Economic Update NATIONAL
Federal Reserve Bank of Dallas

Effects of Debt-Ceiling Scare and Euro Crisis Appear Temporary

January 27, 2012

Recently released indicators suggest that overall economic activity picked up in the fourth quarter of 2011. Consumption, housing and inventory data are evidence of firmer growth. A U-shaped pattern in the consumer confidence indicators portends continuing growth in consumption. Institute for Supply Management (ISM) new orders firmed and manufacturing output jumped in December. Labor markets and consumer loan quality continued to improve, with indications that household deleveraging may be easing. Despite the positive news, the risk from a slowdown in Europe continues to loom.

Consumer Confidence Rebounds

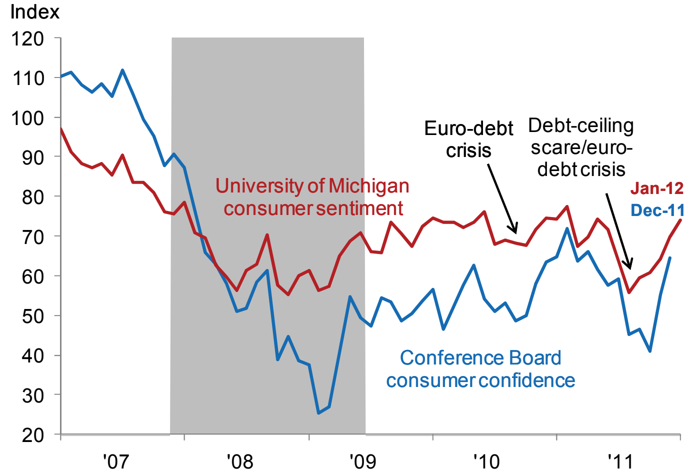
Consumer confidence continued to recover from its late-summer 2011 losses. Spending, employment, confidence and stock price data indicate that the recent pickup in economic activity partly reflects the positive effects of diminishing uncertainty surrounding the combined debt-ceiling scare and euro-debt crisis of late summer. Both the University of Michigan and Conference Board indexes of consumer confidence have risen since October, so far reversing the summer declines (*Chart 1*). This turnaround suggests that the recovery was delayed by a temporary negative shock that has been unwinding. Nevertheless, the two indexes are still low and have yet to show definitive signs of breaking out of ranges seen since mid-2009.

Manufacturing Output Bounces Back

Similarly, manufacturing output jumped in December, led by an uptick in the ISM manufacturing index. As with consumer confidence, the recent dip in investment indicators seems temporary because last fall's stall in investment growth also partly owes to the slowdown in Europe. This is reflected in the November trade report and the sharp deceleration of orders reported in the ISM export index.

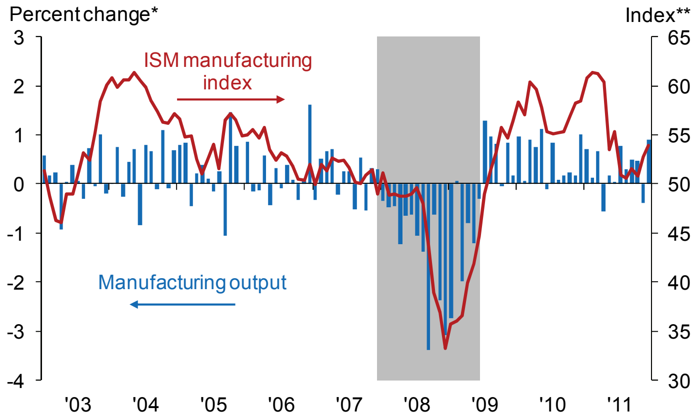
In December, total industrial production rose 0.4 percent as manufacturing output jumped 0.9 percent, more than reversing November's unusual 0.4 percent decline (*Chart 2*). The manufacturing rebound is consistent with recent ISM manufacturing readings, which rose in November and edged up further in December to 53.9. The most recent reading was marginally above the median forecast of 53.5 in the Bloomberg survey and the highest level in six months. The five components of the ISM index hint at more underlying strength than belied by the rather mild rise in the headline measure. The production and employment indexes both jumped more than 3 points, while the new orders component rose by about 1 point.

Chart 1
Consumer Confidence Measures Are Recovering



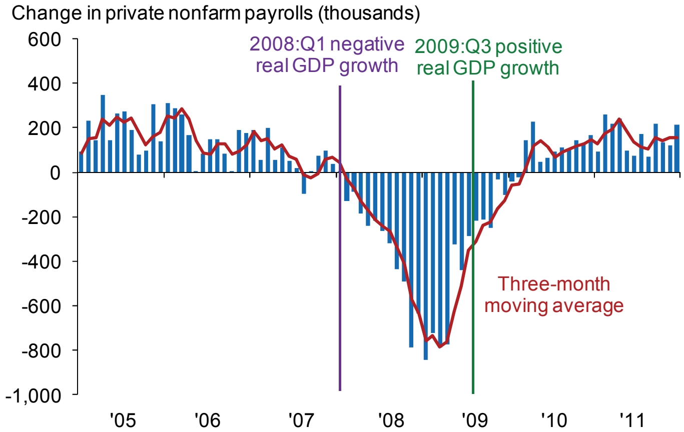
NOTE: Shaded area indicates recession.
SOURCES: The Conference Board; University of Michigan.

