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1440 Broadway, Suite 901  
Oakland, California 94612  
510.419.1024  
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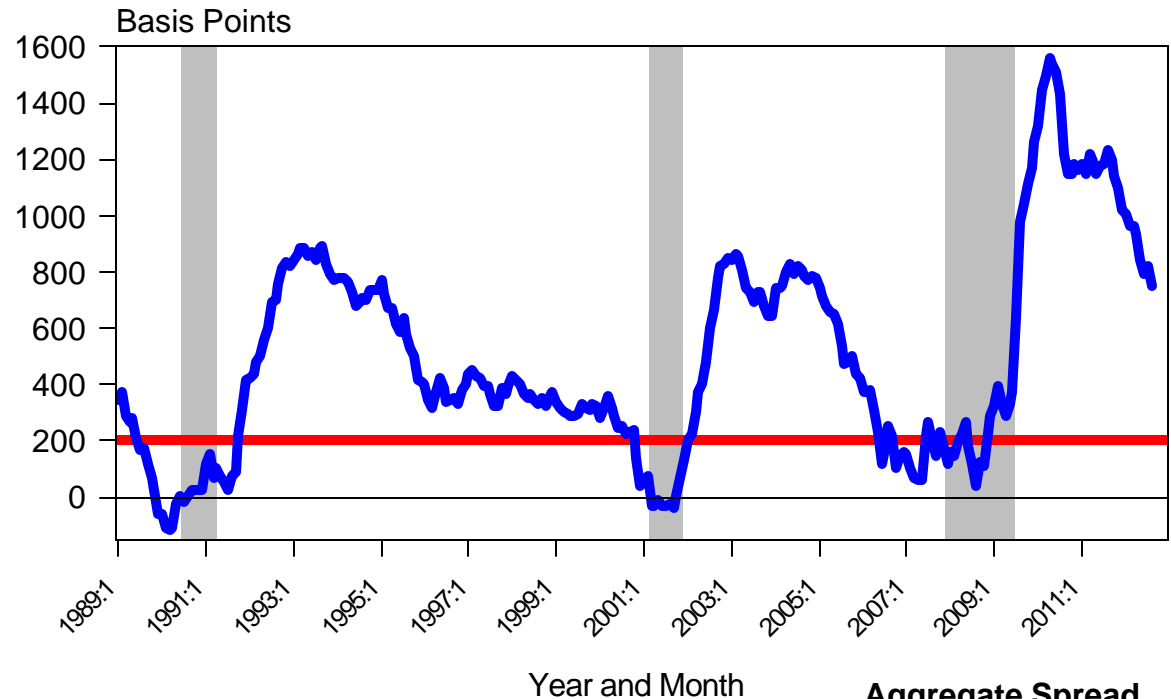


# Chart 1 -- AGGREGATE SPREAD

Latest = August 2012 = 754

**“Lately it occurs to me, what a long strange trip its been.” -- Truckin’ by Jerry Garcia and The Grateful Dead.**

This month's epigraph was prompted by the realization that December marked the fourth anniversary of the start of the Great Recession. While the National Bureau of Economic Research (NBER) has officially placed the end date of that episode in June of 2009, we all know the recovery has been spotty. And, if the last round of reports on the investigations into the mess that accompanied the downturn are to be believed, we have not yet seen all of the fallout from the implosion of the financial system that was the hallmark of the event.



At the same time as the economy has been undergoing structural changes, so has the process of reporting on those events been changing here at NoSpinforecast. It is now a full year since we went to the format now being used to display and comment on the information, and other changes are about to be made, the details of which will be discussed at the end of this report. But first, to the news.

The first piece of recent news is seen here. The Aggregate Spread, for reasons we shall examine presently, resumed its downward track, which is normal. What we will be looking for next, is the flattening of the line you see in the last two expansions. And, most importantly, whether that flattening occurs at a level we associate with continued expansion, or as was the case in front of the 2007 peak, a range that suggests another cycle peak may soon be upon us.

Year and Month	Aggregate Spread
2011:12	1023
2012:1	1008
2012:2	962
2012:3	962
2012:4	938
2012:5	844
2012:6	795
2012:7	820
<b>2012:8</b>	<b>754</b>

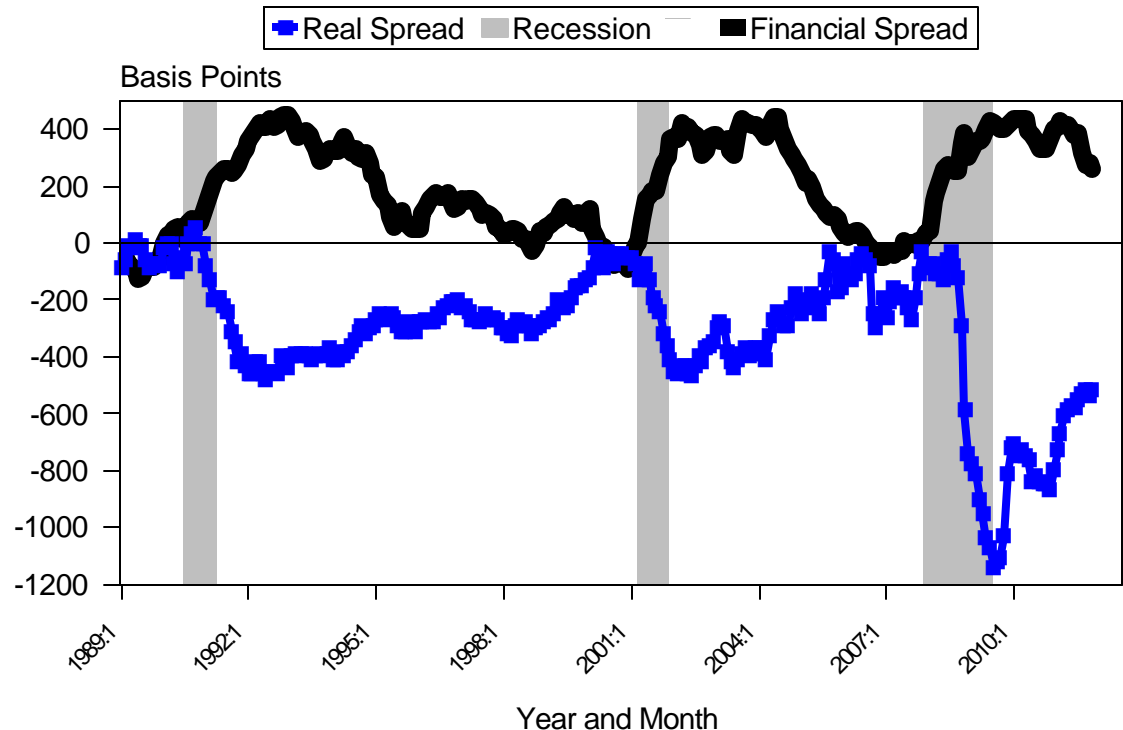
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## Chart 2 -- Real and Financial Spreads

At the center of that query will be the configuration of this chart, because, as we know, the Aggregate Spread is distance between the two lines on the chart. But, as we also know, the structural changes that have taken place in the financial sector are making the Financial Spread behave differently than it has in the past. So, the question becomes whether we will get the traditional flattening of the yield curve that has been a reliable harbinger of the conditions that can produce a business cycle peak.

At the same time, we know that changes in the labor market have brought about a new set of behaviors that may cause the Real Spread to perform differently. By this time in prior cycles, we have usually had more narrowing of the Real Spread because of declines in the Unemployment Rate. As we saw in the last Employment Report, we know that the Unemployment Rate today is not the same beast it was in the past.



<u>Real Spread</u>		<u>Financial Spread</u>	
2011:8	-530	2011:8	314
2011:9	-520	2011:9	275
2011:10	-540	2011:10	280
2011:11	-520	2011:11	262

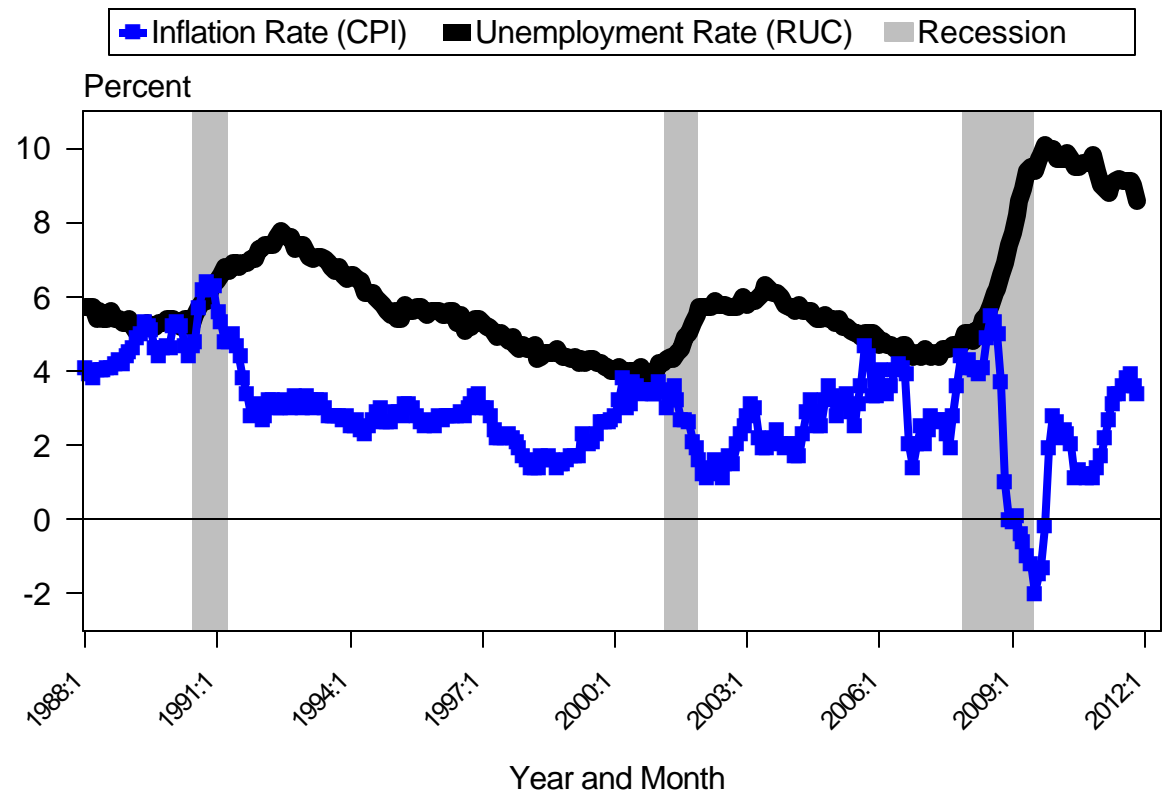


## Chart 3 -- Components of the Real Spread

Which is why in the first part of the monthly analysis we always go into the detail of the components of each of the spreads, starting here with the Real Spread.

Since we devote an entire report to the employment situation, explanations in this report of what is going on in hiring, or the lack thereof, can be brief by making reference to the information discussed earlier in the month. A detailed discussion of inflation is done in here the Prospects report, after we have looked at the coincident indicators. I intend to continue this practice, although there may be times when the inflation analysis is brought forward for reasons of topicality.

What we will be looking for in this part of the report is the convergence of the two lines, a key signal of the approach of a cycle peak. What we will also be monitoring closely is whether there is any information in the employment and inflation data to suggest that cycle peak conditions are developing **without** a convergence of the lines.



