

## US EMPLOYMENT UPDATE

FACED WITH WORKER SHORTAGES, THE US WILL ALSO HAVE A BIG RATE HIKE TO DEAL WITH

Author

ASSET ALLOCATION & MACRO  
RESEARCH

### SUMMARY

- > The highlight of the US employment report for March was the sharp drop in the unemployment rate to only 3.6%, the lowest level since the pre-pandemic rate of 3.5% posted in February 2020.
- > In itself such rapidly declining unemployment rate shows the entrenched, robust momentum of the US economy, and a recession still appears at bay. A red flag would be a stagnating unemployment rate, but so far the unemployment rate seems to be barrelling down almost unstoppable.
- > Wage growth (average hourly earnings) remains firm at 5.6% y-o-y, although looking at the more granular level over the past two months, there seems to be some cooling-off potentially happening very recently.
- > The Federal Reserve could still continue to worry about the potential emergence of a wage-price spiral a la 1970s. We continue to think the next rate move is +50bp at the next scheduled meeting in May due to the ongoing concerns about inflation becoming more entrenched, after a first hike of +25bps in March. We also continue to think the Fed will announce the shrinkage of its balance sheet in May.
- > But since we do not expect such a wage-price spiral to materialise, we think the Fed could return to more serene pace of hikes after May (and, after summer, potentially pause rate hikes altogether). Long-term interest rates have already backed up a lot and could start to affect the economy, with a lag, post summer.

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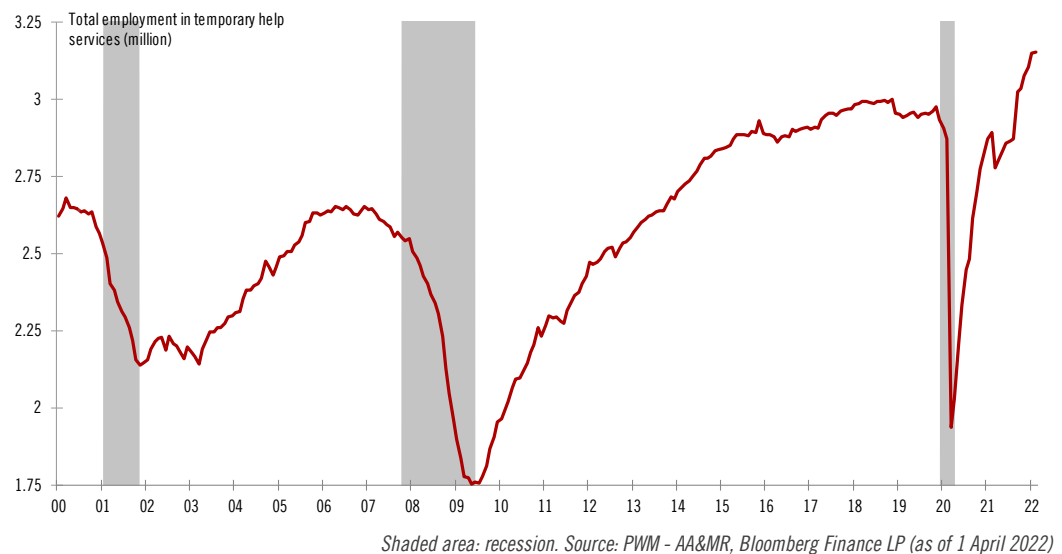
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### The unemployment rate is dropping like a stone

**The US economy, and in particular its labour market, continued to power ahead in March.** To be sure, the monthly jobs gain was less impressive than in February at 431,000 versus a revised 750,000 the previous month but February data were likely boosted by a massive post-omicron return to work.

In itself, **such solid jobs momentum should keep recession worries at bay.** A recession is usually around the corner when the economy is close to 'stall speed' (slow payroll growth and a stagnant unemployment rate). But with the unemployment rate declining rapidly and well below its one-year average (4.8%), concerns of this sort seem misplaced. Another important technical indicator that shows a recession is far off is employment in cycle-sensitive 'temporary help' services, which is going from strength to strength (up 9.0% y-o-y in March versus total employment up 4.5% y-o-y) – see *Chart 1*. Net positive revisions to previous employment prints also point to a solid business cycle, with nonfarm payrolls for the first two months of 2022 revised up by 95,000.

