Flash

Monday, 16 November 2015

Update US Labour Market Dashboard

Strong October payrolls growth, while labour market slack continues to diminish

At the September FOMC meeting, the Fed didn't start its tightening cycle, despite earlier hints. Many were surprised by the decision as labour market conditions improved and the unemployment rate dropped to 5.1%, within the Fed's current definition of full employment. However, the Fed wanted more time to assess the impact of the Chinese/EM slowdown on the US economy. In order to bring clarity, Yellen gave a speech some days after the meeting. She explained that labour market conditions remain at the core of the Fed's reaction function. Inflation is important too, but if labour market conditions tighten a bit further, inflation will start accelerating and the FOMC would be reasonably confident that inflation would move towards the 2% target in the medium term (Phillips curve). Two Fed board governors expressed doubts about the reaction function that Yellen put forward. They doubt that inflation will accelerate once the NAIRU is reached. In October, the FOMC dropped the reference to global developments and put more emphasizes on domestic ones, especially the labour market data. The strong October payrolls report and the September JOLTS report suggest that indeed "some" further improvement in the labour market has occurred.

Here we focus on the labour market developments, as these are crucial in the Fed's decision on when to start its tightening cycle and how to proceed later on. We provide you with an update of our Labour Market Dashboard.

Payrolls growth slowed sharply in August and September to respectively 153K and 137K, suggesting a cooling of labour market conditions. Other data are more mixed. The October payrolls and the September JOLTS report suggest that the labour market has improved further. The **unemployment rate (U3) dropped faster than the Fed expected in past years** reaching the full employment mark (5%). The **faster decline of the more broadly defined unemployment rate (U6)** is also positive. The index dropped to the 9.8% mark, down 1%-point since May 2015 and only 1%-point away from target. The share of long term unemployed fell 5.1%-points in the past year, but is still high at 26.8% and has stopped its declining trend. **So, there is still some slack, but it diminishes and gives less qualified workers better chances to get a job**.

The **JOLTS labour report** is published with a one-month lag. It gives us a richer insight in the dynamics of the labour market. Job openings rose again in September, following an unexpected fall in August. The trend is still up and the level is very high.. Other measures like jobs quits and lay-offs rate all stabilized in August at reasonably good levels, but the second monthly decline in the job hires is a negative .

The **participation rate stabilized in October at a low 62.4, but the downtrend remains in place.** While part of the sharp decline in recent years is due to structural and demographic factors and thus outside the remit of the Fed, another part might be cyclical in nature. This falling participation rate, together with the still higher U6 unemployment rate and the high share of long term unemployed, **might convince the FOMC to increase its rates only very gradually after the lift-off.**

Finally, **wage growth remained** fairly flat since the end of the crisis in 2009 and is well under the desired rates. If employment growth slows and inflation would rise again, maybe due to basis effects, real disposable income growth may fall short of what is needed to have strong consumption growth, the main pillar of GDP growth. However, in October wage growth accelerated to 2.5% Y/Y, a welcome development that needs confirmation though. It might suggest that the causality between low unemployment, wage growth and inflation is still working, but maybe at lower unemployment rates than before (shifting Phillips curve).

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Overview

A quick look at the table below confirms that the **most recent labour market data were encouraging**. Five out of our ten indicators improved compared with the previous month (green arrows), another two stabilized (yellow arrows) and three deteriorated (red arrows). Because of stronger payrolls growth, **four indicators (payrolls, unemployment rate, job openings and lay-offs) now met our self-defined target, one more than last month.** A few other indicators (job quits, job hires) are near target. **Encouraging, the U6 unemployment rate keeps declining fast and nears the target, while wage growth accelerated rather strongly, a development that needs confirmation though.** We wouldn't make too much from the uptick in the long term unemployment share. Still unsatisfactory is the very low participation rate. There is a structural element, but one should expect some cyclical improvement which didn't show up yet. Secondly, while job openings are at a record high level, the job hires rate don't follow to the same extent. So, it might suggest that employers don't find the workers with the right qualifications or employers are looking for more workers but are still not confident enough to really take them on board, maybe due to economic uncertainties. **On the basis of the Yellen labour market indicators, a rate lift-off decision might be imminent or already too late. The Fed indicated recently that it might occur in December when new Fed economic and rate projections become available. Given still some unsatisfactory elements of the labour market conditions (and too low inflation), we expect a very gradual tightening cycle.**