Chart 2
Manufacturing Output Jumps in December



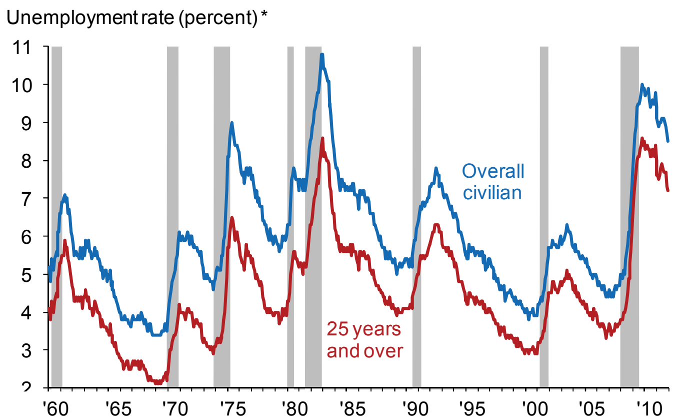
* Month/month.
** Seasonally adjusted.
NOTE: Shaded area indicates recession.
SOURCES: Federal Reserve Board; Institute for Supply Management.

Chart 3
Private Payroll Growth Sluggish but Better than in Mid-2011



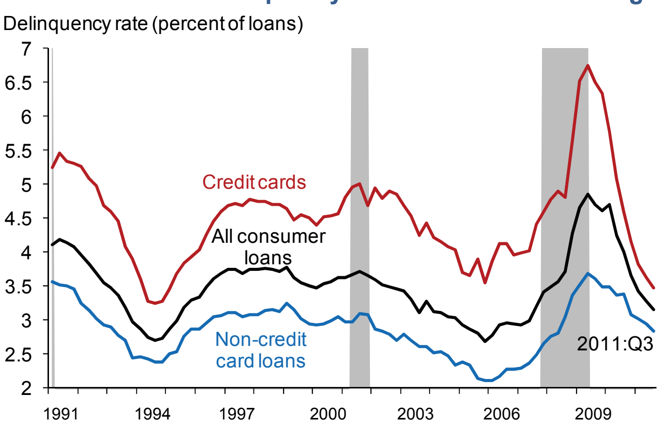
SOURCE: Bureau of Labor Statistics.

Chart 4
Overall and Age 25-Plus Unemployment Rates Fall Further



* Seasonally adjusted.
NOTE: Shaded areas indicate recession.
SOURCE: Bureau of Labor Statistics.

Chart 5
Consumer Loan Delinquency Rates at Banks Receding



NOTE: Shaded areas indicate recession.
SOURCE: Federal Reserve Board.

All three measures are at their highest levels since spring 2011 and are firmly above the neutral threshold of 50.

Payroll Growth Up; Unemployment Falls Further

In line with manufacturing and consumer confidence, recent employment reports seem to suggest a moderate recovery. December saw broad-based payroll gains, a longer workweek and conversions of part-time workers to full-time status. Led by a 212,000 rise in private employment (*Chart 3*), nonfarm payrolls grew by a faster-than-anticipated 200,000 in December after posting a downwardly revised 100,000 increase in November. For all of 2011, payrolls rose 1,640,000, up from a 940,000 increase in 2010. One caution is that temporary employment fell by 8,000 in December. Normally, this is a sign of slowing employment growth in the future, but it may reflect the conversion of many temporary workers to full-time status. Although the headline number for December was strong, there was an outsized jump of 42,000 in messenger and courier payrolls. Because this rise was likely due to a surge in online shopping during the holiday season, it is likely to unwind to some extent in January.

In the same vein, the unemployment rate has receded. After falling a slightly revised 0.2 percent in November, the civilian unemployment rate dropped 0.2 percent further in December (*Chart 4*). The decline from 8.9 percent in October to 8.5 percent in December is encouraging for two reasons. First, only 0.1 of the 0.4 percentage-point drop can be attributed to falling labor force participation. Second, the decline was not attributable to swings in the unemployment rate for teens or college-age people because the unemployment rate for those 25 years and older fell by an even larger 0.5 percent.

Consumer Loan Quality Continues to Improve

Supporting domestic demand, credit availability readings improved further as consumer loan delinquency rates at banks continued to decline. Delinquencies on credit cards have fallen below prerecession levels, while those on other consumer loans have fallen but remain a little elevated (*Chart 5*). This may reflect more prudence on the part of households as well as the tightening of credit standards over the past several years. Recently released data generally indicate that modest house price declines continued amid a slight pickup in sales and construction activity that is still subpar for recoveries. Most notably, single-family permits have risen about 10 percent above their July levels.

Looking ahead, the picture is mixed despite the recent positive news. Economic activity picked up after pausing during the period of uncertainty surrounding the debt-ceiling scare and euro-debt crisis of late summer. Housing construction is starting to rise slowly, while consumer spending has benefited from an easing of consumer credit standards and slightly improved labor market conditions. Recent manufacturing and consumer confidence releases also point to mild recovery. Core measures of inflation are well-contained around or below 2 percent. Yet, signs have emerged that exports will likely sag from the slowdown in Europe.

—Christoffer Koch and J.B. Cooke

About the Authors

Koch is a research economist and Cooke is a research assistant in the Research Department of the Federal Reserve Bank of Dallas.