

VAKIFBANK GLOBAL ECONOMY WEEKLY

Does US Labour Market Start To Recover?



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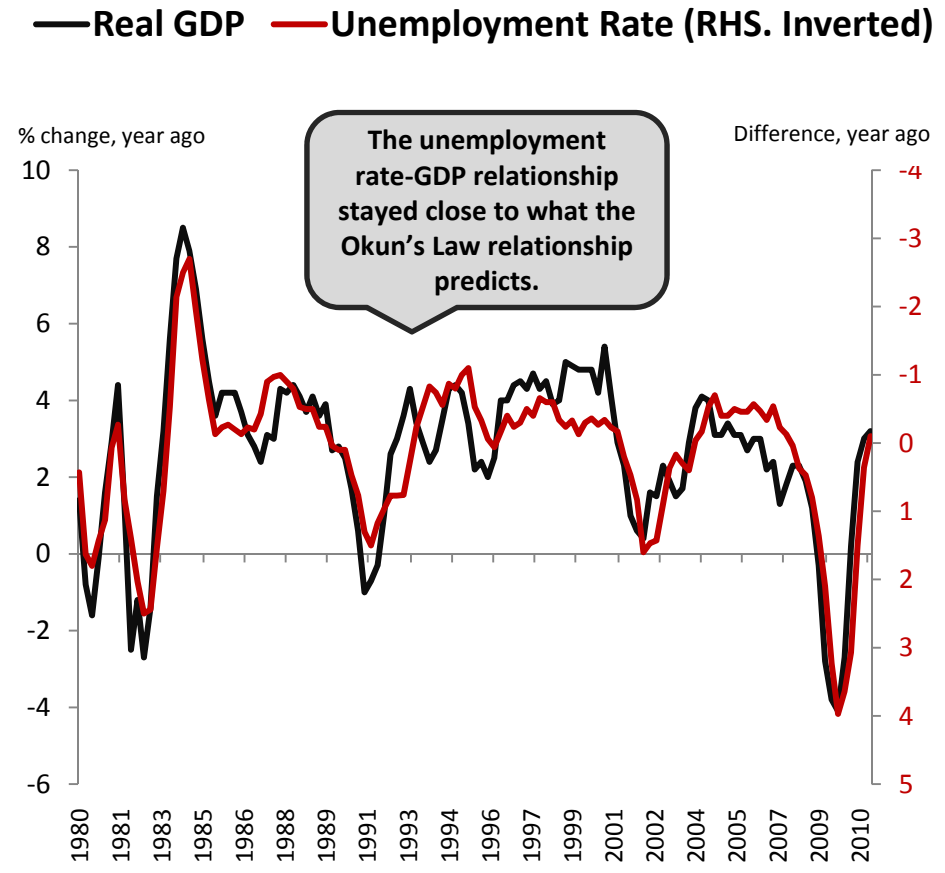
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Vakifbank Economic Research



What is the probability for US to decrease an unemployment rate and sustain improvement in labor market in 2011?..



Source: Bloomberg

- ▣ As US is still the largest economy in the world, its GDP growth and unemployment rate are critically important. Whether US can decrease unemployment rate while sustaining an improvement in labor market or not is the main question for global markets.

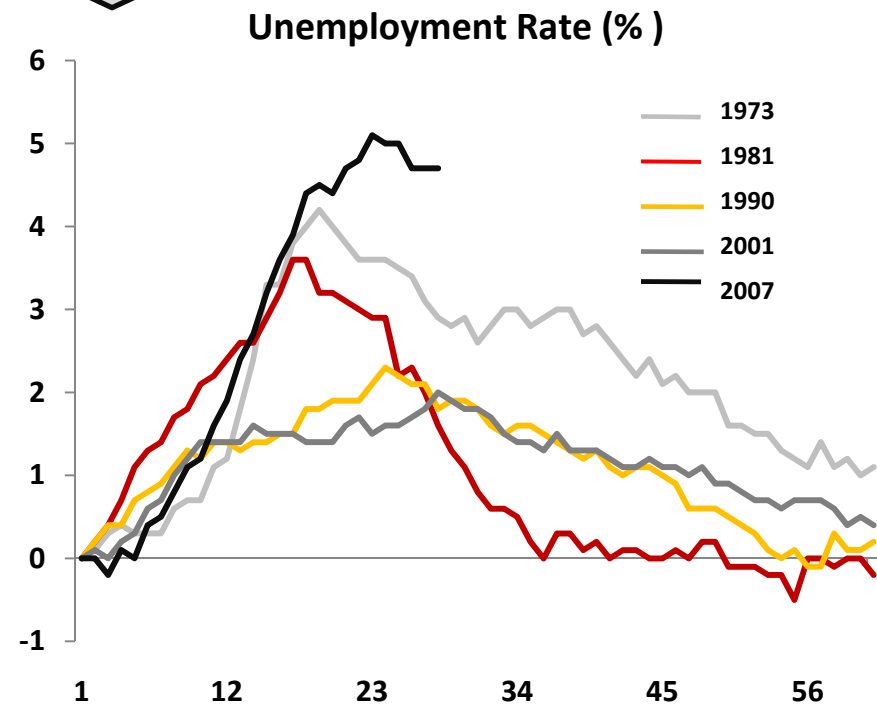
- ▣ Okun's rule refers to the relationship between increases in GDP growth and decreases in unemployment rate. Based on this rule, if the US economy grows by 4% as expected in 2011, the unemployment rate could drop to 9% by the end of 2011.

