

Flash Note

US employment – Goldilocks again

Labour market gathers momentum, still no overheating

Pictet Wealth Management - Asset Allocation & Macro Research | 9 March 2018

February's employment report was solid, with 313,000 job additions. The 3-month average rose to 242,000.

Wage growth remained moderate—a sign that the US labour market is still not overheating. In fact, wage growth slowed to 2.6% y-o-y in February from a revised 2.8% in January.

The Federal Reserve is likely to focus on the strong headline reading of 313,000. This is likely to validate many officials' view that the US economy is starting 2018 on a strong footing as the tax cuts begin to make an impact. That may tempt Fed members to raise their median forecast to four rate hikes this year.

We continue to expect four Fed rate hikes this year and two in 2019.

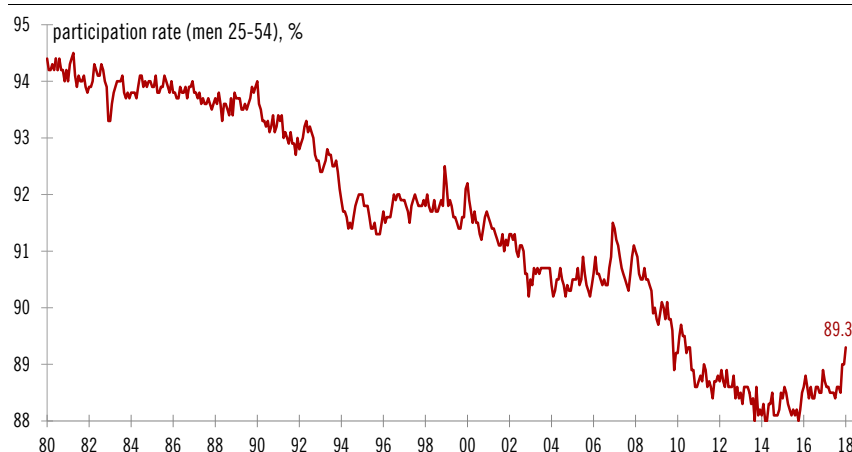
There are two main conclusions to be drawn from the February US employment report. First, **the US economy's underlying momentum is particularly robust**, consistent with our view that GDP growth will pick up to 3.0% this year, from 2.3% in 2017. Second, while the **labour market is tight**, there is **still some slack left**; in other words, the **US labour market is not (yet) overheating**.

That momentum remains solid can be seen not only in the **solid headline nonfarm payroll reading** itself (+313,000, the highest since July 2016) but also the **strong three-month average** (+242,000). The job gains were led by cyclical sectors like construction and manufacturing. In fact, February saw the **biggest monthly increase in construction jobs since March 2007**.

Although it increased in February, the participation rate suggests there is still some slack in the US jobs market. So does the moderate rise in wages (+2.6% y-o-y in February, from 2.8% in January). In other words we believe the **unemployment rate (unchanged at 4.1% in February) will drop in the coming months**.

From the Federal Reserve's perspective, this employment report adds **little incremental value**. It will likely just **validate its existing moderately hawkish** stance based on a strong economy and the impact of fiscal easing. We still think there is a reasonable chance the Fed raises its 2018 median dot on its 'dot chart' from three to four at its next policy meeting on 21 March. **We maintain our call for four rate hikes this year, and two next year.**