Table 1: Overview Yellen Labour Market Dashboard

	Target	Worst	Last	Previous	Diff. With Target	Latest Development	3m Moving Average
Payroll Employment	**161,8**	-824,0	**271,0**	137,0	109 ↑	134 ★	0,0
Unemployment Rate (U3)	★ **5,1**	10,0	**5,0**	5,1	-0,1 ↑	-0,1	5,2
U6 Unemployment Rate	**8,8**	17,1	**9,8**	10,0	1,0 ↑	-0,2	10,2
Long-term Unemployed Share	**19,1**	45,5	**26,8**	26,6	7,7 ↓	0,2	27,1
Participation Rate	**66,1**	62,4	**62,4**	62,4	-3,7 →	0	62,5
Job Openings Rate	**3,0**	1,6	**3,7**	3,6	0,7 ↑	0,1	3,7
Job Hires Rate	**3,8**	2,8	**3,5**	3,6	-0,3 ↓	-0,1	3,6
Job Quits Rate	**2,1**	1,3	**1,9**	1,9	-0,2 →	0	1,9
Layoffs/Discharges Rate	**1,4**	2,0	**0,0**	1,2	-1,4 ↓	-1,2	1,2
Average Hourly Earnings Y/Y	★ **3,5**	1,5	**2,5**	2,3	-1,0 ↑	0,2	2,2

Target = our self-defined target is the average of the 2003-2007 period

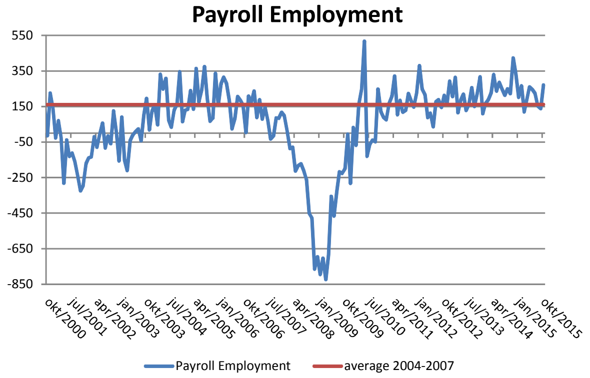
★ Fed target: Yellen said most FOMC colleagues and she tought the unemployment rate with maximum sustainable employment is now between 4,9% and 5,2% . Therefore we define our target at 5,1%.

★ Fed target: Yellen said in the press conference after the March 19 FOMC decision that with 2% inflation and productivity growth they have, wage inflation of between 3% and 4% would be normal. Therefore we define our target at 3,5%

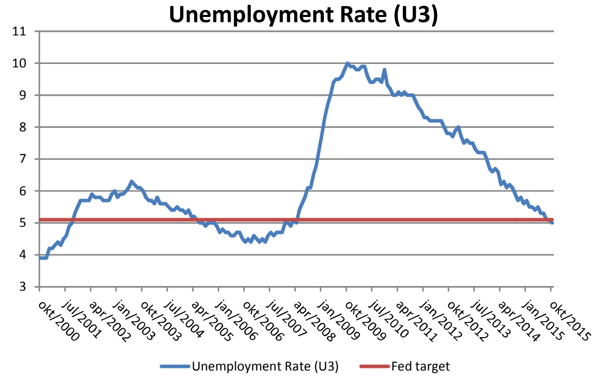
★ Due to the volatility in the payrolls data, we preferred to take a 6-month moving average for this indicator instead of a 3-month moving average

Table2: Definitions of the Yellen Labour Market Indicators

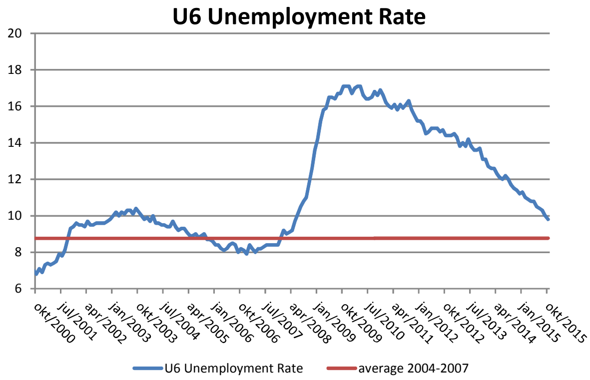
Yellen Labour Market Indicators	Description
Payroll Employment	Net monthly change in number of employees on business payrolls
Unemployment rate	Number of unemployed persons as percentage of the labor force
U6 Unemployment rate	Unemployed & Marginally Attached & Employed Part Time For Economic Reasons As part of the Civilian Labour Force
Long-term Unemployed share	Share of Unemployed who have been out of work for 27 weeks or longer
Participation rate	Total labor force as a percent of the working age population
Job Openings rate	Tracks the number of job openings in an economy as a percentage of paid employees. Includes newly created or unoccupied positions where an employer is taking specific actions to fill these positions.
Job Hires rate	Workers hired as a percentage of paid employees
Job Quits rate	Tracks voluntary job separations initiated by the employee as a percentage of paid employees.
Layoffs/Discharges rate	Layoffs and discharges as a percentage of paid employees (involuntary job separations initiated by the employer)
Average Hourly Earnings	Total hourly renumeration (in cash or kind) paid to employees in return for work done



