



DAILY ECONOMIC COMMENTARY

Major Economic Reports – Mixed Message with Unfavorable Tone

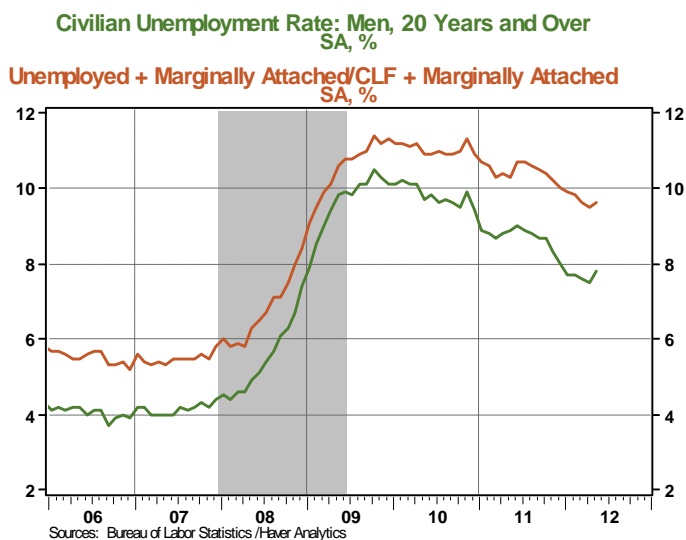
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The three economic reports published this morning – May employment report, ISM manufacturing survey and personal consumption expenditures – include both positive and negative developments in the economy. The employment report, in general, is a heavy weight and the nature of the May report tips the balance toward concern. But, the encouraging aspects of the May ISM manufacturing survey and April consumer spending data should not be discounted.

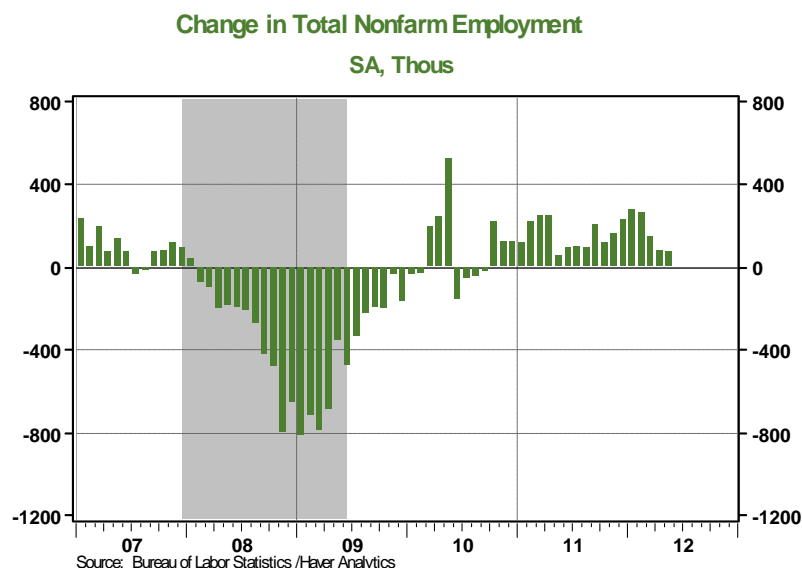
The **civilian unemployment rate** increased to 8.2% in May from 8.1% in April. Essentially, the jobless rate has held nearly steady during the last two months. The good news is that the labor force increased 642,000 in May, after posting declines in March and April, lifting the participation rate to 63.8% in May from 63.6% in April. In addition, employment advanced 422,000 following declines of 31,000 and 169,000 in March and April, respectively. At the same time, the broader measure of unemployment which includes marginally attached workers moved up one notch to 9.6%.

Chart 1



Nonfarm payrolls increased only 69,000 in May, after gains of 143,000 and 77,000 in March and April, respectively. The downward revisions of March and April resulted in a loss of 49,000 jobs. The April and May payroll tally is on the soft side compared with the first quarter average monthly increase of 226,000 jobs. Private sector payrolls advanced 82,000 in May, nearly matching the 87,000 gain posted in April. As shown in Chart 2, payroll employment has deteriorated in the second quarter and casts a shadow on the expansion that is in place at the current time.