For the last four quarters, US economy has grown at an average rate of 2.9% per quarter but unemployment rate has not fallen much. The rigidity of unemployment rate during recessions could be the main reason...

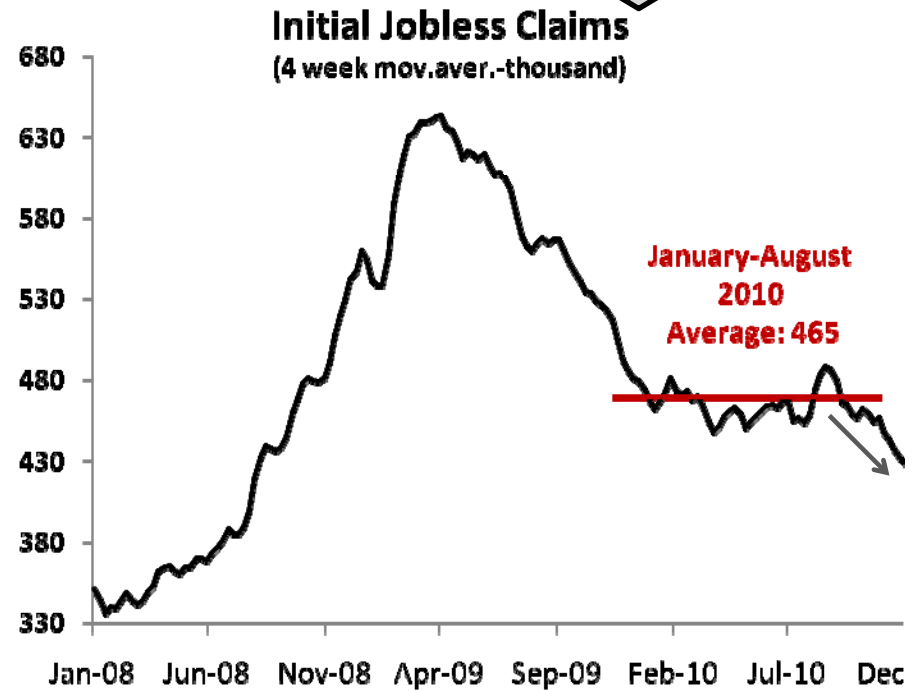
In the past it often took five or six years for the unemployment rate to come down from its post recession highs towards pre-recession lows.

As unemployment rate rose to the record high levels during 2007 recession, the recovery process will be slower than usual.

In the last months of 2010 the decline in initial jobless claims highlights improvement in labor market.

