Payden&Rygel

Payden & Rygel EconomicResearch

January 4, 2007

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Highlights

- The unemployment rate has already risen 0.6% from its cyclical low of 4.4% last March. A rise of this magnitude has typically occurred either in or immediately before a recession.
- Some of the highest paying industries posted the largest job losses in 2007, while the lowest paying industries experienced the largest job gains.
- The risks to consumer spending are certainly increasing at this point. The combination of rising energy prices, declining home values, and a deteriorating labor market are a recipe for retrenchment.
- The question now becomes whether the Federal Reserve should move 25 basis points or 50 basis points in January? We see the fed funds rate down at 3.5% by mid-2008.

New Year's Resolution: Find A New Job

The unemployment rate rose to 5.0% and nonfarm payroll employment increased by just 18,000 in December as large job losses in construction and manufacturing took their toll on the US labor market. Not only did the unemployment rate increase to its highest level in more than two years, the three-tenths monthly rise was the largest since the 2001 recession. Although some analysts may attempt to attribute the poor December numbers to the writers' strike in Los Angeles, according to the Labor Department, the strike only had a minimal impact on today's data. Motion picture employment was down nearly 12,000 during the month.

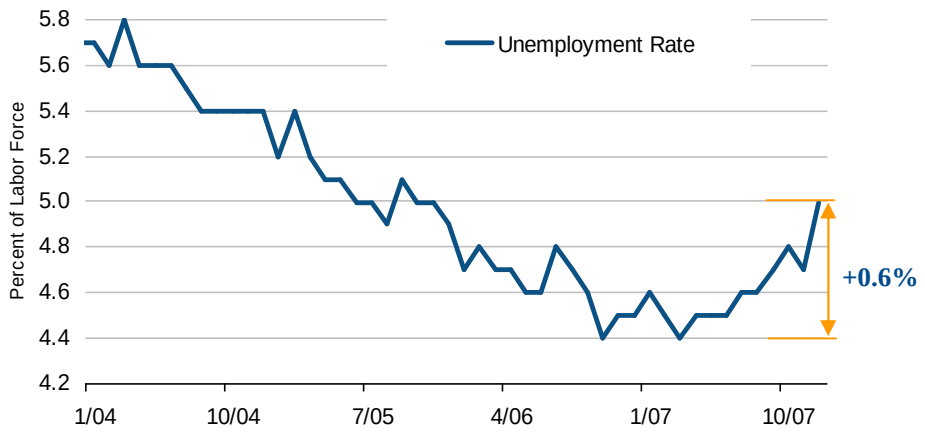
Overall, employment growth slowed dramatically over the course of 2007 with the six-month moving average for nonfarm payrolls dropping from 180,000 at the beginning of the year to less than 90,000 by year end. The US economy probably needs to generate somewhere between 100,000 and 150,000 jobs per month in order to absorb new entrants into the labor force and prevent the unemployment rate from rising further. The unemployment rate has already risen 0.6% from its cyclical low of 4.4% last March. A rise of this magnitude has typically occurred either in or immediately before a recession.

The US economy has been undergoing a shift over the past year from economic growth driven by the consumer and housing sectors to export-driven growth. Unfortunately, this process can lead to dislocations in the labor market as resources need to be reallocated from one industry to another. A similar pattern occurred in the early 1990s following the last housing bust.

The risks to consumer spending are certainly increasing at this point. The combination of rising energy prices, declining home values, and a deteriorating labor market are a recipe for retrenchment. Even worse, most of the job losses over the past year have occurred in the highest paying industries. On average, the goods-producing sector of the economy, which includes construction and manufacturing, pays its workers $770/week. This contrasts with average weekly pay in the private services-providing sector, which is closer to $573/week.

This weak employment report together with December's sub-50 ISM-manufacturing print, steep declines in new home sales, and disappointing new orders for capital goods makes it very likely that the Federal Reserve will be cutting its overnight lending rate when it meets at the end of January. The question now becomes whether the central bank should move 25 basis points or 50 basis points? At the moment, the fed funds futures are pricing in a 33% probability that the Fed does more than 25 basis points compared to a less than 15% probability of such a move a week ago. Either way, we still think the Fed has quite a bit of work to do before it is done. Consequently, we see the fed funds rate down at 3.5% by mid-2008.

Spike in Unemployment Rate Increases Recession Risk



Source: Bureau of Labor Statistics