PICTET WEALTH MANAGEMENT
ASSET ALLOCATION & MACRO RESEARCH
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US FEBRUARY EMPLOYMENT UPDATE

LET'S NOT OVERPLAY THE MONTHLY WEAKNESS, BUT LET'S KEEP AN EYE ON THE CLOCK

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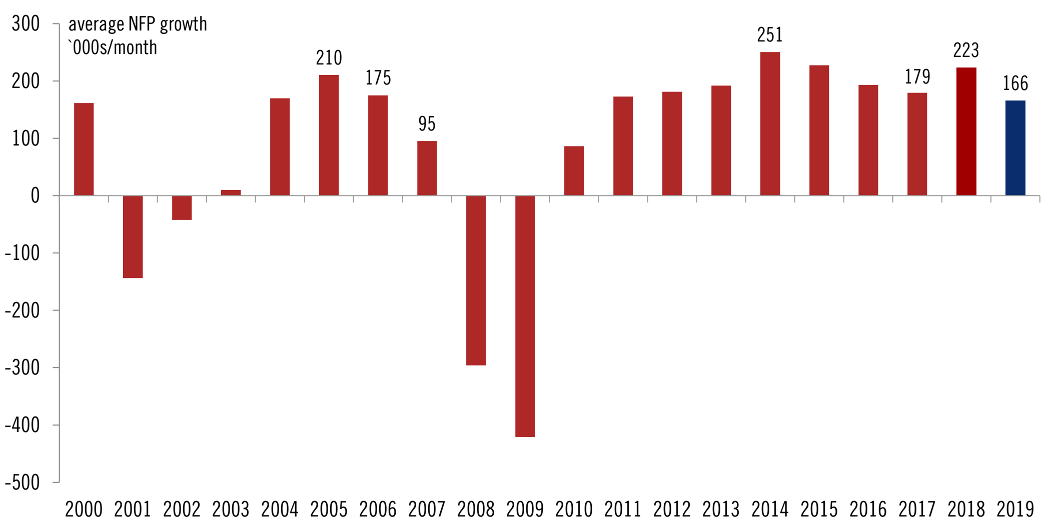
SUMMARY

- The February employment report was weak, with only 20,000 jobs added. That said, the three-month average remained robust at 186,000, and we would tend to dismiss this weak print as just a 'blip'.
- Furthermore, the weak reading is inconsistent with other labour market data, including from recent consumer and business surveys.
- Some details in the report reinforce the view that it is still too early to believe it signals a sharp cyclical turning-point in the economy. Employment in temporary help services was up on the month (+6,000) and up 2.2% y-o-y. This is an important positive bellwether, in our view.
- Wage growth was stronger than expected, at 3.4% y-o-y. From a medium-term business cycle perspective, this can be viewed as an 'amber light': it shows the US business cycle gradually entering a 'late cycle' phase, with higher recession risks. But we would still tend to play these down in the very near term.
- We still think there are several solid factors underpinning growth in the near term, including vibrancy in the domestic energy sector, as well as the ongoing, economy-wide technological upgrade
- From a Federal Reserve perspective, this report is likely to play into Fed doves' hand of more caution being warranted in the near term, as US data are muddy and global growth continues to be uneven (especially in China and Europe). The Fed is likely to ignore the uptick in wage growth, as it no longer believes in the Phillips curve linking the labour market to the inflation picture.
- We still expect a rate hike later this year, though the risk remains geared to the downside, especially as it will hinge on developments in China and Europe. The ECB's dovish shift in stance could heighten downside risks to our Fed scenario.

