

ECONOMIC FORECASTS BROUGHT TO YOU BY



**PACIFIC
MANAGEMENT
CONSULTING
GROUP**

1440 Broadway, Suite 901
Oakland, California 94612
510.419.1024
www.pacmancg.com



Chart 1

Total Nonfarm Payroll Employment -- Change from Prior Month Thousands of Persons

First and Ten. Do it Again!

The December employment report, both in its Establishment and Household configurations, was good enough, as they say in football to “move the chains.” What we have now is first and ten at midfield. We are still quite a ways from scoring a touchdown, but at least we are moving in the right direction. As we shall see as we work through the details, there was enough good news from “clean” numbers to allow us to feel a little bit optimistic about what the latest data portend for conditions going forward. But, as we shall also see, there are still several issues, of both a cyclical and structural nature, that will serve as reminders of just how much work there is left to be done.

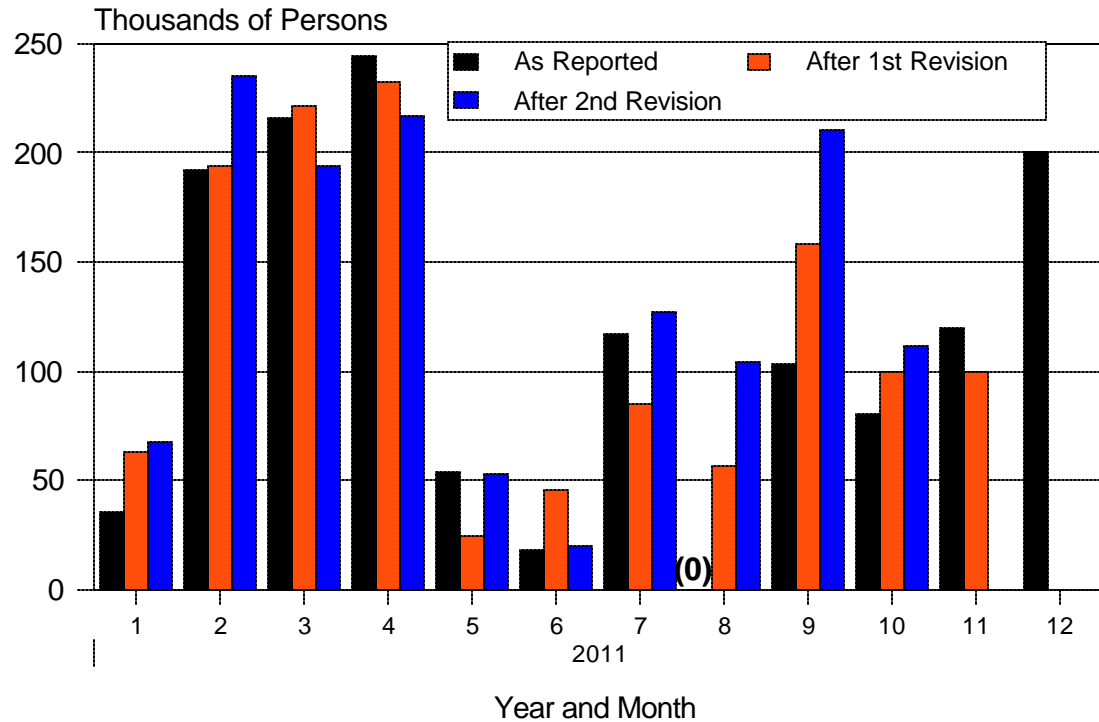
Those of you with eagle-eyes (and I know who you are) may be wondering what happened to the “after bench mark revisions” column that usually appears on this table. Well, this month that column was completely blank, so I left it off. It will be back next month when the revisions to the payroll data are published.

Month:Year	As Reported	After 1st Revision	After 2nd Revision
1:11	36	63	68
2:11	192	194	235
3:11	216	221	194
4:11	244	232	217
5:11	54	25	53
6:11	18	46	20
7:11	117	85	127
8:11	0	57	104
9:11	103	158	210
10:11	80	100	112
11:11	120	100	
12:11	200		



Chart 2 Total Nonfarm Payroll Employment -- Change from Prior Month

The net revisions to the two prior month's figures did not amount to much. As was the case on Chart 1, we don't have a benchmark revision set of bars here. What will be nice is that they will almost certainly revised away that zero in August. Which will have the added benefit for me of not having to move that (0) around every time I update the chart. Of course, knowing Saint Offset's evil mind, they will probably revise it to a negative, which will mean the vertical axis will get messy.



December 2011 Headline Change = +200
December 2011 Change Net of Revisions = +192



Chart 3 Selected Measures of Nonfarm Payroll Employment -- Change from Prior Month

As has been the case every month this year, save the aforementioned August, all of the gain in payrolls have come from the private sector. This is the new normal, at least until we get into another budget cycle at the state and local levels of government.

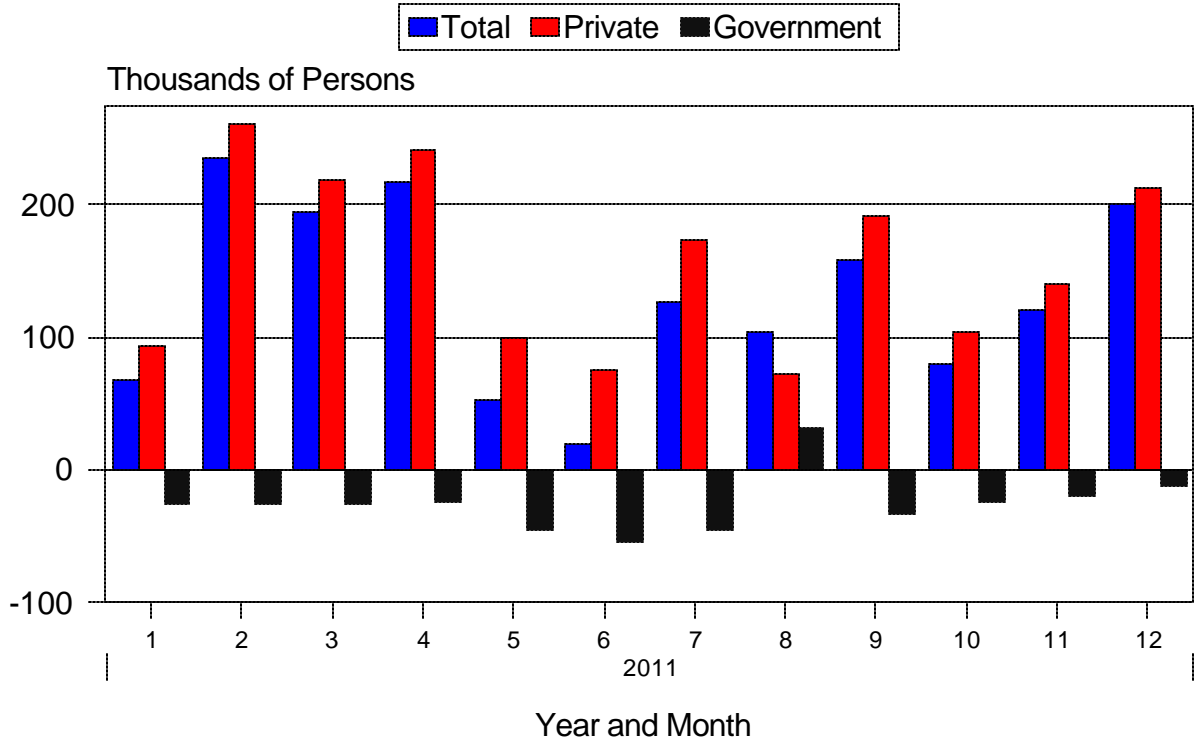




Chart 4 -- Total Nonfarm Payroll Employment Change from Prior Month, Thousands

I am very happy to bid a fond farewell to this chart. Next month we get to drop all the 2010 observations and redo the vertical scale. This will be the last time you see the Census workers.

