PICTET 1805

Flash Note

US employment – It's Goldilocks!

Tepid wage growth to keep Fed on the slow rate-hiking track

Pictet Wealth Management - Asset Allocation & Macro Research | 3 November 2017

October payrolls showed the US economy remains in fine fettle, as underlying payroll growth remained firm, while wage growth was enough to keep Fed monetary policy tightening gradual.

Payrolls rose 261,000, reversing some hurricane-related weakness (18,000 only in September). The unemployment rate dropped to 4.1%, the lowest level since December 2000. Average hourly earnings moderated to 2.4% y-o-y.

The employment report provided strong hints that underlying economic activity remains firm, with some microeconomic exceptions. The retail sector's woes, for instance, are deepening.

This employment report keeps the Fed on track to raise rates again at its December meeting, in line with our long-held scenario.

AUTHOR

Thomas COSTERG
tcosterg@pictet.com
+41 58 323 3963

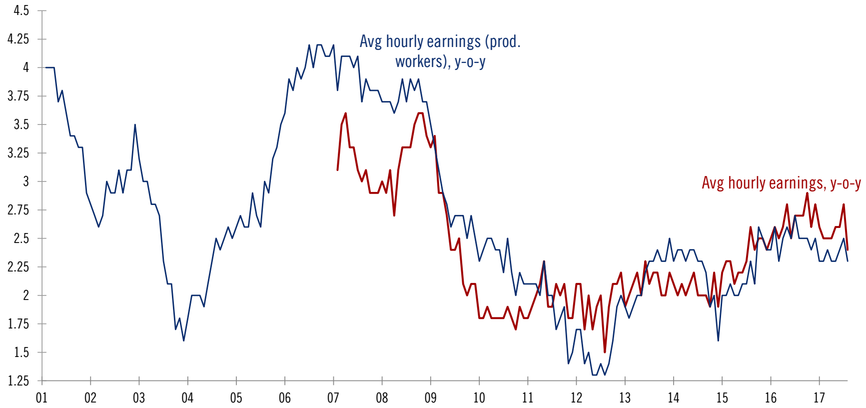
Pictet Group
Route des Acacias 60
CH - 1211 Geneva 73
www.pictet.com

For investors, the October employment report showed 'Goldilocks' conditions: employment growth remained firm, while forward-looking indicators like temporary hiring suggested momentum is still solid. However, wage growth remained tepid – ensuring the Federal Reserve is unlikely to accelerate monetary tightening, and is more likely to keep its expected terminal rate low.

Non-farm employment rose 261,000 in October, from an upwardly revised 18,000 in September (dampened by the hurricanes), leaving the three-month average at a healthy 162,000/month. The unemployment rate fell to 4.1%, the lowest level since December 2000. Meanwhile, average hourly earnings were flat m-o-m, pushing down the y-o-y reading to 2.4%, below the one-year average of 2.6%. We have long been of the view that wage growth should remain tepid, due mostly to structural reasons like technological change, robotisation, and globalisation, which are having a greater effect than the increasing tightness of the labour market conditions.

The picture is still rosy at the macro level, with data neither too hot nor too cold (hence our 'Goldilocks' characterisation). But there are sharp divergences at the micro-economic level. In particular, the crisis in the retail sector seems to be growing. Retail employment fell 0.4% y-o-y in October (the fourth straight decline in the y-o-y reading). The y-o-y decline in grocery retailing jobs was the largest since June 2010 (-1.1% y-o-y in September, the latest data available for this sub-sector).

Chart 1: Wage growth remains tepid despite ongoing labour market strength



Source: Pictet WM-AA&MR, Bureau of Labor Statistics.

PAYROLL DATA RECAP

› Momentum

- **Payroll growth rebounded in October (+261,000) after hurricane-related disruption in September (+18,000 only).**
- The 3-month average (162,000/month) is very close to the 6-month (163,000/month) and 12-month (167,000/month) averages.
- **Hurricane-related disruption was particularly seen in the V-shaped recovery in food services**, most probably due to a rebound in those jobs in hurricane-hit Florida (state-level data will be released later this month). **Employment in food services rose 89,000 in October after a 98,000 drop in September.**
- **It is likely that the hurricanes affected wage growth data too.** Construction wages fell 0.4% m-o-m, after a sharp rise in September (+0.8%). **We think this was probably due to a reversal of the rise in demand for reconstruction services that had pushed wages in this sector sharply up in September**.
- The salient point is that October wage growth data seems to be a good reflection of the current underlying trend in wage growth, which remains tepid.

