A Robust Rebound to Mediocrity?

A robust job recovery is under way. But our desire to celebrate is tempered by the realization that the strong steady growth we expect for the next several years will only get back what we needlessly lost.

NAI Global®
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A Robust Rebound to Mediocrity?

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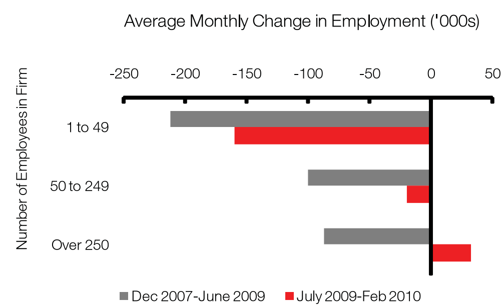
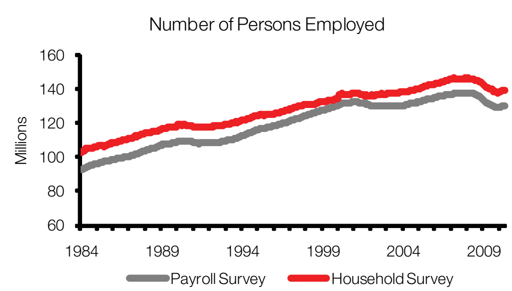
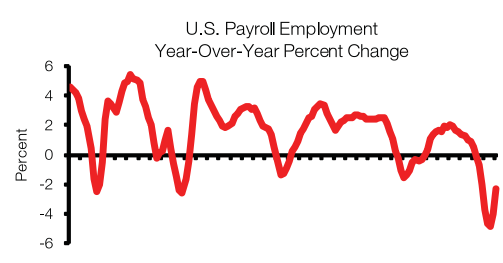
Through August 2008, we were in a typical recession concentrated in housing, autos and a financial sector that financed the overexpansion of these sectors. Then the government caused a complete panic-induced collapse, which resulted in the loss of at least 6.2 million jobs. The needless job losses are underscored by the fact that only 4.6 million (about 55%) of the total 8.4 million lost jobs since year-end 2007 were in manufacturing (including autos), construction or finance.



Historically, you need about six quarters of prolonged profit growth before companies hire aggressively. A robust job recovery is under way, with profitable employers finally replacing employees who died, retired, took extended maternity leave or went back to school. Unfortunately, many small firms were needlessly destroyed as the government artificially channeled scarce capital to large, politically connected firms. As we have said repeatedly, "too big to fail" is code for "too small to succeed."



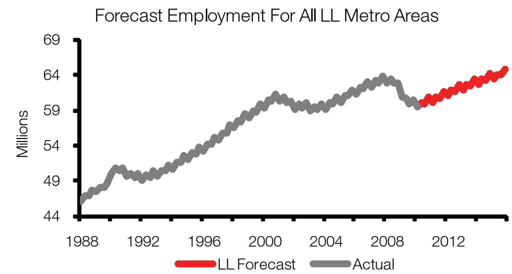
An improving job market is evidenced by: a 1.5% increase in the number of weekly hours worked since June 2009; a 12% decline in "marginally attached" workers from 2.5 million in February 2010 to 2.2 million in May; a year-over-year increase in Temporary Help Service workers; and an increase in the number of employees quitting because they have improved options. Marginally attached workers include those who want a job, have searched for work during the prior 12 months and were available to take a job, but had not looked for work in the past four weeks. Declining levels are an indication that more people are either getting jobs or are actively looking. The increased use of temp workers reflects a rebounding workforce, as temp workers are a flexible means of increasing employment in the early stages of a recovery. Temporary help services increased employment by 175,000 jobs over the first five months of 2010.

