

6 January 2016

US Labour Market Monitor

Wage inflation likely to have picked up further in December

Job report preview

As expected, the Fed increased the Fed funds rate at its December meeting, exactly seven years after it lowered the Fed funds rate to zero. **While PCE core inflation is still subdued, the development of the labour market is key to understanding why the Fed has begun tightening monetary policy.** From January to November 2015, non-farm payrolls increased by 200,000 per month on average and the unemployment rate was 5.0% in November, which is within the Fed's NAIRU range. Also, wage growth has begun to pickup, suggesting that underlying domestically generated inflationary pressure is increasing. Besides that the Fed would very much like to see PCE core inflation picking up, the development in the US labour market will be a key determinant for the hiking pace.

We estimate non-farm payrolls increased 200,000 in December in line with the recent trend but below our own model, which suggests around 160,000. However, the lower model estimate is due partly to the weak jobs report in September. Our trend employment growth models still point towards employment growth around 200,000 per month. We estimate that employment growth in December was driven by private services. We estimate the unemployment rate was unchanged at 5.0%.

We estimate that average hourly earnings (AHE) grew 0.2% m/m in December, implying an increase in the annual growth rate from 2.3% y/y in November to 2.8% y/y in December, the highest since June 2009. This is in line with the consensus view. The annual growth rate in AHE is by nature volatile but **still it is noteworthy that the annual growth rate in average hourly earnings trended up in 2015, suggesting that the Phillips curve is still functioning well.** We expect wage growth to continue trending up in 2016, as we expect the labour market to tighten further.

General condition of the US labour market

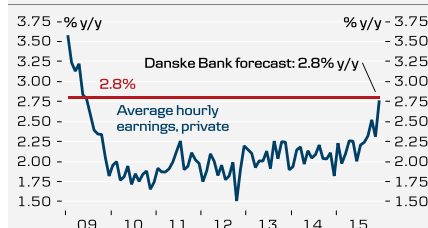
In *Research US: Don't expect a rebound in the participation rate*, 27 November, we showed that one should not expect a rebound in the US participation rate. **In our base case scenario, we think the participation rate will be fairly stable in coming years, as more people will return to the labour force and thus offset the downward pressure from the aging effect.** In the medium term, when the labour market slack has vanished completely, we expect the participation rate to decline further due to the aging effect. **This implies that we expect the labour force to grow in the range 100,000-150,000 per month over the next few years.** The labour market would tighten as long as employment growth exceeds this. **If we are right, the labour market should continue to tighten even if employment growth slows.** We expect the unemployment rate to get below NAIRU early next year, which should boost wages and thus increase the underlying inflationary pressure further.

Danske Bank forecasts (December)

	DB	Consensus	Prior
Non-farm Payrolls	200	200	211
-Private	195	198	197
-Manufacturing	-10	0	-1
-Service	195	-	163
-Construction	10	-	46
-Mining and logging	-	-	-11
-Government	5	-	14
Unemployment rate	5.0%	5.0%	5.0%
Avg. hourly earnings	2.8%	2.8%	2.3%

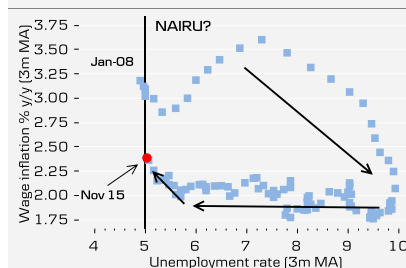
Source: Macrobond Financial, Danske Bank
Markets calculations