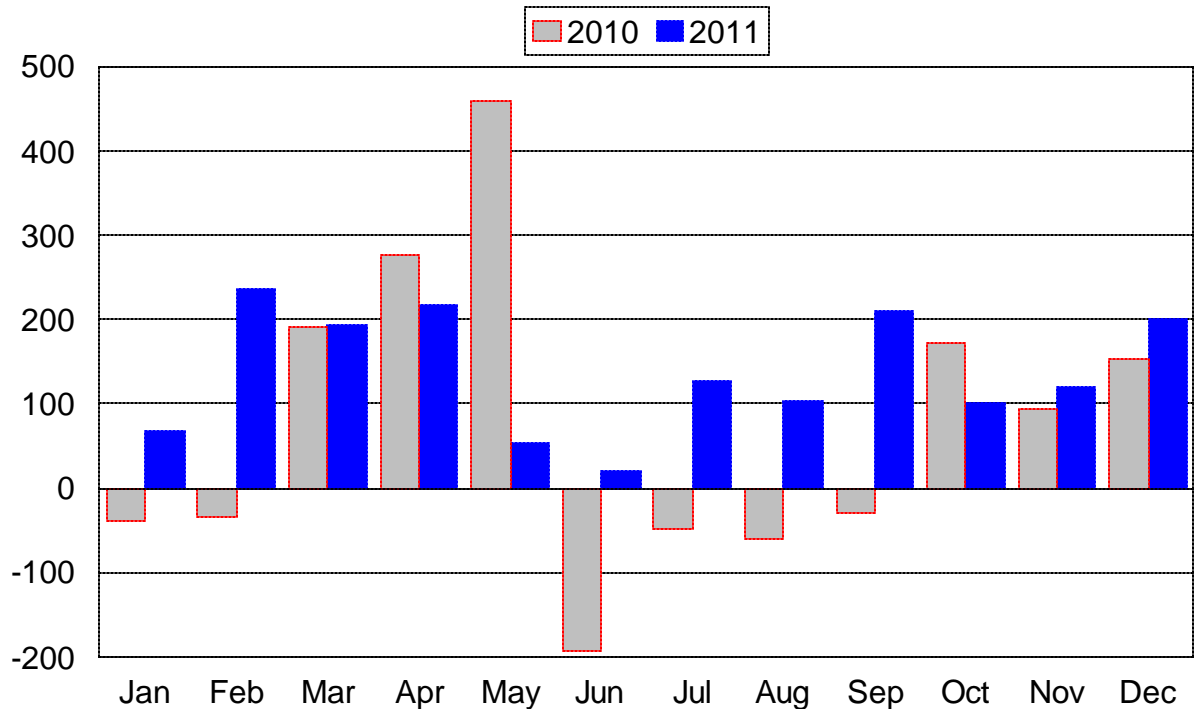




Chart 5 -- Total Private Payroll Employment Change from Prior Month, Thousands

This chart will get more attention Next month you will get an expanded treatment of these numbers as we make charts that show these figures and the revisions that will be published affecting both 2010 and 2011. What I am also thinking of doing is leaving the revised 2010 and 2011 figures on the chart so we can see whether the May and June pattern repeats this year.

As James Bond famously put it: "Once, is an accident. Twice, is a coincidence. Three times, is enemy action."

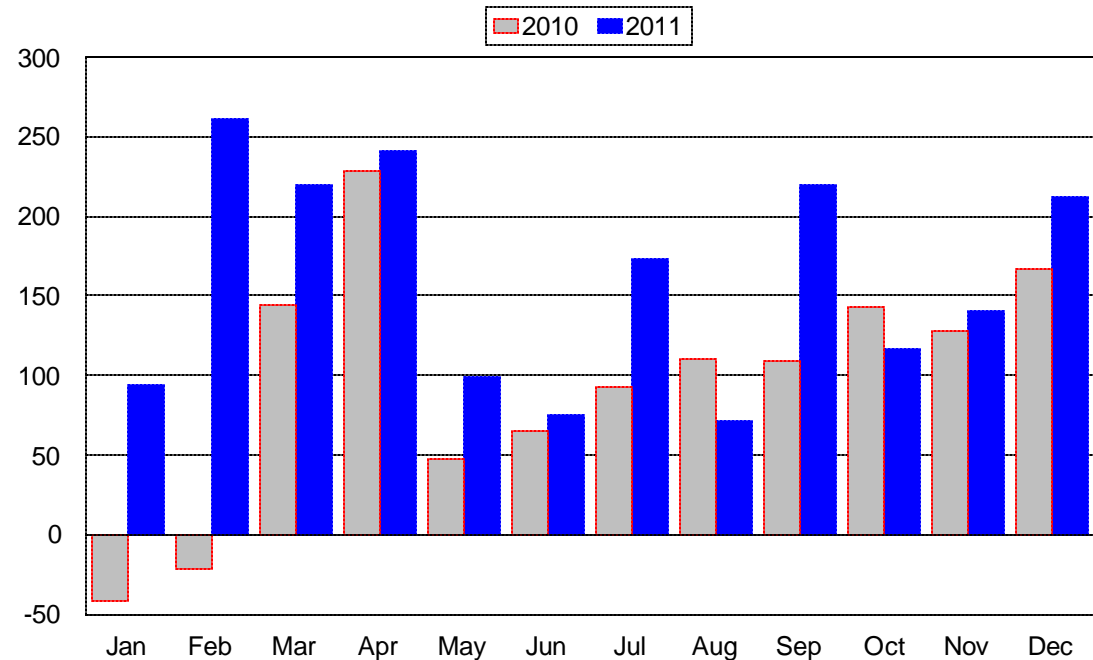




Chart 6 -- Total Government Payroll Employment Change from Prior Month, Thousands

The future status of this chart is still pending. My guess is that after we take the 2010 figures off it we won't have enough data with which to make meaningful comparisons. So, don't be surprised if this chart gets replaced.

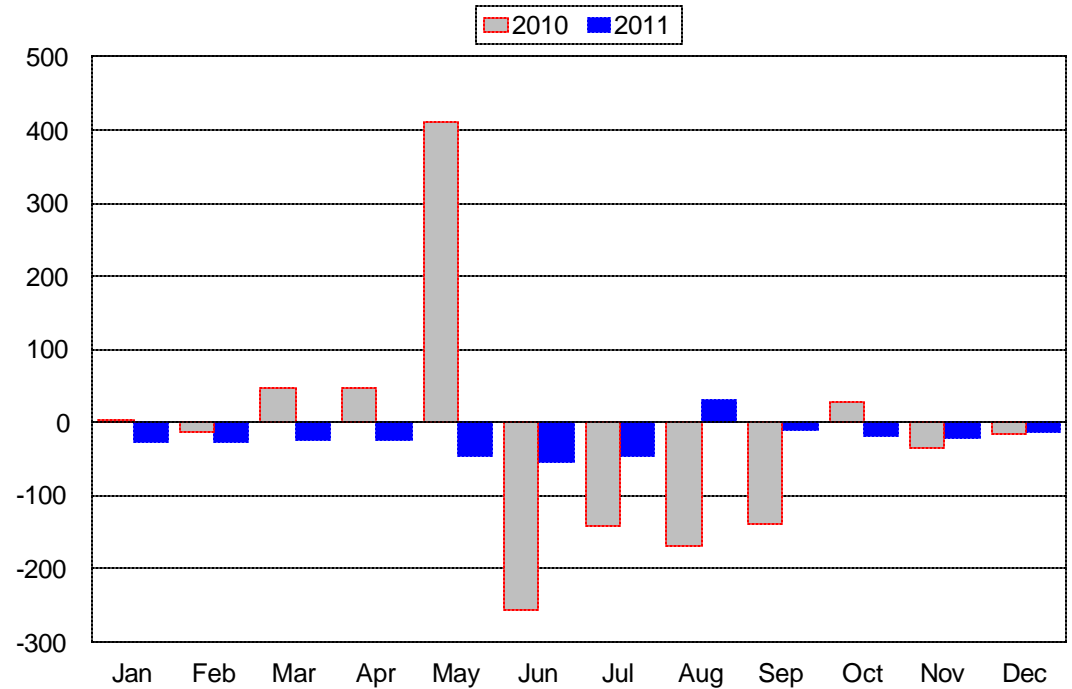
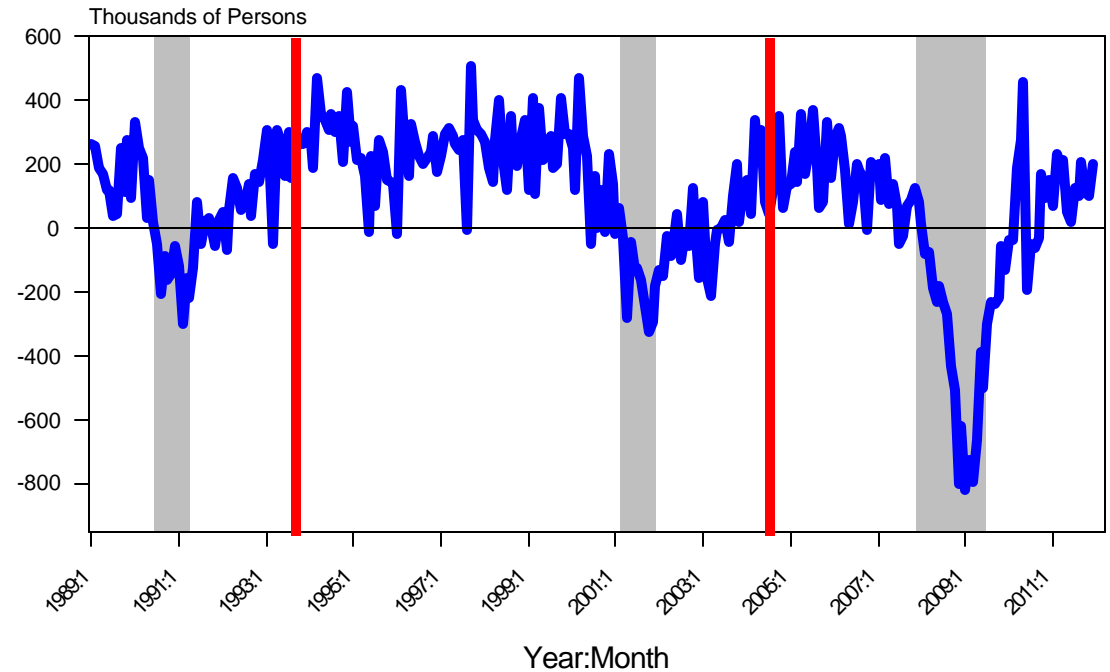




Chart 7 Total Nonfarm Payroll Employment Change from Prior Month

As of December 2011 we are 30 months off the official recession end date of June 2009. The two red bars on the chart mark the same point after the end of the recessions in 1991 and 2001. As was the case then, we have first and ten at midfield.

