Weekly Economic Commentary

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The Next Two Million Jobs: An Update

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Highlights

- The focus this week is likely to be on corporate and Chinese data, rather than U.S. economic data.
- The economy is tracking to our bear case for creating the next two million jobs.

Economic Calendar

Tuesday, October 11
NFIB Small Business Optimism Index

Wednesday, October 12
MBA Mortgage Applications Index
wk 10/07

FOMC Minutes

Thursday, October 13
Initial Claims
wk 10/08

Trade Balance
Aug

Treasury Statement
Sep

Friday, October 14
Retail Sales
Sep

Import Price index
Sep

U of Mich Consumer Sentiment
Oct

Business Inventories
Aug

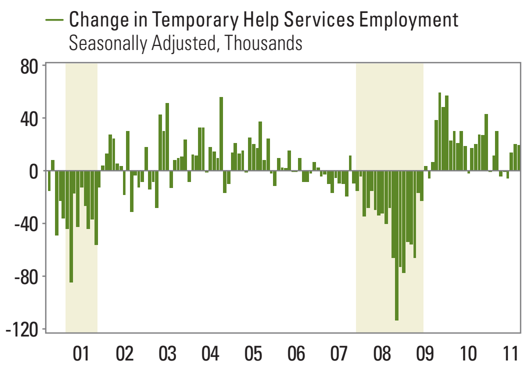
The light calendar for U.S. economic data this week will allow market participants to focus on corporate data (the unofficial start of the third quarter earnings reporting season for S&P 500 companies is this week), Chinese economic data, and monetary policy here and abroad (please see this week's *Weekly Market Commentary* for a full preview of the earnings season). However, the scramble to shore up the European banking system by European officials remains the market's utmost concern. As we have noted in several of our recent commentaries, markets are still calling out for bold, coordinated policy actions here and abroad, and markets in the past week or so have become increasingly confident that such actions will be taken—although the devil is in the details.

The market-moving economic data reports released in the United States this week are: the September retail sales report, weekly readings on retail sales, mortgage applications, and initial claims for unemployment insurance. In addition, the full slate of Chinese economic data for September is set to be released this week: money supply, new loans, imports, exports and, most importantly, the producer and consumer price data. Market participants continue to try to gauge the impact of the global economic slowdown on both the Chinese economy and Chinese inflation. The next policy move by the Chinese central bank, the People's Bank of China (PBOC), could very well be more important for markets than the next move by either the Federal Reserve (Fed) or the European Central Bank (ECB). If the September inflation readings in China continue to show that inflation peaked in July 2011, it may clear the way for a rate cut by the PBOC. On the other hand, a reacceleration of inflation in September might push the PBOC to tighten. Clearly, the market would prefer the former outcome rather than the latter. We continue to expect the next move by the PBOC will be to signal that it is finished raising rates for this cycle, but any rate cut may not occur until late in the year.

Outside of China, there are several key ECB and Fed officials slated to make public appearances this week. Notably, outgoing ECB President Jean Claude Trichet is scheduled to make three public appearances this week, while the man who is set to replace Trichet as ECB President at the end of the month (Italy's Mario Draghi) is also on the docket. This week's contingent of Fed speakers is clearly skewed to the "hawkish" (more concerned about inflation than growth) side of the Fed, so we would not be surprised to see several headlines in the popular press this week citing

Our view here remains that Fed Chairman Bernanke, Vice Chair Janet Yellen and New York Fed President Bill Dudley form the center of gravity at the Fed, and any move by these three to signal less stimulus from the Fed would be significant.

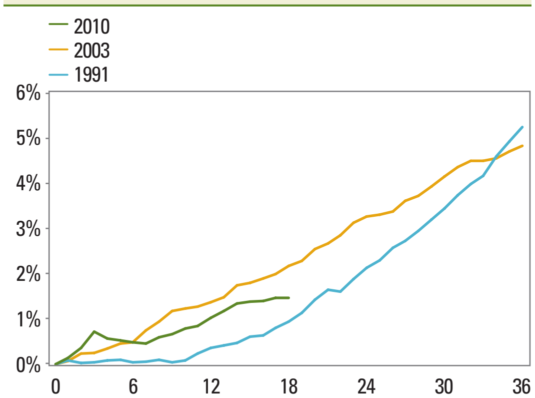
1 Temporary Help Jobs Are Increasing Again, a Good Sign for Future Job Growth



