Weekly Economic Commentary

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Disconnect?

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Highlights

We continue to expect that U.S. economic growth may rebound to a 3% pace for all of 2014.

The June 2014 jobs report was undeniably strong on all fronts, standing in sharp contrast to the weak performance of the economy in the first quarter of 2014.

The last time the economy created at least 200,000 jobs per month for five consecutive months was in late 1999 through early 2000, when the U.S. economy was growing between 4.5% and 5.0%.

This week, financial markets will likely focus on the unofficial start of the second quarter 2014 earnings reporting season for S&P 500 companies and the release of the minutes of the June 17–18 FOMC meeting.

In the wake of the release of the monthly jobs report, many financial market participants are debating the seeming disconnect between the weak first quarter of economic growth and the recent run of strong data for April, May, and especially June 2014.

Economic Snapback

The rapid improvement in the labor market, and in other economic data reported over the past several months, is at odds with the 2.9% decline in gross domestic product (GDP) in the first quarter of 2014. Which is correct? We continue to expect that economic growth may rebound to a 3% pace for all of 2014.* In fact, the return to a more normal weather pattern nationwide has already led to a sharp snapback in economic activity. The U.S. economic data released thus far for April, May, and June 2014 suggest that economic growth could accelerate in the second quarter to well above the economy's long-term average growth rate after a weather-induced slowdown in growth in the first quarter of 2014.

While first quarter GDP was both unusual and disappointing, it does not change our view on the economy. Second quarter GDP is due out in late July. With that release, the GDP data (including the first quarter of 2014) will be revised back as far as 1999 to incorporate new data, methodological and definitional changes, and updated seasonal factors. This annual revision to GDP happens every year in late July.

Jobs on the Upswing

The June 2014 Employment Situation report—released on Thursday, July 3, 2014—was the latest in a series of reports that supported our view that the U.S. economy gathered momentum in the second quarter of 2014. The widely watched report issued by the Bureau of Labor Statistics (BLS) of the U.S. Department of Labor (see "Closer Look: Labor Market Surveys" for details) found that the U.S. economy created 288,000 net new jobs in June 2014, far exceeding the consensus of economists' forecasts (polled by Bloomberg News) of a 215,000 gain. The 288,000 net new jobs created represented acceleration in job growth from the 224,000 net new jobs created in May 2014, and the April and May 2014 job counts were revised higher by a total of 29,000 jobs.

The other half of the Employment Situation report provided an update on the unemployment rate. The unemployment rate dipped to 6.1% in June 2014 from

*As noted in the *Outlook 2014 The Investor's Almanac*, LPL Financial Research expects GDP to accelerate from the 2% pace of recent years to 3% in 2014. Since 2011, government spending subtracted about 0.5% each year from GDP growth. Government spending should be less of a drag on growth which would result in +1% increase for 2014.

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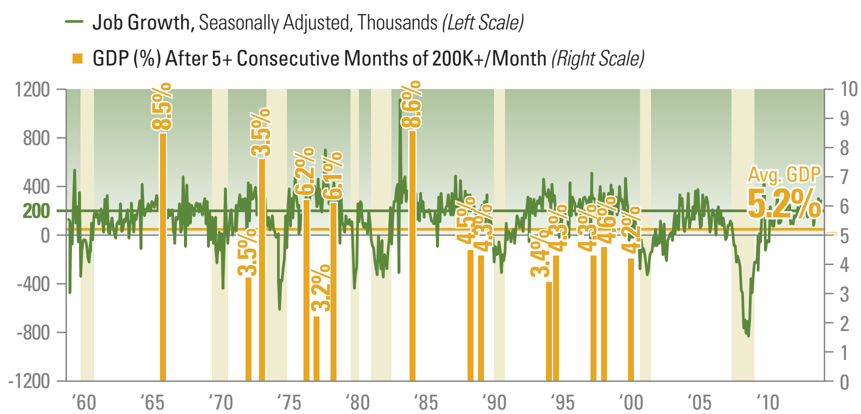
6.3% in May 2014 and has declined by 1.4 percentage points over the past year—nearly four percentage points from its cycle high of 10.0% in 2010. On balance, the June 2014 jobs report was undeniably strong on all fronts, and it stands in sharp contrast to the weak performance of the economy in the first quarter of 2014.