CHART 1: FEBRUARY PRINT PUTS JAN-FEB 2019 AVERAGE AT 166,000, WHICH IS STILL HEALTHY



Source: PWM - AA&MR, Bureau of Labor Statistics (BLS), 8 March 2019

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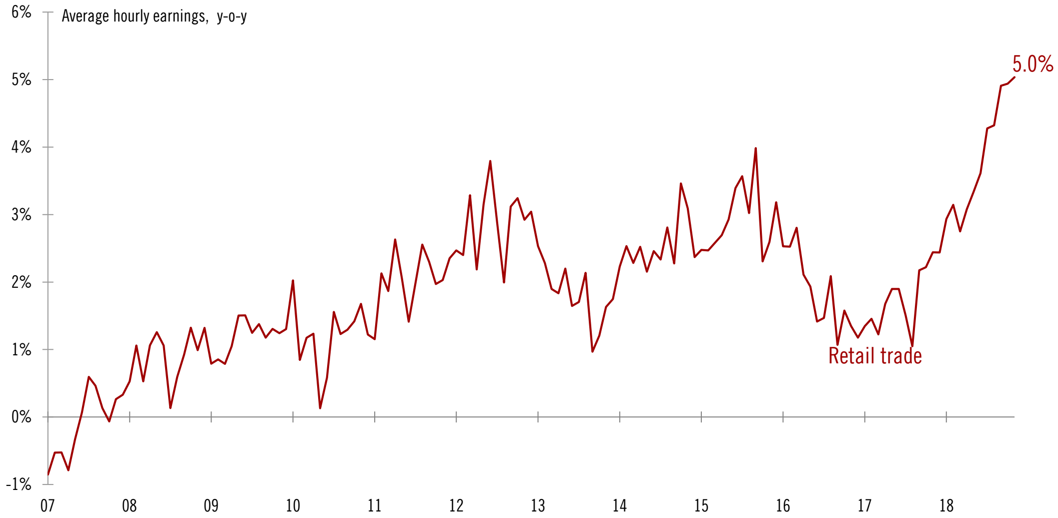
Wage growth is on the rise – That's not necessarily good news

Rather than the weak headline readout, we regard the solid wage (as measured by average hourly earnings) gain of 0.4% m-o-m (3.4% y-o-y) as a key highlight in this February employment report. Wage growth for production workers came in at 3.5% y-o-y. There was a particularly strong spike in the retail sector, with wage gains of 5.0% y-o-y, the fastest rate since the series began in 2006 (see *Chart 2*).

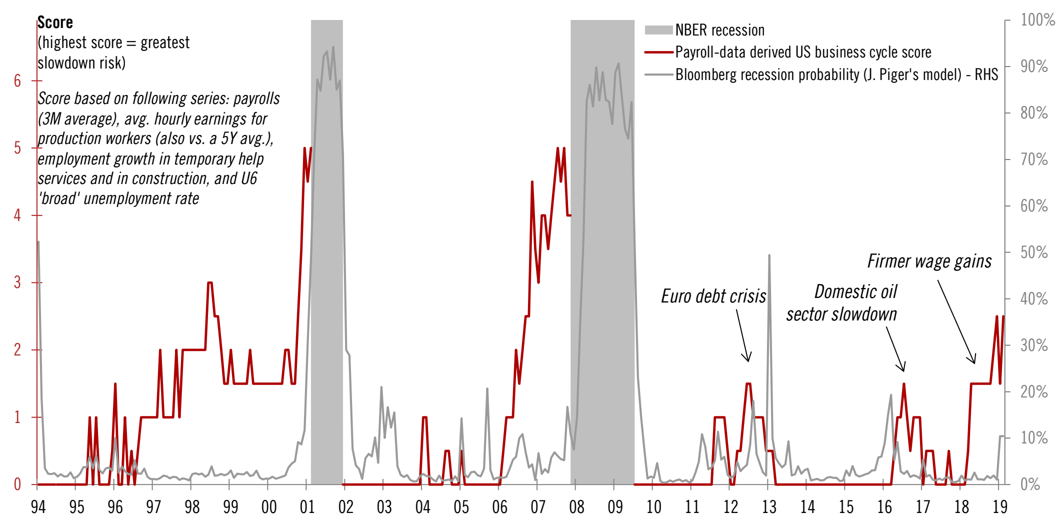
CHART 2: THE RETAIL SECTOR IS SEEING PARTICULARLY SHARP WAGE GAINS



Source: Pictet WM-AA&MR, BLS, 8 March 2019.

This stronger wage gain constitutes a negative in terms of medium-term recession risks, although we do not think that current levels are 'recessionary' yet. Still, our updated 'recession score' has crept higher in the wake of the February wage print (see *Chart 3*)

CHART 3: OUR RECESSION SCORE INDEX IS ON THE RISE GIVEN THE UPTICK IN WAGE GROWTH



Source: Pictet WM-AA&MR, 8 March 2019.