CHART 1: SOLID EMPLOYMENT IN TEMPORARY-HELP SERVICES SUGGEST A RECESSION IS STILL WAY OFF



This does not mean there are no economic risks. One is that the Federal Reserve (Fed) 'overreacts' to wage and inflation signals in particular. In recent weeks, **the Fed has been sounding anxious about the possibility that the tightness of the labour market fuels a wage-price spiral like in the 1970s.** The headline number of 5.6% y-o-y for average hourly earnings in March could increase this anxiety even though taking the past two months together (0.1% m-o-m in February and 0.4% m-o-m in March) there are tentative signs of some cooling-off in wage growth.

**After recent super-strong gains, we continue to believe that wage growth should start easing in coming months,** especially as we expect more immigrants to come to the US now that travel restrictions are eased, and more sick workers and caregivers return to work (as an aside, we note the participation rate for women aged 25-54 rose sharply in March, to 76.5%, still 0.4ppt below the pre-pandemic peak).

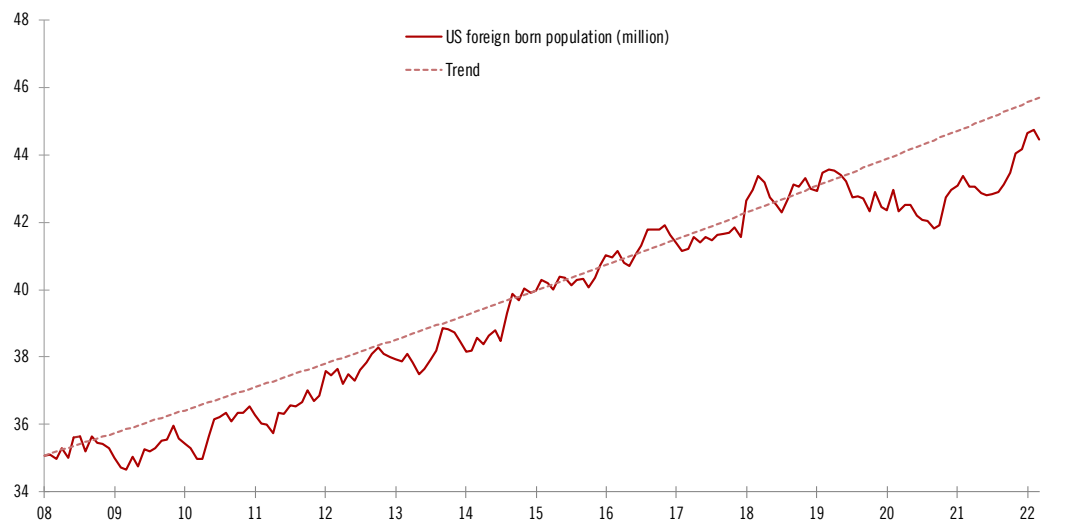
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In particular, we expect service-sector wage growth – where wage gains have been particularly high – to start easing. Nevertheless, **wage growth in leisure & hospitality was still a super strong 11.8% y-o-y in March, so it might be too early to call a turning point.**

Our surprise is that the **labour force has not been rebounding as much as we would hope.** The US labour force grew only 418,000 in March after +304,000 in February. A further resurgence in the virus could lead to a rebound in absenteeism, slow the gains in the employment rate, and lead to higher wage gains eventually. And it remains to be seen whether the covid-19 virus has triggered a more permanent change in work patterns that affects the employment rate, in particular for those aged 55 and over.

CHART 2: IMMIGRATION TO THE US HAS DRIFTED BELOW THE PRE-PANDEMIC TREND



Source: PWM - AA&MR, Bloomberg Finance LP (as of 1 April 2022)

### Federal Reserve: March payrolls to keep Fed on track for big hike

The Fed's pivot to a more hawkish posture in December coincided with the reappointment of Jerome Powell as chairman. Hawkish signals have further abounded in recent weeks, as worries of a 1970s-style price-wage spiral are mounting within the institution, and Powell himself expressing his concern. Powell seems determined to accelerate the pace of rate hikes. After the +25bp rate rise delivered in March, we think **the Fed will opt for +50bp rate rise at its May meeting.**

Impressive labour-force momentum means that recession still seems some way off, although things could change rapidly. Business-cycle and interest-rate sensitive sectors such as construction and real estate could start to suffer if the Fed pushes up rates too rapidly. While not a major red flag, there are already signs of unease in some homebuilder-sentiment surveys as mortgage rates soar. Housing transactions have also softened of late. Employment in construction was still positive in March (+19K, or +3.0% y-o-y), and it may take **several months before a more hawkish Fed feeds into the real economy.**

The Federal Reserve does not have a good track record when it comes to engineering a 'soft landing', especially in an environments where the labour market is tight.