Note that it took about three years for the employment situation to improve to the point where it began to show steady month-to-month gains.

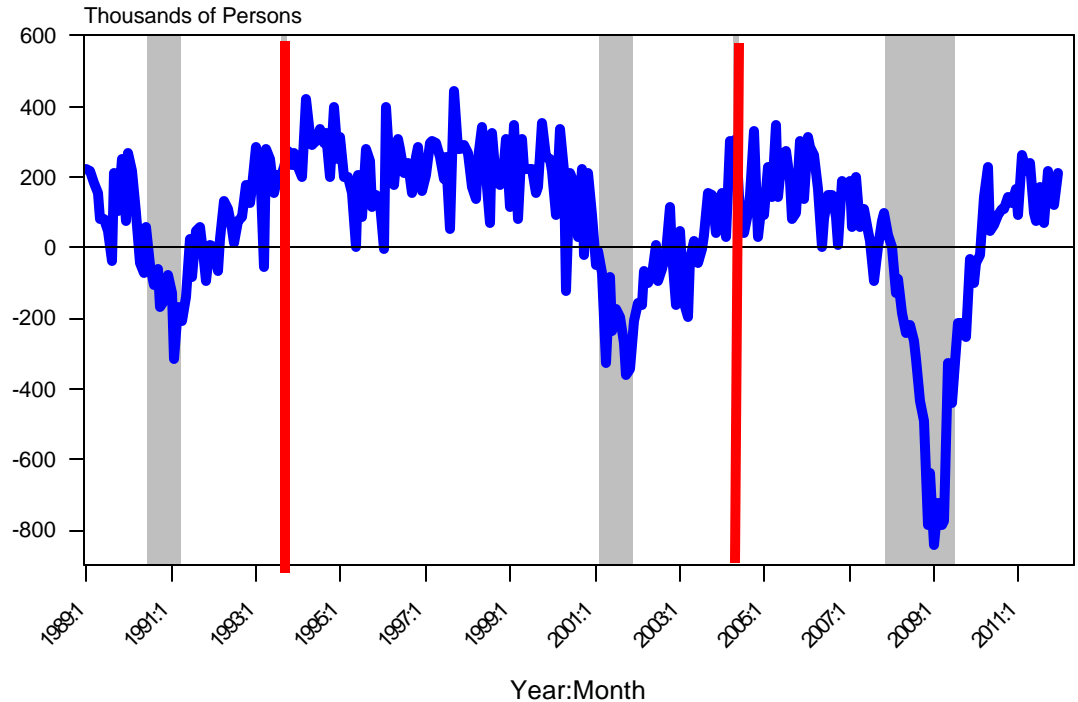


<u>Date</u>	<u>CHG.</u>
2011:9	210
2011:10	112
2011:11	100
2011:12	200



Chart 8 Private Sector Nonfarm Payroll Employment Change from Prior Month

The same mileposts we put on the Total payroll chart are on this chart. One thing that does jump out is that we can see the weakness in employment associated with end of the housing boom starts to have an effect from 2006 forward. For those of you who may not remember, single-family housing starts peaked in January 2006 at about 1.8 million units and then began a precipitous decline.

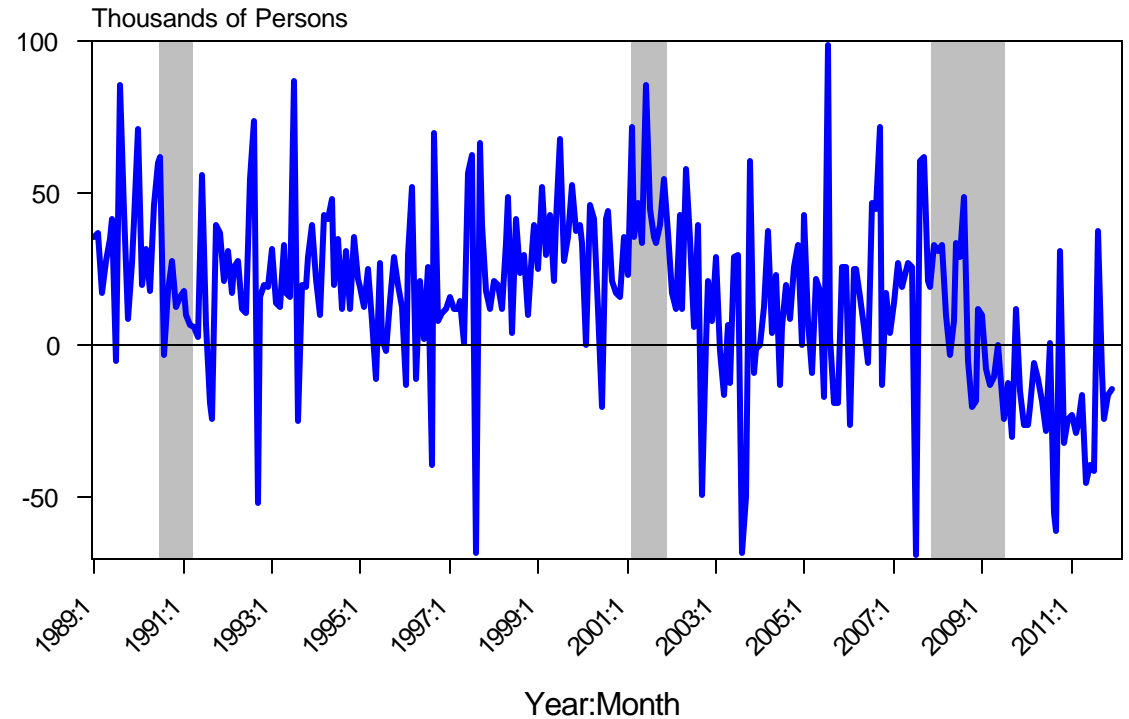


<u>Date</u>	<u>CHG.</u>
2011:9	220
2011:10	134
2011:11	120
2011:12	212



Chart 9 State and Local Government Nonfarm Payroll Employment Change from Prior Month

No need for mileposts here as the only question that will matter is when this line comes back above zero.



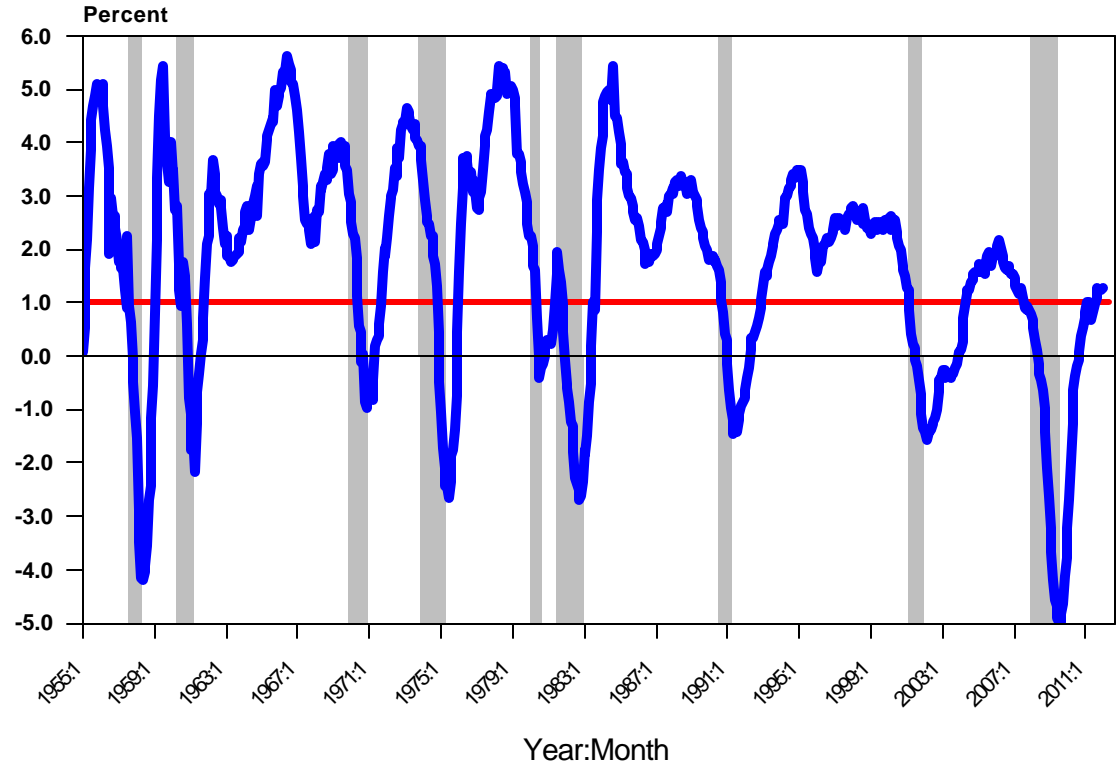
<u>Date</u>	<u>Chg.</u>
2011:9	- 9
2011:10	-24
2011:11	-16
2011:12	-14



Chart 10 Total Nonfarm Payroll Employment Change from Year-Ago Month

Now that we appear to have made it through the +1% line to stay, the question becomes what will we need to see in terms of a headline rate of payroll growth to avoid going back through the 1% line.