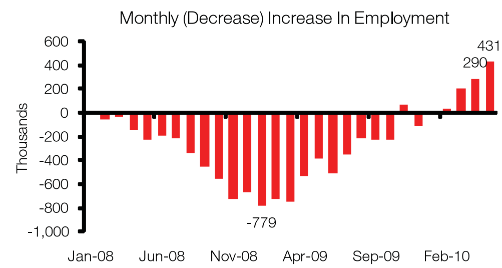


Based on the Payroll Survey, total employment peaked in December 2007 with nearly 138 million jobs, and bottomed two years later with 8.36 million fewer jobs. Since year-end 2009, we have gained back 982,000 jobs through May. In comparison, the Household Survey, from which unemployment statistics are calculated, indicates that employment peaked in November 2007 at just under 146.5 million jobs, bottomed in December 2009 at almost 8.7 million lower, and has since grown by over 1.6 million. Of those lost jobs, 5.2 million were concentrated among males older than 19, and only 1.9 million among women older than 19. This reflects the high concentration of males in manufacturing, construction and finance, while women are disproportionately employed in the less adversely impacted government, healthcare and education sectors.

We anticipate that the next three years will continue to see average job growth of 250,000 jobs per month, for a three-year job increase of at least 9 million jobs by early 2013. This robust recovery will be due primarily to the restocking of jobs vacated during the panic, rather than a net employment expansion. While this robust job growth may seem overly optimistic, it is important to remember that our forecast would leave us with almost the same number of jobs in mid-2013 as existed at the beginning of September 2008, in spite of a population that will have grown by 15 million people. In fact, employment today is at the same level as in September 1999, despite the fact that population has grown by more than 25 million people. If we have a robust recovery, adding 9 million jobs over the next three years, we will still have an anemic unemployment rate of 7%. Hence, we expect a robust rebound to mediocrity.

The key for the real estate sector is job growth, as a recovery without jobs does not fill buildings. Total non-farm payroll employment has grown every month in 2010 through the first five months of the year, with May registering 431,000 new jobs. In comparing sectoral job losses from December 2007 through each sector’s respective trough, it is clear that the pain was disproportionately distributed. While manufacturing (-15.8%) and construction (-25.4%) hemorrhaged jobs during the recession, losses in some industries were more muted. On an absolute basis from peak to respective trough, manufacturing (-2.2 million), trade, transportation, and utilities (-2.1 million), construction (-1.9 million), and professional and business services (-1.7 million) lost the most jobs. Manufacturing and trade, transportation, and utilities turned the corner in the fourth quarter of 2009, while construction did not reverse course until late in the first quarter of 2010.





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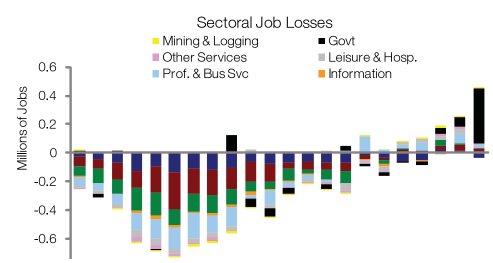


Payroll Survey Employment (000's)

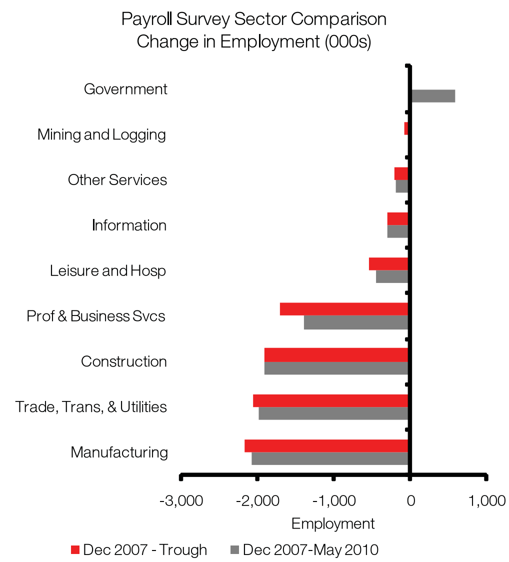
Industry	Dec-07	Trough Date	Trough	May-10	Peak to Trough: Change	Peak to Trough: % Change	Trough to Present: Change	Trough to Present: % Change
Manufacturing	13,726	Nov '09	11,552	11,660	-2,174	-15.8%	108	0.9%
Trade, Trans, & Utilities	26,709	Dec '09	24,653	24,727	-2,056	-7.7%	74	0.3%
Construction	7,491	Feb '10	5,585	5,591	-1,906	-25.4%	6	0.1%
Prof & Business Svcs	18,051	Sep '09	16,349	16,663	-1,702	-9.4%	314	1.9%
Leisure and Hosp	13,535	Dec '09	12,991	13,086	-544	-4.0%	95	0.7%
Information	3,023	Mar '10	2,728	2,728	-295	-9.8%	-	0.0%
Other Services	5,514	Feb '10	5,310	5,334	-204	-3.7%	24	0.5%
Mining and Logging	739	Oct '09	669	720	-70	-9.5%	51	7.6%
Government	22,377	Dec '07	22,377	22,968	0	0.0%	591	2.6%

