THE U.S. ECONOMIC MONITOR

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Most of the evidence suggests payroll growth will-not accelerate further in the near-term.

Surveys show the pace of gross hiring remains subdued with no improvement in sight.

Wage gains continue to slow, so real hourly incomes are falling outright for many workers.

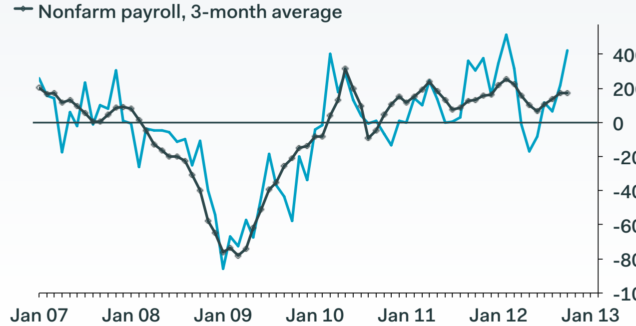
Further Payroll Acceleration Unlikely Despite Decent October

The 184K rise in private payrolls in October was the best since February, but we are reluctant to argue that a further acceleration is likely in the near-term. *Several factors suggest payroll growth is more likely to remain close to the October pace, and we would not be surprised to a modest slowing.* Before we address these factors, though, we want to present the key counter-argument, which is that the remarkable recent performance of the household survey signals much better payroll numbers ahead.

Household employment rose by 410K in October, following a huge 873K September leap; we had expected a sizeable correction. Over the past year, the total increase in household employment has been 922K higher than the rise in payrolls. The gap is a bit smaller, at 622K, when the household numbers are adjusted to match the coverage of the payroll data, but the deviation is still quite substantial.

Despite the magnitude of the gap between the numbers, we are not convinced of the argument that the household survey is telling us anything about the future path of payrolls. In the long run, payrolls and household employment move more or less together, with no *consistent* tendency for one to lead the other. We can find plenty of instances

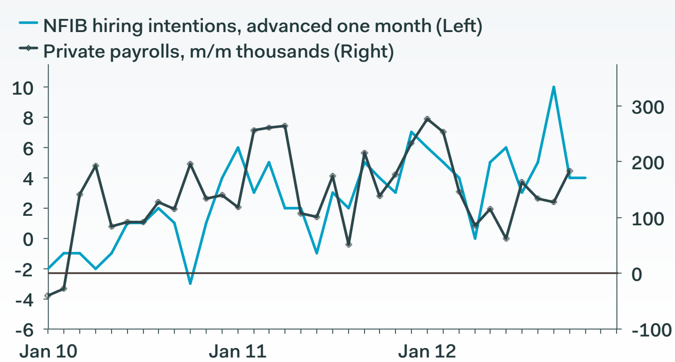
DOES HOUSEHOLD STRENGTH SIGNAL BETTER PAYROLLS?



when household employment has appeared to lead payrolls, but we can also find plenty of examples of the opposite. As far as we can tell, the household employment numbers are just a much noisier version of payrolls, overshooting when payrolls strengthen and undershooting when payrolls weaken, as our first chart shows.

The arguments against expecting a run of improving payroll data are, we think, more powerful. *Let's start with the observation that at least four key survey-based indicators of payroll growth are not improving.* The NFIB hiring index was unchanged in October, suggesting November's private payroll number will look much like October's, while the ISM manufacturing employment index dropped 2.6

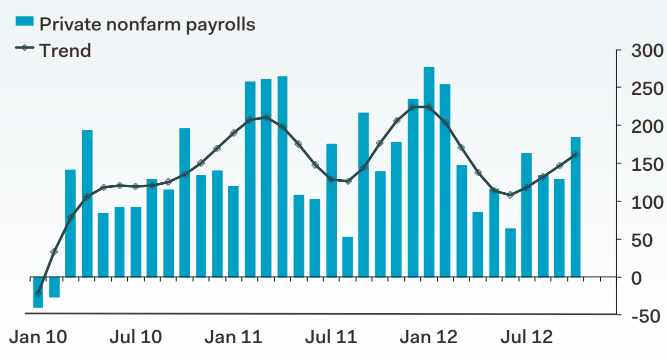
NFIB SIGNALS NOVEMBER PAYROLLS SIMILAR TO OCTOBER



points last month. The online help wanted numbers are stubbornly refusing to pick up, and the Monster employment index has risen only slightly since it slowed sharply ahead of the payroll weakening in the spring of this year. ***Our preliminary model for November, which puts considerable weight on the ISM reading, points to a private payroll gain of only about 100K or so.*** We hope for better than that, but the point is that a further acceleration towards or even through the 200K mark seems unlikely.

