

Economic Update

THOUGHTS FROM OUR ECONOMICS TEAM

MARCH 7, 2014

CHILL OUT

“Severe winter weather occurred in much of the country during the February reference periods.” So advised the statisticians in Friday’s US employment situation release. The headline numbers, though, plowed through snow and sleet as the US economy saw 175,000 net, new nonfarm payroll employees and an unemployment rate of 6.7%. That said, the report brought little that would alter the current stance of monetary policy: tapering will continue, new fed funds rate guidance is forthcoming as the 6.5% threshold becomes obsolete, and depending on inflation data, the fed funds rate will remain near zero well into 2015.

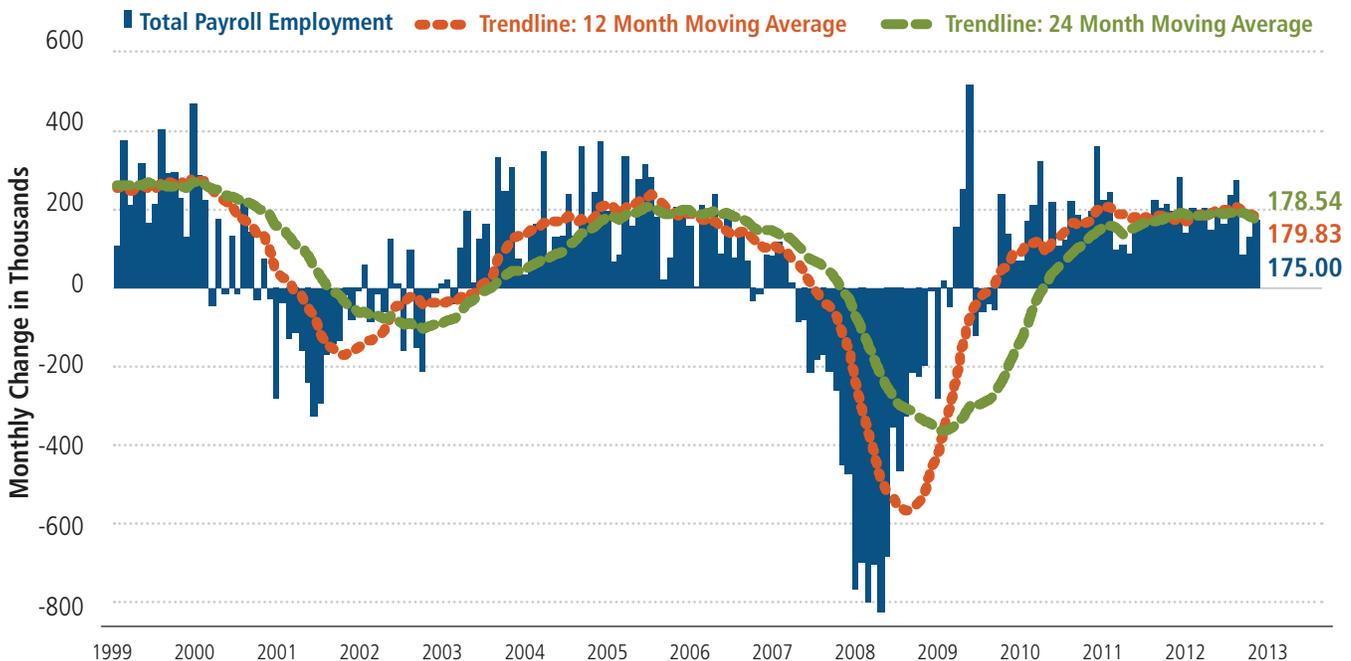
After February’s report, the 12-month and 24-month averages for monthly nonfarm payroll employment growth were 180,000 and 179,000, respectively. As such, February’s number (+175k) continued the remarkable consistency witnessed over the last two years (See Chart 1 below). While nothing in the report suggests that the labor market is on the verge of a 1990s-style payroll boom, neither did the report confirm the deeply negative employment reading gleaned from this week’s ISM services report.

For the FOMC, then, policy stays the same. Indeed, on Thursday, when queried on what would cause the FOMC to deviate from the current pace of tapering, NY Fed President Bill Dudley suggested that only wildly divergent data (think GDP growth at 5% or 0%) would shift their current plans to shutter the QE3 program by year end, reducing asset purchases by \$10 billion per meeting.

