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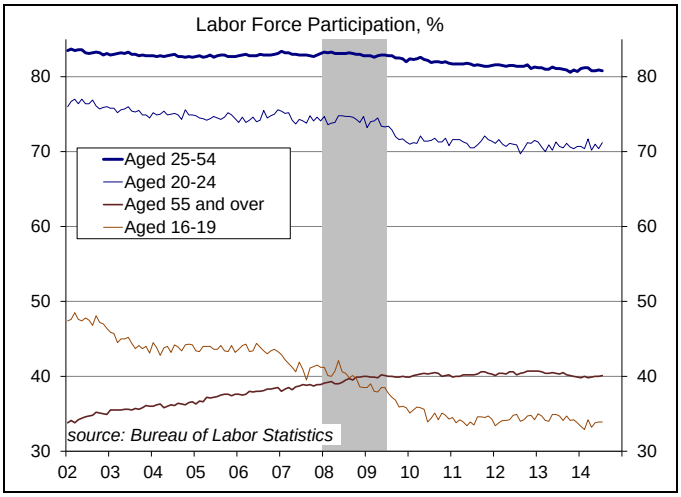
Weekly Market Monitor

Aging, Automation, and Other Labor Market Issues

One of the key characteristics of the current economic expansion has been the decline in labor force participation. Some of that has been attributed to the aging of the population – baby-boomers stepping into retirement – but is that what's really going on? The polarization of the labor market is a growing issue. Technological advances have divided the workforce into high-skill, high-wage positions and low-skill, low-wage positions. However, this polarization may simply be due to the severity of the economic downturn. And the unemployment rate? Well, it's really not all that accurate.

Labor force participation is down by more than 3 percentage points since the recession began. That's equivalent to about six or seven million missing workers. Some of that decline has been attributed to an aging workforce. The Federal Reserve has suggested that the aging of the population accounts for about a third of the decrease in participation. White House economists put it at about half. However, the Household Survey data show that participation for those aged 55 and over is actually a bit higher than before the recession and has been trending roughly flat. The decrease in participation has been more pronounced among younger workers, although prime-aged workers (25-54 years) have also experience a decline in participation.



Older workers have been more likely to continue working. One theory suggests that many were looking to their homes as their main retirement vehicle. With the housing collapse, these potential retirees have presumably had to work a little longer (perhaps a lot longer) to fund their retirements.

The recession and gradual recovery has been especially hard on teenagers and young adults. These individuals are not getting the job experience that they would normally get in a strong economy, and their wages are likely to be generally lower for decades. This isn't a problem unique to the U.S. It is a worldwide issue.

Technological advances have long played a key role in economic growth, but improvements have often met a mixed reception. For example, the Luddites, an early 19th century group of textile artisans, were known for smashing labor-saving textile machinery (the term "Luddite" now refers mockingly to individuals who shun new technologies). The rise of computer technology has generated concerns over the last several decades that many occupations would be made obsolete. However, as David Autor, an MIT economist and author of one of the more interesting papers presented at the KC-Fed's recent Jackson Hole conference, notes, "journalists and commentators overstate the extent of machine substitution for human labor and ignore the strong complementarities." Short-term job losses due to rising productivity have eventually been more than offset by subsequent employment gains.

The polarization of the labor force over the last couple of decades has been clear, but while technology has played a part, there have been other important factors, principally globalization and the economic downturns that followed the tech bubble and housing collapse. As the economy continues to recover and labor market slack is taken up, polarization should be less of an issue. Still, education is sure to remain the most important factor in labor market outcomes.

The more mind-bending aspects of Autor's paper have to do with the more recent advances in technology. Throughout their development, computers have excelled at doing logical, ordered tasks. They haven't done so well in using judgment. Autor quotes the philosopher Michael Polanyi: "we know more than we can tell." Tacit understanding often exceeds explicit understanding, according to Autor. A doctor may study physiology and anatomy, but it is his experience that allows him to practice medicine. A driver's manual may tell one how to drive a car, but the actual task is much more complex than following a simple set of rules. For computers this is beginning to change. Advances in artificial intelligence allow computers to learn more like a human would (and much faster). Combine that with the rapid progress in robotics, and the future looks to be a fascinating place (or at least until Skynet becomes self-aware). Jobs will be lost in this transition (cab drivers, for example), but other jobs will come along, typically things we can't even imagine right now. In 1900, 41% of U.S. workers were employed in agriculture. By 2000, this share was 2%.