We estimate wage inflation picked up in December



Source: BLS, Danske Bank

In our view, the Phillips curve is still functioning well



Source: BLS, Danske Bank Markets

Analyst

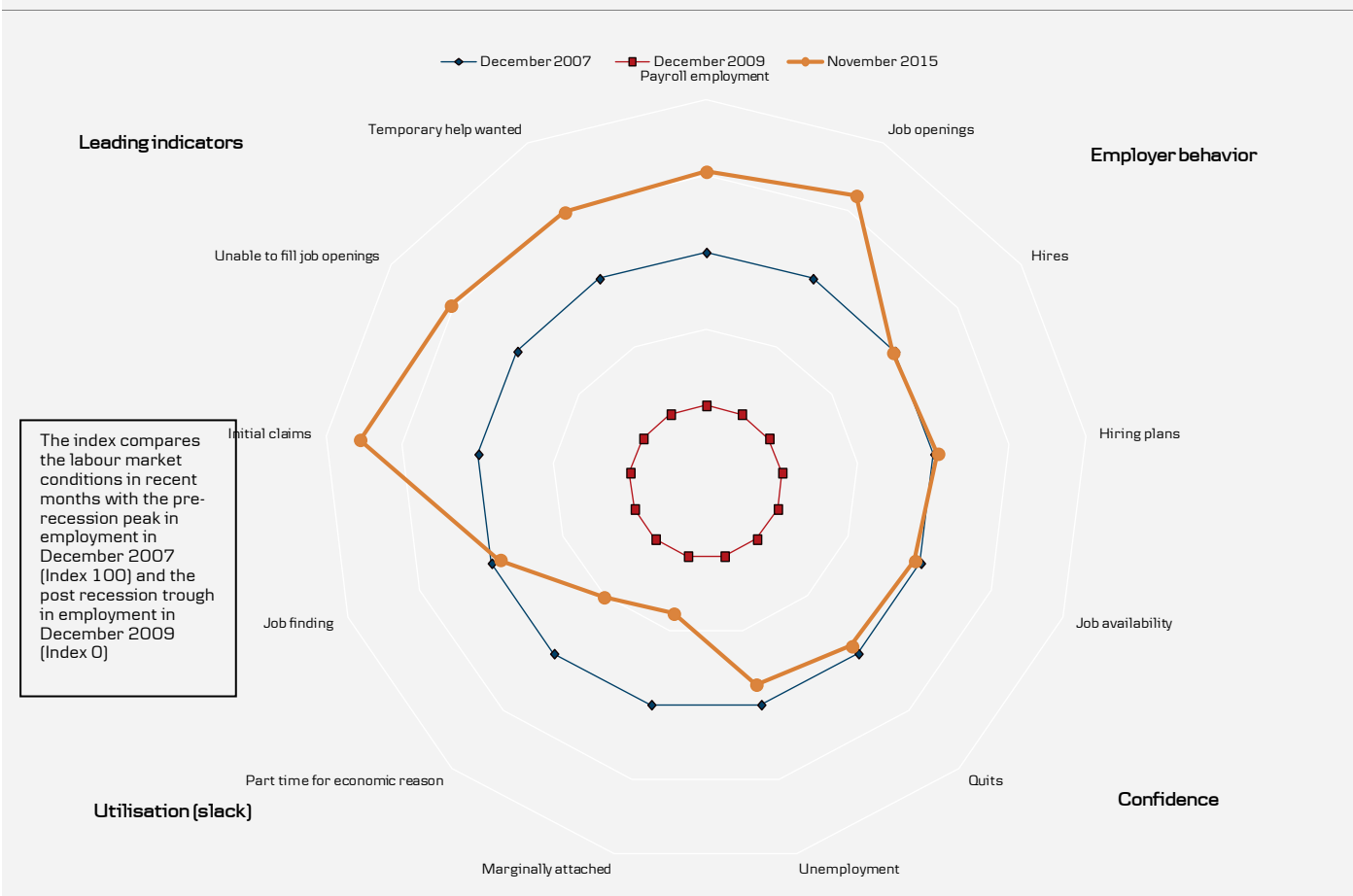
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US labour market in one chart

Strong labour market growth but slack remains – outward moves indicate stronger labour market



