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Economic Update

THOUGHTS FROM OUR ECONOMICS TEAM

NOVEMBER 2, 2012

An Acceleration in US Job Growth? Jury Still Out

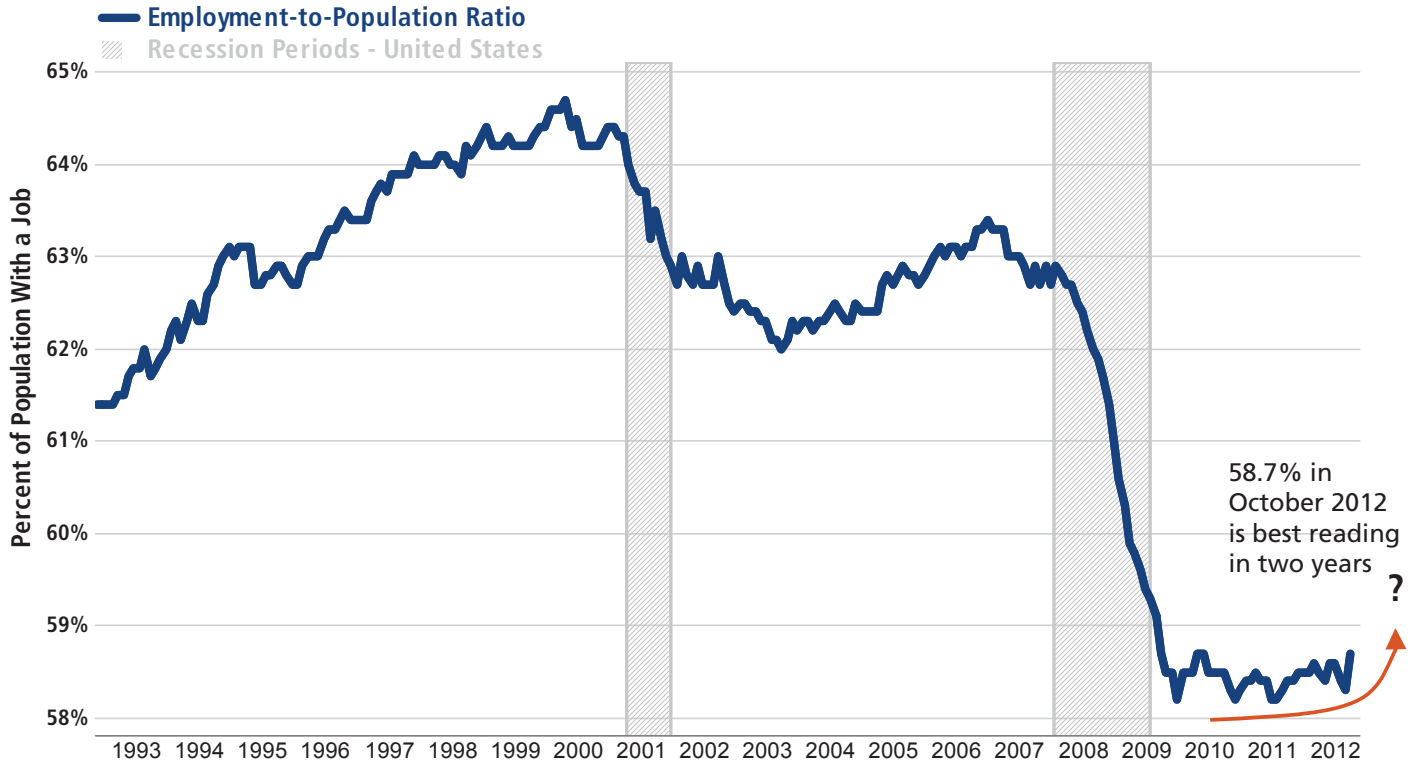
According to *Friday's Employment Situation* report, nonfarm payroll employment rose 171,000 (about 50,000 above the consensus estimate) and the unemployment rate rose to 7.9% from 7.8% after more job-seekers entered the labor force in October. We do not view this report as strong evidence of an acceleration in job growth, but the report discourages the more dire predictions of imminent recession and inflation.

On the **growth** front, +171,000 new nonfarm payroll jobs affirm ongoing expansion, not a recession. Total employment rose 1.5% compared to a year ago, well above the sub 1% rates of growth which usually presage recession. Further, our key gauge of labor market health and potential output, the employment-to-population ratio, provides some evidence of a possible recovery: **the gauge registered a reading of 58.7% in October, the highest level in two years.** Nevertheless, it has hovered in the 58.2% to 58.7% range for the better part of three years, down significantly from pre-recession levels (**See Chart below**—*is this a decisive breakout?*). Although this report encourages us to view things *en couleur de rose*, we remain mindful of the long road ahead.

