AFP EconWatch
Weekly Economic Newsletter for Treasury and Finance
October 8, 2012

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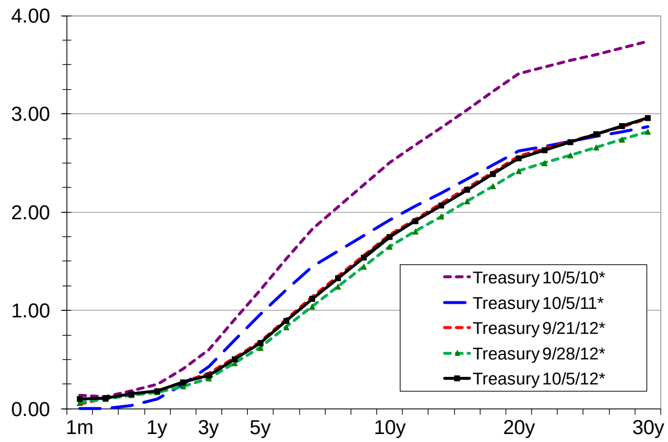
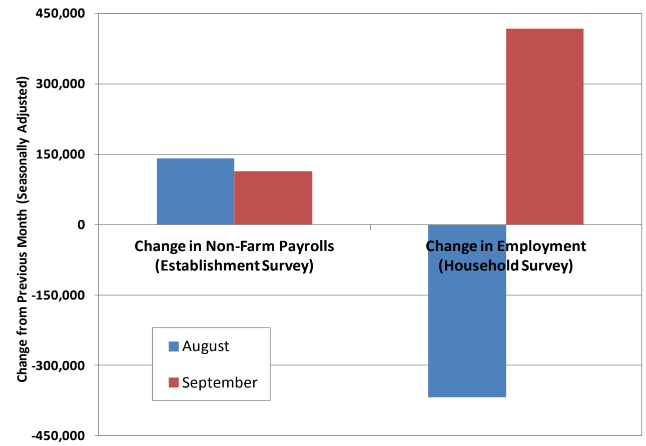
The Big Picture: Yield Curve & Employment



U.S. Treasury Yield Curve—Source: [U.S. Department of the Treasury]



Employment—Source: [Bureau of Labor Statistics]

Measure	Numerical Trend	Current Trend	Analysis
Employment September 2012 *Source: Bureau of Labor Statistics*	*Non-Farm Payrolls* *Seasonally Adjusted* *Thousands* Sep 12: +114 Aug 12: +142 Sep 11: +202	↑	The BLS also added a combined 86,000 jobs to their July and August payroll estimates (now at +181,000 and +142,000). The 3-month moving average payroll gain of 145,670 was the best since April. The private sector was responsible for 104,000 of the additional workers in September while governments added 10,000 workers. Over the past 12 months, the private sector has added 1.86 million workers during which government payrolls contracted by 51,000 workers. Based on a separate household survey, the unemployment rate dropped by 3/10^{ths} of a point to 7.8%, thanks to growth in employment and in the labor force.
Factory Orders August 2012 *Source: Census Bureau*	*Percentage Change from* *Previous Month* *Seasonally Adjusted* Aug 12: -5.2% July12: +2.6% Aug11: -0.2%	↓	New orders for manufactured goods totaled a seasonally adjusted $452.8 billion, down 2.5% from a year earlier. A lack of civilian aircraft orders led to an overall 34.9% decrease in transportation orders. Net of transportation, new orders increased 0.7%. New orders for manufactured durable goods fell 13.2% to $198.3 billion while those for non-durable goods grew 2.2% to $254.5 billion. Shipments were down 0.3% in August but remained 2.6% above levels 12 months earlier. Unfilled orders decreased 1.7% during August while inventories increased 0.6%. The inventories-to-shipments ratio ticked up one-basis point to 1.28.