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There are a few mitigating factors to be taken into consideration before adopting a gloomier view. First, we do not think the labour market has reached full capacity; in other words, we do not think it is 'running out of workers' yet. We particularly take our cue from the 'people not in the labour force, but still wanting a job' series, which now stands 507,000 (people) above its pre-crisis level. We still therefore discern some slack existing there.

We do not think a cyclical downturn in the economy is imminent either. Firstly, many series, such as job openings, continue to point towards further strong job gains. Secondly, we can detect some positive signs within the report itself, such as ongoing gains in jobs for temporary help services (a bellwether for further job gains, in our view). Job growth in this sector was 2.2% y-o-y in February, whereas, if it slowed to 0%, it would be entering a 'danger zone'. We are not there yet.

Cyclical sectors in manufacturing and construction deserve closer scrutiny when it comes to validating or invalidating whether there is any turning-point or not. Three-month averages in construction and manufacturing were +13,000 and +15,000, respectively. Though both were below respective one-year averages (+19,000 and +20,000, respectively), we still cannot conclude there is a marked cyclical slowdown.

The bottom line is that weakness in the February print should not be overplayed, but, at the same time, it is worth keeping a watchful eye on the US business-cycle clock. Further wage gains in coming months could mean that the business cycle is gradually flagging, and it would confirm the view that it is moving into a late-cycle stage. We would, however, qualify that statement by pointing out that a late cycle can still take several months to unfold, and a recession would still not automatically be lurking around the corner. The Federal Reserve, in particular, has accentuated its dovishness of late, particularly to make sure the business cycle can continue. Moreover, it could be prepared to cancel the planned rate hike later this year if there were any more signs of underlying erosion. It will be particularly vigilant about 'imported headwinds' should the global economy continue to weaken.

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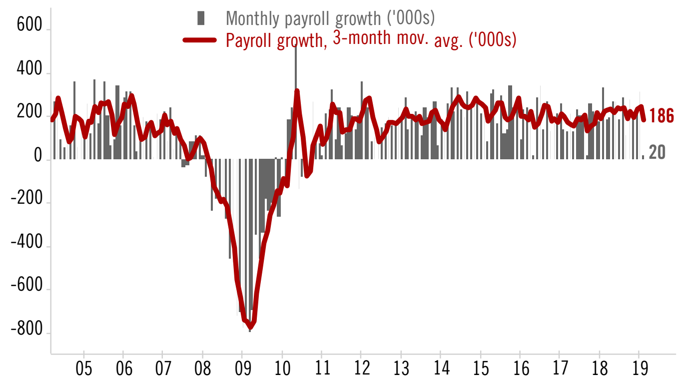
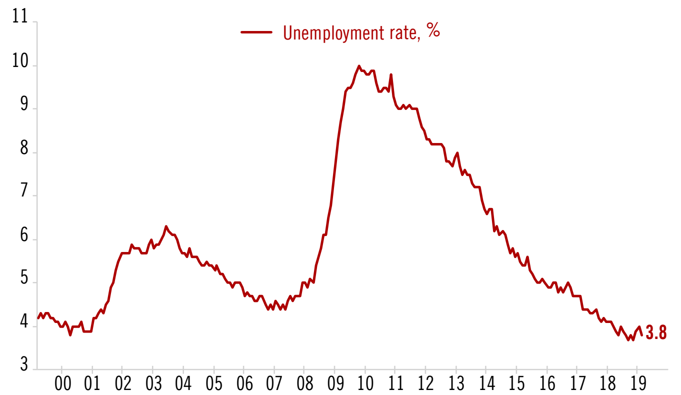
MONTHLY PAYROLL GROWTH AND 3-MONTH AVERAGE, '000S