Chart 2



Highlights of changes in payrolls during May 2012:

Construction: -28,000 vs. -5,000 in April

Manufacturing: +12,000 vs. +9,000 in April

Private sector service employment: +82,000 vs. +87,000 in April

Retail employment: +2,000 vs. +27,000 in April

Professional and business services: -1,000 vs. +37,000 in April

Temporary help: +9,200 vs. +12,600 in April

Financial activities: +3,000 vs. +4,000 in April

Health care: +19,000 vs. +25,300 in April

Government: -13,000 vs. -10,000 in April

The overall workweek was shorter in May (34.4 hours) compared with April (34.5 hours), while the factory workweek also dropped in May (40.5 hours vs. 40.8 hours) and factory overtime slipped slightly (3.2 hours vs. 3.3 hours in April). The factory man-hours index fell 0.4% in May, which bodes poorly for industrial production. Hourly earnings rose only 0.1% in May to \$23.41, which puts the year-to-year increase at 1.7%, the smallest increase since November 2010. The small gains in payrolls and employment suggest an insignificant increase in personal income during May.

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Chart 3



In sum, the household survey has positive and negative elements but the establishment survey details are worrisome. As recently as last week, New York Fed President Dudley noted the following:

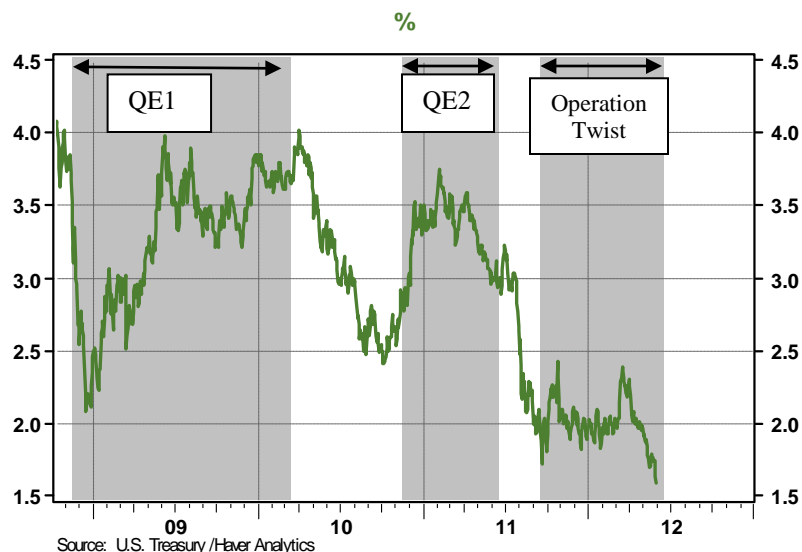
“As long as the U.S. economy continues to grow sufficiently fast to cut into the nation’s unused economic resources at a meaningful pace, I think benefits of further action are unlikely to exceed the costs.”

The May employment report is bound to lead to a modification of this assessment. The latest rally of Treasury securities has done part of the Fed’s work, with the 10-year Treasury note trading at 1.45%, down from a high of 2.39% in March. The decline in the long-term yield is the result of weakness in today’s employment report and heightened uncertainty in the eurozone. The latter is a short-term influence, while economic data can change for the better in the near term, given the current trajectory of growth in bank credit. The recent sharp drop in Treasury yields has bought the Fed ample time to watch and wait before providing new support to the economy, if economic momentum fades further.

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Chart 4

10-Year Treasury Bond Yield at Constant Maturity



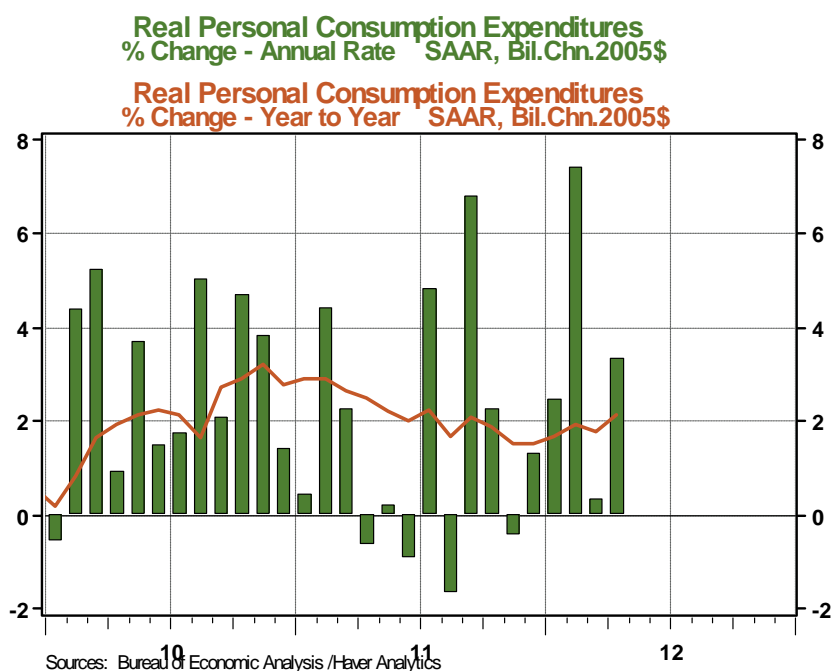
HIGHLIGHTS OF THE MAY 2012 EMPLOYMENT SITUATION

