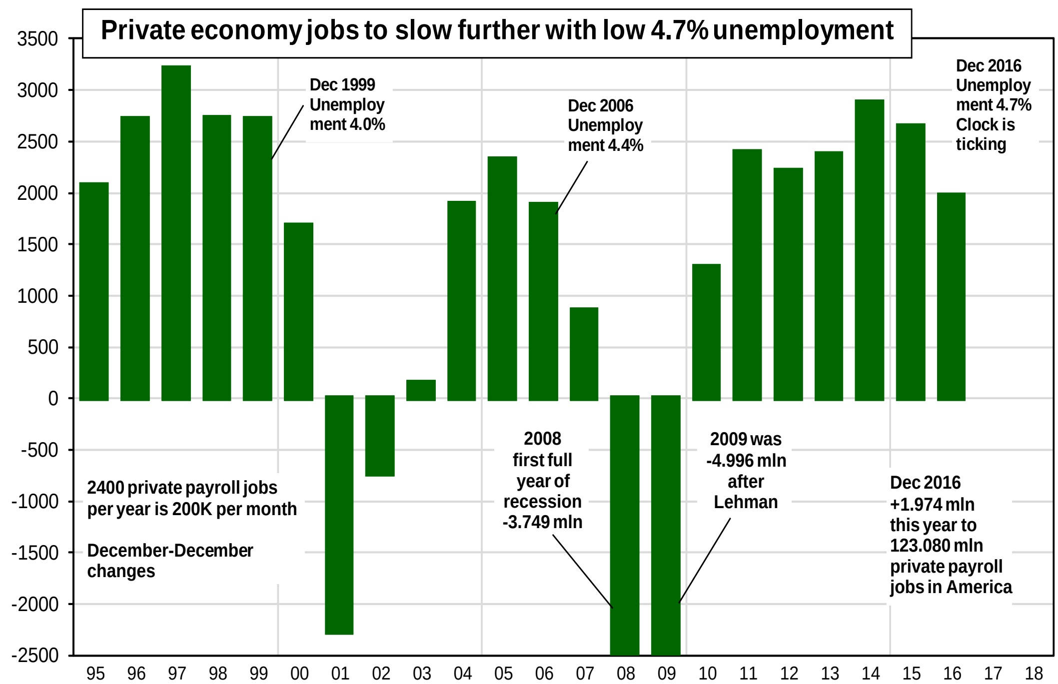
# Financial Market Weekly

CHRISTOPHER S. RUPKEY, CFA
MANAGING DIRECTOR
CHIEF FINANCIAL ECONOMIST
ECONOMIC RESEARCH OFFICE (NEW YORK)
(212) 782-5702
crupkey@us.mufg.jp

MUFG | 1251 Avenue of the Americas
New York, New York 10020

**6 JANUARY 2017**

## ECONOMY RUNS OUT OF WORKERS TO HIRE, AT LEAST WAGES ARE UP




The monthly employment situation report, the biggest economic report in the world. All right stop it. Economic news reports have stopped moving the markets. Bond yields were 2.34% before the jobs report and now three basis points higher at 2.37% (9am EST). Dow stock futures down 18 points and now up 6 points. Incoming economic data like today's "all-important" jobs report are unlikely to alter the course of interest rates. The future path of rates. Unless there is an early change in management at the Fed, officials in Washington will either raise rates two or three times this year, and we are hard put to think of a reason why Yellen would pick up the pace.

| | Dec | Nov | Oct | Sep | Aug | Jul |
|---|---|---|---|---|---|---|
| Payroll jobs (000s) | 156 | 204 | 135 | 208 | 176 | 252 |
| Unemployment rate % | 4.7 | 4.6 | 4.8 | 4.9 | 4.9 | 4.9 |
| Unemployment (3 decimal) | 4.716 | 4.646 | 4.848 | 4.945 | 4.923 | 4.865 |
| Average hourly earnings | $26.00 | $25.90 | $25.92 | $25.81 | $25.74 | $25.71 |
| MTM % Chg | 0.4 | -0.1 | 0.4 | 0.3 | 0.1 | 0.4 |
| YOY % Chg | 2.9 | 2.5 | 2.8 | 2.7 | 2.5 | 2.7 |
| Production Worker earnings | $21.80 | $21.73 | $21.72 | $21.67 | $21.62 | $21.59 |
| MTM % Chg | 0.3 | 0.0 | 0.2 | 0.2 | 0.1 | 0.3 |
| YOY % Chg | 2.5 | 2.4 | 2.4 | 2.6 | 2.4 | 2.6 |

