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UNSETTLED OUTLOOK – FEBRUARY 13, 2014

Another disappointing employment report. In January, nonfarm payroll employment posted a slender gain of 113,000, which was only slightly better than the dismal 75,000 reported in December. One surprising – and puzzling - statistic was, despite the dismal winter weather, construction jobs accounted for 43% of the overall increase in employment. Be that as it may, the December/January gain in payroll employment averaged 94,000, well below the average increase of 195,000 reported in the three months ending in November 2013. Should data for February show another meager gain in jobs, there would likely be a flurry of downward revisions to estimates of GDP growth in the 1st quarter – and even beyond. Of some concern is the possibility that the weak employment reports for December and January were not merely attributable to severe winter weather or some statistical aberration, but instead marked the onset of renewed weakness in the job market. On a more positive note, the percentage of the unemployment that has been out of work for 27 weeks or more fell slightly to 35.75%. And the broader measure of unemployment, which includes workers who can only find part-time -- as opposed to full-time -- employment, dipped to 12.75% compared to 13.1% in December 2013.

In other economic news, the CBO released its latest long-term projections for the federal budget and the economy, which, by and large, were little changed from those published in 2013. So far as the federal budget is concerned, the CBO projects that the deficit will shrink through 2015 but then resume an upward trend, accompanied by a further rise in federal debt. By way of illustration, the deficit in 2024 is placed at $1,074 billion, more than double the expected figure of $478 billion in 2015. According to the CBO, a number of factors, notably an aging population, mounting health care costs and increasing payments of the federal debt, will drive federal spending upward over the coming decade. As a consequence of rising deficits after 2015, the federal debt-to-GDP ratio is expected to climb from 74% in 2014 to around 80% in 2024. The continuing rise in federal debt is likely to have negative consequences for long-term economic growth and is also expected to limit the ability of policymakers to respond to future recessions or other unexpected economic developments. And, as the CBO points out, a growing federal debt carries with it the risk of a financial crisis in which significantly high interest rates would be required to market the government's growing debt.

The CBO's projections clearly indicate the daunting long-term challenge facing the nation's lawmakers as they struggle to contain the rise of federal debt. According to the CBO, spending on social security, major health care payments and interest costs on federal debt, which in 1974 accounted for 6.1% of GDP, will reach 15% in 2024. At the same time, all other spending – including defense – which in 1974 accounted for 12% of GDP, is expected to fall to 7.4% in 2024 – the lowest ratio since 1940. To decrease the debt-to-GDP ratio to around 70% in 2024 could well require a near $2 trillion cut in the budget deficit presently projected for 2014-2024. As we have noted before, a reduction of this magnitude would, in all likelihood, necessitate higher taxes and/or cuts in the political popular entitlement programs.

Finally, we should take note of financial market turmoil in a number of emerging markets, including Argentina, Brazil, Indonesia, South Africa, Turkey, Ukraine and Venezuela. In varying degrees, these countries are having to deal with large scale outflows of foreign capital, depreciating currencies, sharp declines in equity prices and a very uncertain economic future. So far as can be determined, there has been a loss of market confidence, which has stemmed, in large measure, from the inability of many emerging markets to resolve pressing domestic economic political issues. From past experience, there is always a risk that economic difficulties in emerging markets will spread beyond their borders.

Norman Robertson