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Òscar Jordà, research advisor at the Federal Reserve Bank of San Francisco, states his views on the current economy and the outlook.

- The unemployment rate fell to 8.3% on a seasonally adjusted basis in January, down 0.6 percentage point in the past three months alone. The U.S. Bureau of Labor Statistics (BLS) incorporated updated annual population estimates in data from the survey of households, which is used to calculate the unemployment rate. However, it concluded that these revisions had little effect on the unemployment rate. The updated population estimates did result in an upward revision of nonfarm employment by 266,000 jobs in December 2011 on a seasonally adjusted basis. Initial claims for unemployment insurance also suggest that the labor market is gradually improving.

- To a great extent, the improvement in the unemployment rate reflected better-than-expected news on payrolls. Total nonfarm payroll employment rose by a seasonally adjusted 243,000 jobs in January. Private-sector payrolls grew by 257,000 jobs, while state, local, and federal government payrolls fell by about 14,000 jobs. Hours per worker also increased, indicating more intensive utilization of labor. However, both payrolls and hours per worker remain about 4½% below their 2007 peak at the start of the recession. Meanwhile, with the latest decline, state and local government jobs continued to fall and are now about 2% below the 2007 peak.

- The good news on the employment front is tempered. First, technical and other factors boosted the data. These included January's mild weather, new seasonal adjustments, and the annual benchmarking that reflects updated population estimates. More broadly, comparing the current upturn with rebounds from previous recessions, employment is coming back slowly, as it did after the 2001 recession. However, the trough in the recent recession was deeper. The current recovery contrasts with the brisk rebound following the 1981–82 downturn and even the original "jobless recovery" that followed the 1990–91 recession.

- The recent pace of job growth has about tracked population growth. The employment-to-population ratio remains at 58.5%, largely unchanged over the past two years. The employment-to-population ratio was last at current levels during the 1981–82 recession, suggesting that considerable labor resources remain in reserve.

- In the third quarter of 2011, real gross domestic product finally caught up with the figure for the fourth quarter of 2007, the peak of economic activity before the last recession. Yet, this level of output was achieved with 6.5 million fewer workers employed, a reflection of tangible productivity gains.

- Personal consumption expenditures recovered in the second half of 2011 from a soft patch in spring. They closed the year where they started, with a roughly 2% annual growth rate. Consumption represents more than two-thirds of GDP. Solid consumption growth is an important factor in sustaining overall economic growth.

- Although investment represents a much smaller share of GDP than consumption, it is typically a major driver of the business cycle. At this point in the recovery, gross private investment remains about 30% below the historical average. Subpar investment in structures and residential housing explain most of this difference. By contrast, investment in equipment and software has followed a pattern comparable with other recessions.

- December construction spending data were more encouraging. The 1.5% increase, the highest since May 2010, was driven primarily by nonresidential construction. Although construction spending was moderately above expectations, the data overall still point to a very gradual recovery in housing. New home sales are still stuck near modern historical lows.

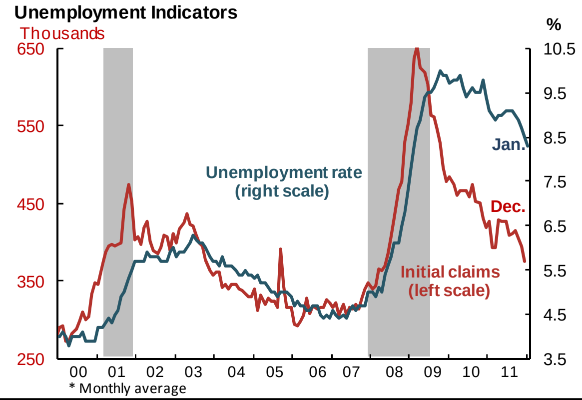
- Housing prices remain unsettled. The S&P/Case-Shiller 20-city composite index of house prices declined 3.7% in November from the year before, although some of the drop was due to sales of distressed properties. More recent data for December from CoreLogic, which excludes distressed sales, point instead to a small but positive 0.5% price increase. Home prices are expected to remain largely flat in 2012 and gradually recover sometime in 2013.