Finally, we note that the seasonal adjustment in October this year was rather more generous than in October last year. *Had the seasonal factor been unchanged, Friday's private payroll number would have been 129K rather than the actual 184K.* This does not mean the seasonal factor was necessarily wrong. October's seasonal tends to be more favorable when growth is faster; GDP expanded by 2.3% in the year to Q3 this year, compared to 1.6% in the year to Q3 2011. But what the seasonal gives in one month it has to take back in another, though our analysis suggests the payback on this occasion will not come until the New Year.

A CLEAR IMPROVEMENT IN RECENT MONTHS, BUT WILL IT LAST?

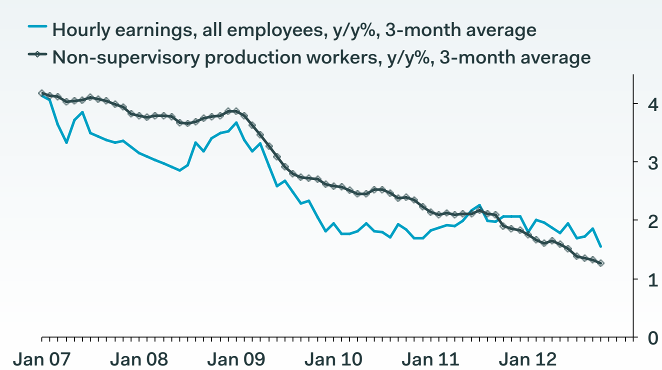


We are happy to see the improvement in private payrolls in recent months, which is real and clear. But we see few signs that the pace of hiring is accelerating, and we are still waiting nervously for signs that the surge in gas prices in the summer has affected business and consumer confidence. Yes, we know that retail gas prices have plunged over the past two weeks, and we fully expect further sharp declines through Thanksgiving at least. *But gas prices affect the economy with a lag, and we worry that the gasoline-sensitive components of payrolls—business services and leisure and recreation—will soften, albeit temporarily, in response to the summer hit.*

At the same time, we are becoming alarmed at the sluggishness of wage growth, which has slipped back in recent months. The year-over-year rate of hourly earnings for all workers was just 1.7% in the three months to October, the lowest since early 2011. *But the picture is worse if you look only at non-supervisory production workers, where the comparable number is a mere 1.3% and slowing relentlessly.* In the three months to October 2011, hourly wages for these workers rose 1.9%, and in the three months to October 2010 they climbed 2.4%.

Consumption accounts for more than two thirds of all spending, so it is hard to imagine a sustained robust recovery in the economy as a whole when employment growth is still relatively modest and real wages for most employees are falling outright. With external demand very soft and government spending declining, domestic private spending has to do the heavy lifting if the economy is to make the break to the upside everyone wants to see. ***Even without the looming fiscal cliff—most of which will be averted, we think—that's a tall order right now.***

SLOWING WAGE GAINS DO NOT AUGUR WELL FOR SPENDING



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THIS WEEK IN BRIEF

Note: "**D**" prefix denotes Datanotes for these releases.

Monday, November 5

• **D: ISM Non-manufacturing Survey (10)/10:00 EST**
The index tends to lag movements in gasoline prices by a few months, so we expect a modest increase to about **56** from 55.1. The index will likely weaken a bit over the next couple of months, reflecting the summer surge in prices. **Consensus: 54.5.**

Tuesday, November 6

• **Redbook Chain Store Sales (11/3)/8.55 EST**
Sales growth rebounded to **1.8%** year-over-year last week from 1.3%; the trend might now be levelling off after reversing September's unexpected acceleration.