The answer is a monthly average of about 135,000 persons, which would appear to be doable in the absence of any shocks. But, let's not provoke Saint Offset. He is an angry and vengeful god.



<u>Date</u>	<u>%Chg</u>
2011:9	1.27
2011:10	1.22
2011:11	1.22
2011:12	1.26



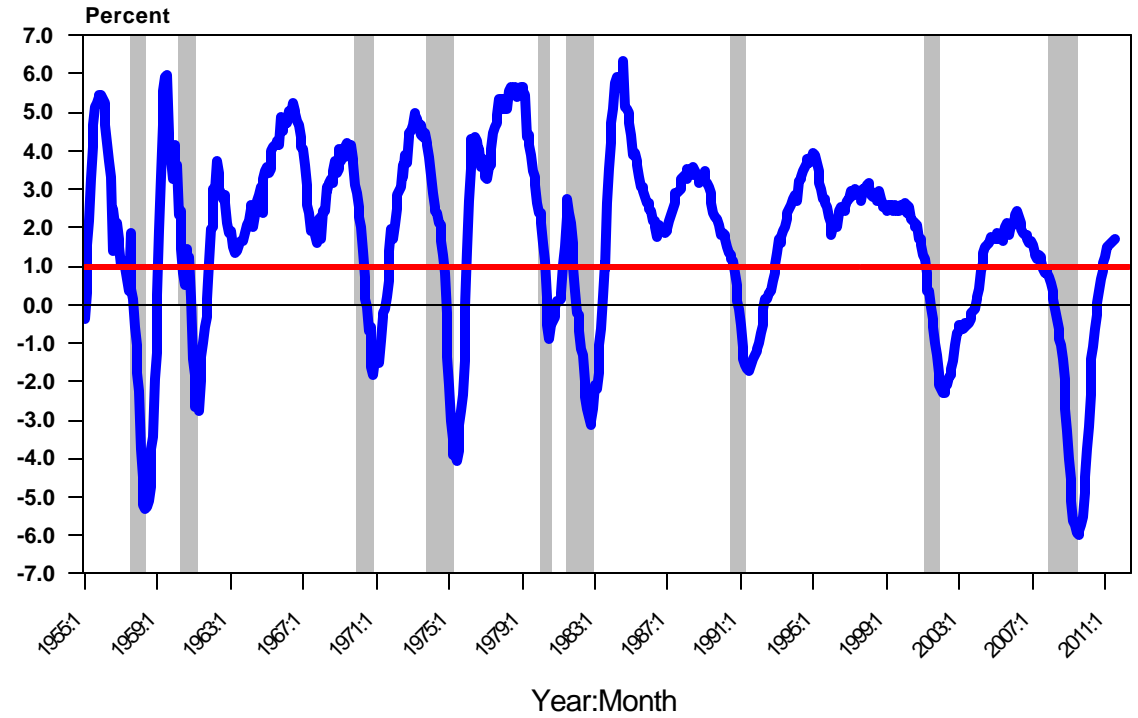
Chart 11

Total Private Nonfarm Payroll Employment

Change from Year-Ago Month

Were we to average private payroll gains of about 160,000 per month, the line on this chart would track sideways across the page, which is something it has been known to do in expansions.

Indeed, I would take a sideways track at the current level in a heartbeat. Not only would such a pattern signal that the expansion is firmly in place. It would also lend an air of calm to the proceedings, something that has been sorely lacking.



Private Payrolls	
Date	%Chg
2011:9	1.76
2011:10	1.75
2011:11	1.74
2011:12	1.78

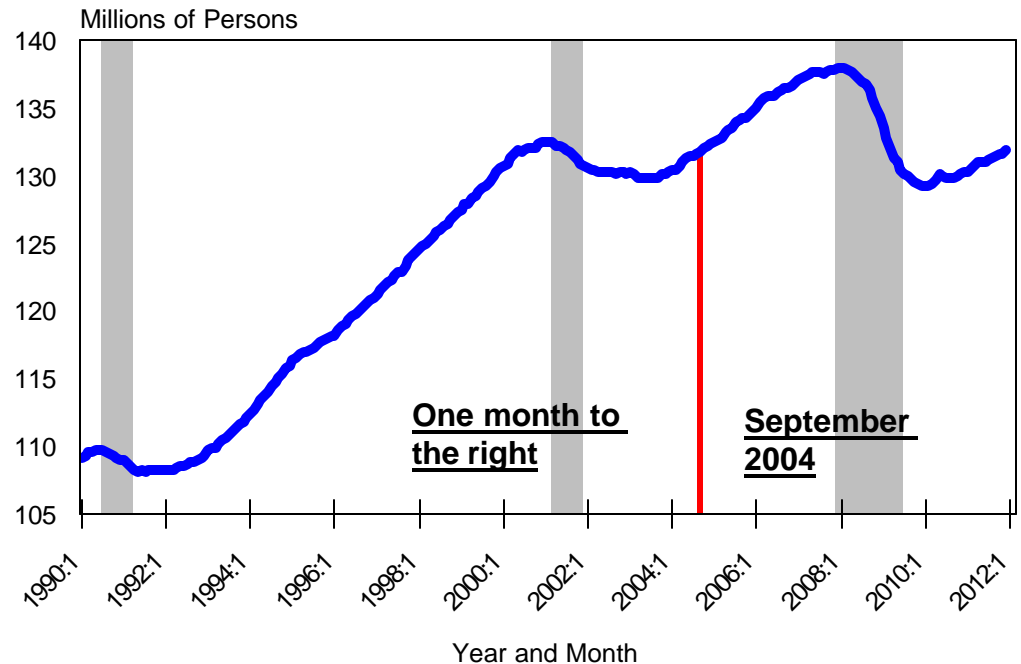


Chart 12 Total Nonfarm Payroll Employment

I had a question about this chart last month, the answer to which I wanted to share with the whole readership. I was asked why there is a red line on the chart. The answer is to remind us of the extent of the damage we did to total employment in the recession. While the track of the blue line does a pretty good job of that, the red line tells us when the last time the level of employment was as low as it is now. Answer, in September 2004.

What is the relevance? I happen to think that the fact that we destroyed almost a decade's worth of job creation in this downturn should be factored into our expectations of when and how a complete recovery in employment may take place. If, indeed, it takes place at all.

So, that concludes our review of the Establishment survey. Pretty much plain vanilla. But that's nice at this stage.



Total Nonfarms (000)	
2011:9	131,488
2011:10	131,600
2011:11	131,700
2011:12	131,900