Payroll jobs 156K, unemployment rate up a tenth to 4.7%, and wages at $26.00 an hour are up 0.4% this month to a 2.9% year-on-year pace, the fastest yet in this "eight-year" recovery from the Great Recession. [Note: hold the champagne, grab a beer like the graph below here of workers, not their bosses, wages up 2.5% to $21.80.] The bond market sold off on wages we guess as it is a sign that labor market pressures are intensifying as companies scramble for workers with the economy moving beyond full employment. HR departments beware, this year is the year of the worker, and you better pay 'em or lose 'em. This is classic Economics 101, the unemployment rate falls and this leads to higher wages. No inflation yet, but more wages for the angry electorate in the middle of the country wound up by the President-elect over their stagnant wages and income inequality.

Payroll jobs did not reach our 210K estimate today, but they keep revising up the past jobs numbers. A couple of months ago there were three straight months of sub-200K jobs numbers, but now we have some big ones in there.

Dec 156K, Nov 204K, Oct 135K, Sep 208K, Aug 176K, July 252K
Seems to be a one-month on, and one-month off situation for this trend.

**Payroll jobs in year eight following the recession**

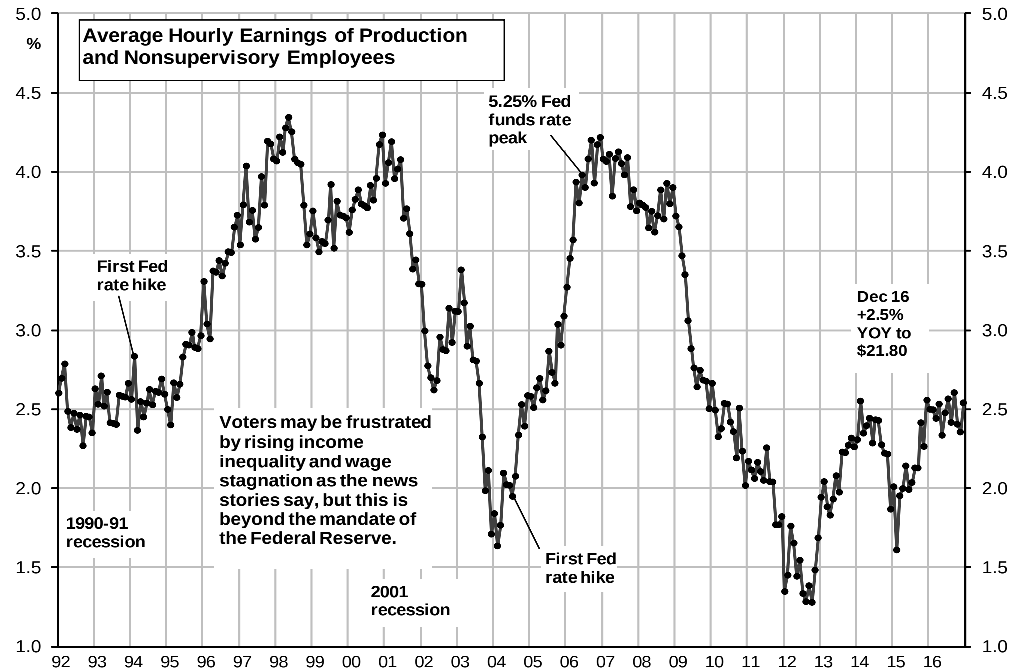
| Dec. 2015 Totals millions | | Dec 16 | Nov 16 | Oct 16 | 12 months Dec 15 to Dec 16 | 12 months Dec 14 to Dec 15 |
|---|---|---|---|---|---|---|
| 143.146 | Nonfarm Payroll Employment | 156 | 204 | 135 | 2157 | 2744 |
| 121.106 | Total Private (ex-Govt) | 144 | 198 | 146 | 1974 | 2651 |
| 19.678 | Goods-producing | 12 | 13 | 8 | -23 | 186 |
| 0.710 | Mining | -2 | 3 | -2 | -79 | -135 |
| 12.320 | Manufacturing | 17 | -7 | -4 | -45 | 26 |
| 0.918 | Motor Vehicles & parts | 3 | 2 | 1 | 16 | 26 |
| 6.597 | Construction | -3 | 17 | 14 | 102 | 296 |
| 101.428 | Private Service-providing | 132 | 185 | 138 | 1997 | 2465 |
| 27.114 | **Trade, transportation, utilities** | 24 | 35 | 19 | 373 | 458 |
| 15.761 | Retail stores | 6 | 20 | -2 | 257 | 284 |
| 3.164 | General Merchandise | -24 | 35 | 15 | 76 | 53 |
| 3.068 | Food & Beverage stores | 2 | 1 | 1 | 46 | 23 |
| 4.889 | Transportation/warehousing | 15 | 11 | 13 | 62 | 110 |
| 1.464 | Truck transport | 1 | 3 | 8 | 10 | 21 |
| 0.624 | Couriers/messengers | 12 | 7 | 4 | 30 | 10 |
| 0.841 | Warehousing and storage | 2 | 3 | 4 | 38 | 66 |
| 0.564 | Utilities | 0 | 0 | 1 | 2 | 9 |
| 2.763 | **Information** | -6 | -12 | -2 | -2 | 30 |
| 8.190 | **Financial** | 13 | 8 | 8 | 159 | 149 |
| 2.573 | Insurance | 4 | -2 | 6 | 47 | 70 |
| 2.105 | Real Estate | 0 | 5 | 1 | 49 | 36 |
| 1.264 | Commercial Banking | 2 | 0 | -1 | 5 | -19 |
| 0.921 | Securities/investments | 2 | 1 | -2 | 11 | 30 |
| 19.981 | **Professional/business** | 15 | 65 | 42 | 522 | 621 |
| 2.944 | Temp help services | -16 | 24 | 5 | 23 | 96 |
| 2.247 | Management of companies | 6 | 2 | 3 | 42 | 58 |
| 1.425 | Architectural/engineering | 4 | -1 | 5 | 29 | 34 |
| 1.951 | Computer systems/services | 4 | 3 | 6 | 79 | 104 |
| 1.124 | Legal services | 2 | -1 | 1 | 3 | 7 |
| 1.004 | Accounting/bookkeeping | -13 | 17 | 1 | 36 | 45 |
| 22.378 | **Education and health** | 70 | 43 | 50 | 593 | 701 |
| 4.999 | Hospitals | 11 | 10 | 13 | 140 | 177 |
| 3.502 | Educational services | 6 | 8 | 7 | 79 | 67 |
| 15.342 | **Leisure and hospitality** | 24 | 37 | 20 | 295 | 441 |
| 1.926 | Hotel/motels | 5 | 4 | -4 | 9 | 17 |
| 11.220 | Eating & drinking places | 30 | 21 | 16 | 247 | 359 |
| 22.040 | Government | 12 | 6 | -11 | 183 | 93 |
| 2.164 | Federal ex-Post Office | 0 | -1 | -1 | 21 | 17 |
| 5.108 | State government | -4 | 1 | -7 | 2 | 20 |
| 2.435 | State Govt Education | 7 | -1 | -5 | 13 | 19 |
| 14.164 | Local government | 11 | 7 | -5 | 145 | 51 |
| 7.814 | Local Govt Education | 7 | -7 | -13 | 49 | -5 |