Chart 1: Young men are finally returning to the workforce



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

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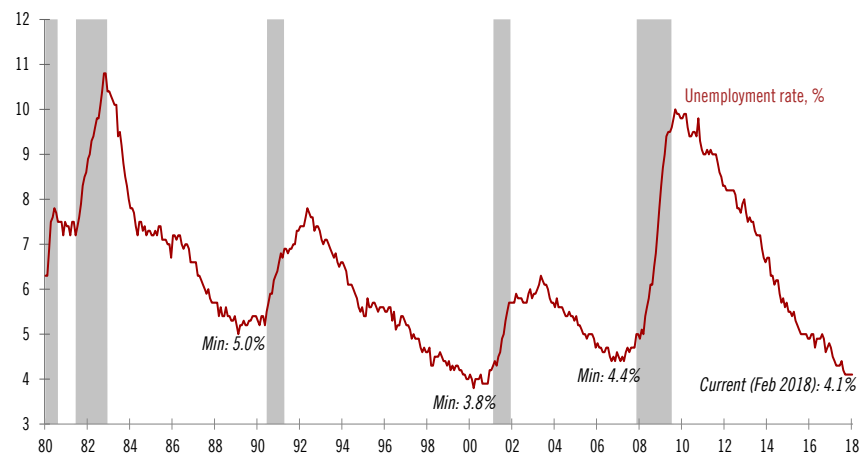
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| > Momentum | <ul style="list-style-type: none">– Particularly solid monthly print of 313,000.– 3-month average of 242,000/month, comfortably above the 1-year average of 190,000/month.– Unemployment rate unchanged at 4.1% for a fifth consecutive month.– Overall, this solid print is consistent with underlying GDP growth of c.3%, even though there are some risks that the headline Q1 GDP print may be lower, failing to reflect adequately current solid underlying momentum. |
| > Business cycle | <ul style="list-style-type: none">– Labour-market signals continue to flash green, with no sign of a slowdown.– Cyclical sectors like manufacturing and construction look particularly robust.– Construction jobs were up 61,000 in February. The 3-month average for this sector now stands at 48,000, well above the 12-month average of 21,000.– Manufacturing jobs were up 31,000, and the 3-month average of 32,000 is also well above the 12-month average of 19,000.– There was good news for car manufacturing employment, with 6,000 job additions in February (3-month average of 4,000 versus 1-year average of only 1,000).– Mining jobs, helped by rising oil production, posted their biggest monthly gain since April 2017. The 3-month average is the same as the 1-year average (5,000).– Temporary-help services – perhaps the best leading indicator for future payroll growth – rose particularly strongly (+27,000) in February, a good omen for continued strength in job growth going forward (at least for the next six months). |
| > Structural trends | <ul style="list-style-type: none">– Employment in the challenged retail sector picked up sharply in February (+50,000), although the Bureau of Labor Statistics noted that this was due to retail companies hiring less, and therefore dismissing workers less before and after the holiday season. On a y-o-y basis, retail-sector jobs were almost flat (+0.2%).– It is worth noting that healthcare sector seems to be losing steam gradually. Job growth in the sector has been 31,000 on average in the past three months, in line with the 12-month average. On a y-o-y basis, job growth slowed to 1.9% – the lowest level since September 2014.– The key ‘structural’ development in the February employment report was the sharp recovery in the participation rate, which means that people out of the labour force are finally coming back.– In particular, the participation rate for men aged 25-54 rose to 89.3%, the highest level since June 2010.– The labour-force participation rate rose to 63% in February, from 62.7% in January. |
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> Fed policy

- The Federal Reserve had been less ‘carried away’ than many market participants by January’s high wage print of 2.9% y-o-y. By the same token, it is unlikely to be particularly disappointed by the downward revision in the January number (to 2.8%) and the slow February print of 2.6% y-o-y.
- What is key from a Fed perspective is the non-farm payroll headline print of 313,000 and the solid 3-month average, which confirms that the US economy’s momentum remains solid. This may validate the Fed’s view that it should maintain the current pace of rate hikes (one hike per quarter).
- The fact that underlying growth is strong, combined with December’s tax cuts, could actually make the Fed more prone to move its 2018 median dot upwards to indicate expectations for four rate hikes from three.
- We ourselves continue to expect four rate hikes this year and two in 2019.

Source: Pictet WM-AA&MR, BLS

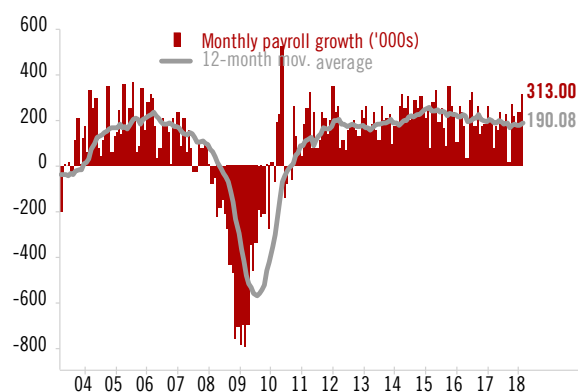
Chart 2: The unemployment rate remains low, 4.1% in February



