Moody's ANALYTICS

U.S. Macro Outlook: It's a Job Machine

BY MARK ZANDI — APRIL 12, 2016
www.economy.com

U.S. Macro Outlook: It's a Job Machine

By Mark Zandi
APRIL 12, 2016

View the Moody's Analytics U.S. Macro Forecast.

- With GDP growth near a standstill, the robust job numbers are a better representation of the reality of the economy's performance and prospects.
- The economy is a job machine; the string of monthly job gains is the longest on record, stretching all the way back to September 2010.
- Wage growth is reviving. An economy at full employment and with stronger wage growth will be a substantial tailwind to consumers.
- The Fed can't wait much longer to resume increasing rates.

GDP growth has come to a near standstill. Growth will be barely positive in the first quarter, after a paltry gain in the fourth quarter of last year. Job growth, however, remains robust, with no sign of slowing. The job numbers are a better representation of the reality of the economy's performance and near-term prospects.

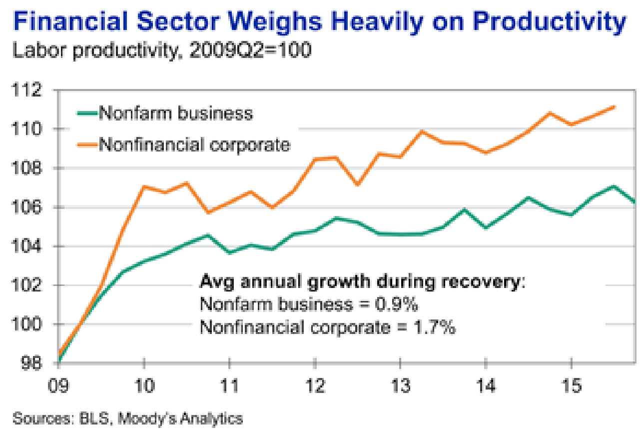
Measurement problems plague the GDP figures. Despite yeoman efforts by the Bureau of Economic Analysis, the source of the GDP data, there remains a significant residual seasonality problem. That is, GDP has a clear seasonal pattern, with the weakest growth not surprisingly during the winter months. But the BEA hasn't been able to fully correct for this seasonality.

GDP head fake

GDP also undergoes significant revision. The initial estimate of GDP for a quarter is revised by close to a percentage point on average in subsequent estimates as more source data, especially inventory and international trade statistics, become available. Big revisions also occur years later when more source data and methodological changes are incorporated into the GDP accounts.

Even if the BEA got it exactly right, GDP growth would still likely to be on the soft side, as productivity growth remains punk. While hard to prove, this can be traced in part most recently to the hit the energy and manufacturing sectors have taken. These are very productive industries, and output has been hammered more than employment.

Productivity has also struggled since the financial crisis, as that wrenching period undermined business risk-taking, which is vital to innovation, and labor mobility, which is key to getting workers into the most productive jobs. Massive reworking of the financial system engineered by Dodd-Frank, and of the healthcare system by the Affordable Care Act, has also played a role.



These, however, are more or less transitory constraints on productivity. The downdraft in energy and manufacturing will abate by year's end and risk-taking and mobility are picking up. Adjustment to the new regulations in the financial and healthcare systems will be over soon.

Job machine

It is much easier to count jobs than GDP. While the Bureau of Labor Statistics estimates jobs based on a sample of businesses, once a year it makes sure its job counts are consistent with unemployment insurance records for all businesses. In recent years, the BLS estimate of the number of jobs has been dead on.

The economy is a job machine. The string of monthly job gains is the longest on record, stretching all the way back to September 2010. And more than 200,000 jobs have been created on average each month during this time. This is twice the pace of job creation needed to absorb the growth in the working-age population.

Lots of jobs of all kinds are being created. Job growth is strong across all pay scales, and nearly every occupation, industry and region of the country. The only blemishes are related to the plunge in oil prices and their impact on energy-related jobs, and the impact on trade-sensitive manufacturing jobs from the tough global economy and strong U.S. dollar.

Help wanted

Everything points to continued strong job gains in coming months. Layoffs remain at record lows, with weekly unemployment insurance claims—arguably the best real-time indicator of the economy's strength—about as low as they ever go. Hiring isn't quite as good as in the best of times past, but given the record number of open job positions, this is either because businesses are becoming pickier in who they hire, or more likely because they can't find qualified workers.

Arguably most encouraging of late is the surge in the number of workers quitting their jobs. People don't leave jobs voluntarily unless they feel confident they can find new ones easily. High and rising "quits" are a tell that the economy is closing in on full employment.

The sharp increase in labor force participation is also consistent with a tightening job market. Participation is up an astounding 60 basis points in the past six months, as the labor force has expanded by a whopping 2.4 million over this period. In a typical year, the labor force will grow by no more than half that.

Some of the increase in participation may be noise, as this number is derived from a small sample of households. But evidence that the increase is across all age groups suggests it is not a statistical mirage. Adding to this view is that most of the increase in participation is due to fewer workers leaving the workforce, and less due to those out of the workforce coming back in.

