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ECONOMIC TALKING POINTS

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With jobs and wages marching higher, how much longer can inflation remain tame?

You may well ask how, with economic growth in the US decelerating, can it be that employment and wages continue to climb?

After all, factory activity and housing have been slowing and consumer confidence has cooled. Yet payrolls in January leaped by 304,000, the most in nearly a year. In fact, the average pace of hiring in the last three months has been 24% greater than the equivalent period a year ago. Moreover, average hourly earnings jumped as well. Wages have been rising at an annual rate above 3% for four consecutive months, a trend last seen 10 years ago!

So what account for these two diverging trends--- slower growth, yet robust hiring?

One quick explanation is simply that it takes time for employers to react to a softer economy. It may take a few months for hiring managers to be convinced that business conditions have genuinely weakened. If that is the case, we may yet see the job market face fresh head winds in the coming month.

A second plausible reason could be there's a lot more noise in the January employment data after you combine the usual seasonal distortions of winter…plus the government shutdown. Consider that last month's preliminary jobs report was based on a response rate of just 60.7%, which is smallest in more than a decade! That same problem occurred in December 2018. The final month of last year had an initial collection rate of only 61% in the first release of the employment report. But as more late responses rolled in, total collection jumped to 88%, the BLS found it necessary to slash payroll growth that month from a preliminary estimate of 312,000 to 222,000. There's there's a high probability we'll see January's numbers come down substantially as well.

There are therefore some reasons to be skeptical about the exceptionally strong job numbers published in January's initial release.

That's not to say labor market conditions have completely soured. Not at all. When you pierce through all the statistical fog from recent months, what emerges is a US economy that still manages to be a powerful job-creating machine. Much of that has been driven by the extraordinary demand for workers in the service sector.

Private sector hiring in services leaped by 224,000 last month, compared to 72,000 among the goods-producing firms. Most of this demand stems from three broad areas: education, health care, and the combined leisure and hospitality group. Why is that?

<u>Education:</u> Many Americans are returning to universities, community colleges, technical and vocational schools in order to obtain the skills that are most in demand in today's hi-tech economy. These are jobs that also come with bigger paychecks.

<u>Health care and leisure & hospitality:</u> Both are hiring heavily because of demographic and political factors. Retiring baby boomers tend to seek out more medical services, and they are also more inclined to do leisure traveling. Hotels and restaurants need to be fully staffed. But efforts by the White House to end illegal immigration and even curb those seeking legal entry into the US have put greater pressure on those two industries to hire more American residents, a group that can be more easily counted when the BLS compiles employment data.

The most significant outcome of the latest jobs report, however, is how will it affect future monetary policy?

Fed policymakers have to be concerned that labor market conditions are edging closer to that critical threshold where employee pay hikes could precipitate a dangerous wage and price spiral later this year. The reason? Wages are now climbing in excess of 3% a year, but nonfarm productivity growth remains stuck between 1% and 1.5%. In the absence of stronger productivity, the jump in labor costs will soon leave companies with a difficult choice. Either pass on those expenses to consumers and raise prices--- or grudgingly sacrifice corporate earnings. The irony is both scenarios would undermine support for equity values. If companies charged consumers more, the pick up in inflation would force the Fed to resume lifting rates. And if CEOs chose instead to absorb those costs, profits would suffer and investors will be inclined to flee stocks.

Simply put, the biggest average hourly increases seen in a decade cannot be sustained with chronically dismal nonfarm productivity. Something soon has to give--- and the Fed knows it. That's the big takeaway from this report. Inflation may be dormant for now, but it will rear its head by mid-year.

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- Actual
- Forecast

United States

	I 2018	II 2018	III 2018	IV 2018	I 2019	II 2019	III 2019	IV 2019	I 2020	II 2020	III 2020	IV 2020
Real Gross Domestic Product (GDP):												
%	2.2	4.2	3.4	2.6	2.1	2.6	2.2	2.1	1.8	1.8	1.3	1.5
Personal Consumption Expenditures:												
PCE %	0.5	3.8	3.5	2.8	1.6	2.3	2.0	2.2	1.2	2.0	1.1	1.6
Inflation, end of period, year-over-year:												
CPI %	2.4	2.9	2.3	1.9	2.2	2.5	2.5	2.7	2.5	2.4	2.4	2.1
Unemployment Rate (end of period):												
%	4.1	4.0	3.7	3.9	3.7	3.6	3.7	3.9	3.9	4.1	4.2	4.4
Non-farm Payrolls, monthly avg. thousand:												
	218	211	190	230	201	189	170	140	140	120	95	110
Treasury 10-yr Note Yield % (end of period):												
	2.74	2.85	3.06	2.76	2.85	2.95	3.00	3.15	3.25	3.40	3.30	3.15
Federal funds rate % (end of period):												
	1.63	1.88	2.13	2.38	2.63	2.63	2.63	2.63	2.38	2.38	2.13	2.13

GDP Growth - Global Economy

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
US	2.6	1.6	2.2	1.8	2.5	2.9	1.6	2.2	3.1	2.4	1.5
Eurozone	1.7	1.4	-0.9	-0.3	1.2	1.6	1.7	2.5	1.8	1.8	1.7
United Kingdom	1.7	0.7	0.3	1.8	2.9	2.2	1.9	1.8	1.3	1.2	1.4
Japan	4.6	-0.4	1.6	1.5	-0.1	1.1	1.0	1.6	1.1	0.9	0.7
Canada	3.1	3.1	1.7	2.2	2.5	0.9	1.4	3.0	2.2	2.3	2.1
India	8.4	8.6	6.7	4.9	7.4	7.9	7.1	8.2	7.2	7.0	7.2
China	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.6	6.3	6.0
Brazil	7.5	2.7	0.9	2.3	0.1	-3.5	-3.5	1.4	2.3	2.2	2.4
Mexico	5.2	4.0	3.9	1.4	2.3	2.7	2.9	2.1	2.0	1.9	1.6
Australia	2.8	2.6	3.6	2.4	2.6	2.5	2.4	2.4	3.0	2.8	2.9
Russia	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.6	2.3	2.0	1.9
World	4.2	3.0	2.6	2.9	3.0	2.8	2.6	3.3	3.1	2.8	2.7