Date	CPI	RUC
2011:8	3.8	9.1
2011:9	3.9	9.1
2011:10	3.6	9.0
2011:11	3.4	8.6

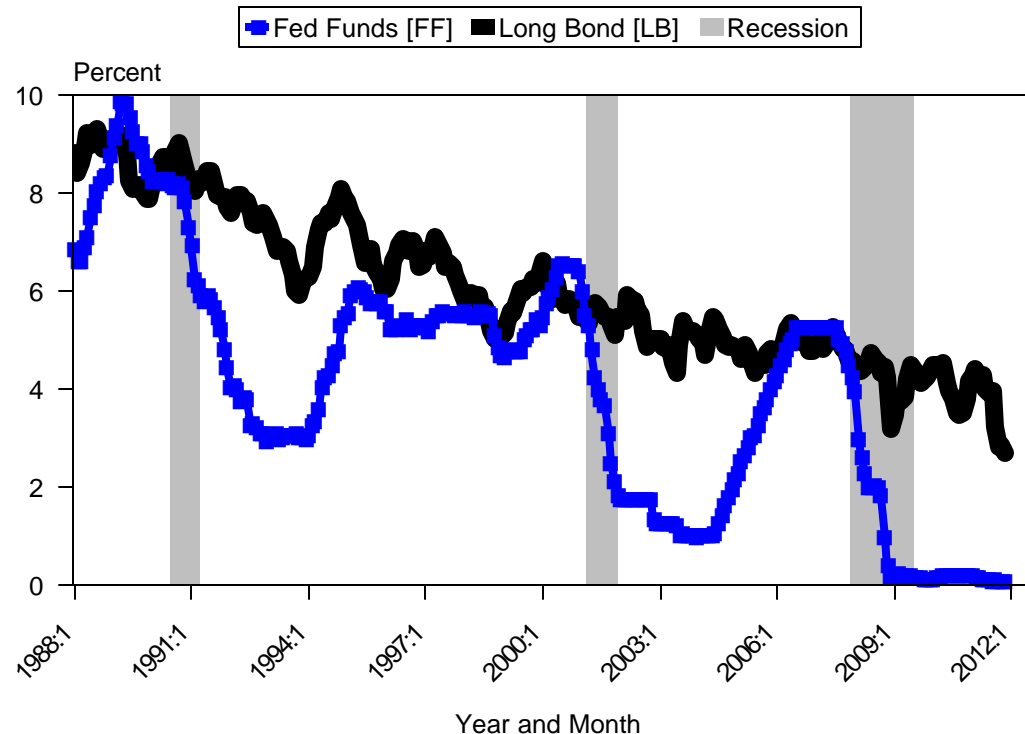


## Chart 4 -- Components of the Financial Spread

The same focus applies here. Both because of the statements made by the Federal Open Market Committee (FOMC) that they will keep the Federal Funds at, or very close to, the current level and because the recurring flights-to-quality engendered by the lunacy of politicians the world over, we have to be careful in drawing conclusions about what the distance between these two lines are telling us about business cycle conditions.

In other words, and I should stop using that phrase (by finding some other words), are conditions conducive to a business cycle peak coming into being that **would not** involve the convergence of these two lines?

All of which gets us back to the “high turn” scenario we have discussed earlier. Could we get, as we did in 1960, a situation where we have a cycle peak with an Aggregate Spread reading well above 200? The answer appears to be yes. But the proof will come from the coincident indicators, the discussion of which will be our next topic.



Date	FF	LB
2011:8	0.10	3.24
2011:9	0.08	2.83
2011:10	0.07	2.87
<b>2011:11</b>	<b>0.08</b>	<b>2.72</b>

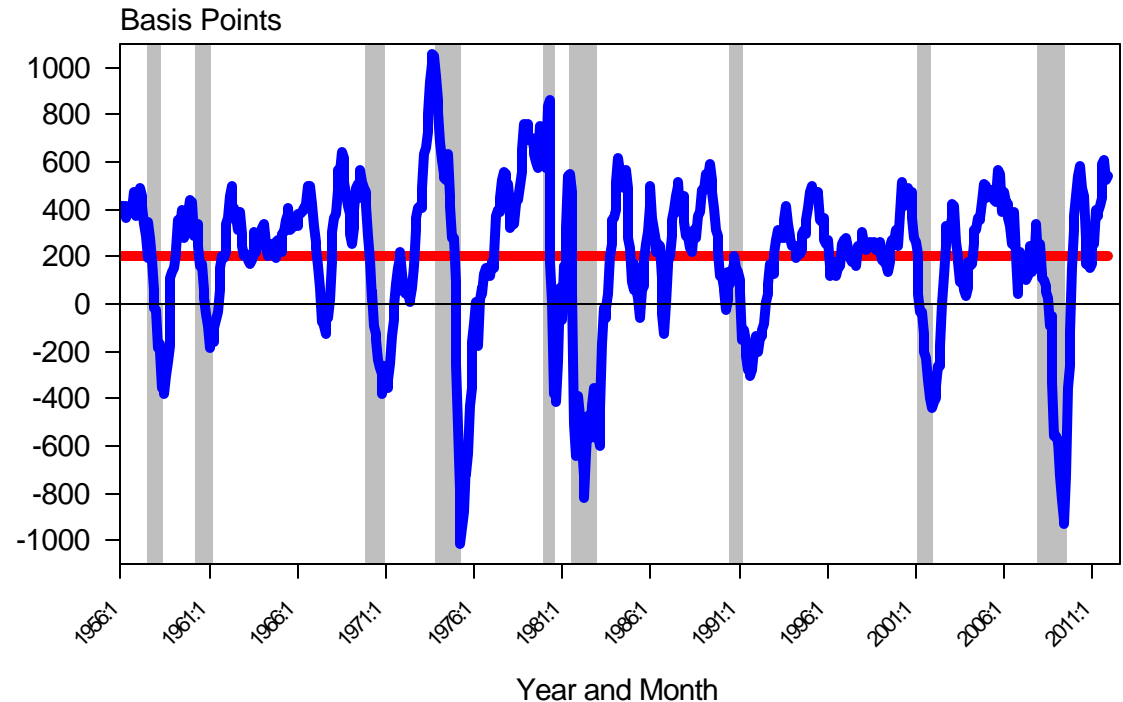


## Chart 5 -- FRED Latest = October 2011 = 521

**FRED = Aggregate Spread nine months ago minus Aggregate Spread this month + 200 Basis Points**

One of the ways we found to solve the “high turn” problem, without going outside the confines of the model, was the information gleaned by the development of FRED. As you see here, FRED did what we want a coincident indicator to do in each and every recession: he went negative. So, while the Aggregate Spread did not go through 200 Basis Points (making a “high turn”) in the 1960 recession, FRED did.

Right now, as you see, FRED is still running north of 500 Basis Points, which I take as strong evidence that we are not looking at an imminent cycle peak. I can, believe it or not, hear many of you either crumpling the report or taking Mr. Model's name in vain at this very moment. Especially those of you who have contacts in Europe, where, I hear, the mood is black and expectations of a downturn are high. But, we are not making a forecast for Europe. I have never denied that a recession there could contribute to the onset of a recession here. What I am saying is that this coincident indicator is not pointing to the existence of recession conditions here right now.



Date	FRED
2011:8	589
2011:9	604
2011:10	521
<b>2011:11</b>	<b>542</b>



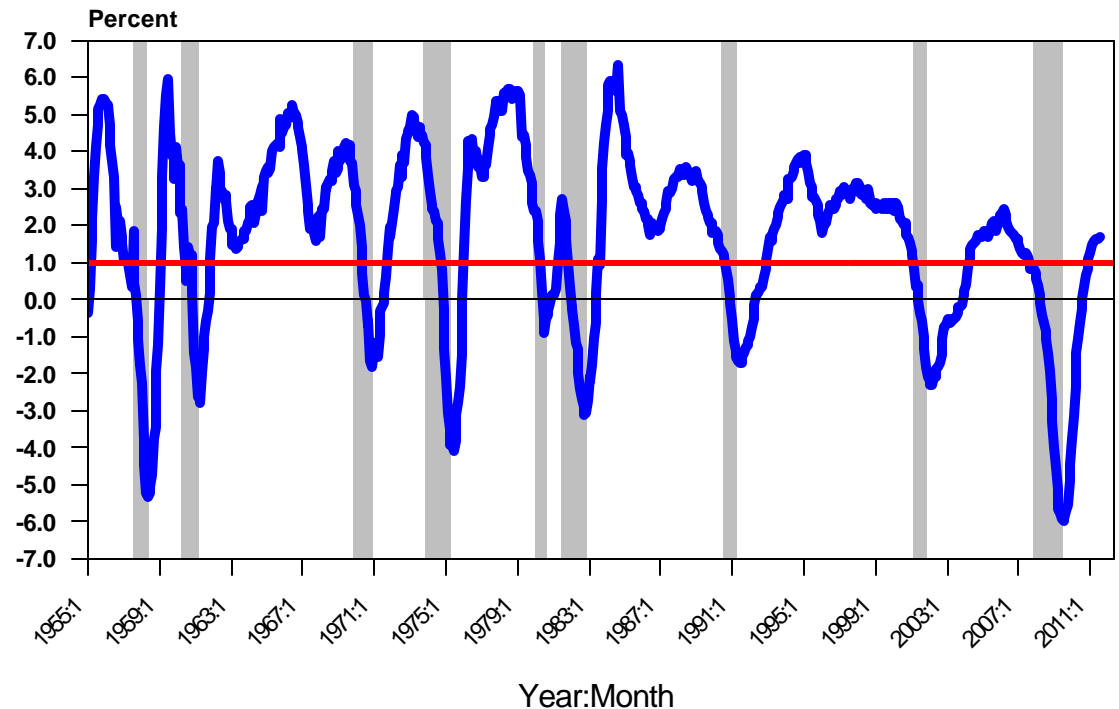
## Chart 6 Total Private Nonfarm Payroll Employment Change from Year-Ago Month

The same conditions apply on this chart with our second-most favorite coincident indicator.

As I mentioned in the Employment Report, the level and trend of this series are not in a recession, or pre-recession, configuration. They may take on that configuration at some time in the future and when they do I will discuss that in the same dispassionate tone that I have been using to discuss their arrival into the shape they are in now.

Which makes this as good a time as any for me to remind several of you, and I know who you are, that the goal of this service is to identify the NBER business cycle turning points with enough notice for you to make profitable use of that information.

My interest in the politics and policies that are proposed and implemented over time, stems from the effects of those policies on the model variables. But that's it. And that is why you don't see much, if any, political or policy comments in these pages. This is also why you don't see me making market calls. Not only I am not in the business of managing money, I also don't know enough about the specifics of your client base to make a market call that would be useful or relevant to you. I am always glad to discuss those specifics, so if you think I can be of assistance in your making a market call, please give me a call. I know that some of you would like to see more political and market commentary, and you may get your wish when I launch my blog (more on that later).



