LPL RESEARCH

WEEKLY ECONOMIC COMMENTARY

March 12 2018

FEBRUARY EMPLOYMENT REPORT

MORE JOBS, LESS WAGE GROWTH

John Lynch *Chief Investment Strategist, LPL Financial*
Shawn Doty *Senior Analyst, LPL Financial*

KEY TAKEAWAYS

The February employment report outpaced expectations, with nonfarm payrolls growing by 313,000.

Wage growth moderated after last month's jump, taking some of the wind out of recent inflation concerns and headlines.

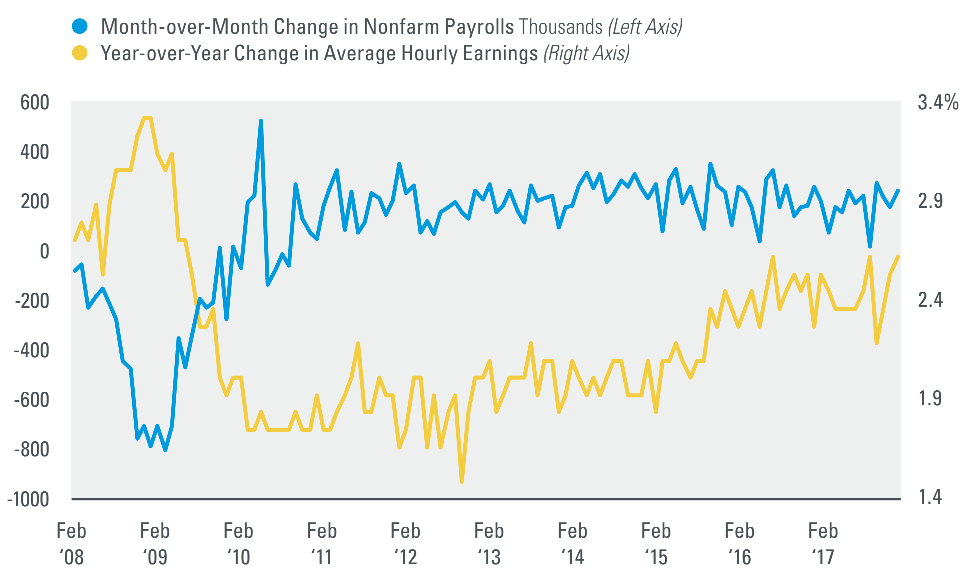
The report keeps the Federal Reserve on track for three hikes in 2018, including one in March.

The February employment report crushed expectations for the number of jobs created (313,000 versus the consensus expectation of 205,000), but wage growth moderated from the surprising January levels. January's numbers were also revised higher from 196,000 to 238,000, and the total two-month revision increased by 54,000. The headline number was the strongest result since July 2016, and points toward continued economic growth in the United States. However, wage growth, which had picked up to multi-year highs in January, weakened to 2.6% year over year from January's downwardly revised 2.8% [Figure 1].

WHERE DID THE GAINS COME FROM?

As usual, the private sector saw the largest gain, with payrolls increasing by 287,000. Construction (+61,000) and manufacturing (+31,000) saw solid gains, adding to the strength seen in goods-producing industries in the last few months. In fact, goods-producing industries added 100,000 jobs in February, which was the largest number since June 1984, though there

1 EMPLOYMENT GAINS ACCELERATED, AND WAGE GROWTH MODERATED IN FEBRUARY



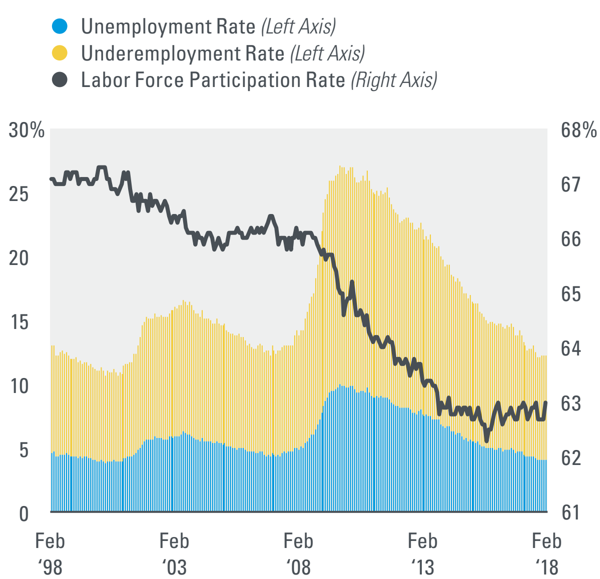
Source: LPL Research, Bloomberg, Bureau of Labor Statistics 03/09/18

