THE WALL STREET JOURNAL.

Robust Jobs Report Spurs Fed Watch

Central bank faces vexing outlook as labor-market strength competes with global tumult and weak business spending

By Jeffrey Sparshott August 5, 2016

The U.S. labor market in July capped off the best two-month stretch of hiring so far this year despite global turbulence and slower business spending, posing a challenge for the Federal Reserve as it aims to raise interest rates again in coming months without spooking investors.

Employers added 255,000 jobs last month while wages for private-sector workers matched their strongest annual pace of growth in seven years. More Americans joined the labor force, keeping the jobless rate steady at 4.9%.

“The July labor market report was exceptionally strong, and the warts were few and far between,” said Millan Mulraine, deputy chief U.S. macro strategist at TD Securities.

The latest figures spurred relief after an ugly May jobs report, a dim first-half U.S. growth reading, falling corporate profits and retreating business spending. At least in the short term, the economy appears to be on solid footing despite longer-run worries.

The firm employment picture has helped to propel consumer spending. But an improving labor market doesn’t entirely square with other data showing a deep slowdown in overall economic growth since the end of 2015. Gross domestic product, a broad measure of economic output, rose a meager 1% at a seasonally adjusted annual rate during the first half of the year, the Commerce Department reported in late July.

American companies, dogged by shrinking profits, have cut investment for three straight quarters. Alongside steady hiring, that’s led to slumping labor-productivity growth. Productivity is a key to rising living standards as steady gains are needed to support higher incomes without sparking inflation.

The outlook is weak outside the U.S., representing another potential drag. The International Monetary Fund last month downgraded its forecast for global economic growth after Britain’s vote to leave the European Union weighed on consumer confidence and investor sentiment.

“This apparent inconsistency—a willingness to absorb the high cost of labor, yet completely shut down business capital spending—illustrates how cautious CEOs remain given the uncertainties about the U.S. election, the fallout from Brexit, and the health of the global economy,” said **Bernard Baumohl, chief global economist at the Economic Outlook Group** consultancy**.**

Fed officials will have to assess the crosscurrents as they consider making only the second increase to the central bank’s benchmark interest rate since 2006. Policy makers boosted rates in December but have since held off amid uncertain risks and volatile markets.

"The question at this point remains, which data point is more telling of the underlying momentum in the economy: an average 1% GDP or an average of 200,000 payrolls," said Lindsey Piegza, chief economist at Stifel Fixed Income. "Until the Fed can answer with confidence, caution will remain the name of the game."

Fed officials meet Sept. 20-21 and again in November and December. For a move in September, Chairwoman Janet Yellen will have to use her speech at the Fed's conference in Jackson Hole, Wyo., later this month to recalibrate investor expectations that are stacked heavily against a rate increase next month. Fed-funds futures, which are used to place bets on central-bank policy, showed Friday that investors and traders see an 18% likelihood of a rate hike at the Fed's September meeting, compared with 12% before the jobs report, CME Group said.

Meanwhile, the improvement in the labor market—alongside a stock market hitting fresh records in recent weeks—could tilt some undecided voters as they enter a crucial stretch ahead of November's presidential election. Democratic nominee Hillary Clinton's campaign is based in part on President Barack Obama's record, which includes recovery from the 2007-09 recession and the creation of 11 million jobs. "The longest streak of total job growth on record continued in July," said Jason Furman, Mr. Obama's chief economist.

But the last seven years also mark the slowest expansion since at least World War II, a point the GOP nominee has hit on. "We are in the middle of the single worst recovery since the Great Depression," said Stephen Miller, a senior policy adviser for RepublicanDonald Trump.

If labor-market resilience continues, the economy could be poised for faster growth, buoyed by more consumer spending. Average hourly earnings for private-sector workers rose by 2.6% in July from a year earlier. While slower than before the recession, that clip is the strongest since 2009 and outpacing inflation. The consumer-price index increased 1.1% in June from a year earlier.

Rising wages have long been expected as a result of a tightening labor market, though a breakout had been slow to come. Some employers suggest that may now be changing. "We're not seeing an abundant pool of workers," said Aaron Weigel, president of Wiegel Tool Works.

The Wood Dale, Ill., metal stamper is hiring tool and die makers, press operators, engineers and front office staff to feed strong demand from the auto industry. His workforce is up by 22 so far this year, bringing company payrolls to about 180. That's likely to grow as high as 195 by the end of 2016, he said.

To help recruitment efforts, Wiegel has started an in-house apprenticeship program, works with a local manufacturing association to train and recruit students, offers annual raises and made a one-time market adjustment to wages this spring, bumping some salaries as much as 30%. "We have quite a few guys in six figures here," Mr. Wiegel said.

Nationwide, another month of hiring was also enough to draw more people into the workforce. The labor-force participation rate rose to 62.8% in July from 62.7% in June. The figure has been hovering near the lowest levels in almost 40 years, partly because the baby boomer generation is retiring but also because some younger workers have given up on finding a job.

Indeed, the rate for men ages 25-54—who should be in their prime working years—has troubled economists. Labor-force participation for the group topped out at 97.9% in 1954. For about five decades, it has been heading lower. The measure was 88.4% in July, matching the worst level of the year.

The figures look even worse for those with less education. Last year, the participation rate for college-educated men was 94%, while the rate for men with at most a high-school diploma was 83%, according to a White House estimate.

One blemish on Friday's report was a rise in a measure of unemployment and underemployment, including Americans who stopped looking for work. The rate rose to 9.7% in July from 9.6% in

June, largely because of a rise in the number of people who were working part-time but wanted a full-time job.

But for those with skills in heavy demand, the market appears robust. Michael Buelt last week started a job as senior digital producer at Karsh Hagan, a Denver ad agency. The 34-year-old said the labor market has improved markedly since his last job search in early 2015, largely because the local economy has heated up but also because of on-the-job experience and project management certifications he added to his résumé.

“I was getting an offer a week to do interviews, and I was able to pick and choose,” Mr. Buelt said. “It seems like there are a lot more jobs.”

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