Finally, it's common knowledge that the decline in labor force participation has biased the unemployment rate lower. However, there's also some evidence that respondents have been more reluctant to respond correctly to government queries. Hence, the unemployment rate is even less valid. That's why we focus on a wide range of labor market indicators.

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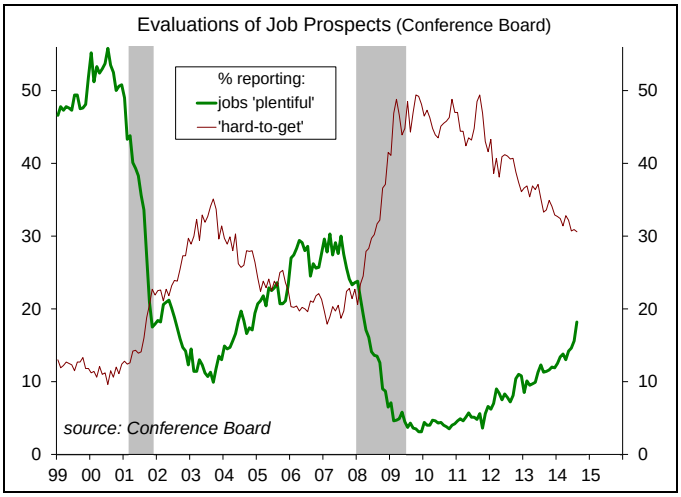
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
8/01/14	0.03	0.05	0.13	0.47	0.94	1.67	2.52	3.29	1.344	1.683	102.45	1.092	4352.64	1925.15	16493.37
8/22/14	0.03	0.05	0.11	0.50	0.95	1.63	2.34	3.08	1.324	1.657	103.97	1.095	4538.55	1988.40	17001.22
8/29/14															

Recent Economic Data and Outlook

The economic data were mixed. The estimate of 2Q14 GDP growth was revised higher, but personal income and spending data indicated a relatively weak start to the third quarter. The PCE Price Index continued to trend below the Fed's 2% target. Russia's invasion of Ukraine had a moderate, negative impact on the stock market.



Real GDP rose at a 4.2% annual rate in the second estimate for 2Q14, reflecting a stronger pace of business fixed investment and a downward revision to imports (which have a negative sign in the GDP calculation) and partly offset by a downward revision to inventory growth. Real consumer spending rose at a 2.0% pace, the same as in the advance estimate. Business fixed investment rose at an 8.4% pace (vs. +5.5%). Domestic Final Sales (GDP less net exports and the change in inventories) rose at a 3.1% annual rate (revised from +2.8%), vs. +0.7% in 1Q14. Corporate profits rebounded 8.0% (q/q), down 0.1% y/y, with domestic nonfinancial corporations up 10.6% (+1.4% y/y).

Personal Income rose 0.2% in July (+4.3% y/y), with wages and salaries up 0.2% (+5.3% y/y). **Personal Spending** fell 0.1% (+3.6% y/y), down 0.2% adjusting for inflation (+2.0% y/y) – a poor start to the third quarter. The **PCE Price Index** rose 0.1% (+1.6% y/y), up 0.1% ex-food & energy (+1.5% y/y).

The Conference Board's **Consumer Confidence Index** rose to 92.4 in the initial estimate for August, vs. 90.3 in July and 86.4 in June, reflecting moderate improvement in evaluations of current conditions and a small decline in expectations (thought to be a driver of big-ticket spending). Evaluations of current job conditions were less depressed, but respondents were less optimistic in their income expectations. Results varied by region.

Durable Goods Orders jumped 22.6% in July, reflecting a 318% increase in civilian aircraft orders (Boeing had reported a sharp spike). Orders for motor vehicles increased 10.2%, likely reflecting difficulties in the seasonal adjustment. Ex-transportation, orders fell 0.8% (following a 3.0% surge in June). Orders for nondefense capital goods ex-aircraft fell 0.5%, but that followed a 5.4% gain in June.

The **Chicago Purchasing Managers Index** rebounded to 64.3 in August, vs. 52.6 in July, 62.6 in June, and 65.5 in May.

