US jobs growth boost case for Fed action

The US labour market continues to tighten with unemployment now firmly blow 4%. Given strong hiring intentions, this will keep upward pressure on pay with the Federal Reserve set to respond with higher interest rates despite uncertainty created by Russia's assault on Ukraine

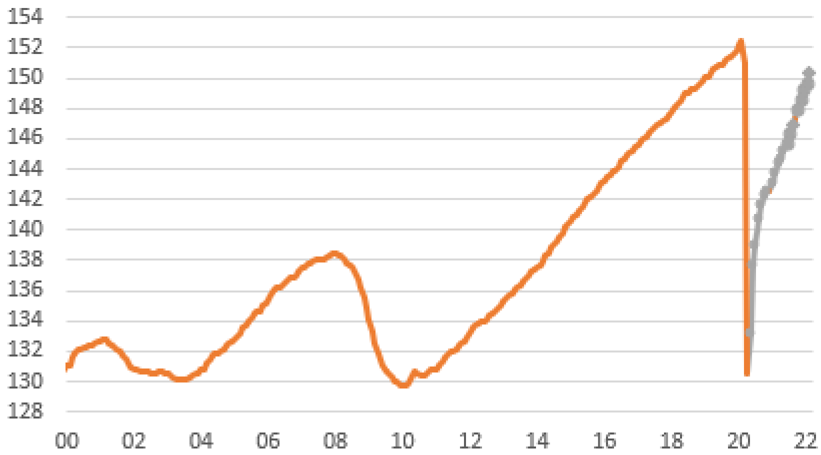
Source: iStockphoto

Yet another upside surprise on jobs

The February jobs report includes another set of very good numbers with non-farm payrolls rising 678,000 versus 423,000 expectations. There were a further net 92,000 upward revisions to December and January, which means employment is now only down 2.105m on the February 2020 peak.

We are pleasantly surprised given the weakness in the ISM employment surveys – the services index actually showed a contraction, while the National Federation of Independent Business (NFIB) had reported slower hiring last month. The Federal Reserve Beige Book had suggested that while there was widespread demand for staff, hiring was “hampered by equally widespread reports of worker scarcity” while “many firms had difficulty maintaining their staffing levels due to high turnover”. Today’s report therefore contradicts much of the other labour data we have seen this week.

US non-farm payrolls level (m)



Source: Macrobond, ING

Don't worry about average hourly earnings, pay is going up

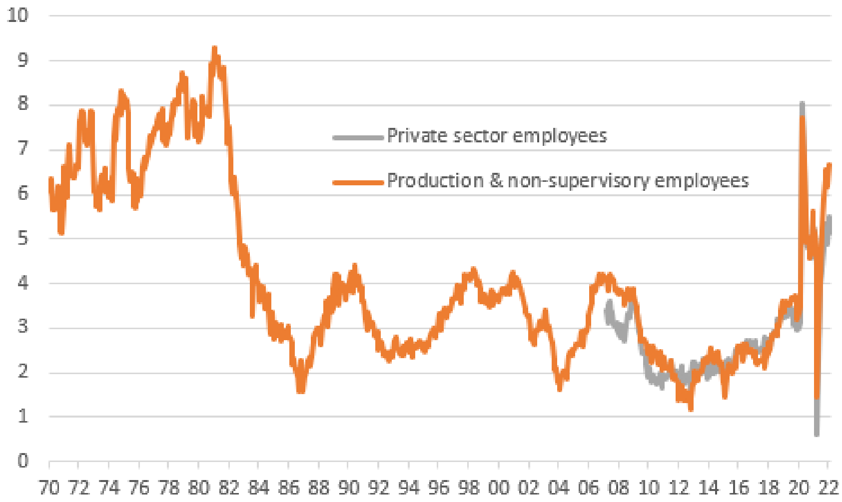
Markets may be a little surprised by the weakness in the wage growth number, coming in flat on the month (consensus 0.5% month-on-month) with the year-on-year rate slowing to 5.1% from 5.5%. After all, the NFIB survey shows considerable pay pressure while the Beige Book stated “firms continued to increase compensation and introduce workplace flexibility to attract workers… with mixed success”.

We suspect the reason for the softness in average hourly earnings is due to how it is measured. They simply divide the total wage bill per hour by the number of employees to get "average" hourly earnings. The jobs gains were led by 179k for leisure & hospitality, 112k in education & health, 48k in transportation & warehousing and 60k in construction, so if you hire hundreds of thousands of people on the lower end of the income distribution this automatically drags down the "average" wage.

Consequently there are times when average hourly earnings can actually fall despite wages going higher for every individual. Essentially it isn't "mix adjusted", hence why the employment cost index is the gold standard to measure labour costs.

The chart below shows average hourly earnings growth and the spike above 8% YoY in early 2020 is attributed to this factor – lower earning workers were the ones who lost their job and with their income no longer included, the “average” automatically jumped higher.

Average hourly earnings are distorted by employment mix

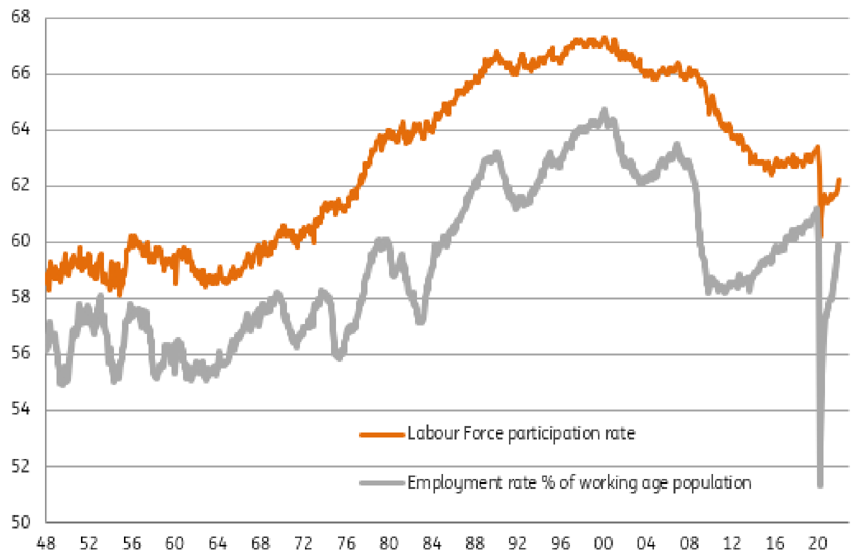


Source: Macrobond, ING

Employment ratio is grinding higher, but still some way to go

Looking at the household survey (used to calculate the unemployment rate), it showed employment rising 548k with the participation rate rising to 62.3% and the proportion of people of working age in employment rising to 59.9%. To put this in context the employment ratio was 61.2% in February 2020 and peaked at 64.3% in December 1999. While there are half a million more men now in the civilian labour force than in February 2020, there are 1.2m fewer women.

Employment ratio and labour participation rates



Source: Macrobond, ING

More ammunition for the Fed hawks

Overall, the report underscores the strength of the domestic economy with employment rising and overall household income rising even more quickly due to increasing pay rates. It will reinforce the view that the Fed can hike 25bp in March despite the concerns caused by Russia's assault on Ukraine. With next week's CPI report set to show CPI running at or very close to 8% – the fastest rate since January 1981 – we would expect the March updated Fed dot plot of individual forecasts to move much closer to the market assessment that the Fed funds rate will be raised six time this year.

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