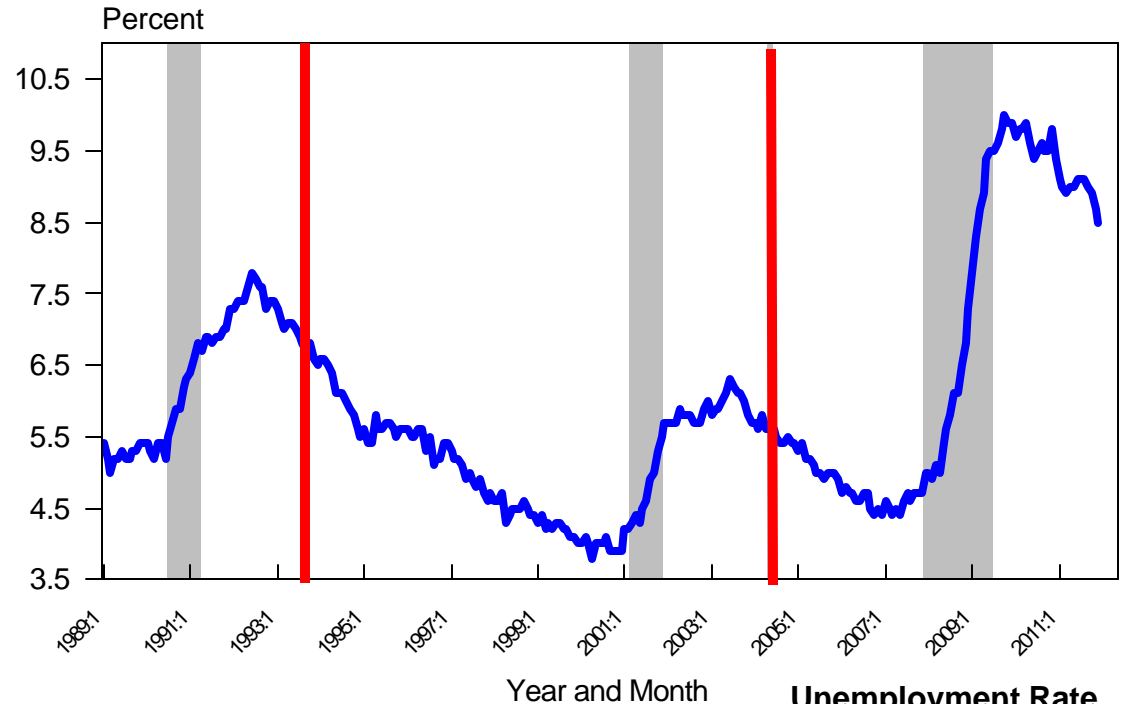


Chart 13 Civilian Unemployment Rate

The Household Survey was not bad, but it was also not good. For those of you who follow the Aggregate Spread very closely, the revisions to the Unemployment Rate that were published with this report are going to move the numbers in the Real Spread and the Aggregate Spread around a little. I will make note of the changes when we do the other reports later in the month. For now, let's just concentrate on the Unemployment Rate itself.

As you can see here it now appears that we may have entered the phase of expansion where we finally see steady declines in the Unemployment Rate. As was the case in the Establishment Survey, I have put vertical lines on this chart indicating the 30 month interval from the ends of the last two recessions. Look familiar?

Now you can certainly argue that the vertical lines should be moved to the left, but that is not the point. The point is that ever since the 1990 recession we have noted the tendency of the Unemployment Rate not to make its cycle-associated peak until well after the recession is over. The question now is how low the number can actually go before we start to worry about the onset of a new downturn.



Unemployment Rate	
2011:9	9.0
2011:10	8.9
2011:11	8.7
2011:12	8.5



Chart 14 -- Unemployed by Duration of Unemployment

Number of Weeks

The main reason for that concern is seen here. The highest single Unemployment Rate is that for the long-term unemployed. Until we see some improvement in that statistic, we will have little real progress to report.

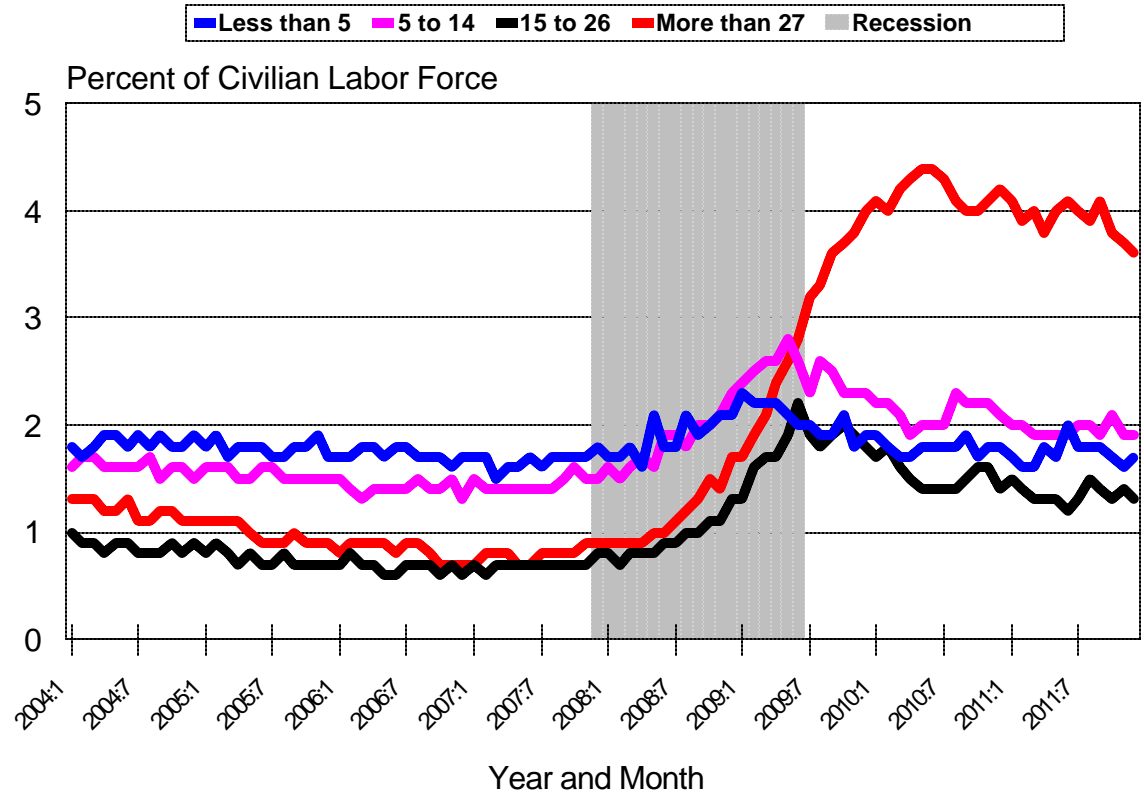




Chart 15 Components of the Civilian Unemployment Rate

Change from Prior Month --Thousands of Persons, except where noted

Along with the composition of the Unemployment Rate as relates to the length of time people have been unemployed, we also have to worry about the continued problem a declining workforce as relates to what the Unemployment Rate actually means.

As you see here, we had another one of those reports where the Unemployment Rate went down at the same time as the workforce went down. As welcome as it was to see another gain in employment, it would have been much nicer to see a rise in the workforce at the same time.

To extend our analogy from the opening section, the Household Survey made a first down only because a defensive penalty. Yes, the chains moved, and it is first down at mid field, but one cannot rely on the errors one's opponent if one hopes to have long-term success.

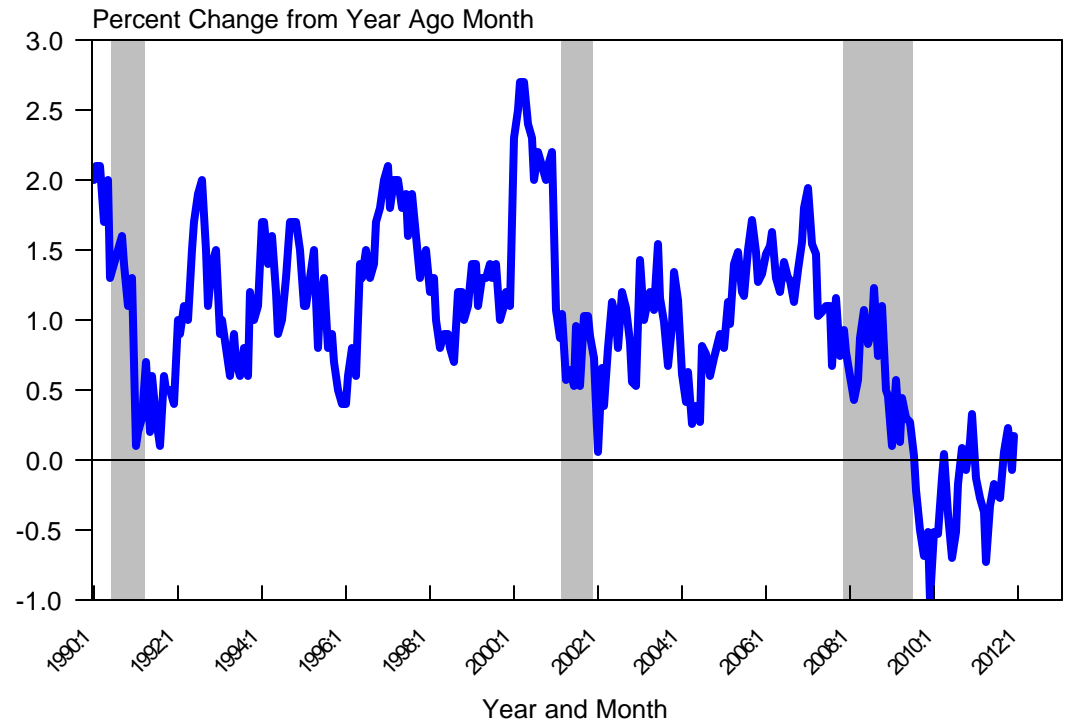
Month:Year	Change in Labor Force [1]	Change in Employment [2]	Difference = [1] - [2]	Change In Unemployment Rate (Basis Points)
7:11	-51	65	-116	0
8:11	316	304	12	0
9:11	330	353	-23	-10
10:11	53	190	-137	-10
11:11	-120	317	-437	-20
12:11	-50	176	-226	-20



Chart 16 Civilian Labor Force

In one of those instances that makes you go back and check your figures, we find that the labor force was down for the month (see the prior chart) but is up slightly on a year-over-year basis (see the inset table below). None of this changes the configuration of the chart. And that is what we worry about.

