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ECONOMIC TALKING POINTS

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This Could Be a Breakout Year for the Economy, in spite of Washington

Today's news on employment, consumer sentiment, the ISM manufacturing activity and construction spending all point to an economy that is building steam. They also reveal a private sector that appears increasingly dismissive to the sequestration and debt ceiling threats coming from Washington.

Let's begin with last month's increase in payrolls, which turned out to be a rather modest total of 157,000, with private payrolls rising by 166,000. These figures are likely to be pushed higher with next month's release. The reason is that when an economy is transitioning toward faster growth, the "advance" economic reports typically fail to capture these macro shifts. Mind you, the preliminary numbers this January were based on getting back 72.4% of the employment forms the BLS first sent to establishments. In contrast, the revised increases for November and December were computed after collecting a more complete 87.2% and 90.8% of responses, respectively.

Of course, Wall Street traders rarely care about revisions since they rush to act based on the flash news. But CEOs, longer term investors, households, and policymakers should rely on data that possess more complete information before making key decisions.

With that caveat, what can we glean from this employment report?

The increase in the unemployment rate from 7.8% to 7.9% was not surprising to us. Those who have been jobless and too frustrated to look in the final months of 2012, often revive their efforts with the start of a new year. Indeed, the number of discouraged workers, or persons not currently looking for work because they believe no jobs are available, plummeted by 264,000 in January, the biggest monthly drop in two years --- and the *second largest decline since the BLS collected such statistics in 1994.*

There are a couple of additional highlights for January worth noting. Long term unemployment, defined as being out of work 27 weeks or longer, fell by 58,000, to 4.71 million, the lowest since June 2009. Both the average and median number of weeks out of work declined to multi-year lows in January

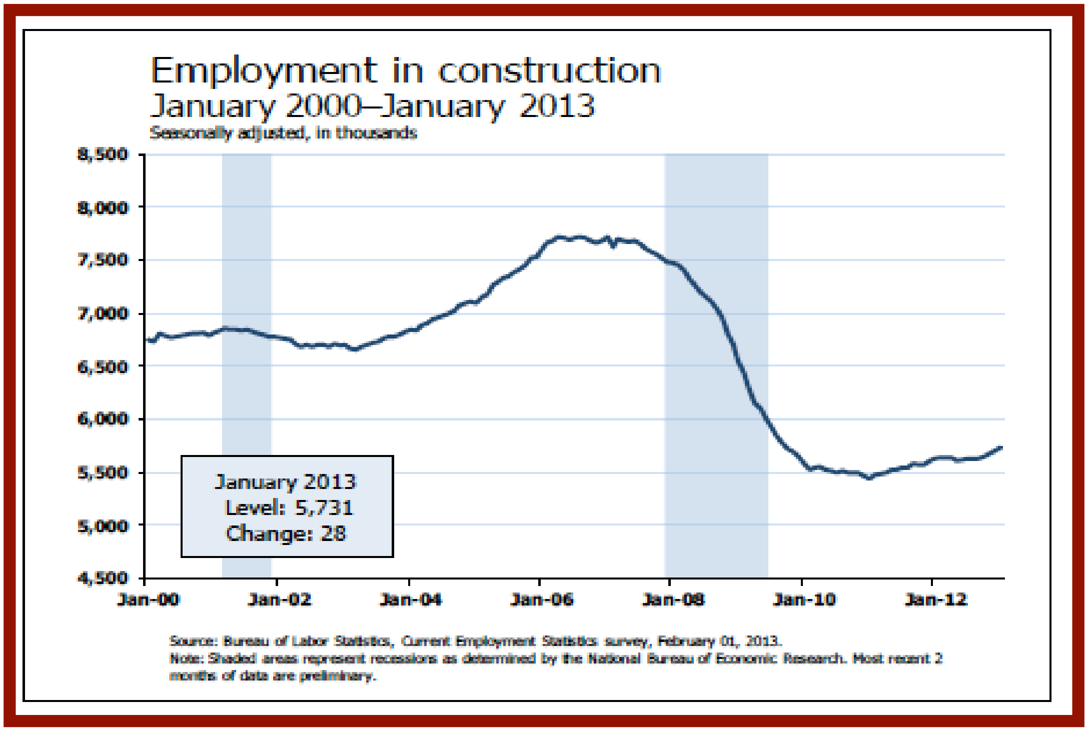
The average number of weeks unemployed dropped to 35.3, the least in more than 2 years, while the median fell to 16 weeks, the fewest in 3 1/2 years.

