PICTET 1805

Flash Note

United States: Employment report

Strong job creation so far this year

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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).

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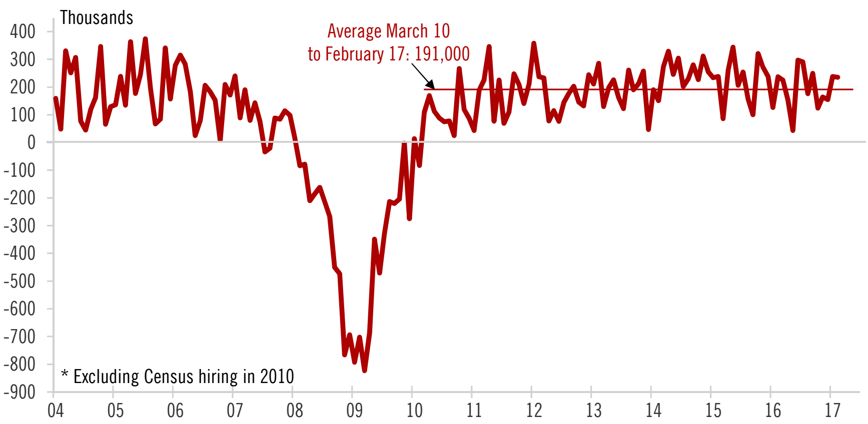
February's US non-farm payroll figure was strong, partly due to temporary factors. Other data in the February employment report were also upbeat. The unemployment rate declined month over month (m-o-m), and y-o-y wage increases bounced back after having declined noticeably in January.

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*).

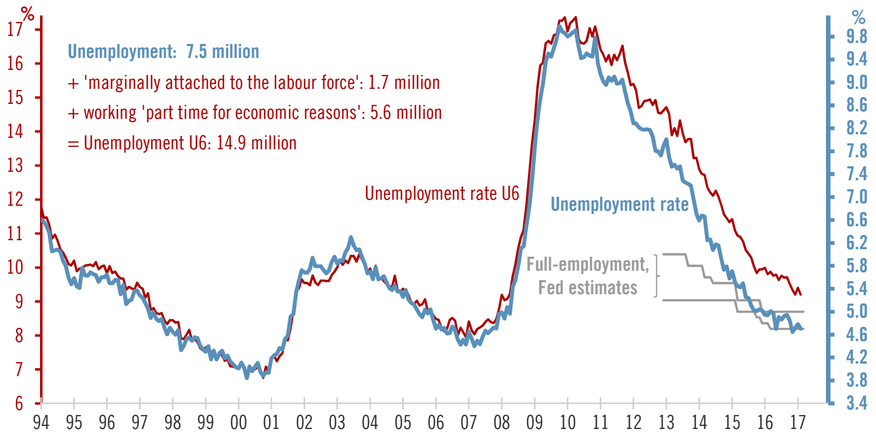
Nevertheless, between Q4 and January-February, employment grew by 1.7% annualised (after +1.4% q-o-q in Q4, +2.0% in Q3 and +1.4% in Q2), quite a solid rate considering the pace of growth in economic activity. However, given that the US has probably reached full employment, a gradual slowdown in job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

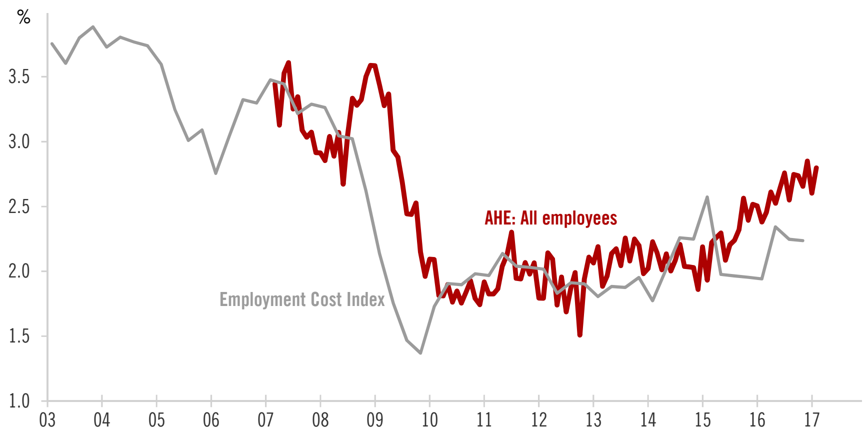
The Fed has repeated many times that the unemployment rate probably underestimates the amount of labour resources available. It is therefore interesting to consider a wider measure of unemployment, the U6 measure, which includes: (1) employees working part time, but who would prefer a full-time job; 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.