- In another sign of a strengthening economy, the manufacturing outlook was broadly positive. The motor vehicle industry was particularly notable, with auto sales up 13.9% in January from December, far exceeding expectations. For the sector as a whole, orders, shipments and inventories in December all pointed to a rebound in manufacturing activity and capital spending after some softness earlier in the quarter. Nationally, the Institute for Supply Management purchasing managers indexes indicate expanding activity across both the manufacturing and nonmanufacturing sectors.

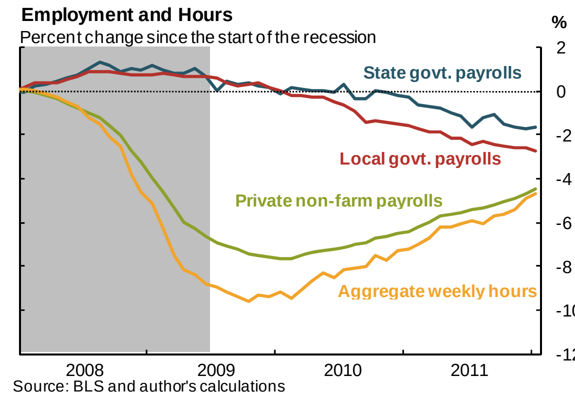
- We expect GDP growth to average a little over 2% in the first half of 2012, with growth accelerating in the second half of 2012 and into 2013. Although the unemployment news has been surprisingly good in recent months, we expect that the gradual nature of the recovery will translate into slower improvement in the unemployment rate. We expect the rate to reach the 8% mark by the end of 2013.

- With considerable slack in labor markets remaining for some time, we expect labor costs to remain in check. Indeed, compensation per hour increased by 1.7% from the fourth quarter of 2010 to the fourth quarter of 2011, nearly identical to the 1.6% increase the year before. With modest labor cost growth, we expect that both headline and core inflation, as measured by the personal consumption expenditures price index, will average about 1½% in 2012. This is below the 2% objective recently laid out by the Federal Open Market Committee, the Federal Reserve’s policymaking body.