<b>Private Payrolls</b>	
<b>Date</b>	<b>%Chg</b>
2011:8	1.66
2011:9	1.76
2011:10	1.73
<b>2011:11</b>	<b>1.74</b>

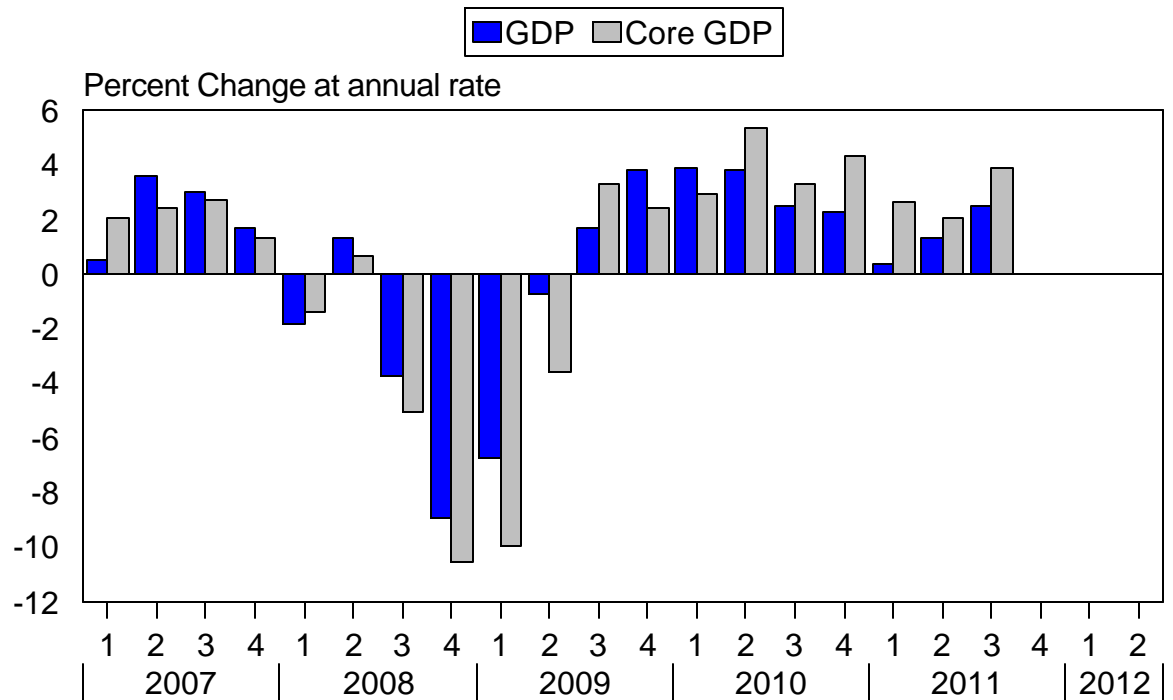


## Chart 7 -- Selected Measures of Aggregate Economic Activity

$$\text{Core GDP} = \text{PCE} + \text{BFI} + \text{Exports}$$

Our next key coincident indicator is Core GDP. The design of this variable owes a debt to some work I have been doing for a client for the past several years in which we have been trying to get a better description of what goes on his part of economy than that provided by GDP. The details of that work are proprietary to his business, but the methodology is the same.

Headline GDP does not always tell us what we need to know about how well, or how poorly, the economy is performing. I think, and I am tooting my own horn here, Core GDP does a better job. Time will tell whether or not I am placing too much confidence in this measure, but for now I have no reason to distrust what this chart tells us about current conditions.



So, along with FRED and the employment data, this is where I will be looking to tell you whether I think a business cycle peak is developing in the absence of a convergence of the Real and Financial spreads. Yes, it is just that simple. If the spreads converge and take the Aggregate Spread towards 200 Basis Points, we will have most of the evidence we need to make a cycle call. But, if the Aggregate Spread remains wide, we have the additional information from three other sources to alert us that something serious may be happening.

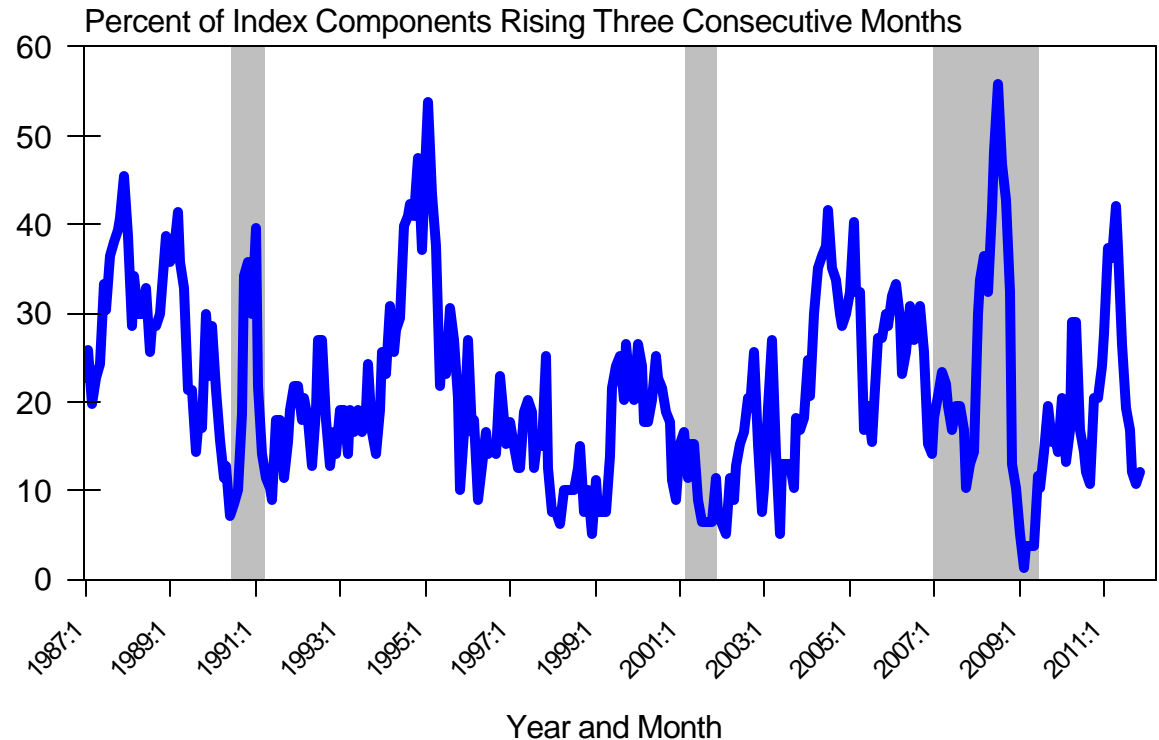
PCE = Personal Consumption Expenditures  
BFI = Business Fixed Investment

Date	GDP	Core GDP
2010:4	2.3	4.34
2011:1	0.4	2.63
2011:2	1.3	2.04
<b>2011:3</b>	<b>2.5</b>	<b>3.87</b>



## Chart 8 -- Intermediate Goods PPI Diffusion Index

The next set of variables we will be looking at in detail are those relating to inflation. Early on in the design phase of Mr. Model I had considered doing an Inflation Situation Report that would be the companion to the Employment Situation Report. The reason I decided not to do that was because of the timing of the price reports. Since I write the Prospects Report immediately upon the release of the inflation news, it is easier and quicker to include the inflation analysis here. And so it has remained, and will remain.



This chart, and the one that follows, cover the Producer Price Index which I use as both a leading indicator of consumer price inflation and as a measure of the strength of demand. Producer prices are far more sensitive to changes in aggregate demand than are consumer prices. This is because producers, at all stages of processing, don't buy inputs with which to make output unless they think they can profitably sell that output. Hence, the degree to which producer prices are rising, or falling, provides important clues as to how well we can expect the economy to perform.

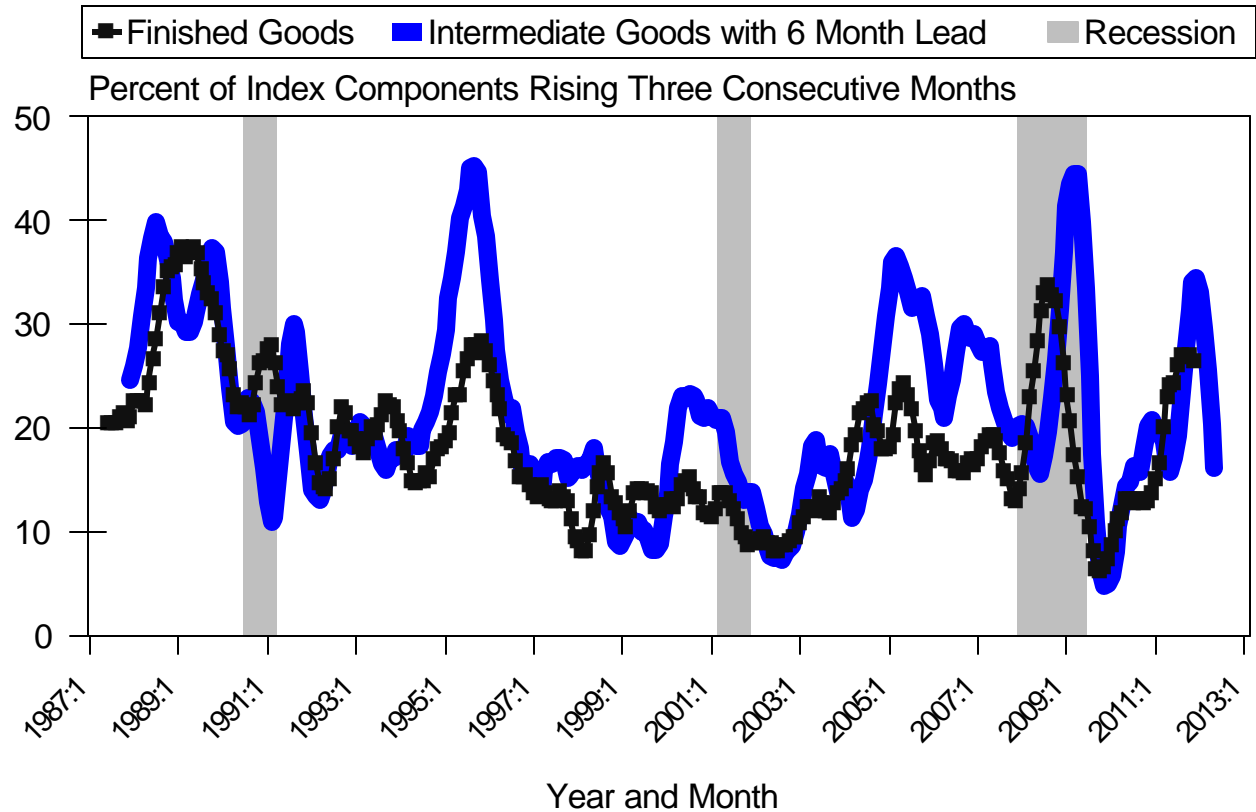
The index you see plotted here tracks the incidence of price increases and not their size. How intermediate prices are behaving for goods such as flour, sheet metal and industrial chemicals, used to make finished goods, such as cookies, cars, and cosmetics, tells you a lot about the strength of demand.



## Chart 9 -- PPI Diffusion Indexes 6 Month Moving Average

The other nice aspect about the movements of the Intermediate Goods Price diffusion index, is that it has a consistent leading aspect as relates to Finished Goods prices. In order to reduce some of the noise in the series on the previous chart, I use a six month moving average of that series and its companion for the Finished Index here.

As you see, with a six-month lead, the incidence of price increases at the Intermediate level is reflected in a change in the incidence of price increases at the Finished level. What the chart is telling us now, is that we should expect the incidence of price increases at the Finished level to diminish over the next six months.



