Payden&Rygel

Economic Update

THOUGHTS FROM OUR ECONOMICS TEAM

DECEMBER 6, 2013

HOLD YOUR HORSES

The Bureau of Labor Statistics reported Friday morning that the US economy added +203,000 jobs in the month of November. The report was a strong one, beating consensus expectations of 180,000. Treasury yields initially rose, with the market convinced that November payroll data would tip the balance and bring about tapering at the FOMC's December meeting. However, as we think about the report, and the economic environment more generally, we advise thus: hold your horses.

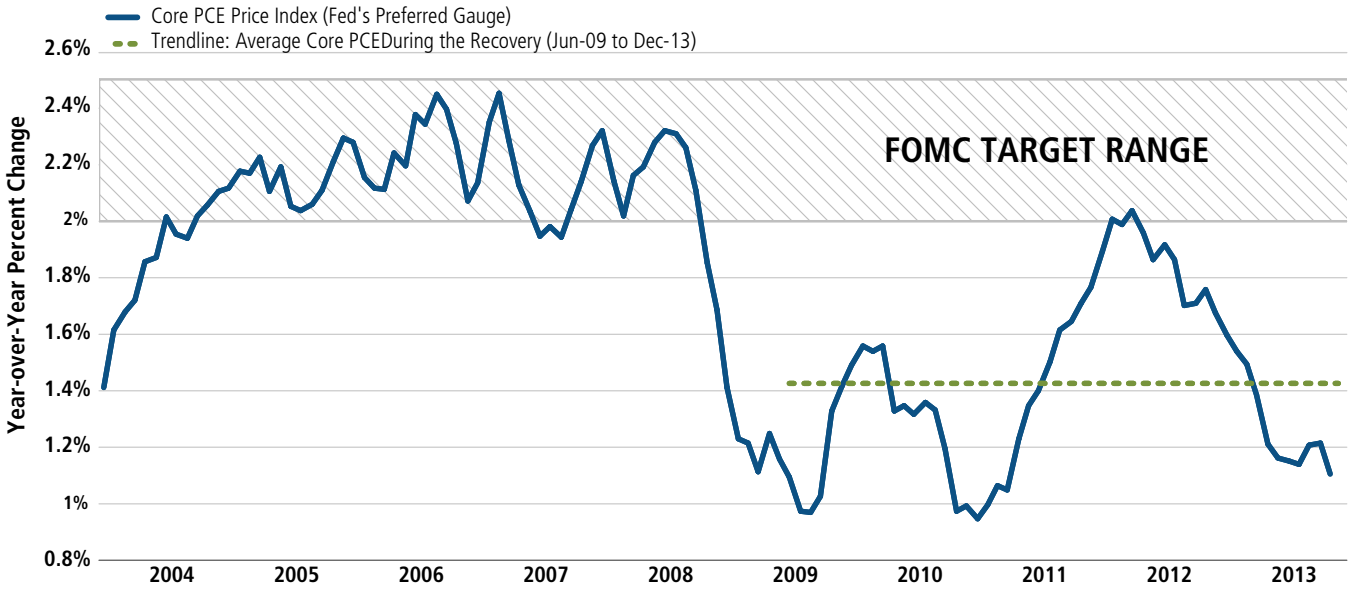
As the Fed reflects on the labor market, they may take heart in payroll growth exceeding 200,000 for two months in a row for the first time in a year. Additionally, the unemployment rate declined to its lowest level in five years. However, the job growth for the last 12 months has averaged 195,000 and over the last three years has averaged 190,000. So while the FOMC will be glad to see job growth lifting, today's report is nothing too out of the ordinary.

Lost in the fray of the employment situation, the Bureau of Economic Analysis also released data on Friday indicating that the core PCE price index (the Fed's preferred inflation gauge) increased by only 1.1% over the past year. The Fed has expressed concerns that "persistently low" inflation poses risks to the economy. In 2013, core PCE has averaged 1.3%, down from 1.8% in 2012. Since the recovery began in 2009, core PCE inflation has averaged only 1.4% year-over-year. We think that the continued low inflation only provides an additional reason for the Fed to be patient in their removal of asset purchases.

Finally, this week, the Bureau of Economic Analysis also released their second estimate of GDP growth in the third quarter. The result: 3.6% annualized growth during the quarter. While the headline number looks strong, an outsized contribution from inventory accumulation (+1.7%) accounted for most of the increase and will likely slow or reverse in the fourth quarter. Current data suggest Q4 GDP growth between 1.5-1.8% at an annualized rate, not the sustained pick-up desired by the Fed.

In total, payroll growth, inflation and economic growth all factor into the tapering question—and two of the three argue against it for now. Further, the 7% unemployment rate overstates the health of the labor market—and still remains a long ways away from the FOMC's "long run" employment rate estimates (closer to 5.3%). Since the FOMC's current forward guidance threshold is 6.5% on the unemployment rate, we would not be surprised to see the FOMC lower their unemployment threshold in 2014. The more important point, however, is that regardless of when the Fed slows asset purchases, we remain a great distance away from the first fed funds rate hike.

THE FED'S PREFERRED INFLATION GAUGE FLASHES LOWEST INFLATION READING SINCE BEFORE THE FED LAUNCHED QE2



Source: BEA