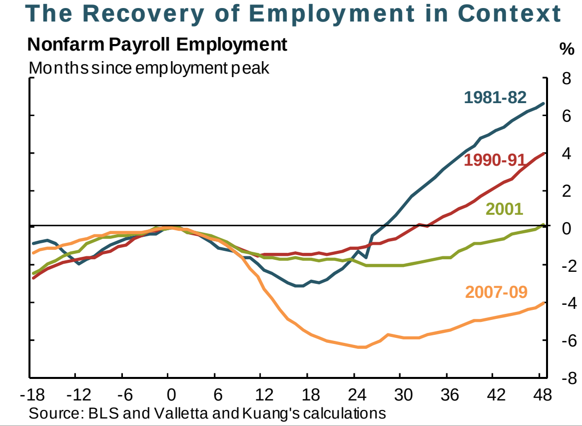
Unemployment, Initial Claims Falling



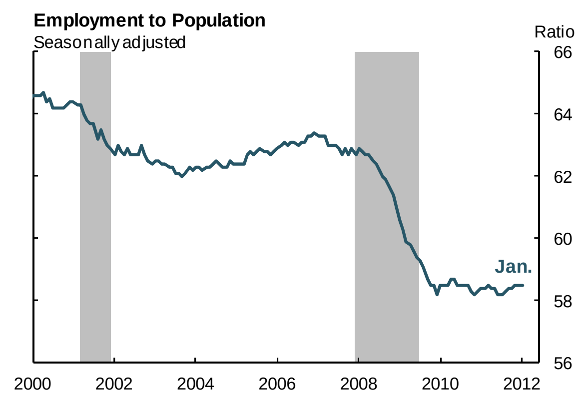
Private Employment Recovering



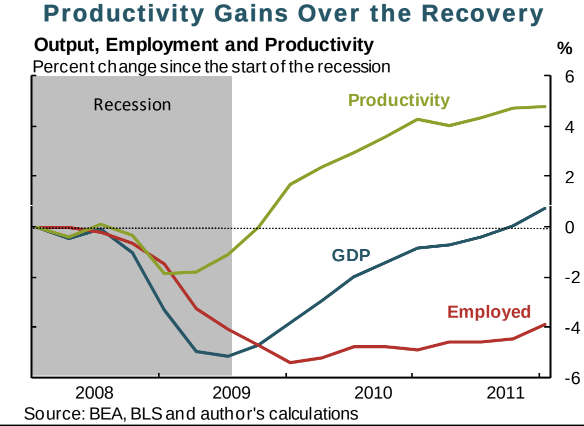
The Recovery of Employment in Context



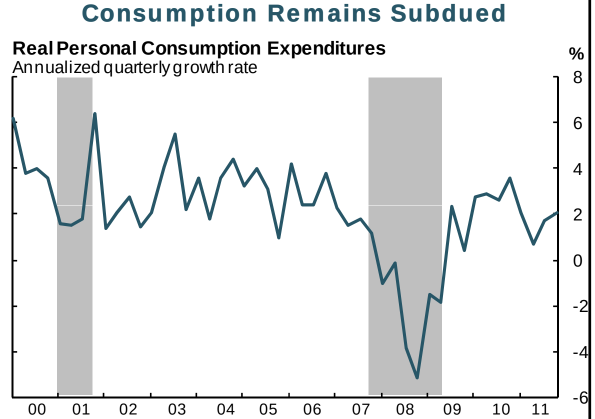
Employment Keeping Up with Population

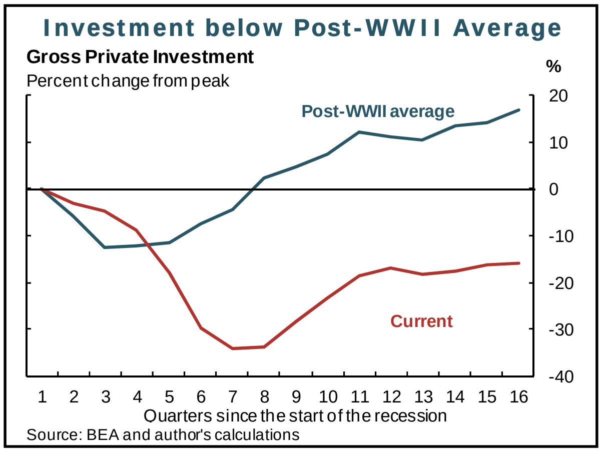


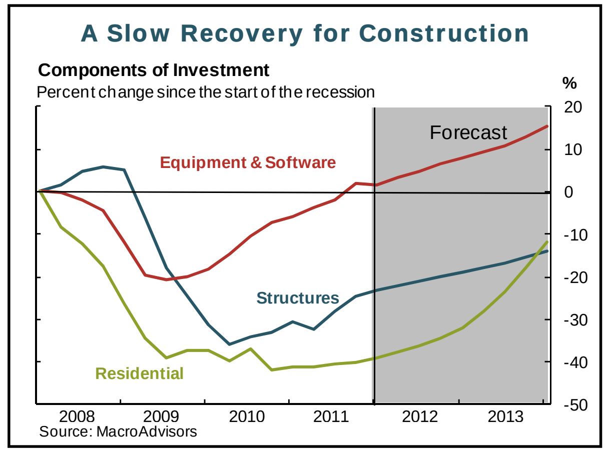
Productivity Gains Over the Recovery

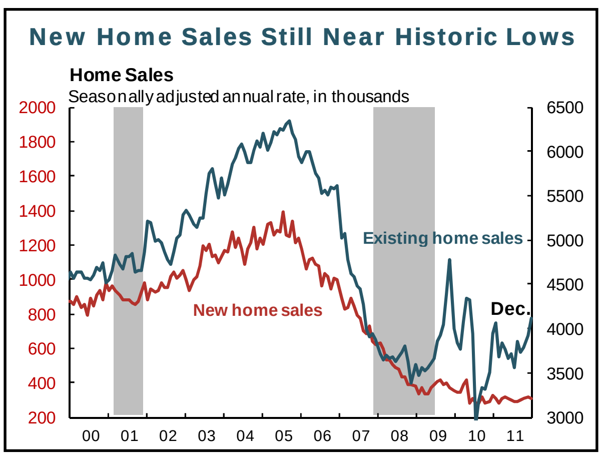


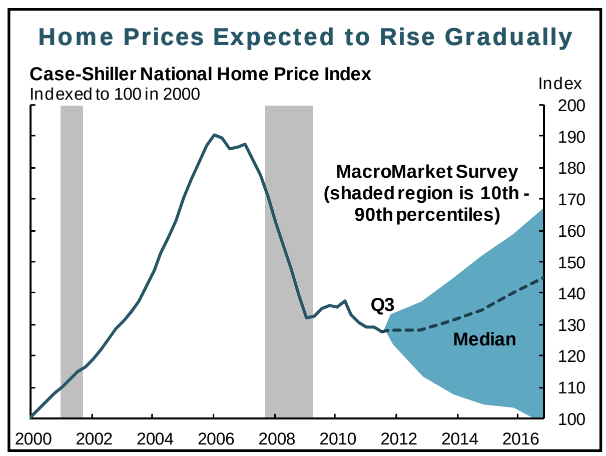
Consumption Remains Subdued

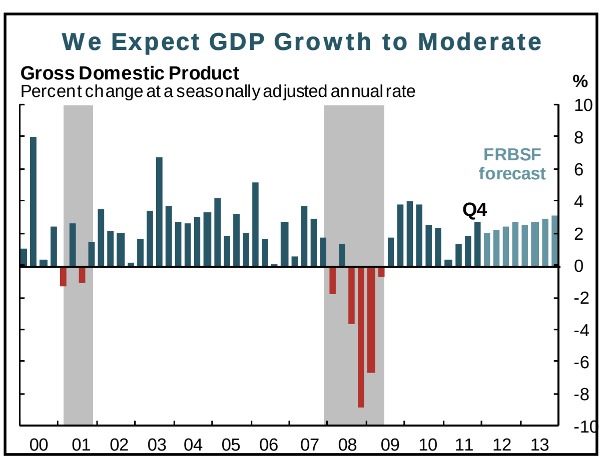


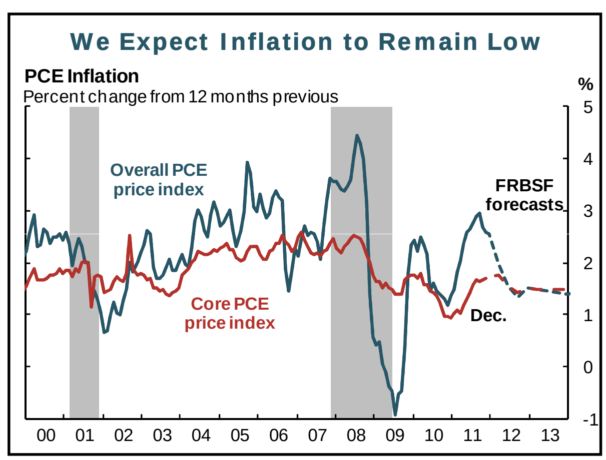

Investment below Post-WWII Average
Gross Private Investment
Percent change from peak
%
Post-WWII average
Current
20
10
0
-10
-20
-30
-40
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16
Quarters since the start of the recession
Source: BEA and author's calculations


A Slow Recovery for Construction
Components of Investment
Percent change since the start of the recession
%
Forecast
Equipment & Software