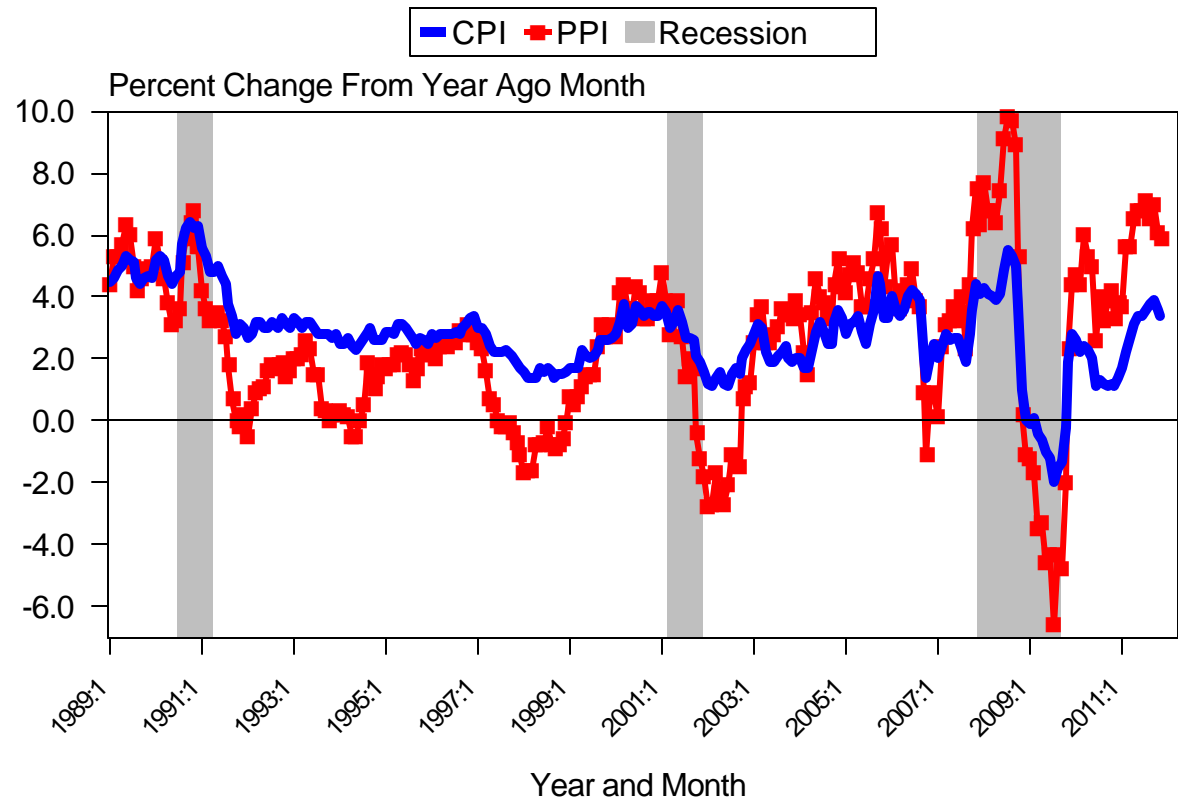
If that turns out to be the case, we should also expect some cooling in the rate of inflation of finished goods prices. And, that, in turn, would suggest some diminution of the pace of increase of the Consumer Price Index. But what will also matter greatly is the reason for the diminution of price pressures. As you see on the chart the black line has been known to fall during recessions. And so if and when the black line does go nose down we will have to check to see whether this is just part of its normal fluctuating pattern, or an indication of something more ominous.



## Chart 10 -- Selected Measures of Inflation

To make the point more clearly of the link between Producer and Consumer prices, and to provide a segue into the analysis of the Consumer price inflation, we show you this chart.

Here we are plotting the inflation rates at both the consumer and producer levels to let you see how the two series track each other. As you can see here, and especially on the inset table, the pace of Producer Price inflation has been slowing over the past several months. Based on what we saw on the previous chart, we expect further slowing into 2012. Were this to be accompanied by a further break in the rise of the Consumer Price Index, certain members of the FOMC would sleep better and perhaps be less cranky when it came time to vote on policy actions.



<u>Date</u>	<u>CPI</u>	<u>PPI</u>
2011:8	3.8	6.5
2011:9	3.9	7.0
2011:10	3.6	6.1
<b>2011:11</b>	<b>3.4</b>	<b>5.9</b>



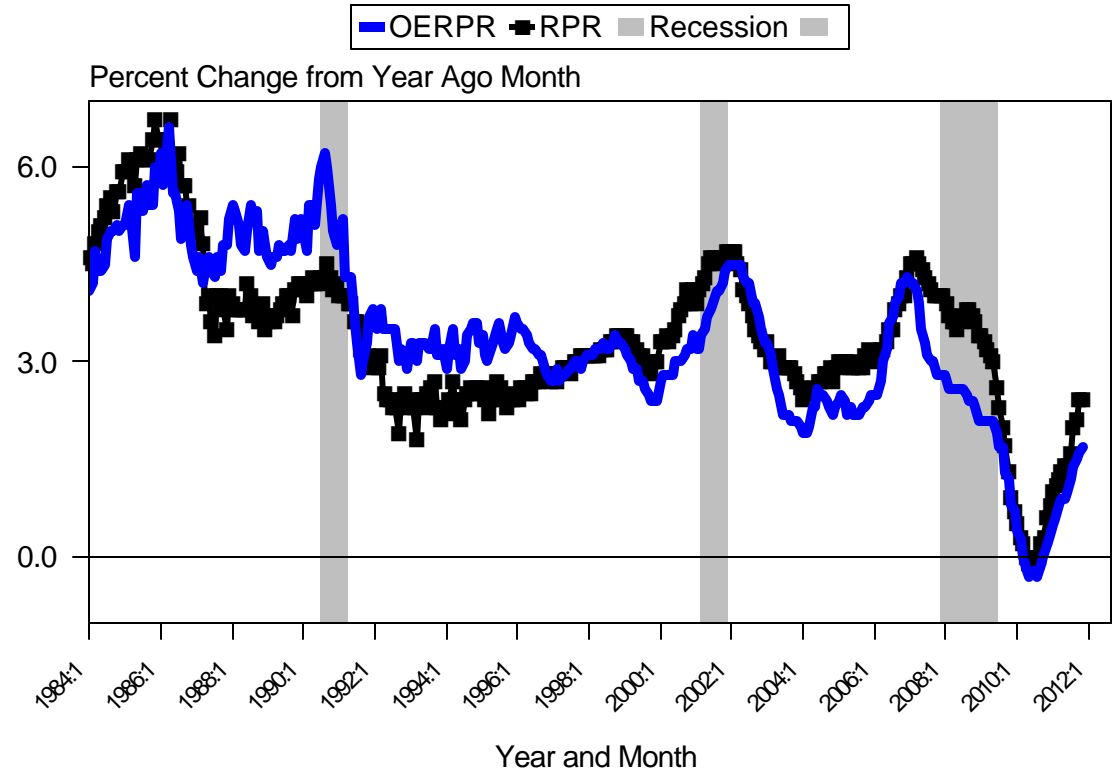
## Chart 11 -- Selected Measures of CPI Shelter Costs: Owners' Equivalent Rent of Primary Residence (OERPR) Rent of Primary Residence (RPR)

Our discussion on consumer inflation will be centered on what we see on this chart and the one that follows.

This chart used to have only the OERPR data plotted on it. OERPR, as you surely recall, is the largest single component of the Consumer Price Index. It carries a weight of 23.3% and as such acts as the bellwether of the index. While energy prices get more play because of their visibility and volatility, the fact is they account for only 9.1% of the CPI.

But, as you see from its name, OERPR is the equivalent rent. I thought this might be a good time to include actual rents, and they are now on the chart as the black line. It should come as absolutely no surprise that the two numbers track each other closely.

One piece of news from the real estate sector that has been consistent is the rise in rents all over the country. This trend is expected to continue and because of that we can expect both of these series to trend higher in the months ahead.



Date	OERPR	RPR
2011:8	1.4	2.0
2011:9	1.5	2.1
2011:10	1.6	2.4
2011:11	1.7	2.4



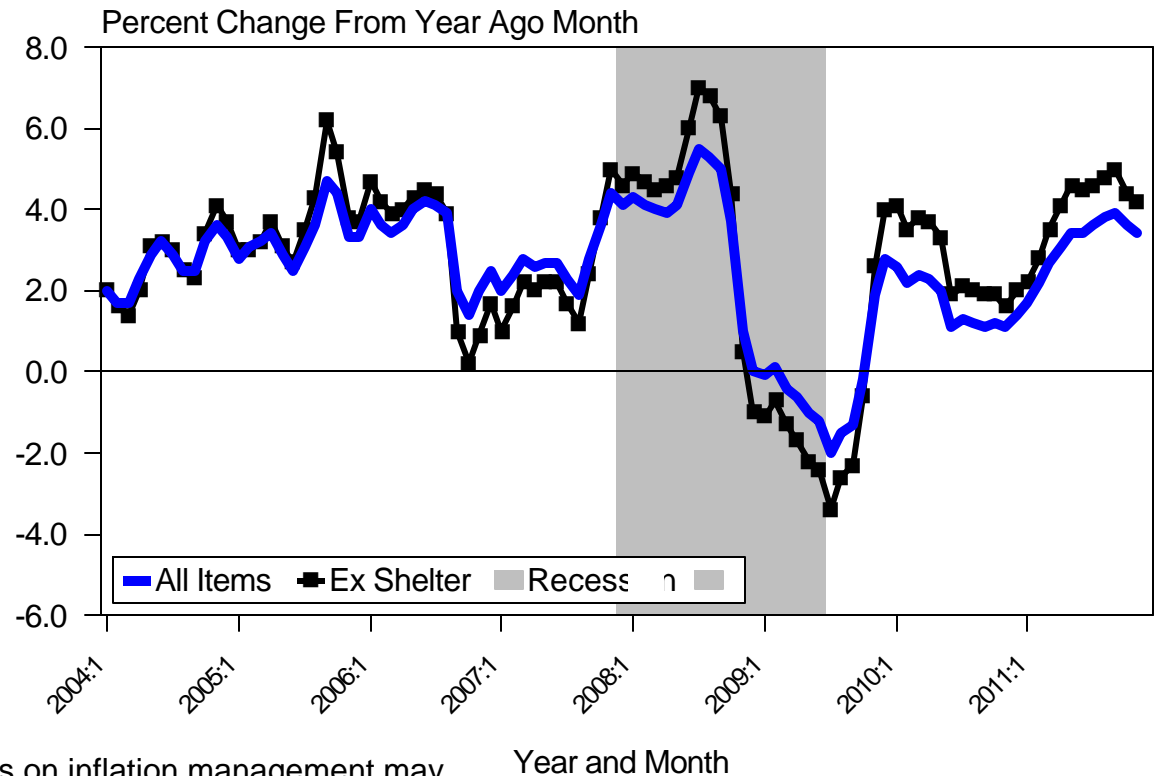
## Chart 12 -- Selected Measures of Consumer Inflation

Why does that matter? Because as Rents and Equivalent Rents trend higher there is a very good chance that the two lines on this chart will converge, returning to the configuration they had before the recession when they moved in unison.

Since the Ex-Shelter index is running higher than the All Items, and the major components of the Shelter sector are moving higher as well, it stands to reason that the convergence will take place around the level of the black line and not around the level of the blue line.

Should this be the case, those FOMC members we alluded earlier will start to step up their efforts to get monetary policy to take on a more urgent focus on the rate of inflation.

While this would not be a surprise, renewed focus on inflation management may come at a time when the FOMC is still having to contend with the effects of problems in Europe and the mounting evidence of malfeasance in the domestic financial system. Since both of those problems are capable of causing the global financial system to seize up again, the FOMC may be forced to continue to make system liquidity its main focus at the expense of its other mandates to promote the growth of aggregate economic activity while maintaining price stability. In short, the long strange trip may get longer and stranger.



Date	All Items	Ex Shelter
2011:8	3.8	4.8
2011:9	3.9	5.0
2011:10	3.6	4.4
<b>2011:11</b>	<b>3.4</b>	<b>4.2</b>



## Chart 13

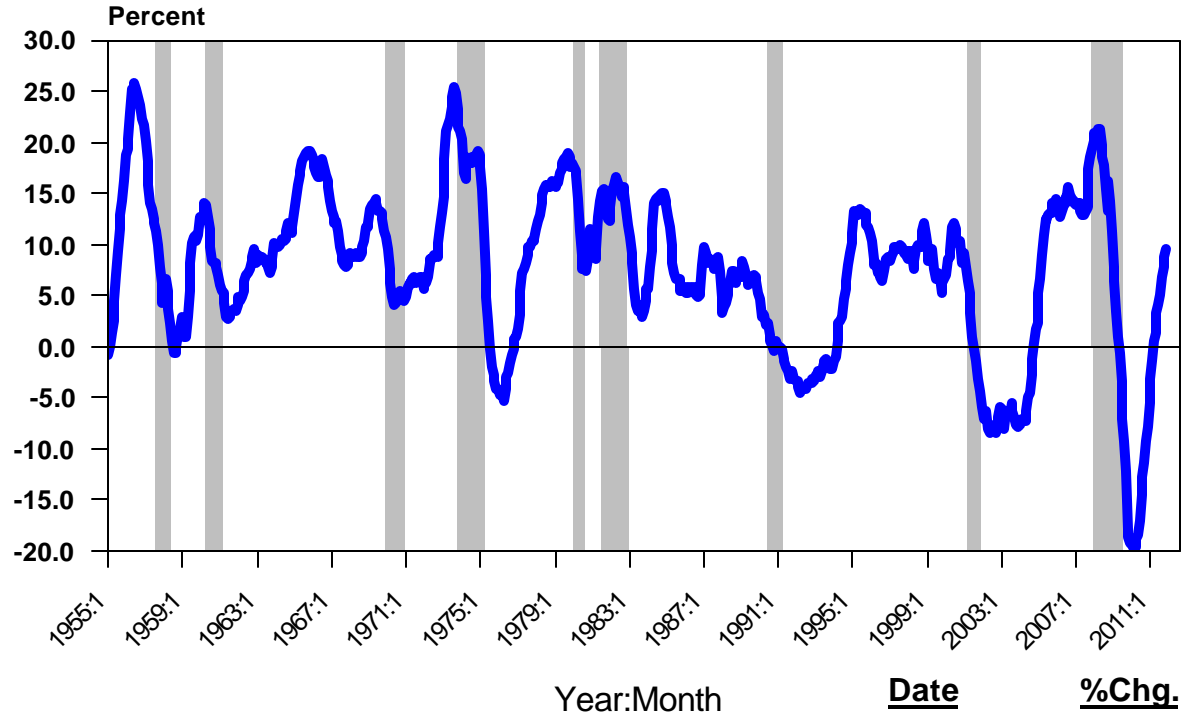
### Total Commercial and Industrial Loans At Commercial Banks

#### Change from Year-Ago Month

The next group of charts focuses on variables related to the components of the Financial Spread and issues in the fixed-income and equity markets.