	<u>Dec-11</u>	<u>Jan-12</u>	<u>Feb-12</u>	<u>Mar-12</u>	<u>Apr-12</u>	<u>May-12</u>
Household Survey						
Chg. in Civilian Labor Force (000)	-50	508	476	-164	-342	642
Chg. in Civilian Employed (000)	176	847	428	-31	-169	422
Civilian Unemployment Rate	8.5	8.3	8.3	8.2	8.1	8.2
Chg. in employment payroll and pop. Adjusted (000)	170	491	879	-418	-495	400
Chg. in Part-time workers for economic reasons (000)	-371	132	-111	-447	181	245
Participation Rate	64.0	63.7	63.9	63.8	63.6	63.8
Employment-Population ratio	58.5	58.5	58.6	58.5	58.4	58.6
Establishment Survey						
Chg. in Total Nonfarm Payrolls (000)	223	275	259	143	77	69
Chg. in Private Nonfarm Payrolls (000)	234	277	254	147	87	82
Chg. in Manufacturing Payrolls (000)	28	52	30	42	9	12
Chg. in Services - Private Sector (000)	172	199	218	119	83	97
Chg. in Government payrolls (000)	-11	-2	5	-4	-10	-13
Total Workweek (Hours)						
Manufacturing Workweek (Hours)	40.7	40.9	40.9	40.7	40.8	40.5
Manufacturing Overtime (Hours)	3.3	3.4	3.3	3.3	3.3	3.2
Average Hourly Earnings (Pvt.)						
	23.25	23.28	23.33	23.37	23.39	23.41
Chg. from prior month	0.1%	0.1%	0.2%	0.2%	0.1%	0.1%
Chg. from year ago	2.1%	1.8%	2.0%	2.0%	1.8%	1.7%
Average Weekly Earnings						
	660.18	662.82	664.17	662.88	664.23	663.89
Chg. from prior month	0.1%	0.4%	0.2%	-0.2%	0.2%	-0.1%
Chg. from year ago	2.5%	2.7%	2.3%	2.0%	1.7%	1.7%
Index of Aggregate Weekly Hours:						
Chg. from prior month in Total Index	0.2%	0.6%	0.3%	-0.2%	0.1%	0.1%
Chg. from prior month in Mfg. Index	0.5%	1.0%	0.7%	-0.4%	0.4%	-0.4%

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Moving on to other economic news of the day, **real consumer spending** increased 0.3% in April, after holding steady in March. In April, purchases of durables (+0.8%), non-durables (+0.2%) and services (+0.2%) advanced. Conservative assumptions about consumer spending in May and June yield as annualized increase of 2.4% in the second quarter. The consumer spending trajectory suggested by the April data are an offset to the gloomy aspects of the May employment report.

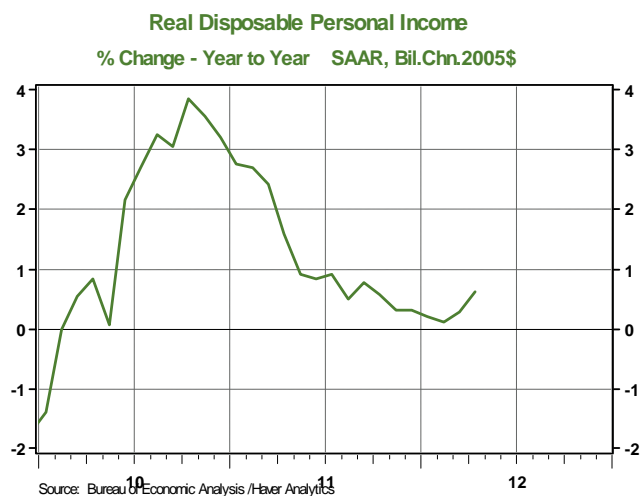
Chart 5



Personal income rose 0.2% in April, while the year-to-year change in real disposable personal income also showed an improvement (+0.6% vs. 0.3% in March). The personal saving rate of the U.S economy slipped one notch to 3.4% in April.

