

WILL A WEAK JOBS REPORT AND POOR PRODUCTIVITY GIVE THE FED PAUSE?

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Last Friday, Professor Jeremy Siegel and I sat down with Sam Chandan, founder and chief economist at Chandan Economics, to discuss the unexpectedly weak jobs report, productivity, low [interest rates](#) and implications for the housing market.

March's Disappointing Payrolls Report This was the first disappointing report in months. The jobs numbers missed by more than 100,000 jobs, and estimates for the prior two months were revised downward quite significantly. Accordingly, the [Federal Funds futures](#) market pushed back expectations for a rate hike beyond September. Chandan says that even among the less optimistic economists who had modest forecasts, the numbers missed those expectations significantly. That said, he doesn't think investors should read too much into a single weak report as we have had 12 months of strong employment reports otherwise. In his opinion, this may be a temporary lull, perhaps due to especially bad weather. Additionally, countering this weak report, first-time unemployment claims looked pretty strong, and the unemployment rate kept steady at 5.5%.

Weak Productivity: Is It Really Just a Measurement Problem? One of the big economic puzzles this year has been disappointing productivity figures. One theory is that this is because the fastest growth in employment levels has come from 16- to 19-year-olds, who clearly have less to add to employers and may drag down [productivity](#). But Professor Siegel thinks it's something else. He wonders whether we're even correctly measuring economic output. There has been great innovation allowing us to do for free many things that we previously paid for and counted in economic output. New technology such as point-and-shoot cameras being substituted by iPhones, free Google Maps instead of purchased Garmin navigation devices and books substituted by Kindles are counted as "other factors." The economy is rapidly changing, and Siegel believes there may be a measurement problem.

Depressed Participation Rates The labor participation rate is at a 32-year low and has experienced a big drop that started before the financial crisis began and has only accelerated since, Siegel says. Additionally, he cited a J.P. Morgan research piece that indicated that since the crisis began, about half of this drop in productivity is attributable to demographic factors, including the retirement of baby boomers. The other half is unexplained, suggesting a secular decline in the participation rate. Chandan believes that baby boomers' retirement will bring down participation rates. The flip side is that demographics and population are driving the increased demand in different property types, in particular an increased demand for and mainstreaming of senior housing as a separate investment class. He believes that the unexplained component of the participation rate is cause for concern as we haven't seen this falling participation rate in roughly 40 years. The political side of the labor markets, particularly the rigidity in the wage force and difficulty of acquiring new skills, is weighing on the numbers.

Housing Starts Lower than 1930 Housing starts during the last recession fell to the lowest level even when compared to the 1930s and the 1970s and '80s, which were characterized by double-digit interest rates. Many claim that housing starts need to be close to the 1.5 million level (average since 1947) in order to satisfy growth of population and formation of new houses. Chandan made a point about how remarkably slow this recovery has been. Levels of new single-family houses are not consistent with well-functioning single-family homes. Growth numbers are dominated by multifamily housing and almost exclusively rental units. More young people want to live in the city today, and what's more, empty nesters are indicating that cities are not a bad place to live for their cultural benefits. We are seeing a change in people's attitudes about the urban environment and a shift in leasing activity toward urban areas. That Google's East Coast headquarters is right in the middle of Manhattan is testimony to attracting talent in urban areas.

Ben Bernanke Started Blogging: Why Are Interest Rates so Low? Former Fed Chairman Ben Bernanke remarked in a blog post recently that if you ask average people on the street why interest rates are low, they'd respond that it's because the Fed is keeping them low, and it is punishing savers. Bernanke retorts this is true only in a very narrow sense, and much bigger forces are at work. Siegel believes rates are low due to fundamental factors, such as lower normal growth and pension funds derisking due to new regulations. Siegel believes Bernanke's blog is right on, and pointed out that Bernanke and Alan Greenspan (chairman of the Federal Reserve between 1987 and 2006) penned a piece on how the savings glut in Asia 10 to 15 years ago helped to bring rates

down. Chandan added that low rates have spurred the boom of the commercial real estate sector, which tends to be largely debt driven. The absence of [yield](#) in low-risk investments has encouraged strong inflows. Real estate presents an interesting challenge as there is a supply constraint. If capital flows in, and leverage is attractively priced, it has tended to increase asset prices, especially since global investors may see the U.S. as a safe haven. Read the Conversations with Professor Siegel Series [here](#).

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Interest rates : The rate at which interest is paid by a borrower for the use of money.

Fed fund futures : A financial instrument that let's market participants determine the future value of the Federal Funds Rate.

Productivity : Measure of efficiency that details how much output is obtained per unit of input.

Yield : The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.