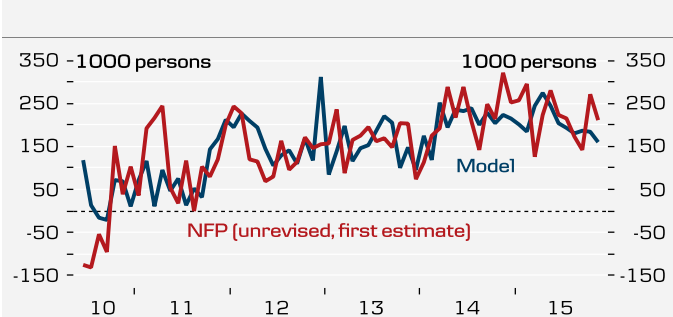
Note: The diagram shows the level of tightness of different US labour market key figures at different times, compared with the level of the same figures in December 2007 (index= 100) and December 2009 (index = 0). Counter cyclical figures (unemployment rate, jobless claims, marginally attached and work part time for economic reasons) are inverted; thus, the higher index (the further from the middle) the better (tighter) is the state of the labour market

For JOLTS data we have used the average of the last two observations as the newest figures

Source: BLS (JOLTS), Macrobond Financial

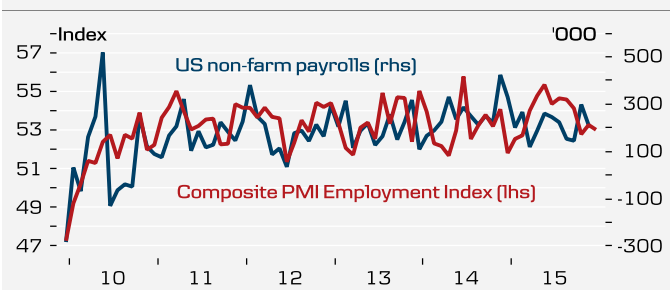
Models and leading indicators

Our model estimate seems a bit too pessimistic



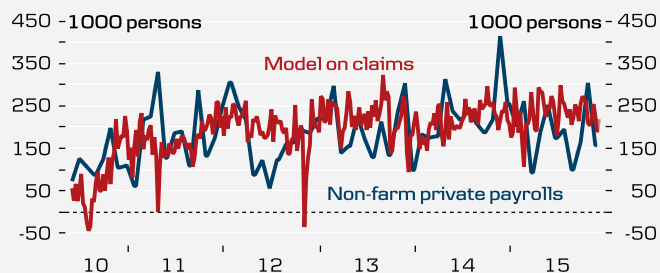
Source: Macrobond Financial, Danske Bank Markets calculations

PMI employment suggests stable employment growth of around 200,000



Source: Macrobond Financial, ISM, BLS

Initial jobless claims model suggests better job growth



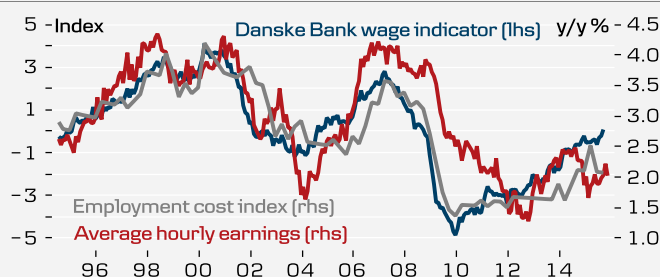
Source: Macrobond Financial, US Department of Labor