Structures
Residential
20
10
0
-10
-20
-30
-40
-50
2008 2009 2010 2011 2012 2013
Source: MacroAdvisors


New Home Sales Still Near Historic Lows
Home Sales
Seasonally adjusted annual rate, in thousands
2000
1800
1600
1400
1200
1000
800
600
400
200
6500
6000
5500
5000
4500
4000
3500
3000
Existing home sales
New home sales
Dec.
00 01 02 03 04 05 06 07 08 09 10 11


Home Prices Expected to Rise Gradually
Case-Shiller National Home Price Index
Indexed to 100 in 2000
Index
MacroMarket Survey
(shaded region is 10th -
90th percentiles)
Q3
Median
200
190
180
170
160
150
140
130
120
110
100
2000 2002 2004 2006 2008 2010 2012 2014 2016


We Expect GDP Growth to Moderate
Gross Domestic Product
Percent change at a seasonally adjusted annual rate
%
FRBSF
forecast
Q4
10
8
6
4
2
0
-2
-4
-6
-8
-10
00 01 02 03 04 05 06 07 08 09 10 11 12 13


We Expect Inflation to Remain Low
PCE Inflation
Percent change from 12 months previous
%
Overall PCE
price index
Core PCE
price index
FRBSF
forecasts
Dec.
5
4
3
2
1
0
-1
00 01 02 03 04 05 06 07 08 09 10 11 12 13