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## **ECONOMIC TALKING POINTS**

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### **Waiting for the “Godot” Indicator**

One of our clients calls it the “Godot” indicator. It is the one concrete, unmistakable statistic signaling the economy has finally turned the corner. We’ve been waiting for months for that “Godot” indicator, but it remains elusive. Today’s economic releases certainly don’t get us any closer. In fact, what they show is an economy that is still bouncing along the bottom, utterly devoid of any upward momentum. About the best thing that can be said is that with the US and foreign economies shutting down, at least inflation has started to cool. Could this set the stage for the Fed to lower rates again later this year? Very possibly.

Let’s begin with the timeliest release out today, which is first time claims for unemployment benefits. New applications for jobless benefits filed the week ending September 6th slipped marginally to 445,000, from 451,000 the previous week. This is the 8<sup>th</sup> consecutive week new applications exceeded 400,000, which is the range typically associated with an economic downturn. The states with the largest increase in new filings for benefits were Ohio (with layoffs in the automobile industry), North Carolina (furniture and financial services), and Pennsylvania (manufacturing, chemicals and petroleum).

What slightly muddies this particular statistic point is that last June Washington approved extending benefits by another 13 weeks for those who have run out of their initial 6-month insurance, so some of the new claims include Americans who have previously filed. A purer measure of labor market conditions would be the total number

of Americans still reliant on unemployment benefits to help pay for basic living expenses. That figure jumped to 3.525 million for the week ending August 30<sup>th</sup>. (This series always lags by one week.) That's the most since October 2003 and it underscores how few jobs are being created in the economy these days.

So far this year, claims for unemployment insurance have averaged 380,000 a week, compared with 321,000 in 2007 and 313,000 in 2006. When you combine the nine straight months of job losses in the business sector (eight consecutive months if you want to include government hiring), plus the latest acceleration in the number of Americans collecting unemployment insurance, it is easy to see why retailers are getting anxious about the upcoming holiday shopping season. We're expecting this year to be among the worst in a decade.

The Godot indicator was also absent in the July trade figures. The deficit had swollen to \$62.2 billion, after a \$58.8 billion shortfall in June. The jump was entirely due to the record amount of oil purchased in July (342 million barrels) at the most expensive price ever (an average \$124.66 a barrel). That kicked up the America's import bill for crude to \$42.6 billion. Needless to say, the US deficit with OPEC alone soared to an historic \$24.2 billion in July. Had it not been for petroleum, the trade deficit would have fallen to \$29.63, the lowest in 6 years.

Some may wonder why the average price of oil in the trade report didn't actually drop? After all, that was the month investors began selling off crude on the NYMEX, causing it to tumble from its \$147 a barrel peak. There are two reasons the trade data didn't capture it. First, we have to make a distinction between the volatile minute-by-minute trading price of crude on the NYMEX's futures market --- and the price of oil that is negotiated contractually well in advance of shipment. The contracted price for shipment can lag the NYMEX price by several months. The second point is the benchmark crude on the NYMEX is based on West Texas Intermediate, while the oil referred to in the trade data includes a variety of different blends. Nonetheless, we do expect to see the price of petroleum in the trade data to trend lower the next few months.

The larger than expected shortfall in trade for July portends a much weaker GDP figure for the third quarter. The inflation-adjusted trade deficit for July, which is what is used to calculate real GDP, increased to \$41.24 billion, after declining in each of the last four months. That is going to sharply reduce overall growth in the summer quarter. Remember, foreign trade alone accounted for 94% of the 3.3% GDP growth seen in the second quarter. But now, even that lifeline is fading fast as foreign economies weaken and the dollar gathers strength. With virtually every major sector of the economy now dormant, our expectation is that the business activity will be flat the rest of the year.

This raises some interesting questions about future Federal Reserve monetary policy. Given the recessionary conditions in the real economy and the crises in the financial sector, will the Fed reconsider the option of lowering fed funds another 25 basis points to 1.75%? Up until recently, we believed the Fed would stand pat at 2% until next year --- unless the economy took a serious turn for the worse and/ or inflation began to cool.

Well, we certainly have an economy that's struggling. What's kept Fed policymakers from easing further has been rising inflation. But even that roadblock may soon be gone.

One noteworthy sign came today with the release on import prices, which last month fell by a record 3.7%. This time it was the price of oil AND non-petroleum imports that fell in August. Another recent set of indicators pointing to a deceleration of inflation has been the ISM reports. Manufacturers have seen their costs retreat for the last two months. (In the June ISM survey, 84% of respondents saw prices rise, while in August that fell to 60%). There was a similar pattern in the ISM service sector (with 72% reporting higher prices paid in June, compared to just 50% in August).

Certainly inflation expectations ought to hold still given the lack of any wage pressures in the economy. Labor costs have actually fallen by 0.5% in the second quarter, helped largely by the surge in productivity growth. The stronger dollar, now at its highest value in a year based on a trade-weighted index, will also help cap inflation in the months ahead.

For the moment we're still holding to our position that the Fed keeps its benchmark at 2% this year. However, we'll be looking closely at tomorrow's producer prices and next week's CPI and capacity utilization data to see if the odds of another rate cut this year has increased.