April 4, 2010

The Labor Market Speaks & So Does Manufacturing

In its release on April 2, nonfarm payrolls in March grew 162,000. In addition, the 36,000 decline in February payrolls has been revised up 22,000 to now show only a 14,000 payroll drop. Furthermore, the January data was revised up 40,000, from a 26,000 payroll decline to a 14,000 increase. As a result of the March release and the revisions to January and February, payrolls are cumulatively 224,000 higher. .

Importantly, the hiring of temporary Census 2010 workers contributed 48,000 to March payrolls vs. expectations of at least 105K. Beyond the temporary hiring of Census workers, March payrolls were up 114,000. We believe the recovery from February snowstorms probably added perhaps 75,000 to March payrolls. This is suggested by the revisions to construction employment, which increased 15,000 in March, up from an average 52,000 decline in the prior three months.

Temporary help payrolls have risen for seven straight months. This is a strong leading indicator of additional net payroll increases. This leads in turn to rising incomes, further gains in consumer and business spending including inventory investment, and strong gains in production. All of this supports further increases in production. The fragile upswing has been reinforced and solidified. On a negative note, state and local government payrolls dropped in March, as they did in February.

Stronger than the ADP employment report, the Bureau of Labor Statistics (BLS) March payroll data showed a rise of 123,000 in private sector payrolls, after increasing only 8,000 in February. This suggests a snapback from the February snowstorms. Manufacturing payrolls jumped 17,000 in March, marking the third successive monthly rise. Relating to improving consumer spending, retail payrolls grew 15,000 in March, following an 8,000 payroll increase in February.

Aggregate hours worked for private sector workers increased 0.4% in March, following a 0.3% decline in February. Manufacturing production workers hours worked advanced 1.5% in March. The private sector workweek increased from 33.9 hours in February to 34.0 in March. The workweek for production and nonsupervisory workers increased from 33.1 hours in February to 33.3 hours in March. Aggregate average hourly

The Lavery Consulting Group, LLC • PO Box 734 • Spring Lake, NJ 07762-0734
Office Phone 732-974-1946; Mobile 609-731-6226 • Fax: 732-974-3140
Jack Lavery • jlavery@laveryconsultinggroup.com
Website: http://www.laveryconsultinggroup.com

earnings slipped 0.1% in March, following a 0.2% increase in February. March 2010 average hourly earnings are up 1.8% y/y.

The household survey measured the unemployment rate stable at 9.7%. The cyclical high of 10.1% was reached in October 2009. On a negative note, the household survey showed a rise in the average duration of unemployment. Those workers unemployed for more than 26 weeks rose in March to a record high of 6.547 million, up over 400K from February.

The March ISM Manufacturing Index increased sharply to 59.6 from 56.5 in February. March's reading beat consensus expectations of 57.0. The new orders and production subcomponents moved above 60. New export orders soared to 61.5. Supplier Deliveries jumped to 64.9, its highest level since mid-2004. This slowness in deliveries tells us suppliers have underestimated the staying power of the recovery. The Dallas Fed reported on March 29 its Manufacturing Outlook. Its general business activity index rocketed into expansionary territory, with higher readings for production, new orders, shipments, employment, the workweek, and capacity use.

Importantly, the strength in U.S. manufacturing is being echoed around the developed world. The March manufacturing reading in the Eurozone reached its highest level in 40 months. Japan's Tankan report revealed the fourth straight quarter of increased business confidence, the best reading since prior to the fall of Lehman in September 2008. Both the U.K. and China also had manufacturing data that exceeded expectations.

U.S. construction data have been an Achilles heel of the recovery, as has increasingly the state and local government sector. February Construction Spending was far weaker than expected, declining 1.3% m/m from January, which was revised to show a fall of 1.4%, from the 0.6% decline originally reported. Construction spending in February was down 12.8% y/y, worsening from a 12% y/y fall in January.

Non-residential construction in December was first reported as up 0.2% m/m. When the data for January came out, December was revised to a 0.7% decline m/m. With the report of the February data, December was revised further to a drop of 3.0% m/m. January non-res spending was first reported as declining 2.1% from December. Revision makes the January drop now 3.8%m/m. With all the downward revisions, February didn't look too bad on the surface, down only 0.4% m/m. But, the y/y decline has been worsening. In February 2010 non-res spending was down 24.3% y/y.