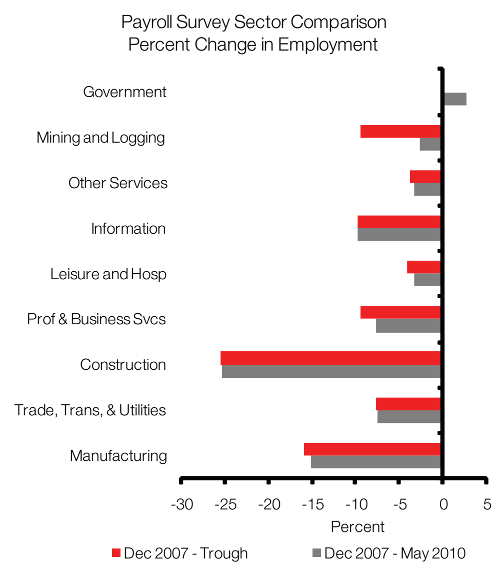
The obvious winner was the government sector, which effectively did not shed any jobs at all. The other relatively strong sectors (healthcare, information technology, education and pharmaceuticals) experienced demand growth during the recession, yet still shed jobs, largely via hiring freezes. That is, job losses in those sectors were due more to the lack of replacements for employees who died, retired or went on maternity leave. As profits have rebounded over the last 18 months and the panic has subsided somewhat, these sectors have lifted hiring freezes and begun replacing those who left.

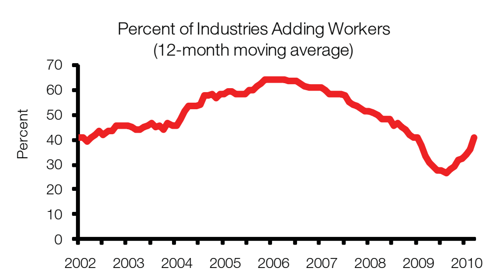
According to the March 2010 Job Openings and Labor Turnover Survey, just 40.8% of industries are adding workers on a 12-month moving average basis, versus the nine-year average of 49%. This is massively improved from 27.5% eight months ago. Comparing payroll employment from the December 2007 peak through May 2010, it is clear that most sectors have posted very modest gains from their respective troughs but are still significantly below their peaks. The notable exception is the government sector, which registered an increase of 591,000 jobs between December 2007 and May 2010. On an absolute basis, the biggest job losses during this period were: manufacturing (2.1 million); trade, transportation, and utilities (2 million); construction (1.9 million); and professional and business services (1.4 million). On a percentage basis, construction (-25.4%) and manufacturing (-15.1%) were the worst performers.

The good news is that all major industries except the information sector have registered employment gains from their respective troughs. Aside from the government sector (591,000), the largest absolute job increases were in professional and business services (314,000), manufacturing (108,000), leisure and hospitality (95,000), and trade, transportation and utilities (74,000). On a percentage basis, the largest gains were made in mining and logging (7.6%), government (2.6%), professional and business services (1.9%), and manufacturing (0.9%).