ISM Report on Business: Manufacturing September 2012 *Source: Institute for Supply Management*	*Purchasing Managers' Index* *>50 = Expansion* *Seasonally Adjusted* Sep 12: 51.5 Aug 12: 49.6 Sep 11: 52.5	↑	The manufacturing sector expanded for the 1st time since May. 3 of 5 index components both improved from August and were in expansionary territory: new orders (+5.2 points to 52.3), supplier deliveries (+1.0 to 50.3) and employment (+3.1 to 54.7). The inventories index dropped by 2.5 points but continued to indicate expansion (50.5) while the production index picked up 2.3 points but remained in contractionary range (49.5). 11 of 18 industry segments expanded during September.
ISM Report on Business: Non-Manufacturing September 2012 *Source: Institute for Supply Management*	*Diffusion Index* *>50 = Expansion* *Seasonally Adjusted* Sep 12: 55.1 Aug 12: 53.7 Sep 11: 53.0	↑	The headline index increased for a 3rd straight month to its highest reading since March. All 4 index components were above the critical 50.0 point expansion/contraction threshold, with business activity jumping 4.3 points to 59.9 and new orders gaining 4.0 points to 53.7. The employment index fell 2.7 points to 51.1 while the supplier deliveries index was stable at 51.5. 12 of 18 industry segments expanded during the month.
Vehicle Sales September 2012 *Source: Autodata Corp.*	*Seasonally Adjusted Annualized Rate* *Millions* Sep 12: 14.94 Aug 12: 14.52 Sep 11: 13.14	↑	This was the strongest pace of sales since March 2008, with 13.7% growth over the past 12 months. Sales of autos were at a SAAR pace of 7.68 million units in September, an increase of 4.1% from August and 23.9% from September 2011. Light truck sales totaled 7.26 million units (SAAR), up 1.7% from August and 4.6% from a year earlier. Autos represented 51.4% of sales.
Construction Spending August 2012 *Source: Census Bureau*	*Percentage Change from Previous Month* *Seasonally Adjusted Annualized Rate* Aug 12: -0.6% Jul 12: -0.4% Aug 11: +3.0%	↓	Despite falling 2 months in a row, the SAAR construction spending pace of $837.1 billion during August was 6.5% above levels of a year earlier. Despite a 0.9% jump in private residential construction spending, overall private construction spending dropped 0.5%. The reason: spending on non-residential construction dropped 1.7%. Public construction spending declined 0.8% during August and was off 3.5% from a year earlier.
Jobless Claims Week ending September 29, 2012 *Source: Department of Labor*	*First-Time Claims* *Seasonally Adjusted* *Thousands* Sep 29 12: 367 Sep 22 12: 363 Oct 1 11: 401	↑	The 4-week moving average for initial filings was unchanged from the prior week's 375,000 but came in 8.1% lower than that of a year earlier (408,250). The seasonally adjusted insured unemployment figure for the week ending September 22 was 3.281 million while the 4-week moving average for insured unemployment decreased by 12,750 to 3.285 million. A year earlier, it was 3.718 million.
Consumer Credit August 2012 *Source: Federal Reserve*	*Change in Outstanding Balances* *Seasonally Adjusted* *Billions* Aug 12: +$18.1 Jul 12: -$2.5 Aug 11: -$8.6	↑	Outstanding consumer credit balances—net of real estate-backed loans—were at $2.726 trillion at the end of August, up 5.5% from a year earlier. Revolving credit balances grew by 6.1% to $854.9 billion (+0.9% from August 2011). Non-revolving credit balances grew 9.4% in August to $1.857 trillion. This was the 12th straight month of growth in non-revolving credit, with outstanding balances up 7.8% from a year earlier.

Economic Commentary edited by Kevin Roth

The Bureau of Labor Statistics report on Friday managed to both meet expectations and deliver a surprise, as the U.S. economy created 114,000 jobs during September and the unemployment rate dropped to its lowest level since January 2009. The pace of job creation during the month was pretty much what had been expected. Private sector payrolls expanded by 104,000 workers during September after growing by 97,000 workers in August. Over the past year, the private sector has added 1.86 million workers. Industry sectors with the greatest job gains during the month were health care (43,500), transportation/warehousing (17,100), food services/bars (15,700) and retail (9,400). Manufacturing, however, lost 16,000 workers. Government employment grew by 10,000 workers, which would have been big news given the job losses the sector has sustained over the years, but it was overshadowed by a massive upward revision of 45,000 jobs for the sector in August.

Where the report had surprised many observers was news that the unemployment rate dropped 3/10ths of a point to 7.8 percent. The unemployment rate is calculated from data collected in a separate survey of households (the data described in the previous paragraph come from a survey of establishments). This survey showed a massive increase in employment of 873,000 workers and an impressive 456,000 person drop in the number of unemployed. Further, the labor force expanded by 418,000 people during September. The normal caveat about the household survey is worth repeating here: that is, the data from this survey tend to be quite volatile. Hence, next month's report will be closely watched to see whether this represents a shift in momentum or merely a data blip caused by cyclical variations not picked up the seasonal adjustments.

The report also indicates that the number of people "involuntarily" holding a part-time job surged during September. There were 8.61 million people who held a part-time job but were seeking a full-time opportunity, a jump of 582,000 during the month and the highest level since last October. The typical unemployed person has been out of work for 18.5 weeks, up a half week from August but well below the 21.8 week median of a year earlier. "Just" 4.84 million people were unemployed for at least half a year, down from 5.03 million in August and 6.20 million a year earlier. The broadest measure of labor underutilization, the "U-6" series, was unchanged during September at 14.7 percent. A year earlier, the same percentage was at 16.4 percent.