Tapering was the story of 2013. The question for 2014: [does the U-3 \(official\) unemployment rate accurately represent labor market health?](#) Just in case anyone thinks this case is cut and dry, think again. Those who answer “yes” might point to the 0.4% jump in average hourly earnings in February and 2.5% rise from a year ago as evidence of sharply tighter labor market conditions. Those who answer “no” will point to broader measures such as the share of working-age adults with jobs still stuck at 58.8% and the 203,000 jump in long-term unemployment (27+ weeks or longer) to 3.8 million in February as evidence of broader weakness masked by the U-3 gauge.

MONTHLY NONFARM PAYROLL IMPROVEMENTS HAVE HELD STEADY AT ~180K SINCE 2011

Payroll Employment, Monthly Change – 12 Month, 24 Month Averages

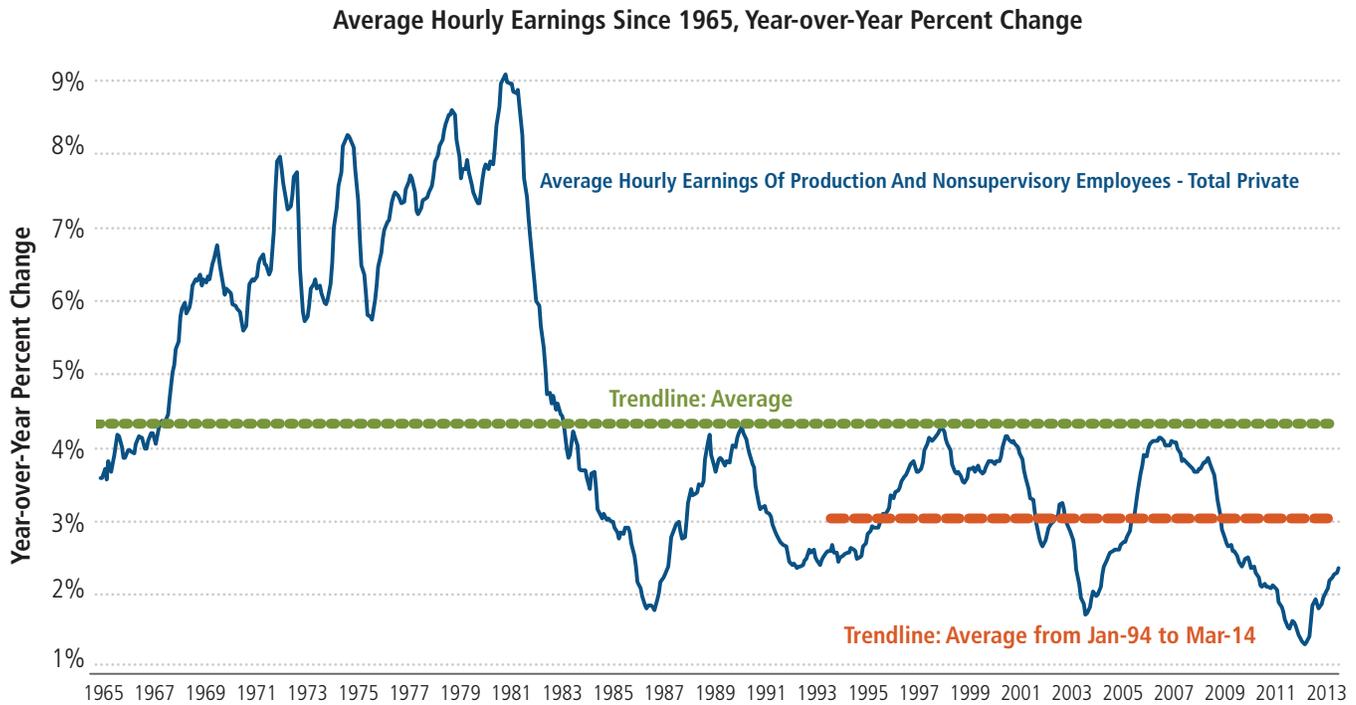


Source: Bureau of Labor Statistics

Considering still-high unemployment, sluggish wage growth and low inflation, we are inclined to believe Mr. Dudley when he said yesterday, "We have a long time to go before we actually have to think about raising short term rates." The February uptick notwithstanding, we think average hourly earnings remain well below pre-crisis growth

rates as well as the long-run averages (see Chart 2 below). But the debate over the next move in short-term interest rates will center around how the labor market story and wage data evolve. Don't be distracted by the hoopla surrounding the headline nonfarm payroll number.

WAGE GROWTH BOTTOMED IN 2012 BUT REMAINS WELL BELOW LONG-TERM AVERAGES



Source: Bureau of Labor Statistics