Residential construction dropped 2.1% in February m/m, but is off only 3.8% y/y. February was the fifth consecutive month with a slowing in the y/y decline of residential construction spending. Besides non-res, public construction in the state and local area is the other Achilles heel in the construction landscape. In February, state and local construction was down 8.4% y/y. The trend is worsening sharply. The y/y decline was 1.1% in December, and in January was a y/y drop of 4.4%. Public construction spending in the state and local area has fallen seven months in a row m/m.

Economic Indicators in the Coming Week:

Monday, April 5 10:00a.m. March ISM Non-Manufacturing
The Institute for Supply Management (ISM) nonmanufacturing Index was at 50.5 in January and 53.0 in February. We expect that this service sector gauge rose to 55.0 in March. At this writing, the consensus is at 54.0, and the consensus range of expectations goes from 51.0 to 55.0. Consumer spending on services has been escalating. The ISM services Index has moved meaningfully above 50.0. A combination of falling jobless claims, a healthier service sector index from the Richmond Fed, and strong chain-store sales should keep the ISM Non-Manufacturing moving higher. For the ISM business activity index we expect a jump from 54.8 in February to 56.0 in March. Seasonal adjustment factors will restrain the actual results, or our estimates would be still higher.

Wednesday, April 7 2:00p.m. FOMC Meeting Minutes from 3/16 Mtg.
The March 16 meeting of the Federal Open Market Committee (FOMC) was the second successive meeting at which Kansas City Fed President Thomas Hoeing marked his dissent with regard to the Fed maintaining the posture of the federal funds rate at a 0%-.25% range. The April 7 release of the FOMC minutes will reiterate Hoenig's belief made first at the January 26-27 FOMC meeting: "that continuing to express the expectation of exceptionally low levels of the federal funds rate for an extended period was no longer warranted because it could lead to the buildup of financial imbalances and increase risks to longer-run macroeconomic and financial stability." Will the minutes reveal that Heonig's position has more support than at the January FOMC meeting? We believe the Hoenig position will have some additional philosophical support, but no additional dissenters. The Fed has ceased its $1.25 trillion mortgage-backed securities purchase program on March 31, as

they said they would. Now risk premiums on mortgage-backed securities sold by Fannie Mae, Freddie Mac and Ginnie Mae have widened 0.4% compared with Treasuries to a 1.34 percentage point spread. Will mortgage rates move higher and further jeopardize the housing sector? Yes, we believe so, as the 30 year fixed rate mortgage has risen to 5.05%

Wednesday, April 7 3:00p.m. February Consumer Credit
Consumer Credit Outstanding (CCO) increased a surprising $5.0 billion in January. The January advance followed 11 consecutive monthly declines, reflecting both the desire of the consumer to deleverage (a diminution of credit demand), as well as tougher lending standards by the banking system (a lessening in credit supply). We see CCO likely to increase $4.0 billion in February, more than fully accounted for by an increase in revolving credit (credit card balances), given the February 0.8% rise in retail sales excluding autos. Non-revolving credit (auto related credit, education loans, vacation loans, and pools of secured assets) are likely to decline in February. The consensus expectation, at this writing, is a $1.4 billion February advance in CCO. On a y/y basis, our forecast increase of $4 billion in CCO yields a 3.6% y/y decline. In January, CCO dropped 4.2% y/y.

Thursday, April 8 8:30a.m. Jobless Claims, Week Ending April 3
Initial jobless claims have fallen four times in the last five weeks. With the timing of Good Friday, and the closure of many state unemployment offices, we expect initial claims will likely remain at or very near the 439K level of the week ending March 27. Our exact estimate is 438K. The consensus expectation is 433,000.

Friday, April 9 February Wholesale Inventories
Our expectation is a build in wholesale inventories of 0.4% in February, following a net liquidation of 0.1% in January. Our February expectation is in line with consensus. The February factory orders report of March 31 showed higher inventories throughout manufacturing. With sales rising as well, our expectation is that the inventory/sales ratio remains unchanged at the 1.16 level of January.

Jack W. Lavery
CEO & Economist