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Economic Update

THOUGHTS FROM OUR ECONOMICS TEAM

AUGUST 3, 2012

Better, But Not Good Enough to Derail Fed Easing Train

Nonfarm payroll employment rose 163,000 in July (the best jobs number since February) and the unemployment rate rose 1/10th of a percentage point to 8.3%. While this is an improvement from last quarter's +75k monthly pace of job gains, it still keeps further easing from the Fed as a viable possibility. Why?

As we commented in our note on the Fed earlier this week ("Still in Wait-and-See Mode? More Accommodation 'As Needed'"), policymakers will "closely monitor" the July and August jobs reports (August's will be released September 7) for "a sustained improvement" in labor force data.

Last month we quantified the "sustained improvement" needed in terms of number of jobs required to achieve the Fed's implicit employment rate target by year-end 2013: +160,000 jobs per month (assuming a gentle rise in the labor force participation rate). After a few weak monthly reports, July's number is just barely enough to improve the underlying trend. Taking a three-month average (as we think you should), job growth is just +106,000 through July. Our conclusion: the Fed is at risk of falling short of its objectives.

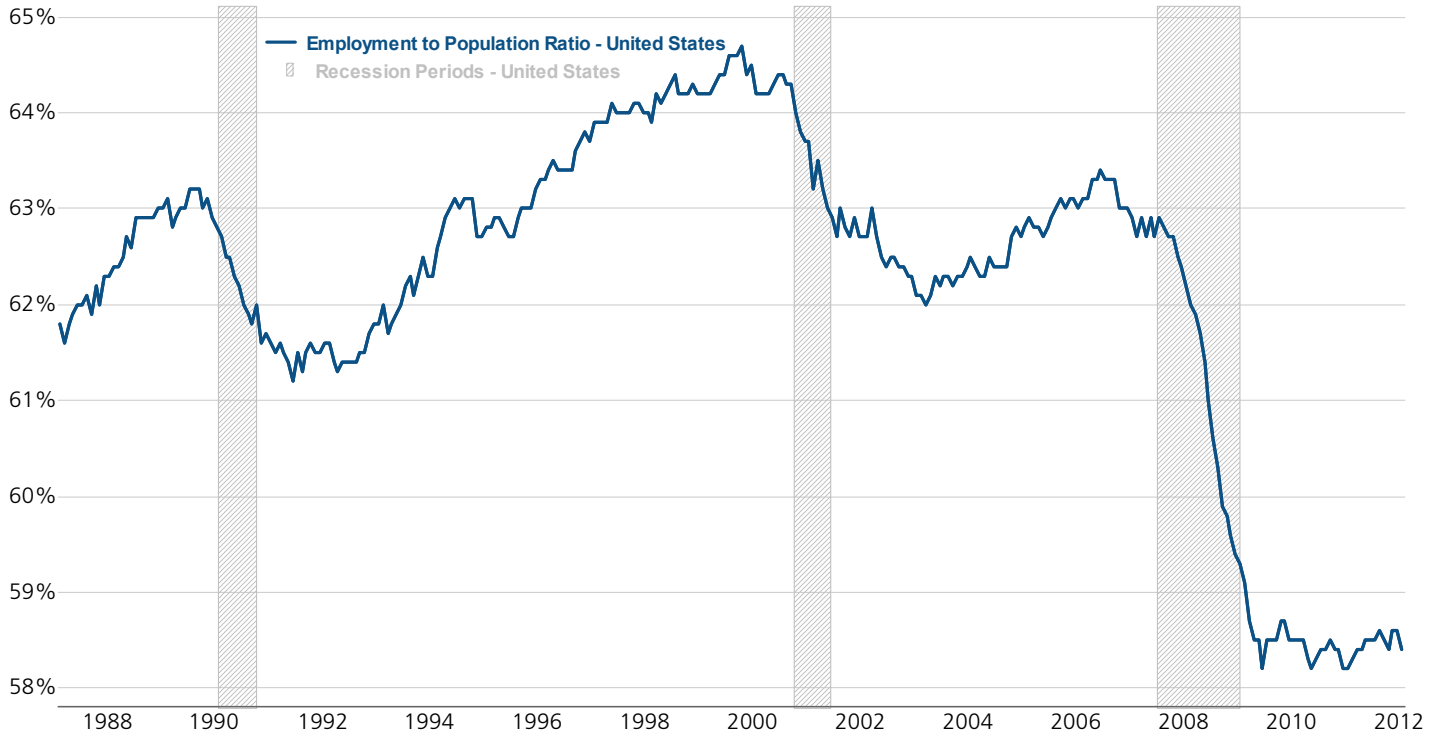
Further, our favorite labor market gauge--the employment-to-population ratio--registered at 58.4% in July, down 2/10ths of a percentage point on the month and essentially unchanged over the last 3 years (**See Chart below**). If the Fed is not worried about inflation (which it should not be given average hourly earnings rose just 1.28% in July 2012 versus a year ago—the lowest reading in the 50-year history of the series), talk of further easing steps will continue.

In terms of the unemployment rate, household employment fell on the month (-195k) and the labor force shrank slightly. On net, this pushes the unemployment rate up – also an unwelcome change for the Fed.

Finally, for those of you "recession-casting" out there, here is the good news: the pace of year-over-year job growth increased to a four month high, rising to 1.4% from 1.0% a year ago. Usually this rate dips under 1% prior to the onset of recessions.

Bottom line: while the report exceeded market expectations, it will not necessarily prevent the Fed from easing further in September.

EMPLOYMENT TO POPULATION RATIO: NOT MUCH PROGRESS IN THREE YEARS



Source: Labor Department

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