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# Pretty Ugly

Written by Jeff Thredgold, CSP, President, Thredgold Economic Associates

U.S. employment data for the month of August can only be described as dismal. Such weaker employment data may be on tap for awhile before the economy regains its sea legs, presumably as 2008 unfolds.

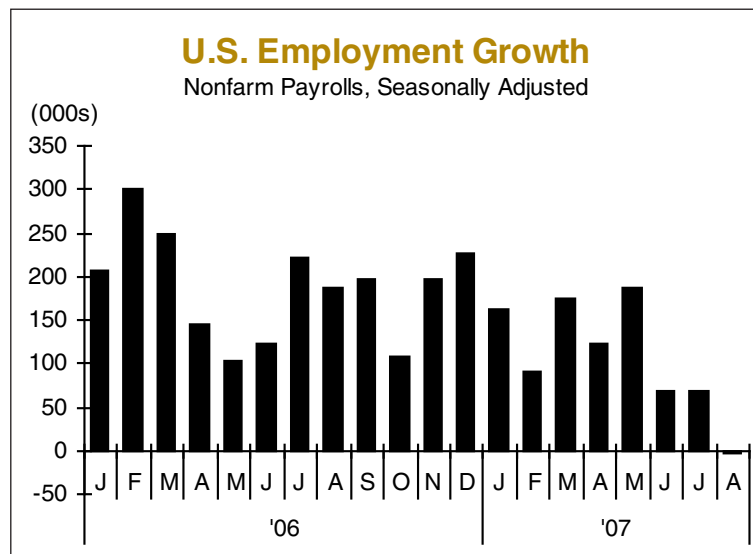
reasons. The estimated labor force declined by 340,000 people to 152.9 million, with many people presumably discouraged from seeking jobs. Weakness in employment creation...should it continue...could find the nation's jobless rate approaching 5.0% in coming months, a level last recorded in November 2005.

Why the significant weakness in U.S. job creation in recent months? The easy answer seems to be that the turmoil in the nation's subprime mortgage industry, combined with widely reported softness in coastal and Southwestern home prices, has further poisoned consumer

and corporate attitudes. In addition, the heightened level of global credit market anxiety has added to more conservative American hiring patterns.

## A Recession?

Is recession now likely? It certainly depends on who you listen to. A handful of Wall Street and regional economists are actively voicing their views that recession is already, or will soon be, underway. These same forecasters have been calling



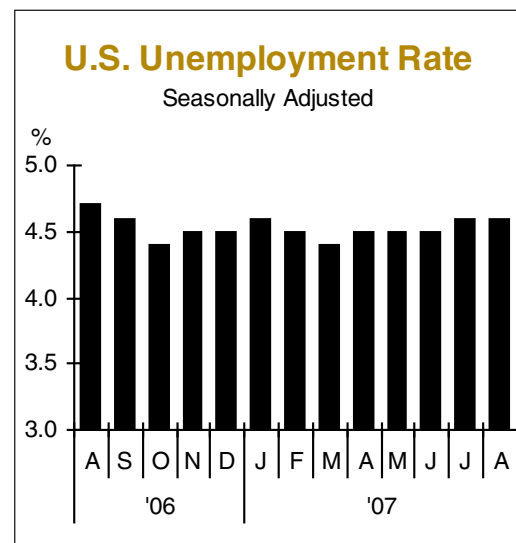
The American economy recorded a net loss of an estimated 4,000 jobs in August, the first monthly decline in four years, and sharply below the 100,000 consensus gain expected by economists. To add insult to injury, previously reported employment gains for the two prior months were revised lower by 81,000 jobs.

This latest data now suggests that the U.S. economy added a less-than-impressive average of 44,000 net new jobs monthly during the June-August period, down sharply from the 147,000 average monthly gain in 2007's first five months, as well as the 189,000 average monthly gain in 2006.

## 4.6%...and Rising?

Better news saw the nation's unemployment rate remain at 4.6%, not far from the five-year low of 4.4% of March 2007. The nation's jobless rate has averaged 4.6% during the past 20 months, and has not deviated from a 4.4%-4.8% range during that time.

Unfortunately, the jobless rate remained unchanged for the wrong



for imminent recession almost without hesitation during the past five years, always loud and always wrong. Even a broken clock is right twice a day.

There is no question that the combination of mortgage market distress and home price weakness in many communities has hurt the economy. The Federal Reserve has modified its prior view that the subprime mortgage issue would largely play out with only limited impact on the broad economy. Like many other forecasters, we have lowered our economic growth expectations as well for 2007's second half.

We continue to expect the U.S. economy to avoid recession, with odds of recession now approaching 40%. Aside from employment and housing, auto sales have improved in recent weeks. Retail sales have also come in stronger than expected. A recent survey of manufacturing also noted continuing growth. In addition, global economic growth remains impressive.

You can expect to hear more about a "growth recession" in coming months, the notion that while the economy could technically avoid a recession, it might feel like one. The second quarter's strong 4.0% real (after inflation) annual economic growth pace could slow to between 1.0% and 2.0% over the balance of the year. We still expect more solid performance in 2008.

## Details...Details

Weakness was widespread in the August data. The nation's goods production sector got hammered with a net loss of 64,000 jobs. The nation's manufacturing sector took it on the chin in August, with a loss of another 46,000 jobs, even as American export growth remained healthy. The manufacturing sector has now lost 215,000 jobs during the past 12 months.

It was no surprise that the nation's construction sector continued to lose jobs, with another 22,000 jobs down the drain. Strength in commercial real estate construction activity (office buildings, retail and industrial space) has not been enough to offset continuing losses in single-family home construction. Total employment within the broad construction

sector is down roughly 100,000 jobs since peaking in September of last year.

Employment gains in the larger services sector were positive, though hardly worth writing home about. The net gain of 60,000 jobs was the smallest increase in nearly two years. Education & health services added 63,000 net new jobs, while the leisure & hospitality sector added 12,000 new jobs. The professional & business services sector added a paltry 6,000 jobs.

One questionable set of numbers involved a decline in government employment. The August survey noted that overall government employment declined by 28,000 jobs in August, following the loss of 52,000 jobs in July. Such unlikely declines raise the specter that seasonal adjustments to government hiring, particularly as it involves school teachers, have some bugs in it.

Better news saw the average hourly wage rise a nickel (up 0.3%) to \$17.50 hourly. The 3.9% increase during the past 12 months easily outpaces the 2.4% rise in consumer prices in the 12-month period ending in July.

## Fed Response?

The dismal August employment report simply raises the odds that the Federal Reserve will respond next week (on September 18) with a cut in its most important interest rate—the federal funds rate. This most critical rate has been parked at 5.25% for nearly 15 months. Any reduction in the rate would mark the first decline in four years.

Wall Street is split between expectations of either a 0.25% or 0.50% rate cut next Tuesday. Some suggest the Fed will do nothing. We do expect a rate cut, with another cut on Halloween. Many forecasters now expect the federal funds rate to be at or close to 4.50% by the end of the year.

In my mind, the Fed's greater risk is to do nothing on September 18 and risk a sharp plunge in stock prices, a move which in subsequent days could lead to you-know-what...a rate cut. The Fed wants to avoid THAT scenario.

## "TEA"ser

I don't think they should perform random drug tests on *all* airline employees—just test the ones who keep changing the fares.

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