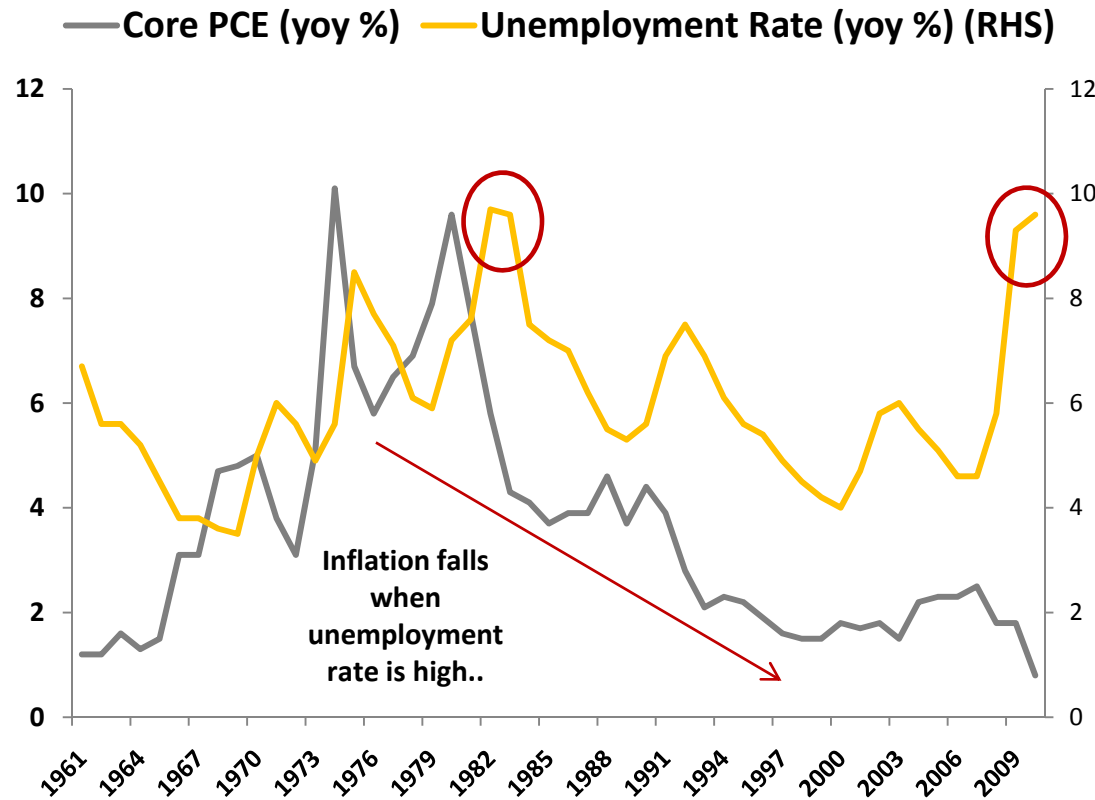


Source: Bloomberg



Source: Bloomberg

Since 1980, core inflation has stayed subdued as long as unemployment rate remained higher...



Source: Bloomberg

Due to slack in US economy, (negative output gap) core inflation is expected to stay below 1% during 2011.

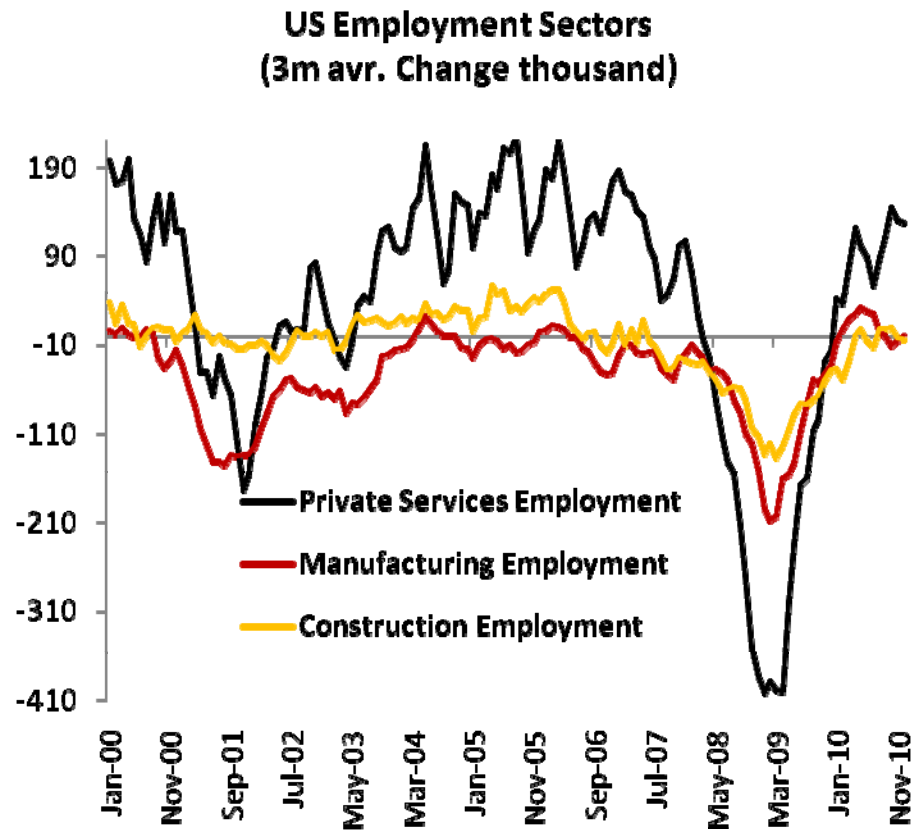
Record high unemployment level keeps downward pressure on prices.

Capacity utilization and wage growth remain at low levels.

So;

The risks for the economy tilts more towards deflation rather than inflation in US.

