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**How Realistic is the FOMC's Unemployment Forecast?** – When the Federal Reserve published its November 2011 key economic projections the national rate of unemployment stood at 8.7%. The Summary of Economic Projections (SEP) forecast that the rate would stand between 8.5 – 8.7% by the end of 2012. It is a pity it did not stick with its prior June projection of 7.8 – 8.2%, which would have been closer to the latest reading of 7.7%. The December 2012 projections are shown in the second column of the following table along with some scenario analysis to show the required reading of payroll gains over the next three years if the Fed is to reach just the upper end of its unemployment forecasts.

FOMC SEP Projections	Unemployment Rate %	# Months	# Payrolls Required	Partn Rate %	2011 Avg Partn Rt	# Payrolls Required	Avg Partn Rt Since 2000	# Payrolls Required	Lower Band
2013	7.4 - 7.7	12	108,957	63.6	64.1	197,505	65.8	498,568	536,443
2014	6.8 - 7.3	24	130,668	63.6	64.1	175,541	65.8	328,109	359,960
2015	6.0 - 6.6	36	150,629	63.6	64.1	181,044	65.8	284,453	310,166

Data derived using Jobs Calculator available on the Federal Reserve Bank of Atlanta's website

In order to maintain unchanged rate of unemployment through the end of 2013 the economy will have to generate just below 110,000 new jobs each month. But in order to achieve 7.3% unemployment through the end of the following year it would need to deliver 130,000 jobs per month. Yet raise the bar to the top end of the Fed's 2015 target of 6.6% and the economy needs generate 150,000 jobs monthly. That would also just about be sufficient to snap the FOMC's low rate pledge, which is now tied to unemployment reaching 6.5% so long as inflation remains no more than one half percent above its current 2% ceiling.

And with the average monthly payroll gain of 151,000 so far this year, the target seems achievable. Note, however, that the fifth column in this table assumes a participation rate of 63.6%, which is in-line with the latest reading from the household survey. This assumes then that much of the ancillary weakness accompanying the labor market fails to go away as the economy strengthens and raises the fortunes of the labor market. We would argue that the participation rate would *rise* as confidence creeps higher, forcing a rethink amongst business owners recognizing ever-strengthening demand.

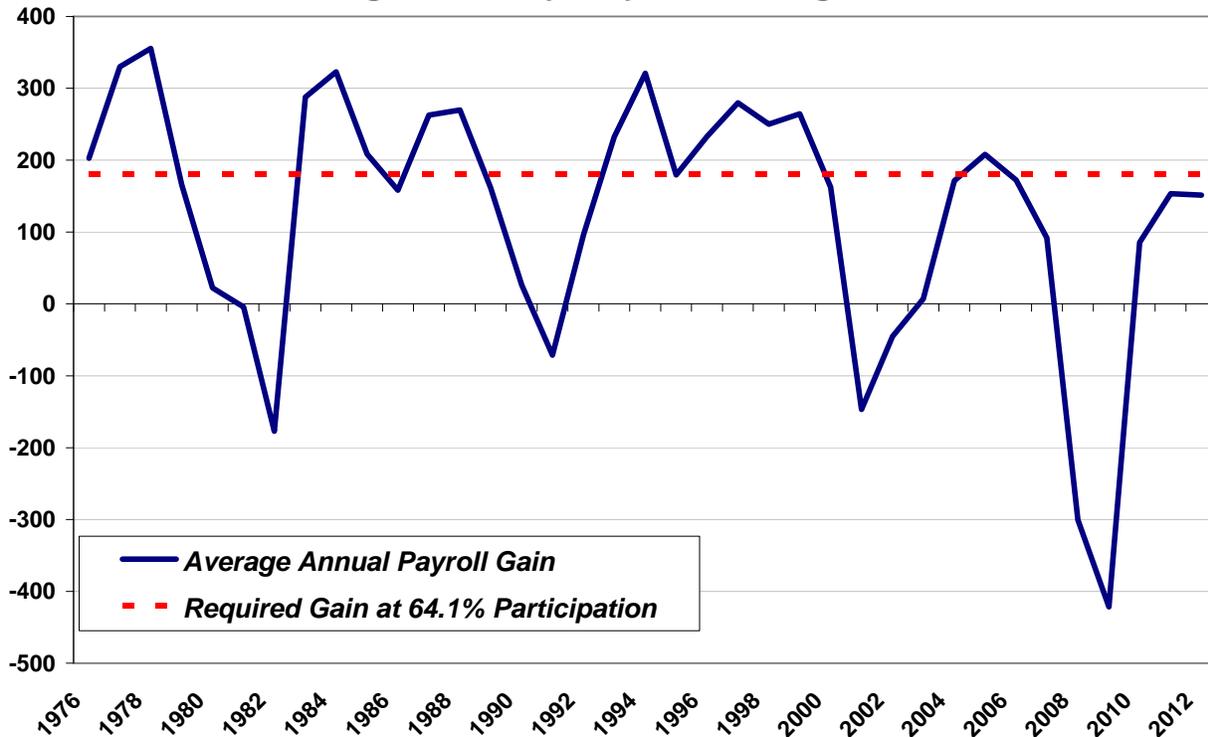
If we raise the participation rate by one half of one percent to 64.1%, which is the average reading for 2011, notice how this increases the monthly job creation requirement, but also how it changes the shape of the employment creation trajectory over time. While employers would need to add 197,500 new jobs on average through the next 12 months to maintain stable unemployment at that participation rate, it would take a smaller average reading of 181,000 to prompt the Fed to take away the punchbowl by the end of 2015. This is accounted for by labor force growth rates. For a higher participation rate and a constant population growth rate, the lower is the net new job creation reading needed to absorb the implied change in the labor force. Once again a rebound in payrolls of this magnitude is not out of the question if the Fed's GDP projection of 2.5% holds true next year, accelerating to around 3.25% for each of the next two years.

What looks far less realistic and distinctly unachievable are the results shown in the final two columns. If we assume a rebound in the participation rate to 65.8, which is the average reading since 2000, maintaining unchanged unemployment in one year would require additional employment gains of 498,000 per month. Once again that pace, if to be achieved over a longer three-year time period, is reduced to 284,000 jobs per month. The final column ups the ante by reaching for the FOMC's lower band at an unemployment rate of 6.0% under the same assumed participation rate.

As you can see there are plenty of moving pieces in projecting advances for the labor market. In plain and simple terms arriving at an unchanged unemployment reading through 2013 might require payroll gains of anywhere between 110,000 and 500,000 depending on how many people you want to involve in the labor market. In turn population growth and assumptions over labor force growth rates muddy the picture. At worst the Fed's projections seem to be on track, although we maintain that the labor force is improving and that participation rates will continue to rebound.



### Average Monthly Payroll Change Per Year



The chart shows the average monthly payroll gain for each year since 1976 and highlights the fact that the last two recoveries failed to deliver the employment growth the US economy had become accustomed to. However, we doubt the economic expansion is past its sell-by date at this point and would agree with Chairman Bernanke’s observation that by generating accommodative conditions, over time the creeping return of confidence will become self-reinforcing in terms of jobs growth. One thing should be clear from the chart above: In order for the desired unemployment rate to meet the falling projection laid down by the Fed, payroll growth is going to have to start picking up from its present pace. If it does not, the Fed is likely to be highlighting on an ongoing basis the lack of quality in the improving fortunes of the labor market.

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