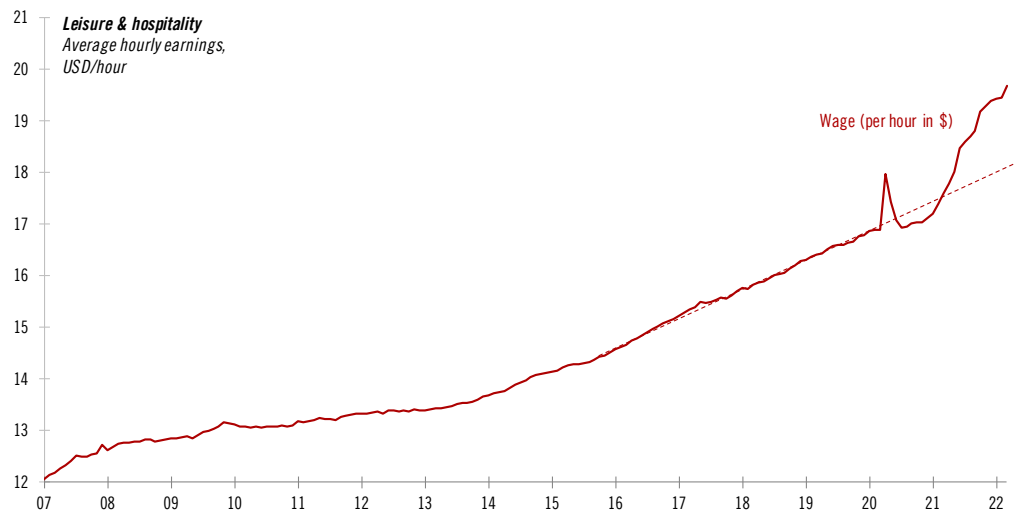
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Meanwhile, our sense is that the Fed may put too much onus on labour-driven inflation dynamics rather than fiscal-policy driven ones. The latter are especially relevant now due to the deluge of government support to households in 2020-21, although the fiscal impulse may fade in the coming months.

The next crucial indicators the Fed will watch are the March consumer price index (to be released on 12 April, with consensus expectations for a 1.2% rise m-o-m, up from 0.8% in February), and the Q1 employment cost index (ECI) on 29 April. The Fed tends to prefer ECI to the unadjusted average hourly earnings figure released in the monthly employment report (the Q4 ECI print was 1.0% q-o-q, 4.0% y-o-y).

### CHART 3: WAGES ARE STILL RISING FAST IN THE LEISURE & HOSPITALITY SECTOR



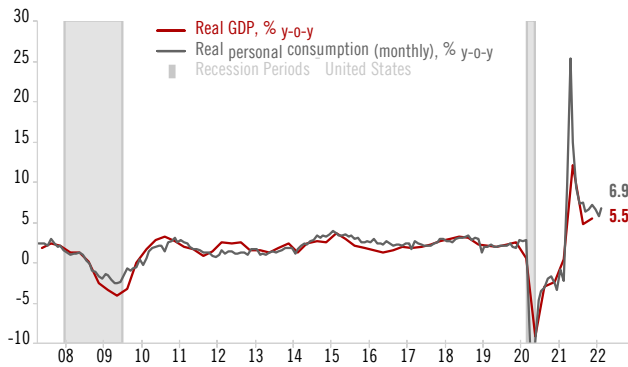
Source: PWM - AA&MR, Bloomberg Finance LP (as of 1 April 2022)

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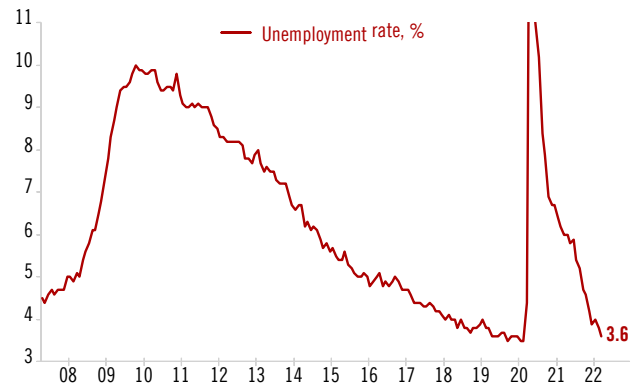
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REAL GDP AND PRIVATE CONSUMPTION GROWTH, % Y-O-Y



