also have far reaching consequences for fiscal and monetary policy.

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Key Economic Forecasts

- Actual
- Forecast

United States

	I 2014	II 2014	III 2014	IV 2014	I 2015	II 2015	III 2015	IV 2015	I 2016	II 2016	III 2016	IV 2016
Real Gross Domestic Product (GDP):												
%	-2.1	4.6	5.0	2.2	-0.2	3.1	4.2	3.2	2.3	3.5	3.2	2.8
Personal Consumption Expenditures:												
PCE	1.2	2.5	3.2	4.4	2.1	3.2	3.4	2.8	2.7	3.6	3.2	3.3
Inflation, end of period, year-over-year:												
CPI %	1.5	2.1	1.7	0.8	-0.1	0.6	1.0	1.3	2.0	2.3	2.3	2.5
Unemployment Rate (end of period):												
%	6.7	6.1	5.9	5.6	5.5	5.3	5.2	5.1	5.0	4.9	4.8	4.7
Non-farm Payrolls, monthly avg. thousand:												
	189	267	237	324	195	223	255	275	235	245	250	250
Treasury 10-yr Note Yield % (end of period)												
	2.72	2.52	2.51	2.17	1.93	2.38	2.62	2.80	3.05	3.25	3.75	4.00
Federal funds rate % (end of period)												
	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.25	1.75	2.00

GDP Growth - Global Economy

Country	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
US	1.8	-0.3	-2.8	2.5	1.6	2.3	2.2	2.4	2.7	3.1
Eurozone	2.6	0.6	-4.1	1.7	1.4	-0.6	-0.4	0.9	1.7	1.9
United Kingdom	3.1	0.6	-5.2	1.7	0.7	0.3	1.8	2.6	2.8	3.0
Japan	2.1	-0.7	-5.4	4.6	-0.4	1.6	1.5	0.0	1.2	1.9
Canada	2.7	0.7	-2.8	3.2	2.5	1.7	2.0	2.5	2.3	2.9
India	9.1	8.8	6.3	8.4	8.6	6.7	4.9	7.5	6.5	7.0
China	14.2	9.6	9.2	10.5	9.3	7.8	7.7	7.4	6.7	6.4
Brazil	5.7	5.1	-0.3	7.5	2.7	0.9	2.3	-0.1	0.5	2.2
Mexico	3.3	1.4	-4.7	5.2	4.0	3.9	1.4	1.9	3.4	4.0
Australia	4.0	2.3	1.2	2.8	2.6	3.6	2.4	2.5	2.7	3.0
Russia	8.1	5.6	-7.9	4.0	4.3	3.4	1.3	0.6	-3.9	1.0
World	5.4	1.6	-1.9	4.2	3.0	2.6	2.9	3.2	3.9	5.4

Key Currency Values

	End 2008	End 2009	End 2010	End 2011	End 2012	End 2013	End 2014	End 2015	End 2016
USD/Yen	91	93	81	77	87	105	119	125	110
Euro/USD	1.40	1.43	1.34	1.29	1.32	1.37	1.21	1.18	1.26

Oil (Brent spot) & Gasoline (Average retail unleaded, $)

	End 2008	End 2009	End 2010	End 2011	End 2012	End 2013	End 2014	End 2015	End 2016
Crude oil per barrel	46	78	95	107	111	111	58	73	84
Gasoline	1.61	2.57	3.00	3.27	3.30	3.32	2.26	2.45	2.70