

6 January 2017

Flash Comment US

Jobs report on the hawkish side for Fed

New cycle-high wage growth figure

The jobs report for December was on the hawkish side for the Fed due to a combination of higher wage growth and a fall in the underemployment rate (a broader measure than the headline unemployment rate). The annual growth rate of average hourly earnings rose to 2.9% y/y, from 2.5% y/y, which is a new cycle high supported by a tighter labour market. The so-called underemployment rate (which, besides the official number of unemployed, includes workers who are marginally attached or working part-time for economic reasons) fell to 9.2% in December, from 9.3%, a new cycle low. The underemployment rate is one the Fed's favourite slack indicators. Employment grew 156,000 in December, slightly weaker than expected, but October and November were revised up a total of 19,000, which offsets the disappointment of the headline figure. On average, employment grew 180,000 per month in 2016, which was somewhat below the monthly average in 2013-15, when employment grew 215,000 per month on average. It is likely this is due to a combination of the slowdown in the first half of the year and it becoming harder to hire workers with the right skills, as the labour market is more or less back to 'normal'. We expect employment to grow around 160,000 per month this year.

One of the big questions this year is how many Fed hikes to expect. In our view, there are three triggers for the next Fed hike (assuming markets stay calm and the economic recovery continues): (1) higher wage growth to ensure a sustained increase in core inflation, (2) lower unemployment rate (absorbing remaining labour market slack) and (3) higher actual PCE core inflation. The December jobs report was good news in terms of point 1 and 2. Although the Fed wants to see further evidence that the economy remains on track and core inflation is moving towards 2%, the jobs report supports the hawks' case for another hike relatively soon, perhaps in March or April. This said, we learned last year that it does not take much for the (dovish) FOMC members to postpone a hike. For instance, it is well known that the Fed takes the strong USD into account (a strong USD dampens growth and holds down inflation through import prices, all else being equal), which gives the Fed the opportunity to stay patient for now.

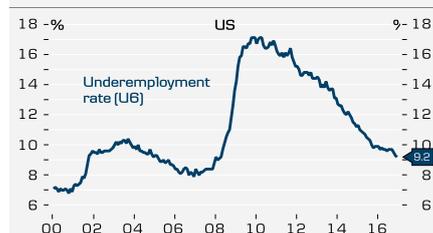
We still expect two Fed hikes this year (June and December) in line with market pricing but, in our view, the jobs report has increased further the probability of a third hike. The FOMC minutes from the December meeting revealed that FOMC members think the economic outlook is uncertain due to 'Trumponomics' (the word 'uncertain' was mentioned 15 times in the minutes versus five times in the November minutes despite better economic data) but that 'almost all' FOMC members think there are upside risks to their growth forecasts due to the likely fiscal boost, which they have not fully taken into account (see also *FOMC Minutes: Fed is waiting for more information on 'Trumponomics'*, 4 January). Given the Fed's focus on 'Trumponomics', any comments or tweets from President-elect Donald Trump on economic policy will be followed closely. Note that he is scheduled to speak at a press conference on Wednesday. We still believe the Fed is likely to increase its hiking pace in 2018 (late 2017 at the earliest), as we think Trump's fiscal policy is likely to have the biggest growth impact in 2018 due to policy lags (see also *Five Macro Themes for 2017*, 1 December 2016), although much could still happen before 2018.

Wage growth at 2.9% y/y, new cycle high



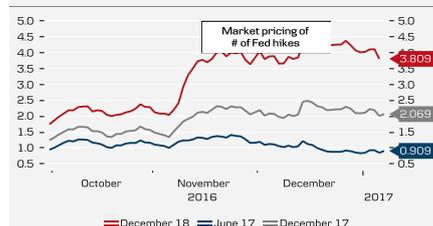
Source: BLS

Underemployment rate (U6 unemployment) fell to 9.2% – new cycle low but still a bit elevated



