PICTET 1805

Flash Note

United States: Employment report

Unemployment fell to 4.4% in April, a fresh low for this cycle

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Non-farm payroll employment rose by a solid 211,000 m-o-m in April, above consensus expectations. However, the strength of job creation last month is partly due to unusually warm weather and followed a soft reading in March.

Unexpectedly, the US unemployment rate fell further, from 4.5% in March to 4.4% in April, and is now significantly below the Fed median estimate for full employment (4.7%). The U6 measure of underemployment fell to a new cyclical low of 8.6% in April.

However, wage data were somewhat disappointing. Y-o-y increases fell back from a downwardly revised 2.6% in March to 2.5% in April.

We view today's report as upbeat. It reinforces the case for a Fed hike in June. Our projection for yearly average US GDP growth of 2.0% in 2017 remains unchanged. And we continue to expect the FOMC to raise rates twice more this year (in June and September).

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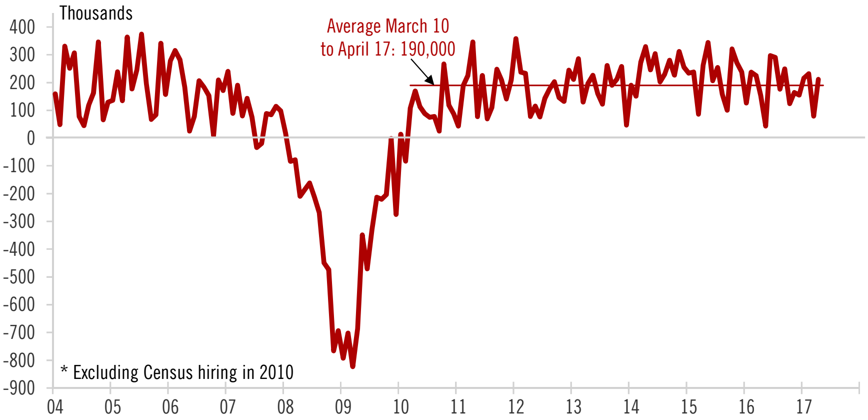
US average hourly earnings data were slightly disappointing in April, but the non-farm payroll figure was robust and the unemployment rate unexpectedly continued to decline, reaching its lowest level in a decade.

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 211,000 m-o-m in April, slightly above consensus expectations (190,000). The figure was revised modestly down for March (from 98,000 to 79,000) and slightly up for February (from 219,000 to 232,000). Cumulative net revisions for the previous two months thus worked out at 6,000 less than initial estimates.

The soft number recorded in March was partly due to unusually cold weather, while the strong figure registered in April was partially due to seasonably warm temperatures. In any case, job creation is very volatile in the short run (*see chart 1*). It is therefore more instructive to look at 3-month moving averages. Job creation averaged a healthy 174,000 over the past three months, a similar pace as over the previous three months (178,000 per month) and on average in 2016 (180,000).

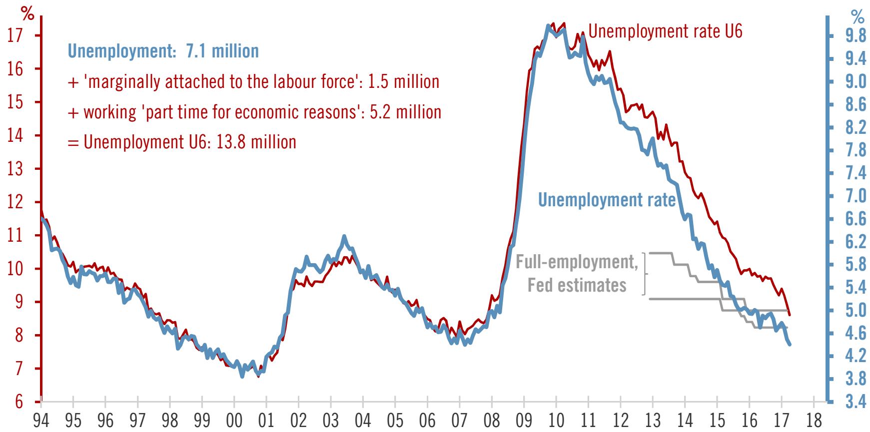
Between Q1 and April, employment grew by 1.4% annualised (after +1.5% q-o-q in Q1 and 1.4% in Q4 2016), quite a healthy rate considering the pace of growth in economic activity. However, given that the US has probably reached full employment, a gradual slowdown in job creation is to be expected at some stage. Hopefully, this will be accompanied by some improvement in productivity growth.