If this pattern persists much longer we will have to start talking about the Unemployment Rate differently. The best situation, the one associated with healthy economic growth, is where we have employment rising faster than people enter the workforce to look for jobs. The situation we have now is second best, by a wide margin, because we have people getting jobs, which is always good, but the workforce is not growing, which is bad. Why? Because we have a lot of people of working age who are not in the workforce. And, because demography is destiny, we are going to have a lot more of those folks over the next several years as the echo of the baby boom reaches working age. Our task, boomers, is to find jobs for our kids that will pay them enough for them to buy our houses and stocks. This chart says we are failing at that task.



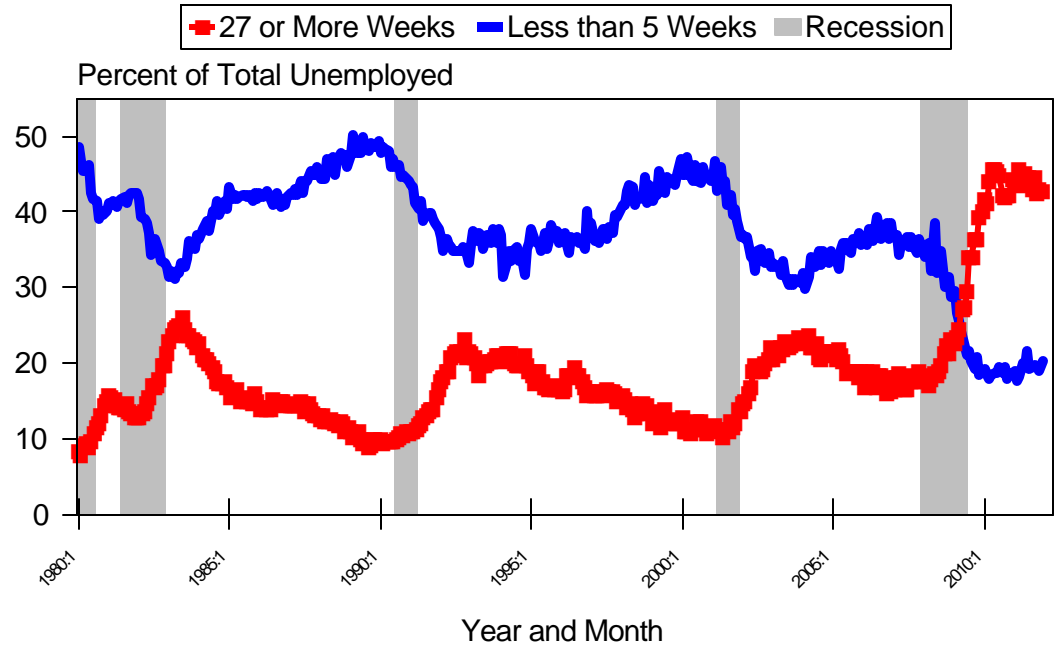
<u>Date</u>	<u>Pct. Chg.</u>
2011:9	0.06
2011:10	0.23
2011:11	-0.07
2011:12	0.18



Chart 17 Duration of Unemployment

For the record, the last time the red line on this chart was below 40 was in November 2009. Until such time as the line goes below that level, I don't think there is much meaning in the month-to-month changes we have been seeing recently.

And, while we are on the subject of records, the high of 45.6 occurred in May 2010.

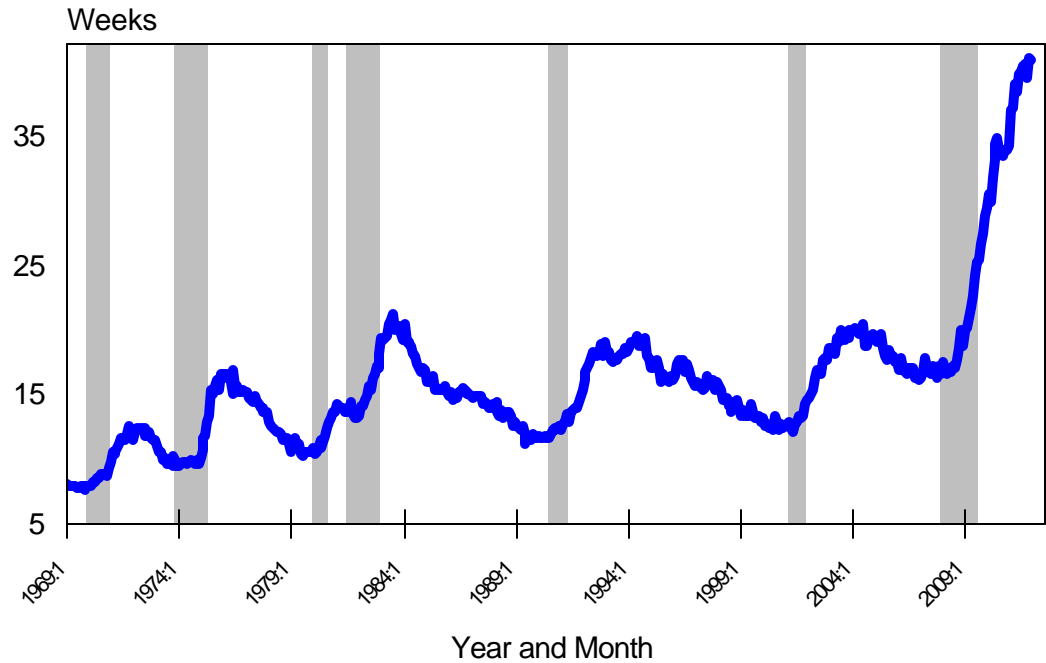


<u>Date</u>	<u>%27+Weeks</u>
2011:9	44.6
2011:10	42.4
2011:11	43.0
2011:12	42.5



Chart 18 Average Duration of Unemployment

The latest reading here is just slightly below the all time high that was set last month. My surmise is that the track of the line is going to depend on what is finally decided about long-term unemployment benefits. As you know, we had another round of Congressional brinkmanship last month over precisely that point. The benefits were extended through February, when there will be another round of fun and games.

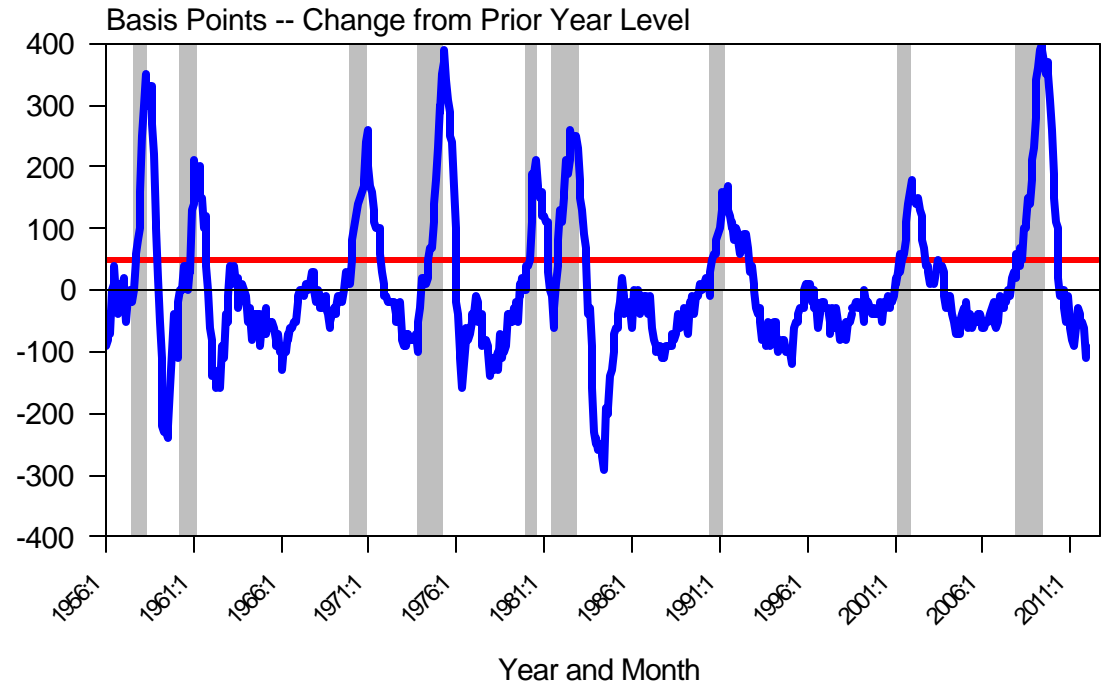


<u>Date</u>	<u>Weeks</u>
2011:9	40.5
2011:10	39.4
2011:11	40.9
2011:12	40.8



Chart 19 Civilian Unemployment Rate

One last item, for those of you who are in the imminent recession camp: The Unemployment Rate will have to go back to at least 9% for the line on this chart to get to zero. So, even if all we did was go sideways at 8.5% the line on this chart will stay in negative territory.



