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ECONOMIC TALKING POINTS

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The Job Market Recovered in April --- But Not Wages and That Poses a Rising Threat to Future Growth

April's strong bounce back in jobs (211,000) confirms that employers are still actively hiring and that March's disappointing payroll numbers (79,000) were mostly weather-related. That's good news since it reinforces the view the economy remains in fundamentally sound shape.

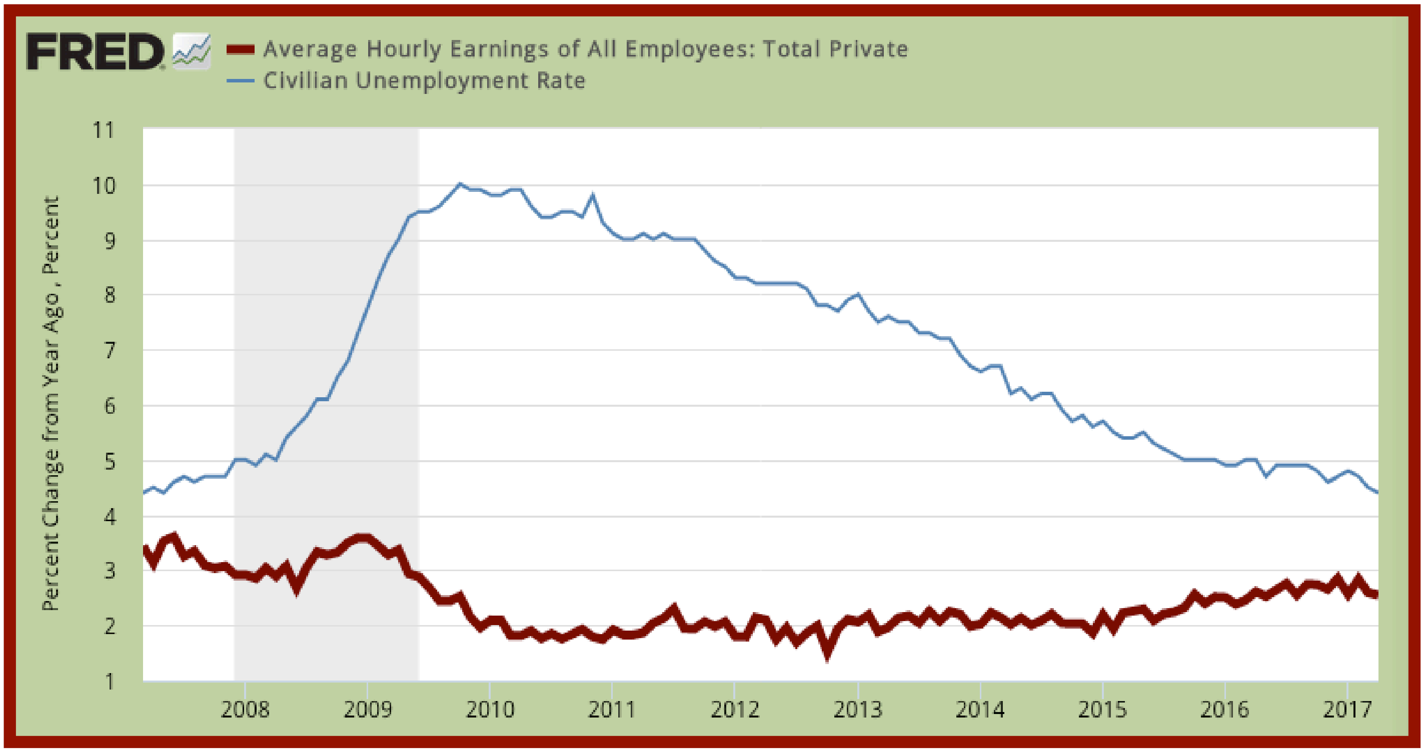
But before you breath a sigh of relief, there is one glaring factoid about this jobs report that has potentially ominous implications for future economic growth.

Look at the feeble annual increase in average hourly earnings last month – up just 2.5%. That was down from 2.8% just two months earlier! But here's what's truly disturbing. When the jobless rate stood at 10% in 2009, employers saw so much slack in the labor market, they felt no compunction to boost hourly pay to attract workers. The result: average hourly earnings back then rose at the exact same modest 2.5% a year.

How could it be that with the unemployment rate tumbling from a high of 10% to just 4.4% last month --- the lowest in a decade ---that wage growth remains so sluggish.

Let me make an even stronger case of how unusual this is.

Here we are, well into our 8th year of this business cycle, with a decade low jobless, the more broadly defined underemployment measure dropping to a level we last saw in November 2007 (to 8.6%), and with companies now scrambling to fill 5.57 million job openings in the US. Yet for some reason the annual increase in pay now is identical to when the joblessness stood at double-digits?



This key metric on earnings is just not behaving with our understanding of how economies are supposed to work. When there is a scarcity of labor, you would expect wage pressures to build. However, that doesn't seem to be happening this time. Why is this so? And what does this mean?

