Pay growth fears strong but unfounded

The Week Ending Friday February 2nd 2018

A terrible Friday for equities and bond prices topped off a poor week overall. Some cooling off for equities from the super start to 2018 was probably inevitable. On top of a natural tendency to pause, some spurious hourly wage growth data on Friday seriously spooked markets.

The All Private Employees Average Hourly Earnings growth hit 2.9% YoY for the first time since the recession. However, this 12-year old data series includes a lot of higher paid managers and professionals, who are definitely not hourly paid employees. Thus, the hourly earnings figure cannot yield much meaning.

Evidence comes from the strong fall back in Average Hours Worked – a meaningless stat for those managers. The somewhat better guide of Average Weekly Earnings in the month did not show record growth, falling back from 3% to the trend of just 2.6%. Likewise the much more established Non-Supervisory and Production Employees wage indexes showed no upward movement.

Sure, the 200k payroll growth figure was a little bit better than expected but is not great given the size the of the workforce these days. When multiplied by Average Weekly Earnings, it implies the income element of NGDP will not be showing any acceleration.

More is the pity. In fact, the payroll growth rate continues to fall. Having peaked in 2015 at 2.3% YoY, it is now below 1.5% YoY.

Thus, there really is no reason for bond markets to be spooked nor, in turn, for equities to sell off strongly due to any expected surge in inflation. The USD recovered from its new lows on the employment data but was flat over the week as a whole.

Positive trends remain in place

That said strong equity markets over the last few months, driven by growing earnings and sales are good signs. The bond market yield curve shifting up is a good sign too. We would love to see higher yields across the curve and not just the flatter curve we were seeing until a few weeks ago.

Some market participants tried to read something new in Yellen’s final FOMC statement but there really was no change from previous meetings. Sure, markets are expecting three rate rises in 2018 but we think that it will only happen if inflation picks up too. We cannot see that inflation happening, nominal growth is just too low.

It is always possible markets would like to know more about new Chair Powell and may spook themselves waiting for him to say something, anything, authoritative. We wait with interest too.

Data

We have already discussed the January payroll data. The healthy December Personal Income data confirmed what we already knew from the 2017Q4 GDP data. The Core PCE Index remains flat on its back at just 1.5% YoY – which makes the run up in bond yields across the curve welcome, but essentially puzzling. This week there was little other news of interest. The Atlanta Fed is expecting a blowout 5.4% for RGDP in 2018Q1 but the nowcast is often a bit screwy early in a new quarter when it has little data to extrapolate. The NY Fed is at more realistic 3.2%

Lots more January surveys arrive next week but no hard data.