United States

Already over?

- **The labour market's dynamic momentum has been confirmed, with robust job creations, low unemployment rate, rebound in the labour participation rate and wage growth.**
- **ISM surveys point to a rebound, an improvement that could be sustained if upbeat "production" and "new orders" components are a guide.**
- **Key rate expectations – which are too low according to Boston Fed President Eric S. Rosengren – should begin to pick up.**

Although economic data were disappointing at the beginning of the year, notably for durable goods orders and household consumption, the labour market continues to steam along at a dynamic pace. Survey results have also rebounded. It is against this backdrop that Eric S. Rosengren, President of the Federal Reserve Bank of Boston, who is generally viewed as a centrist on the FOMC, indicated that key rate expectations were too low.

Once again, the labour market report contained excellent news: more than 200,000 jobs were created in March, and the labour participation ratio rebounded strongly. This latter upturn explains the slight increase in the unemployment rate, to 5% in March from 4.9% for the previous two months. This should be seen as a positive trend: Americans previously discouraged about finding a position and who had given up on job hunting are returning massively to the job market. The labour participation ratio – the share of the working-age population (16 and over according to the American definition) that have jobs or actively seek one – rose to 63% over the past six months, from a low of 62.4%. Such a big jump illustrates the return to activity of some 2.4 million individuals, virtually all (98%) of whom have directly joined the employment statistics without experiencing an extended period of unemployment.

At first it might seem surprising that such a large number of Americans could go directly from not seeking work to employment. This is all the more surprising considering that over this six month period, the jobs that were created were full time. This phenomenon illustrates the statistical porosity between "not in the labor force" and "unemployed", which is due to the way data are collected[1]. This trend also confirms the Fed's analysis in recent years, notably that underemployment is and remains much larger than is suggested by the unemployment rate alone[2]. This "shadow unemployment"; as Janet Yellen once called it, also explains (at least in part) why wages are relatively weak despite the sharp drop in unemployment.

Admittedly, wage dynamics are more upbeat than they have been in recent years, and a slight acceleration can be highlighted. Our

Dynamic job growth!

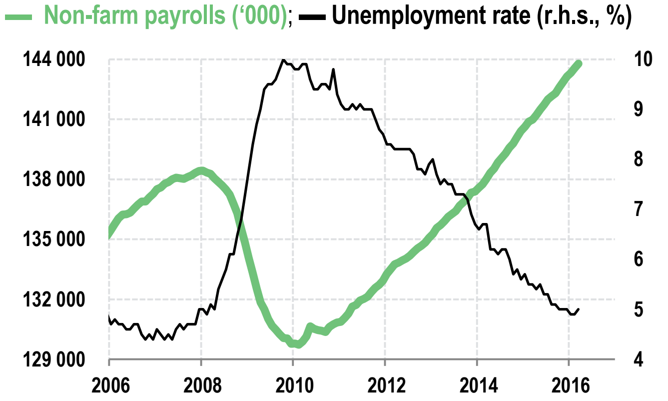

Chart 1 Source: US Bureau of Labor Statistics

Inversion?

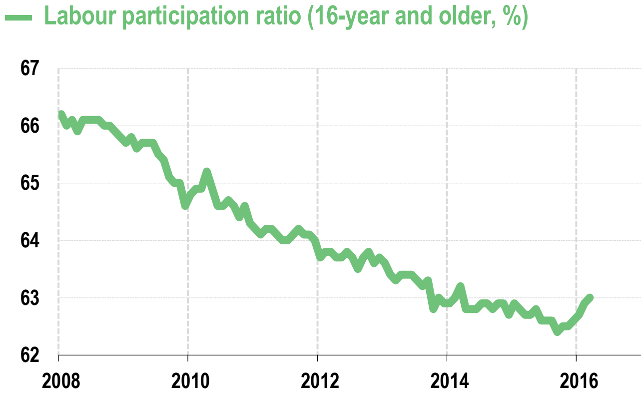

Chart 2 Source: US Bureau of Labor Statistics

preferred measure – average hourly earnings of production and nonsupervisory employees of the private sector, which covers about 70% of payroll employees – accelerated to 2.6% year-on-year in December 2015 from a low of 1.6% in February 2015. Since then, wage growth has eased to 2.3% in March. Under a positive but not excessively optimistic scenario, the labour participation ratio would continue to pick up, preventing the unemployment rate from declining, and wage growth would hold to a rate of about 2.5% a year. Of course, this figure pales when compared to the wage growth reported in 1997-2001 and 2006-2008 (3.8% and 3.9%, respectively), but at a time of low inflation, it would nonetheless support household purchasing power.

It is this last point that supports our relative confidence in the outlook for the US economy. Lately, that confidence might have seemed excessive in the light of manufacturing sector trends. However, over the past few months, we have already expressed our conviction that American manufacturing activity had surely bottomed out. In support

[1] See "The truth is out there – or why the falling unemployment rate is slow in accelerating US inflation", Alexandra Estiot, Conjoncture BNP Paribas, October-November 2014.
[2] See notably "A whiter shade of pale – Janet Yellen and the challenges of US monetary policy" Alexandra Estiot, Conjoncture BNP Paribas, February 2014.

of our hypothesis, the manufacturing ISM rebounded strongly to 51.8 in March, after averaging 48.7 over the previous five months. Based on the most advanced components – “production” and “new orders” both rose, to 55.3 and 58.3, respectively – and past trends, we expect the manufacturing ISM to rise towards 53 points in the months ahead.