New Home Sales fell 2.4% in July to a 412,000 seasonally adjusted annual rate (+12.3% y/y). Figures for April, May, and June were revised higher. Unadjusted sales for the last three months were 3.5% higher than the same period in 2013.

The **Pending Home Sales Index** rose 3.3% in July (-2.1% y/y), following a 1.3% decline in June.

The **Case-Shiller Home Price Index** of 20 metropolitan areas fell 0.2% in June (+1.0% before seasonal adjustment), down 8.1% from a year ago. Prices fell in 13 metropolitan areas, but each was higher over the last 12, 36, and 60 months.

The **Congressional Budget Office** revised its projection for the FY14 budget deficit to $506 billon, or 2.9% of GDP, but cautioned on the longer-term outlook.

Inflation in the **euro area** was 0.3% for the 12 months ending in August. The unemployment rate held steady at 11.5%.

Economic Outlook (3Q14): 2.5% to 3.0%

Employment: Measures of short-term unemployment are at normal levels, but other gauges continue to suggest a large degree of slack in the labor market. Job growth should remain relatively strong in the near term.

Consumers: Real average earnings are trending about flat, which will limit the pace of improvement in spending, but job growth is a key driver in the aggregate.

Manufacturing: Mixed results across industries, but mostly strengthening. Weakness in Europe and a stronger dollar should have a negative impact on exports.

Housing/Construction: Affordability issues have been a constraint at the middle level and below. Supply constraints remain an issue for many builders, but should fade over time.

Prices: The PCE Price Index, the Fed's chief inflation gauge, remains well below the Fed's 2% target on a y/y basis. Pipeline pressures appear mild. Wage pressures are limited. Inflation expectations remain well-anchored.

Interest Rates: The tapering of the Fed's monthly pace of asset purchases should be completed at the end of October. Short-term interest rates are expected to remain exceptionally low *"for a considerable period"* after the asset purchase program ends. The Fed's policy moves in 2015 will be dictated by the evolution of the economic outlook in the second half of 2014.

This Week:					*forecast*	last	last –1	comments
Monday	9/01		Labor Day Holiday					markets closed
Tuesday	9/02	9:45	Market US Manf PMI (final)	Aug	***NF***	55.8	57.3	58.0 in the "flash" estimate
		10:00	Construction Spending	Jul	***+1.6%***	-1.8%	+0.8%	seen rebounding, watch for revisions
		10:00	**ISM Manf. Index**	Aug	***57.0***	57.1	55.3	seen moderately strong
Wednesday	9/03	8:15	**ADP Payroll Estimate, th.**	Aug	***+210***	+218	+281	moderately strong
		9:00	BOC Policy Decision					
		10:00	Factory Orders	Jul	***+11.0***	+1.1%	-0.6%	durables reported up 22.6%
		2:00	**Fed Beige Book**					seen a bit brighter
		tbd	Motor Vehicle Sales, mln	Aug	***16.6***	16.4	16.8	likely to pickup
			domestically built		***13.2***	12.9	13.2	still a strong trend
Thursday	9/04	7:00	BOE Policy Decision					no change
		7:45	**ECB Policy Decision**					leaning toward doing more, but QE?
		8:30	Jobless Claims, th.	8/29	***300***	298	299	a low trend
		8:30	**Trade Balance, $ bln**	Jul	***-42.5***	-41.5	-44.7	likely a bit narrower
			goods only		***-61.3***	-60.3	-63.3	first look at 3Q14 foreign trade
		10:00	**ISM Non-Manf. Index**	Aug	***57.8***	58.7	56.0	moderately strong
Friday	9/05	8:30	**Nonfarm Payrolls, th.**	Aug	***210***	209	298	some pickup in government hiring
			private-sector		***200***	198	270	moderately strong
			Unemployment Rate		***6.1%***	6.2%	6.1%	likely lower
			employment/population		***59.1%***	59.0%	59.0%	a gradual uptrend
			Avg. Weekly Hours		***34.5***	34.5	34.5	steady
			Avg. Hourly Earnings		***+0.2%***	+0.0%	+0.2%	modest wage pressures
Next Week:								
Monday	9/08		no significant data					U.S. Open Men's Final at 5 pm
Tuesday	9/09	7:30	Small Business Optimism	Aug	***NF***	95.7	95.0	an improving trend
		10:00	JOLTS: Hiring Rate	Jul	***NF***	3.5%	3.4%	a gradual trend higher
			JOLTS: Quit Rate		***NF***	1.8%	1.8%	still below normal
		1:00	Treasury Note Auction					3-year notes
Wednesday	9/10	1:00	Treasury Note Auction					re-opened 10-year notes
Thursday	9/11	8:30	Jobless Claims, th.	9/06	***300***	***300***	298	still low
		1:00	Treasury Bond Auction					re-opened 30-year bonds
		2:00	Treasury Budget, $bln	Aug	***NF***	-147.9	-190.5	should be down from a year ago
Friday	9/12	8:30	**Retail Sales**	Aug	***+0.6%***	0.0%	+0.2%	likely to have improved
			ex-autos		***+0.4%***	+0.1%	+0.4%	watch for revisions
			ex-autos, bld mat, gasoline		***+0.5%***	+0.1%	+0.5%	a moderate trend
		8:30	Import Prices	Aug	***NF***	-0.2%	+0.1%	no inflation pressure from abroad
			ex-food & fuels		***NF***	-0.1%	0.0%	flat or trending lower
		9:55	UM Consumer Sentiment	m-Sep	***NF***	82.5	81.2	range-bound over the last several months
		10:00	Business Inventories	Jul	***NF***	+0.4%	+0.5%	should slow in 3Q14

