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## Highlights

- The US economy shed 263,000 jobs in September, which was worse than the consensus forecast by nearly 100,000.
- Although today's labor market figures are disappointing, they do not change our belief that a US recovery began in the third quarter.
- Looking ahead, we are forecasting US GDP growth of between 2% and 3% in the second half of 2009 which is consistent with positive job growth.

## Employment Is a Disappointment, Not a Disaster

The US economy shed 263,000 jobs in September, which was worse than the consensus forecast by nearly 100,000. At the same time, the unemployment rose to a 26-year high of 9.8% during the month. Although today's labor market figures are disappointing, they do not change our belief that a US recovery began in the third quarter and that real GDP growth is likely to have increased at a 3% annual rate during that period. Moreover, we still expect the US economy to begin generating jobs by the first quarter of next year.

### Surprise Came In Government and Retail Sectors

For the most part, the composition of the September job losses was consistent with that of recent months. The construction sector reduced payrolls by 64,000 and the manufacturing sector by 51,000. The reason why the consensus was so far off the mark had more to do with government and retail employment. Government payrolls shrank by 53,000 in September primarily due to budget cuts at the state and local level. Government payrolls had been contributing positively to overall employment earlier this year, but that has reversed as states struggle with falling tax revenues and increased transfer payments to the unemployed. Retail employment declined by 39,000 in September compared to 8,000 in August. The Cash for Clunkers program may have temporarily suppressed layoffs at auto dealers this summer.

### Positive Job Growth by Early Next Year?

Looking ahead, we are expecting the Commerce Department to report real GDP rose at an annual rate of around 3% in the third quarter. The rate of growth will likely moderate to a 2% annual rate in the fourth quarter as the impact of the Cash for Clunkers program fades. Historically, that level of economic growth is consistent with the creation of about 100,000 jobs per month. Unfortunately, this is still below the 150,000 to 200,000 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 north of 10%. Furthermore, even after the unemployment rate peaks and begins to come back down in the second half of 2010, the natural rate of unemployment is likely to be much higher than it was in the recent past due to structural changes in the labor market and lower economic growth rates caused by household deleveraging.

### Economic Growth Should Eventually Translate Into Jobs