The BLS report was not the only labor market data released last week. Among the others:

- The seasonally adjusted unemployment rate calculated by polling firm Gallup was unchanged in September at 8.1 percent. A year earlier, it was at 8.9 percent. The group's measure of involuntary part-time workers dropped by 4/10ths of a point to 8.6 percent (it was at 9.7 percent back in September 2011). Their measure of underemployment—the sum of the non-seasonally adjusted unemployment rate (7.9 percent) and involuntary part-time workers—was at 16.5 percent. In August, the same metric was 17.1 percent while a year earlier it was at 18.3 percent.

- The number of first-time claims made for unemployment insurance benefits grew by 4,000 during the week ending September 29 to a seasonally adjusted 367,000 claims. The four-week moving average of the Department of Labor data series was unchanged at 375,000. 5.099 million people were receiving some form of unemployment insurance benefits during the week ending September 15, down from 5.174 million a week earlier and 6.859 million a year earlier. (A big part of the difference from a year earlier reflected extended benefit programs that had run out of funding in recent months.)
- The measure of announced job cuts by outplacement firm Challenger, Gray & Christmas was at 33,816 jobs during September. This represented a 4.9 percent increase from August but the fewest for a September since 1997. For the first nine months of 2012, the Challenger measure has tracked 386,001 planned job cuts. This was a decline of 19.4 percent from the 479,064 cuts reported during the same nine months of 2011.
- The number of job openings listed on online job sites slipped 1.9 percent during September, according to the Monster Employment Index. The index reading of 153 (October 2003 = 100) was up five points from a year earlier. The index failed to increase in any of the nine Census regions during the month.

It was the slow pace of job creation that led to the Federal Open Market Committee to launch another round of quantitative easing at its September meeting. Last week, the Federal Reserve released the minutes to that meeting that showed not only concerns about the "small" growth in employment but also of the "persistent headwinds" to further economic growth. These issues include the continued weakness in housing, ongoing household deleveraging, tight credit conditions and "fiscal consolidation" among governments. Discussions continued among meeting participants as to the cause of the lethargic pace of job creation—i.e., whether it is due to the sluggish pace of economic growth or the result of greater structural shifts that could be long lasting. As for the decision to purchase $40 billion in mortgage backed securities per month: while one member expressed concerns that the action could lead to "excessive risk taking…and undermine financial stability over time," the majority of the meeting's participants agreed that these risks "could be managed."

Following up from the durable goods report released the prior week, the Census Bureau's factory orders report showed a struggling manufacturing sector in August. New orders slumped 5.2 percent during the month, partially due to a lack of orders for civilian aircraft and a 14.9 percent drop in orders for vehicles. Net of transportation goods, new orders were up 0.7 percent. Orders for durable goods plummeted 13.2 percent, falling in almost every category except for electronic equipment/appliances. Orders for non-durable goods were up 2.2 percent during August.

But there may be hope for the sector as survey data suggest manufacturing expanded during September. The Purchasing Managers' Index from the Institute for Supply Management added 1.9 points to hit a seasonally adjusted reading of 51.5. This not only ended the diffusion index's three month losing streak, it was the first time since May in which it was above the important 50.0 threshold. Four of five index components improved from their August readings—production (49.5), new orders (52.3), supplier deliveries (50.3) and employment (54.7)—while the inventories index shed 2.5 points to 50.5. Elsewhere in the report, the new export orders index spent its fourth consecutive month in contractionary territory at 48.5 while the prices paid index added 4.0 points to 58.0. The comments from survey respondents suggested a mixed picture, with orders "beginning to pick up" and "continued concern" about both demand overseas and "an unsettled political environment."

The headline index from ISM's report for the non-manufacturing sector indicated expansion for the 33rd consecutive month during September. The composite index's seasonally adjusted reading of 55.1 was up 1.4 points from August and its best reading since March. While all four index components were above the critical reading of 50.0, only two had improved from their August readings: business activity (up 4.3 points to 59.9, its best since February) and new orders (up 4.0 points to 57.7, its best since March). The employment index lost

2.7 points during the month to a reading of 51.1 while the supplier deliveries index was unchanged at 51.5. The press release noted that a "majority" of comments received from survey respondents showed a "slightly more positive perspective" on business conditions.