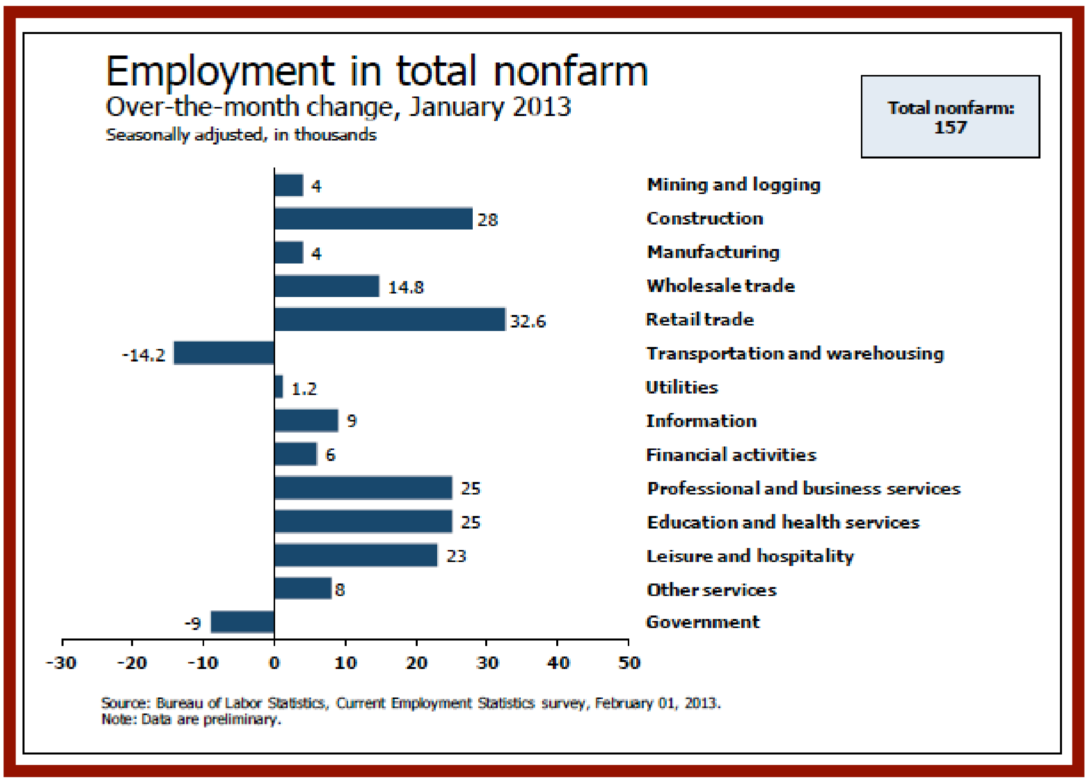
Don't write off the consumer!

Another key stat in this report is average hourly earnings, which rose 2.1% over the last 12 months, an increase that outpaced the rise in the cost of living. The subsequent increase in purchasing power, plus the steady improvement in household wealth, decline in gasoline prices, and rise in consumer sentiment suggest the jump in payroll taxes will not materially curb household spending this year.

Construction news

Among the industries that ramped up, there is one that has truly rebounded: construction. Since hitting a cyclical low of 5.43 million in January 2011, builders have hired 296,000 workers since (28,000 last month alone) as the residential housing sector comes to life and post-Sandy recovery efforts begin. Construction employment has now risen for an eighth straight month and now totals 5,731,000,the most since October 2009. Construction spending as a whole was up in 2012, the first annual increase in six years.

