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Economics Group

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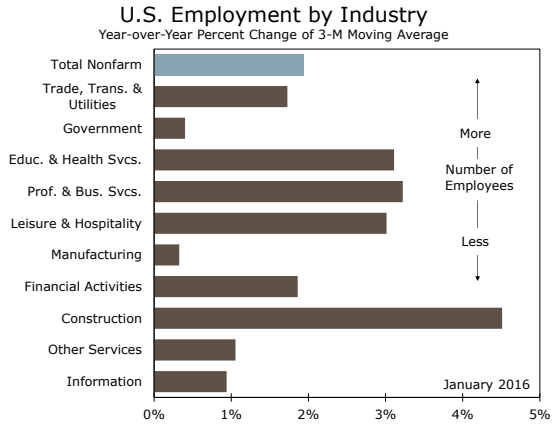
John E. Silvia, Chief Economist
john.silvia@wellsfargo.com • (704) 410-3275
Alex V. Moehring, Economic Analyst
alex.v.moehring@wellsfargo.com • (704) 410-3247

Jobs: Late Cycle Job Slowdown, Rising Labor Costs

For 2016, monthly job gains were expected to slow and labor costs to rise. Today's gain of 151,000 jobs and rising unit labor costs reported earlier this week are consistent with this theme. The Great Divide continues.

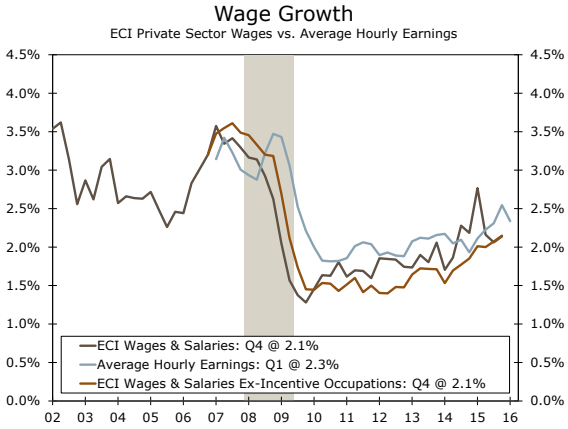
The Great Divide: Divergent Job Gains Persist

Our theme for the annual outlook was the Great Divide and we certainly see this in today's employment report. Nonfarm employment rose 151,000 in December—a downshift consistent with slower overall GDP and industrial production growth in 2016 compared to 2015. We have emphasized the divergence between the production and services sides of the economy over the past six months and we can see that divergence in today's numbers. Although manufacturing employment surprised to the upside, mining employment fell for the 11th straight month. Employment in the services sector, on the other hand, rose by 118,000 jobs, yet there has been a clear slowdown relative to the second half of 2015. Moreover, growth in the residential and nonresidential construction sectors remains evident in the 18,000 gain in construction jobs last month. These gains represent solid trends supporting continued economic growth and certainly do not signal recession.



Labor Market Tightening, Rising Cost of Labor

Another late cycle indication from the labor market is the rising cost of labor (middle graph). As expected, the unemployment rate fell to 4.9 percent, however, the 0.5 percent increase in average hourly earnings was a surprise, but consistent with rising labor cost pressures. For 2013 and 2014, the employment cost index rose roughly 2 percent, but the trend has been clearly upward. Going forward, we anticipate this measure of labor costs will pick up, thereby signaling rising labor cost pressures, especially since productivity gains remain very modest at best. For the economy, this will put further pressure on corporate profit growth and further limit companies' willingness to invest and hire.

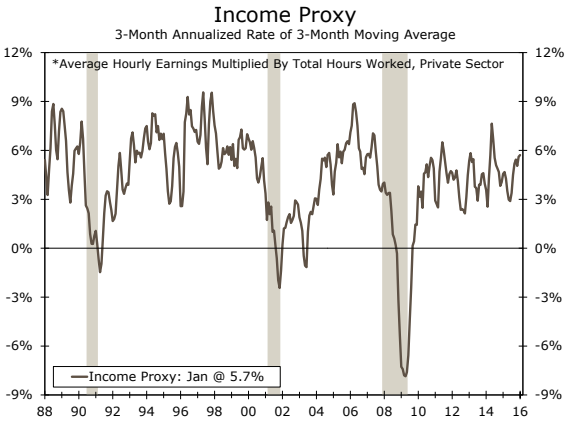


Income Growth: Slowdown in 2016 in Line

With more modest job gains and higher wage growth pushing inflation higher, the balance in real disposable income is tilting towards lower real income growth and slower real consumer spending in 2016 relative to 2015.

Moreover, as illustrated in the bottom graph, income gains this cycle have been more modest compared to the two prior cycles. Certainly, job gains themselves have moderated, although wage gains picked up. In addition, hours worked have also been disappointing this cycle given the prevalence of part-time employment as a reasonable option for many firms today.

Bottom line, the pace of job growth and labor costs are consistent with a more modest pace of FOMC moves in 2016 and certainly not four rate hikes in 2016. We did not expect an FOMC move in March and possibly not in June as well. We retain that view. Moreover, the more modest job gains continue to signal an economy that is drifting on thin ice as we indicated with our GDP report last week.



Source: U.S. Department of Labor and Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Anika R. Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Erik Nelson	Economic Analyst	(704) 410-3267	erik.f.nelson@wellsfargo.com
Alex Moehring	Economic Analyst	(704) 410-3247	alex.v.moehring@wellsfargo.com
Misa Batcheller	Economic Analyst	(704) 410-3060	misa.n.batcheller@wellsfargo.com
Michael Pugliese	Economic Analyst	(704) 410-3156	michael.d.pugliese@wellsfargo.com
Julianne Causey	Economic Analyst	(704) 410-3281	julianne.causey@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com