Surprisingly, the unemployment rate fell further

The unemployment rate fell further from 4.5% in March to 4.4% in April, below consensus estimates of a rebound to 4.6%. This means US unemployment has reached a fresh cyclical low and is at its lowest level since March 2007.

A more in-depth look at the household survey (the basis for the unemployment rate calculations) reveals that the decline in joblessness in April reflected healthy employment growth together with near-stagnation in the labour force. The employment measure of the household survey (itself very volatile) rose by 156,000 m-o-m, while the size of the labour force increased by a marginal 12,000, and the participation rate inched back down from 63.0% in March to 62.9% in April. The end result was that the number of unemployed people in the US declined by 146,000 in April. At 4.4%, the US unemployment rate is now significantly below the median long-run projections of FOMC participants (4.7%), 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

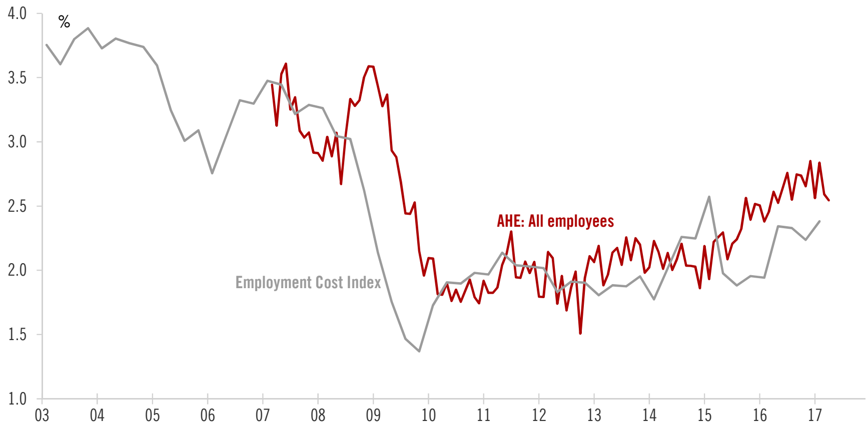
The Fed has repeated many times that the unemployment rate probably underestimates the amount of labour resources available. It is therefore interesting to consider a wider measure of unemployment, the U6 measure, which includes: (1) employees working part time, but who would prefer a full-time job; 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 also fell further last month, declining from 8.9% in March to 8.6% in April, its lowest level since November 2007. On this yardstick as well, full employment seems to have been more or less reached (*see chart 2*).

Y-o-y increase in wages fell back in April

Average hourly earnings (AHE) rose by 0.3% m-o-m in April, in line with consensus estimates. However, as the figure for March was revised down, on a year-on-year basis wage increases fell back from 2.6% in March (revised down from 2.7%) to 2.5% in April, below consensus estimates of +2.7%. This is rather disappointing, but this series is quite volatile (*see chart 3*) so short-term movements should not be overstated. Basically, the picture remains unchanged. There was a gradual pick-up in AHE increases between Q1 2015 (+2.1% y-o-y) and Q3 2016 (2.7% y-o-y), but the pace has more or less stabilised since then according to this set of statistics (+2.7% y-o-y over the past three months).

The quarterly Employment Cost Index (ECI) – the most reliable measure of wages and salaries – is pointing to a similar picture, i.e. a slow and modest 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 in the US increased from 34.3 hours in March to 34.4 hours in April, and the index of 'aggregate weekly payrolls' (calculated on the basis of aggregate hours worked and average hourly earnings) rose by a strong 0.7% m-o-m in April. As a result, between Q1 and April, this index – which is a good proxy for nominal household income in the form of private wages – grew by a strong 5.2% annualised, after +3.7% q-o-q in Q1 and +4.4% in Q4 2016. This should support household income growth in the US in the current quarter.

Healthy employment report

All in all, today's employment report was upbeat. Admittedly, average hourly earnings disappointed somewhat, but job creation remains basically healthy and both the unemployment rate (U3) and the U6 measure of underemployment have declined substantially over the past two months. In our view, this rosy picture reinforces the probability that the Fed will hike rates in June.

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 2.7% q-o-q annualised in Q2 remains unchanged, as do our projections for yearly average growth of 2.0% in 2017. We also continue to forecast that the Fed will hike rates again by 25 basis points in both June and September, and that later this year it will likely announce the start of balance sheet reduction at the beginning of 2018.