US jobs report 'good enough'

Friday's US jobs report appears to be good enough to keep the Fed on a gradual policy tightening path

Waiting and hoping...

Strong jobs growth should eventually translate into higher wages, but it is taking time to do so. The Fed remains confident it will come, suggesting gradual hikes will continue, but the market continues to have doubts. The US jobs report for June has shown the economy created 222 thousand jobs last month, which was 44 thousand more than expected, while there were a net 47,000 revisions upwards to the history.

'We forecast one more rate hike this year.'

The unemployment rate has ticked a little higher to 4.3%, but this isn't a material issue since it chops and changes quite a lot and was up at 4.8% in January. Iin any case we saw a big increase in people entering the labour force last month and the overwhelming majority found work.

Furthermore, the underemployment (U6) number at 8.6% versus 9.4% in January underlines the improvements in the health of the labour market seen in the first six months of 2017.

Wage growth still not strong

The main disappointment relates to wage growth, which is just 2.5%YoY. There were some downward revisions to the history so it represents an improvement from 2.4%YoY growth in May. Taking it all together this report is good enough to keep the Federal Reserve on the path of gradually tightening monetary policy.

In any case, the Fed has repeatedly used the term “transitory” to describe the slowdown in activity and subdued inflation backdrop and believe that it is only a matter of time before the tightness in the labour market translates into rising wage pressures. We agree.

We expect 2Q GDP to rebound back above 3% annualised growth while rising commodity prices and dollar weakness should further boost inflation later this year. With wage growth also likely to gradually pick up we forecast one more rate hike this year (most likely September) with a further two next year, in addition to the Fed’s plans to shrink its balance sheet.

What to expect from Yellen

Attention now switches to Fed Chair Janet Yellen’s testimony to Congress next week. We don’t expect her to drastically change the narrative regarding the outlook for monetary policy. Federal Reserve officials at the June FOMC meeting signalled that they expect to raise interest rates by 25bp on four occasions over the next eighteen months.

However, she may well seek to narrow the gap between the Fed’s assessment on the policy outlook (100bp of hikes by end 2018) and what the market is currently anticipating (45bp).

We will be looking for any expansion of her comments regarding “somewhat rich” asset price valuations and those of William Dudley that loose financial conditions can provide “additional impetus” for rate hikes. In addition comments on the timing of the balance sheet reduction programme will be of major interest – we expect that to start in 4Q17.

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