<u>Date</u>	<u>Level</u>
2011:9	-50
2011:10	-60
2011:11	-110
2011:12	-90



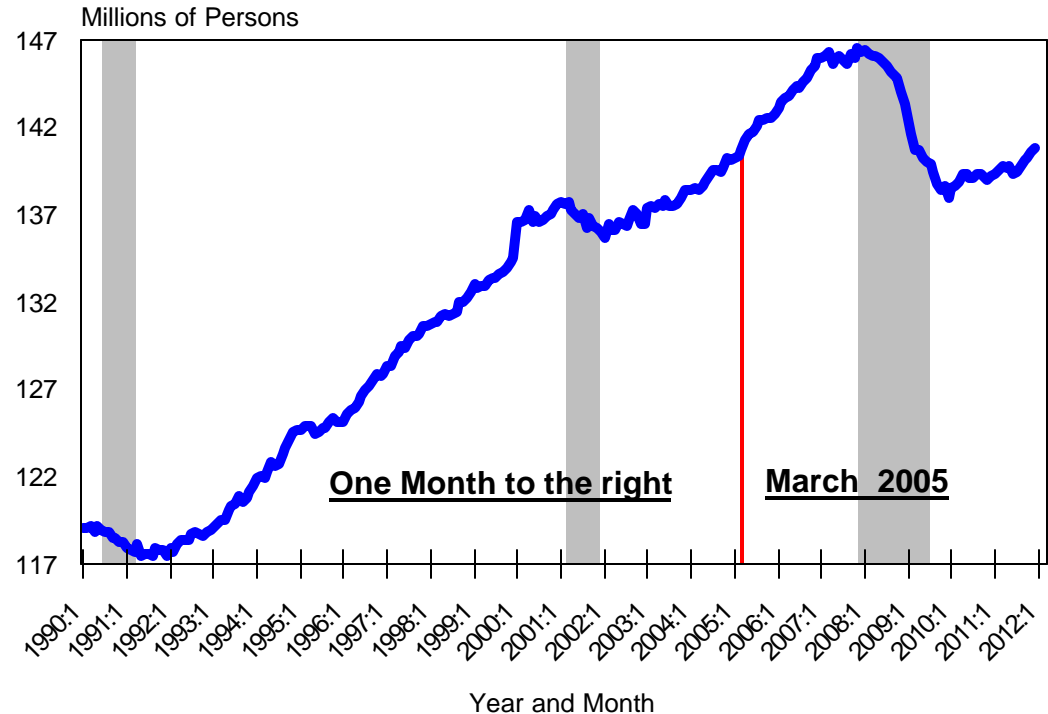
Chart 20 Total Civilian Employment

Let's conclude our review of the Household data with companion information to Chart 12 on Nonfarm Payrolls.

Household Survey employment bottomed at 139.2 million in December 2010. The previous reading of a level of employment that low occurred in June of 2004. So, today, we are at approximately the same level of employment that we had in March of 2005.

While I have no doubt that much will be made of the recent declines in the Unemployment Rate, the details of the report continue to show a great degree of distress in the labor market.

The other day I happened to have a conversation with some of the younger people (which is just about anybody other than me) who work in the building. We were talking about the employment numbers and one of them said: "When I got my job back the depression ended. But as long as I know someone who is unemployed, you are not going to convince me that the recession is over." I think there is a lot of truth to that, as far as the general public is concerned. As long as they know someone who can't find a job they are not going to believe the recession is over.



Total Civilian (000)	
2011:9	140,107
2011:10	140,297
2011:11	140,614
2011:12	140,790



Chart 21 10-Year Treasury

Now, on to what the latest numbers might portend for interest rates and stock prices.

As I mentioned in the last set of reports, we reformatted the comparison charts for interest rates and stock prices to show 2011 and 2012. Since we are only three trading days into the new year, the data points are few.

But, as you can see on this chart there is already something to ponder. Today the 10-Year is about 150 Basis Points lower than it was a year ago. The question is why? Part of the answer is the flight to quality associated with the problems in Europe. Part of the answer is what bond-portfolio managers have had to do (buy the damn stuff) in order to keep their portfolios within hailing distance of their bogeys.

None of the answer, however, includes a lower perceived level of risk or a reduced inflation rate. So, the larger question becomes: How much longer can this go on?

You now know one of the major topics for this month's reports.

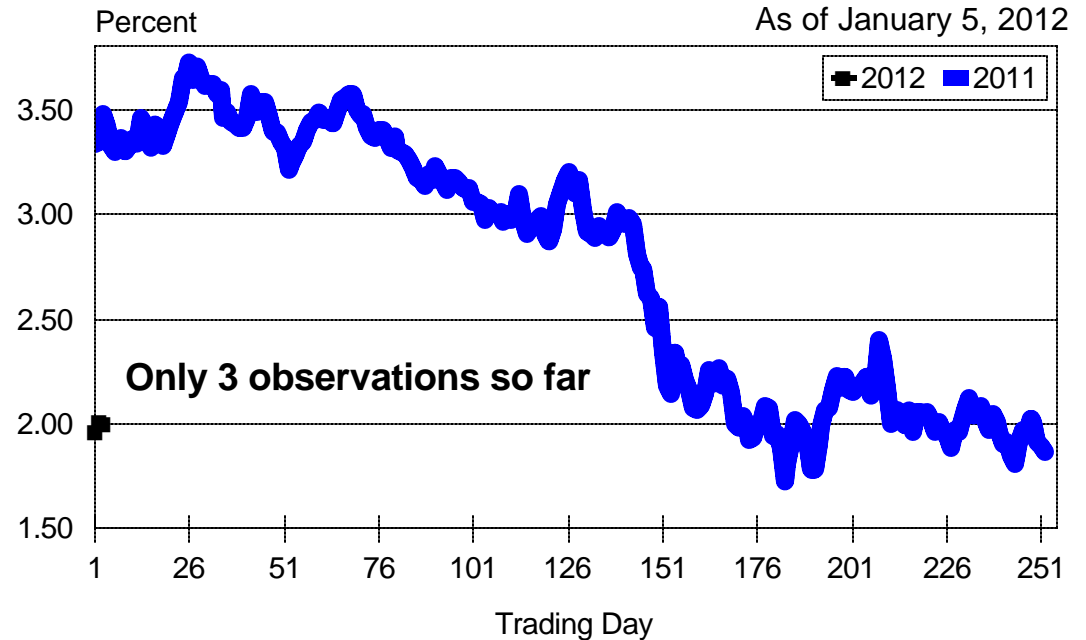
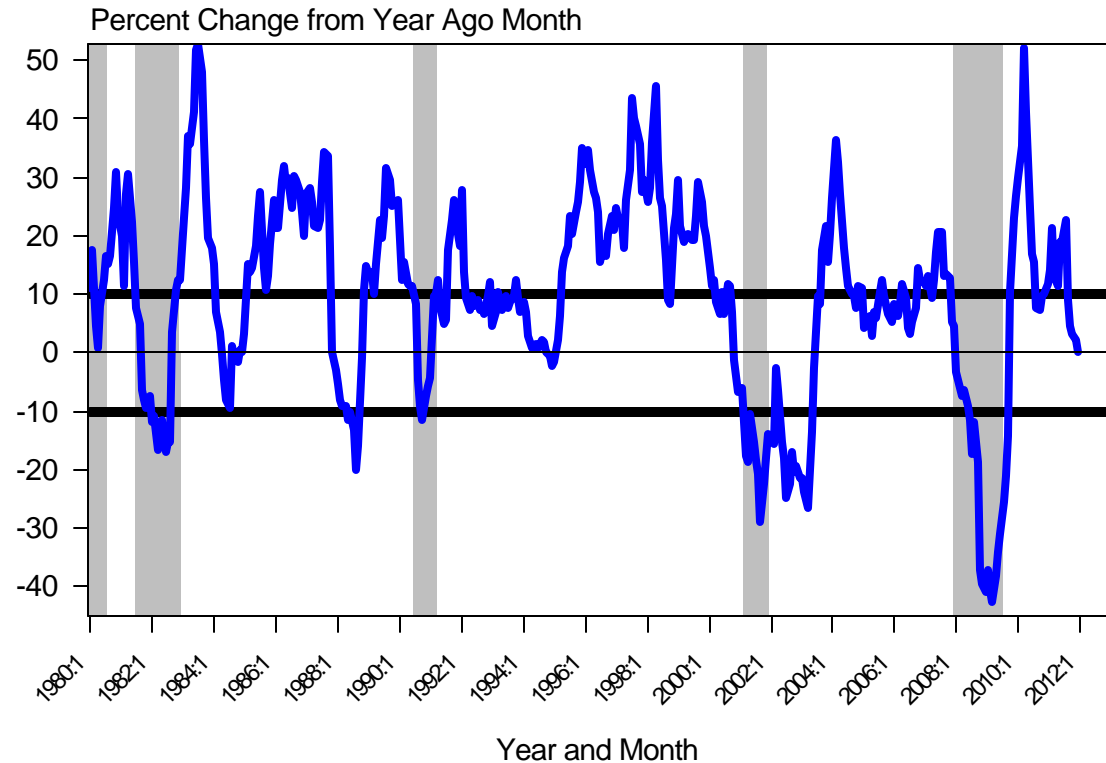




Chart 22 -- Standard and Poor's 500 Stock Index

Here is the chart for stock prices. I noticed the last time I looked at the tape that the equity boys were underwhelmed with this morning's employment news. And rightfully so. The news was really not that good.

