WAGE GAINS: IS THIS TIME FOR REAL?

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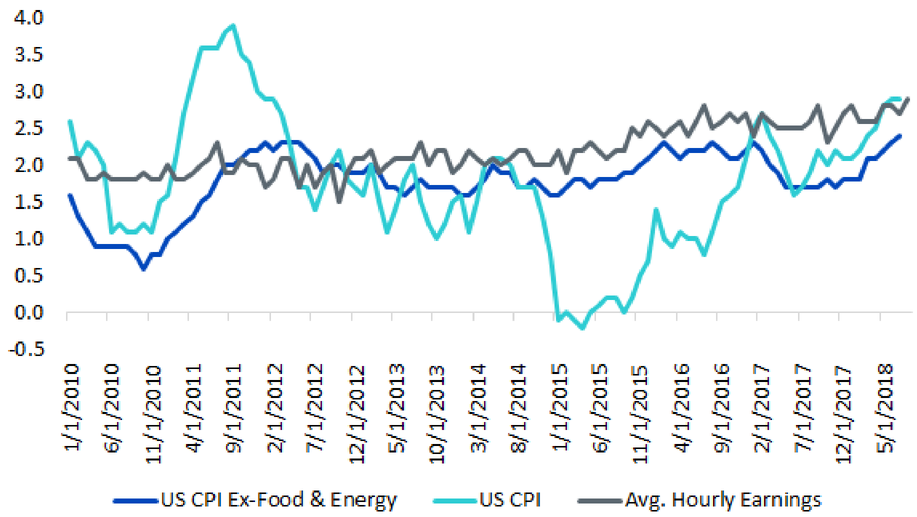
09/12/2018

The money and bond markets received another solid jobs report last week. Indeed, the unemployment rate remained at historic lows, while new job creation maintained its upward trajectory compared to 2017. The fixed income arena has become somewhat accustomed to this development, and as a result, the attention has shifted to another vital part of the monthly employment data: wages.

As I mentioned in the August 8, 2018, blog post, "Stuck in a Moment and You Can't Get Out of It," [the wage aspect of the broader economic landscape had been a bit of a disappointment]. It's not that wages were declining; it's that the pace of growth for average hourly earnings (AHE) was relatively flat and mired in a narrow range. Sure, the bond market had seen its share of surprises to the upside, but these surprises tended to be essentially false starts and either short-lived or, even worse, revised downward in later reports.

Inflation vs. Wages



Source: Bureau of Labor Statistics, as of 9/7/18. Past performance is not indicative of future results.

That brings us to the latest jobs data for August. The Bureau of Labor Statistics reported that the year-over-year rate increase for AHE came in at 2.9%. This reading was not only 0.2 percentage points higher than consensus estimates, but it also represented the highest level since 2009.

Prior to the August print, AHE in 2018 had been stuck in a range of +2.6% to +2.8%, so the natural question becomes whether this latest move to the upside will also be fleeting, or has a new, more elevated trend commenced? Certainly, the underlying data were encouraging because wage gains were not just centered on one or two groupings but were more widespread. Another key point is that the jobless rate remains at 3.9%, a figure that, if sustained, would seemingly be a positive sign for future wage growth as well.

Let's look at this from a broader inflation picture. Thus far in 2018, inflation has been flying under the radar. In other words, the Consumer Price Index (CPI), on both a headline and core (excluding food and energy) basis, has been making inroads to the upside, but the bond market has apparently not given this development too much thought. To be sure, after a boost in late 2017 and early this year, inflation expectations have remained fairly anchored. So what has been the missing ingredient to the inflation backdrop? Wages. If this latest wage gain is "for real," anxiety levels in the U.S. Treasury (UST) market may start creeping higher, notwithstanding escalated trade wars or further deterioration in the emerging market landscape.

Conclusion

The enclosed graph highlights how wages and both CPI readings are on a path of convergence. If this trend is sustained or built upon further, it will continue to offer more confidence for the Federal Reserve (Fed) that hitting its inflation target is here to stay, and perhaps make it more likely that it could, at some point in the not too distant future, declare victory on the inflation front. We do expect the policy makers to raise rate rates for the third time this year at the upcoming September 25/26 FOMC meeting, and they more than likely will add another increase to the Fed Funds Rate in December. As far as declaring victory, the Fed would probably say that is premature at this juncture.

Unless otherwise noted, data source is Bureau of Labor Statistics as of September 7, 2018.

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DEFINITIONS

Inflation : Characterized by rising price levels.

Consumer Price Index (CPI) : A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Federal Open Market Committee (FOMC) : The branch of the Federal Reserve Board that determines the direction of monetary policy.