Small business hiring plans next three months



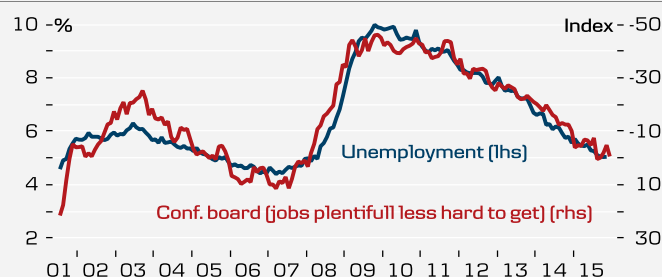
Source: Macrobond Financial, NFIB

Danske Bank wage indicator and wage inflation



Source: BLS, Danske Bank Markets

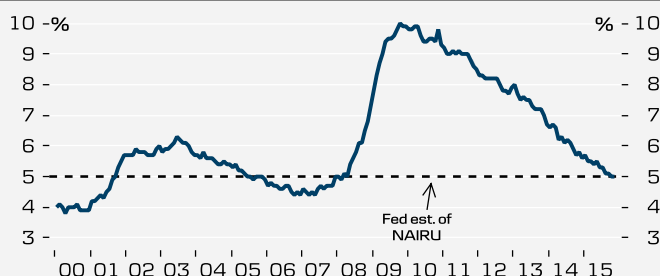
Worker confidence and unemployment rate



Source: BLS, Conference Board

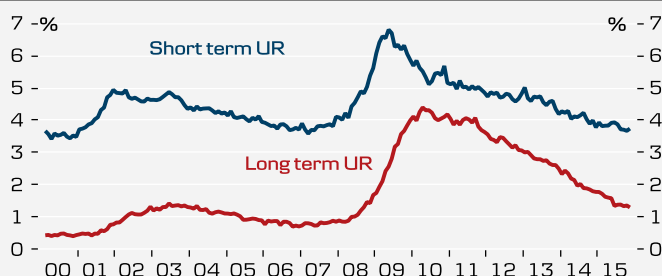
Unemployment measures

Unemployment rate



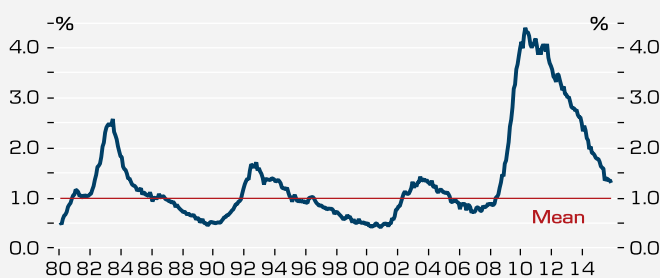
Source: Macrobond Financial, FOMC, BLS

Unemployment decomposed by duration



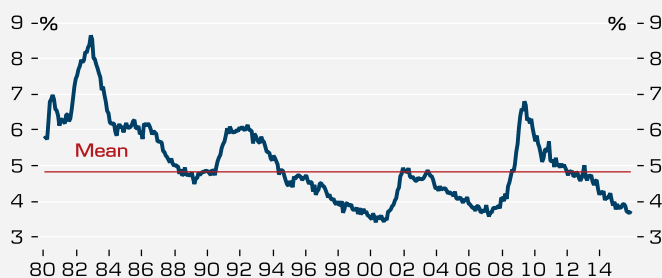
Source: Macrobond Financial, BLS

Long term unemployment rate



Source: Macrobond Financial, BLS

Short-term unemployment rate



Source: Macrobond Financial, BLS

Long term unemployment as % of total unemployed



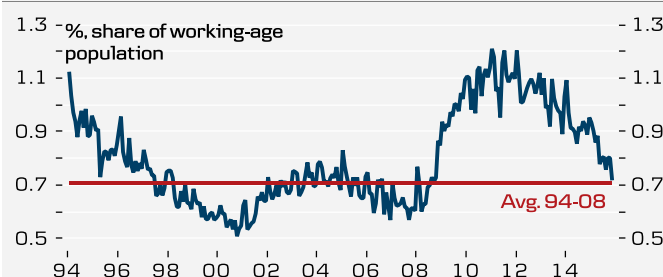
Source: Macrobond Financial, BLS

Distribution of duration of unemployment



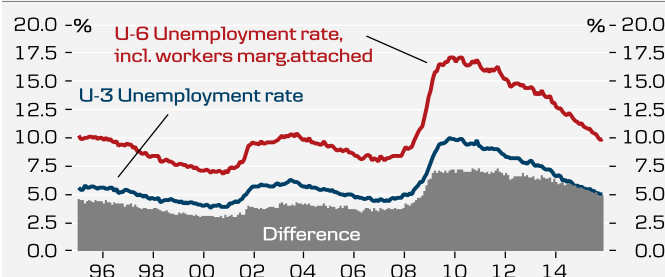
Source: Macrobond Financial, BLS

Marginally attached workers



Source: Macrobond Financial, BLS

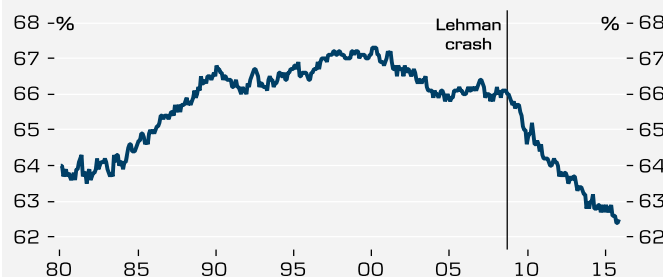
U6 unemployment rate vs U3 unemployment rate



