Payden&Rygel

Payden & Rygel Economic**Research**

August 7, 2009

Jobs Numbers Confirm Recession Is Easing

Contact:
Thomas D. Higgins, PhD
Chief Economist
ph: 213 830-4302
email: thiggins@payden-rygel.com

Highlights

- The US economy shed 247,000 jobs in July 2009, which is less than half the average of 556,000 jobs that were lost each month during the first half of the year.
- The improvement in the labor market is the latest signal that the US recession is easing. Looking ahead, we expect positive economic growth in the third quarter to translate into a gradual increase in hiring by year end.
- Although we believe hikes in short-term interest rates remain unlikely until the middle of 2010, the Fed may discuss the timing of exiting its credit easing program when it meets next week.

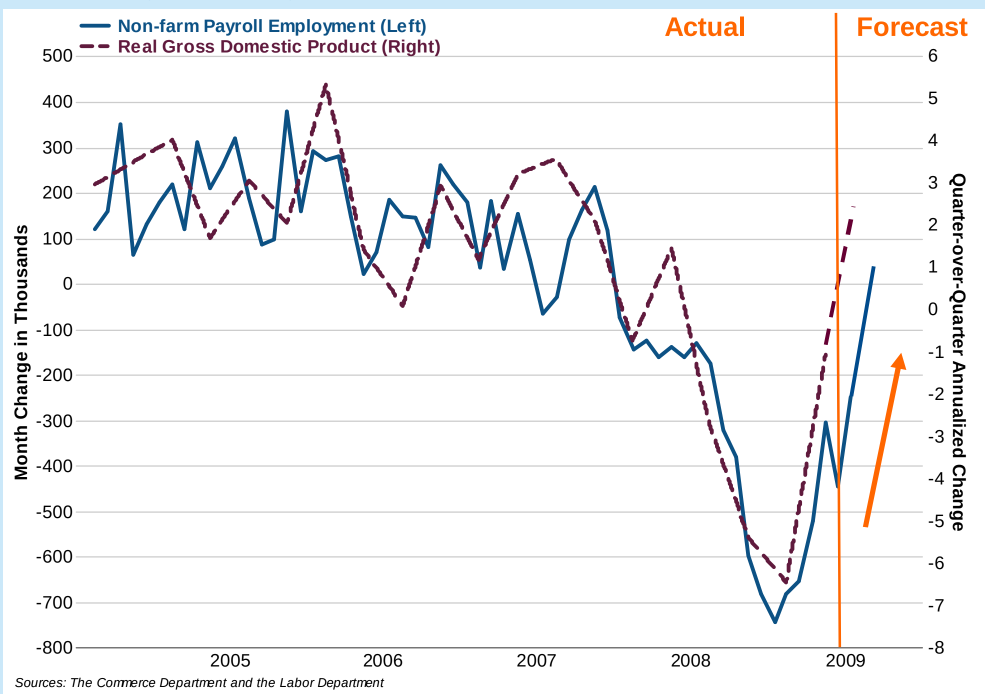
The US economy shed 247,000 jobs in July 2009, which is less than half the average of 556,000 jobs that were lost each month during the first half of the year. At the same time, the unemployment rate edged down slightly from 9.5% to 9.4% marking the first decline since April 2008. The improvement in the labor market is the latest signal that the US recession is easing. Looking ahead, we expect positive economic growth in the third quarter to translate into a gradual increase in hiring by year end. However, the unemployment rate may drift up as new entrants to the labor force overwhelm the number of jobs available.

Positives Outweigh Negatives

Digging below the surface of the employment report, we find at least two reasons for optimism. First, the improvement in the labor market in July was broad-based with job losses abating in both the service and manufacturing sectors of the economy. In addition, though the number of industries hiring remains low, it has increased from one-in-five in March to one-in-three in July according to the one month diffusion index. Second, the work week increased for the first time in about a year. A rise in weekly hours typically precedes a return to job growth since companies will often have existing workers work longer before bringing on new hires.

Despite these positive developments, it is far too early to sound the all clear on the labor market or the US economy. A total of 6.6 million jobs have vanished since the recession began in December 2007, and a portion of those will never return due to structural changes in the economy in the manufacturing sector. Moreover, the slight decline in the unemployment rate in July was primarily due to the large number of Americans who dropped out of the labor force during the month, rather than an increase in the number of those finding jobs. Indeed, the labor force shrank by 422,000 during the month. If we added those workers back in, the unemployment rate would have risen to 9.6% during the month.

New Hiring Could Begin By Year End



Sources: The Commerce Department and the Labor Department

Contact:
Thomas D. Higgins, PhD
Chief Economist
ph: 213 830-4302
email: thiggins@payden-rygel.com

Even so, given our expectation that real gross domestic product will increase at an annual rate of around 3% in the third quarter, we expect the economy to begin generating an average of 100,000 jobs per month by year end. Unfortunately, this is still below the 150,000 jobs that are necessary to absorb new entrants to the labor force. Therefore, the unemployment rate will continue to rise through the first half of 2010 before peaking somewhere around 10%.

Fed to Discuss Exit Strategy

The stronger tone of the jobs report and other recent economic data are likely to dominate the discussion among Federal Reserve policy makers when they meet next week. Although we believe hikes in short-term interest rates remain unlikely until the middle of 2010, the central bank may discuss the timing of exiting its credit easing program. The program, which was designed to help lower private sector borrowing costs, has met with a reasonable degree of success. However, some aspects of the credit easing have proven less useful than others and thus may be unwound sooner.

For example, the Fed's decision to purchase $300 billion in Treasury bonds in order to hold down long-term interest rates may be the first part of the credit easing that goes to the chopping block. There never really seemed to be broad support for the purchases at the Fed and the program never became large enough to have a meaningful impact on long-term interest rates. Indeed, the $300 billion allocated toward Treasury purchases represents less than 5% of the $6.5 trillion in marketable Treasury securities available to investors. Consequently, the Fed may indicate its willingness to allow the program to expire in September when it completes its remaining purchases.

Treasury investors may already be anticipating this move. The yield on the 10-year Treasury has risen from about 3.5% at the end of the second quarter to 3.85% today.