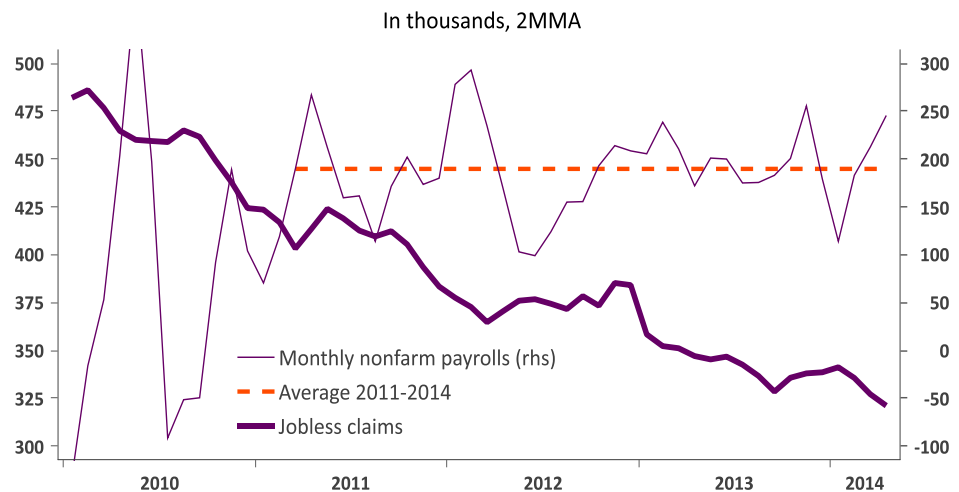


U.S. jobs, the markets can't see straight

When it was announced that U.S. weekly jobless claims fell again, it immediately overshadowed the much less positive 1% fall in Q1 GDP. A drop in unemployment claims continues to be seen as a signal that the job market and, along with it, consumption are improving. This lends credence to the idea that the GDP drop in the first quarter was a mere blip on the radar and did not reflect the reality of the American situation: The idea being to look ahead and not back. We have a considerably different interpretation of this data; our take on the jobs figures is significantly less upbeat. Here are two reasons to not take for granted the markets' renewed optimism in recent days.

Jobless Claims and Nonfarm Payrolls



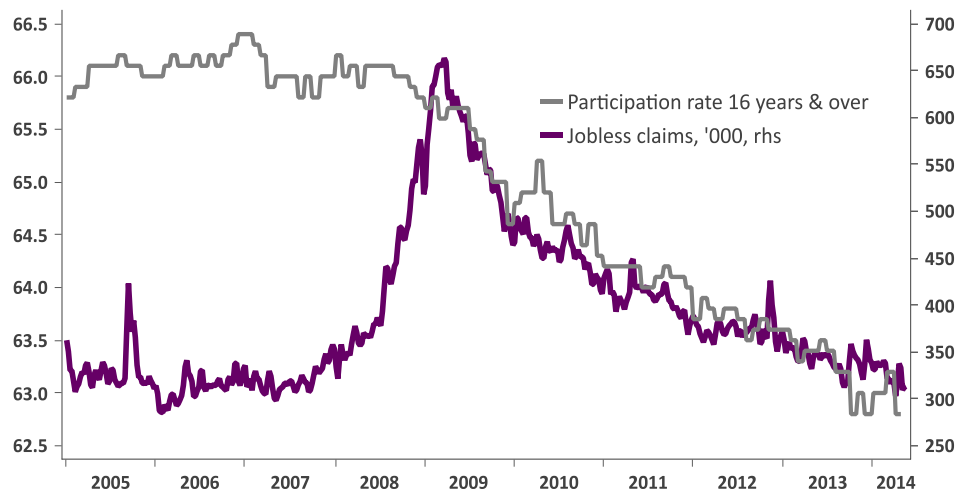
The misleading message from the drop in jobless claims