Source: Macrobond Financial, BLS

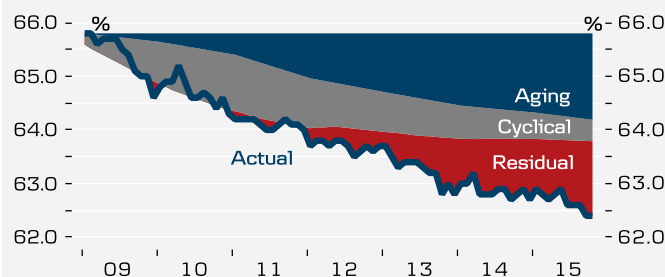
Participation

Participation rate, all



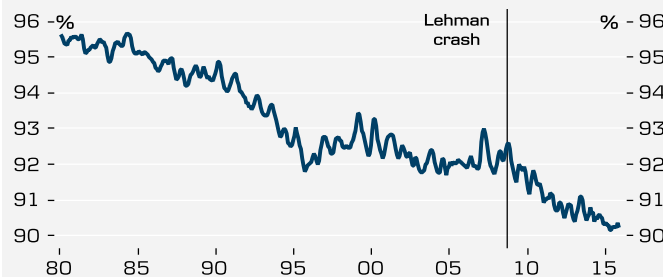
Source: Macrobond Financial, BLS

Fall in participation mostly due to aging effects



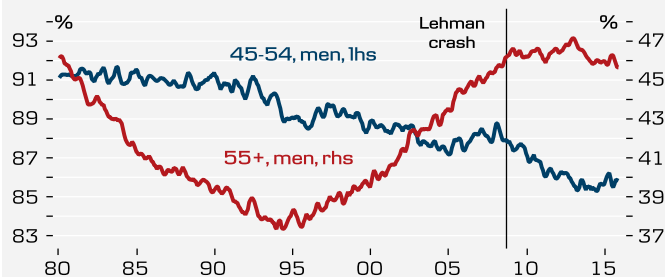
Source: Macrobond Financial, BLS

Participation rate, 35-44, men



Source: Macrobond Financial, BLS

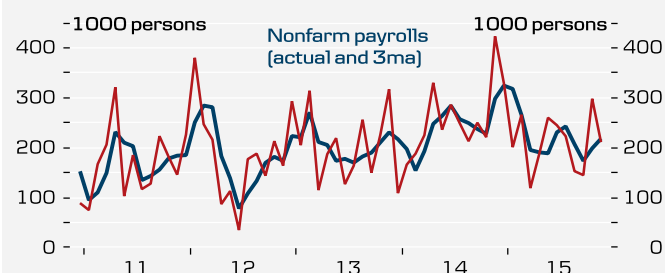
Participation rate, 45-54 and 55+, men



Source: Macrobond Financial, BLS

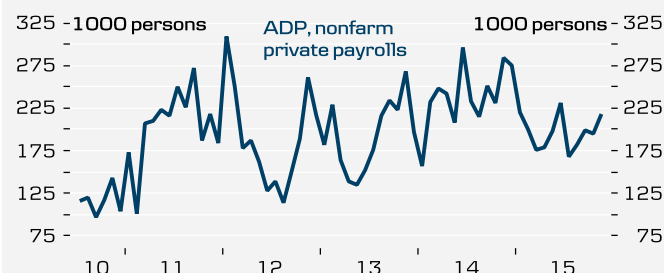
Employment measures

Non-farm payroll



Source: Macrobond Financial, BLS

ADP private payrolls



Source: Macrobond Financial, ADP

Part-time employed for economic reasons



Source: Macrobond Financial, BLS

Employment to population ratio



Source: Macrobond Financial, BLS

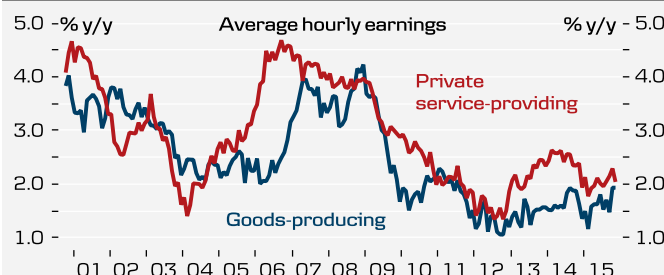
Wage growth and inflation

NFIB compensation plans



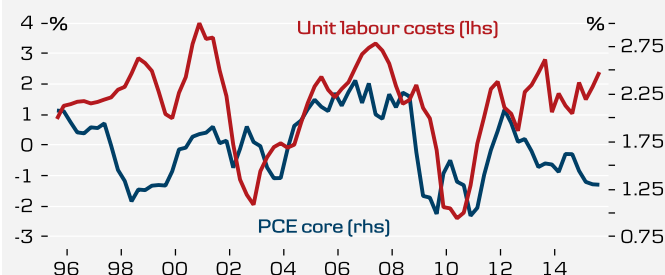
Source: Macrobond Financial, NFIB

Hourly earnings, production and non-supervisory



