

Flash Note

United States: Employment report

Strong job creation so far this year

Pictet Wealth Management - Asset Allocation & Macro Research | 10 March 2017

Non-farm payroll employment rose by a strong 235,000 m-o-m in February, above consensus expectations. However, the strength of job creation so far this year is partly due to unusually mild weather.

The US unemployment rate fell back from 4.8% to 4.7%, slightly below the Fed median estimate for full-employment (4.8%). And the U6 measure of underemployment fell to a fresh new cyclical low of 9.2%.

Wage data were in line with expectations. Y-o-y increases rebounded from 2.6% in January to 2.8% in February, moving back to the cyclical high recorded in December (2.8%).

This upbeat employment report reinforces the case for a Fed hike next week. Our projection for yearly average US GDP growth of 2.0% in 2017 remain unchanged. And we expect the FOMC to raise rates three times this year (March, September and December).

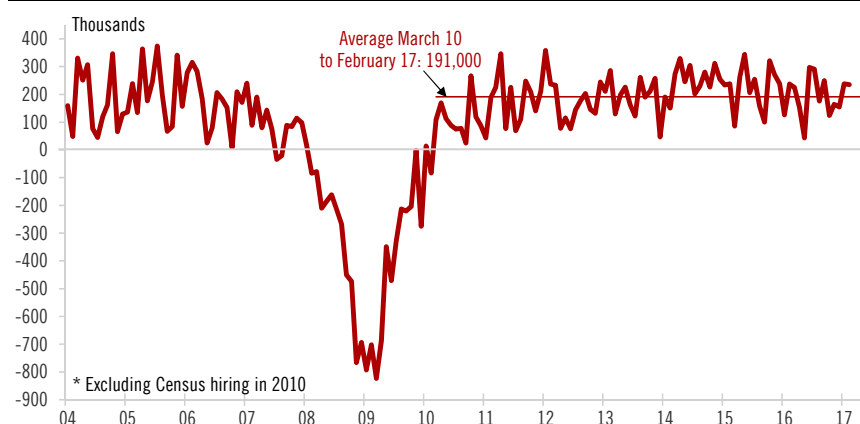
AUTHOR

Bernard LAMBERT
bernard.lambert@pictet.com
+41 58 323 2476

Pictet Group
Route des Acacias 60
CH - 1211 Geneva 73
www.pictet.com

February's US non-farm payroll figure was strong, partly due to temporary factors. Other data in the February employment report were also upbeat. The unemployment rate declined month over month (m-o-m), and y-o-y wage increases bounced back after having declined noticeably in January.

Chart 1: m-o-m changes in non-farm payroll employment (in thousands*)



Source: Pictet WM - AA&MR, Thomson Reuters

US non-farm payrolls rose by a strong 235,000 m-o-m in February, above consensus expectations (200,000). The figure was revised slightly up for January (from 227,000 to 238,000) and marginally down for December (from 157,000 to 155,000). Cumulative net revisions for the previous two months thus worked out at a small gain of 9,000.

Job creation averaged a strong 237,000 in January-February, compared with a soft 148,000 in Q4 2016 and 200,000 over the first three quarters of last year. But the strength of job creation so far this year must not be overstated. Employment growth was soft in Q4 the weather was unusually warm in the first two months of this year, which boosted activity in weather-sensitive sectors. Construction hiring averaged 49,000 in January-February, against 13,000 in 2016 as a whole. In any case, job creation is very volatile in the short run (see chart 1).

Nevertheless, between Q4 and January-February, employment grew by 1.7% annualised (after +1.4% q-o-q in Q4, +2.0% in Q3 and +1.4% in Q2), quite a solid rate considering the pace of growth in economic activity. However, given that the US has probably reached full employment, a gradual