The issue here is whether what we see now with line just about to touch zero is a repeat of the situations in front of all the recessions on the chart or a repeat of the three cases you see there where the number went through zero without a business cycle peak following close behind.



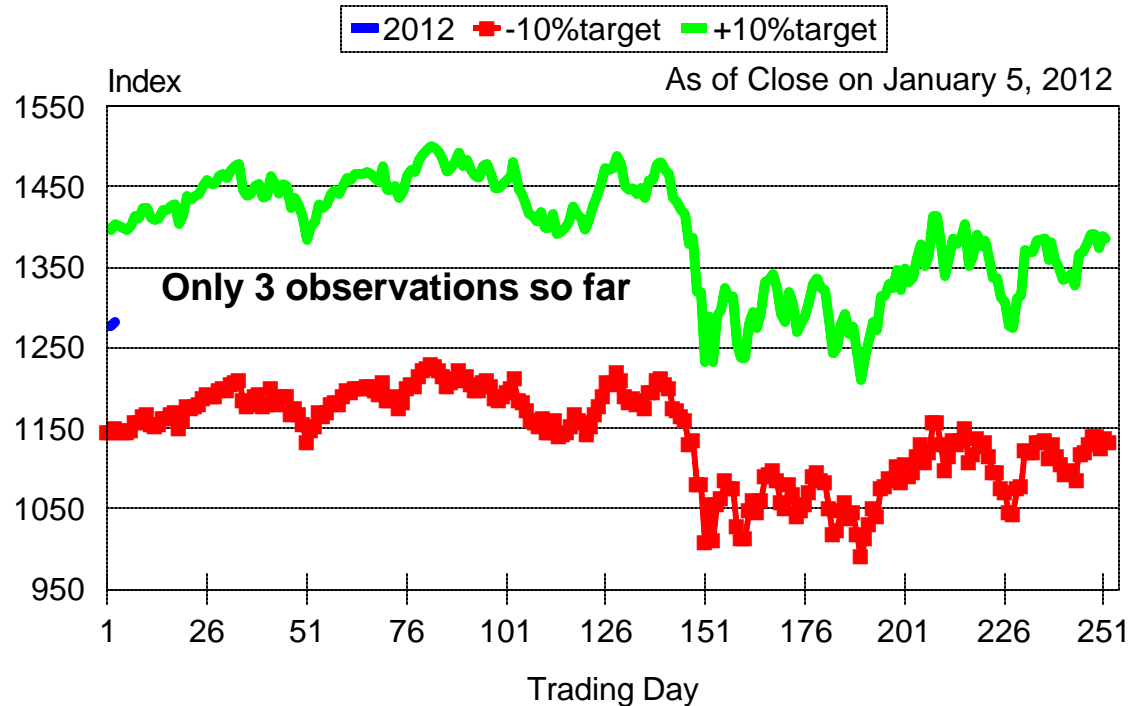
Date	%Chg.
2011:8	9.02
2011:9	4.61
2011:10	3.04
2011:11	2.30
2011:12	0.15



Chart 23 -- SP500 2012 Daily Close with Zone of Death Limits

Which of those instances this episode replicates will be decided here.

When I updated this chart I noticed that we have started the year almost exactly halfway between the red and green lines of the chart. And so, you can see the levels at which the SP500 has to trade over the course of the year for us to get out of the Zone of Death.





Summary and Conclusions

- **Establishment Survey:**
 - The December gain in payrolls was decent and reasonably well balanced. If we can keep this up we will solve many problems.
 - The private sector continues to account for all the forward progress and is expected to do so for the foreseeable future.
 - Service-providing firms will continue to be the main engine, but manufacturing may help. The key will be when we get construction back on line.
- **Household Survey:**
 - The continued drop in the Unemployment Rate did not signal any significant improvement in labor market conditions.
 - Continued contraction of the labor force remains a concern.
 - Long-term unemployment remains high and little changed
- **Major Players:**
 - **Political:** All drops in the Unemployment Rate favor the incumbent. But the high rate and pace of improvement provide ammunition to the challengers.
 - **Federal Reserve:** A new roster of voting members will be present at the next meeting. The minutes should make interesting reading.
 - **Fixed-Income:** Still hostage to the flight-to-quality crowd. But rates are more like to rise than to fall once that effect wanes.
 - **Equity Market:** Thrashing around in the Zone of Death is likely to continue.
- **The Drive's Alive:**
 - The Establishment Survey showed that we are making progress in putting people back to work.
 - The Household Survey gave the illusion of progress, which may serve in short run as we try to make more substantive gains.



Disclaimers and Limitations of Liability. THE SERVICES AND INFORMATION PROVIDED BY RDLB ARE PROVIDED "AS IS", WITHOUT WARRANTY OF ANY KIND TO SUBSCRIBER OR ANY THIRD PARTY, INCLUDING, BUT NOT LIMITED TO, ANY EXPRESS OR IMPLIED WARRANTIES OF MERCHANTABILITY OR FITNESS FOR PARTICULAR PURPOSE, ACCURACY OF INFORMATIONAL CONTENT, AND NON-INFRINGEMENT. RDLB, INC. SHALL NOT BE LIABLE TO SUBSCRIBER OR ANY THIRD PARTY FOR ANY LOSS OF PROFITS, LOSS OF USE, INTERRUPTION OF BUSINESS, OR ANY DIRECT, INDIRECT, INCIDENTAL OR CONSEQUENTIAL DAMAGES OF ANY KIND THAT MAY RESULT FROM THE USE OF ITS REPORTS OR THE *RDLB WEB SITE* BY SUBSCRIBER OR ANY THIRD PARTY, WHETHER UNDER THIS AGREEMENT OR OTHERWISE, EVEN IF RDLB, INC. WAS ADVISED OF THE POSSIBILITY OF SUCH DAMAGES OR WAS GROSSLY NEGLIGENT.

RDLB, INC. HAS MADE ALL REASONABLE EFFORTS TO INSURE THE ACCURACY OF THE DATA ON WHICH THE FORECASTS AND PROJECTIONS CONTAINED IN ITS REPORTS HAVE BEEN BASED BUT CANNOT AND DOES NOT GUARANTEE THE ACCURACY OF SUCH UNDERLYING DATA OR STATISTICS.

RDLB, INC. FURTHER ASSUMES NO RESPONSIBILITY OR LIABILITY OF ANY KIND TO SUBSCRIBER OR ANY THIRD PARTY DUE TO ANY LOSS OR DAMAGE THAT SUBSCRIBER OR ANY THIRD PARTY MAY INCUR IN THE EVENT OF ANY FAILURE OR INTERRUPTION OF THE *RDLB WEB SITE* OR THE TIMELY DELIVERY OF ITS REPORTS TO SUBSCRIBER, OR DUE TO ANY OTHER CAUSE RELATING TO SUBSCRIBER'S ACCESS TO, INABILITY TO ACCESS OR USE THE *RDLB WEB SITE* OR THE REPORTS SUBSCRIBED TO HEREUNDER, WHETHER OR NOT THE CIRCUMSTANCES GIVING RISE TO SUCH CAUSE MAY HAVE BEEN WITHIN THE CONTROL OF RDLB, INC.

SOME JURISDICTIONS DO NOT PERMIT THE EXCLUSION OR LIMITATION OF LIABILITY FOR CONSEQUENTIAL OR INCIDENTAL DAMAGES, AND, AS SUCH, SOME PORTION OF THE ABOVE LIMITATION MAY NOT APPLY TO SUBSCRIBER. IN SUCH JURISDICTIONS, RDLB'S LIABILITY IS LIMITED TO THE GREATEST EXTENT PERMITTED BY LAW.

Copyright © 1989-2012 RDLB, Inc. The trademark Mr. Model is owned by RDLB, Inc.

Visit our web site at:

WWW.NOSPINFORECAST.COM

RDLB, Inc.

One Imperial Place, Suite 300

Lombard, IL 60148

630-261-8128