

Hung Jury

Last week was a huge week for economic data. We had hoped that the new information would let economists render a verdict on the question: recession, or not? Instead, we have a hung jury.

As we said in last week's Monday Morning Outlook, proof of a current or imminent recession would require "that the numbers are *consistently* painful and much worse than the consensus expects." At the end of the week, what we were left with was enough painful reports to allow a pessimist to remain pessimistic. But there was also a great deal of very positive news, which reinforces our more optimistic forecast of no recession.

The labor market provided some highly conflicting news. Friday's payroll report generated the worst negative headlines, with an overall payroll decline of 17,000 in January and a private sector increase of a mere 1,000. This contradicted the ADP National Employment Report, which counted a 130,000 increase in private sector payrolls. Initial unemployment claims soared to 375,000. But this can be attributed to seasonal adjustment problems that also drove a previous week down to an artificially low 300,000.

Although many claimed the decline in January payroll employment was the first "drop" in four years, this is not true. Most don't remember, but payrolls also fell in September 2005 and August 2007, only to be revised upwardly later to show healthy job growth. In addition, December job growth (originally reported as +18,000), which was thought at the time to be clear evidence of economic problems, was revised to show an 82,000 gain.

Moreover, the technical details of the report are suspect. Every month the Labor Department uses a birth/death model to estimate net job creation (or loss)

from firms that start-up (or fold-up) beneath the radar of the payroll survey. The January adjustment is almost always negative. But the January 2008 adjustment subtracted 378,000 jobs – a huge number – more than double the 175,000 subtraction in January 2007.

The BLS also incorporated new population estimates in its civilian employment data. After adjusting for these distortions, January civilian employment grew a very large 635,000, not the reported 37,000. In addition, the share of adults working increased to 62.9% from 62.7% in December, while the unemployment rate fell to 4.9% in January from its elevated reading of 5.0% in December.

And as if that weren't confusing enough for the jury, the ISM Manufacturing Index came in at 50.7, much better than the consensus expected and consistent with 3% real economic growth. But, Friday's figures on auto sales were extremely weak, suggesting December's softness in real consumption continued into January.

In addition, fourth quarter 2007 real GDP growth was just 0.6% at an annual rate, only one-half what the consensus expected. But the largest drag on growth was found in inventories. This would be very difficult to duplicate in early 2008 as corporate stockpiles are already razor thin. Meanwhile, home sales continued to plummet, while non-residential (business) construction continued to soar. Moreover, business investment in equipment and software accelerated in Q4, while new and unfilled orders for durable goods were strong in December, suggesting this will continue.

After all this, the judge has ordered the jury back into deliberation. And with so little data coming out in the week ahead, a final verdict is still a ways off. As a result, recent market volatility is highly likely to continue.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
2-4 / 9:00 am	Factory Orders – Dec	+2.6%	+2.6%		+1.8%
2-5 / 9:00 am	ISM - Services – Jan	53.0	52.6		53.2
2-6 / 7:30 am	Non-Farm Productivity – Q4	+0.5%	+0.1%		+6.3%
7:30 am	Unit Labor Costs – Q4	+3.0%	+2.4%		-2.0%
2-7 / 7:30 am	Initial Claims – Feb 2	340K	351K		375K
2:00 pm	Consumer Credit – Dec	\$7.1 Bil	\$9.6 Bil		\$15.4 Bil
2-8 / 9:00 am	Wholesale Trade Sales	+0.1%	-0.5%		+2.2%