• **Elections**
Our working assumptions are that President Obama will be re-elected, the Democrats will retain the Senate and the Republicans will retain the House.

Wednesday, November 7

• **MBA Mortgage Applications (10/28)/7:00 EST**
The purchase index rose marginally last week, up 0.5% to **185.2,** but overall the response to the drop in rates triggered by QE3 as been underwhelming.

• **Consumer Credit (9)/15:00 EST**
After volatile numbers in July and August, we expect a reversion to the underlying trend, or thereabouts, with total credit outstanding rising by about **$10B. Consensus: $10.3B.**

Thursday, November 8

• **D: Initial Jobless Claims (11/3)/8:30 EST**
This week's number will likely be distorted by Hurricane Sandy. Typically, claims surge in the week after a major storm but on this occasion, with public transportation wrecked and power out to so many people, we cannot be sure what this week's report will show. Our guess is that claims will rise because the storm hit at the start of the week, giving people more time to realize they need to make a claim, but we look for only **375K** or so, up from 363K. The big hit will likely come next week, but you should be prepared for anything today. **Consensus: 370K.**

• **D: International Trade (9)/8:30 EST**
A combination of rising core imports, signalled by container flow data, and increased net oil imports, thanks to higher prices, should be enough to push the headline deficit up to **$47B** from $42.B. **Consensus: $45.0B.**

Friday, November 9

• **Import Prices (10)/8:30 EST**
Lower oil prices mean total import prices should drop about **0.5%**; prices ex-petroleum should be more or less **unchanged**. **Consensus: All imports 0.0%.**

• **D: Univ. of Michigan Consumer Sentiment (11p)/9:55 EST**
We expect the index to dip to about **80,** reversing part of the hefty gains of the past two months. The final October reading was 82.6. **Consensus: 82.9.**

• **Wholesale Trade (9)/10:00 EST**
Total inventories should rise about **0.5%.** The inventory-to-sales ratio for wholesale durable goods has risen in recent months, pointing to lower orders for manufacturers. **Consensus: 0.4%.**

THIS WEEK'S FUNDING

Monday 5	Announcement: 4-week bills (November 6) Auction: $32B 3-month, $28B 6-month bills
Tuesday 6	Auction: 4-week bills Auction: $32B 3-year notes (settles November 15)
Wednesday 7	Auction: $24B 10-year notes (settles Nov. 15)
Thursday 8	Announcement: 3-month, 6-month bills (Nov. 12) Announcement: 52-week bills (November 14) Auction: $16B 30-year bonds (settles Nov. 15)
Friday 9	Nothing

PANTHEON'S FINANCIAL FORECASTS

		End-month:			
	4:00pm Fri.	Dec	Mar	Jun	Sep
Fed funds actual	0.17	0.15	0.20	0.20	0.20
2-yr	0.28	0.25	0.30	0.35	0.40
10-yr	1.71	1.75	1.75	1.75	2.00
30-yr	2.91	2.90	2.90	3.00	3.25
Curve 10-2	143	150	145	140	160
Curve 30-2	263	265	245	265	285
Dow Jones IA	13093	13500	13500	13500	13750
Dollar/Yen	80	78	79	80	81
Dollar/Euro	1.28	1.26	1.24	1.23	1.22
Dollar/Sterling	1.61	1.60	1.58	1.58	1.54

PANTHEON'S ECONOMIC FORECASTS

GDP	Q4 third	4.1%	2010 year:	2.4%
	Q1 third	2.0%	2011 year:	1.9%
	Q2 third	1.3%	*2012 year:*	*2.1%*
	Q3 advance	2.0%	*2013 year:*	*2%*
	Q4 forecast	*<2%*		
	Q1 forecast	*<2%*		

CPI	Sep: 0.6% (2.0% y/y); core 0.1% (2.0% y/y)
	December 2012 forecast: 2.1% y/y; core 1.9% y/y
	June 2013 forecast: 2.5% y/y; core 1.7% y/y

Unemployment: March 2013, 7.9%; June 2013, 7.6%

Federal budget: FY 13 forecast: -$1.0T (6.9% of GDP)