We examined each MSA's respective employment peak versus where it stood in February and April 2010 (latest available at print). According to both the Payroll and Household Surveys, none of the markets in our analysis have reached their peak employment levels. However, all markets except Northern/Central New Jersey (-0.3% on the Payroll Survey and -0.6% on the Household Survey) and Seattle (-1% on the Household Survey) posted positive employment growth from February through April 2010. For the Payroll Survey, the largest three-month percentage gains were seen in Baltimore (3.6%), Austin (2.7%), Washington, D.C. (2.3%), Indianapolis (2.3%) and St. Louis (2.2%). Is it any surprise that three of the top five performers are government seats? Similarly, the markets with the top three-month percentage growth based on the Household Survey include Charlotte (2.9%), Nashville (2.6%), St. Louis (2.5%), Long Island (2.5%), Baltimore and Raleigh-Durham (each with 2.4%).







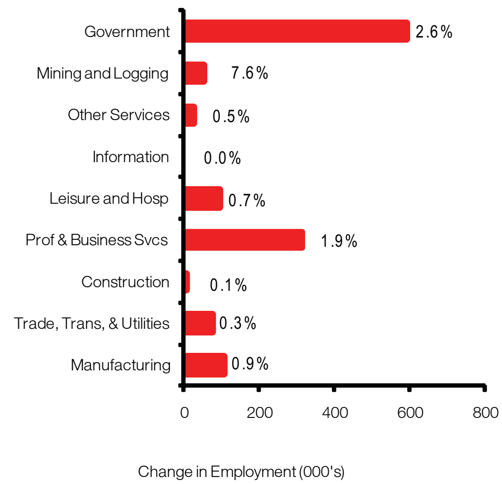
Based on the Payroll Survey, only Washington, D.C., and Columbus employment levels are fewer than 300 basis points (bps) off December 2007 employment. Markets that are 500 bps or fewer away from their respective peaks include Austin (-500 bps), Dallas-Fort Worth (-460 bps) and Philadelphia (-400 bps). At the other end of the spectrum, the markets farthest from pre-recession levels are Detroit (-2,480 bps), Northern/Central N.J. (-1,490 bps) and West Palm Beach (-1,330 bps). The Household Survey also indicates that Portland (-10 bps), Philadelphia (-110 bps), Miami (-160 bps), Minneapolis, (-230 bps), Dallas-Fort Worth (-250 bps), Phoenix (-260 bps), Washington, D.C. (-290 bps) and Nashville (-240 bps) are all fewer than 300 bps away from their respective December 2007 levels.

At 9.7%, the May 2010 unemployment rate declined by 40 bps compared to its peak of 10.1% in October 2009. The median unemployment duration stands at 23.2 weeks, with the percent unemployed more than 27 weeks rising from a low of 17.5% in December 2007 to 45.2% in May 2010. At the same time, short-term (five weeks or less) unemployment spells are at 18.4%, compared to 36.5% at the beginning of the recession. Except for a short-lived improvement in February 2010, the longer-duration unemployment statistic has been weakening steadily since early 2008. However, the percent unemployed for fewer than five weeks showed the first sign of improvement with an increase in May 2010.

This recession was extraordinarily male-centric, with 9.8% of males over the age of 20 unemployed, versus 8.1% of females. In late 2007, the unemployment rates for both males and females over the age of 20 were 4.5% and 4.6%, respectively. At their peaks, the adult male unemployment rate was 10.6% in October 2009, and the adult female unemployment rate was 8.2% in April 2010.

Teens were crushed by the recession. As a result of the minimum wage increase, teen workers accounted for about 18% of the nearly 8.7 million jobs lost from the Household Survey peak. Their unemployment rate rose from 16.9% at the end of 2007 to 26.5% in May 2010. Although today's level is below the October 2009 peak of 27.6%, it represents an increase over April 2010. Today's 960-bp increase over the pre-recession level stands in stark contrast to the 200-300-bp increase that normally occurs for teens during a recession. This dramatic increase is similar to that of the 1973-1975 recession, which also coincided with a precipitous increase in the minimum wage. If there is a bright side to this disastrous teen unemployment profile, it is that teens are not as important as adults in terms of family income generation. However, their re-employment is critical for the multifamily rental market, as absent jobs these youths remain at home rather than rent apartments.

