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Economic Update

THOUGHTS FROM OUR ECONOMICS TEAM

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Unconventional Policy Steps, Wholly Conventional Results

Nonfarm payroll employment rose +162,000 in July, below both market expectations (Bloomberg consensus: +182,000) and the three-month average pace of growth (+195,000) but consistent with expectations of continued moderate growth. The unemployment rate, though, fell to 7.4%, its lowest reading in four years.

To put the Employment Situation report in perspective, we refer you to a note we published yesterday that provides a "road map" for thinking about monetary policy. Investors should watch the evolution of the data versus Fed expectations.

On economic growth, as noted in the July FOMC statement, the Fed expects a "pick up" in economic activity and needs acceleration in real GDP in Q3 and Q4 to hit its forecast range for the year. Hours worked in the private nonfarm sector have grown 2.0% since last summer, a slowdown from a 2.5% rate of growth over the prior 12 months. It's early but it suggests the subpar economic activity exhibited in Q1 and Q2 persisted into July—the start of the third quarter.

Second, inflation pressures remain muted. Average hourly earnings ticked down to 1.9% year-over-year in July, showing minimal upward price pressures. In fact, average hourly earnings have been growing at a paltry sub-2.0% rate for 24 consecutive months, hardly the sign of nascent inflation. In the personal income report released this morning, the monthly core personal consumption expenditures (PCE) index rose 1.2% versus a year ago. This gauge seems to have stabilized around 1.2% but monetary policy settings are calibrated for this measure to return toward 2%, not to stabilize at historically low rates.

Third, the unemployment rate surprise. As we wrote yesterday, the Fed needed to see +212,000/month in nonfarm payrolls through year end but with an important caveat: unless the labor force participation rate fell. While the jobs number fell short of the payrolls threshold required to keep the unemployment rate forecast on track, labor force participation ticked down to 64.5%, enough to push the unemployment rate down two-tenths to 7.4%. If the labor force held constant, the result would be a 7.5% unemployment rate instead.

Where does this leave us?

Hints or clues of an imminent decision to "taper" were absent from Wednesday's FOMC statement—most notably a specific numeric threshold for ending asset purchases (e.g., 7% on the unemployment rate). Further, speaking this morning on "The Tapering Debate," St. Louis Fed President James Bullard (FOMC voter this year) surveyed the available information and concluded that "the Committee needs to see more data on macroeconomic performance for the second half of 2013 before making a judgment on this matter." Yes, the lower unemployment rate suggests improvement, Bullard acknowledged, but he noted that "other measures suggest otherwise."

Today's jobs report does not provide conclusive evidence one way or the other on the September "taper debate". However, here is what we can say: a broad array of indicators point to lackluster economic activity since QE's September 2012 launch. The labor force participation rate fell (63.4% versus 63.7% a year ago), real GDP growth slowed (1% on average last 3 quarters versus 2.6% during previous 3 quarters), core inflation fell (1.5% on average versus 1.9% in 2012), while the pace of payroll growth remained nearly unchanged (1.6% year-over-year on average versus 1.7% year-over-year). Unconventional policy steps, wholly conventional results.