Source: Pictet WM – AA&MR, BLS

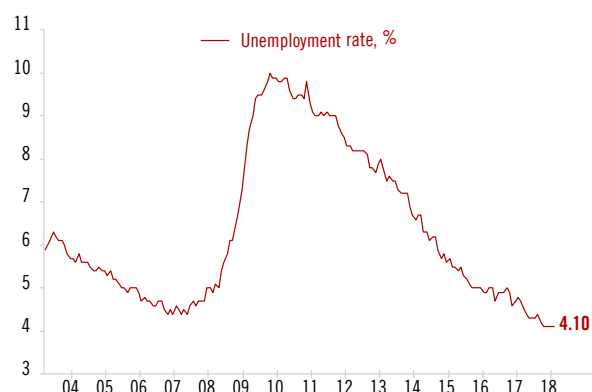
US labour market dashboard – as of February 2018

Payroll growth (and 12-month average), '000s/month



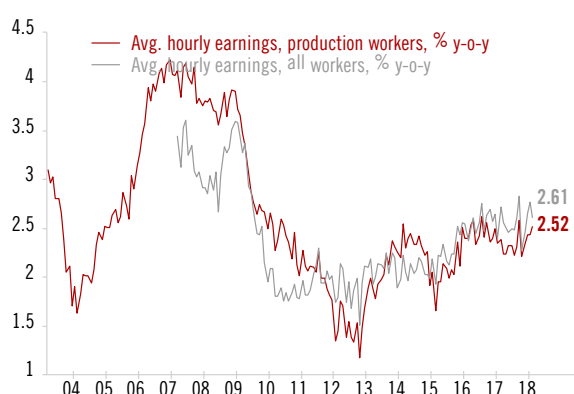
Source: Pictet WM – AA&MR, Factset

Unemployment rate, %



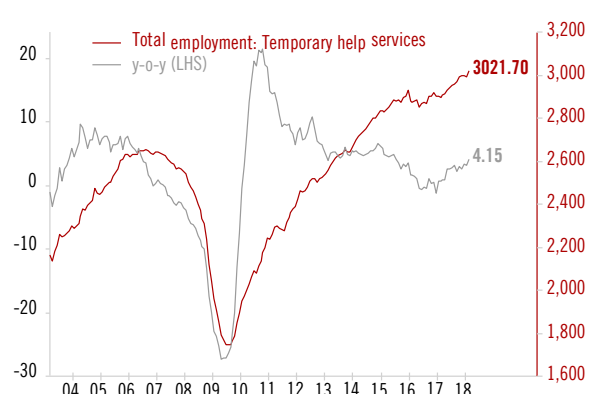
Source: Pictet WM – AA&MR, Factset

Average hourly earnings, % y-o-y



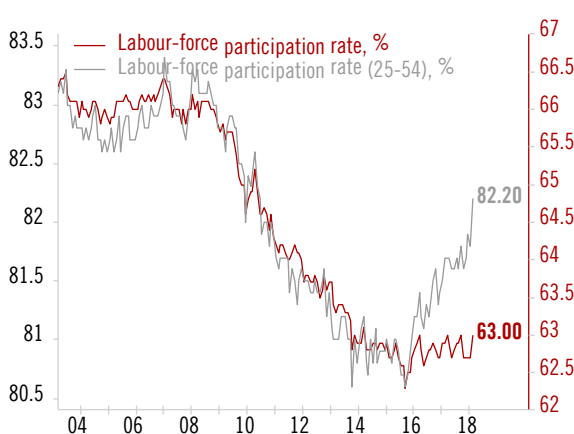
Source: Pictet WM – AA&MR, Factset

Temporary help services jobs ('000s), and y-o-y gain



Source: Pictet WM – AA&MR, Factset

Labour-force participation rate, %



Source: Pictet WM – AA&MR, Factset

People not in the labour force, but want a job ('000s)



Source: Pictet WM – AA&MR, Factset

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