This Week…

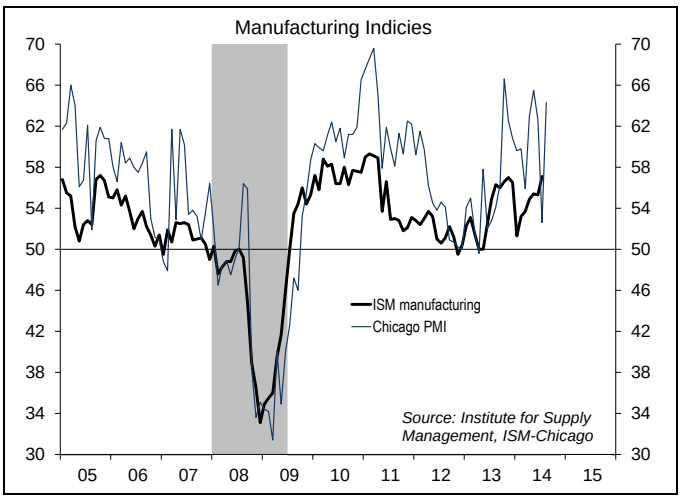
Fresh August data. The ISM surveys, unit auto sales, and employment data will help refine the third quarter picture. However, the ECB policy meeting may be more important. Faced with a weakening economy and a low trend in inflation (and more importantly, declining inflation expectations), the ECB is poised to embark on its own asset purchase program (QE). However, it's unclear whether ECB President Draghi will have the votes to achieve that.

Monday

Labor Day Holiday – Markets Closed.

Tuesday

ISM Manufacturing Index (August) – Results have been moderately strong in recent months, consistent with a continued recovery in the overall economy. Expect more of the same in the report for August, but watch the components on new orders and employment.



Wednesday

ADP Payroll Estimate (August) – The ADP is not a good predictor of the monthly changes in the official BLS data, but that should

not be surprising (there is a large amount of statistical noise in the monthly payroll figures). Still, the ADP can easily generate a reaction in the financial markets if we get a surprise.

Factory Orders (July) – Durable goods orders spiked 22.6% higher in the advance estimate for July, reflecting a sharp jump in orders at Boeing. Ex-transportation, orders were down across industries. Those figures will be subject to revision in the full report on factory orders. Orders for nondurable goods are likely to have been little changed.

Fed Beige Book – The anecdotal reports on economic conditions around the country should paint a bit brighter picture than in the precious assessment (although still a mixed bag). Wage and price pressures should remain relatively low.

Motor Vehicle Sales (August) – Unit sales slipped in July and the decline was a factor in the relatively soft reading on consumer spending. That was likely a fluke and we should see a rebound in August. Vehicle sales continue to be driven by replacement needs and by relatively easy bank credit on auto loans.

