WEEKLY ECONOMIC LETTER

December 6, 2002

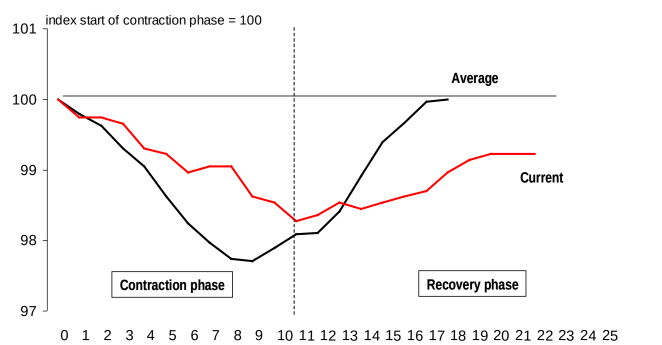
THE U.S. RECOVERY: A TALE OF TWO LABOUR MARKETS

Key Points

- The U.S. economy seems to be taking forever to recover. What's going on?
- The cyclical picture is distorted by strong structural headwinds in manufacturing.
- U.S. manufacturing has been shedding jobs since the spring of 1998 – 56 consecutive months. Obviously the story is more than cyclical.
- However, the U.S. labour market is 82% services and only 18% goods production.
- The picture is rosier in services, where the recovery phase was completed last summer.

(1) A Particularly Slow U.S. Recovery?

Current vs. historical average cycle: coincident indicator



Source: NBF Economic Research

Stuttering

The latest string of economic indicators confirms that the U.S. recovery remains on track. But it seems to be taking forever. Chart 1 compares the current business cycle with the historical average. After 11 months of recovery, the U.S. economy has yet to recover all the ground it lost in the 2001 recession. Historically, this has tended to take only about nine months. Given the substantial impetus provided by the Fed since the beginning of 2001, one can't help asking why it's taking so long.

On measuring business cycles

Measuring business cycles is not necessarily easy. To help with the call, the U.S. National Bureau of Economic Research (NBER) years ago developed a coincident economic indicator. This is a weighted composite of four components: employment, industrial production, manufacturing trade and sales, and personal income less transfers. Since the component indicators don't necessarily move together, they will send conflicting signals at times. The current episode is a good example.

As chart 2 illustrates, the coincident index excluding employment gives a very different picture. While total employment is rolling over very slowly, other coincident indicators have fully recovered.

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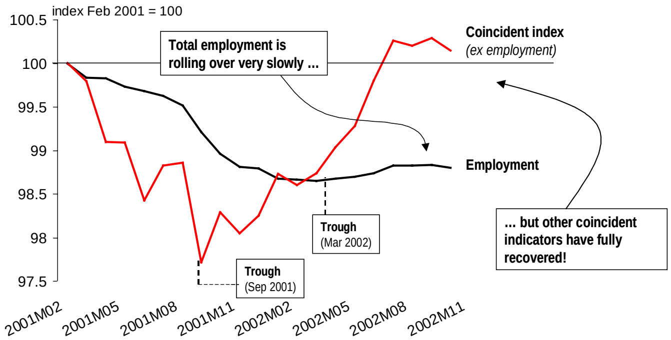
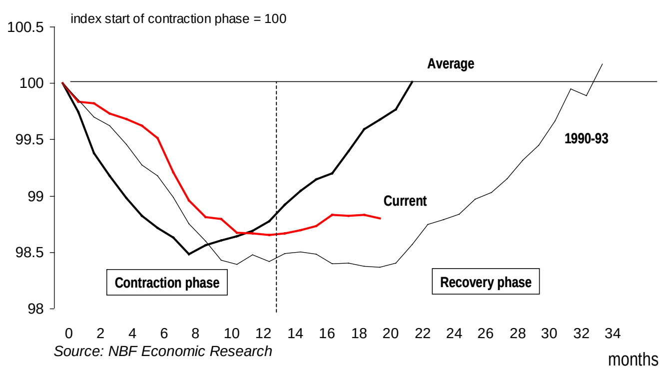
(2) The Hidden Strength of the U.S. Economy
Total employment vs. coincident index excluding employment



Source: NBF Economic Research

Of course, employment can hardly be excluded. After all, according to the NBER, it is the most reliable gauge of the business cycle. It was the employment peak in March that decided the NBER to choose that month as the official start of recession.

