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ECONOMIC TALKING POINTS

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A Great Jobs Report to End the Year. So Why Is Pay Still So Anemic?

Chart 1. Unemployment rate, seasonally adjusted, December 2013 – December 2015

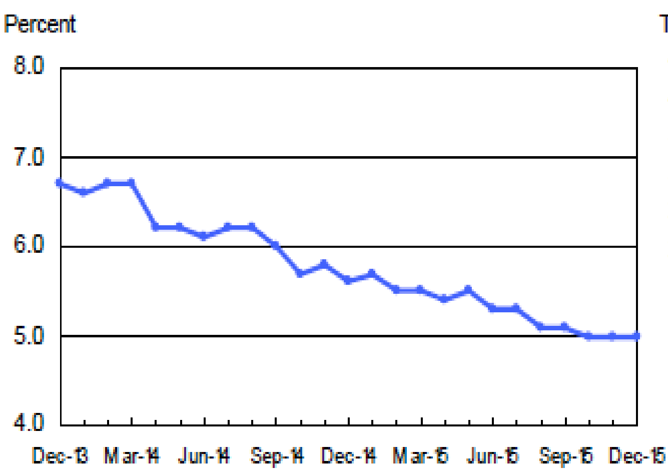
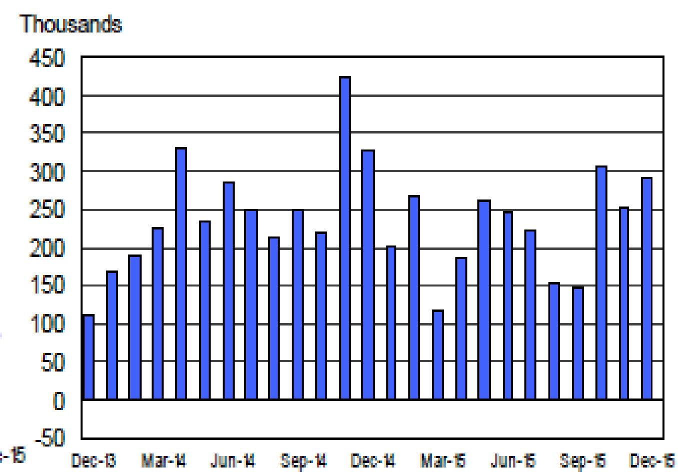


Chart 2. Nonfarm payroll employment over-the-month change, seasonally adjusted, December 2013 – December 2015



Two key themes emerged from December's employment report. First, the strong job numbers illustrate once again why the U.S. remains the bright star in an otherwise dull and troubled global economy. Little wonder this country continues to attract so much foreign capital.

Second, there remains the persistent paradox of an economy that is able to produce a robust job market --- yet still unable of generating the kind of pay increases one would expect under such circumstances. And given the important linkages between wages and consumer spending, we need to drill down and better understand what is going on here. Are we way overestimating job growth, or does the data on average hourly earnings have some shortcomings?

Let's begin with the gains in employment simply because it has more statistical integrity. The establishment survey, which is based solely on responses from employers, shows total payrolls leaped by 292,000 in December --- and it follows hefty upward revisions in November and October. This has lifted the average gain in payroll in the final quarter to 284,000 a month, the fastest pace all year.

And if someone argues that a major factor behind this improvement was a surge in government hiring, well, they would quickly be proven wrong. The private sector added a monthly average of 276,000 new employees in the last quarter, also the best of the year.

In the separate survey, where households are queried about the job status, we find the number of Americans employed in December jumped by 485,000 last month, bringing the quarterly average to 329,000, again the best figure of the year.

Even the labor force participation rate improved last month, reaching to 62.6, highest since August. **A cousin of that metric, the portion of the population that is employed (known as the employment-population ratio), jumped to 59.5%, the largest percentage in more than six years!**

But let's not stop here. Virtually every other major barometer on the job market showed healthy demand for labor.