Whether it is because of the efforts of the FOMC, other bank regulators, or some new found courage in the banking community, it appears that a rising trend has been established on this chart. Before we get too happy about the news here, let's look at three of the numbers that underlie these data. Namely, the level of C&I Loans outstanding on the date the last time the line on the chart went through zero from above, that same level when the line on the chart went through zero from below and the level now. For ease of viewing, I made the other table.

As you see there, even after some fairly rapid growth in recent months, we are still \$175 billion below the level early 2009. But, we are, at least moving in the right direction. The question now will be how long it takes for the perception that no lending activity is taking place to be fully dispelled. Part of the reason why the perception remains is because the progress has been spotty both regionally and across the various sectors of the economy. Note that this chart says nothing about Real Estate.



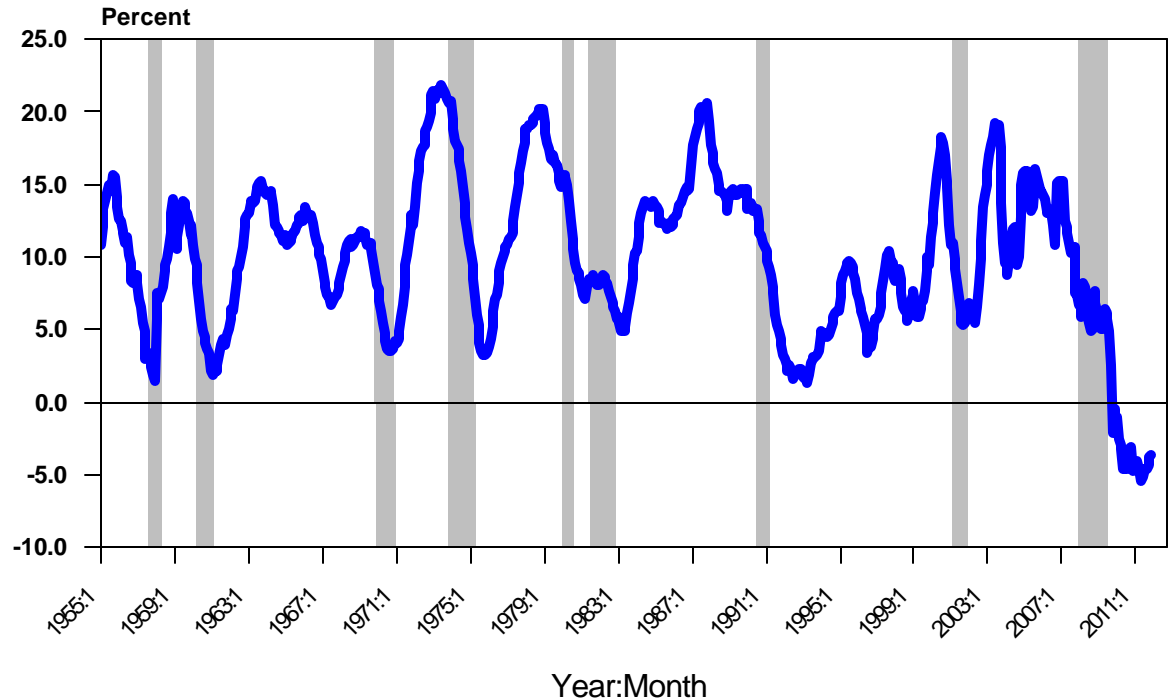
<u>Date</u>	<u>%Chg.</u>
2011:8	6.9
2011:9	7.7
2011:10	8.8
<b>2011:11</b>	<b>9.5</b>
<u>Date</u>	<u>Level*</u>
2009:5	\$1,493
2011:3	\$1,245
2011:11	\$1,318

\* Billions



## Chart 14 Total Real Estate Loans At Commercial Banks

### Change from Year-Ago Month



The reason why it didn't is because Real Estate has its own chart. And, as you can see, lending activity is still falling.

Anecdotal evidence suggests the decline is not over, both because of the still widespread weakness in the real estate and construction sectors and because of the mounting revelations that real estate lenders were guilty of bad practices that are only now being prosecuted.

In short, the current situation, which is completely at variance with the historical record, is not likely to be resolved soon.

<u>Date</u>	<u>%Chg.</u>
2011:8	-4.6
2011:9	-4.3
2011:10	-3.8
<b>2011:11</b>	<b>-3.6</b>

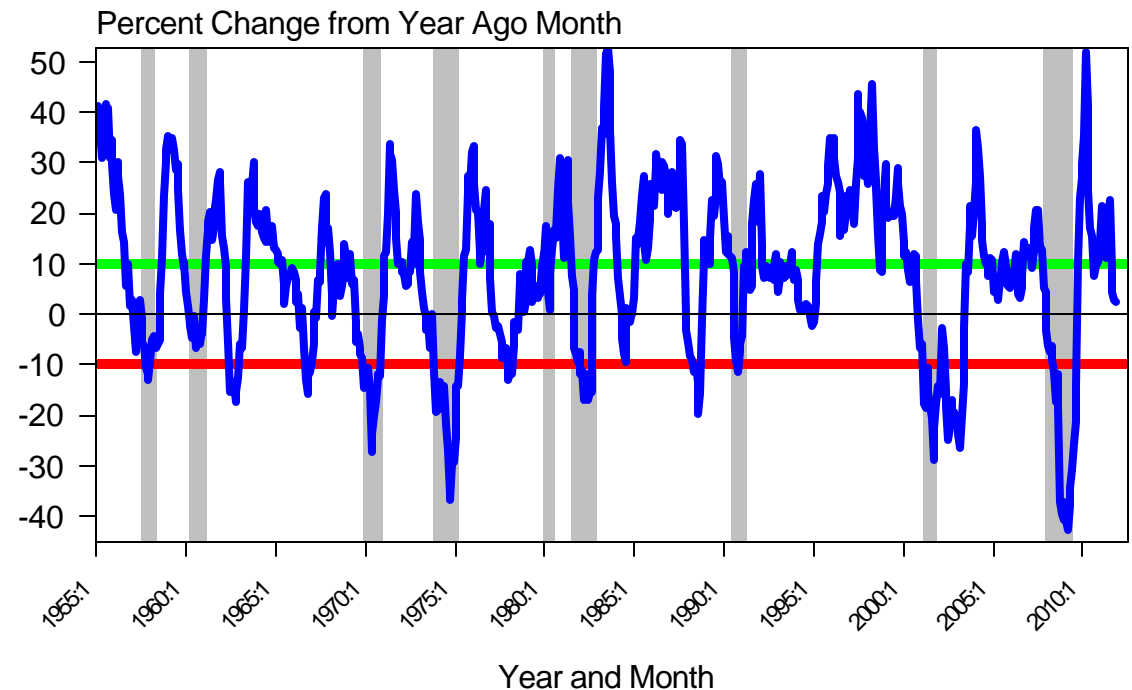


## Chart 15 -- Standard and Poor's 500 Stock Index

Turning now to the equity market, this chart and the one that follows are the mainstays of the analysis I do on the subject. My interest in the stock prices is limited to what they tell me about the phases of the business cycle. I don't own any stocks. My reason for that stems, in part, from my inability to understand the equity pricing mechanism and, more importantly, that owning stocks induces a tendency to "talk one's book", a tendency that is fundamentally incompatible with the concept of NoSpinforecast.

The red and green lines mark the boundary of what I call the Zone of Death (ZOD). So named because of the propensity of the series not to spend much time between within that range. Furthermore, it turns out that the real news about cycle peaks and troughs, at least during those times when the series is telling us something about the cycle, is when the blue line crosses either the red or the green line.

Because of the penchant of this series to over-forecast cycle peaks, I always caution against the use of this chart as the sole forecasting tool. *But since I have been telling you that we should not be using any one variable, including the Aggregate Spread, as our forecasting tool, that warning is consistent with the way we run things around here.*



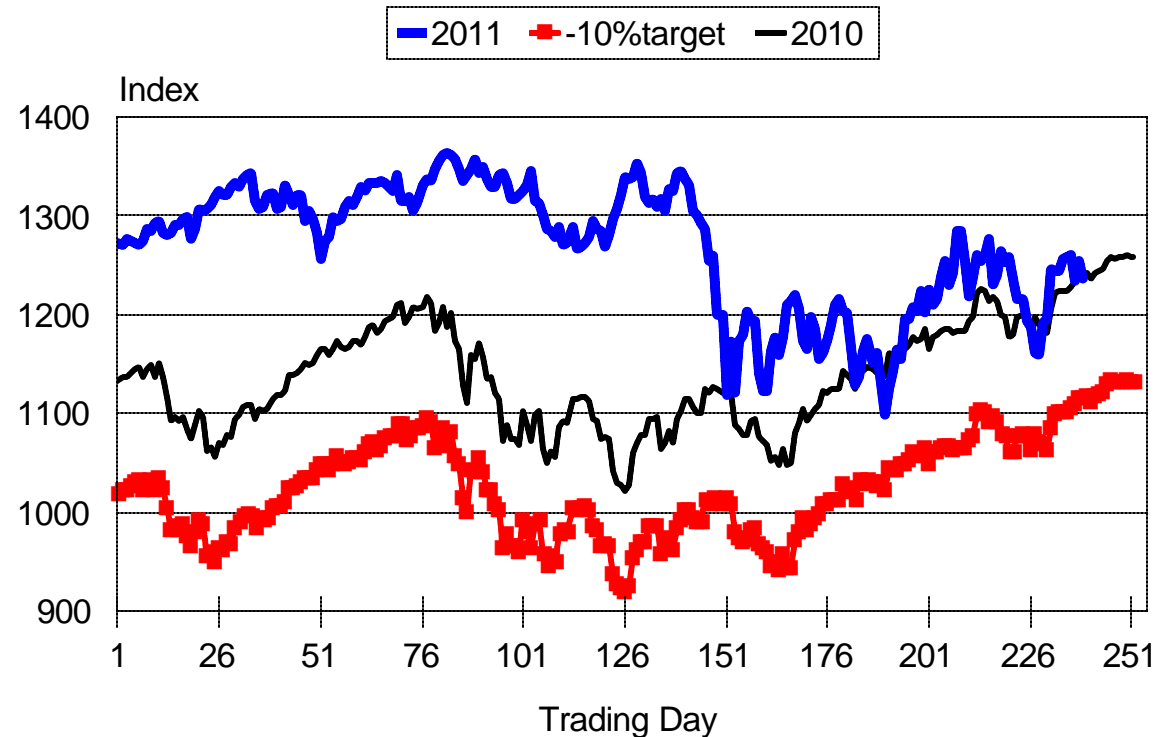
Date	%Chg.
2011:8	9.02
2011:9	4.61
2011:10	3.04
<b>2011:11</b>	<b>2.30</b>



## Chart 16 -- SP500 2011 Daily Close with Zone of Death Limits

This chart is what I refer to in client briefing as the “secret decoder ring”. It allows you to synch up the rates of change we used on the prior chart with the level of the SP500 published every day. I removed the green line from the chart because I don't think it is currently of much interest. What the chart is telling us is that we will have to take the SP500 below 1,100 in order to penetrate the bottom of the Zone of Death.