(3) The Other Side of Productivity Growth
Current, 1990-93 and historical average cycle: U.S. total employment



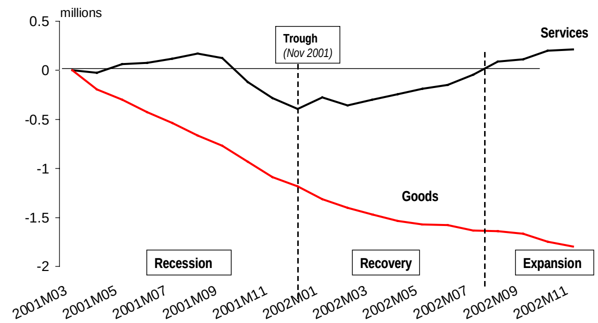
Source: NBF Economic Research

Another jobless recovery

The employment picture is depressing at first glance. The U.S. appears caught in another jobless recovery. As chart 3 shows, the current cycle in employment has much more in common with 1990-93 than with the historical average cycle. In the early 1990s it took ages for employment to roll over – 14 months from the February 1992 bottom back to the pre-recession peak.

However, today as in the early 1990s, it is employment in goods production that is hardest hit. There is a huge difference in length and magnitude between the cycle in services and the cycle in goods production. Chart 4 tracks job losses and gains since the downturn of early 2001. As it shows, service employment has recovered fully and goods production is still shedding jobs. Service industries have added 212,000 jobs since March 2001 while goods-producing industries have lost 1.80 million.

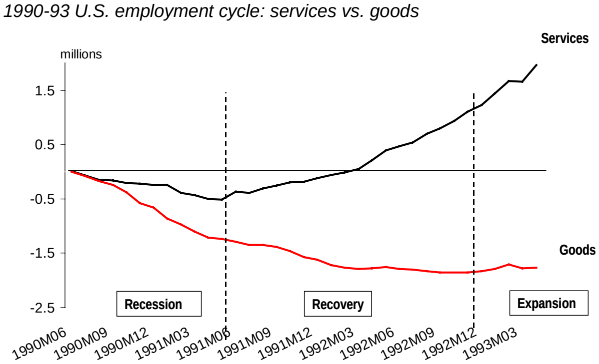
(4) Split Personality …
Current U.S. employment cycle: services vs. goods



Source: NBF Economic Research

Much the same happened a decade ago. Over 11 months of contraction in the early1990s, 500,000 jobs were lost in services compared to 1.2 million in goods production.

(5) … Just as in the Early 1990s
1990-93 U.S. employment cycle: services vs. goods



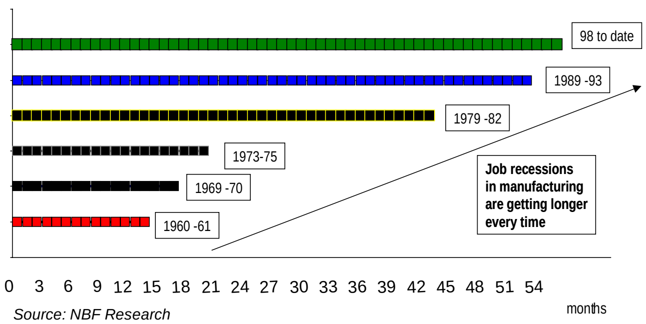
Source: NBF Economic Research

Obviously something is going on. As chart 6 shows, downturns in U.S. manufacturing employment have been getting longer and longer. In the early 1990s, the manufacturing job recession lasted 52 months. This time around, it has so far lasted 56 months – since the spring of 1998.

So the story is more than cyclical. Goods-producing jobs are being transferred elsewhere around the world where labour is much cheaper. This is the dark side of the U.S. productivity miracle.

(6) Jobless U.S. Manufacturing Recoveries

Duration of U.S. manufacturing employment downturns

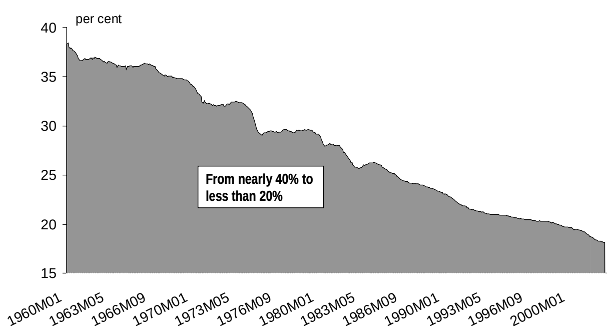


Source: NBF Research

The secular downtrend in manufacturing employment means that the transformation of the U.S. into a service economy is continuing apace. Goods production now accounts for only 18% of the U.S. labour market (chart 7).