• The number of part time workers unable to find full time employment has fallen steadily last year and dropped to 6.0 million last month, down from 6.8 million in January. **It's now the second lowest level since pre-recession.**

• Moreover, the percentage of Americans who voluntarily left their job to seek a more lucrative post jumped to 10.3% of the unemployed in December, the highest in more than seven years! Keep in mind the data on "job leavers" is one Janet Yellen and her colleagues at the Fed watch closely because it shows workers are sufficiently confident to walk away from one secure position and search for another.

• Because of the resilience in the labor market, those jobless are of work for a shorter period of time**. The median duration of being unemployed fell to 10.5 weeks in December, the shortest since December 2008.** (As a reference point, this indicator stood at 13.4 weeks at the start of the 2015 – and was as high as 25.2 weeks in June 2010, when the economy was, by definition, already in recovery).

• With such strong employment gains, you might have expected December's unemployment rate to dip below 5%. But it didn't and for good reason. Encouraged by the improvement in job opportunities, 466,000 Americans jumped back into the work force either locking up a new job or actively seeking one. That was the biggest surge since January.

• In terms of specific industry hires, several sectors stood out because of their implications for 2016.

An acceleration in residential and commercial building activity increased construction employment by 263,000 in 2015, and it shows no sign of slackening. Construction hiring in the fourth quarter turned out to be the strongest since pre-recession (1Q 2006). This is good news for the housing recovery in 2016, especially given the low level of inventory out there. And if history is any guide, as housing picks up, so goes commercial real estate activity with a slight lag.

Similarly, the hospitality and leisure sectors took on more than 400,000 new employees last year, with the largest number of new hires coming in the final three months of the year. It's indicative of the fact that travel and leisure is growing much faster than the rest of the economy, a trend we expect will continue throughout this year.

Now for the puzzler: With such hugely good news on the jobs front, why has pay barely moved?

Look, first of all, average hourly earnings has in fact been creeping up during the year, to 2.5% annually in December. True, it doesn't merit opening up Champaign bottles, but it is still a distinct improvement over 2014, when AHE increased just 1.8%.

Secondly, when discussing pay, it's also important to contrast it with inflation. Headline CPI has been rising at a 0.5% rate, which means the real average hourly even at a nominal pace of 2.5%, brings in real earnings of 2%. In other words, purchasing power is increasing. Not by much, but it's on the rise.

Frankly, we have tended to downplay the value of average hourly earnings because this metric does have some limitations as a measure of wage growth. Average hourly earnings are computed based on responses from 140,000 establishments who provide information on total pay, which then gets divided by hours worked. We much prefer the pay data from the Bureau of Economic Analysis, which publishes the monthly report "Personal Income and Spending." While the BEA does use average hourly earnings from the BLS uses this data from the BLS, it also takes into account several other factors, such as the size of the working population. The result is a more comprehensive measure with the BEA's latest read that wages and salaries jumped 4.5% year-over-year

Interestingly, the BLS does release a much broader, but terribly dated report on wage growth every quarter known as the Quarterly Census on Employment and Wages. It noted that wages and salaries in the latest quarter (IIQ 2015) actually rose at a 5.8% rate!

Finally, more and more employers have also chosen to boost compensation in ways other than straight pay. These companies may prefer to increase benefits since it is less of a burden on cash flow. For example, to preserve capital, a firm may grant an employee an extra week of vacation, pay for child care services, or subsidize a gym membership rather than commit to a hefty salary increase. Even unions these days are more focused on protecting their member's health care and pension benefits, rather than demanding big wages increases.

They key point here is that while average hourly earnings has become a politically sensitive indicator, it should not be viewed as the defining one on pay increases.

Having said that, we still expect to see average hourly earnings accelerate this year. The slack in the labor market is nearly gone and the competition to find suitable workers will invariably drive up wage inflation. Our forecast calls for the BLS's average hourly earnings to rise 3.2% in 2016, and 6.4% for wages and salaries as computed by the BEA. Household income will thus be increasing faster than inflation and allow consumers to enjoy even more purchasing power this year. That should translate into stronger consumer spending, faster economic growth, and sets the stage for more significant hiring ahead.

