Weekly Economic Commentary

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The Employment Situation: Slow Climb Back

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Highlights

The January 2014 employment report will garner plenty of attention from market participants, the media, and the public as the labor market continues its slow climb back to the pre-recession peak.

The Federal Reserve will be watching for key metrics: the participation rate, long-term unemployment, wages, and hiring.

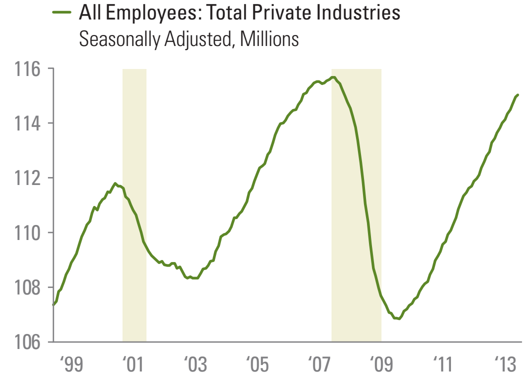
We expect the economy to create between 175,000 and 200,000 net new jobs per month in 2014, with some variation around the trend.

This Friday, February 7, 2014, the U.S. Department of Labor will release its monthly Employment Situation report. Though a lagging indicator of the economy, the report will likely garner plenty of attention from market participants, policymakers, politicians, pundits, the news media, and the public.

In December 2007 and January 2008, U.S. private sector jobs peaked at 115.7 million. The Great Recession and its aftermath saw the private sector economy shed 8.9 million jobs, and by February 2010, the private sector economy was down to 106.8 million jobs. Since then, the private sector economy has created 8.2 million jobs, and as 2013 ended, needed just under 700,000 net new jobs to get back to the pre-recession peak. We expect that to occur sometime in the first six months of 2014 [Figure 1].

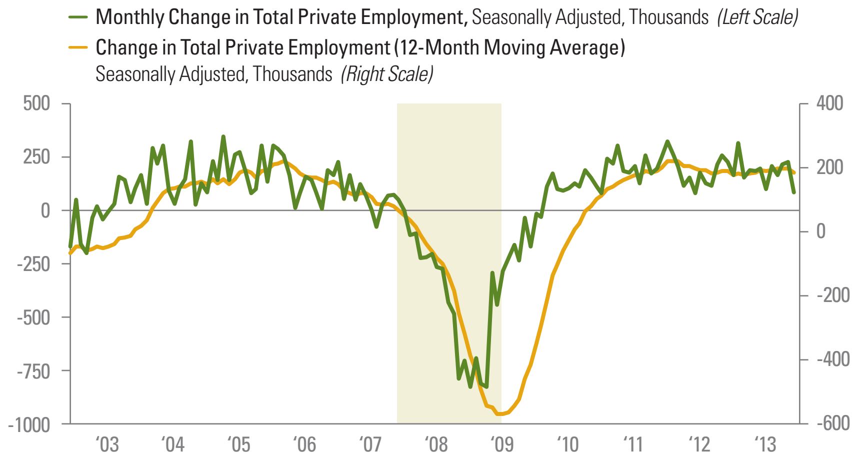
Prior to the disappointing December 2013 employment report (released in early January 2014), which revealed that the private sector economy had created only 87,000 net new jobs in the weather-impacted month of December 2013, the economy had consistently been creating between 175,000 and 200,000 net new jobs per month [Figure 2]. We expect this pace of job creation to continue in 2014, with some variation around the trend due to fundamentals and weather. (See below for a discussion of weather's impact on the January 2014 report.)

1 The Labor Market Is on Pace to Regain its Pre-Great Recession Highs in the First Half of 2014



Source: LPL Financial Research, Bureau of Labor Statistics, Haver Analytics 02/03/14

2 The Private Sector Has Been Consistently Creating Between 175,000 and 200,000 Jobs per Month



Source: LPL Financial Research, Bureau of Labor Statistics, Haver Analytics 02/03/14

Employment is a lagging, not leading, indicator of economic activity.

Although the monthly labor market report gets a lot of attention from market participants, policymakers, politicians, the media, and the public, it is important to note that employment is a lagging, not leading, indicator of economic activity. So while the health of the labor market is a very personal issue—most of us know someone who is still looking for a job, is underemployed or working several jobs just to make ends meet—it is not a very good predictor of future economic growth. However, several components of the monthly employment report are forward looking (employment at temporary help agencies and overtime hours worked are two examples), and those will, as always, be closely watched in this week's report.

Weather and Revisions: Sources of Uncertainty

The consensus of economists as surveyed by Bloomberg News is looking for a 190,000 gain in private sector payrolls in January 2014, after the 87,000 gain in December 2013. The range of estimates—the difference between the high and low estimate—is unusually wide for the January report. In recent years, the range of estimates has been around 120,000; for January's report it is 200,000. The unusually wide range reflects the uncertainty around the impact of the weather on both the December 2013 and January 2014 reports, and also the revisions to the employment data made each year at this time.

