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First Trust

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Monday Morning Outlook

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Yes Job Losses Hurt, But the Recovery Is Still on Track

A double thumbs down, was the response of markets and analysts to the June jobs report, which was released last Thursday. The Dow Jones Industrials fell 223 points (or 2.6%), and many economists who had been getting more hopeful became more bearish on the outlook for the economy.

The negativity was driven by three parts of the report in particular. First, the overall drop of 467,000 jobs in June was a larger loss than in May and 100,000 more than the consensus expected. Second, the average workweek in the private sector fell to 33.0, the lowest on record, while total hours of work declined 0.8%, the largest drop in three months. Third, average hourly earnings were unchanged in June and are up at only a 0.7% annual rate in the past three months, the slowest pace on record (dating back to 1964).

In other words, if you were already bearish on the economy, Thursday's report provided you with plenty of ammunition to support your case. And, if you were thinking that things were improving, it was weak enough to allow doubt to grow.

From our point of view, the report was disappointing, but not inconsistent with the history of previous recoveries. Please don't think we are immune to the awful economic hardship many are feeling today. The unemployment rate is the highest it has been in 26 years and fear is widespread.

But the employment report alone does not change our view that the economy will grow strongly in the second half of this year and into 2010. What the report does do is suggest that profits will be replenished faster and household balance sheets a bit slower.

A wide array of economic data supports the case that the US economy is in recovery. The overall ISM Manufacturing index hit 44.8 in June while the production index hit 52.5. The economy is almost always growing when these indexes are at those levels. Meanwhile, the four-week moving average for initial claims for unemployment insurance is down 43,500 (or 7.1%), in the past 2½ months, again something that almost never happens unless the economy is expanding.

In addition, personal consumption, new orders for durable goods, home sales, and single-family housing starts are all off the lows of earlier this year.

Of course, we rarely see the economy go from reverse, to full-speed ahead, in one gear shift. There is almost always an intermediate period of at least a few months when the economy passes through slow declines to neutral and then to slow growth, before its acceleration finally gets it to a speed fast enough to create net payroll increases. This time is no different.

Our forecast right now is that real GDP shrank at a 2.5% annual rate in the second quarter, with all of the decline attributable to inventory reductions. Otherwise, rising net exports and government spending should roughly offset weakness in business investment and home building.

But profits should accelerate sharply in Q2 because hours worked fell at a 7.9% annual rate. This means productivity growth (output per hour) must have soared. In fact, this helps explain why jobs growth has not turned yet – a technology boom is still boosting how much production companies can get from each hour worked.

A similar thing happened in the last quarter of 2001. Real GDP grew at a 1.6% annual rate even though hours worked fell at a 4.5% rate. Corporate profits increased at a 51.7% pace.

While we understand the negativity, and certainly wish the jobs market was healthier, the recovery is still on track. The sky is not falling. The jobs data are still a lagging indicator. Thursday's jobs report had more to do with who will benefit the most early on, not how strong the recovery will be.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-6 / 9:00 am	ISM Non-Man. - Jun	46.0	**47.0**	47.0	44.0
7-8 / 2:00 pm	Consumer Credit - May	-$8.3 Bil	**-$7.0 Bil**		-$15.7 Bil
7-9 / 7:30 am	Initial Claims - Jul 4	607K	**608K**		614K
7-10 / 7:30 am	Int'l Trade Balance - May	-$30.0 Bil	**-$26.9 Bil**		-$29.2 Bil
7:30 am	Export Prices - Jun	+0.2%	**+0.8%**		+0.6%
7:30 am	Import Prices - Jun	+2.0%	**+4.2%**		+1.3%
9:00 am	U. Mich. Consumer Sentiment	70.3	**71.5**		70.8