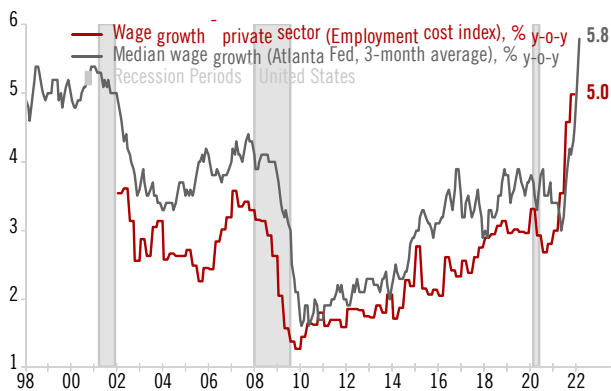
Source: Pictet WM – AA&MR, Factset

UNEMPLOYMENT RATE, %



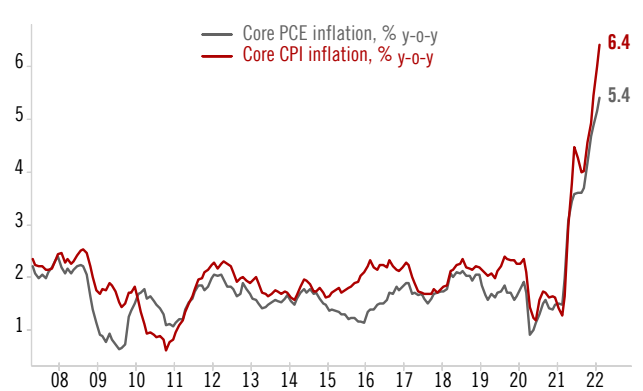
Source: Pictet WM – AA&MR, Factset

WAGE GROWTH INDICATORS, % Y-O-Y



Source: Pictet WM – AA&MR, Factset

CORE INFLATION (PCE AND CPI INDICES), % Y-O-Y



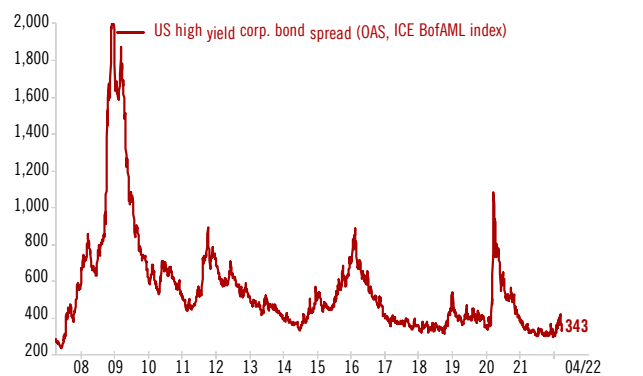
Source: Pictet WM – AA&MR, Factset

ISM BUSINESS SURVEYS



Source: Pictet WM – AA&MR, Factset

HIGH-YIELD CORPORATE BOND SPREAD, BASIS POINTS



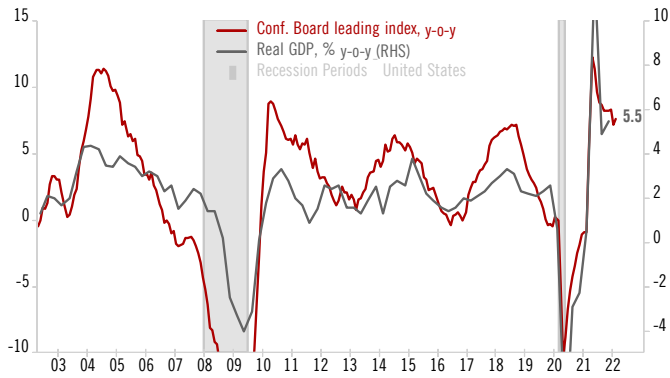
Source: Pictet WM – AA&MR, Factset (last close)

