PICTET 1805

Flash Note

US employment – Solid start to 2018

Wages on the rise as US maintains cyclical momentum

Pictet Wealth Management - Asset Allocation & Macro Research | 2 February 2018

January's solid nonfarm payrolls gain of 200,000 brought the 3-month average to a very healthy 192,000/month. There have been particularly solid gains lately in 'cyclical' sectors such as manufacturing and construction.

Wage growth firmed up, as average hourly earnings rose 2.9% y-o-y. But gains for production workers were more modest (2.4% y-o-y). Still, the overall trend is for firming wages as the US labour market tightens.

The retail sector posted employment gains in January of +15,000, despite fierce ongoing competition from online retailers. Maybe this is a sign that the sector is more resilient than expected.

From a Federal Reserve perspective, solid wage growth could lead to a more hawkish tone. We expect four rate hikes this year (including one in March)—more than the three rate hikes the Fed indicated in December.

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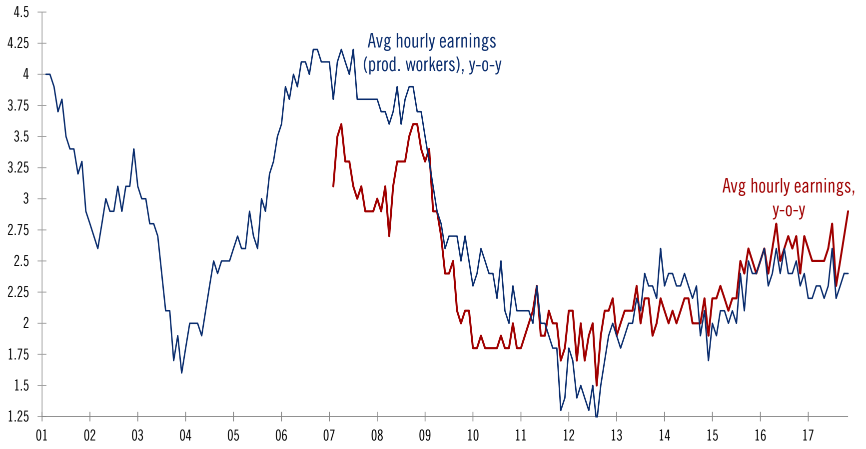
The January employment report showed that the **US economy started 2018 on a strong footing**, with particularly robust momentum in **cyclical sectors** such as construction and manufacturing. This supports our scenario that US growth will step up to **3% in 2018**, from 2.3% in 2017, driven by an uptick in investment. With January's increase of 200,000, the 3-month average growth in payrolls stands at **192,000/month, well above the one-year average of 176,000/month**. This could entice the Fed to indicate **more rate hikes** at its March meeting. We see four quarter-point rate increases in the US in 2018.

The highlight of the report was the **sharp acceleration in wage growth**, with average hourly earnings rising **2.9%** year-on-year (y-o-y), the highest rate since 2009. But the wage gains were not broad based. Manufacturing workers, for instance, saw only +1.9% y-o-y growth in wages. More broadly, production workers' earnings rose 2.4% y-o-y, barely above the one-year average of 2.3%. Still, the **overall trend in wage growth looks to be firming**, echoing signs that the US labour market is nearing **full employment**.

At the microeconomic level, the real story is the sharp improvement in **retail-sector employment**. The sector has posted a 6,000/month gain on average in the last three months, versus an average loss of 2,000/month in the previous 12 months. Retail employment is 'resisting' online competition. Still, the **share of retail in total employment fell to a new low of 10.74% in January**.