Payroll Survey Sector Comparison
Trough - May 2010



Changes in MSA Employment

	Payroll Survey		Household Survey	
	% Change Feb-April '10	% Change Peak to Present	% Change Feb-April '10	% Change Peak to Present
Baltimore	3.6	-5.1	2.4	-7.2
Austin	2.7	-5.0	2.2	-5.1
Washington, D.C.	2.3	-2.1	1.8	-2.9
Indianapolis	2.3	-7.7	2.1	-9.7
St. Louis	2.2	-5.8	1.8	-7.5
Long Island	2.2	-13.8	2.5	-10.0
Kansas City	2.0	-5.3	0.8	-7.0
Las Vegas	2.0	-7.3	2.3	-5.6
Boston	1.9	-5.3	0.8	-4.4
Cincinnati	1.9	-5.8	0.5	-5.3
Houston	1.8	-8.6	0.4	-9.3
Minneapolis	1.8	-7.9	1.9	-2.3
Charlotte	1.7	-8.2	2.9	-5.9
U.S.	1.6	-6.5	1.5	-5.4
New York City	1.6	-6.5	2.1	-4.7
Chicago	1.5	-9.0	1.8	-7.3
Fairfield County	1.5	-7.4	0.6	-5.5
Dallas/Fort Worth	1.4	-4.6	1.0	-2.5
Atlanta	1.2	-8.6	1.3	-8.2
Phoenix	1.2	-11.7	1.5	-2.6
Detroit	1.2	-24.8	2.0	-19.0
Raleigh-Durham	1.1	-4.6	2.4	-3.1
Denver	1.1	-7.4	2.1	-5.9
Cleveland	1.1	-8.0	2.1	-5.7
Nashville	1.0	-7.4	2.6	-1.4
Columbus	1.0	-1.3	1.4	3.4
Portland	0.9	-4.8	1.2	-0.1
Seattle	0.9	-9.2	-1.0	-6.5
Orange County	0.8	-11.7	0.9	-8.2
Riverside-San	0.7	-13.7	1.0	-9.9
San Diego	0.7	-8.2	0.8	-4.8
Philadelphia	0.6	-4.0	0.8	1.1
San Jose	0.6	-8.8	0.8	-19.2
Westchester County	0.6	-9.3	1.5	-5.0
Orlando	0.6	-9.9	1.9	-7.1
Sacramento	0.6	-10.5	0.6	-6.8
Tampa	0.4	-11.1	1.6	-7.5
San Francisco	0.3	-9.0	0.4	-11.1
Los Angeles	0.3	-9.6	0.5	-7.9
West Palm Beach	0.3	-13.3	1.5	-9.4
Miami	0.2	-9.6	0.9	-1.6
Ft. Lauderdale	0.0	-12.8	1.4	-8.8
Northern/Central NJ	-0.3	-14.9	-0.6	-6.0

Outlook

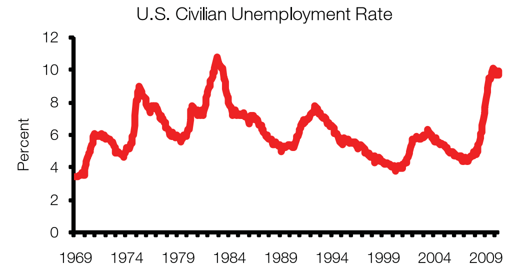
As noted earlier, we believe that 3 million to 3.5 million jobs a year will be formed in each of the next three years. In fact, this is roughly the rate at which jobs have been added since March 2010. However, this rate of job creation must be viewed in the context of the nearly 8.4 million jobs lost during the recently concluded recession, and the 1.8 million jobs normally added annually to the U.S. economy.

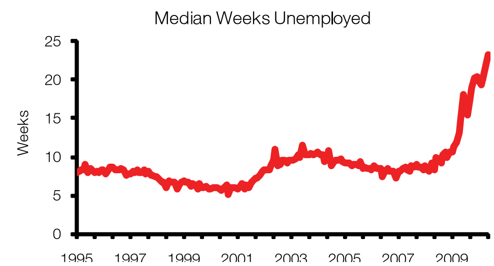
We believe that just as the standard economic models failed to predict outsized job losses, they are similarly incapable of predicting an outsized recovery. This pattern characterized the super recessions of 1973-1975 and 1980-1982. In both cases, the extent of the recession was seriously under-predicted by economic models, as was the robustness of the recovery. This is because these models are based on centrality and momentum, making it almost impossible to predict extreme ups and downs, even though notable ups tend to be followed by notable downs (and vice versa).