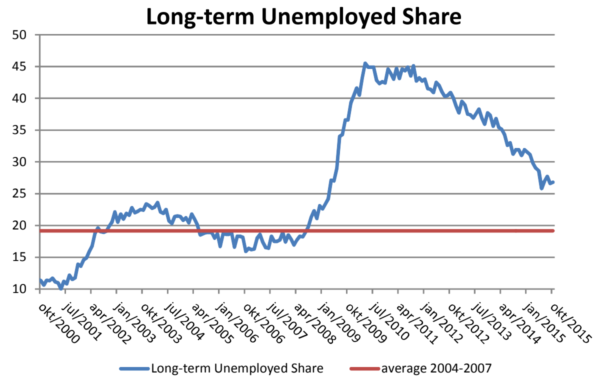
After strong payrolls growth in the period May-July, payrolls growth unexpectedly slowed to 153K in August and 137K in September. The strong 271K job growth in October has eased concerns about a too fast and too sharp cooling of labour market conditions. 6 month average stands at 214K.



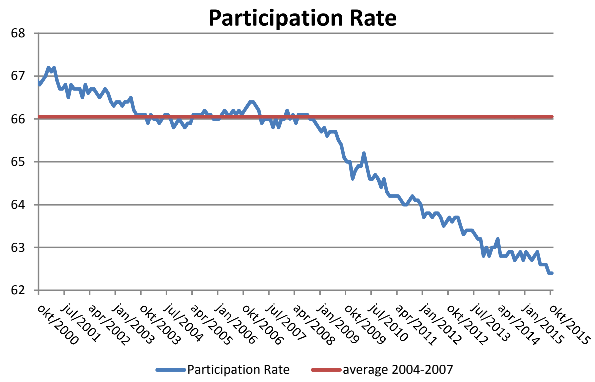
In October, the unemployment rate declined to 5% from 5.1% in September (within the 4.9-5.2% NAIRU, the Fed's September estimate of full employment). .



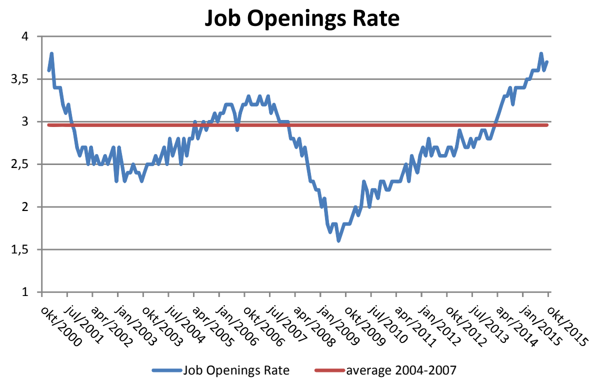
*The **U6 unemployment rate extended its downtrend in October,** falling from 10% to 9.8% (1%-point decline in 5 months). The U6 unemployment rate includes the marginally attached and part-time workers for economic reasons. Being on a sustained downtrend, the **U6 unemployment rate is closing in on** our target of 8.8% (average 2003-2007). This suggests that the existing slack **diminishes fast**.*



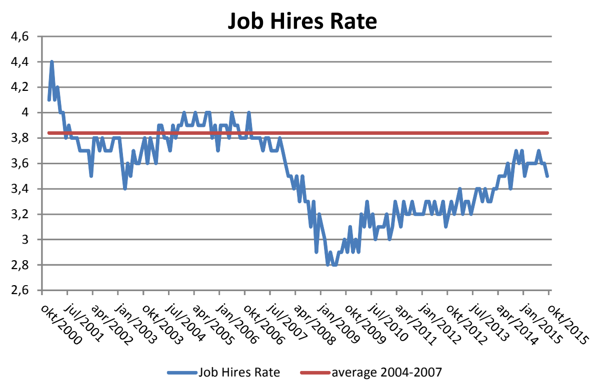
***The downtrend in the long-term unemployed share** (share of unemployed who have been out of work for 27 weeks or longer) takes a pause and showed volatile result in past months. It increased slightly to 26.8% from 26.6% previously but is down from 27.7 in August. The indicator remains **well above our target** of 19.1% (2003-2007 average).*



