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JVB FINANCIAL

Weekly Commentary

by Bill Sullivan, JVB Chief Economist

ABOUT BILL SULLIVAN

William V. Sullivan, Jr. serves as Chief Economist at JVB Financial Group, working closely with the firm's trading desk, providing analysis and commentary on the U.S. economy and the financial markets. Among his duties are authoring a weekly report on credit market trends and maintaining a regular schedule of conference calls that focus on interest rate developments. He appears frequently on Bloomberg TV and is often quoted in Barron's.

Mr. Sullivan is the familiar voice that JVB features on our weekly conference call, where he discusses the economy and the events that affect the marketplace.

He was previously associated with Morgan Stanley in New York City for more than twenty years, where he was an Executive Director and a Senior Economist in the firm's Retail Fixed Income Division. Bill published a widely quoted weekly letter on the financial markets and was a frequent guest commentator on several business networks, including Bloomberg TV, CNBC, and Fox News.

Mr. Sullivan received his Bachelor of Arts Degree in Economics from Fairfield University.

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Can it be done again?

In the last cycle of double digit unemployment, the nationwide jobless rate stayed above 10.0% for ten consecutive months. The peak reading for this measure was reached in November and December of 1982 with 10.8% of the labor market being idled during that period. However, within one year of that high watermark for joblessness, the unemployment rate had tumbled 2.5% to 8.3% of the workforce as businesses added nearly 3.5 million individuals to their payrolls by the end of 1983. Clearly, a key question in the current environment is whether the economy can duplicate that performance in the quarters ahead. From that perspective, it may be useful to examine the pattern of growth that took place some 26 year ago that propelled the job markets forward and resulted in a surprisingly large decline in unemployment over a relatively brief interval.

CHANGE IN REAL GROSS DOMESTIC PRODUCT – 1983

	$ change	% change
Total G.D.P.	+454.6	+7.7%
Personal Spending	+255.3	+6.5
Private Investment	+211.5	+34.0
Government Outlays	+23.1	+1.6
Net Exports	(-67.6)	(-194.8)
Residual	+32.3	+37.9

Source: Department of Commerce. Data in billions of chained 2005 dollars.

The surge in job creation early in the 1980's occurred in the context of a rapid acceleration in Gross Domestic Product (G.D.P.). Indeed, according to the Department of Commerce, the economy expanded at a 7.7% annual rate over the four quarters ending December, 1983. (See table.) The sharp jump in overall activity was associated with an increased willingness of corporate business to hire new workers and to lengthen the duration of the workweek. The strong recovery also encouraged many new startup firms that provided job opportunities for unemployed workers. In fact, the momentum of the economic rebound was so powerful, payroll employment continued to expand for another seven years before a brief pullback in hiring transpired during 1991.

The interesting attribute to the initial stages of the business cycle recovery process that took place during 1983 was that the upturn was basically a private sector phenomenon. As detailed, Government spending, which includes outlays for state and local entities as well as the Federal sector, rose by only $23.1 billion over the four quarters under review, accounting for just 5.0% of the total increase in real Gross Domestic Product. Dominating the rebound were hefty gains in personal consumption expenditures and a very vigorous performance in business fixed investment. Offsetting these improvements to a limited extent was a widening in the nation's trade gap which was driven by a tremendous rise in the purchase of foreign produced goods.

The consumer was a key force in generating the recovery with aggregate outlays climbing by $255.3 billion during 1983, representing the largest dollar contribution to the overall rise in real G.D.P.

(Continued on page 2)

(Continued from page 1)

The 6.5% annualized gain incorporated improved spending on durable and non-durable goods as well as service-related expenditures. In relative terms, the revival in business fixed investment was even more impressive with this category rising at a 34.0% annualized pace during the twelve months that ended December, 1983. The economy during this period also benefited from a turnaround in inventories. In particular, as 1982 came to a close, business firms were still liquidating stock positions, but by year-end 1983 modest accumulations were underway, driving national output higher, accordingly. Moreover, spending on equipment and software in the early stages of the recovery helped to lift the economy out of recession as did a resurgence in new home construction.

Whether the economy needs to expand at a 7.0% to 8.0% annual rate over the next year in order to produce a significant drop in the unemployment rate is certainly open to debate. Nevertheless, it is very apparent in our judgment that significant obstacles are in place that could lessen the probabilities of a meaningful recovery by late 2010. With the size of the economy so much larger today, the ability to replicate the gains of the 1983 period seem far more daunting. As an example, the rise in non-farm payrolls in the twelve months following the peak in joblessness represented a 3.9% gain in new hiring. In the present setting, a similar percentage increase in job creation would require business firms to add 5.1 million new workers to payrolls or 425,000 per month over the next year. Militating against a similar revival in hiring in the year ahead is the globalization process that has lead to a significant transfer of jobs overseas. Additionally, the manufacturing sector is a visibly smaller share of the economy now as compared to a quarter century ago, suggesting it will be very difficult to replicate the rise in factory jobs that occurred in the early 1980's. The potential for a sharp gain in capital spending, a situation that no doubt aided job creation during 1983, seems far less today, given the tight lending standards that currently prevail. A reduced access to external funding could virtually eliminate any opportunity for business fixed investment to rise by one-third over the next twelve months as was the case twenty-six years ago. Further complicating the outlook for the job markets through 2010 is the health care reform effort which at this point entails unknown costs for adding new workers to payrolls. Obviously, each business cycle has its own unique attributes but it does appear as if the financial community is beginning to discount a recovery process that emulates the 1983 pattern. Although history can repeat, the prospects of nearly 8.0% growth over the next year and a concomitant 2.5% drop in the nationwide unemployment rate seem remote. If anything, there are still risks, in our opinion, for significant disappointment vis-à-vis the economy during 2010 and beyond. ■

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