Northern Trust

DAILY ECONOMIC COMMENTARY

U.S. Productivity Improves, Labor Cost Remains Contained

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Productivity of the U.S. economy rose 3.1% in the third quarter, after posting decline in the first-half of the year. The downside of the improvement in productivity in the present environment is that it prevents firms from increasing payrolls.

Chart 1

Unit labor cost dropped 2.4% in the third quarter compared with gains in the first six months of the year. The recent trend of unit labor cost suggests that labor cost pressures are absent (see Chart 2) and do not present a threat of inflation. This is a source of comfort as it allows the Fed to focus on economic growth in the formulation of monetary policy.

Chart 2

The Fed's Forecast Begs for Action, Bernanke Hints at QE3

The main conclusion from Bernanke's press conference on November 2 is that the Fed has two choices. QE3 (quantitative easing) is one option given the Fed's gloomy forecast (see Table 1). The precise timing, magnitude and composition of QE3 are unknown but Bernanke's responses suggest that there is a willingness to engage, if essential. Large asset purchases are likely to be a combination of Treasury securities and mortgage-backed securities. The second alternative is its communication strategy much like the August announcement that the federal funds rate would be held at the current rate at the least until mid-2013. In other words, it would entail tying interest rate decisions to economic conditions in policy communications.

Bernanke described the circumstances under which the Fed would consider policy easing as follows: Additional policy support would follow if economic growth is insufficient or inflation is below the level consistent with price stability. Chairman Bernanke also noted that the Fed had taken aggressive steps in the past two meetings and would act again if required. Essentially, the Fed is buying time, for now. The Fed will have more data about business conditions in October and November prior to the December 13 FOMC meeting. The Fed would need a higher unemployment rate, noticeably tepid increase in payrolls, weak retail sales, and the tone of economic reports leaning towards a further weakening of economic conditions to consider new policy action. Incoming economic data – ISM manufacturing survey, auto sales, housing starts, new home sales, orders of durable goods – do not suggest that the U.S economy is on the brink of another recession. The October employment data could change this assessment; employment numbers are reputed to offer surprises of all sorts. Our forecast is a 9.2% jobless rate and an increase in payroll employment of 100,000.

Table 1

Economic Projections of Federal Reserve Board Members and Federal Reserve Bank Presidents, November 2011

Advance release of table 1 of the Summary of Economic Projections to be released with the FOMC minutes

Percent

Variable	Central tendency[1]					Range[2]				
	2011	2012	2013	2014	Longer run	2011	2012	2013	2014	Longer run
Change in real GDP	1.6 to 1.7	2.5 to 2.9	3.0 to 3.5	3.0 to 3.9	2.4 to 2.7	1.6 to 1.8	2.3 to 3.5	2.7 to 4.0	2.7 to 4.5	2.2 to 3.0
June projection	2.7 to 2.9	3.3 to 3.7	3.5 to 4.2	n.a.	2.5 to 2.8	2.5 to 3.0	2.2 to 4.0	3.0 to 4.5	n.a.	2.4 to 3.0
Unemployment rate	9.0 to 9.1	8.5 to 8.7	7.8 to 8.2	6.8 to 7.7	5.2 to 6.0	8.9 to 9.1	8.1 to 8.9	7.5 to 8.4	6.5 to 8.0	5.0 to 6.0
June projection	8.6 to 8.9	7.8 to 8.2	7.0 to 7.5	n.a.	5.2 to 5.6	8.4 to 9.1	7.5 to 8.7	6.5 to 8.3	n.a.	5.0 to 6.0
PCE inflation	2.7 to 2.9	1.4 to 2.0	1.5 to 2.0	1.5 to 2.0	1.7 to 2.0	2.5 to 3.3	1.4 to 2.8	1.4 to 2.5	1.5 to 2.4	1.5 to 2.0
June projection	2.3 to 2.5	1.5 to 2.0	1.5 to 2.0	n.a.	1.7 to 2.0	2.1 to 3.5	1.2 to 2.8	1.3 to 2.5	n.a.	1.5 to 2.0
Core PCE inflation[3]	1.8 to 1.9	1.5 to 2.0	1.4 to 1.9	1.5 to 2.0		1.7 to 2.0	1.3 to 2.1	1.4 to 2.1	1.4 to 2.2	
June projection	1.5 to 1.8	1.4 to 2.0	1.4 to 2.0	n.a.		1.5 to 2.3	1.2 to 2.5	1.3 to 2.5	n.a.	

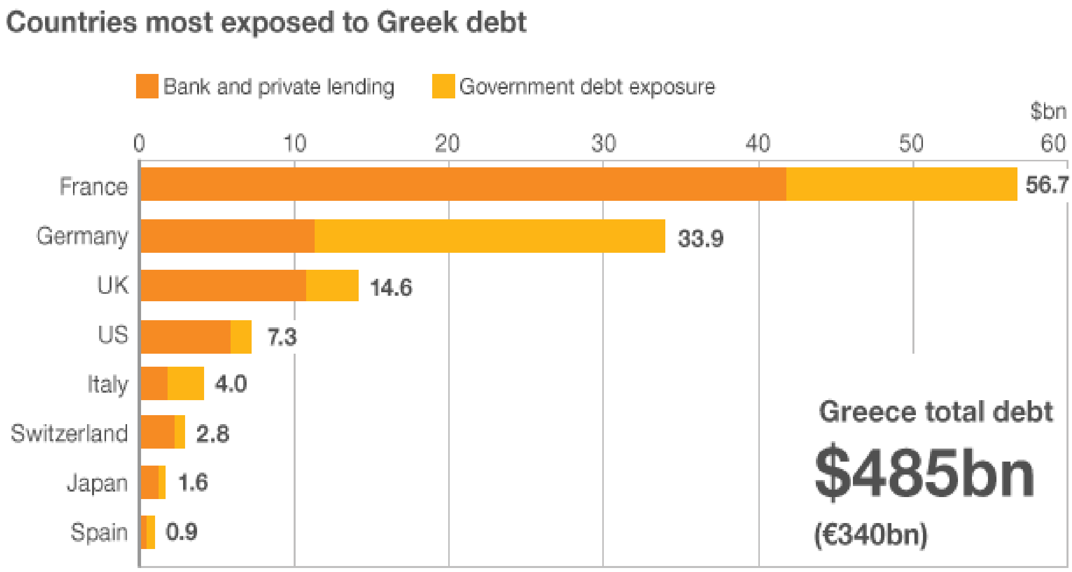
NOTE: Projections of change in real gross domestic product (GDP) and projections for both measures of inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The June projections were made in conjunction with the meeting of the Federal Open Market Committee on June 21-22, 2011.

1. The central tendency excludes the three highest and three lowest projections for each variable in each year.
2. The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.
3. Longer-run projections for core PCE inflation are not collected.

Source: http://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20111102.pdf

Wondering About the Size of Greek Debt Exposure?

Greek drama is now no longer confined to the literature class. The current Greek economic drama will be enshrined in economic history books and economic/financial policy studies. As the crisis has unfolded, it has been frequently challenging to find a succinct representation of the exposure to Greek debt. Thanks to the folks at the BBC, here is that picture.



Source: http://www.bbc.co.uk/news/business-13798000

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