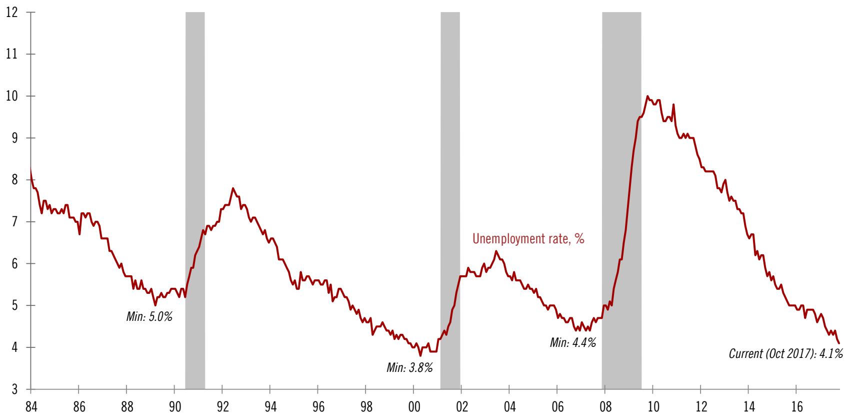
› Business cycle

- **All cyclical indicators are flashing green, suggesting healthy underlying momentum.**
- **Construction employment remains firm,** with the y-o-y gain (+2.8%) in October still almost double total US employment growth (+1.4%).
- **Manufacturing employment has risen at a particularly brisk pace in the past three months** (25,000/month versus 13,000/month on average in the past year).
- **Signs of renewed vigour in the auto sector are worth noting,** with a 3,400 gain in auto sector employment in October (+8,000/month on average in the past three months)
- However, **the energy sector seems to be moderating,** as mining jobs fell by 2,000 in October, compared with a gain of 1,000 in September. **This echoes the recent softening in oil rig count**. The recent rise in oil prices could, however, give a cyclical boost to the sector, and therefore to employment in energy drilling. This is something to watch closely in the coming months.
- **The robust rise in temporary-help employment**, up 18,000 in October (from 8,000 in September and 9,000 in August) is a crucial sign of the strong momentum of the jobs market in general. Temporary-help employment was up a solid 4.1% y-o-y in October.
- **These robust labour-market signals echo recent solid business surveys, strong job opening data, and very low levels of initial jobless claims. Payroll growth looks likely to remain firm for the next three to six months, at least.**

› Structural trends	– **The retail crisis is deepening: employment in the sector fell 8,300 in October**. On a y-o-y basis, retail employment was down 0.4%, the fourth consecutive negative reading. Retail employment has averaged -1,000/month on average in the past three months, and -5,000/month on average in the past year. – **Meanwhile, employment at non-store retailers went up 12.2% y-o-y in October**. – **It is interesting to note that the sharp rise in employment in software seen in recent years seems to be stalling.** The y-o-y gain in this sector was 'only' 1.8% in October, compared with 5.9% in the same month last year. – The labour force participation rate fell to 62.7% from 63.1%, suggesting that the **re-appearance of previously discouraged workers seems to be stalling**. – **More worryingly, the participation rate for men aged 25-54 dropped to 88.5% in October, below the one-year average of 88.6%.**
› Fed policy	– **This report most likely keeps expectations for the trajectory of monetary policy unchanged**. Slow wage growth is likely to keep monetary tightening very gradual, and the Fed's terminal rate is likely to remain low. – The scenario would change if wage growth was above 3-3.5%, which seems unlikely. – But the three-month non-farm payroll average (162,000/month) is solid enough to persuade Fed members that economic activity remains robust, in turn **cementing the case for a December rate hike**, with the Fed likely to blame low inflation on temporary factors. – Particularly key to the Fed's stance is the decline in the unemployment rate to 4.1% and the **spectacular decline in the U6 'broad' unemployment rate to 7.9% (the lowest rate since December 2006)**. – Incoming Fed Chair Powell is likely to follow Yellen's approach to employment/wage data.

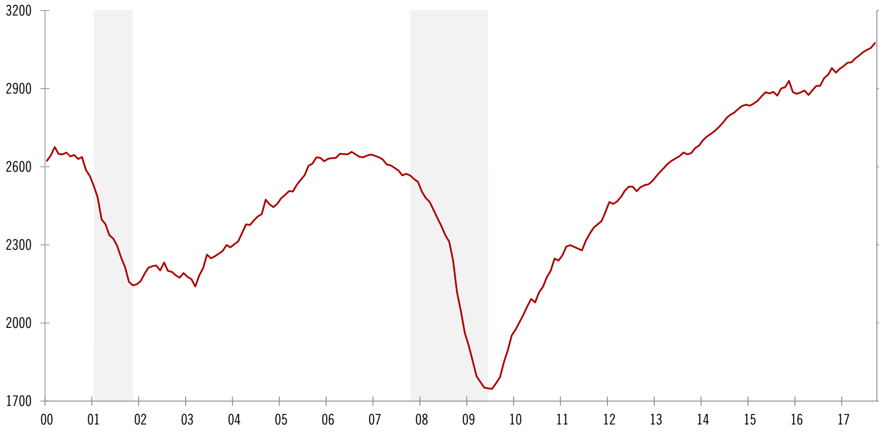
Source: Pictet WM-AA&MR, BLS

Chart 2: The unemployment rate down to its lowest since December 2000



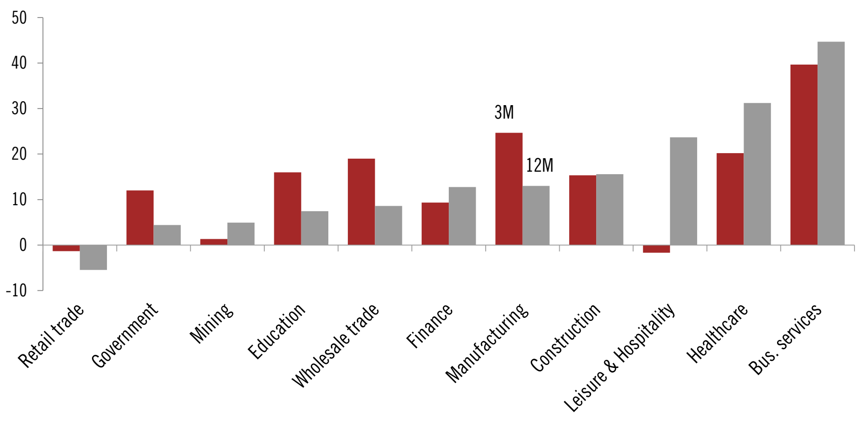
Source: Pictet WM – AA&MR, BLS

Chart 3: Temporary employment is still moving up, a good omen for the US outlook



Source: Pictet WM – AA&MR, BLS

Chart 4: There has been a sharp uptick in manufacturing employment lately, while leisure and hospitality jobs have slowed sharply. The retail sector remains tough



Source: Pictet WM – AA&MR, BLS

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