Source: Macrobond Financial, BLS

Unit labour costs is putting upward pressure on core inflation



Source: Macrobond Financial, BLS, Census, BEA

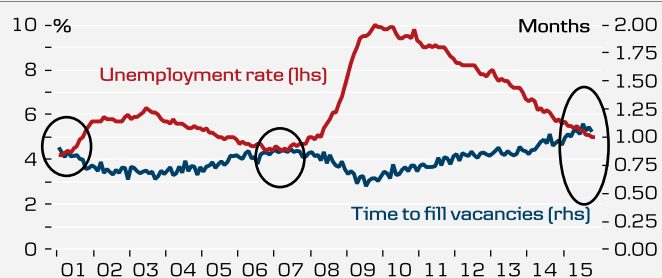
Worker confidence is slowly rising – will wages follow?



Source: Macrobond Financial, Conference Board, BLS

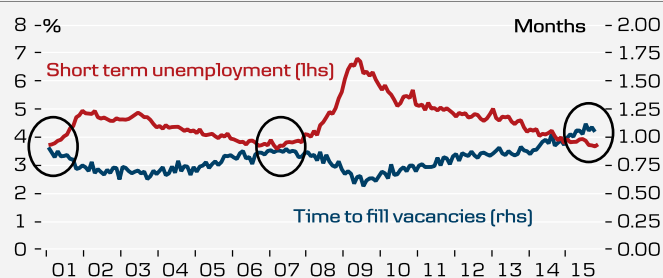
The employer's perspective

Unemployment and time to fill vacancies



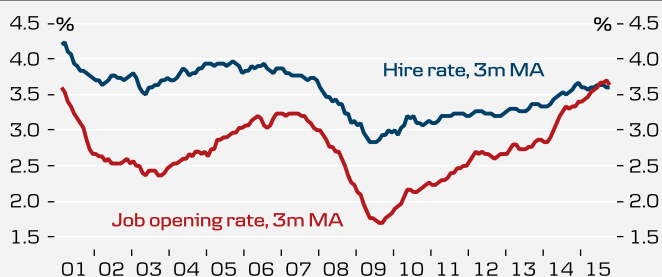
Source: Macrobond Financial, BLS

Short-term unemployment and time to fill vacancies



Source: Macrobond Financial, BLS

The rate of new job openings and hire rate (3M moving average)



Source: Macrobond Financial, BLS

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This research report has been prepared by Danske Bank Markets, a division of Danske Bank A/S ('Danske Bank'). The authors of the research report are Mikael Olai Milhøj, Analyst, and Andreas Mey Kjøller, Assistant Analyst.

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