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IS THE U.S. ECONOMY TAKING OFF?

To judge from recent comments in the media and elsewhere, one gets the impression that at long last the U.S. economy is rapidly gathering strength and momentum. The proximate cause of this latest surge of optimism regarding the economic outlook was an increase of 321,000 in nonfarm payroll employment during November. This gain, which was much larger than had been expected, was also the biggest monthly increase since January 2012. Not only that, the BLS noted that nonfarm payroll employment gains in September and October combined was 44,000 more than had been previously reported.

In addition to the huge increases in employment, the BLS reported that, in November, average hourly earnings for all employees on private nonfarm payrolls climbed by $0.09 over the prior month. The combination of vigorous gains in employment and rising earnings are now widely seen as signaling a quickening pace of consumer spending in 2013. In our judgment, however, we should not read too much into statistics for a single month. In April of this year, for instance, a substantial gain in payroll employment of 304,000 was followed by smaller increases in subsequent months. Likewise, in 2013, sizable job increases of around 280,000 in February and November did not mark the onset of more rapid gains in employment.

Despite the latest increase in hourly earnings, it should be noted that, in November, the year-over-year increase in the average weekly earnings of all employees on private nonfarm payrolls was less than 2½%, which, after adjusting for inflation, implies a meager gain of roughly 1%. Plainly stated, recent gains in earnings have barely exceeded the rate of inflation. One reason for this disappointing performance is that gains in employment have been concentrated in a number of relatively low-wage industries, including food services, retail trade and employment services. There has been little or no job growth in the higher-wage industries, such as manufacturing, which, in 2014, represented just 10.4% of private nonfarm employment as compared with a ratio of 34% in 1960.

To many observers, the coming months are expected to see a marked strengthening of consumer spending, not only as a result of gains in employment and income, but also as a direct consequence of cheaper oil, which, for all intents and purposes, is tantamount to an increase in earnings. On the downside, however, any gains in consumer outlays could well be offset, at least in part, by cuts in capital spending – and employment – by oil, natural gas and energy services companies.

What triggered the dramatic fall in oil prices? With the benefit of hindsight, we should not have been surprised by the plunge in oil prices. After all, the rebound in U.S. oil production, along with increased competition from natural gas and sluggish economic growth in much of Europe and Asia, should have suggested the likelihood of cheaper oil. Looking ahead, the upsurge in U.S. oil production, along with increased output from Canada and Mexico, as well as advances in energy conservation, all suggest that oil prices will remain low, at least over the short-term.

For now, the positive economic implications of the oil price decline appears to outweigh the negatives. Bear in mind, however, that no one can yet say whether or not cheap oil will be a near-permanent feature of the economic landscape. From our perspective, a quickening pace of global economic growth and/or supply disruptions in the Middle East and elsewhere could, once again, push oil prices upward. In our view, moreover, the near collapse of oil prices, despite giving a shot in the arm to consumer spending, has also increased the degree of uncertainty regarding economic prospects for 2015 and beyond.