Source: BLS

Markets expect approximately two hikes this year



Source: Bloomberg

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Employment

Employment growth disappointed slightly in December



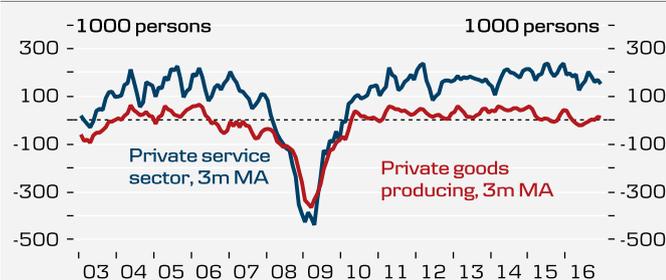
Source: BLS, Danske Bank Markets

Average hourly earnings rose 2.9% y/y, new cycle high



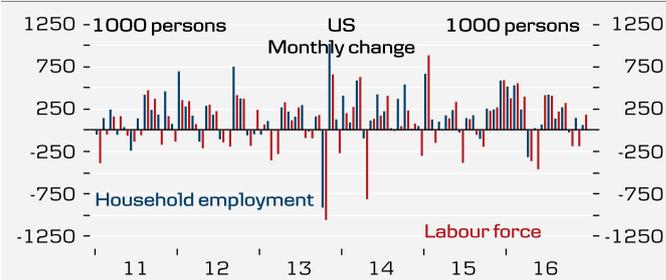
Source: BLS, Danske Bank Markets

Employment still driven by services



Source: BLS, Danske Bank Markets

Increase in unemployment rate rose to 4.7% due to an increase in the labour force