By the way, this is the last time you will see this version of the chart. With the January edition we will reformat this to show the new ZOD boundaries. The blue line on this chart will become the black line on the 2012 version. I will include the 2012 version in the Employment Situation Report.





### Chart 17 -- 10-Year Treasury 2008-2011

While the Financial Spread uses the monthly averages of the Federal Funds Rate and the 20-Year Treasury as inputs, I have found it more useful to include the daily rate on the 10-Year Treasury in the running commentary about conditions in the fixed income market.

This chart also allows us to see the periods of financial distress that have accompanied the Great Recession and its aftermath. And it will be the incidence of financial distress that will continue to drive the path of rates going forward.

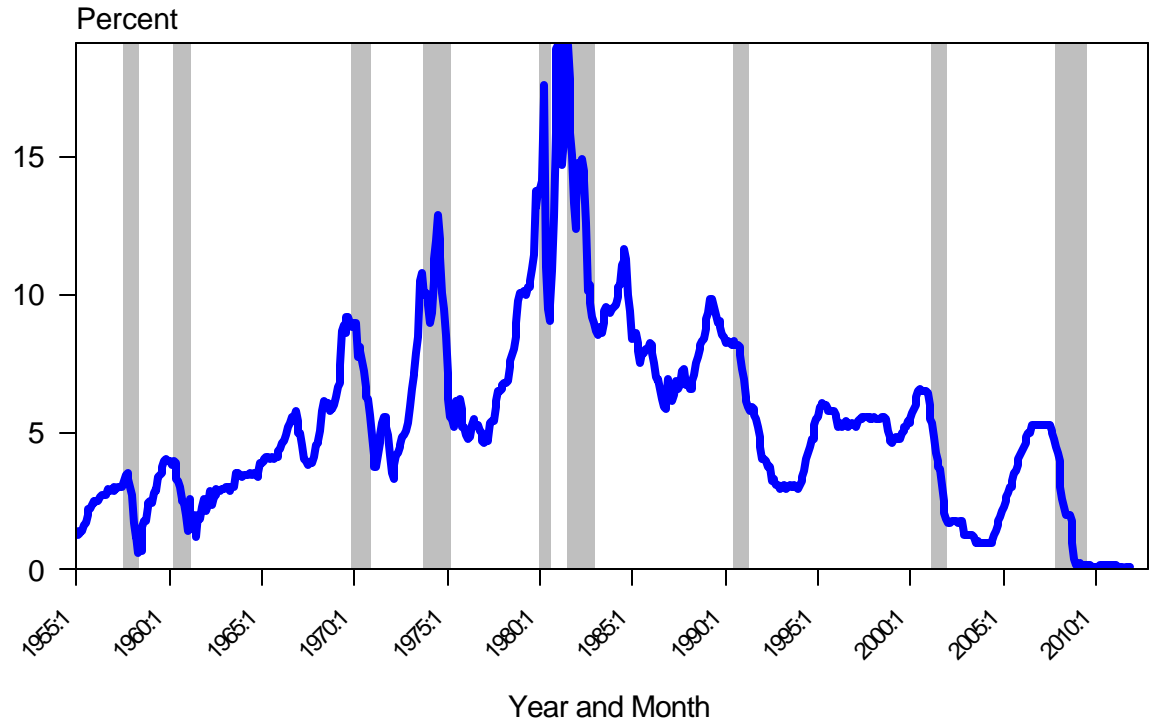




## Chart 18 -- Federal Funds Rate

In the original version of the Prospects Report, the concluding section consisted of charts similar to this one in which we included a discussion of what to expect in the model components. That discussion was intended to take the analysis back towards a higher level review of current and prospective conditions. Over time, that format has proven to be less flexible than desired in order to maintain the narrative of the analysis. So, recently, you have seen fewer of these charts and more of others with a narrower focus.

Going forward, you are most likely to see charts like this one being used to set up the antecedents for topics of more current interest. This time this chart serves to introduce some matters in the fixed income markets that we will be following closely over the next several months.



### Federal Funds Rate (%)

2011:8	0.10
2011:9	0.08
2011:10	0.07
2011:11	<b>0.08</b>



## Chart 19 -- Long Treasury Bond

As you are probably beginning to suspect, given that we opened with the Federal Funds Rate and have now brought in the Long Bond, our topic is interest rates and the Financial Spread.

What we are going to be looking at are the relationships between the Federal Funds Rate, the Long Bond, and the Inflation Rate. As we shall see, among the many distortions introduced to the system by the Great Recession and the subsequent episodes of financial distress, are changes in the relationships between those three variables that could portend major differences in what conditions look like around the next cycle peak.



<b>Long Treasury (%)</b>	
2011:8	3.24
2011:9	2.83
2011:10	2.87
<b>2011:11</b>	<b>2.72</b>



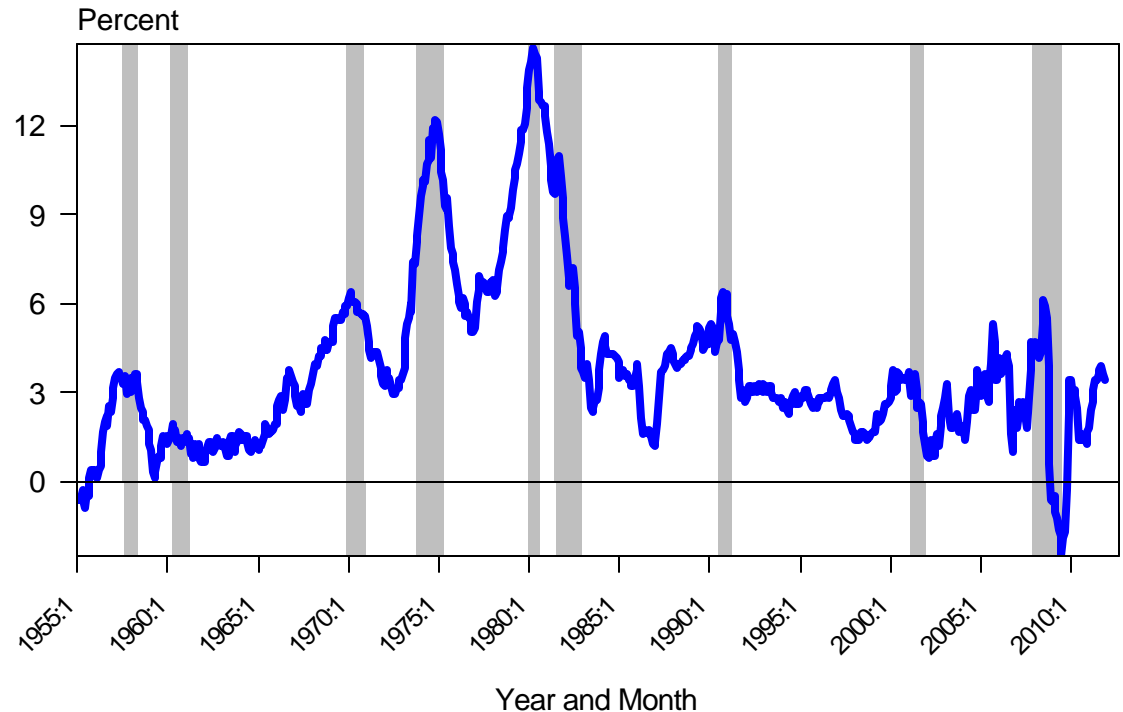
## Chart 20 -- Change From Prior Year Month of the Consumer Price Index

Having glanced at the interest rates, let's pause for a moment to look at the inflation rate.

Unlike the two interest rates, both of which are running at levels not seen since the 1950s, the inflation rate has come back to a level very much like that it has maintained since the end of the 1981-1982 recession. And as we saw in our discussion of inflation earlier in the report, there is every reason to think that the inflation rate may be headed higher rather than lower.

Thus we find ourselves with interest rates that are low both because of the policy being followed by the FOMC and because of the flight-to-quality demand for US Treasuries generated by the financial distress. But we also have an inflation rate that is tracking at more “modern” levels.

The question then becomes: can these conditions be maintained going forward? Or, how much more strange will the long strange trip become?



<b><u>Inflation Rate</u></b>	
2011:8	3.8
2011:9	3.9
2011:10	3.6
<b>2011:11</b>	<b>3.4</b>

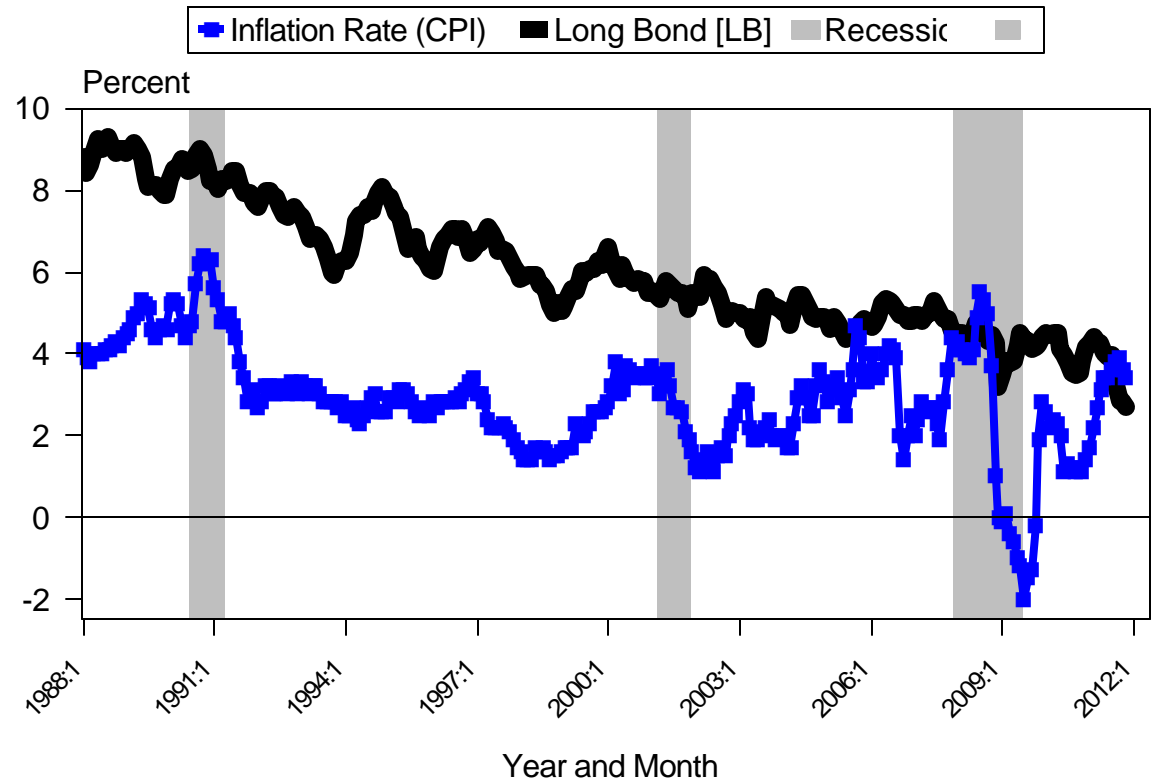


## Chart 21 - Interest Rates and Inflation

In the next several charts we are going to be mixing and matching the interest rate and inflation data we gathered on the prior three pages. We start with the first question: How much longer will bond investors continue to accept a negative real rate of return? Meaning, why would a person buy a bond that does not pay a rate of return at least equal to the rate of inflation?