Construction spending slowed for the second straight month in August, with a 6/10^{ths} of a percentage point drop from July. Public construction spending continued its descent, declining 0.8 percent during the month and 3.5 percent from year ago levels. Among the big decliners: education (-3.4 percent from July), transportation (-1.6 percent) and highway/street (-0.6 percent). Private construction spending dropped 0.5 percent, as spending on non-residential construction plummeted 1.7 percent. One bright spot: residential construction spending, which was up 0.9 percent during the month and an impressive 17.8 percent over year ago levels.

Matching trends in other housing reports, the CoreLogic Home Price Index increased 0.3 percent during August and was up 4.6 percent above year ago levels. The national index appears to have been hurt a bit by a number of sales of distressed homes as the price index net of distressed homes gained 1.0 percent and was up 4.9 percent from a year earlier. The three states with the largest year-to-year price appreciation: Arizona (+18.2 percent), Idaho (+10.4 percent) and Nevada (+9.0 percent). Just six states suffered year-to-year price depreciation: Kentucky (-0.3 percent), Connecticut (-0.5 percent), Alabama (-0.7 percent), New Jersey (-1.4 percent), Illinois (-2.3 percent) and Rhode Island (-2.6 percent). The list drops to two states (New Jersey and Rhode Island) if you knock out the distressed properties from the analysis.

Even if factory orders for vehicles declined in August (as reported above), demand for vehicles continued to…well…rev up as we entered autumn. The seasonally adjusted annualized sales rate of 14.94 million vehicles was the most for the sector since the start of the recession and was up a robust 13.7 percent from a year earlier. Auto sales were at a SAAR pace of 7.68 million units, up a whopping 23.9 percent from that of September 2011 while the light truck/SUV sales pace of 7.26 million units represented an increase of 4.6 percent from a year earlier.

The Week in Corporate Finance edited by Brian Kalish

As expected, it was a rather quiet week until the release of the Employment report on Friday. The report was slightly more optimistic than expected and the market responded by adding a bit of risk rather than safety. The payroll number was nothing to write home about at a +114k (versus a consensus number of +113k). Where the market derived a bit of hopium was from (1) the upward revision to both July's (+40k to +181k) and August's (+46k to +142k) payroll numbers; (2) the unemployment rate dropping to 7.8 percent from 8.1 percent (now at its lowest level since January 2009); (3) the number of long-term unemployed dropped under 5 million for the first time since early 2009; and (4) both the average workweek and the average hourly wage increased. All of these numbers play into the narrative of a positive but sluggish economic recovery.

U.S. Treasuries sold-off after the Employment report as investors looked to higher returning assets. For the week, the U.S. 2-year Treasury note yield was up +3bps to 26bps (after being as low as 23bps); the 5-year note was up +5bps to 67bps (after being as low as 60bps); the 10-year note was up +10bps to 1.73 percent (after being as low as 1.60 percent); and the 30-year bond was up +15bps to 2.97 percent (after being as low as 2.81 percent).

It was a similar story in Germany, as the need for safety diminished. The German 30-year Bund yield was higher by +11bps to close at 2.37 percent; the 10-year Bund was higher by +8bps to settle at 1.52 percent; and the 2-year Bund was higher by +4bps to finish the week at 6bps. The French 10-year Oat was higher by +11bps to end the week at 2.29 percent.

Spain benefited from the desire to add riskier assets, as its 10-year bond yield fell -27bps to 5.69 percent. This was a return to its recent downward trend after peaking at 7.75 percent back in late July. The 10-year Italian bond yield was down slightly for the week, dropping -4bps to 5.05 percent. After being as high as 6.71 percent back in late July, it is pushing to get back under five percent. Likewise, the Portuguese 10-year bond yield also fell this week, dropping -78bps to 8.22 percent. The Portuguese 10-year yield has now fallen over -1,000bps from its high of 18.29 percent back in late January.

Greece continues to be an exceptional story (at least on a relative basis) as its 10-year bond yield fell another -100bps this week, as its slow and steady grind lower continues. This week it fell -102bps to 18.47 percent. It's hard to believe the yield was over thirty percent as recently as June.

At its highs on Friday, both the S&P 500 and the Dow touched near five-year highs. The S&P peaked at 1,470.96 and the Dow peaked at 13,661.87, the highest levels since December 2007.

What to watch over the next week:

Monday, October 8, 2012
No Major Releases

Tuesday, October 9, 2012
- NFIB Small Business Survey (September 2012)

Wednesday, October 10, 2012
- Job Openings and Labor Turnover (August 2012)
- Wholesale Trade (August 2012)
- Treasury Budget (September 2012)

Thursday, October 11, 2012
- International Trade (August 2012)
- Import/Export Prices (September 2012)

Friday, October 12, 2012
- Producer Price Index (September 2012)

AFP EconWatch—Weekly Economic Newsletter by:
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