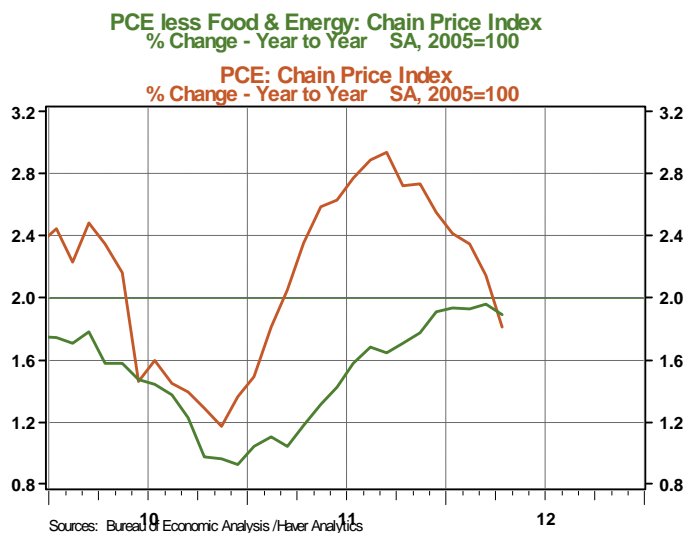
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Chart 6



The personal consumption expenditure price index, the Fed's preferred measure of inflation, rose 0.1% in April, putting the year-to-year increase at 1.81%. The core personal consumption expenditure price index, which excludes food and energy, moved up 1.89% in April on a year-to-year basis, down from a high of 1.95% in March. The decelerating trend of both these price measures (see Chart 7) allows the Fed wiggle room in the inflation-growth debate to focus on growth and employment.

Chart 7

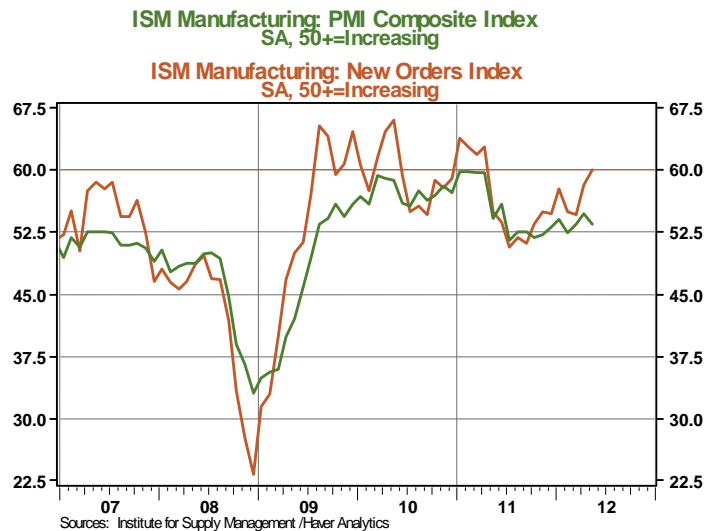


The **ISM manufacturing survey** for May shows continued growth in the factory sector during May albeit at a slower pace compared with April. The composite index inched down to 53.5 in

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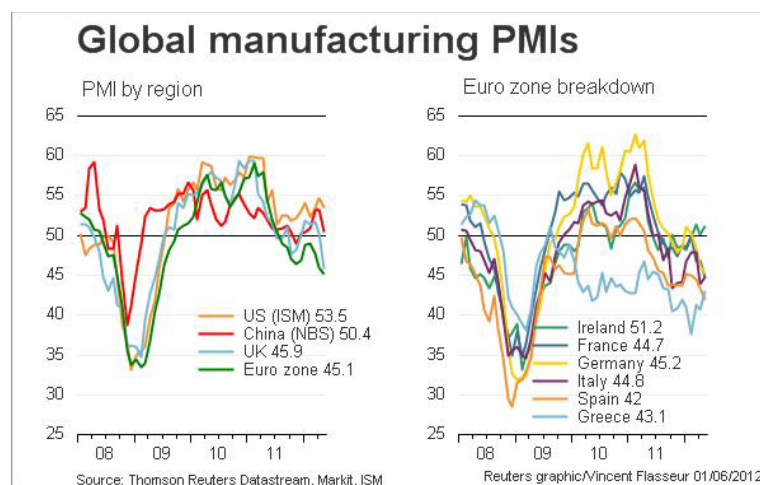
May from 54.8 in April. Indexes above 50.0 denote an expansion in factory activity, while readings below 50 signify a contraction. The most outstanding aspect of the survey is the increase in the index tracking new orders to 60.1 during May vs. 58.2 in the prior month, the highest since April 2011.

Chart 8



While we are speaking about the factory sector, reports from rest of the world indicate weakening factory conditions in major economies of the world. The Purchasing Managers' Index (PMI) of China slipped to 50.4 in May from 53.3 in April, with the indexes measuring new orders (49.8 vs. 54.5 in April) and production (52.9 vs. 57.2 in April) also declining. The PMI of the Indian factory sector held above 50.0 in May (54.8 vs. 54.9 in April) but is down from a year ago (57.5, May 2011). The Markit eurozone PMI fell to 45.1 in May from 45.9 in the prior month,

Chart 9



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