As you can see on the chart we have a situation not often seen: the blue line is above the black line. While this is not unheard of, the prior instances of this happening have both been brief and largely associated with spikes in the inflation rate.

But given what we know about inflation wanting to trend higher, and the increased propensity of bond rates to spike lower every time another politician does something loony, we have to wonder whether the current situation will turn out to be longer lasting than the other two. If so, what will this mean for the level of interest rates as far as that level telling us something useful about how investors are assessing current and prospective risk?



<u>Date</u>	<u>CPI</u>	<u>LB</u>
2011:8	3.8	3.24
2011:9	3.9	2.83
2011:10	3.6	2.87
<b>2011:11</b>	<b>3.4</b>	<b>2.72</b>

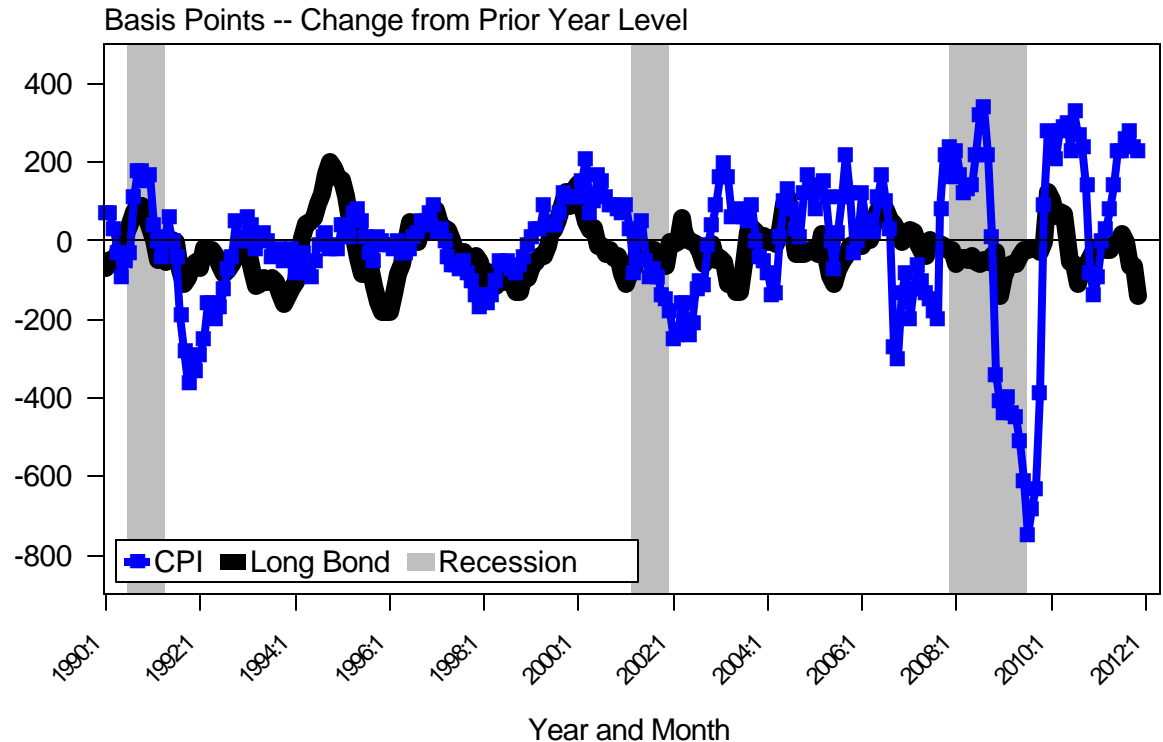


## Chart 22 -- Inflation and Interest Rates

Here is another way to frame the question. The blue line on the chart is the change, in basis points, of the level of inflation rate from its level 12 months earlier. The black line performs the same calculation for the Long Bond. If you glance at the table in the lower right hand corner you can see that in November the inflation rate was 230 BP higher than it had been in November 2010 and the rate on the Long Bond was 140 BP lower than it had been in November of 2010.

Now, if you notice on the chart, historically, the change in the long bond has been about as large as the change in the inflation rate (the two lines track on top of each other). Furthermore, they track on top of each other in nearly synchronous fashion. But not at this time.

Given that we know that the blue line is likely to remain above zero for several months at least, what should we expect the black like to do?



<u>Date</u>	<u>CPI</u>	<u>LB</u>
2011:8	260	-1
2011:9	280	-64
2011:10	240	-65
<b>2011:11</b>	<b>230</b>	<b>-140</b>

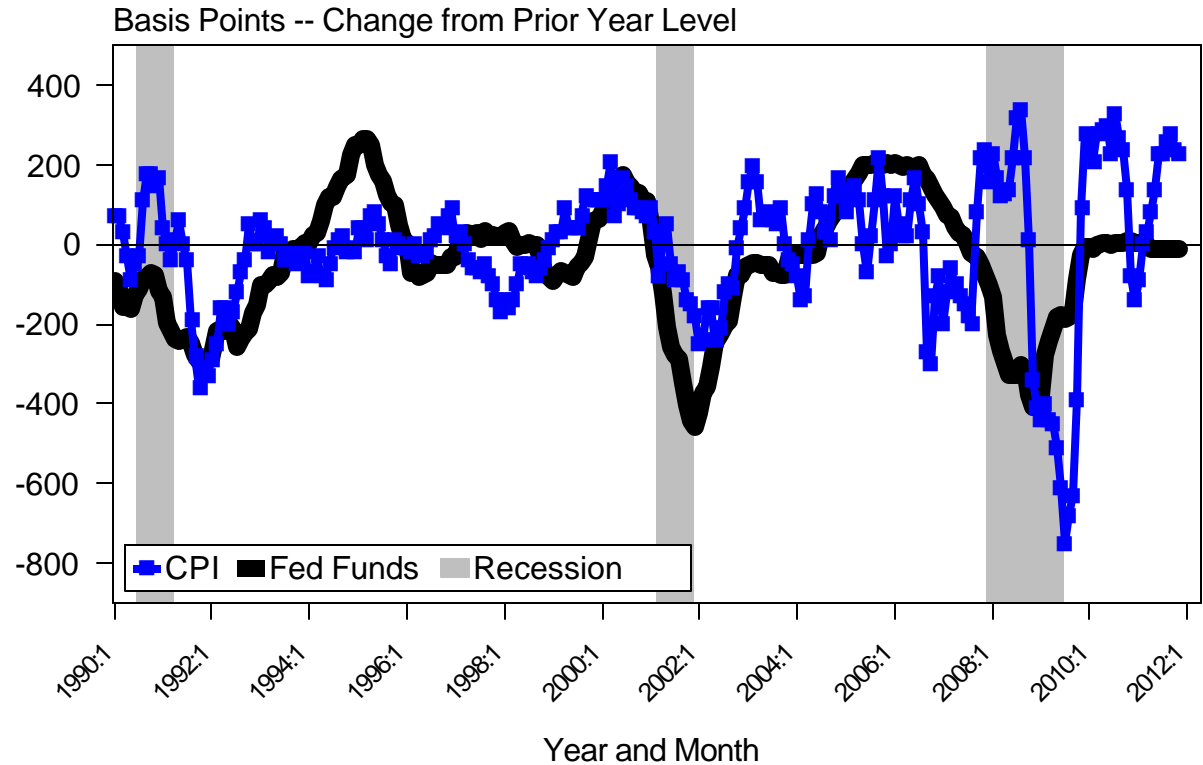


## Chart 23 -- Inflation and Interest Rates

This chart has been a regular part of the analysis for quite some time. It is our Inflation Hawk monitor. It shows that over time, the tendency of the FOMC has been to raise the target Fed Funds rate more less in tandem with the changes in the Inflation rate.

As was the case with the Long Bond on the previous chart, we have a situation where, from a historical standpoint, there is a crying need for higher interest rates. But, as we noted earlier, the dictates of the current situation in the world banking system have lashed the FOMC to the need to maintain liquidity at the expense of their mandates for maintaining price stability and economic growth.

The Inflation Hawks have been silent, although you can hear their teeth grinding when you read the FOMC minutes. One has to wonder how long before they start dissenting again.



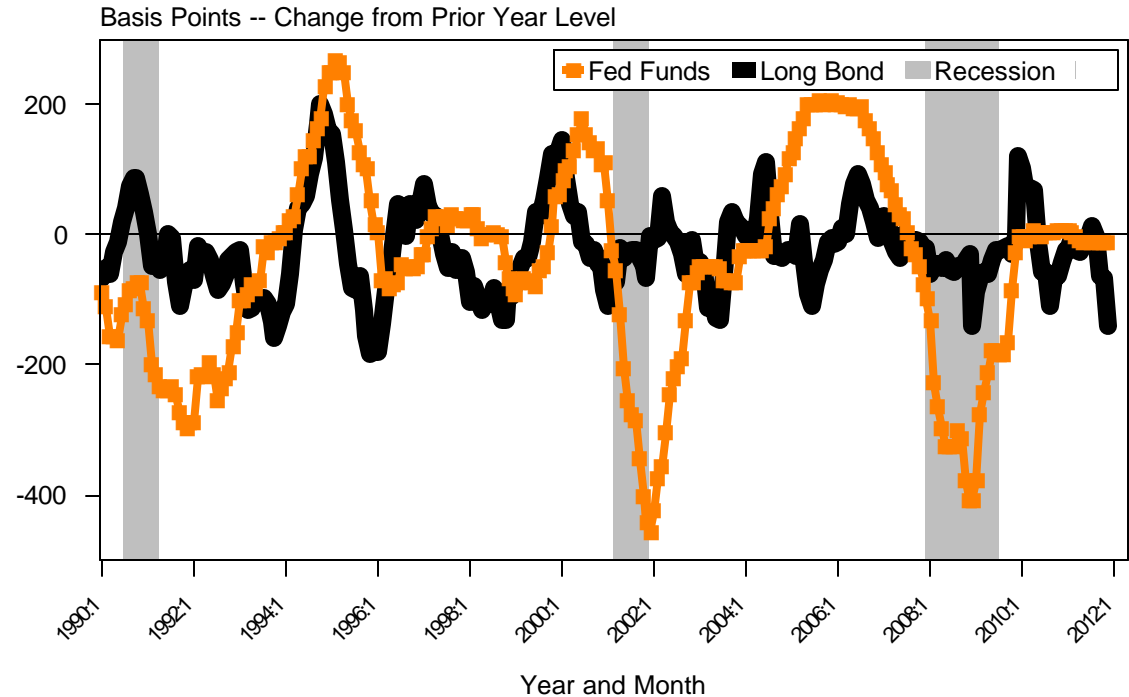
<u>Date</u>	<u>CPI</u>	<u>FF</u>
2011:8	260	-9
2011:9	280	-11
2011:10	240	-12
<b>2011:11</b>	<b>230</b>	<b>-11</b>



## Chart 24 --Selected Interest Rates

This chart takes the interest rate related lines from Charts 22 and 23 and puts them together so you can see what has happened to long rates when short rates rise and fall. Because both of those had been plotted in black, I put the Federal Funds rate in orange (a shade with no graphical overtones) here.

As you see, the current situation is new. The question is whether it signals the beginning of a new era or whether it is an anomaly. History would suggest the latter. But, as we have learned over the past four years, history ain't what it used to be.



