Better wage data won't change the market's view on Fed hikes

A strong rebound in wage growth in Friday's jobs report won't be enough to convince markets of the Fed's hike plans.

Rebound in wages won't make markets any less sceptical about the Fed

When it comes to the US jobs report, gone are the days where big swings in non-farm payrolls can make big differences to Fed policy perceptions. Instead, we think a strong rebound in wage growth will be the key thing to look for. But after several months of sluggishness, it's going to take a lot to make markets any more convinced about the Fed's fairly ambitious plan to hike once more this year and three times in 2018.

We continue to expect both wage growth and core inflation (which has also had a disappointing few months) to recover over the next couple of quarters. But that's going to take time and that means the market's scepticism is unlikely to dissipate anytime soon.

Fed funds futures are barely pricing one hike by the end of next year. We think that's a bit low and instead, we expect the next hike in December - but with some Fed voters becoming increasingly concerned about inflation, four hikes in 18 months equally looks like a stretch.

Here's what we expect from the key numbers in Friday's report...

Wage growth

Pay growth has been surprisingly lacklustre since the start of the year. The 3 month annualised rate of growth current sits at just 1.8%. That's much lower than the 2016 average of 2.7%.

This slowdown is hard to square against the strength in the broader jobs market. Job-to-job flows, typically a sign that firms are struggling to retain talent, remain at multi-year highs. One explanation is that the dip is purely a statistical thing. An alternative Atlanta Fed measure (which is based on the same data) suggests pay is actually rising much faster.

Either way, we continue to expect wage growth to gradually accelerate as the jobs market continues to tighten. But that's going to take time - we think it is very unlikely that wage growth will top 3% this year.

The 3M annualised rate of growth can be a better measure of the current pace of pay rises than year-on-year comparisons

2.5% Average hourly earnings growth (YoY%)

(Consensus 2.5%)

Jobs growth

After a strong 222-thousand reading in June, we're likely to see a correction closer to the underlying trend in July. Importantly, as the economy closes in on full employment (if it isn't there already), you'd expect jobs growth to slow. It would now take a series of very poor (sub-100k) readings to make policymakers worried.

170k Change in non-farm payrolls

(Consensus 180k)

Unemployment rate

June's data saw a small "good" rise in the unemployment rate as 400,000 people entered the work force, with around two thirds finding a job. We expect the unemployment rate to fall back to 4.3% this week. But even a rise this time has to be taken in the context of the remarkable drop in the rate that we've seen since the start of 2017.

4.3% Unemployment rate

(Consensus 4.3%)

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