

Flash Comment US

Jobs report removes the last obstacle for a Fed hike

Solid jobs report overall

In our view, the jobs report for February was solid and in line with expectations after the strong ADP jobs report released on Wednesday. Employment rose by 235,000 in February (although partly driven by warm weather which boosted construction employment) which was enough for the unemployment rate to fall from 4.8% to 4.7% despite an increase in the participation rate to 63.0% from 62.9%. The Fed's favourite slack indicator, the underemployment rate, fell to 9.2% in February from 9.4% in January, the lowest rate in this cycle (tied with December), suggesting labour market slack continues to decline. Average hourly earnings disappointed slightly, as they rose +0.2% m/m in February, slightly below consensus of 0.3% m/m. The annual growth rate was 2.8% in line with expectations, which is close to post-cycle high, but low from a historical perspective.

The jobs report removes the last obstacle for a Fed hike on Wednesday, in our view, in line with the message Fed Chair Yellen sent in her speech on Friday 3 March, see also our *Flash Comment US* of 5 March. A hike is the consensus among analysts and fully priced in by markets. The interesting question is how many hikes to expect for the rest of the year. Although the FOMC members have signalled a March hike, they have also repeated that they think three hikes are appropriate. **We expect the Fed to maintain the 'dot' signal for this year unchanged at three hikes in the updated projections.** Notice that Yellen in her speech said that four hikes is one too many as it would make monetary policy neutral instead of accommodative and the Fed has signalled that it still wants to support the economy through accommodative monetary policy. It is worth keeping in mind that the Fed is data dependent and will not hike unless data support the case – remember the Fed signalled four hikes during 2016 back in December 2015 but only delivered one.

We expect the Fed to hike three times this year in March, July and December, as the Fed seems less worried about inflation and has increased its weight on labour market and growth data. We stick to our view that the Fed is only set to hike once in H1 17 but now twice in H2 17 when we get more information about Trumponomics. By hiking at one of the small meetings in July, the Fed shows that it means that every meeting is 'live'. **We expect the Fed to begin the reduction of its balance sheet in Q1 18.**

Markets have fully priced in the Fed hike next week but note that markets price a 50% probability of the next hike in June (corresponding to a hike pace of every other meeting). The markets price in 2.7 hikes this year and nearly a total of five hikes before year-end 2018. We think it is difficult to see a more hawkish pricing of the Fed at the moment, although one trigger could be that the Fed begins to signal four hikes this year in the updated projections next week. However, we think this is unlikely, as it would make monetary policy neutral (according to Yellen's speech) and given comments from other FOMC members, we think the Fed will continue to signal three hikes.

Today's key points

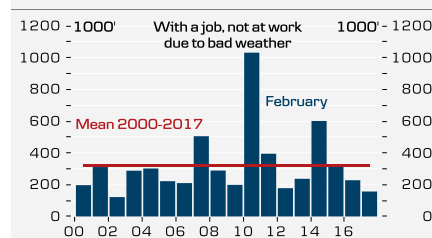
Flash Comment US: Yellen supports hike in March – we now expect a total of three hikes this year, 5 March

Flash Comment US: Limited new information about Trumponomics in Trump's joint address to Congress, 1 March

US-China Trade: US probes ways to bypass WTO system, 28 February

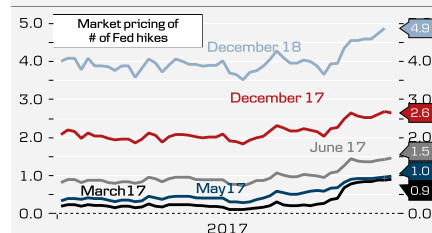
Research US: Trump to nominate three Fed governors as Tarullo resigns, 13 February

Strong employment growth in February partly driven by warm weather



Source: BLS

Markets have fully priced in a Fed hike next week – 50% probability of a hike in June

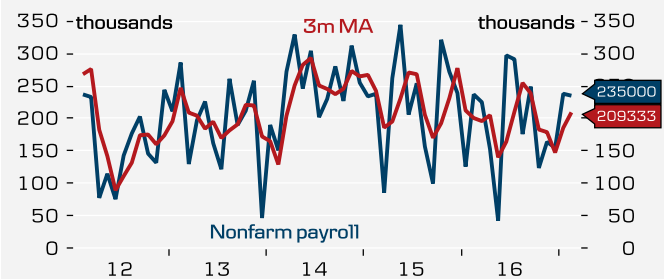


Source: Federal Reserve, Bloomberg, Danske Bank

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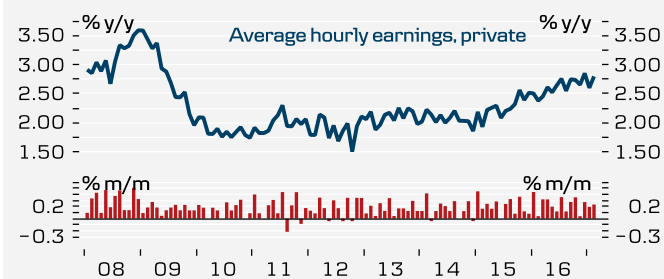
Employment