Source: Bureau of Labor Statistics, Haver Analytics 10/10/11

(Shaded areas indicate recession)

2 Job Creation in This Recovery Is Running In Line With the Prior Two Economic Recoveries



Source: LPL Financial, Bloomberg Data 09/14/11

Fed officials worried about too much monetary policy stimulus in the United States. Our view here remains that Fed Chairman Bernanke, Vice Chair Janet Yellen and New York Fed President Bill Dudley form the center of gravity at the Fed, and any move by these three to signal less stimulus from the Fed would be significant.

The Next Two Million Jobs: An Update

The private sector economy added 137,000 jobs in September, beating expectations (+90,000) and accelerating from the 42,000 jobs added in August. The report was all the more encouraging given the simply horrendous policy and sentiment backdrop during the month of September here in the United States and overseas. Some of the bounce in jobs in September can be attributed to the return of 45,000 Verizon workers who went on strike in August. Looking at the past three months to smooth out the Verizon impact, the economy added around 120,000 jobs per month. Year-to-date, private payrolls have grown an average of 149,000 per month. While not a booming number, it is not a recessionary number either, and confirms our view that while employers are not doing much hiring, they are not laying off workers as they did in 2007, 2008, and 2009.

The monthly job count culled from a survey of 440,000 businesses across the nation, was not spectacular in September, but was solid and the details were modestly encouraging.

- First, the prior two months' employment readings were revised up by a total of 99,000.
- Second, Hurricane Irene and severe flooding as a result of the remnants of Hurricane Lee likely held the job count down by around 25,000 in September. These jobs are likely to return in October.
- Finally, the September report noted the third consecutive increase in temporary help employment. This category is a very good leading indicator of future job gains.

On the downside, there was yet another loss (33,000) in state and local government jobs in September, the tenth time in the past 12 months that state and local governments shed jobs. Since August 2008, state and local governments have shed 615,000 jobs, as states and municipalities continue to struggle to align costs with revenues.

The nation's unemployment rate, culled from a survey of 60,000 households, found that the unemployment rate remained at 9.1% in September. The unemployment rate is defined as the number of unemployed persons (totaling about 14 million) as a percentage of the labor force (totaling about 154 million). In order for the unemployment rate to fall steadily, the economy must grow above its long-term potential growth rate of around 2.5%. Currently, the economy is growing, but only by around 2.0% or so.

The July 5, 2011 edition of the *Weekly Economic Commentary* was entitled: "The Next Two Million Jobs." In that report, we noted that the economy had created over two million private sector jobs in the 14 months between

February 2010 and April 2011, and outlined a bull, base and bear case for how long the economy would take to create the next two million jobs.

Since then, of course, the U.S. economy has hit another soft patch amid a torrent of bad news at home that included:

- The lingering impact of the Japanese earthquake on the global supply chain.
- The debt ceiling debate in July and early August.
- The downgrade of the United States' AAA-credit rating in early August.
- The effects of Hurricane Irene.
- Further declines in both consumer and business confidence.
- The near 20% decline in the equity market, as measured by the S&P 500, between late July and early October.

Abroad, conditions also deteriorated with yet another flare-up of the European sovereign debt crisis that has dominated the landscape since mid-July.

During this period (May–September 2011), the private sector economy created another 526,000 jobs, or an average of just over 100,000 per month. While, the September employment report (released last Friday, October 7) was a relief to financial market participants who were expecting another dour report on the nation's labor market, the September jobs report (and the revisions to prior months' data) leave the nation's job creation engine tracking much closer to our bear case than to our base case for creating the next two million jobs.