(7) A Services Economy

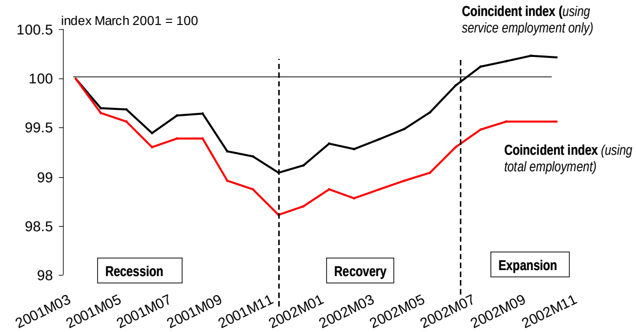
Share of goods-producing jobs in total U.S. employment



Source: NBF Economic Research

(8) Fully Recovered?

Current cycle: coincident index vs. coincident index using service employment only



Source: NBF Economic Research

Fully recovered?

In sum, the cyclical picture is somewhat distorted by strong structural headwinds in U.S. manufacturing. Abstracting from these, the picture is brighter. Chart 8 plots a modified U.S. coincident index using service employment instead of total employment. By this yardstick, the U.S. economy had fully recovered by last July and has been in expansion mode since then.

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U.S. ECONOMIC SCOREBOARD

NBF U.S. Economic Scoreboard

Prices Indicators

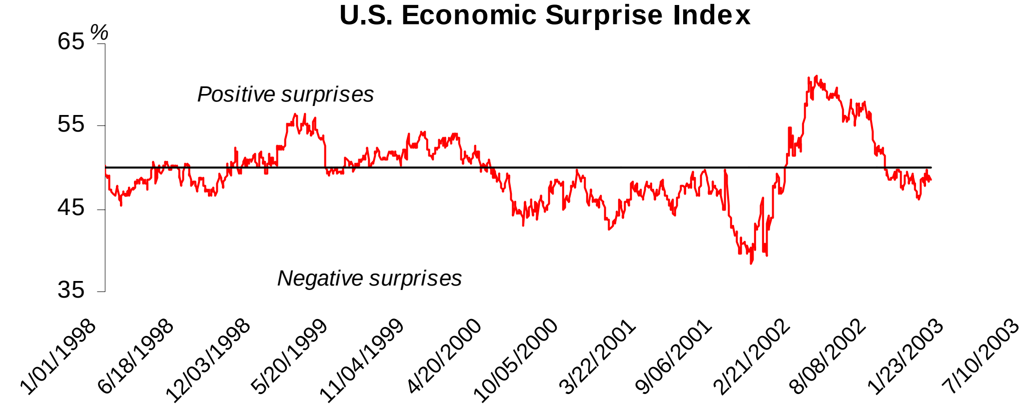
Indicator	Negative	←	←	←	←	Neutral	→	→	→	→	Positive
ISM (price)			●								
Hourly earnings					●						
CPI total								●			
Core CPI					●						
PPI total										●	
Core PPI											●
Employment Cost index (wages)								●			
Employment Cost index (benefits)	●										
Import prices					●						
Money supply			●								
CRB Raw industrials					●						
Oil Prices					●						
GDP Deflator				●							
Total (prices)				✓							

Economic Indicators

Indicator	Negative	←	←	←	←	Neutral	→	→	→	→	Positive
ISM							●				
Industrial production		●									
Payroll employment					●						
unemployment rate		●									
Retail sales								●			
ISM Non-Manufacturing									●		
Leading indicator				●							
Durables goods orders									●		
Unfilled orders					●						
Consumer confidence									●		
New home Sales			●								
Housing Starts		●									
Trade Balance									●		
Initial claims									●		
GDP										●	
Total (economic)							✓				
Overall					✗						

Source: NBF Economic Research

U.S. Economic Surprise Index



Source: NBF Economic Research

ECONOMIC CALENDAR : CANADA & UNITED STATES

The Week Ahead
(December 9 – December 13)

US Indicators

Date	Time	Release	Month	Previous	Estimate Consensus	Estimate NBF
10-Dec	10:00	Wholesale inventories	October	0.5%	0.2%	0.3%
	14:15	**FOMC meeting**	**December**	**1.25%**	**1.25%**	**1.25%**
12-Dec	8:30	Retail sales	November	0.0%	0.3%	0.6%
	8:30	exlc. Autos	November	0.7%	0.2%	0.2%
13-Dec	8:30	PPI	November	1.1%	0.0%	0.1%
	8:30	excl. food & energy	November	0.5%	0.0%	0.1%
	9:50	Consumer Sentiment Index	December (P)	84.2	85.0	86.0

Canadian Indicators

Date	Time	Release	Month	Previous	Estimate Consensus	Estimate NBF
9-Dec	8:15	Housing starts	November	220 K	209 K	200 K
11-Dec	8:30	Capacity utilization	2002 Q3	83.2%	83.6%	83.5%
12-Dec	8:30	New motor vehicles sales	October	-0.4%	1.0%	1.2%
13-Dec	8:30	Leading indicator	November	0.2%	0.1%	0.2%