Remember how the litmus test of a strong economy was consistent 200K monthly jobs reports? Tapering and "liftoff" required 200K numbers? Well, forget about it. The economy is at full employment 4.6, no 4.7, no 4.6, no 4.7 percent unemployment. This is it. The labor market is at full employment already for this cycle. The housing bubble boom economy years had an unemployment rate low of 4.4%. This is it. And don't be concerned about the one-tenth rise to 4.7% today. Last month's 4.6% unemployment rate was barely there the 3-digit figure being 4.646%.

Why the slower 156K in December after 204K in November? Well it cuts both ways really. Construction weaker (-3K), but Donald Trump brought back 17K manufacturing jobs. More manufacturing jobs in furniture, motor vehicles, fabricated metals, primary metals, wood products. Good stuff. The relative slowdown this month is services related, especially business services where temporary help jobs fell 16K after rising 24K last month, a 40K slowdown all by itself.

To conclude, don't be fooled by the slower 156 thousand jobs created in December in today's report, the economy's engines continue to rev up the labor market and wages are starting to jump even before we get those minimum wage hikes in January. The good times are starting to roll. The economy has hit the wall of full employment and we are going to see wages really start to jump. Payroll jobs grew 2.2 million this year, down from 2.7 million in 2015, down from 3.0 million in 2014. The Great American jobs machine is starting to sputter and slow, not because the economic outlook is darkening, but because the labor pool has shrunk. The pool is all but drained especially for skilled workers. We can't bring factory jobs back because there's no one out there to run them. All those who lost jobs in the Great Recession have found work. We honestly don't see a role for monetary policy to play at this stage of the business cycle. Fed officials should think more carefully about their current plan to raise rates gradually and cautiously. The economy is normal and so should interest rates be. The economy is stronger than the 156K jobs report thinks.

