

WEEK OF MAY 8, 2006—THE JOBS PICTURE

April's unemployment report showed our economy still adding jobs—138,000 to private payrolls—though not at the rate of past recoveries. “The 12-month gain in payroll employment has been averaging about 160,000,” commented Barron's Gene Epstein, “which is below the standard of the late 1990s. However, it's been enough to lower the unemployment rate by about a half-percentage point over the past year (to 4.7 percent).”

However, there is puzzlement among economists on whether wages are increasing as well. This is important for future purchasing power that drives our consumer-oriented economy, needless to say. The question is whether in fact wages have grown at all when inflation is factored in. Most estimates (There are at least 5 different wage indexes published by government) show that from the Nov. 1, 2001 beginning of this recovery, average hourly and weekly earnings shrank until July 2005, before beginning to grow again.

The culprit has been inflation (at 3.6 percent) that has risen at almost the same annual rate as earnings (3.8 percent)! Earnings after inflation finally rose above the Nov. 2001 value this April. Inflation, in other words, has been an invisible hand keeping the lid on consumers' purchasing power. This is perhaps why consumers haven't been able to save any money at all. In fact, 2005 was the first year since the Great Depression that the personal savings rate went negative for the year.

There now is hope the jobs market has tightened enough that wage-earners will finally begin to get ahead. This is even though a whole segment has been left out of this recovery. Due perhaps to the structural changes (read globalization) that have displaced workers in the industrial sector, 18.6 percent of those unemployed have been out of work for at least 26 weeks, vs. 11.3 percent at this unemployment rate in past recoveries, according to the Economic Policy Institute.

A sign that consumers are trying valiantly to save more comes from the Federal Reserve's quarterly Consumer Credit statistics. Credit debt (not counting mortgages) has steadily declined from a 7.7 percent annual increase in 2001 to 1.4 percent in March 2006. Revolving debt (credit cards) has in fact shrunk by 0.2 percent over that time, while non-revolving debt (e.g., auto, boat, trailer loans) is rising 2.4 percent annually. But it rose 9 percent in 2001.

This does show that the Federal Reserve rate hikes have at least encouraged less borrowing of consumer loans. So much of today's consumer spending has to come from their homes. What will happen when and if mortgage rates—especially equity loans tied to the Prime Rate—continue to climb? That is why the Fed may take a pause at this time.

Another heartening statistic was the first quarter jump in labor productivity of 3.2 percent in output per worker. This is above the 2.5 percent 10-year average and therefore gives the Fed another reason to pause, since higher productivity per worker lowers production costs, and theoretically inflation pressures.

UNEMPLOYMENT RATE—Of the 138,000 new payroll jobs, 37,000 were in the higher-paying construction and manufacturing for a change, which is why average hourly earnings rose faster than inflation. The picture doesn't look so good behind the numbers, however. The number of unemployed in the Household survey (that determines the jobless rate) increased 112,000, while 65,000 more stopped looking for work! Bottom line is that more workers are entering the workforce than are finding work. This is keeping the unemployment rate from declining further. Is their optimism misplaced? We shall see.

RETAIL SALES—"April Sales Sizzle" said one headline, increasing 6.6 percent year-over-year. Much of it was due to an early Easter. High-enders such as Nordstroms and discounters like Wal-Mart and Costco beat projections. This was to be expected with the huge jump in March personal income of 0.8 percent, largest gain since last Sept. And consumers are spending all of it, with the personal savings rate still negative. But rising prices took up half of the increase (i.e., 0.4 percent), which will prove worrisome to Fed officials debating whether to pause after the May 10 quarter-percent rate hike.

One sign of a weakening real estate market is declining affordability, as measured by the National Association of Realtors Affordability Index. It has been falling steadily from its 2001 high of 140 percent plus. It was 111.9 percent in March.

The index measures the percentage of a median-priced house that a family with median income can afford to buy. Such a family can therefore buy a house worth 111.9 percent of a median-priced house (of \$217,300) in March, which equals \$243,159. This is even though median prices have fallen \$12,000 since June 2005 (from \$229,000). Why? Interest rates have risen three-quarters percent since then.

The May 10 Federal Open Market Committee meeting of Fed Governors ended as expected with another quarter point rate hike, so that the Prime Rate is now 8 percent. The FOMC chose not to predict an end to the rate hikes just yet, disappointing many. The reason? Inflation seems to be rising at present, which means consumers have not stopped shopping and are willing to pay the higher prices.

So the Fed's earlier prediction that growth is "likely to moderate to a more sustainable pace, partly reflecting a gradual cooling of the housing market and the lagged effects of increases in interest rates and energy prices" isn't happening yet.

Therefore, the press release accompanying the increase noted that "some further policy firming may yet be needed to address inflation risks but emphasizes that the extent and timing of any such firming will depend importantly on the evolution of the economic outlook as implied by incoming information."