Solid employment growth in February



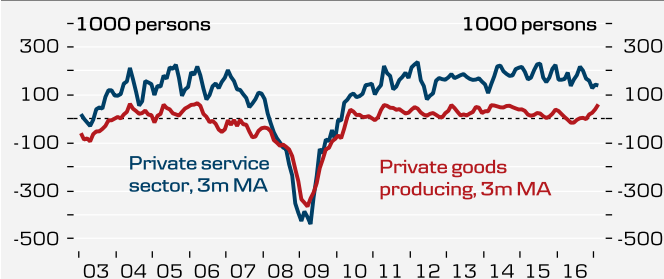
Source: BLS, Danske Bank Markets

Average hourly earnings 2.8% y/y, close to cycle high



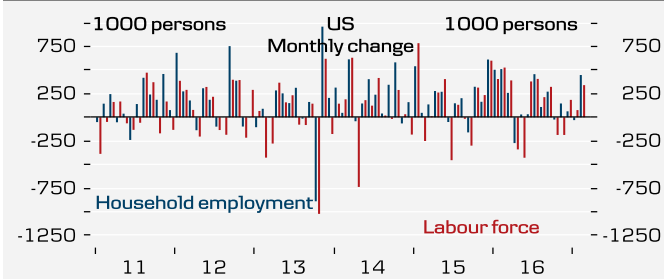
Source: BLS, Danske Bank Markets

Employment still driven by services but manufacturing employment has begun to pick up again



