That Sinking Feeling

Things are not looking up for the US, what with the employment numbers barely picking up. Ths growth curve this time us going to take a long time to peak, says **Kunal Kumar Kundu**

While Europe plunges from hope to despair and back to hope (when China scoffed at the rumour of offloading Euro) only possibly to plunge back to despair as some other bad news erupts somewhere (how about Hungary?), a drop in the first time jobless claims in the US (a few days back) resulted in innumerable nervous laughter, pinning hope on US recovery. However, the recently released unemployment data put paid to all hopes. Things are definitely not looking good, although there has been a marginal improvement of unemployment rate from 9.9 per cent to 9.7 per cent. The devil, as they say, lies in the detail:

- Out of 4,31,000 jobs added in May, 4,11,000 jobs were temporary hiring for the census, thus leaving only 20,000 real jobs being added. This means, as the census work is over, these workers would be released.
- The private sector added only 41,000 new jobs as compared to 2,18,000 jobs created in the previous month. More importantly, it was lower than the ADP's estimate of 55,000 jobs being created. Historically, the ADP numbers tend to underestimate. Not this time though. This means that revisions are unlikely to happen.
- The state and the local governments cut 22,000 jobs last month.
- Temporary help services added 31,000 jobs during the month, indicating that business is not as confident about the future prospect.
- An additional 2,91,000 workers became discouraged (persons not currently looking for work, believing no jobs are available for them).
- Reversing the earlier declining trend, as many as 4,93,000 workers fell out of the labour force.
- The deepening of the problem can also be gauged by the fact that an additional 47,000 workers remained unemployed for 27 weeks or more, as a result of which the mean duration of unemployment rose from 33 to 34.4 weeks. This is likely to lead to

more people being discouraged in the coming days.

So what happened to all the stimuli? According to CBO (Congressional Budget Office) estimates, without the stimulus many more jobs would have been lost and the unemployment rate would have climbed to 11.2 per cent, rather than peaking at 10 per cent. That's fine. But what now, as the stimulus reverses? For sure, the stimulus has helped ease the pain, but that has not put the economy into auto pilot so that it can continue to grow as the stimulus is being withdrawn.

According to the second estimate of Q12010 GDP released recently, the annualised growth estimate has been reduced from 3.2 per cent to 3 per cent (and down from 5.6 per cent during Q4, 2009). Rather than showing a more robust growth in the immediate aftermath of a deep recession, moderation of growth is not a positive signal. More importantly, more than 50 per cent (1.65 per cent) of the growth was accounted for by private inventories which increased by USD 33.9 billion. Meanwhile, given the sharp contraction in inventories experienced earlier, inventory rebuilding is expected to add to growth in the coming quarters. The sustainability, however, depends on how the consumers behave and the data does not leave much room for optimism.

- Retail sales for the month of May fell 1.2 per cent as compared to April.
- The stress on the consumers' pocket was evident as there was across the board a pull-back in demand.
- The decline was the biggest – and the first – since September 2009, when sales fell 2.2 per cent.
- Excluding auto and gas sales, retail sales slipped 0.8 per cent, the largest drop since 1 per cent in March 2009.
- That the US consumers are in distress is amply clear from the fact that a record 40 million (i.e. one in every eight Americans) plus US consumers now survive on food stamps. This number is expected to touch 43 million in 2011.

Given that the government is now forced to withdraw the stimulus and curtail spending, the stress on the US consumers will be more, especially since transfer income via government spending has become an important source of their personal income.

The corresponding chart shows the transformation that has been taking place in the US economy. As the data indicates, the entire loss in the private industries' share in personal income is being explained by the increasing role that the government has been playing through increasing transfer payment. Clearly, the recent recession hastened the process. Nevertheless, with a huge run-up in debt (with the problem likely to be exacerbated further as the debt to GDP ratio is expected to breach the 100 per cent mark by 2011), the US government can ill-afford to play Santa Claus to the US consumers for long. Agreed, personal income is not the sole driver of consumption, wealth effect has a big role to play as well. However, given that the US housing market is unlikely to recover

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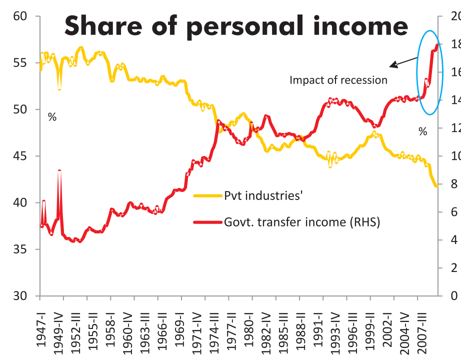

Source: BEA, my calculation

soon and with the stock market playing truant (especially with a deepening crisis in Europe), the wealth effect will be lost on the US consumers, struggling unemployment.

To conclude, the US is in for a long haul of slow and low growth. In fact, the growth concern was clearly visible in the statement issued recently by the Fed, post their meeting. While they did not adjust the growth forecast downwards (I was expecting a mild revision), they are clearly concerned about the growth prospects and hence have pushed the decision to raise rates beyond 2010 and further into 2011. Given the weak housing market, high level of joblessness and no signal of consumers coming back, I expect the rate hike decision to be postponed to the second half of 2011.

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