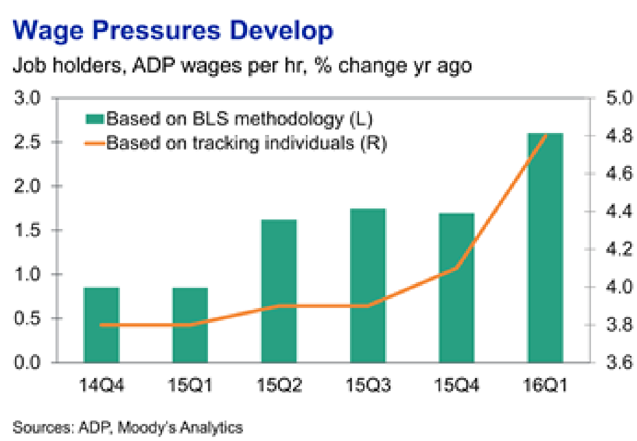
While there is still an elevated number of workers out of the workforce who say they want a job and part-timers who want more hours, they are quickly being absorbed. At the current pace of job growth—if sustained, which seems likely—the economy will be at full employment by summer. While job growth is sure to slow after that, as it will be increasingly tough for businesses to fill jobs, the economy will be beyond full employment by this time next year.

Wages revival

Wage growth is reviving in response. This is somewhat evident in the various wage data constructed by the BLS. Average hourly earnings have picked up from closer to 2% per annum through most of the recovery, to just below 2.5% most recently. Compensation as measured in the labor productivity statistics shows a somewhat stronger increase, but the preferred employment cost index shows little increase.

The BLS measures of wage growth are likely biased downward, even the ECI. The problem is that given the way the BLS measures wages, they are affected by the changing composition of workers leaving and coming into the workforce. With lots of higher-paid baby boomers leaving, and lower-paid millennials coming in, the BLS wage measures are being pushed down. Another likely factor is that marginal, lower-paid workers are finding jobs as the labor market tightens.

Wage data collected by human resource company ADP and constructed by Moody's Analytics affirm this. The data are able to track the wages of the same individuals over time and is thus not biased by the compositional issues plaguing the BLS data. The ADP-based data show that for workers who have stayed at the same job over the past year, wages are up a strong 4.8% through March of this year. This is approximately 2 percentage points stronger than wage growth using the ADP data but based on the BLS methodology for measuring wages.



According to the ADP-based data, wage growth is also accelerating, consistent with a tightening job market. A year ago, wages for the same workers on the job more than a year were rising by 3.8%. This is a 100-basis point acceleration in wage growth in just the past year. Adding credence to the ADP-based data is that wage growth for all workers, including job switchers is consistent with wage growth as measured by the BLS.

More consumption, Fed tightening

An economy at full employment and with stronger wage growth will be a substantial tailwind to consumers. Not only will consumers have more income to spend, but their psyches should get a lift. People likely judge their financial well-being through the prism of their pay. Are their pay increases this year bigger than last, and are the increases beating inflation? For most of the recovery, the answers were no and no. Until now. With wage growth picking up, so too should consumer confidence. Continued strong consumer spending growth is vital to the U.S. economic recovery, and even to the global economy.

A full-employment economy and stronger wage growth also imply that the Federal Reserve will soon resume its normalization of monetary policy. The Fed raised rates off the zero lower bound in December but has been on hold since, given the weak global economy and turmoil in financial markets at the start of the year.

But the Fed can't wait much longer to resume increasing rates as its full-employment mandate has been nearly met. Inflation is still below the Fed's target of 2%. But it won't be for much longer, given the strengthening wage growth that will pressure businesses to raise prices more quickly. Reinforcing the case are sturdy rent growth and an anticipated pickup in healthcare inflation as some of the constraints resulting from healthcare reform fade.

The longer the Fed fails to respond to the tightening job market, the greater the risks that it will need to raise rates more quickly next year and the year after in order to catch up. This is the classic dynamic that has done-in most other business cycles. The Fed can still forestall it, but not for much longer.

About Moody's Analytics

Moody's Analytics helps capital markets and credit risk management professionals worldwide respond to an evolving marketplace with confidence. With its team of economists, the company offers unique tools and best practices for measuring and managing risk through expertise and experience in credit analysis, economic research, and financial risk management. By offering leading-edge software and advisory services, as well as the proprietary credit research produced by Moody's Investors Service, Moody's Analytics integrates and customizes its offerings to address specific business challenges.

Concise and timely economic research by Moody's Analytics supports firms and policymakers in strategic planning, product and sales forecasting, credit risk and sensitivity management, and investment research. Our economic research publications provide in-depth analysis of the global economy, including the U.S. and all of its state and metropolitan areas, all European countries and their subnational areas, Asia, and the Americas. We track and forecast economic growth and cover specialized topics such as labor markets, housing, consumer spending and credit, output and income, mortgage activity, demographics, central bank behavior, and prices. We also provide real-time monitoring of macroeconomic indicators and analysis on timely topics such as monetary policy and sovereign risk. Our clients include multinational corporations, governments at all levels, central banks, fi nancial regulators, retailers, mutual funds, financial institutions, utilities, residential and commercial real estate fi rms, insurance companies, and professional investors.

Moody's Analytics added the economic forecasting firm Economy.com to its portfolio in 2005. This unit is based in West Chester PA, a suburb of Philadelphia, with offices in London, Prague and Sydney. More information is available at www.economy.com.

CONTACT US
For further information contact us at a location below:

U.S./CANADA
+1.866.275.3266

EMEA
+44.20.7772.5454

ASIA/PACIFIC
+852.3551.3077

OTHER LOCATIONS
+1.610.235.5299

Email us: help@economy.com
Or visit us: www.economy.com

Moody's
ANALYTICS