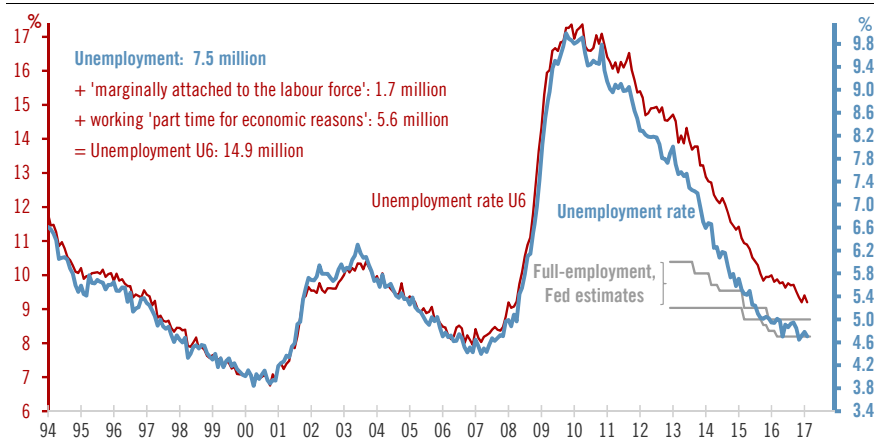
slowdown in job creation is to be expected at some stage. Hopefully, this will be accompanied by some improvement in productivity growth.

The unemployment rate fell back

The unemployment rate fell back from 4.8% in January to 4.7% in February, in line with consensus estimates. It reached a cyclical low of 4.6% in November last year.

A more in-depth look at the household survey (the basis for the unemployment rate calculations) reveals that the small decline in joblessness in February reflects strong employment growth, only partially offset by a solid increase in the labour force. The employment measure of the household survey (itself very volatile) rose by a huge 447,000 m-o-m, while at the same time the size of the labour force increased by a hefty 340,000, and the participation rate inched up further from 62.9% in January to 63.0% in February. The end result was that the number of unemployed people in the US declined by 107,000 in February. At 4.7%, the US unemployment rate is below the median long-run projections of FOMC participants (4.8%), i.e. the rate the Fed feels corresponds to full employment.

Chart 2: Different measures of labour underutilisation



Source: Pictet WM - AA&MR, Thomson Reuters

The Fed has repeated many times that the unemployment rate probably underestimates the amount of labour resources available. It is therefore interesting to consider a wider measure of unemployment, the U6 measure, which includes: (1) employees working part time, but who would prefer a full-time job; and (2) people who want a job, are available for work, have looked for a job sometime over the past 12 months, but did not do so during the latest survey week and were therefore not counted as unemployed. This measure has also fallen back, declining from 9.4% in January to 9.2% in February, its lowest level since April 2008.

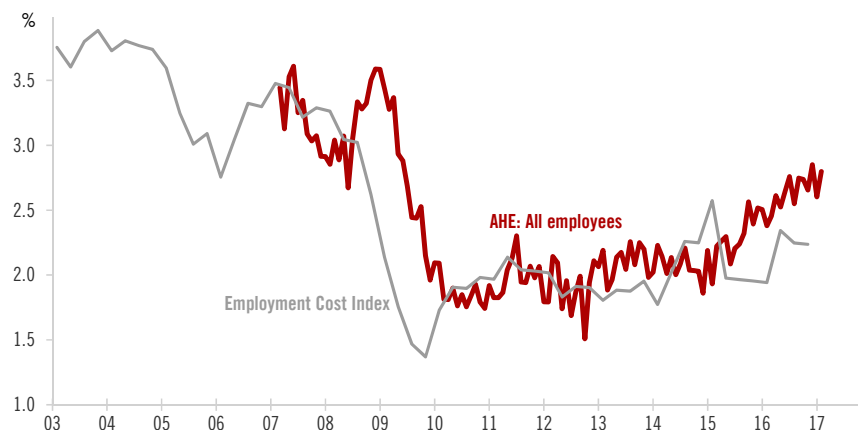
Y-o-y increase in wages bounced back in February

Average hourly earnings (AHE) rose by 0.2% m-o-m in February, slightly below consensus estimates (+0.3%). On a year-on-year basis, wage increases rose from 2.6% in January (revised up from 2.5%) to 2.8% in February, moving back very close to the cycle-high recorded in December (2.85%). This series is quite volatile (see chart 3) so short-term movements should not be

overstated. Basically, the picture remains the same. There has been some gradual pick-up in the pace of AHE increases between Q1 2015 (+2.1% y-o-y), Q2 2016 (+2.6% y-o-y) and the latest-three-month average of 2.75%.

However, the quarterly Employment Cost Index (ECI) – the most reliable measure of wages and salaries – is pointing to a less blatant acceleration in wage increases (see chart 3). Nevertheless, we continue to expect wage increases in the US to gradually pick up over the coming quarters.

