THE ECONOMIC OUTLOOK GROUP

475 WALL STREET
PRINCETON, NEW JERSEY 08540 TEL: 609 - 529 - 1300
WWW.ECONOMICOUTLOOKGROUP.COM

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist & Managing Director

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With the Job Market Getting Worse, All Eyes Turn to Washington for Relief

- **A Recessionary Employment Report**
- **Will the Bailout Plan Turn Things Around?**
- **But Who Will Bail out the US?**

As bad as the September job numbers are, it is likely to get much worse in the months ahead. The reason? The US is reeling from two intractable problems: An utter lack of confidence in the economy by consumers and business leaders, and second, the ever-deepening credit crises. As for the first problem, evidence continues to mount that we are in recession. Today's employment report shows September payrolls fell by 159,000, more than twice the number of losses in the previous month and the largest single drop since 2003. Total job losses so far this year have jumped to 760,000. Clearly, labor market conditions are now deteriorating. Payroll losses averaged 82,300 a month in the first quarter, then declined to a pace of 71,300 a month in the second, and finally shot up to 99,600 during the third quarter.

As you know, these headline payroll stats include hiring by governmental agencies, which have been adding workers all year. If we just look at employment trends in the business sector, the job losses were far more dramatic. September payrolls in the business

community fell by 168,000, its tenth straight monthly decline, for a total of 983,000 jobs gone since last December.

But it is the trend that stands out for us. In the first quarter, business payrolls shrank an average of 97,000 a month, which then rose to 100,000 in the second, and finally jumped to 126,000 in the third quarter. Virtually every sector of the economy took a hit last month: The residential construction sector lost 10,700 jobs, while commercial construction saw a reduction in 7,400 in jobs. The automakers had 18,200 payroll jobs disappear. Motor vehicle and parts dealerships were down 18,800 jobs. Department stores got rid of 10,800 positions. Airlines lost 4,600. Trucking industry got rid of 12,300 jobs. The financial sector handed out a net 17,000 pink slips last month.

Given all this dismal news, it may be somewhat surprising the unemployment rate was unchanged at 6.1%. But, remember, the unemployed are only counted as part of the labor force so long as they are actively looking for work --- meaning they have to make an effort to seek a job in the last four weeks. The September household survey tells us that many unemployed workers have simply stopped looking!! Some 375,000 have left the labor force, many because they were too discouraged to even bother seeking employment. So the 6.1% jobless rate really doesn't tell the full story. If you add into the mix all those unemployed who were too frustrated to look for work, plus those who grudgingly took part time jobs because they couldn't find suitable full time employment, then the jobless rate shot up to 11% in September, the highest in 14 years.

Here are a few other sobering stats from the employment report that point to recession.

• Companies are cutting back production. Average weekly hours worked in the private sector fell to 33.6 last month, down from 33.7 in August.

• Overtime was down to 3.6 hours a week in September, from 3.7 in August and 3.8 hours in July.

• Americans grabbing part time work because of the absence of full-time employment jumped to 6.055 million, the most since the government kept records.

• The unemployed are now out of work for a much longer period of time. The median duration of joblessness has climbed to 10.2 weeks last month, longest in more than four years.

• The outlook for consumer spending also took another blow. Average weekly pay has increased just 2.8% the last 12 months, far short of the 5.4% rise in consumer prices. With purchasing power eroding, Americans are forced to buy less. (Of course, the difference can be made up by borrowing, but good luck finding a lender these days.) As consumers retrench, the economic downturn worsens.

Corroborating the dismal state of the job market were three other very timely reports. The Institute for Supply Management noted today that its service employment index weakened to 44.2 from 45.2 in August. This trend is consistent with the ISM manufacturing report two days earlier, which showed their factory employment index slumping to 41.8 from 49.7 in August. Finally, there was yesterday's filing of new applications for unemployment benefits. It climbed to 497,000 in the week ending September 27th, a level not seen since the 2001 recession.

What's behind all these awful employment numbers? Certainly the collapse in housing, the slowdown in business investments and exports all played a role. But the deterioration in the labor market this past quarter was primarily because credit has almost completely frozen up and brought economic activity to a standstill. An increasing number of small, medium, and even large firms have been unable to get short term financing to cover payrolls and inventories, leaving employers little choice but to cut back on production and lay off workers. In those rare instances where credit is available, the cost of capital is just too high.

Will the Bailout Plan Turn Things Around?

Today's passage of the bailout plan by the House which the President will very shortly sign will raise expectations that the credit freeze should begin to thaw in the months ahead. But the fact is no one really has a clue whether this bill will be enough to help fix the balance sheets of financial institutions so they can lend again. It gives the government some starting tools to remediate the banking crises, but it is not by any means a panacea. In any event, we believe that in an effort to lift investor confidence and give the bailout plan a little extra forward momentum, the Federal Reserve will probably lower rates by as much as 50 basis points in the next few days. Of course the rate cuts, in and of themselves, are not expected to do much. The Fed has already dropped fed funds by 325 basis points in the last 12 months and injected about a trillion dollars of liquidity into the financial system. Moreover, monetary policy has been extraordinarily simulative with the "real" fed funds rate (Fed funds minus inflation) at a negative 2% to 3%. The purpose of the rate cut this time would be to compliment and support the emergency rescue package, and to convey to consumers, investors and business leaders that Washington will do whatever it takes to restore stability to the financial sector.

But Who Will Bail out The US?

Another major uncertainty looming on the horizon is who will bail out the US? To finance the rescue package, the Treasury will have to increase the national debt by $1.35 trillion. The cost of the plan and the $150 billion worth of tax revenue losses the Senate added to the package will likely cause the budget deficit to balloon to a record $650 billion this fiscal year, and possibly by $1 trillion by 2011 as the government goes hat in hand to finance the entitlements of 77 million baby boomers.

Who is going to buy all this new Treasury debt? That's the next BIG question. We've seen foreign investor enthusiasm for dollar-denominated securities wane in recent years. Yet, given the absence of any significant domestic savings, the US will have to depend on foreigners more than ever before. But will these investors insist on a much higher interest rate return for taking on the additional risk of holding dollars? Will the rating agencies reassess the creditworthiness of US government debt? Is the US Triple A credit rating on US sovereign debt in jeopardy? If this becomes the dominant narrative in 2009---as we expect--- US markets rates will edge higher next year and delay the recovery in the financial sector, housing and the economy.

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