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Key Economic Forecasts

- Actual
- Forecast

United States

	I 2015	II 2015	III 2015	IV 2015	I 2016	II 2016	III 2016	IV 2016	I 2017	II 2017	III 2017	IV 2017
Real Gross Domestic Product (GDP):												
%	0.6	3.9	2.0	2.4	2.6	3.2	3.1	2.7	2.2	3.2	3.1	2.8
Personal Consumption Expenditures:												
PCE	1.8	3.6	3.0	2.9	2.5	3.5	3.2	2.9	2.8	3.2	3.0	2.8
Inflation, end of period, year-over-year:												
CPI %	-0.1	0.1	0.0	0.6	0.8	1.2	1.5	1.6	1.6	1.9	2.2	2.3
Unemployment Rate (end of period):												
%	5.5	5.3	5.1	5.0	4.9	5.0	5.0	4.8	4.9	4.8	4.9	4.9
Non-farm Payrolls, monthly avg. thousand:												
	195	231	174	284	235	245	250	250	225	240	220	210
Treasury 10-yr Note Yield % (end of period)												
	1.93	2.38	2.06	2.27	2.50	2.65	2.88	3.10	3.10	3.10	3.15	3.30
Federal funds rate % (end of period)												
	0.13	0.13	0.13	0.38	0.63	0.63	0.63	0.88	1.13	1.38	1.63	1.88

GDP Growth - Global Economy

Country	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
US	1.8	-0.3	-2.8	2.5	1.6	2.2	1.5	2.4	2.5	2.8	3.0
Eurozone	2.6	0.6	-4.1	1.7	1.4	-0.6	-0.4	0.9	1.3	1.6	1.8
United Kingdom	3.1	0.6	-5.2	1.7	0.7	0.3	1.8	3.0	2.3	2.5	2.6
Japan	2.1	-0.7	-5.4	4.6	-0.4	1.6	1.5	-0.1	0.6	1.0	0.6
Canada	2.7	0.7	-2.8	3.2	2.5	1.7	2.0	2.4	1.1	1.8	2.1
India	9.1	8.8	6.3	8.4	8.6	6.7	4.9	7.4	7.3	7.5	7.8
China	14.2	9.6	9.2	10.5	9.5	7.8	7.7	7.3	6.7	6.5	6.5
Brazil	5.7	5.1	-0.3	7.5	2.7	0.9	2.3	0.1	-3.5	-1.8	1.1
Mexico	3.3	1.4	-4.7	5.2	4.0	3.9	1.4	2.1	2.3	2.4	2.8
Australia	4.0	2.3	1.2	2.8	2.6	3.6	2.4	2.7	2.3	2.8	3.2
Russia	8.1	5.6	-7.9	4.0	4.3	3.4	1.3	0.6	-3.6	-1.0	0.3
World	5.4	1.6	-1.9	4.2	3.0	2.6	2.9	3.0	2.8	3.1	3.7

Key Currency Values

	End 2008	End 2009	End 2010	End 2011	End 2012	End 2013	End 2014	End 2015	End 2016	End 2017
USD/Yen	91	93	81	77	87	105	119	120	121	130
Euro/USD	1.40	1.43	1.34	1.29	1.32	1.37	1.21	1.09	1.11	1.18

Oil (Brent spot) & Gasoline (Average retail unleaded, $)

	End 2008	End 2009	End 2010	End 2011	End 2012	End 2013	End 2014	End 2015	End 2016	End 2017
Crude oil per barrel	46	78	95	107	111	111	58	38	53	67
Gasoline	1.61	2.57	3.00	3.27	3.30	3.32	2.26	2.00	2.28	2.55

Major Stock Indexes

	End 2013	End 2014	End 2015	% Change '15	End 2016	% Change '16
DJIA	16,577	17,823	17,425	-2.2	19,875	14.1
S&P 500	1,848	2,059	2,044	-0.7	2,277	11.4
NASDAQ	4,177	4,736	5,007	5.7	5,435	8.5
RUSSELL 2000	1,164	1,205	1,136	-5.7	1,249	9.9