February 8, 2009

The Glass Is Half-Full, Not Half-Empty

Thursday's dramatic equity market decline was initially reported by U.S. commentators as related to a rise in jobless claims, whereas expectations saw a decline. The reality was the market weakness related to European country debt problems that are a serious concern. The rise in jobless claims related to a California backlog in claims processing, not to any fundamental deterioration in the labor markets.

The January employment data were revealing. Payroll employment fell by 20,000 last month. Consensus expectations looked for a 15 to 20K rise in payrolls. The weaker than expected payroll number was more than fully accounted for by one sector: construction, wherein payrolls collapsed by 75,000. The consensus expected that temporary Census-related hiring would boost public sector employment, but government jobs fell 8,000. This means private sector payrolls fell only 12K.

The Bureau of Labor Statistics (BLS) had previously reported a preliminary benchmark revision of an incremental employment decline of 824,000 through the year ended March 2009. The revised BLS benchmark decline was 902,000. More recent employment data were also revised lower with an aggregate downward revision of 1.4 million jobs between April 2008 and December 2009, i.e., the recession induced employment declines were 1.4 million worse than previously reported. (This includes the revised benchmark revision of 902K.) Some 617K of the 1.4 million is downside revision to 2009.

That's the bad news. The glass is half-full, not half-empty. Going forward, the outlook for payroll employment is encouraging. "Temporary help" payrolls increased 52,000 in January, atop a 59K increase in December. January was the sixth straight monthly rise in this category. Temporary help payroll increases lead overall payroll gains by six months. We expect February payroll employment will increase when it is reported on March 5th. Rather than adding to payrolls to date, companies have been increasing total hours worked by an annual rate of 1.8% in the last three months.

The January payroll data showed an 11,000 rise in manufacturing employment. This was the first gain in manufacturing payrolls since January 2007. Although aggregate payroll employment fell 20K in January, **civilian employment, defined here as a measure of jobs that includes self-employment, rose 785K in January.**

The **household employment survey, which better captures employment by small businesses, had a 541K increase in civilian employment in**

January, and showed a drop to 9.7% in the unemployment rate in January from 10% in December, and a cyclical high to date of 10.1% in October 2009. The number of "discouraged workers" in the economy reflects people who have given up trying to find work. As such, they are not part of the labor force, and are therefore not considered unemployed. Many workers are employed part-time because they can't find full-time work, or their hours have been cut back. This is a reasonable proxy for "under-employment." These "under-employed" are not counted in the headline unemployment rate either. A broader measure of the unemployment rate counts discouraged workers and the "under-employed," as herein defined. The broader unemployment rate was 17.4% in December, but improved to 16.5% in January.

A big negative in the labor market data is the incidence of long-term unemployment, defined as 27 weeks and higher. This measure edged higher to 6.3 million in January, and is up fully 5.0 million over the course of the Great Recession. And, a real negative for the overall economy is the weakness in the housing and non-residential construction sphere. Residential housing remains affected by high foreclosures, an increased incidence of negative equity (where the outstanding mortgage is higher than the value of the home), and impending mortgage resets. Commercial real estate is being hammered by falling rents and escalating vacancies.

In December, consumer credit outstanding (CCO) declined $1.7 billion, the 11th consecutive decline, the longest stretch in the history of comparable data going back to January 1943. CCO is down 4.4% y/y. The data reflect the consumer sector's desire to deleverage, as well as still tight lending standards. (CCO does not include mortgage debt, or any loan secured by real estate, e.g., home equity loans.) Consumer spending grinds forward at a cautious pace, but labor market improvement will enhance consumer spending.

The overall recovery endures. The release of the January ISM manufacturing index beat consensus expectations with an overall reading of 58.4. New orders hit 65.9 in January, with production rising to 66.2, and employment reaching 53.3, all recovery highs. The non-manufacturing ISM composite rose to 50.5 in January, all major sub-indices rose, with some going above the 50.0 level that connotes expansion. Factory orders rose 1% in December, following a like gain in November. Durable goods orders rose 1%, revised higher than the earlier report of 0.3%. Non-durable goods orders rose 1% in December, atop a 2.2% gain in November.

Final quarter 2009 productivity expanded at an annualized pace of 6.2%, with unit labor cost receding at a 4.4% annual rate. This bodes well, ceteris paribus, for corporate profitability.

Economic Indicators in the Week Ahead:

Tuesday, February 9 10:00a.m. December Wholesale Inventories

We expect wholesale inventories fell 0.1% in December. This is at odds with market consensus expectations, which have a 0.5% inventory accumulation in December. Wholesale inventory gains of 0.6% and 1.5% in October and November respectively were fueled by price rebounds in food and energy. Non-durable inventories will likely be flat, while durable goods inventories are likely to be pared for the 15th consecutive month. With sales firming, the inventory to sales ratio should decline to 1.13 in December from 1.14 in November.

Wednesday, Feb. 10 8:30a.m. December Merchandise Trade Balance

The trade deficit should narrow slightly from $36.4 billion In November to $35.0 billion in December. We see a 1.1% increase in exports, while higher imported oil prices will act to offset declining imported barrels. The plus to exports is the increase in outbound container exports from the West Coast of the U.S. to Asia. Our forecast has a narrower trade deficit than the market consensus of $35.5 billion.

Thursday, February 11 8:30a.m. Jobless Claims, week ending 2/6/10

We expect initial claims will fall 45,000 in the week ending February 6 from 480,000 to 435,000. The market's disappointment with last Thursday's rise in claims was somewhat misguided, as the primary factor continues to be the problems in processing claims in California. Claims in California have had processing backlogs, and have been consequently elevated. If that backlog thaws, initial claims should fall. Continuing claims should edge below 4.6 million, but unemployed workers getting federal extended benefits is still rising.

Thursday, February 11 8:30a.m. January Retail Sales

January retail sales likely rose 0.6%, owing to rising gasoline station sales on higher prices and escalated home deliveries of heating bill. This follows a 0.3% decline in December retail sales, and a market consensus rise of only 0.3% in January.

Thursday, February 11 10:00 December Business Inventories

We expect business inventories fell 0.1% in December, following accumulation of 0.4% in November and 0.3% in October. The consensus sees a 0.4% rise in business inventories in December. With overall sales rising 0.6%, the inventory to sales ratio should fall to 1.27.

Friday, Feb. 12 10:00a.m. February (P) Consumer Sentiment Index

The consensus expects the preliminary February level of the Reuters/University of Michigan Consumer Sentiment Index to rise from 74.4 in January to 74.8. With an improving economy, consumer sentiment will be sharply higher than the 56.3 reading in February 2009, but equity market weakness, growing fears about debt problems in Europe, and weakness in the ABC/Washington Post Consumer Comfort Survey suggest the consensus could be wrong in magnitude and direction. We think Consumer Sentiment in the preliminary February reading will drop to 73.8. The Consumer Comfort

Survey for the week ending February 7 will be reported on February 9. The Rasmussen Consumer Index is a daily measure and dropped 3 points on February 5 to 75.8 and fell again on Saturday February 6 by 1.3 points to 74.5.

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