GM360

Global Macro 360

Global Macro 360 Note

Weekly Note – Full Employment in the US

19-December-2017

Good Morning,

The US labour market looks set to end 2017 on a high note, with payroll employment up 228,000 and private-sector hours worked up 0.5% in November. Part of the strength is due to residual hurricane bounce back effects, but even if we look at the past 3-4 months, the payroll trend remains in the same 150-200k range that has prevailed all year. Admittedly, this is 50,000 below the breakneck pace of 2014-2016, but it remains well-above the rough 100,000 estimate of the breakeven rate.

Table 1 This week in markets

Name	YTD %	MTD %	WTD %
DOW JONES	24.40%	1.29%	1.84%
S&P 500	18.94%	0.58%	1.28%
RUSSELL 2000	12.33%	-1.28%	1.03%
NASDAQ COMPOSITE	27.73%	0.03%	1.47%
Euro Stoxx 50	8.69%	0.30%	0.21%
FTSE 100	4.82%	2.19%	2.27%
DAX 30	14.24%	0.71%	0.55%
NIKKEI 225	18.73%	-0.13%	0.87%
HANG SENG	32.57%	-0.04%	3.05%
S&P/ASX 200	6.10%	0.69%	0.56%
EUR-USD X-RATE	12.52%	-0.59%	0.52%
EUR-GBP X-RATE	-3.09%	-0.07%	-0.80%
Gold Spot $/Oz	9.40%	-1.54%	0.66%
Crude Oil	5.81%	-0.98%	0.26%

The strength comes at a point when the unemployment rate is already at 4.1%, the lowest in nearly 17 years. What's more, other indicators such as the underemployment rate, job openings, quits, firm surveys on skill shortages, and household surveys on job availability also suggest that the labour market has started to move beyond full employment. The one labour market indicator that still suggests some slack remains is the pace of wage growth. Indeed, average hourly earnings grew by just 0.2% in November, undershooting consensus expectations. It is interesting to note that a model of wage growth recently introduced by Fed Chair, Janet Yellen, implies that the full employment rate of wage growth (in this case measured by the employment cost index) is slightly below 2½%.

In any case, the broader growth signals suggest that further job market tightening is very likely, particularly in the context of ongoing fiscal developments in Washington.

The final shape of the tax legislation is still in flux, but we expect a conference agreement by the end of the coming week and enactment shortly thereafter. The tax boost looks likely to be slightly greater than what we built in a few months ago, partly because the proposed individual tax cuts are bigger. Also, we did not expect the corporate income tax rate to come down all the way to 21%, as now appears likely. Individual income tax cuts boost growth via higher consumer demand, while the corporate tax rate cut increases the incentive to invest via a lower cost of capital.

The key economic question stemming from all of this concerns the impact of a more stimulative fiscal policy at a time when the economy is already moving beyond full employment. If most of the added growth takes the form of stronger aggregate demand without an offsetting increase in aggregate supply, as we expect, then it is only a matter of when, not if, financial conditions and monetary policy turn more restrictive to reverse the demand expansion.

To put it another way – in a full employment economy, what Congress giveth, the Fed ultimately taketh away. The prospect of fiscal stimulus thus reinforces our forecast that the funds rate will rise well-beyond current market pricing, with our expectation that there will be four hikes in 2018 and a terminal rate of 3¼%-3½%.