Thursday

Bank of England Policy Decision – Recently, the BOE was seen as the central bank most likely to hike rates first. However, BOE Governor Mark Carney has toned down the rhetoric. Minutes of the previous meeting showed two (of nine) Monetary Policy Committee members dissenting in favor of a rate hike, but it seems unlikely that they will be able to pull the others over.

European Central Bank Policy Decision – In his recent Jackson Hole speech, Mario Draghi deviated from his written comments. Some have suggested that he was speaking off the cuff (the ECB's website now has the full speech), but it's more likely that the speech was updated at the last minute. Importantly, the added paragraphs demonstrate a more heightened concern about low inflation: *"…if this period of low inflation were to last for a prolonged time, the risk to price stability would increase. Over the month of August, financial markets have indicated that inflation expectations exhibited significant declines at all horizons… The real rates on the short and medium term have gone up…"* In the initial written comments, the ECB *"would also use **unconventional instruments** to safeguard the firm anchoring of inflation expectations."* In the as-presented speech, this is changed to *"will use all the **available instruments** needed to ensure price stability over the medium term"* (emphasis added). So, Draghi sees a greater need for the ECB to do more, but he may not have a majority behind him to embark on QE.

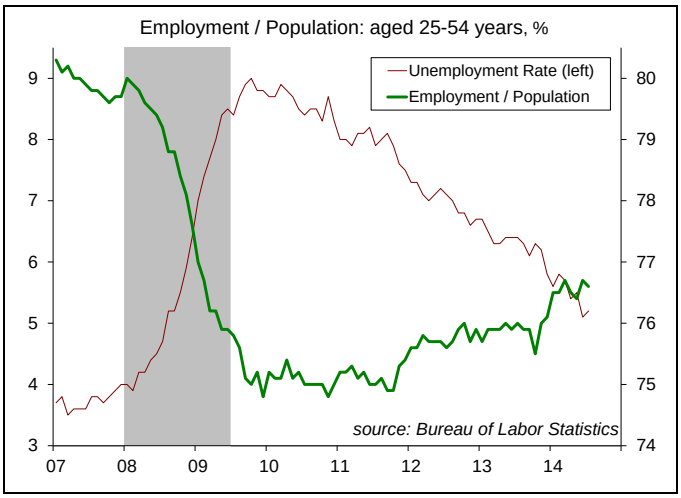
Jobless Claims (week ending August 30) – Claims appear to be settling at a very low level. As with other measures of short-term unemployment, we're at "normal" levels. However, other labor market gauges continue to reflect a large amount of slack.

Trade Balance (July) – The trade deficit is expected to have widened a bit in July. Note that trade figures are normally choppy. Import and export decisions don't turn on a dime. The key is the underlying trend. A stronger dollar can be expected to restrain export growth and encourage import growth in the months ahead (a wider trade deficit subtracts from GDP growth).

ISM Non-Manufacturing Index (August) – The ISM's other survey has been consistent with moderately strong growth in the overall economy. July figures surprised a bit to the upside, and we could see some moderation in the August data.

Friday

Employment Report (August) – Nonfarm payrolls are expected to have risen at a moderately strong pace, but remember, the monthly change is reported accurate to ±90,000 (watch for revisions). Seasonal adjustment is a moderate issue in August (as the school year gets underway). The unemployment rate is likely to have fallen further. However, the figure has been distorted due to the decline in labor force participation and reporting issues. The employment/population ratio for prime-aged adults (25-54 years) has improved, but suggests that there is still a large amount of slack in the job market. Average hourly earnings are likely to have risen modestly, but there is a fair amount of noise from month to month.



Next Week …

A light economic calendar. Following soft results for July, the August retail sales report will take on more weight than usual. Estimates of 3Q14 GDP growth should be reduced if we don't see the expected rebound in spending.

Coming Events and Data Releases

September 12	Retail Sales (August)
September 15	Industrial Production (August)
September 17	FOMC Policy Decision, Yellen press conference
September 18	Building Permits, Housing Starts (August)
October 3	Employment Report (September)
October 29	FOMC Policy Decision (no press conference)
December 17	FOMC Policy Decision, Yellen press conference
January 28	FOMC Policy Decision (no press conference)
March 18	FOMC Policy Decision, Yellen press conference
April 29	FOMC Policy Decision (no press conference)
June 17	FOMC Policy Decision, Yellen press conference