630-322-7756
www.ftportfolios.com

Mar 10, 2008

Monday Morning Outlook

Brian S. Wesbury - Chief Economist
Robert Stein, CFA - Senior Economist

Shrinking Payrolls Mean Sluggish Growth, Not Recession

Yes, it is true that employment data has been weak. It is also true that pessimism is rampant. As a result, following Friday's report that private payrolls dropped 101,000 in February (the second consecutive decline), it has become easy to believe that a recession has begun.

However, this would be a significant overreaction. Employment data in the past few months has not changed nearly as much relative to its trend as it did in previous recessions. Moreover, jobs fell in 2002 and early 2003, but the economy still expanded. Demographic patterns have slowed employment growth below historical norms. Consequently, the recent decline in payrolls is not proof that the overall economy is contracting.

One way to see this is to look at the difference between job gains during expansions and recessions. In the recovery of the1980s, payrolls grew by an average of about 230,000 per month. In the 1990-91 recession, payrolls declined by an average of 140,000 per month. The difference between gains during the expansion and losses during the recession was 370,000, or 4.4 million at an annualized rate. Total payrolls at that time were 110 million, which meant that the swing represented roughly 4% of total payrolls.

In the expansion of the 1990s, payrolls grew by an average of about 200,000 per month. In the 2001 recession, payrolls declined by an average of 200,000 per month. This difference of 400,000 per month represented 4.8 million at an annual rate and was 3.6% of total payrolls.

So far, the current shift in payroll growth pales by comparison, suggesting that the economy is not suffering as much as many fear. The last recession officially ended in November 2001 and since then payrolls have grown by an average of about 100,000 per month. In the past two months payrolls have dropped by an average of 43,000. The total swing is 143,000 and this represents a 1.7 million annual change or 1.2% of the total number of payroll jobs currently in existence. This is a significantly smaller shift than those that occurred in the recessions of 1990-91 or 2001.

Why? Well, one reason is that we may not really be in recession. Swings of 100,000 per month in jobs are barely above the level of statistical significance. Another reason is that we have seen a major shift in demographic factors.

Unlike the expansions of the 1980s or 1990s, the current one is the first to be affected by the aging of Baby Boomers beyond their peak working years. At the same time, the current expansion has seen much higher college enrollment rates for young people, while labor force participation by students has fallen. As a result, the trend growth in payrolls has been understandably lower. (Making up for this has been a strong increase in productivity, outdoing the expansions of the 1980s and 1990s.)

How can the economy still grow if payrolls are shrinking? The answer is productivity growth: more output per hour worked. For an historical example, we need look no further back than 2002 and the first half of 2003. During that 18-month period, payrolls *declined* by an average of 50,000 jobs per month (worse than the average in the past two months) while real GDP *expanded* at a 2% annual rate (matching our forecast for Q1).

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
3-10 / 9:00 am	Wholesale Trade - Jan	+0.5%	**+0.6%**		-0.7%
3-11 / 7:30 am	Int'l Trade Balance - Jan	-$60.0 Bil	**-$57.7 Bil**		-$58.8 Bil
3-12 / 1:00 pm	Treasury Budget - Feb	-$143.5 Bil	**-$174.0 Bil**		$17.8 Bil
3-13 / 7:30 am	Retail Sales - Feb	+0.2%	**+0.2%**		+0.3%
7:30 am	"Core" Retail Sales - Feb	+0.2%	**+0.2%**		+0.3%
7:30 am	Import Prices - Feb	+0.7%	**+0.6%**		+1.7%
7:30 am	Export Prices - Feb	+0.6%	**+0.6%**		+1.2%
7:30 am	Initial Claims - Mar 8	355K	**352K**		351K
7:30 am	Business Inventories - Jan	+0.4%	**+0.7%**		+0.6%
3-14 / 7:30 am	CPI - Feb	+0.2%	**+0.3%**		+0.4%
7:30 am	"Core" CPI - Feb	+0.2%	**+0.2%**		+0.3%
8:45 am	U. Mich. Consumer Sentiment	69.0	**71.0**		70.8