

Weekly Economic Commentary



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Unemployment Improving, but Still Uncomfortably High

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Highlights

Incredibly busy week for global economic and policy events.

Focus on the unemployment rate.

Economic Calendar

Monday, February 27 Pending Home Sales <i>Jan</i>	Thursday, March 1 Initial Claims wk 2/25
Tuesday, February 28 Durable Goods Orders and Shipments <i>Jan</i>	Chain Store Sales <i>Feb</i>
Consumer Confidence <i>Feb</i>	Personal Spending <i>Jan</i>
Wednesday, February 29 GDP Price Index <i>Q4</i>	Personal Income <i>Jan</i>
Real GDP <i>Q4</i>	ISM Manufacturing <i>Feb</i>
Chicago Purchasing Managers Index <i>Feb</i>	Construction Spending <i>Jan</i>
Bernanke Testimony	Domestic Light Vehicle Sales <i>Feb</i>
Beige Book	

This week is extraordinarily busy for economic reports and potentially market-moving events in the United States and abroad. On the domestic economic front, the February Institute for Supply Management (ISM) report highlights a week that will also include the release of February vehicle sales data, January personal income and spending, and the second look at the fourth quarter Gross Domestic Product (GDP) data. Fed policy will also vie for attention as the Fed releases its Beige Book and Fed Chairman Bernanke delivers his semiannual monetary policy testimony to Congress.

It is just as busy overseas as Greece, Finland and Germany will vote to approve the latest Greek bailout. In addition, there is a European Union summit late this week, and several European nations (Italy, Germany, Spain and France) will hold bond auctions. The key event of the week will likely be the European Central Bank's (ECB) offering of an unlimited amount of cheap money for three years to European financial institutions. There are parliamentary elections in Iran, and Iran will likely be in the news over its nuclear program and as long as oil prices stay high and in the headlines. China will release its ISM data for February as well.

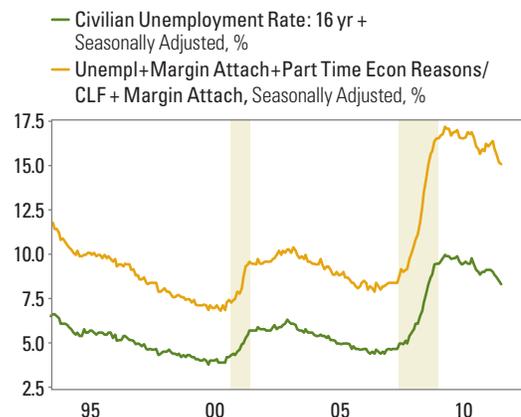
Unemployment Rate Putting Pressure on Wage Growth and Spending

- Any way you slice it, the unemployment rate remains uncomfortably high. We would be more skeptical of the drop in the unemployment rate if other measures of labor market stress (layoff announcements, initial claims for unemployment insurance, job openings) had not moved in the same direction as the unemployment rate. The recent rise in consumer sentiment to four-year highs also helps to corroborate the drip in the unemployment rate.
- The slow pace of income growth (which takes underemployment into account) and the tepid pace of consumer spending for this stage in the business cycle confirms that the labor market is far from "normal."
- The basic methodology used to calculate the unemployment rate (and the other measures of labor market stress) has been in place since 1940.

The nation's unemployment rate dropped from a recent high of 10.0% in October 2009 to 8.3% in January 2012. The next employment report is due out on Friday, March 9. The pre-recession low in the unemployment rate was 4.4%, hit in late 2006 and early 2007. Thus, even after declining



1 Measures of Unemployment Have Come Down Recently, but Remain Nearly Twice As High as Pre-Recession Levels



Source: Bureau of Labor Statistics, Haver Analytics 02/26/12

(Shaded areas indicate recession)

steadily for two-and-a-half years, the unemployment rate is still double where it was just prior to the onset of the recession. Broader measures of the stress in the labor market have moved lower recently as well, but also remain at nearly twice the level seen prior to the onset of the recession. For example, a measure of the unemployment rate that takes into account both people who have largely given up looking for work and workers who are able to find only part-time work stood at 15.1% in January 2012, down from the peak of 17.2% hit in late 2009, but still nearly double the rate (7.9%) in late 2006 and early 2007.

A survey of 60,000 households nationwide—an incredibly large sample size for a national survey—generates the data set used to calculate the unemployment rate. (Nationwide polling firms typically poll around 1,000 people for their opinion on presidential races.) The “household survey” has been conducted in much the same way since 1940, and although it has been “modified” over the years, the basic framework of the data set has stayed the same. The last major modification to the data set (and to how the data is collected) came in 1994.

The headline unemployment rate is calculated by dividing the number of unemployed (12.8 million in January 2012) by the number of people in the labor force (154.4 million). The civilian population over the age of 16 stood at 242.3 million in January 2012. You are identified as being part of the labor force if you are over 16, have a job (employed) or don’t have a job (unemployed) but are actively looking for work. You are not in the labor force if you are neither employed nor unemployed—this category includes retired persons, students, those taking care of children or other family members, and others who are neither working nor seeking work.

In January 2012, the labor force was 154.4 million, which consists of 141.6 million employed people and 12.8 million unemployed people. Another 87.9 million people over the age of 16 were classified as not in the labor force.