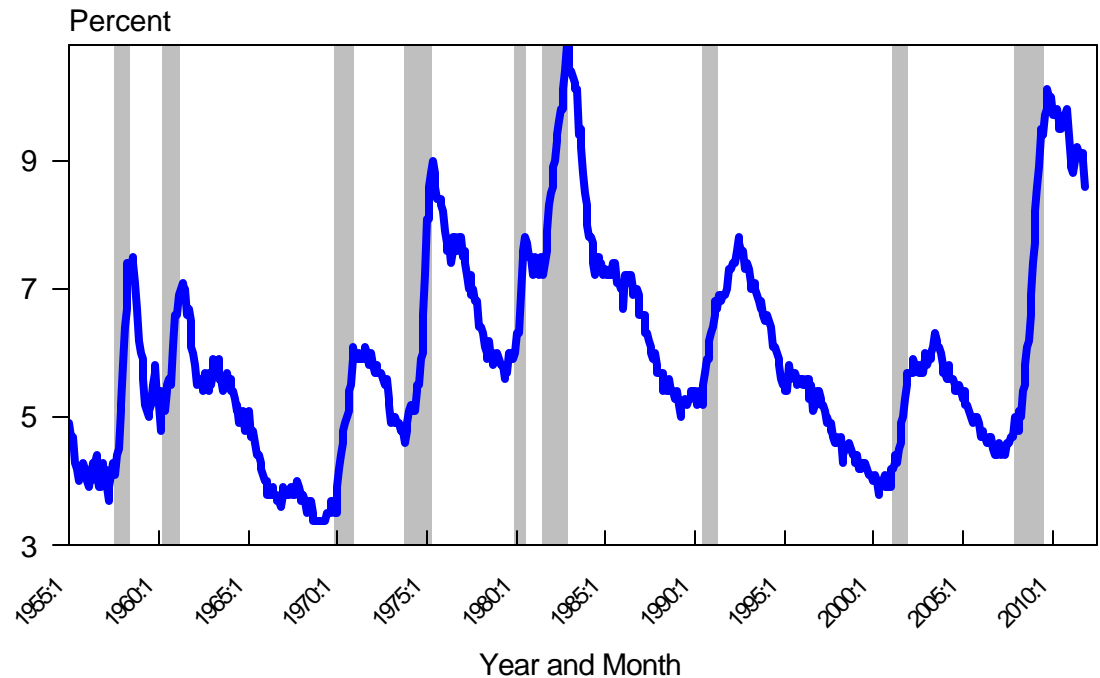
<u>Date</u>	<u>FF</u>	<u>LB</u>
2011:8	-9	-1
2011:9	-11	-64
2011:10	-12	-65
<b>2011:11</b>	<b>-11</b>	<b>-140</b>



## Chart 25 -- Unemployment Rate

The last structural issue I would like to touch on is what has been going on with the Unemployment Rate.

As mentioned earlier, the Unemployment Rate of today is not the Unemployment Rate of yesteryear. The principal difference, as we discussed in the Employment Situation Report and in last month's edition of this report, is that today's Unemployment Rate is dominated by the long-term unemployed. That being the case, we cannot, and should not, expect the level of unemployment to change the way it used to after the other recessions you see plotted on the chart.



Labor economists have traditionally divided the unemployed into several categories, the most important being cyclical, frictional and structural. Cyclical unemployment is exactly what its name suggests, changes in the demand for labor associated with current business conditions. Frictional unemployment is related to the time it takes for the unemployed to find new work. Some frictional unemployment may be voluntary, as when, for example, a worker leaves on job to look for another. Structural unemployment deals with mismatches between the supply and demand for labor that can stem from factors such as participation rates, skill sets, location and labor laws. We are currently afflicted with all three problems.

### Unemployment Rate (%)

2011:8	9.1
2011:9	9.1
2011:10	9.0
<b>2011:11</b>	<b>8.6</b>

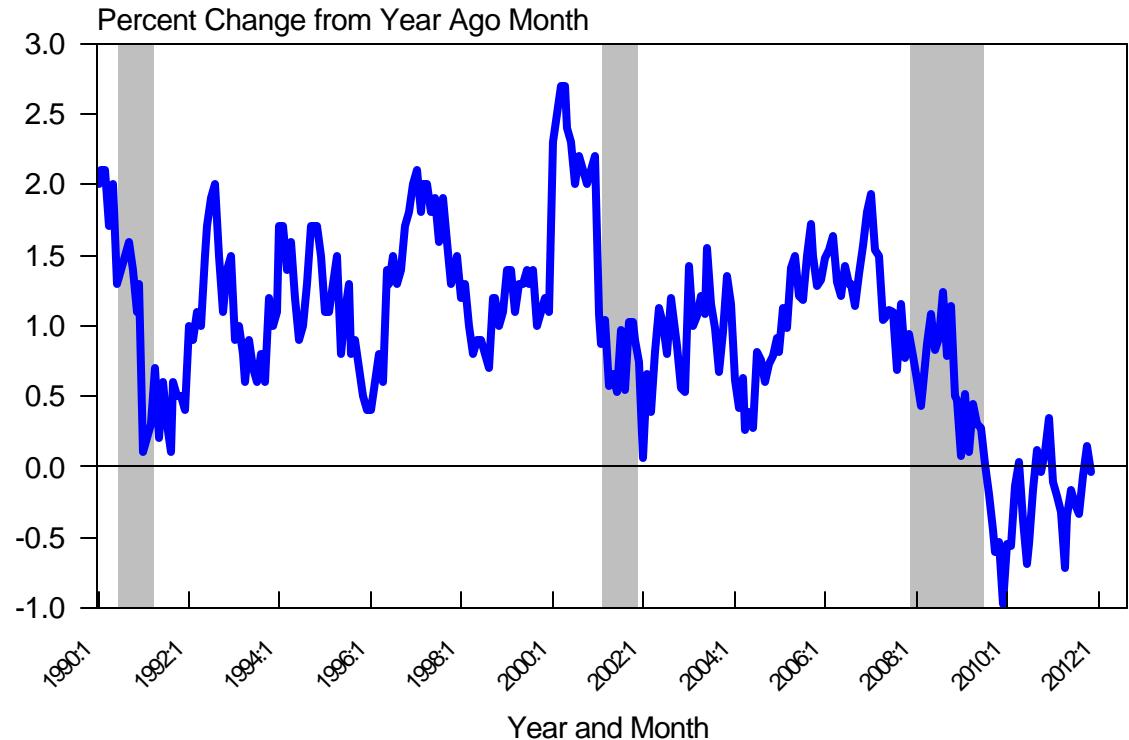


## Chart 26 Civilian Labor Force

One of the most worrisome is how the labor participation rate is affecting the growth of the labor force. The labor force is the denominator in the Unemployment Rate.

As we noted in the last edition of the Employment Situation Report, some of the “improvement” we have seen in the Unemployment Rate on Chart 25 is the result of the shrinking of the labor force that is plotted on this chart. A chart that is currently in a configuration we have not seen at any other time in recent history.

Thus we have yet another chapter in the “long strange trip.” That being a circumstance where the Unemployment Rate is falling, in part, because there are fewer people in the labor force not because more people are working.



<u>Date</u>	<u>Pct. Chg.</u>
2011:8	-0.34
2011:9	-0.07
2011:10	0.15
<b>2011:11</b>	<b>-0.04</b>



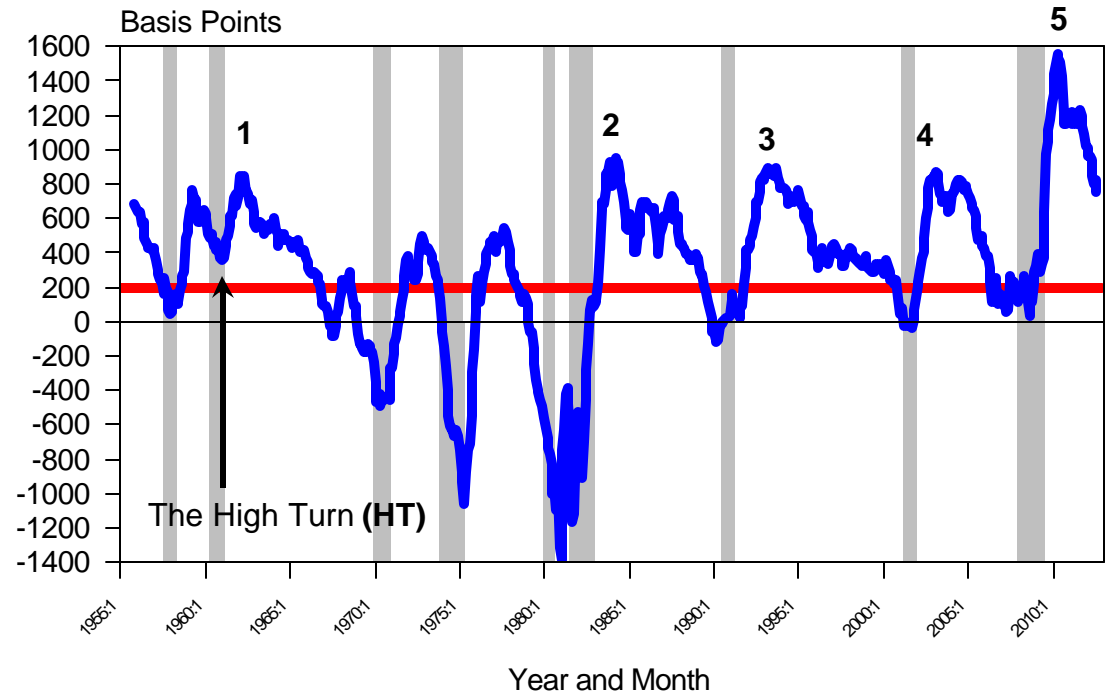
## Chart 27 -- AGGREGATE SPREAD

Latest = August 2012 = 754

All of which brings us back to the Aggregate Spread, here in full historical display, so we can make a couple of concluding comments. There are six points noted on the chart, and you will find a summary of the AS values and the dates on which they occurred in the table below the chart. The points were selected to bring out some matters of concern to me.

The first concern is HT. As noted several times in this report, one of my major sources of worry is that we could develop cycle peak conditions with the Aggregate Spread replicating the move it made around the high turn. To that end we have bolstered the analysis with the addition of FRED, which is based on the same inputs as the Aggregate Spread, Core GDP and Private Nonfarm Payrolls.

The second worry is the current level of the Aggregate Spread relative to the other peaks it made in long-lasting expansions. As you see on the chart, the peak this time was more than 600 BP higher than the peak set in 1984. The question is whether the height of the latest peak will have anything to do with the level of the Aggregate Spread at the start of the next recession. Time will tell. But, the key thing to note is that we are aware of this problem and will be taking it into account as we interpret the results going forward.



<u>Point</u>	<u>AS Level</u>	<u>Date</u>	<u>Aggregate Spread</u>	
HT	361	1961:1	2011:12	1023
1	846	1962:4	2012:1	1008
2	955	1984:3	2012:2	962
3	892	1993:9	2012:3	962
4	866	2003:2	2012:4	938
5	1562	2010:4	2012:5	844
			2012:6	795
			2012:7	820
			<b>2012:8</b>	<b>754</b>

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## Chart 28 -- Conclusions and Announcements

- Conclusions:
  - The long strange trip continues:
    - ▶ Structural changes in all of the model inputs are being closely monitored to insure that proper inferences are drawn.
    - ▶ Historical parallels are still valid but must be assessed carefully.
    - ▶ Cycle peaks traditionally are preceded by periods of imbalance based on excess. This time we could get a cycle peak brought about by imbalances reflecting unrepaired recession-inflicted damage.
  - In addition to the economic problems created by the Great Recession, we face an array of political issues, here and abroad, that will complicate matters greatly. This will be especially acute in 2012 as the election cycle, both here and in several European countries, kicks into high gear.
- Announcements:
  - We expect to go live with a completely redesigned web site some time in early 2012.
  - There will be a round of beta-testing to insure its full functionality before we move everything to the new site.
  - We would like to thank those of you who have offered to supply endorsements for use on the new site. You will be getting a note soon from the website designer confirming your message. If there are any of you out there would like to add an endorsement, please let me know and I will put you in touch with the website designer.
  - The new site will include a blog. The blog will include content and comments on topics not always covered in the reports.
- Lastly, I would like to thank you again for your continued support of this effort. I hope you and yours receive a full measure of the season's bounty and that you have a happy, healthy, and prosperous 2012.



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**RDLB, Inc.**

One Imperial Place, Suite 300

Lombard, IL 60148

630-261-8128