US Macroeconomics

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A Powell Unfriendly Jobs Report

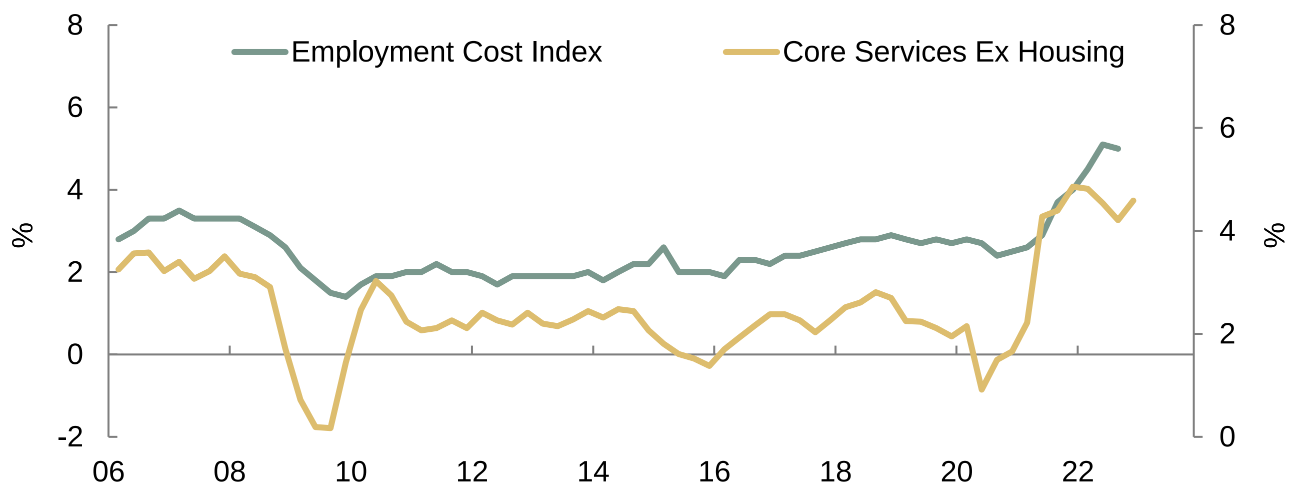
The November employment report, which produced a 263k increase in employment and a steady 3.7% unemployment rate, is precisely what Chair Powell told us earlier this week he was most worried about. **Wages are rising more than productivity, as labor supply continues to shrink**. To restore labor demand and supply, monetary policy must become more restrictive and remain there for an extended period.

November average hourly earnings jumped 0.6%, the largest increase in 10 months. The three-, six- and 12-month rates of changes all rose in November versus October. The growth rates were 5.8% vs. 4.7% previously, 5.3% vs. 5.0% and 5.1% vs. 4.9%, respectively. These figures are well above the roughly 3% annual rate (i.e., 1% labor productivity + 2% inflation) consistent with long-term price stability.

Powell said that the price of core services excluding housing is "the most important category for understanding the future evolution of core inflation," accounting for more than half of the core PCE deflator. "Because wages make up the largest cost in delivering these services, the labor market holds the key to understanding inflation in this category", said Powell. As we show in the chart below, the price of core services excluding housing closely follows the trend in wage growth.

In this case, we substituted the employment cost index for average hourly earnings because the latter was distorted by the pandemic lockdown and reopening. And the ECI is the Fed's preferred wage metric. The acceleration in average hourly earnings suggests the ECI will accelerate, too, when the data are released next month. Shrinking labor supply is a key factor pushing up underlying wage trends.

The labor force participation rate slipped a tenth to 62.1% in November, its third decline in a row. This series is back to where it was this past July. If participation remains stuck around 62%, it will represent the lowest non-pandemic related readings since the late 1970s. For wage trends to moderate, labor supply must increase, or aggregate demand must slow. Look for Powell to deliver another hawkish message at the December 13-14 FOMC meeting.



Source: Haver, Bureau of Labor Statistics, SMBC

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