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Article

Are markets in for another reality check on US wages?

What to expect from Friday's US jobs report

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Wage growth

To say markets were caught off-guard by last month's jobs report is quite an understatement. A combination of a strong month-on-month increase and positive backward revisions saw the headline rate of wage growth jump from 2.5% (later revised to 2.7%) to 2.9% in January. This surprise has been widely cited as being at least one of the catalysts behind last month's market turmoil.

Having been the missing link in the otherwise strong economic growth story, the evidence increasingly suggests wage pressures are building. It's now taking firms an average of 28 days to fill vacancies - almost double the time taken during the depths of the crisis - whilst there is now barely one unemployed person for every job opening created (compared to around six back in 2008). And that, in turn, appears to be putting pressure on firms to lift pay more rapidly to attract talent. The latest survey of small businesses by the National Federation of Independent Business showed the highest net proportion of firms planning to raise compensation since 1989.

This is one reason why we think there is a risk of another above-consensus wage growth figure today (albeit a repeat of last month's market reaction looks rather less likely). That said, we suspect the usual calendar quirk will play a role in this too. There were three fewer workdays in February compared to January (so fewer hours worked), which oddly enough, often results in an artificially higher month-on-month wage growth figure.

2.9% Average hourly earnings growth (YoY%)
(ING forecast)

Jobs growth (Payrolls)

The labour market defied the cold snap at the start of 2018 and posted a respectable 200,000 jobs increase in January. We suspect we'll see a more moderate rate of growth this time, more in-line with the underlying trend of 170-180k. That was certainly the message from the latest ISM non-manufacturing survey, which pointed to a fairly sharp slowdown in hiring during February - although we'd note that, as a directional indicator for month-to-month moves in payrolls, the ISM indices aren't usually particularly helpful.

Whatever happens, a slower pace of jobs growth should not necessarily be seen as a concern. The Fed has noted in the past that the rate of employment growth can be expected to slow as the economy converges on full employment - particularly if firms are increasingly finding it harder and more time-consuming to source talent.

180k Change in non-farm payrolls ('000s)
(ING forecast)

Unemployment rate

According to the household survey, January saw a surge of workers entering the labour force, 80% of whom found employment straight away. That very nearly saw a "good rise" in the unemployment rate, but ultimately it stayed at 4.1% by the skin of its teeth.

Predicting what happens next is always a bit tricky given how choppy the data often is. But should we see a fairly sizable drop in unemployment as more workers secure jobs, we could potentially see the overall unemployment rate dip to 4% - which would be a new post-crisis low.

4.0% Unemployment rate
(ING forecast)

What this means for interest rates

We suspect it would take a very substantial negative surprise on wage growth today to make policymakers think twice about hiking rates later this month. In fact, if we do get another decent reading, it would give the Fed more confidence that the past year's inflation dip was indeed 'transitory'.

This should be backed up by the next few inflation reports, too: core CPI looks set to hit 2% in March (released in April) as a quirk in mobile data pricing drops out, and should subsequently receive further impetus from the weaker dollar and rising housing & medical costs.

This is a key reason why we now expect the Fed to hike four times this year (including at the next meeting), more than is currently pencilled into the FOMC "dot diagram".

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