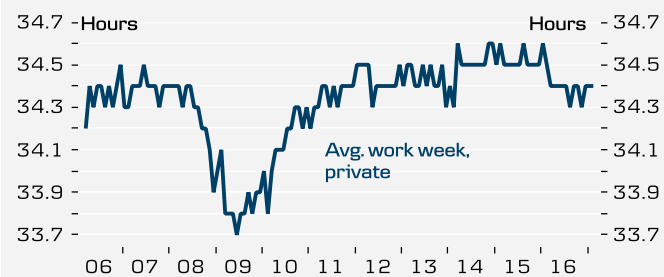
Source: BLS, Danske Bank Markets

Lower unemployment rate despite larger labour force



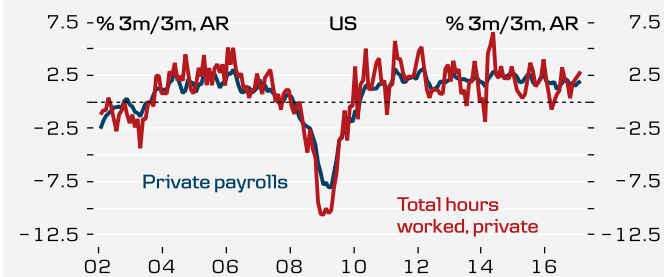
Source: BLS, Danske Bank Markets

Average weekly hours unchanged



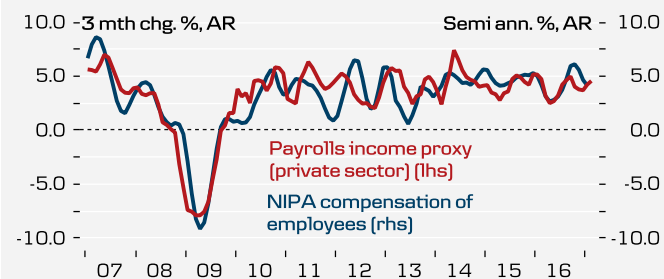
Source: BLS, Danske Bank Markets

Total hours worked vs payrolls



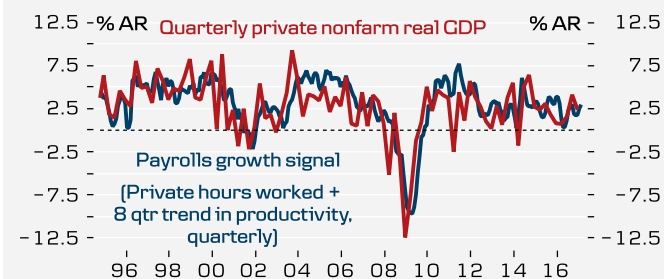
Source: BLS, Danske Bank Markets

Payrolls income proxy



Source: BLS, Danske Bank Markets

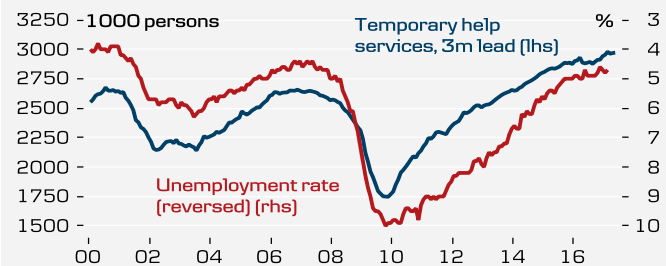
Payrolls GDP signal



Source: BLS, Danske Bank Markets

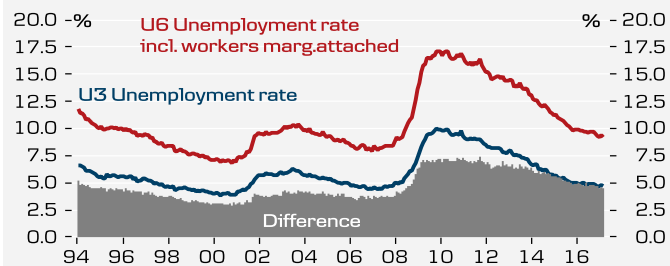
Unemployment

Temporary help services and unemployment



Source: BLS, Danske Bank Markets

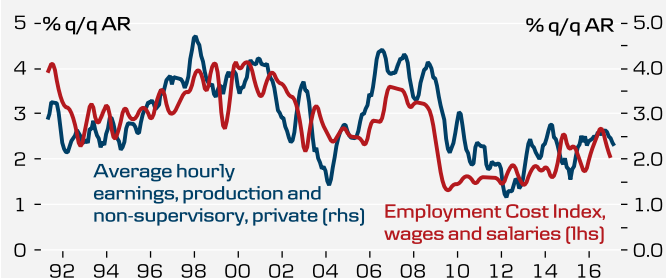
Unemployment narrow and broad measure



Source: BLS, Danske Bank Markets

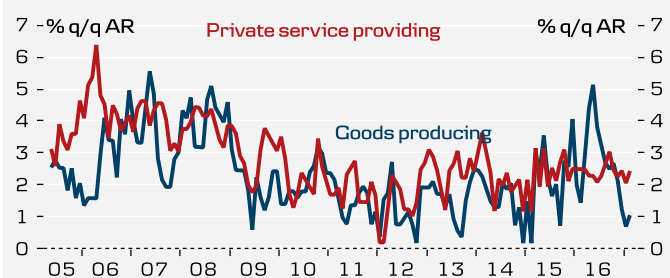
Wages

Average hourly earnings and Employment Cost Index



Source: Macrobond Financial, BEA

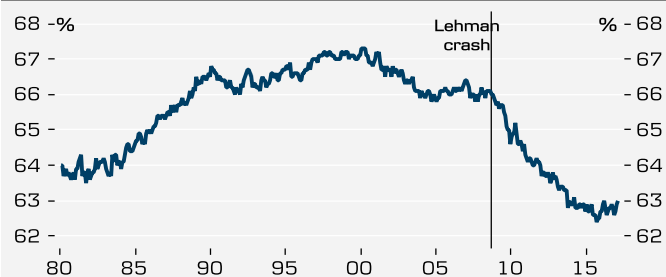
Hourly earnings, production and non-supervisory



Source: Macrobond Financial, BLS

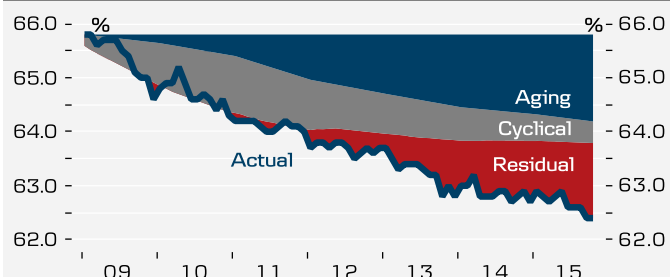
Participation

Participation rate, all



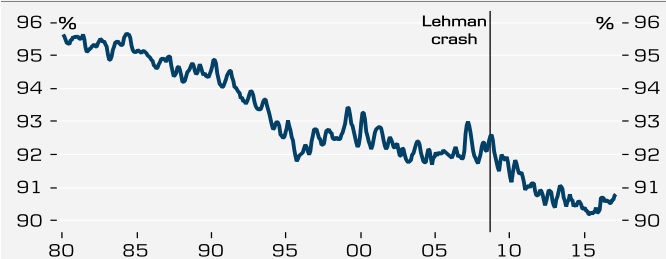
Source: Macrobond Financial, BLS

Modest cyclical rebound in the participation rate on the cards



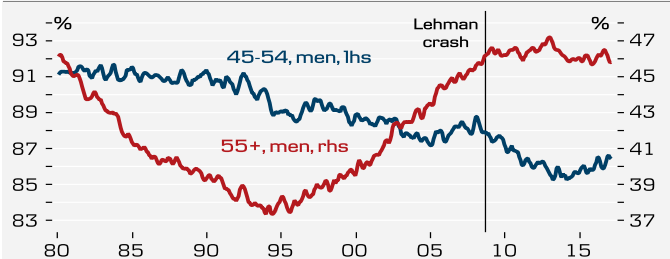
Source: Macrobond Financial, BLS

Participation rate, 35-44, men



Source: Macrobond Financial, BLS

Participation rate, 45-54 and 55+, men



Source: Macrobond Financial, BLS

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None.

Date of first publication

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