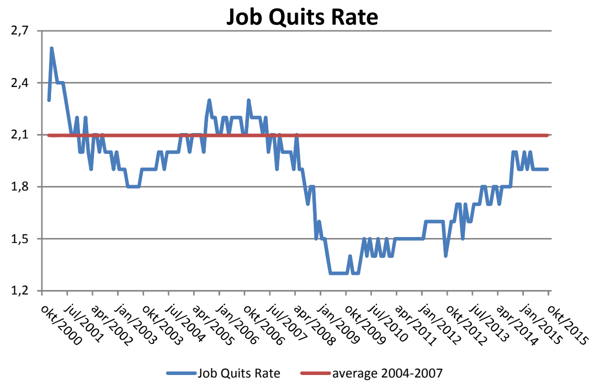
The US participation rate dropped sharply since the crisis in 2008 *from about 66% to 62.4% in September, followed by a stabilization in October. Usually, as the labour market recovers, the participation rate tends to pick up as people return to the labour market. Structural factors (demographics) are a headwind though. The resumption of the downtrend suggests that some potential workers are leaving the labour force discouraged.*



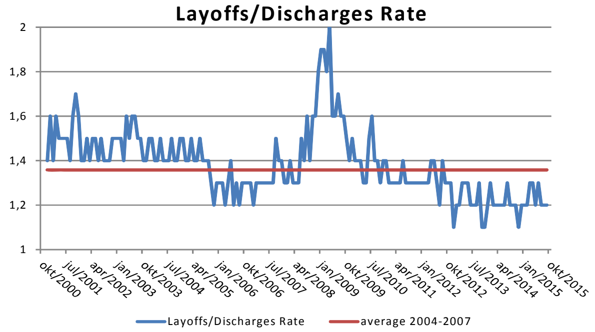
The job opening rate is at a very high level, well above our yardstick. Following a dip from 3.8 in July to 3.6% in August, the indicator rose again to 3.7% in September (PS JOLT report is published with one month delay). We are curious to wait for the October result to get confirmation that the downtick in August was just a downtick.



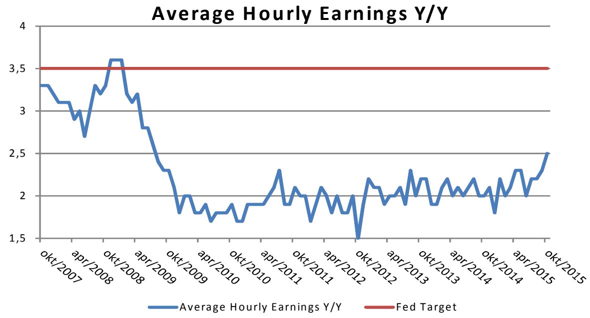
Despite the recent strong increase in job openings, ***the hires rate dropped in July to 3.6% from a cyclical high of 3.7% previously and stabilized in August, before declining to 3.5% in September. This is a disappointment, especially if the decline would continue in the following months. Since February 2014, the indicator moves sideways between 3.4% and 3.7%, just below our target of 3.8%, the average of the 2003/07 period.***



Job quits tend to give an indication on the health of the labour market as workers will only quit their jobs if they have a decent chance to find another. ***The job quits rate stabilized at 1.9% since April,*** *just below our 2.1% target (average 2003-2007), indicating that workers are rather confident in leaving their jobs while firms are also becoming active in recruiting workers away from their competitors. Some hesitation to change jobs is still present*



Layoffs/Discharges picked up sharply at the start of the recession, but dropped again soon afterwards. ***The layoffs rate dropped to 1.1% last year and hovers since in a tight 1.1% to 1.3% range. In September, the rate stabilized at 1.2%.*** *It remains below our target of 1.4% (average in the 2003-2007 period). These data suggest that firms have completed their necessary layoffs.*



Average hourly earnings (AHE) jumped in October to ***2.5% Y/Y from 2.3% Y/Y in September.*** *Since the start of the year, AHE moved sideways (2%-to 2.3% Y/Y)* ***So, only in October, there are some signs of wage inflation, which still needs to be confirmed. Some Fed governors want to see higher wages. It would make the recovery more robust.. The absence of wage growth suggests that some slack remains. The indicator is still below "our" 3.5% target.***

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