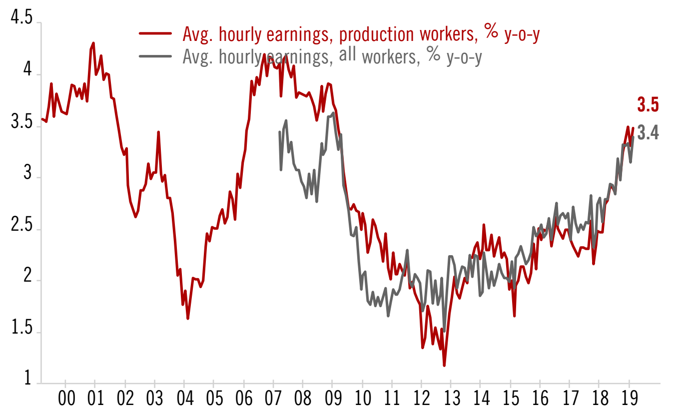
Source: PWM - AA&MR, Factset

UNEMPLOYMENT RATE, %



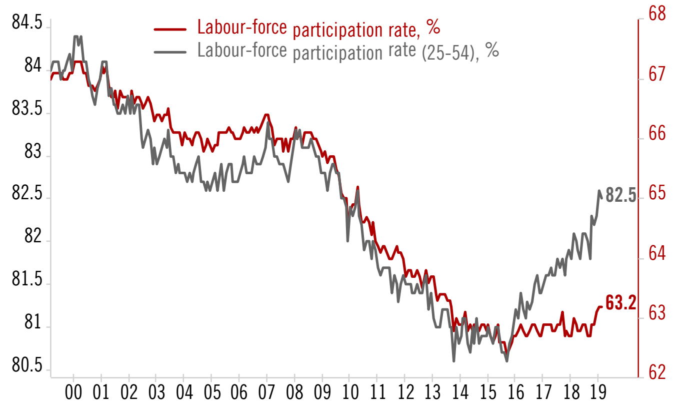
Source: PWM - AA&MR, Factset

AVERAGE HOURLY EARNINGS (WAGE GROWTH), % Y-O-Y



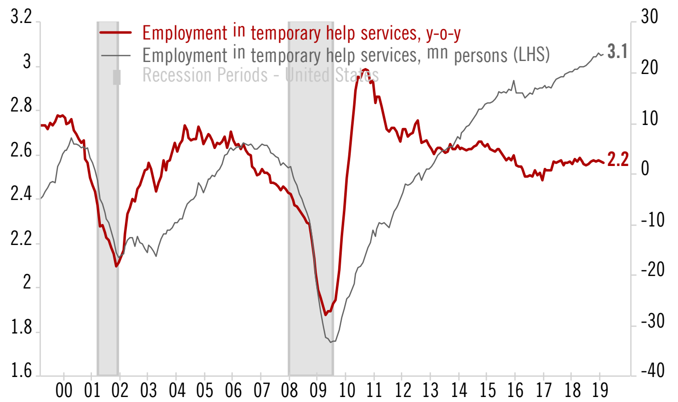
Source: PWM - AA&MR, Factset

LABOUR FORCE PARTICIPATION RATE, % (AND FOR 25-54 SEGMENT)



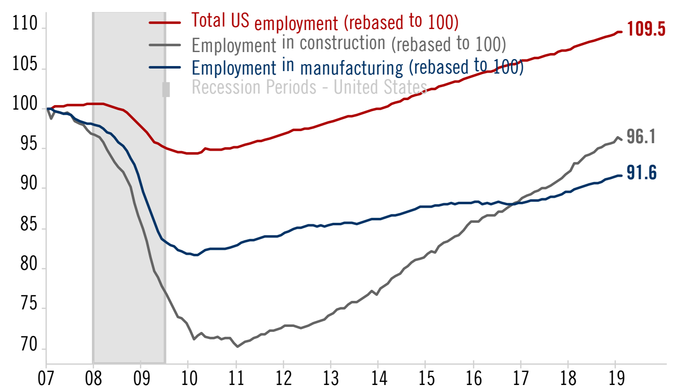
Source: PWM - AA&MR, Factset

TEMPORARY HELP SERVICES, MILLION (AND YOY)



Source: PWM - AA&MR, Factset

EMPLOYMENT IN MANUFACTURING AND CONSTRUCTION (BASE 100 IN 2007)



Source: PWM - AA&MR, Factset

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