The weekly jobless claims report, published every Thursday, is used extensively by economists to fine-tune their job market estimates for that month, which are published the first Friday of every following month. As a result, they are particularly important for market, which see in them a leading indicator of one of the most closely watched statistics in the American economy, the “non-farm

payrolls”. The next report is scheduled to be published on June 6th. The reliability of the “weekly jobless claims” report is often off base and its relevance is coming under increasing criticism. For at least two years, the relationship between jobless claims and the reality of the labor market has grown increasingly divergent. For instance, as jobless claims have fallen by 100,000 since the start of 2011 (from 428,000 to 300,000 today) the pace of job creation has not changed, hovering around its average of 188,000 per month. The fall in jobless claims cannot be construed, right now, as an indicator that the job market is improving.

Based on our analysis, it could even be a rather worrisome sign, one that the participation rate continues to fall, as illustrated by the similarities between the two since 2009. The latter measures the percentage of active people (the employed or people looking for work) among the working age population (over 16 year of age). Its marked decline, often attributed to the ageing of the population, is in reality much bigger than previously thought. Unlike what is happening with other age categories, the participation rate of persons 65 and older has increased considerably since the crisis, while the number of active persons between the ages of 16 and 64 has decreased by 4.8 million since 2008, according to our calculations which are based on a stable participation rate. Falling jobless claims could in fact be telling us that the job market is not improving and that the participation rate continues to worsen. This phenomenon was likely made worse by the termination of assistance to the long-term unemployed, which was set up by the Obama administration during the 2009 crisis.

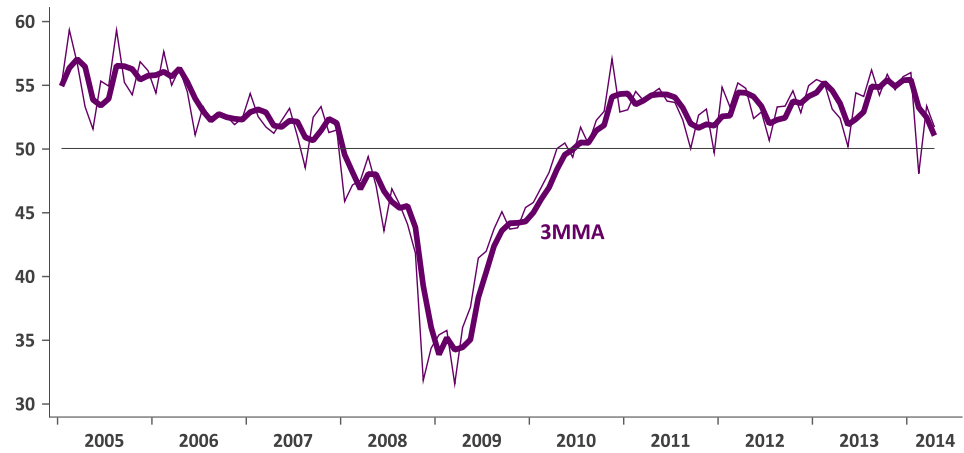
Jobless Claims and Labor Force Participation Rate



Sources: RichesFlores Research, Macrobond

In other words, there are very few factors that justify the markets’ confidence on the present situation, especially given what the corporate picture is telling us: employment is deteriorating rapidly not improving.

Private Payrolls Composite Indicator According to ISM Survey in Services and Manufacturing Sector



Sources: RichesFlores Research, Macrobond

Against such a backdrop, it is difficult not to heed the warning sent by first quarter growth. We may not be able to rely too heavily on the lower growth rate for temporary economic reasons, but it certainly reflects a worrisome fragility for future growth.

The next few stages of tapering will be harder than the first. We continue to believe the Fed will slow the taper, either by slowing the pace of the reduction in asset buys or stabilizing asset purchases at a low level, which would be analogous to the Fed giving itself a safety buffer. If this were to play out, two-year rates would fall to around 0.25% and the 10Y to below the 2.25% mark before the end of the year.

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