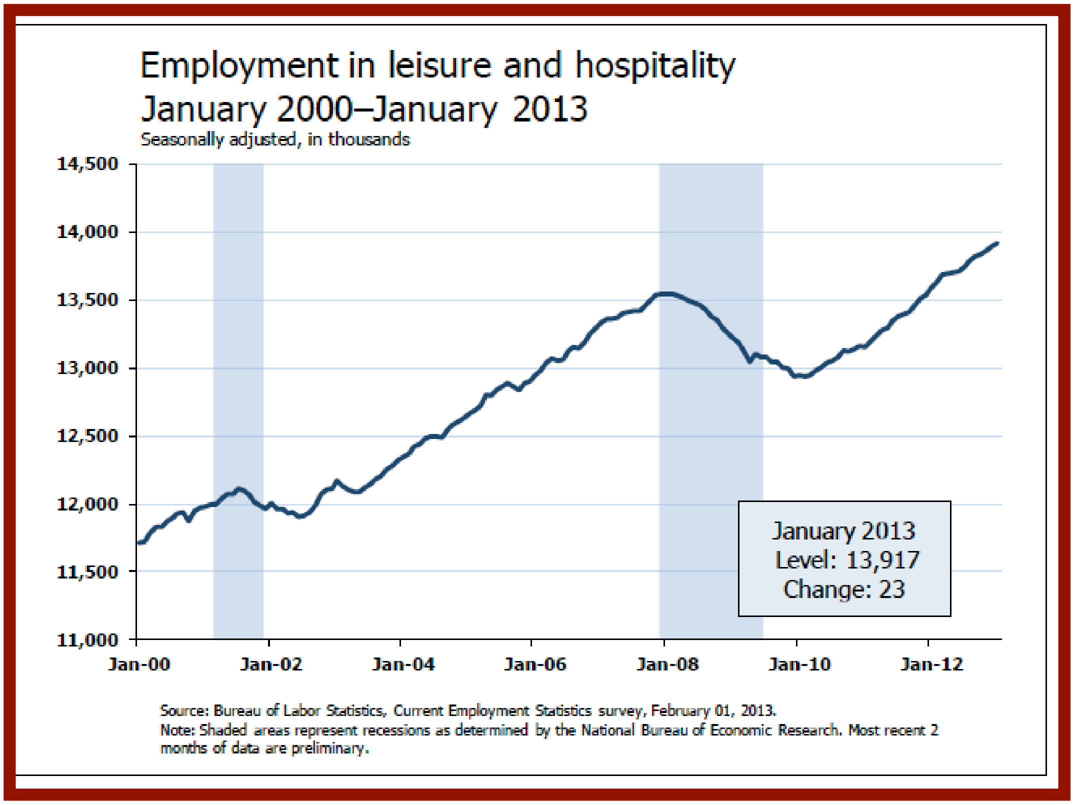




Industries with record high employment

But only a few sectors in the economy can now claim the status of possessing record high employment.

One of those fields should not come as a surprise. The number of workers in education and health care jumped in January to 20.5 million, up 429,000 from a year ago. But the other industry with bragging rights is something of a surprise because it relies so much on discretionary spending by consumers and businesses: leisure and hospitality (L&H). After peaking out at 13.55 million in December 2007, this industry shrank by 615,000 employees during the last recession. But it has bounced back dramatically to reach a new high of 13.9 million employees.



Huge revisions in the labor market

The biggest news, of course, were the upward revisions in payrolls for the two previous months along with the benchmark changes on employment going back to 2008. With more complete information in, December payrolls were actually up 196,000 (not 155,000 as initially reported), and November's increase turned out to be 247,000 (a massive 69% upward correction from the 146,000, first reported that month).