LPL Financial

were periods of similar strength in March 1994 (+99,000) and March 2000 (+96,000). Other major gains occurred in retail (+50,000) and professional and business services (+50,000). Within professional and business services, temporary help services—which can be viewed as a leading indicator of future jobs growth—saw a gain of 26,500, the third largest increase in the last five years. Government employment was responsible for the rest of the gain in payrolls (+26,000 jobs), with gains in local (+31,000) and state government (+2,000) offsetting a decline in federal employment (-7,000).

The labor force participation rate increased slightly, but remains within its recent range at 63% [Figure 2]. This may show that wage gains have started to draw some marginalized workers back into the workforce, but it was not enough to raise the unemployment rate or underemployment rate, which remained at 4.1% and 8.2%, respectively. Both remain at low levels, with unemployment at its lowest level since early 2001, and underemployment near the cycle low of 8% reached in October 2017.

2 LABOR FORCE PARTICIPATION, UNEMPLOYMENT, AND UNDEREMPLOYMENT RATES REMAIN LOW



Source: LPL Research, Bloomberg, Bureau of Labor Statistics 03/09/18

WAGE GROWTH STORY NOT OVER YET

January's employment report, released last month, showed a surprise uptick in wage growth (2.9% year over year versus 2.6% expected), which brushed off the inflation concerns that markets had been focused on over the past month. February's employment report, however, did see a moderation of wage pressures. Average hourly earnings increased by just 0.1% month over month, bringing year-over-year growth down to 2.6%. January's year-over-year number was also revised lower to 2.8%.

While this might mean that wage growth falls out of the headlines, we wouldn't count the theme out just yet. Though wage growth missed expectations in this report, market expectations for the future path of Federal Reserve (Fed) rate hikes didn't change much. Following the January report, fed funds futures markets moved to price in three rate hikes in 2018, and this continued to be the case following the February report. Expectations for 2019 were also little changed (at 1.5 rate hikes), and breakeven inflation expectations, as measured by the difference between the 10-year Treasury yield and 10-year Treasury Inflation-Protected Security (TIPS) yield, remained stable at just over 2.1%.

Additionally, the Fed's most recent Beige Book—a qualitative assessment of the domestic economy and each of the 12 Fed districts individually—showed that businesses were dealing with tight labor market conditions, wage growth had "picked up to a moderate pace," and that "most Districts saw employers raise wages and expand benefit packages in response to tight labor market conditions." It is also important to note that though wage growth did decelerate in February, it remains toward the upper end of its post-crisis range.

As mentioned previously, the labor market remains tight and if strong employment growth continues as expected, wage growth could continue to pick up as well. Given labor force participation rates that are below previous expansions, it may still be some time before wage growth picks up to the 4% level that has historically meant higher inflation and a more aggressive Fed, but this is an area we will continue to watch closely in the coming months.

CONCLUSION

February's employment report saw payrolls expand at a significantly faster pace than markets expected, though a moderation in wage growth helped offset any market concerns about a faster pace of Fed rate hikes. We don't expect wage growth to move high enough to warrant a more aggressive Fed in the near term, but it's worth noting that year-over-year growth in average hourly earnings remains near the top of its post-crisis trend. Other indicators such as the Fed's Beige Book and a tight labor market may mean that wage growth is still worth keeping an eye on. Overall, the labor market and economy continue to show strength, which we believe will lead to three Fed rate hikes in 2018. ■