Chart 1: The highlight of the report was the sharp acceleration in wage growth



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

PAYROLL DATA RECAP

› Momentum	– **Another solid monthly payroll print of +200,000 in January,** up from a revised 160,000 in December. – **The 3-month average of 192,000 is comfortably above the 1-year average of 176,000.** – The unemployment rate stayed unchanged at 4.1%. – **The payrolls report is consistent with a solid start to the year in terms of GDP growth,** which is also in line with our scenario of 3% annual GDP growth in 2018.
› Business cycle	– **From a cyclical point of view, labour-market signals continue to flash green** – Manufacturing employment rose 15,000 in January, with a 3-month average of 16,000/month – The exception was the car manufacturing sub-sector, which stagnated in January after +6,000 in December and +3,000 in November. **The recent deterioration in car sales could lead to some headwinds in this sub-sector**. – Construction employment rose 36,000, close to the 3-month average of 37,000 (employment in construction was up 3.3% y-o-y) – **Mining jobs rose solidly (+5,000) in January, echoing the broader improvement in the US energy sector as oil prices and production rise steadily.** Mining employment is up 9.5% y-o-y, the highest rate since May 2012. – **The crucial 'cyclical' series of temporary help services showed another gain of 2,000 in January,** from 6,000 in December and 7,000 in November. On a y-o-y basis, the gain was +3.4%. At **face value, this indicates the near-term economic outlook is serene.** – Overall, the solid payroll picture is consistent with other recent economic data, including still-low claims for unemployment insurance, and very solid business and consumer surveys. **Visibility on payrolls remains strong for the next three to six months at least.**
› Structural trends	– **After some difficult months in early 2017, employment in the retail sector seems to have stabilised in the second half of last year.** The January gain of 15,400 is a welcome development, but it is still too early to shout the 'all clear' given the sector's uncertain outlook in the face of fierce internet competition. **The share of retail in total employment fell to 10.74% in January**. – **The participation rate was unchanged from December's level at 62.7%.** – The participation rate for men aged 25-54 remained unchanged from December at 89.0%, but the underlying trend is positive.

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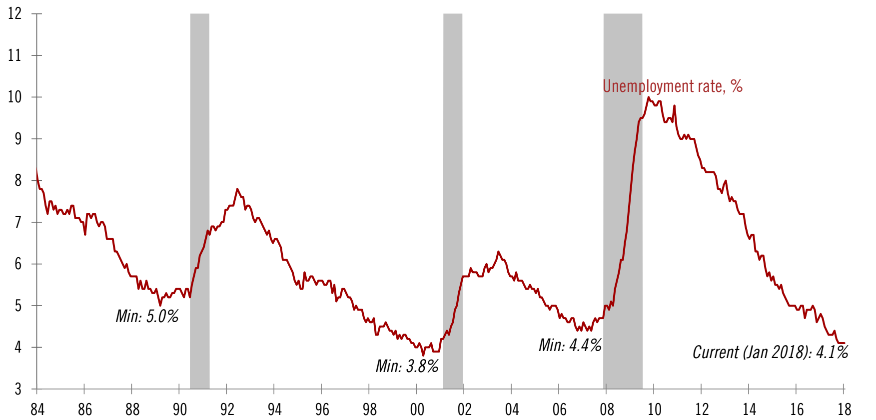
› Fed policy	– **The Fed has been getting more hawkish lately**, noting the "solid" momentum in the US economy in its January meeting statement. It is also re-evaluating in a more positive light the impact of the December tax cuts on the economy (echoing market consensus, which is also upgrading its forecasts). – The January payrolls report confirms that the underlying trend in US employment is sound. – The Fed has been sensitive to the average hourly earnings (AHE) series to gauge wage growth, and the probability of rising inflation. The **solid gain in the January AHE reading could revive fears that inflation resurrects more suddenly than the Fed expects**. The Fed's hawks may call for additional rate hikes. – The January payroll report validates our scenario of four rate hikes this year. We think the Fed's **dot plot could indicate as much as 4 rate hikes in March** (versus three in December), especially if Q1 GDP stays on track to be above 3% growth.

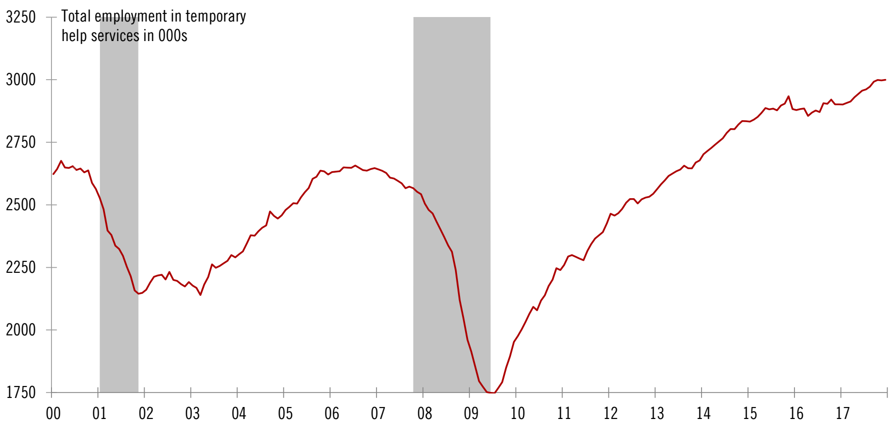
Source: Pictet WM-AA&MR, BLS

Chart 2: The unemployment rate remained low at 4.1% in January



Source: Pictet WM – AA&MR, BLS

Chart 3: Temporary-help jobs are still moving up, a good sign



Source: Pictet WM – AA&MR, BLS