This isn't merely some academic issue. The lack of pay increases can affect consumer spending. Remember, we saw actual declines in retail sales in both February and March. Indeed, real personal consumption in Q1 grew at paltry 0.3% rate, the smallest increase since Q4 2009.

So, yes, there will no doubt be a sigh of relief that payrolls recovered last month by adding another 211,000, nearly three times that of March. And certainly Federal Reserve officials are happy achieving their two goals--- full employment and getting inflation closer to their 2% target. You can also bet the Trump Administration will crow endlessly about how strong job creation has been since they were in charge.

But given the crucial role consumers play in the economy, the lack of wage growth at a time when prices are inching higher has to be disconcerting at this stage. This is especially the case since the proportion of Americans at work now is the highest since February 2009. (The employment - population ratio just climbed to 60.2 in April!)

Perhaps one explanation for the lack of wage growth is due to the persistently dismal productivity numbers. Output per worker fell at an annual rate of 0.6% in the first quarter of 2017. If output dropped, but your payrolls increased, it stands to reason that unit labor costs would climb, which it did at a 3% rate. That means firms are paying workers a tad more for doing much less work. So, to protect profit margins companies are working to keep a lid on labor expenses.

Another explanation for the anemic pay increases could be the ongoing demographic change in the economy. For example, higher-wage baby boomers have been retiring and so lower-wage workers, many of whom have been sidelined during the recession, are now taking new full-time posts but at a lower pay scale, and with fewer increases.

A third factor could be that the Phillips Curve, the economic theory that claims there's an inverse relationship between wages and unemployment, has lost its validity. It may have applied when the US economy was largely autarkic, but has far less legitimacy mow that businesses and financial markets are much more integrated into the global economy. In other words, firms now view the supply of labor as a global resource, which helps suppress wage increases in the US.

The bottom line is that while companies have picked up the pace of hiring last month, the absence of any meaningful wage growth at a time when inflation is reawakening will increasingly squeeze the purchasing power of consumers.

That's why upcoming data on household spending takes on even more relevance. We know Q1 GDP growth was awful in large part because Americans curbed their shopping. But this expansion could be in peril if the lack of wage growth leads to a sustained pullback in real consumer spending.

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Key Economic Forecasts

- Actual
- Forecast

United States

	I 2016	II 2016	III 2016	IV 2016	I 2017	II 2017	III 2017	IV 2017	I 2018	II 2018	III 2018	IV 2018
Real Gross Domestic Product (GDP):												
%	0.8	1.4	3.5	2.1	0.7	2.3	2.5	2.6	2.5	2.7	3.0	2.7
Personal Consumption Expenditures:												
PCE	1.6	4.3	3.0	3.5	0.3	3.1	2.6	2.9	2.6	3.5	3.3	2.5
Inflation, end of period, year-over-year:												
CPI %	0.9	1.0	1.5	2.1	2.4	2.5	2.6	2.5	2.5	2.6	2.6	2.8
Unemployment Rate (end of period):												
%	5.0	4.9	4.9	4.7	4.5	4.7	4.9	5.0	4.8	4.7	4.6	4.5
Non-farm Payrolls, monthly avg. thousand:												
	196	164	239	148	176	166	170	180	177	165	150	155
Treasury 10-yr Note Yield % (end of period)												
	1.78	1.49	1.60	2.45	2.39	2.28	2.36	2.60	3.00	3.15	3.15	3.20
Federal funds rate % (end of period)												
	0.38	0.38	0.38	0.63	0.88	1.13	1.13	1.38	1.63	1.88	2.13	2.13

GDP Growth - Global Economy

Country	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
US	1.8	-0.3	-2.8	2.5	1.6	2.2	1.7	2.4	2.6	1.6	2.1	2.6
Eurozone	2.6	0.6	-4.1	1.7	1.4	-0.9	-0.3	1.2	2.0	1.7	1.3	1.7
United Kingdom	3.1	0.6	-5.2	1.7	0.7	0.3	1.8	2.9	2.2	2.0	1.2	1.5
Japan	2.1	-0.7	-5.4	4.6	-0.4	1.6	1.5	-0.1	1.1	1.0	1.2	1.3
Canada	2.7	0.7	-2.8	3.1	3.1	1.7	2.2	2.5	1.2	1.4	2.0	2.5
India	9.1	8.8	6.3	8.4	8.6	6.7	4.9	7.4	7.8	7.2	7.3	7.8
China	14.2	9.6	9.2	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.7	6.5
Brazil	5.7	5.1	-0.3	7.5	2.7	0.9	2.3	0.1	-3.8	-3.6	0.2	2.2
Mexico	3.3	1.4	-4.7	5.2	4.0	3.9	1.4	2.3	2.5	2.2	1.8	2.4
Australia	4.0	2.3	1.2	2.8	2.6	3.6	2.4	2.6	2.5	2.5	2.5	2.8
Russia	8.1	5.6	-7.9	4.0	4.3	3.4	1.3	0.6	-3.7	-0.8	0.7	1.8
World	5.4	1.6	-1.9	4.2	3.0	2.6	2.9	3.0	2.6	2.5	2.8	3.2