Editor:

Dimitris Malliaropulos:
Economic Research Advisor
dmalliaropoulos@eurobank.gr

Written By:

Olga Kosma:
Economic Analyst
okosma@eurobank.gr

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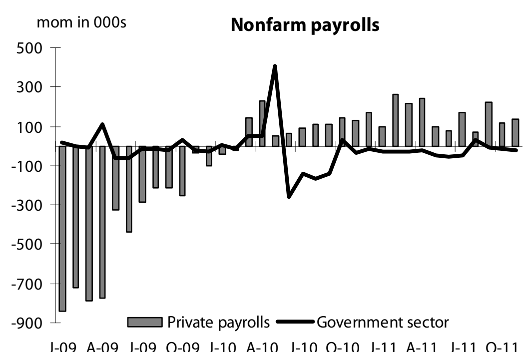
The US labor market keeps on strengthening, albeit at a slow pace

- The November employment report took a stronger tone, signaling accelerating nonfarm payroll growth towards year-end.
- However, we remain cautious about future developments in the US labor market, as goods-producing employment continued declining, while the service-providing employment growth was somewhat distorted by seasonal factors related to the Thanksgiving holiday.
- Whatever the recent improvement in the labor market conditions, the employment growth is still relatively weak, placing the ongoing economic recovery among the jobless US recoveries.
- Sluggish investment in residential and commercial real estate has been an important factor contributing to the slow pace of growth in employment.
- Jobless recoveries since 2000 may also be attributed to a slowdown on the long-term employment trend.

The US employment report for November took a stronger tone, signaling accelerating nonfarm payroll growth towards year-end (Establishment Survey). Total nonfarm payrolls were up 120k, after a 100k increase in October, and private payrolls increased 140k, after a 117k gain in the previous month (Figure 1). Meanwhile, data for both October and September were revised upwards by a net 72k (from 80k to 100k and from 158k to 210k, respectively), bringing the three-month average gain up to 143k from 135k in the previous three months through October. Looking at the performance of major sectors, we find that the government sector -especially at the state and local level- keeps on cutting jobs (-20k), while the private sector accelerates slowly its pace of hiring. The service sector leads the jobs acceleration, with broad-based gains in trade and transport, retail trade, business services, education and health and leisure and hospitality. On the contrary, goods producing payrolls declined 6k, driven by an outright fall in the construction sector (-12k), while the manufacturing sector posted a modest increase of 2k. The recent softness in manufacturing employment growth is in line with the ISM manufacturing survey, which showed slower growth in November manufacturing jobs.

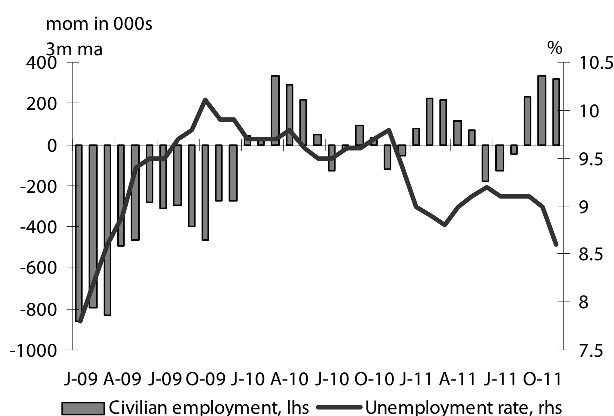
Figure 1



Source: U.S. Bureau of Labor Statistics

As has been the case over the last four months, the Household Survey for November was even stronger than the Establishment Survey, reporting a civilian employment monthly gain of 278k. As a result, the unemployment rate fell to 8.6% in November from 9.0% in October (Figure 2), although it should be noted that almost half of this decline was attributed to a large fall in the civilian labor force (-315k). Household employment has been increasing by an average of about 320k during the past three months, almost double the average gain in total nonfarm payrolls.

Figure 2

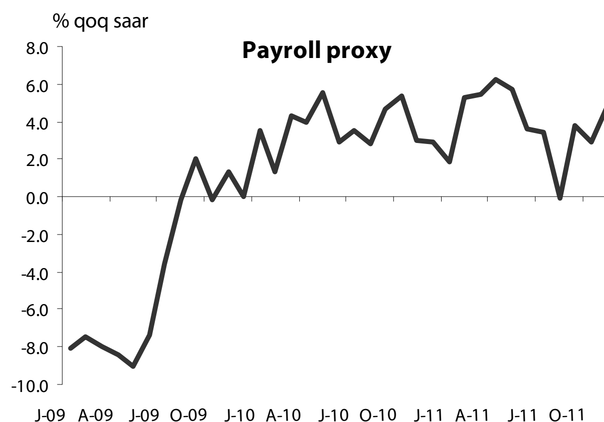


Source: U.S. Bureau of Labor Statistics

However, we remain cautious about future developments in the US labor market, as goods-producing employment continues its downward trend for a second consecutive month and much of the growth in service-providing employment was due to retail trade employment (+50k). Even on a seasonally-adjusted basis, the monthly gain in retail trade has probably been distorted by seasonal factors related to the Thanksgiving holiday. Meanwhile, the payroll diffusion index, which measures the proportion of industries that reported job monthly gains, dropped from 59.6% in October to 54.7% in November, the lowest level since September 2010. However, it remains above the threshold of 50, indicating that most industries are increasing hiring. Indeed, the NFIB small business survey suggests that small business hiring, as well as hiring plans, improved in November for the first time in six months.