Measuring Underemployment

Other measures of the unemployment rate attempt to measure the level of underemployment. To examine these more closely, we first need to define some terms:

- Workers who are marginally attached to the workforce are those who currently are neither working nor looking for work but indicate that they want and are available for a job and have looked for work sometime in the past 12 months.
- Discouraged workers, a subset of the marginally attached, have given a job-market-related reason for not currently looking for work.
- Persons employed part-time for economic reasons are those who want and are available for full-time work but have had to settle for a part-time schedule.

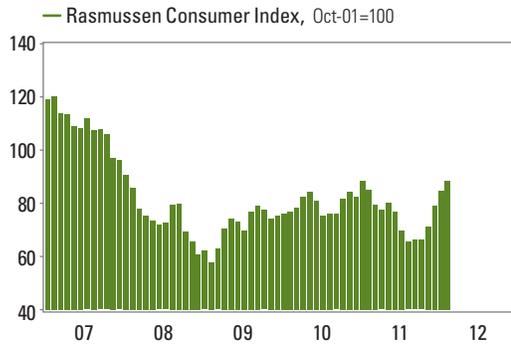
Stress Measures

We would be more skeptical of the drop in the unemployment rate if other measures of labor market stress (layoff announcements, initial claims for unemployment insurance, job openings, hours worked, etc.) had not moved in the same direction as the unemployment rate.

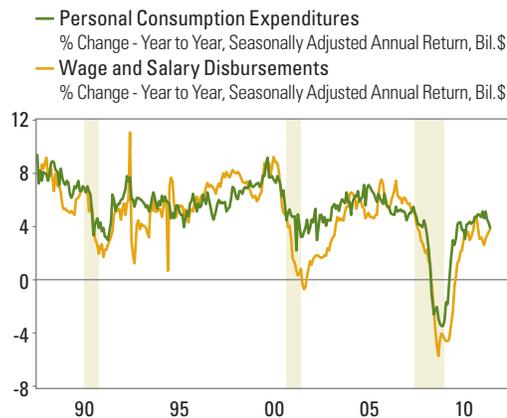
- Layoff announcements—collected by a private sector outplacement firm, Challenger, Grey and Christmas—in the 12 months ending in January 2012 totaled 621,000, very close to a 12-year low hit in early 2011. In mid-2009, the 12-month total of announced layoffs was over 1.6 million.
- Initial claims for unemployment insurance—tallied at the state level—averaged just 359,000 per week in the four weeks ending February 18, 2012, the lowest reading in four years. Claims peaked at nearly 650,000 per week in mid-2009. In mid-February, just under nine million people were receiving some type of unemployment benefit, down from close to 15 million in early 2010.



2 Consumer Sentiment (as Measured by the Rasmussen Polling firm) Hit a New Four-Year High in February



3 The Weak Performance of Personal Income from Wages and Salaries and Personal Spending Suggests While the Labor Market Is Healing, it May Have a Long Way to Go to Get Back to Normal



- The number of job openings, as measured by the Bureau of Labor Statistics Job Opening and Labor Turnover report, found that in December 2011, there were nearly three million open jobs, up from just under 1.9 million in mid-2009.
- Virtually every measure of consumer sentiment, all of which are collected by the private sector, is at or close to four-year highs. The improved sentiment is a function of a stronger equity market, less volatility in financial markets, improved labor markets, and until recently lower gasoline prices.
- The private sector Gallup polling firm regularly asks 18,000 Americans about their employment status, and the unemployment rate derived from that survey has moved down significantly since the beginning of 2010, tracking the official unemployment rate calculated by the U.S. Department of Labor.
- However, the Gallup data also suggest that “underemployment” remains quite high, consistent with the government’s measure of “underemployment.”

The high level of underemployment (15.1% reading on the broadest measure of the unemployment rate) can be seen in the tepid gains in personal income derived from wage and salary income, which takes into account unemployment, underemployment and part-time work. By this measure, personal income (derived by adding up all the paychecks earned by all workers throughout the economy) is up by less than 4.0% from a year ago. The weak pace of personal spending (up just 3.9% from a year ago in December 2011) is another sign that while the labor market is healing, consumers are still struggling, especially as we are nearly three years into the economic expansion. Normally, at this point in the business cycle, personal incomes from wages and salaries, as well as personal spending are growing between 5% and 7% per year. The sluggish labor market helps to support our below-consensus view that the U.S. economy will grow at a below-average 2.0% in 2012. ■

LPL Financial Research 2012 Forecasts

- GDP 2%*
- Federal Funds Rate 0%[^]
- Private Payrolls +200K/mo.[†]

Please see our *2012 Outlook* for more details on LPL Financial Research forecasts.



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* Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

^ Federal Funds Rate is the interest rate at which depository institutions actively trade balances held at the Federal Reserve, called federal funds, with each other, usually overnight, on an uncollateralized basis.

† Private Sector – the total nonfarm payroll accounts for approximately 80% of the workers who produce the entire gross domestic product of the United States. The nonfarm payroll statistic is reported monthly, on the first Friday of the month, and is used to assist government policy makers and economists determine the current state of the economy and predict future levels of economic activity. It doesn't include:

- general government employees
- private household employees
- employees of nonprofit organizations that provide assistance to individuals
- farm employees

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