Jobless Recovery Prospects Raise Worries

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If the economy truly is on its way to recovery, there will be a whole lot of unemployed workers watching it happen.

With each passing unemployment report, the prospect of a "jobless recovery" becomes increasingly certain. Thursday's **jobless claims report from the government** showed the economy shedding workers at a stubbornly high though expected rate, even as some other economic indicators are showing rays of light.

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Economists increasingly are seeing a recovery that mirrors the previous two recessions, and it's raising the notion that any recovery will be unsustainable.

"Most of our job growth is predicated on the servicing and building of asset bubbles. That's not healthy and viable growth," said Michael Pento, chief economist at Delta Global Advisors in Middletown, N.J. "This recovery will be subpar as far as growth, just as the 2001 recession was."

No less an authority than Federal Reserve Chairman Ben Bernanke seemed to be pointing to a jobless recovery during remarks to Congress earlier this week.

"Unemployment is going to stay up for quite a while, and it's not going to feel like a strong economy," Bernanke said in testimony before the lawmakers.

A changing economy indeed has been the cause for the trend of jobless recoveries. But while asset bubbles such as those in dot-coms and real estate have been responsible for growth, the economy also has adjusted by increasing productivity during down times for corporate bottom lines.

Investors have been largely ignoring the unemployment news lately. The stock market has bounced healthily off its March lows then sustained a June swoon. The Dow on Thursday passed 9,000 for the first time since January.

"The economy is definitely on the mend and we are heading to recovery by the latter part of this year," says Peter Cardillo, chief market economist at Avalon Partners in New York. "Jobs generally recover after the economy recovers. That's traditional and I think that will be the case around this time, too."

Portfolio managers, though, are eyeing the recent enthusiasm warily, with some attributing the market rally to traders covering short positions that have lost money as the market has bounced off technical support levels.

Consumer weakness combined with low revenue numbers during earnings—even as corporate bottom lines have improved—raise concerns that a true economic recovery is still in the distance.

"If two-thirds of the economy is struggling right now, it's hard to make the case that we're going to have sustainably strong economic growth," said Gary Flam, portfolio manager at Bel Air Investment Advisors in Los Angeles. "What we're seeing now is everything seized up in the first quarter of the year—now it's loosening up a little bit but it is by no means seeing any sign of sustainability."

In the meantime, policy makers have been issuing fairly stern warnings recently about the possibility of a jobless recovery.

Minneapolis Fed President Gary Stern said recently that there is a "reasonable possibility" of another jobless recovery. At the same time, the San Francisco Fed put out a dour forecast in June that the employment picture remains perilous and a jobless recovery similar to the 1992 model is "a plausible scenario."

Using a detailed analysis that looked at "involuntary part-time workers" and their impact on the standard unemployment rate, the San Francisco Fed concluded "that the labor market has considerably more slack than the official unemployment rate states."

"This suggests that, more than in previous recessions, when the economy rebounds, employers will tap into their existing workforces rather than hire new workers," the San Francisco Fed said. "This could substantially slow the recovery of the outflow rate and put upward pressure or future unemployment rates."

Economists also point out that the rate of recovery in the jobless market is slower than predictions. The Federal Reserve recently upped its projected level for unemployment, saying the jobless rate is likely now to eclipse 10 percent by the end of the year.

That has some investment experts wondering what type of stock market climate will be left with significant consumer weakness.

"How could we have a recovery if there are no jobs?" said Kathy Boyle, president of Chapin Hill Advisors in New York. "Seventy percent of GDP is consumer spending, the US is 25 percent of world GDP. This started with housing, it's going to end with housing, and housing and jobs are related. One's connected to the other."

Boyle sees a market that is determined to go higher but likely to hit a wall once valuations reach a level not supported by an economy still struggling to put people to work.

"We think there's still going to be another shoe to drop," she says.

One positive prospect for the market is the possibility that the rash of positive earnings surprises for the second quarter is indicating a stronger recovery than anticipated, which will entice companies to rehire workers.

"If you get any kind of upside surprise on demand you could see companies scrambling to bring workers back," Michele Girard, of RBS Global Banking and Markets, told CNBC.

The unemployment picture for the remainder of the year is likely to get clearer in the upcoming weeks. Data from the past two weeks has been clouded by aberrations in automotive layoffs typical at this time of year.

Some are worried that the recovery in store will not be what investors are hoping for.

"I don't think you're going to see a very healthy recovery at all," Delta's Pento said. "You're going to see very choppy growth. It's going to be short-lived and the day of reckoning has not yet arrived."

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