The other subject of concern was the possibility that the manufacturing sector could contaminate the rest of the economy, as the non-manufacturing ISM index seemed to suggest. This index has declined almost constantly since last August, with a cumulative loss of 6.2 points. Yet the non-manufacturing ISM was not only holding at comfortable levels, it also rebounded in March to 54.5 (from 53.4 in February), thanks to particularly upbeat “production” and “new orders” components, which rose in March to 59.8 and 58.5, respectively. Our M&N index, a weighted average of ISM data comparable to the PMI composite index, rose 1.3 points in March to 54.1, which is in line with GDP growth of about 2.5%. After a first quarter promising disappointment[3], a rebound seems to be taking shape.

Under these conditions, there would be nothing surprising about renewed expectations of a key rate increase in June. Janet Yellen reaffirmed the FOMC’s attachment to a data-dependent policy. Positive statistics thus should lead the financial markets to increase the probability given to a June rate increase. As to the next FOMC meeting on 26 and 27 April, expectations have not changed. Although the FOMC meets eight times a year, only every other meeting is followed by a press conference. Whatever the Fed does, its officials have never managed to convince the markets that at this phase in the tightening cycle a rate increase could occur at a meeting without a press conference. The minutes from the March meeting showed that the Fed had heard the message: although some FOMC members believe that recent economic trends could merit another rate increase in April, many more fear that acting immediately would lend a sense of urgency to the decision, which is not the message they want to deliver.

We did not learn much from the minutes of the 15-16 March meeting, which once again confirmed our analysis. 1) The economic outlook remains generally the same. There was a perfect leftward translation of individual projections for 2016, which confirms that the Fed officials only updated their forecasts using the most recently available statistics. 2) The uncertainty attached to these forecasts is broadly the same as in the past, but it is clearly on the downside: the majority of FOMC members identified downside risks to their inflation forecasts, and although the risks associated with their growth forecasts were smaller (notably for unemployment), they were also on the pessimistic side. 3) Near the effective lower bound, risks are asymmetrical: it is much easier to tighten monetary policy more rapidly than expected than to ease policy any further.

We would like to highlight one last point. Eric S. Rosengren, President of the Boston Fed, made a speech this week. With the reputation of a “centrist” and someone close to Janet Yellen, his interventions are followed closely. Without the least ambiguity, he indicated that the financial markets’ key rate expectations were too low this year. He stated: *“While it has been appropriate to pause while waiting for information that clarified the response of the U.S. economy to foreign turmoil, it increasingly appears that the U.S. has weathered foreign shocks quite well. As a consequence, if the incoming data continue to show a moderate recovery – as I expect they will – I believe it will likely be appropriate to resume the path of gradual tightening sooner than is implied by financial-market futures”.*

[3] See “Don’t change a winning team”, Alexandra Estiot, EcoWeek BNP Paribas, 1 April 2016.

Progress

Purchasing power generated by one hour of work (2009 USD)

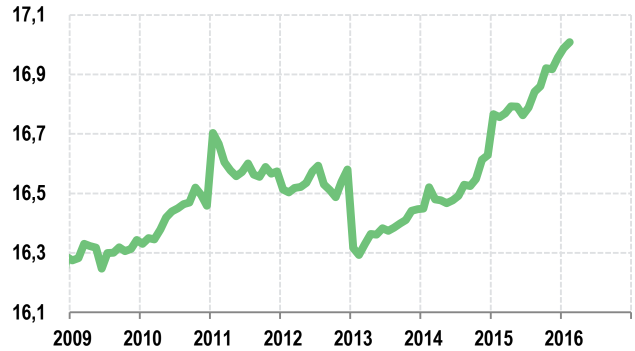

Chart 3 Sources: BEA, BLS, BNP Paribas Economic Research

Rebound

M&N index; Production; --- New orders

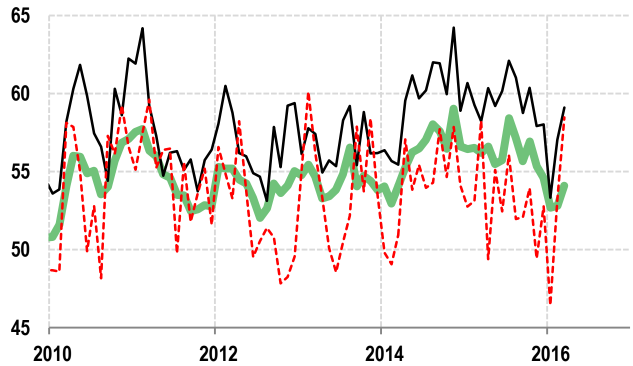

Chart 4 Sources: ISM, BNP Paribas Economic Research

Fed Fund Target Projections (%)

Fed Fund Market Futures (April 4th, 2016) FOMC members’

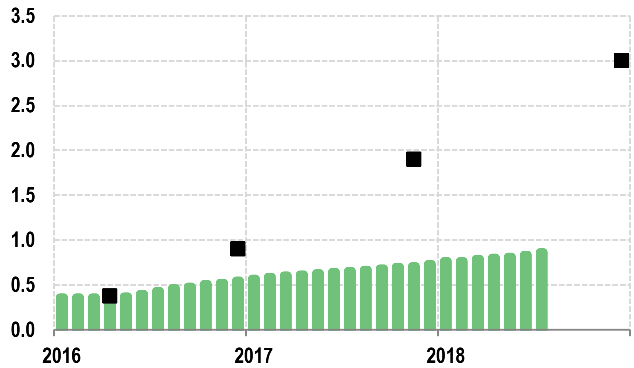

Chart 5 Sources: Bloomberg, FOMC