The service sector is the driving force behind the employment growth in US...

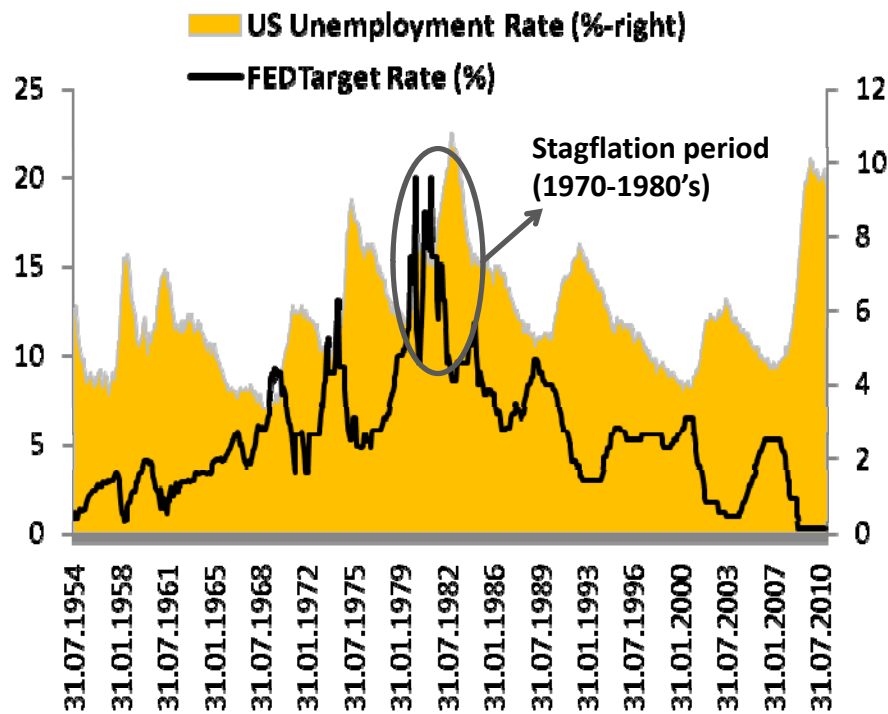


Source: Bloomberg, Vakifbank

- ▣ Of the total employment, service sector get the highest share in total US labor force.
- ▣ Similarly, in other developed economies, service sector makes a large contribution to the GDP growth and employment.
- ▣ Labor loss in service sector increased dramatically during the crisis period, but afterwards it has recovered more rapidly than other sectors since March 2009.

Any increase in the FED's target rate before 2012 is low due to high unemployment rate and low inflation...

- ✔ Taking prior recessions into account in US history, on average, FED never restarted the monetary tightening in six months until average unemployment rate declined by 0.7% from its peak.
- ✔ However, since present unemployment (jobless recovery) have more similarities to the ones, occurred in 1994 and 2004, Thus FED may take same approach and wait for longer for a rate hike (till 2012).



Source: Bloomberg

FED's first monetary tightening date after crisis period	Decline in the unemployment rate after the peak levels in rate (%)	The period after the peak levels in unemployment rate (month)
December 1954	-%1.1	3
August 1958	-%0.1	1
February 1962	-%1.6	9
April 1971	-%0.2	4
June 1975	-%0.2	1
September 1980	-%0.3	2
June 1983	-%0.7	6
February 1994	-%1.2	20
June 2004	-%0.7	12
Average	-%0.7	6

Source: Bloomberg

Main Risks on the growth and unemployment rate...

Possible risks for a higher unemployment rate could be categorized as follow;

- ✔ Any Increase in household saving rate would retard the US growth rate:** The magnitude of economic growth rate in US mainly depends on the behavior of consumers willingness to spend since US consumer spending comprise of roughly 70% of the GDP. The US household saving ratio which decreased to 2.1% in 2007 prior to the recent recession, has recently risen to 5.5%.
- ✔ The market could lose a confidence in Fed's policy:** After all these measures taken by FED, if US economic growth can not be sustained, there might be a loss in market confidence about riding out the crises. If the market concludes that FED monetary policy is not working that might lead to another sell off at the market.
- ✔ Possible crisis in Eurozone or other countries may also affect the US economy:** If the European sovereign debt crisis spreads further, the global financial system would suffer a renewed shock, investors may become risk adverse again. In that case there will be sell off in US financial market that may lead to another economic recession in US. Nonetheless this scenario is deemed to be not possible at present as it is thought that European Union governments will do everything to prevent EU crises from going further.

While there are still questions about the sustainability of US growth, taken together all these potential risks, improvement in unemployment rate seems to take time even longer.

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