We project that for the next three years, we can add 3.3 million jobs each year, consisting of the normal 1.8 million new jobs associated with the additional 3 million people entering the economy, plus 1.5 million of the 8.4 million lost jobs being recovered. Stated differently, if we recreate 1.5 million of the lost 8.4 million jobs each year, in addition to population-driven job growth, for the next three years, we will have restored only 4.5 million of the 8.4 million lost jobs. This is hardly a rapid return of the lost jobs, as 45% will not have been made up after three years.

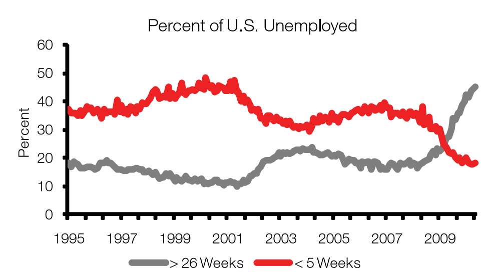
Many of those who lost their jobs were highly productive individuals who took maternity leave, went back to school, retired or died. Employers did not replace these workers in the face of panic. However, as panic has receded and profits rebounded over the past six quarters, employers will bring these positions back online. The simplest example is a woman who was not replaced when she took an extended maternity leave 14 months ago. When she now returns to work, this will be counted as a newly created job.

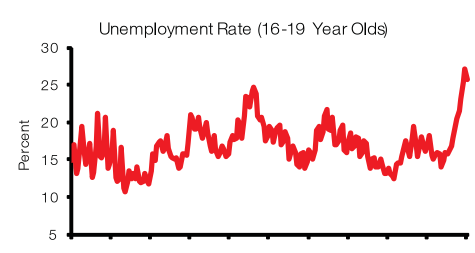
We believe that 3 million to 3.5 million jobs a year for the next three years is almost a certainty; otherwise the U.S. economy must register about 4% annual productivity growth increases. That is, everyone in the economy must be able to achieve with "96" next year what they can achieve with "100" today. This may be achievable for a year, but does not pass the smell test of long-term achievability. The prevailing U.S. business model over the last two years has been that "the beatings will continue until morale improves." That is, employees have done whatever was required because they have had no alternative. But as profits have rebounded over the past 18 months and demand has grown, more employees are needed, lest workers refuse to endure further beatings.





Employment today is at the same level as in September 1999, despite the fact that population has grown by more than 25 million people.





U.S. real GDP is approximately the same size today as it was in early 2008. Historically, if the economy does not grow, there ensues a loss of approximately 1.5 million to 2 million jobs. Thus, we lost at least 6.2 million more jobs than normal. These excess job losses will be relatively easy to regenerate, and will be driven by the growing sectors of healthcare, pharmaceuticals and education. Another way of viewing this phenomenon is that in the past 2.5 years, we have added 7.5 million people to the U.S. population, yet have the same output produced with 8.4 million fewer workers. That is not sustainable. And over the next three years, we will add another 9 million people. These 16.5 million people will require at least 9 million more jobs.

Ironically, our audiences generally greet our forecast of 3 million to 3.5 million new jobs for each of the next three years with great skepticism, as most believe that the U.S. unemployment rate will still be approximately 7% three years from now. But in order for the unemployment rate to be approximately 7% in three years, we must add 3 million to 3.5 million jobs each year for the next three years! That is to say, much as was the case in 1975-77 and 1982-84, we expect a robust employment recovery to a very mediocre job market.

We believe that 3 million - 3.5 million jobs a year for the next three years is almost a certainty; otherwise the U.S. economy must register about 4% annual productivity growth increases. This may be achievable for a year, but does not pass the smell test of long-term achievability.

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