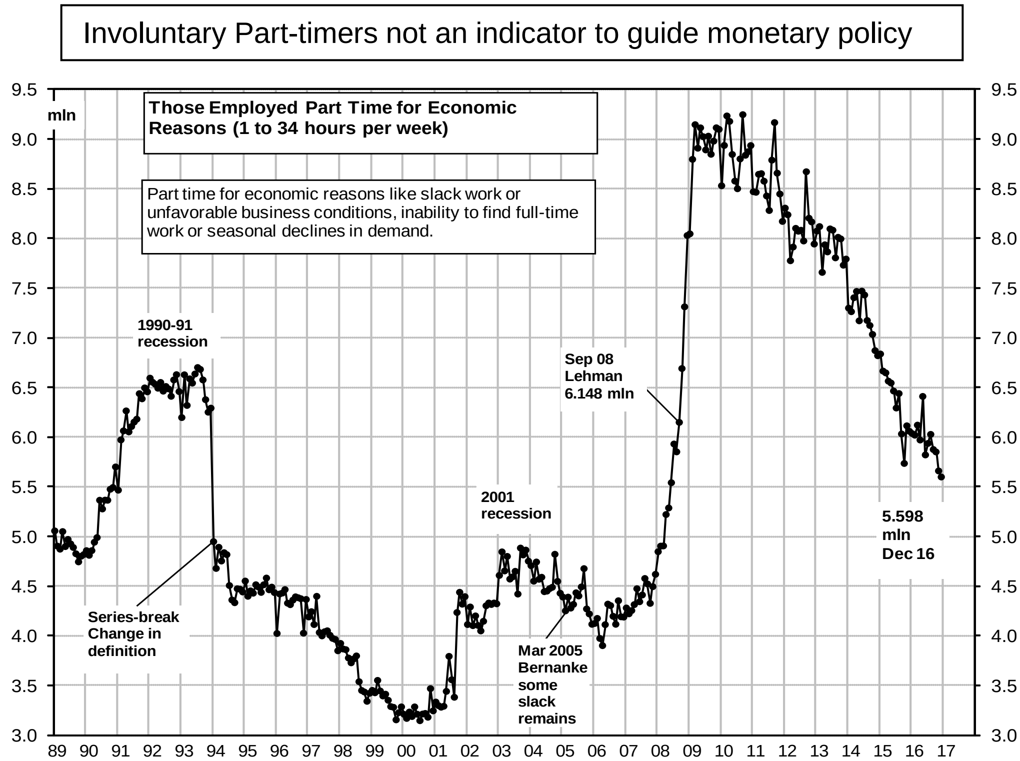
Low unemployment might push wages to 3.5 – 4.0% eventually, but wages also follow inflation and inflation is low at 2%.




## FEDERAL RESERVE POLICY

The Fed meets next on ~~March 14-15~~ we mean January 31-February 1 to consider its monetary policy. We are looking for them to… no, we can't say it. Nothing's gonna happen. As far as the Fed taking action, we've kind of given up on these non-press conference meetings as being ones where there is even a "very tiny" possibility that a rate hike could in fact occur. After the 156K payroll jobs data today, there is no reason to believe that a March 2017 meeting rate hike is especially urgent either given the cautious track record of the Yellen Fed on the normalization of interest rates. And don't get too excited by the increase in "wages."