In terms of hours and earnings, average weekly hours remained essentially flat at 34.3 hours, while aggregate hours have increased by about 3.0% q-o-q saar through November, up from 1.7% in Q3. Furthermore, average hourly earnings declined 0.1% m-o-m after two months of positive average gains of 0.3%. This monthly cutback in hourly earnings was partly offset by an upward revision to October earnings. The trend in payroll proxy for labor income, i.e. the product of weekly hours, hourly earnings and private payrolls, is moving upwardly, increasing by an annualized rate of 4.7% q-o-q through November from 3.8% in Q3 (Figure 3). This upward trend underpins our view of more strength in hours and earnings in the final quarter of the year relative to Q3, due to production acceleration ahead following the significant contraction in inventories in Q3.

Figure 3



Source: U.S. Bureau of Labor Statistics, EFG estimates

Whatever the recent improvement in the labor market conditions, the employment growth is still relatively weak, placing the ongoing economic recovery among the jobless US recoveries. A jobless recovery occurs when a relatively steady real GDP growth is accompanied by sluggish employment growth that takes much longer to recover than in previous cycles. Sluggish investment in residential and commercial real estate has been an important factor contributing to the slow pace of growth in employment. While real GDP is currently slightly above its pre-recession peak, real fixed investment is still about 20% below its pre-recession peak due to a 60% cumulative decline in real residential investment and a 30% cumulative decline in commercial real estate investment (structures).

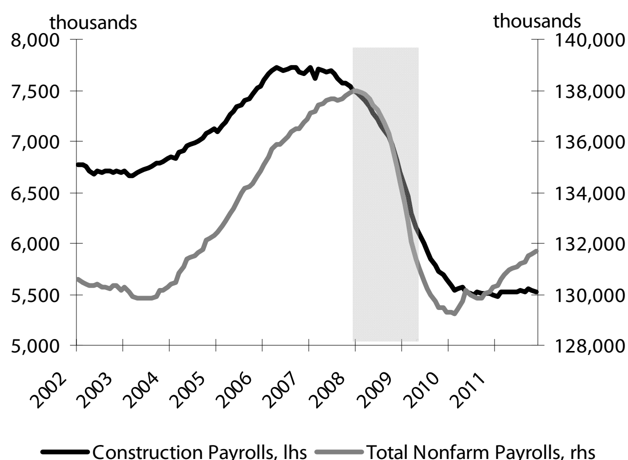
As a result, total nonfarm payrolls have declined by nearly 8.8 million between December 2007 (recession start in the US) and February 2010 (trough in total employment) and the decline in the construction sector alone accounts for roughly 23% of the total decline. Taking into account that by the start of the recession payrolls in the construction sector had already declined by about 250k (April 2006-December 2007), this number could be added to the cumulative increase in the construction sector attributed to the recession (Figure 4). In addition, economists from Federal Reserve Bank of St. Louis[1] estimate the indirect effects of the decline in construction employment that caused a decline in employment in other industries using the Employment Requirements Matrix of the Bureau of Labor Statistics[2]. They

[1] *See Sanchez M. Juan and Daniel L. Thornton (2011) "Why is Employment Growth So Low?", Fed of St. Louis Research, November 14.*

[2] *For further information concerning the Employment Requirements Matrix see www.bls.gov/emp/ep_data_emp_requirements.htm.*

conclude that the decline in the construction sector accounts for about 40% of the slump in total employment during December 2007-February 2010. Thus, we should experience a significant improvement in the US real estate sector before we see strong growth rates of employment.

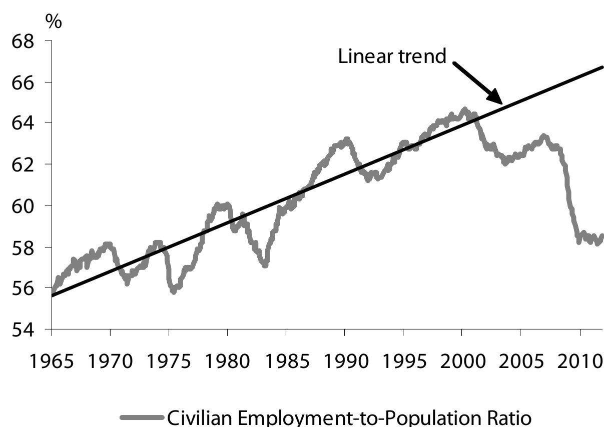
Figure 4



Source: U.S. Bureau of Labor Statistics
The gray area portrays the 2008-09 recession as determined by the NBER.

Another reason for explaining the slow growth in employment since the end of the 2008-09 recession is a slowdown in the long-term employment trend since 2000[3]. Figure 5 portrays the civilian employment-to-population ratio during 1965-2010 and an extrapolated linear trend of the ratio based on 1965-2000. The ratio increase of about 10% since 1965 was due to the entrance of women into the labor force. But employment began to lag behind since 2000, compared to the extrapolated linear trend; although real GDP actually reached its peak in 2007, the employment-to-population ratio was already 3% below the noted trend by the end of 2007 that the recession started. The ratio's deviation from its trend has about tripled after the most recent crisis, reinforcing the view that the US economy has moved to a regime of jobless growth.

Figure 5



Source: Federal Reserve of St. Louis, EFG estimates

[3] *See Peralta-Alva Adrian (2011) "Jobless Recoveries or Jobless Growth?", Fed of St. Louis Research, December.*

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Platon Monokroussos, *Head of Financial Markets Research Division*
Paraskevi Petropoulou, *G10 Markets Analyst*
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Theodosios Sampaniotis, *Senior Economic Analyst*
Theodoros Stamatiou, *Research Economist*

Eurobank EFG, 20 Amalias Av & 5 Souri Str, 10557 Athens, tel: +30.210.333 .7365, fax: +30.210.333.7687, contact email: Research@eurobnak.gr

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