Payden&Rygel

Economic Update

THOUGHTS FROM OUR ECONOMICS TEAM

OCTOBER 2, 2015

On The Cusp of a New Recession?

Nonfarm payroll (NFP) employment appears to have slowed in the last couple months. In September, 142,000 jobs were added to payrolls, while August saw just 136,000 net new jobs created. Newspaper headlines and market watchers seized on the "terrible" and "weak" data as evidence of a material deterioration in the US labor market. One popular economic commentator went so far as to assert that "we cannot dismiss the notion that a new recession may be starting." We do not think this is appropriate. Here's why.

First, the noticeably weaker August and September jobs reports arrived on the heels of a rather remarkable string of payroll reports over the last couple of years. We saw 17 reports over with NFP growth above 200,000 during that two-year period. Job growth hadn't been that strong on a sustained basis since the 1990s cycle. Historically, as the unemployment rate has dipped below 5% (closer to the so-called "full employment" level), NFP growth decelerates from its mid-cycle rate of growth. While we are reluctant to declare a new trend, a deceleration in the pace of job growth wouldn't be all that unusual as labor market slack declines.

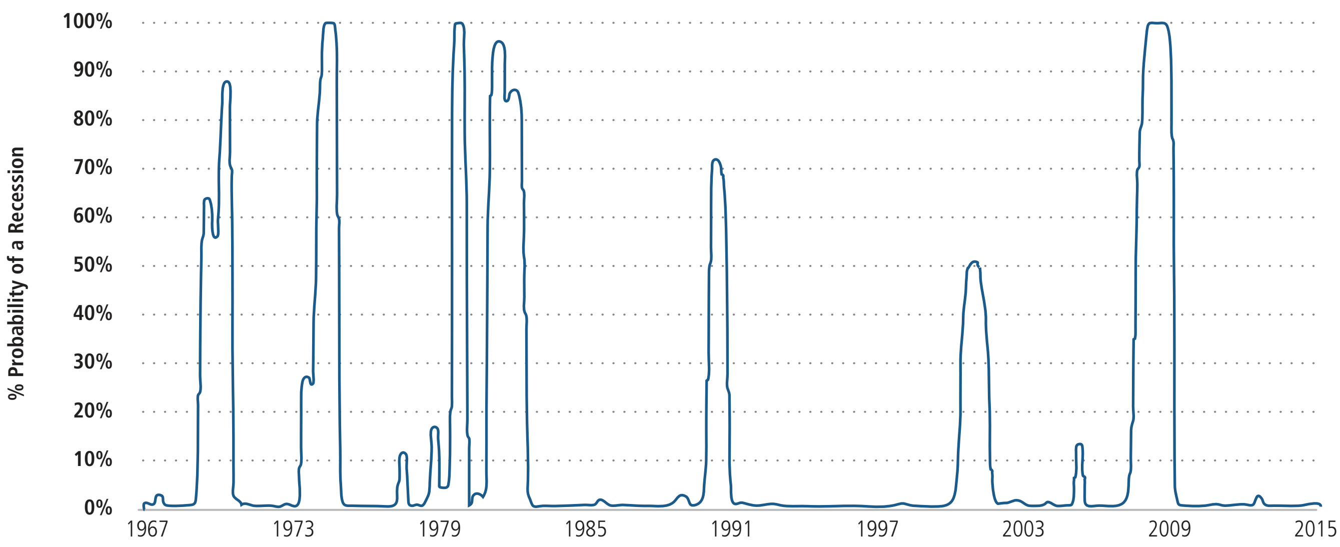
Second, the NFP number can be erratic on a monthly basis, varying from lows of just +119,000 in March 2015 to highs of +423,000 in the fall of 2014. Did economic bears throw in the towel in the fall of 2014 on the +400k number? Of course, not. Nor should the bears celebrate on a +34,000 print—or a +142,000 report. And yet that is precisely what we have seen after September's jobs report.

Third, some weakening was to be expected due to slower global economic activity and a stronger US dollar. Global trade rose just 0.8% from a year ago and global PMIs point to a contraction in global manufacturing activity. While the US labor market has suffered, it's hard to call the recent global economic tremors a smoking gun. Mining & logging employment fell by about 100,000 jobs in the last 12 months as oil prices tanked, while manufacturing employment is nearly unchanged from a year ago.

In light of the global headwinds, today's jobs report isn't bad, even if it was less good than the trend we've seen over the past two years. What is more, other indicators of broader US economic health still look positive. Though flatter, the US yield curve (10s – fed funds) remains steep at just under 200 basis points. Historically this yield curve spread turns negative before a recession. No sign of that.

Elsewhere, the US leading economic index continues to improve. The index of 10 major economic indicators rose 4% since last year. Finally, if we look at an academic model built to estimate the probability of a recession, there is no sign the US economy is on the chopping block (see chart below). Economic activity may end up being slower in Q3 than Q2's strong report, but a recession? Unlikely.

Smoothed U.S. Recession Probabilities



Source: Federal Reserve Bank of St. Louis, Piger, JeremyMax, Chauvet

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