While not all of the weakness in the December 2013 employment report was due to an unusually cold and snowy December, a sizable portion was. In January 2014, the population-adjusted average temperature was two degrees above normal. In December 2013, the same metric was two degrees colder than usual. The anomaly was even worse during the survey week (the week containing the 12th of the month) for the December 2013 employment report. It was six degrees colder than usual during the survey week in December 2013, and two degrees warmer than usual during the survey week in January 2014. In addition, the Department of Labor said that 273,000 people were "unable to work because of bad weather" in December 2013, the most for any December since 1977. This metric will be very closely watched again in January.

Another source of uncertainty surrounding the January 2014 employment report is revisions. In February of each year, the Labor Department releases revised data on the number of employees on payrolls. The revisions are based on new information gathered from businesses records and tax returns. Because of these revisions, the monthly changes in the payroll job count over the past year will be adjusted, but the pattern of employment is unlikely to change very much.

As noted in our Outlook 2014: The Investor's Almanac, our view for this year is that U.S. economic growth will accelerate to 3.0% from the 2.0% pace seen in 2013. We expect both the federal government's lifting of fiscal drags and increased state and local government spending to boost economic growth this year. In all of 2013, state and local government spending subtracted a small amount (0.02 percentage points) from gross domestic product (GDP) growth, but all of that drag occurred in the first quarter of 2013. By contrast, state and local governments added 54,000 jobs in 2013, marking the first year since 2008 that the sector added jobs. This sector added jobs in eight of the final 11 months of 2013, and we expect that trend to persist well into 2014 and beyond.

Fedlines and Labor Market Health Points

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Of course, financial markets pay so much attention to this report because policymakers at the Federal Reserve (Fed) have tied the pace of quantitative easing (QE), and indeed the Fed's guidance on rates, to the health of the labor market. "Maximum employment" in the context of price stability is the Fed's goal, and the new Fed chairwoman, Janet Yellen, has cited several labor market metrics in public appearances over the past several years. Next week, Tuesday, February 11, 2014, Yellen will deliver the Fed's semiannual Monetary Policy testimony (also known as the Humphrey-Hawkins testimony) to Congress, providing the market with her views on policy, the economy, and the labor market for the first time as Fed chairwoman.

In its most recent (January 29, 2014) statement, the Federal Open Market Committee (FOMC), the Fed's policymaking arm, reaffirmed that:

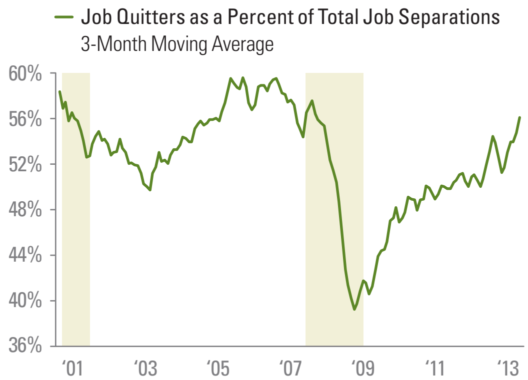
> The current exceptionally low target range for the federal funds rate of 0 to 1/4 percent will be appropriate at least as long as the unemployment rate remains above 6-1/2 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored.

In addition, in his final press conference as chairman in December 2013, Ben Bernanke discussed the unemployment rate, saying:

> And so we were comfortable setting a 6.5 percent unemployment rate as the point at which we would begin to look at a more broad set of labor market indicators. However, precisely because we don't want to look just at the unemployment rate, we want to — once we get to 6½ — we want to look at hiring, quits, vacancies, participation, long-term unemployment, et cetera, wages. We couldn't put it in terms of another unemployment rate level, specifically. So, I expect there will be some time past the 6½ percent before all of the other variables that we'll be looking at will line up in a way that will give us confidence that the labor market is strong enough to withstand the beginning of increases in rates.

The metrics Bernanke noted, including hiring, quits, vacancies, and participation, have been cited by Yellen in the past as indicators she was watching to gauge the health of the labor market. This week's employment report for January 2014 will provide updates of several of these metrics (the participation rate, long-term unemployment, wages, hiring), and market

3 The "Quit Rate" Points to an Improving Labor Market



Source: LPL Financial Research, Haver Analytics 02/03/14

participants will closely watch these as they gauge the pace of tapering and the Fed's guidance on rates.

On the other hand, the data on "quits" and "vacancies" are found in the monthly Job Openings and Labor Turnover Survey (JOLTS). The JOLTS report (for December 2013) is due out on the same day (and at the same time) that Janet Yellen delivers her first Humphrey-Hawkins testimony to Congress, next Tuesday, February 11, 2014. Figure 3 shows that the "quit rate"—the percentage of job leavers who leave their jobs voluntarily (presumably because they have better prospects elsewhere)—climbed to near-record highs in late 2013. However, some of the other labor market metrics noted recently by Bernanke and Yellen are still at depressed levels.

On balance, the January 2014 employment report will garner plenty of attention from market participants, the media, and the public as the labor market continues its slow climb back to its pre-recession peak.

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