| **Selected Fed assets and liabilities** | | | | | Sep 10 |
|---|---|---|---|---|---|
| Fed H.4.1 statistical release | | | | | 2008** |
| billions, Wednesday data | 4-Jan | 28-Dec | 21-Dec | 14-Dec | pre-LEH |
| **Factors adding reserves** | | | | | |
| U.S. Treasury securities | 2463.591 | 2463.601 | 2463.566 | 2463.531 | 479.782 |
| Federal agency debt securities | 16.180 | 16.180 | 16.180 | 18.493 | 0.000 |
| Mortgage-backed securities | 1741.391 | 1741.387 | 1758.481 | 1760.415 | 0.000 |
| Primary credit (Discount Window) | 0.035 | 0.017 | 0.013 | 0.026 | 23.455 |
| Term auction credit (TAF auctions) | 0.000 | 0.000 | 0.000 | 0.000 | 150.000 |
| Asset-backed TALF | 0.000 | 0.000 | 0.000 | 0.000 | |
| Maiden Lane (Bear) | 1.707 | 1.707 | 1.707 | 1.708 | 29.287 |
| Maiden Lane II (AIG) | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| Maiden Lane III (AIG) | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| Central bank liquidity swaps | 5.563 | 4.826 | 4.743 | 1.476 | 62.000 |
| Federal Reserve Assets | 4498.8 | 4497.3 | 4515.2 | 4517.0 | 961.7 |
| 3-month Libor % | 1.01 | 1.00 | 1.00 | 0.97 | 2.82 |
| **Factors draining reserves** | | | | | |
| Currency in circulation | 1509.068 | 1509.076 | 1502.971 | 1498.565 | 834.477 |
| Term Deposit Facility | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| Reverse repurchases w/others | 266.468 | 323.912 | 307.477 | 169.563 | 0.000 |
| **Reserve Balances (Net Liquidity)** | 1998.165 | 1942.975 | 1962.755 | 2123.554 | 24.964 |
| Treasuries within 15 days | 3.105 | 11.702 | 11.702 | 0.000 | 14.955 |
| Treasuries 16 to 90 days | 41.249 | 30.795 | 30.794 | 42.495 | 31.549 |
| Treasuries 91 days to 1 year | 150.766 | 146.822 | 146.821 | 146.821 | 69.272 |
| Treasuries over 1-yr to 5 years | 1232.322 | 1241.849 | 1241.843 | 1241.837 | 170.807 |
| Treasuries over 5-yrs to 10 years | 402.996 | 399.275 | 399.268 | 399.261 | 91.863 |
| Treasuries over 10-years | 633.154 | 633.160 | 633.138 | 633.117 | 101.337 |
| **September 10, 2008 is pre-Lehman bankruptcy of 9-15-08 | | | | | |




What could put a rate hike in March on the table? We suppose a couple months of 250K jobs numbers and a 4.4% unemployment rate could do it. Headline PCE inflation is 1.4% and core PCE inflation is 1.6% and with energy prices moving up it is possible that PCE headline inflation gets very close to 2.0%. Perhaps with the January PCE inflation data to be reported March 1, 2017, the last inflation report before the March Fed meeting. Maybe inflation "heating up" could do it, prompt a rate hike, but you'd probably need the bond market to "ratify it," to push 10-yr yields to 3% for Fed officials to be convinced that there are "expectations of greater inflation." So maybe stronger labor market data which we aren't expecting, or stronger GDP growth that we also aren't expecting so early on ahead of any President-elect Trump initiatives is not going to put a March rate hike on the table. It would have to be more inflation, chiefly through higher gasoline prices at the pump. Have you noticed these gas prices have moved up recently? Us either. But they have. The public is not thinking too much about inflation. Either is the Fed if you believe San Francisco Fed President Williams who said in a NY Times interview on December 20, 2016, that theoretically there is no reason not to allow inflation to go as high as 3 to 4 percent. Allowing inflation to overshoot for what we don't know; maybe to bring those "95 million labor force dropouts" back into the labor force, the 95 million that don't exist unless you are a politician looking for votes. We don't know how to answer a Williams 3-4% inflation target, so we will wait for Paul Volcker the 80s "inflation-slayer" to respond to the young man.

In short, there is not a lot of change coming for Fed policy in the near term that we can see. Wages may be picking up and this sent bond yields up on Friday after the jobs report, but wages are ways away still from 3.5 to 4.0 percent seen in 2006 when the Fed was pushing interest rates to 5.25%. We will watch to see if there is any news that could put March back up on the Fed's calendar for a rate hike.

## Analyst Certification

The views expressed in this report accurately reflect the personal views of **Christopher S. Rupkey**, the primary analyst responsible for this report, about the subject securities or issuers referred to herein, and no part of such analyst's compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed herein.



About MUFG Union Bank, N.A.

MUFG Union Bank, N.A., is a full-service bank with offices across the United States. We provide a wide spectrum of corporate, commercial and retail banking and wealth management solutions to meet the needs of customers. We also offer an extensive portfolio of value-added solutions for customers, including investment banking, personal and corporate trust, global custody, transaction banking, capital markets, and other services. With assets of $115.4 billion, as of December 31, 2015, MUFG Union Bank has strong capital reserves, credit ratings and capital ratios relative to peer banks. MUFG Union Bank is a proud member of the Mitsubishi UFJ Financial Group (NYSE: MTU), one of the world's largest financial organizations with total assets of approximately ¥295.8 trillion (JPY) or $2.5 trillion (USD)1, as of December 30, 2015. The corporate headquarters (principal executive office) for MUFG Americas Holdings Corporation, which is the financial holding company and MUFG Union Bank, is in New York City. The main banking office of MUFG Union Bank is in San Francisco, California.