In fact, the +171,000 print on payrolls is statistically indistinguishable from the 12-month trend rate of +162,000. Consequently, the "jobs jury" remains off-site deliberating whether or not this is the start of an acceleration in hiring (which we would warmly welcome). **If employment growth continues at around its current pace, the unemployment rate will arrive at 7.0% in mid-2014**—over that time translating into bond purchases ("QE") that would bring the Fed balance sheet close to $4 trillion.

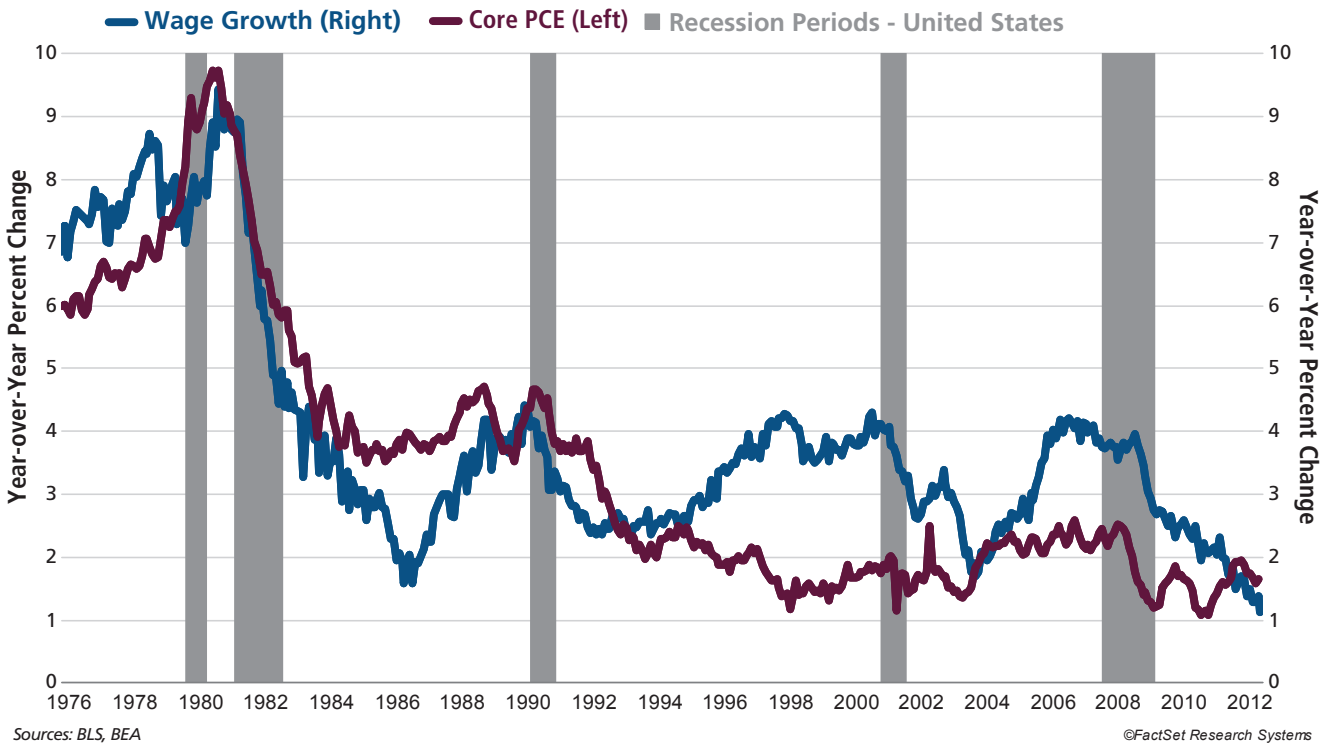
On the **inflation** front: one way to look at price pressures is through the lens of the price of labor as measured by average hourly earnings. Through October, average hourly earnings rose just 1.1% versus a year ago—the lowest rate of increase since the early 1960s (**See Chart on next page**). Compare this with the 2000s when core inflation grew at average rates in the 2-3% range, wage growth averaged 3-4%. Or, during the 1970s, when core consumer price inflation approached 10%, wage growth first accelerated from 5% to the 8% range. While inflation pressures may return, we found little evidence for this in the October jobs report.

OUR LABOR MARKET RECOVERY GAUGE: EMPLOYMENT-TO-POPULATION RATIO



Source: BLS

INFLATION: WAGE GROWTH AND CORE INFLATION, 1975-2012



What it means for the Fed and the markets: with modest employment growth, a mediocre 8% unemployment rate, moderate economic expansion and minimal hints of inflation, the Fed is likely to remain in easing mode (buying liquid, safe assets from the marketplace and forcing bond investors elsewhere). This macro environment should continue to support risk assets (the non-Treasury sectors), though considerable uncertainty surrounds this week's US Presidential election and the fiscal consequences.