We've Seen This Before

Looking back over the last three months—April, May, and June 2014—the U.S. economy has created an average of 231,000 net new jobs per month, the best three-month performance for job creation since late 2005 and early 2006, when the economy was growing between 3.0% and 3.5%, as measured by real GDP. June 2014 marked the fifth consecutive month in which the economy created at least 200,000 new jobs. The last time the economy created at least 200,000 jobs per month for five consecutive months was in late 1999 and early 2000, when the U.S. economy was growing between 4.5% and 5.0%. Since 1960, the economy has never been in a recession when the economy has created 200,000 jobs per month in five consecutive months.

1 The Recent Labor Market Data Is Consistent With Strong, Above-Trend GDP Growth



Source: LPL Financial Research, Bureau of Labor Statistics, Haver Analytics 07/07/14

In fact, the average rate of growth for the economy in the 14 episodes in which the U.S. economy has created at least 200,000 jobs per month for five consecutive months was 5.2%. More importantly, the growth rate of GDP in the 12 months after such a streak averaged 3.8%. Given the size of the working age population today versus 40 and 50 years ago, a gain of 200,000 jobs per month in the 1960s, 1970s, or even 1980s was a much bigger feat than it is today. Looking at just the last 25 years, when the economy created 200,000 or more jobs five months in a row, the average rate of GDP growth was 4.2%. Over that same period, the growth rate of GDP in the 12 months after the economy created at least 200,000 jobs per month for five consecutive months was 3.5%.

On balance, the evidence is mounting that the U.S. economy accelerated in the second quarter of 2014 and that further acceleration may be likely in the second half of 2014 and into next year. ■

A Closer Look: Labor Market Surveys

- A survey of 60,000 households nationwide — an incredibly large sample size for a national survey — generates the data set used to calculate the unemployment rate, the size of the labor force, part-time and full-time employment, the reasons for and duration of unemployment, and employment status by age, educational attainment, and race. The "household survey" has been conducted essentially the same way since 1940, and although it has been "modified" over the years, the basic framework of the data set has stayed the same. The last major modification to the data set (and to how the data is collected) came in 1994. To put a sample size of 60,000 households into perspective, nationwide polling firms typically poll around 1,000 people for their opinion on presidential races.
- The headline unemployment rate (6.1% in June 2014) is calculated by dividing the number of unemployed (9.5 million in June 2014) by the number of people in the labor force (155.7 million). The civilian population over the age of 16 stood at 247.8 million in June 2014. A person is identified as being part of the labor force if they are over 16, have a job (employed), or do not have a job (unemployed) but are actively looking for work. A person is not in the labor force if they are neither employed nor unemployed. This category includes retired persons, students, those taking care of children or other family members, and others who are neither working nor seeking work.
- In June 2014, the labor force was 155.7 million, which consisted of 146.2 million employed people and 9.5 million unemployed people. Another 92.0 million people over the age of 16 were classified as not in the labor force. The 155.7 million people in the labor force plus the 92.1 million people not in the labor force is equal to the over-16 civilian population, 247.8 million.
- The payroll job count data are culled from a survey of 440,000 business establishments across the country. The sample includes about 141,000 businesses and government agencies, which covers approximately 486,000 individual worksites drawn from a sampling frame of Unemployment Insurance (UI) tax accounts covering roughly 9 million establishments. The sample includes approximately one-third of all nonfarm payroll employees. From these data, a large number of employment, hours, and earnings series in considerable industry and geographic detail are prepared and published each month.

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