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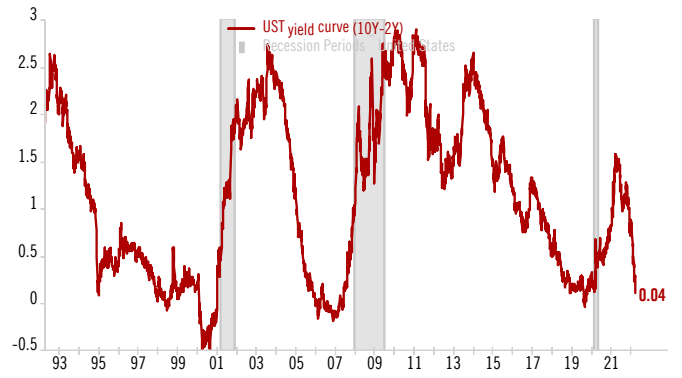
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CONF. BOARD LEADING INDEX, % Y-O-Y VS GDP GROWTH, % Y-O-Y



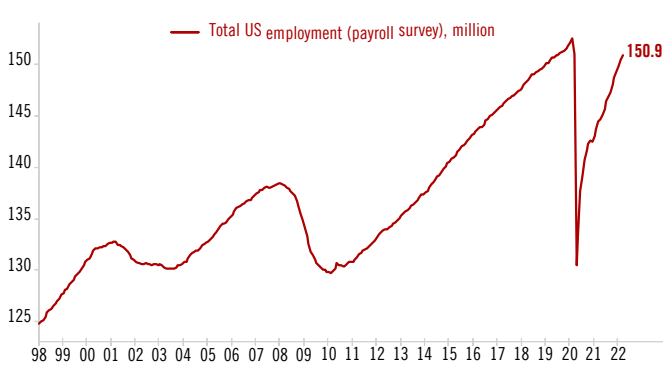
Source: PWM - AA&MR, Factset

US YIELD CURVE SPREAD (10-YEAR YIELD MINUS 2-YEAR YIELD)



Source: PWM - AA&MR, Factset (last close)

TOTAL US EMPLOYMENT



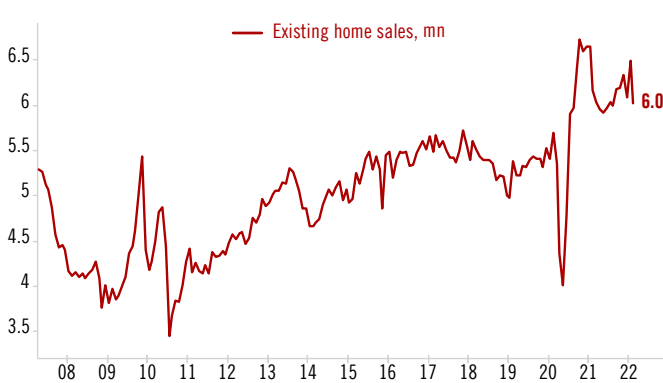
Source: PWM - AA&MR, Factset

US INVESTMENT (EQUIPMENT) VS EMPLOYMENT GROWTH, % Y-O-Y



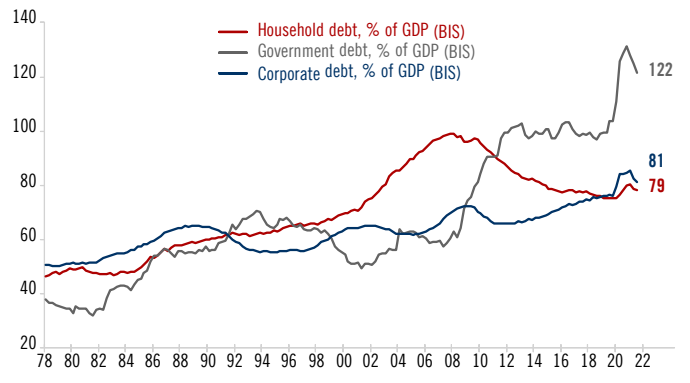
Source: PWM - AA&MR, Factset

EXISTING HOME SALES, MILLION UNITS (ANNUALISED)



Source: PWM - AA&MR, Factset

DEBT RATIOS (HOUSEHOLD, CORPORATE, GOVERNMENT), % OF GDP



Source: PWM - AA&MR, Factset

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