Various Outcomes for Job Creation

	Jobs Created Per Month	Date By Which "Next Two Million Jobs" Are Created	Months To Create "The Next Two Million Jobs"	How Many More Years To Recoup All Jobs Lost in Great Recession	Date By Which All Jobs Lost During Recession Would Be Recouped	Economic Outlook Under This Scenario	Fed Outlook Under This Scenario
Base Case	225,000	Early 2012	12	2 Years, 4 Months	Early 2014	Modest GDP Growth Near 3.0%	On hold until mid-2012
Bull Case	325,000	Early 2012	10	1 Year, 8 Months	Mid 2013	Robust GDP Growth near 4.0%	Stimulus starts to be removed in late 2011
Bear Case	125,000	Late 2012	17	4 Years, 3 Months	Late 2015	Very Sluggish GDP growth below 2.0%	More stimulus from the Fed
Current Pace	105,000	Late 2012	19	5 Years	Late 2016	Very Sluggish GDP growth below 2.0%	More stimulus from the Fed

Source: LPL Financial Research 10/10/11

Using the prior two recoveries as a baseline, a goal of creating the next two million jobs in the ensuing eight to 12 months is consistent with monthly job growth of between 200,000 and 250,000 jobs per month, which has been our forecast since the beginning of 2011.

Setting aside the robust employment recoveries from the recessions in the mid-1970s and the early-1980s, we can compare how quickly the next two million jobs were created in the so-called "jobless recoveries" in the early 1990s and early 2000s. After the private sector economy created two million jobs in the aftermath of the 1990-91 recession, it took the private sector economy only another eight months to create the next two million jobs. Over this eight-month period (mid-1993 through early 1994), the economy created around 250,000 jobs per month as the Fed remained on hold and the economy reacted to an increase in tax rates in mid-1993.

After the private sector created roughly two million jobs in the aftermath of the mild 2001 recession, it took another ten months to create the next two million jobs. Over this ten-month period in 2005, the economy created around 200,000 jobs per month as the Federal Reserve raised interest rates by 175 basis points, the housing market boomed and fiscal policy in the United States tightened somewhat.

Using the prior two recoveries as a baseline, a goal of creating the next two million jobs in the ensuing eight to 12 months is consistent with monthly job growth of between 200,000 and 250,000 jobs per month, which has been our forecast since the beginning of 2011. At this pace of job growth, it would take another two and a half years (early 2014) for the economy to recoup all the jobs lost in the Great Recession. Under this scenario, the unemployment rate would likely decline modestly, the Fed would remain on hold until mid-2013, and the overall economy would probably grow at around 3.0%, just slightly above its long-term average.

A faster pace of job growth (around 300,000 to 350,000 per month) would create the next two million jobs by early 2012, and that outcome would certainly push down the unemployment rate, speed up the Fed's exit from quantitative easing, and ease concerns about the durability of the recovery. At this pace, it would take around two years (mid-2013) to recoup all the jobs lost during the Great Recession. The economy would grow at around 3.5 to 4.0% under this scenario.

Unfortunately for the still nearly 14 million unemployed workers, neither our bull case nor our base case for "the next two million jobs" is unfolding so far. As noted in the "Various Outcomes" table (See page 3), the private sector economy is creating around 100,000 jobs per month over the past three months. At this pace, it would take until late 2012 for the economy to create the next two million jobs, and would leave the unemployment rate about where it is now (9.1%). At this pace of private sector job creation, it would take five more years (late 2016) before the economy recoups all the private jobs lost in the Great Recession. Under this scenario, the economy would continue to struggle to grow at around 2.0% per year.

This outcome has already prompted the Fed to enact more stimulative monetary policy (committing in August 2011 to keep rates low until mid-2013 and embarking on "Operation Twist" in September 2011) and could prompt more monetary stimulus from the Fed if the slow pace of job creation persists. The slow pace of job growth has already led to continuous talk about a "double-dip" recession, and that talk is likely to persist until the pace of job creation picks up.

While we expect the pace of job creation to reaccelerate back toward our base case (200,000 to 250,000 jobs per month) in the coming months and quarters as the factors restraining hiring fade, we continue to expect that the labor market will remain relatively subdued by historical standards, but grow just enough to promote near trend-like GDP growth in the quarters ahead.

The Federal Open Market Committee action known as Operation Twist began in 1961. The intent was to flatten the yield curve in order to promote capital inflows and strengthen the dollar. The Fed utilized open market operations to shorten the maturity of public debt in the open market. The action has subsequently been reexamined in isolation and found to have been more effective than originally thought. As a result of this reappraisal, similar action has been suggested as an alternative to quantitative easing by central banks.

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Credit rating is an assessment of the credit worthiness of individuals and corporations. It is based upon the history of borrowing and repayment, as well as the availability of assets and extent of liabilities.

An obligation rated 'AAA' has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong.