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TRENDMACRO LIVE!

On the August Jobs Report, And the Wage Conundrum

Friday, September 7, 2018

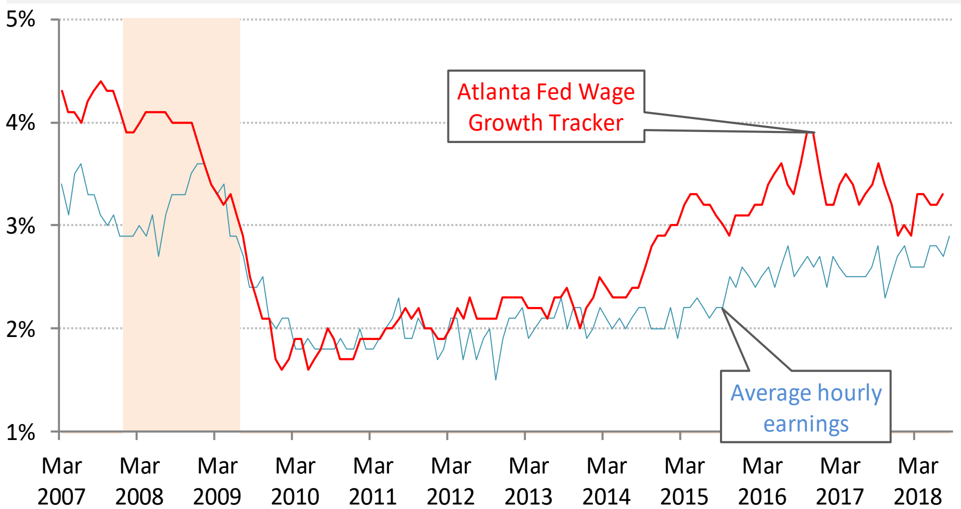
Donald Luskin

The jump in earnings growth is illusory. Nothing here to make the Fed more hawkish.

This morning's August Employment Situation report with 201,000 net payroll gains looks like a beat versus the consensus for 194,000. *But it's actually a miss, because of downward revisions of 50,000 payrolls for the prior two months* (the re-revision of prior *upward* revisions, by the way – see "On the July Jobs Report, and The Education Dividend" August 3, 2018). With that accounted for properly, today's jobs report came in perfectly in-line with all the other contemporaneous indicators of labor market activity – and it's a perfectly run-of-the-mill report for this business cycle expansion, which is actually somewhat extraordinary considering that the expansion is starting into its tenth year.

- Post-release headlines have all been about the 2.9% year-over-year gain in average hourly earnings, the largest since the end of the Great Recession (please see the chart below). The fear is that this will drive the Fed toward more hawkish policy, especially considering that its favored inflation measure – core Personal Consumption Expenditures – just printed at 1.98%, not quite the 2% target, but it sure rounds to it.
- We're not that worried about it. August's monthly earnings growth at 0.37% was nothing special. *The only reason the year-over-year*

Wage growth YOY **Recession**



Source: BLS, Atlanta Fed, TrendMacro calculations

Update to strategic view

US MACRO, US FED: A headline beat was really a miss, thanks to large downward revisions that reversed previous upward revisions. It was a middle-of-the-road jobs report, extraordinary for the tenth year of an expansion. The headline earnings growth of 2.9% jump, the best in this expansion, is somewhat illusory thanks to a weak month one year ago rolling off. Monthly earnings growth was not exceptional. The conundrum of low wage growth remains, with some new evidence from the Atlanta Fed's microdata pointing to poor economic dynamism. Nothing here ought to move the Fed toward more hawkishness.

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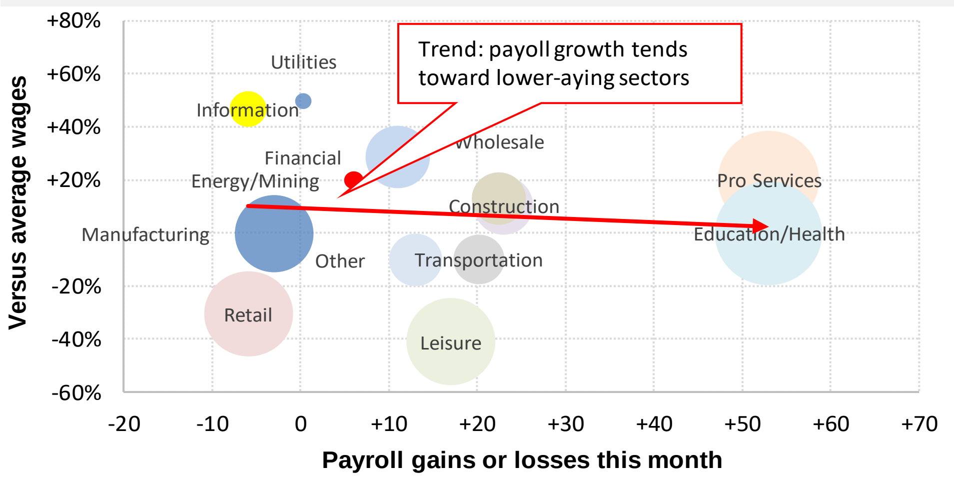
reading jumped so much is because a weak August 2017 just dropped out of the calculation.

- And the labor force participation rate dropping to 62.7% as 463,000 persons left the labor force is not itself a positive development – but it cuts against any arguments that there is no slack left in the labor force, or that we are "running out of jobs" (see, among others, "On the May Jobs Report: What Labor Shortage?" June 1, 2018).
- Besides, chair Jerome Powell's keynote speech two weeks ago at Jackson Hole made it clear that his Fed isn't going to robotically follow Phillips Curve superstitions that employment causes inflation (see "On Powell's Debut at Jackson Hole" August 24, 2018).

Most fundamentally, even this high tick in post-recession year-over-year earnings growth is still well below pre-recession levels. That remains something of a conundrum.

- We've offered a number of explanations that go a little deeper than generalized narratives of post-crisis malaise leading to weak bargaining power for workers.
- We've noted that the prime-age labor force is getting younger now, following almost two decades of graying (see "The Demographics Myth" March 20, 2017). The substitution of young workers entering the workforce for old workers retiring from it ought to lower *average* earnings.
- We've noted that the composition of post-crisis payroll growth has favored relatively low-wage sectors such as hospitality and health care (please see the chart below, and every month in "Data Insights: Jobs").

Wage distribution of payroll gains and losses



Source: BLS, TrendMacro calculations

- Yesterday the White House Council of Economic Advisors issued a report attempting to solve the wage conundrum – or actually to refute it, that is, to adduce evidence that the Trump boom has produced wage growth greater than what is generally reported. While the report may be intended as political cheer-leading, it

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Recommended Reading

How Much Are Workers Getting Paid? A Primer on Wage Measurement
Council of Economic Advisors
September 2018

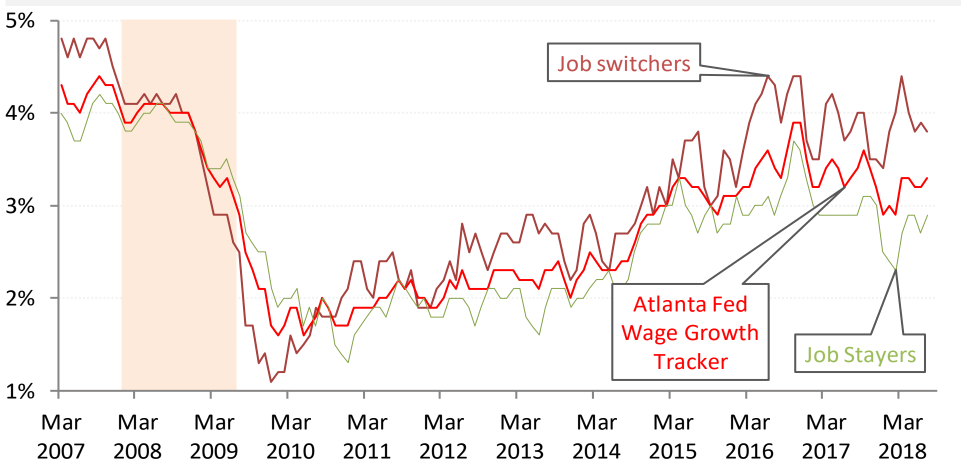
Sage Against the Machine
Tunku Varadarajan
Wall Street Journal
9/1/2018

[Reading home]

nevertheless makes some interesting points.

- It demonstrates that among all the regularly reported earnings growth statistics, the most widely followed one – monthly average hourly earnings – is the lowest.
- Among the higher-trending data series the report covers is the Atlanta Fed's Wage Growth Tracker. For July, the most recent month for which data is available, it is reporting year-over-year earnings growth of 3.3% (while the typical average hourly earnings statistic was 2.7% – again, please see the chart on the previous page).
- The Atlanta Wage Tracker is derived from the usual Current Population Survey data from Bureau of Labor Statistics, but slices-and-dices it in useful new ways. *Most important, it uses microdata to track unique individual households across time* – *so the earnings growth it reports is not the change in the population average, but the average of each unique household's change.* This filters out spurious changes in the composition of the workforce, and allows for new kinds of aggregations within the workforce.
- One such aggregation strikes us as offering a key to understanding the wage conundrum.
- Breaking workers down into two camps – those who stayed with the same job over the last year, versus those who switched jobs over the last year – shows two very different levels of wage growth. Growth for "switchers" has been higher than growth for "stayers" (please see the chart below).

Wage growth YOY **Recession**

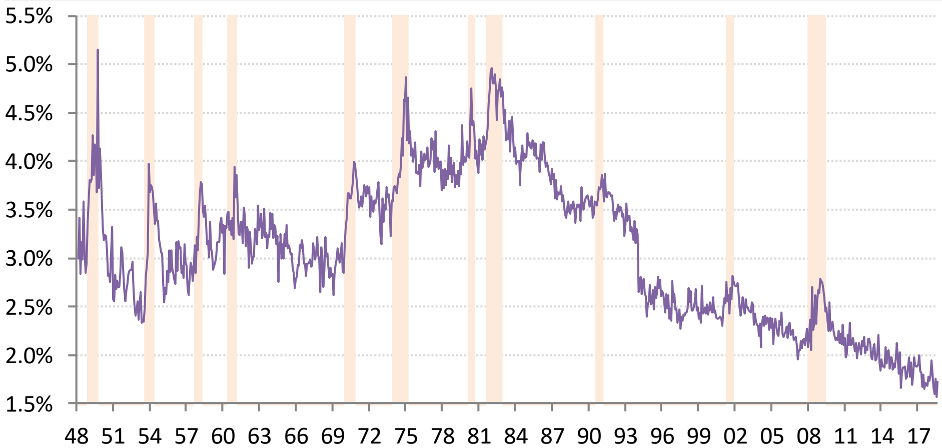


Source: Atlanta Fed, TrendMacro calculations

- This has one obvious implication. Since the recession, there has been enough dynamism in the economy, despite so-called "secular stagnation," so that, on average, workers who switched jobs were able to do so profitably. While obvious, this nevertheless confounds the often-heard narrative that workers have been forced out of high-paying "manufacturing" jobs into low-paying "services" jobs. That may have been true during and in the first year after the Great Recession, but since 2011 it has paid to switch, on average.

- Yet even the higher earnings growth for switchers has been lower *after* the Great Recession than *before* the Great Recession. So the fundamental conundrum remains.
- *That said, why don't more people switch if there are rewards for doing so?*
- *We do know that there aren't very many switchers.* That's reflected in the fact that overall wage growth is closer to that of the stayer than that of the switcher (again, please see the chart on the previous page). But we've known it all along as we've watched the "inflow rate to unemployment" – the monthly rate of workers becoming unemployed for all reasons – fall to all-time lows (please see the chart below, and every month in "Data Insights: Jobs").

The "inflow rate" to unemployment **Recession**



Source: BLS, per Shimer (2005) TrendMacro calculations

- On the face of it, it is a paradox that in a time of economic uncertainty, job-security is at an all-time high. It must be that the world isn't really all that uncertain – or people wouldn't be able to remain employed this steadily. *So we must conclude that people are deciding to act uncertain in a world where certainty is actually quite high. They are choosing to be risk-averse by sticking with a pat hand, even when, when it comes to employment, in a truly uncertain world you don't even have the option to stick with that pat hand – you're fired!*

Bottom line

A headline beat was really a miss, thanks to large downward revisions that reversed previous upward revisions. It was a middle-of-the-road jobs report, extraordinary for the tenth year of an expansion. The headline earnings growth of 2.9% jump, the best in this expansion, is somewhat illusory thanks to a weak month one year ago rolling off. Monthly earnings growth was not exceptional. The conundrum of low wage growth remains, with some new evidence from the Atlanta Fed's microdata pointing to poor economic dynamism. Nothing here ought to move the Fed toward more hawkishness.