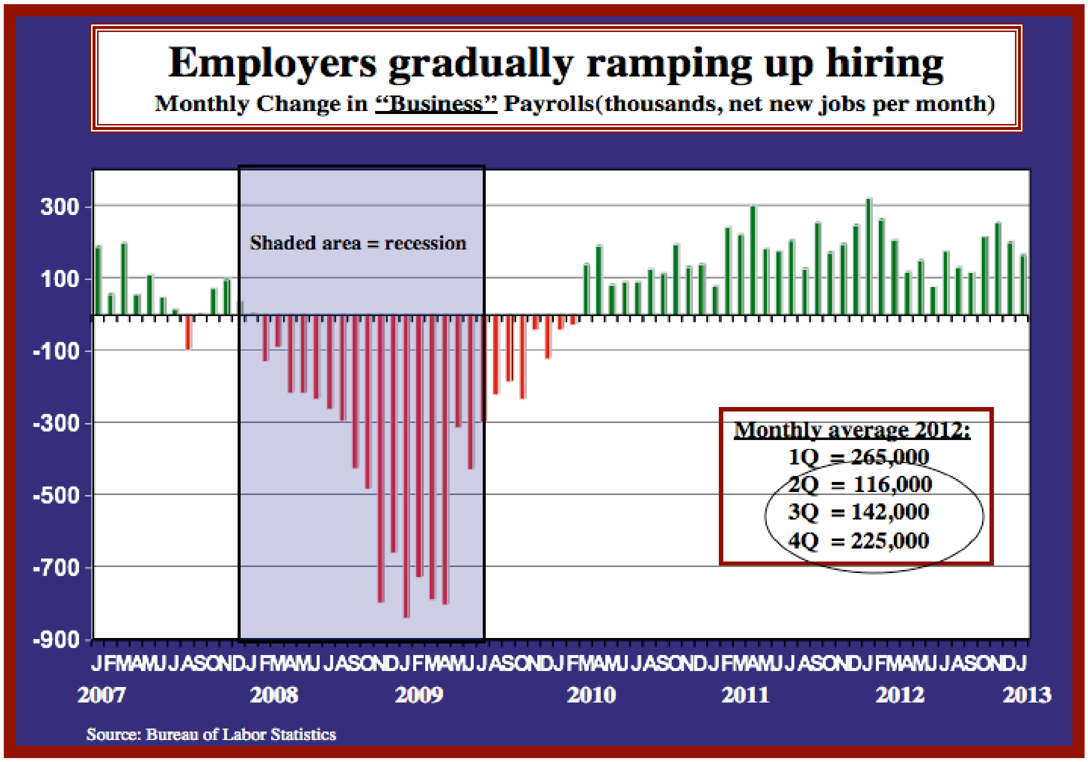
Private payrolls in December rose by 202,000 (so scratch the 168,000), with November up 256,000 (instead of 171,000).

The broader benchmark changes, which reviewed payrolls from April 2011 to March 2012, showed employment actually increased by another 424,000.

The statistical bottom line is that companies hired more workers than previously thought in the last two years, with private payrolls up 2.25 million in 2012 (not 1.9 million) and 2.42 million in 2011 (instead of 2.1 million).

What does this tell us about job gains in 2013?

There are growing indications that employment will accelerate further this year, largely because the economic fundamentals look so much better. Household finances are stronger, corporate balance sheets have never been better, and the cost of credit is still dirt cheap. As we said earlier this week, business leaders are focusing less on the partisan battles in Washington and more on growing domestic and foreign demand for U.S. goods and services.



One fresh piece of evidence on this was today's report on factory activity in January. The ISM manufacturing index came in much stronger than expected. New orders, which is a leading indicator of future production and hiring, turned up sharply. Of the 15 industries the ISM looks at, 10 reported orders accelerating. One result of this trend: The ISM's employment index rebounded to a 7-month high.

Another very interesting piece of news this week came from the monthly ADP employment report on private sector hiring. It may have put to rest the notion that the Affordable Care Act (Obamacare) will so hurt small businesses, that these enterprises will be forced to slow or end hiring, or even layoff workers. There is no evidence of that occurring. Instead, the data shows the opposite. Small companies remain in the vanguard of hiring. In fact, companies with employees that number 49 or less, added 115,000 workers to their payrolls last month, the biggest increase since February 2006 when the economy surging.

Bottom line:
The economy, sales, employment and the stock market are all higher in spite of the bickering and rancor in Washington. It conjures up an image of dogs barking in the desert, yet the caravan steadily moves on. This economy is clearly ready to move on.

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