Chart 3: Average Hourly Earnings (AHE), Employment Cost Index (ECI), y-o-y % ch.



Source: Pictet WM - AA&MR, Thomson Reuters

The average work week remained unchanged at 34.4 hours in February, and the index of 'aggregate weekly payrolls' (calculated on the basis of aggregate hours worked and average hourly earnings) rose by 0.5% m-o-m in February. As a result, between Q4 and January-February, this index – which is a good proxy for nominal household income in the form of private wages – grew by a strong 5.0% annualised, after +4.4% q-o-q in Q4 and +4.3% in Q3 (see chart 4). This should support household income growth in the US in the current quarter.

Healthy employment report

All in all, today's employment report was encouraging. Although boosted by temporary distortions, job creation was solid and both the unemployment rate (U3) and the U6 measure of underemployment declined. And, as expected, the y-o-y pace of wage increases bounced back in February. All this reinforces the probability that the Fed will hike rates by 25 bps next week.

We are not modifying our scenario for US economic growth and monetary policy in light of the latest statistics. Our forecast that US GDP will grow by 1.7% q-o-q annualised in Q1 remains unchanged, as do our projections for yearly average growth of 2.0% in 2017. After raising rates by 25 bps next Wednesday, we expect two additional 25bp hikes to follow this year, probably in September and December.

Notice:

This communication is not intended for persons who are citizens of, domiciled or resident in, or entities registered in a country or a jurisdiction in which its distribution, publication, provision or use would violate current laws and regulations.

The information, data and analysis furnished in this document are disclosed for information purposes only. They do not amount to any type of recommendation, either general or tailored to the personal circumstances of any person. Unless specifically stated otherwise, all price information is indicative only. No entity of the Pictet Group may be held liable for them, nor do they constitute an offer or an invitation to buy, sell or subscribe to securities or other financial instruments. The information contained herein is the result neither of financial analysis within the meaning of the Swiss Bankers Association's Directives on the Independence of Financial Research, nor of investment research for the purposes of the relevant EU MiFID provisions. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness.

Except for any obligations that any entity of the Pictet Group might have towards the addressee, the addressee should consider the suitability of the transaction to individual objectives and independently assess, with a professional advisor, the specific financial risks as well as legal, regulatory, credit, tax and accounting consequences.

Furthermore, the information, opinions and estimates in this document reflect an evaluation as of the date of initial publication and may be changed without notice. The Pictet Group is not under any obligation to update or keep current the information contained herein. In case this document refers to the value and income of one or more securities or financial instruments, it is based on rates from the customary sources of financial information that may fluctuate. The market value of financial instruments may vary on the basis of economic, financial or political changes, currency fluctuations, the remaining term, market conditions, the volatility and solvency of the issuer or the benchmark issuer. Some investments may not be readily realizable since the market in the securities can be illiquid. Moreover, exchange rates may have a positive or negative effect on the value, the price or the income of the securities or the related investments mentioned in this document. When investing in emerging countries, please note that the political and economic situation in those countries is significantly less stable than in industrialized countries. They are much more exposed to the risks of rapid political change and economic setbacks.

Past performance must not be considered an indicator or guarantee of future performance, and the addressees of this document are fully responsible for any investments they make. No express or implied warranty is given as to future performance. Moreover, forecasts are not a reliable indicator of future performance.

The content of this document can only be read and/or used by its addressee. The Pictet Group is not liable for the use, transmission or exploitation of the content of this document. Therefore, any form of reproduction, copying, disclosure, modification and/or publication of the content is under the sole liability of the addressee of this document, and no liability whatsoever will be incurred by the Pictet Group. The addressee of this document agrees to comply with the applicable laws and regulations in the jurisdictions where they use the information reproduced in this document.

This document is issued by Banque Pictet & Cie SA. This publication and its content may be cited provided that the source is indicated. All rights reserved. Copyright 2017.

Banque Pictet & Cie SA is established in Switzerland, exclusively licensed under Swiss Law and therefore subject to the supervision of the Swiss Financial Market Supervisory Authority (FINMA).

Distributors: Banque Pictet & Cie SA, Pictet & Cie (Europe) SA