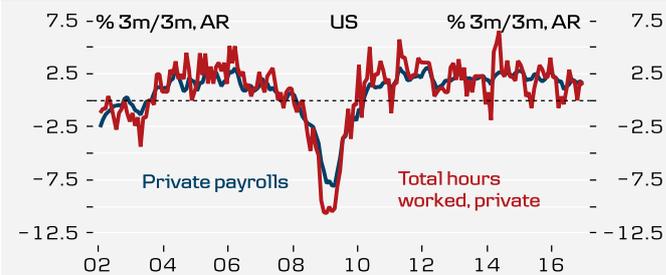
Source: BLS, Danske Bank Markets

Average weekly hours unchanged in November



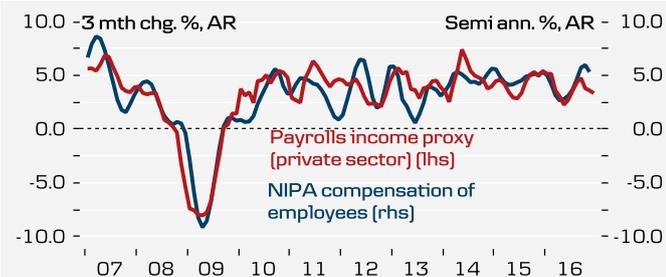
Source: BLS, Danske Bank Markets

Total hours worked vs payrolls



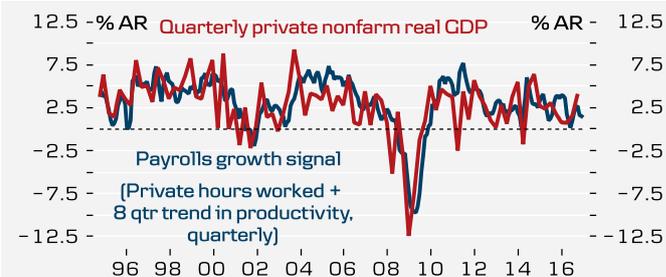
Source: BLS, Danske Bank Markets

Payrolls income proxy



Source: BLS, Danske Bank Markets

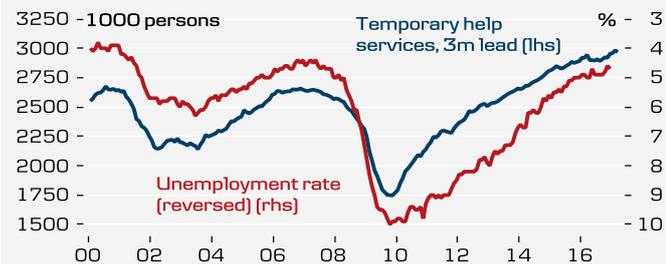
Payrolls GDP signal



Source: BLS, Danske Bank Markets

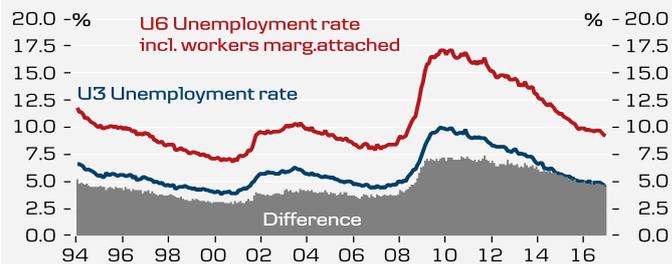
Unemployment

Temporary help services and unemployment



Source: BLS, Danske Bank Markets

Unemployment narrow and broad measure



Source: BLS, Danske Bank Markets

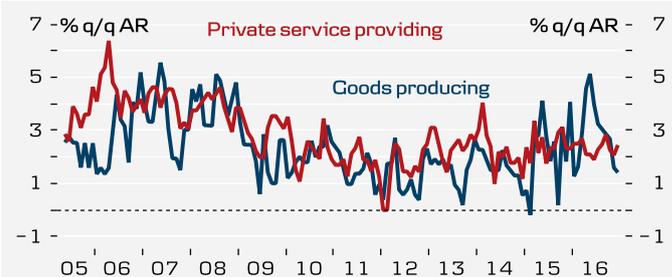
Wages

Average hourly earnings and Employment Cost Index



Source: Macrobond Financial, BEA

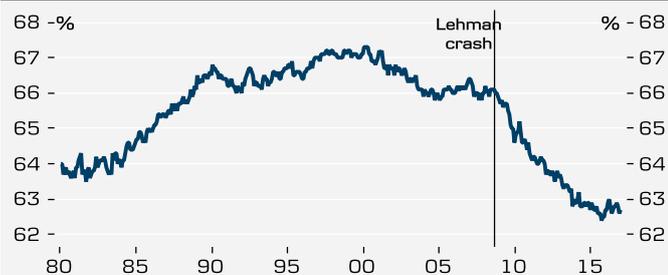
Hourly earnings, production and non-supervisory



Source: Macrobond Financial, BLS

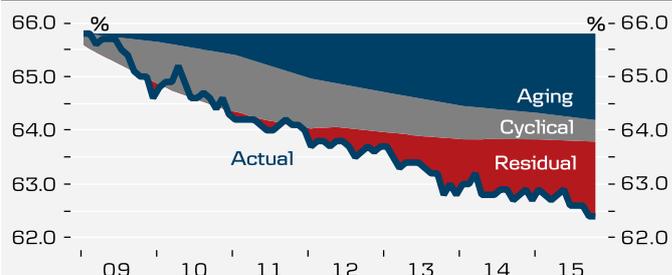
Participation

Participation rate, all



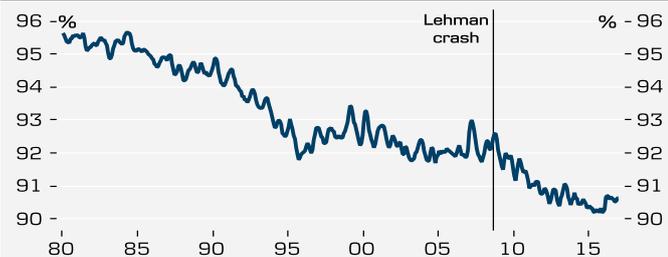
Source: Macrobond Financial, BLS

Modest cyclical rebound in the participation rate on the cards



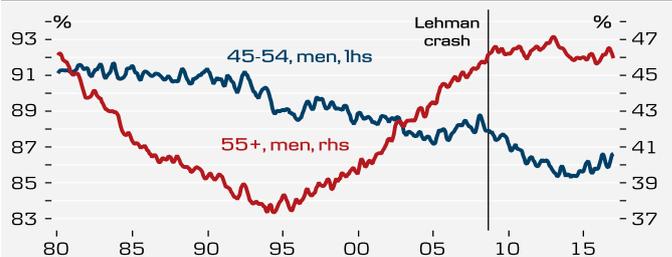
Source: Macrobond Financial, BLS

Participation rate, 35-44, men



Source: Macrobond Financial, BLS

Participation rate, 45-54 and 55+, men



Source: Macrobond Financial, BLS

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