IS US WAGE GROWTH FINALLY STEPPING OUT?

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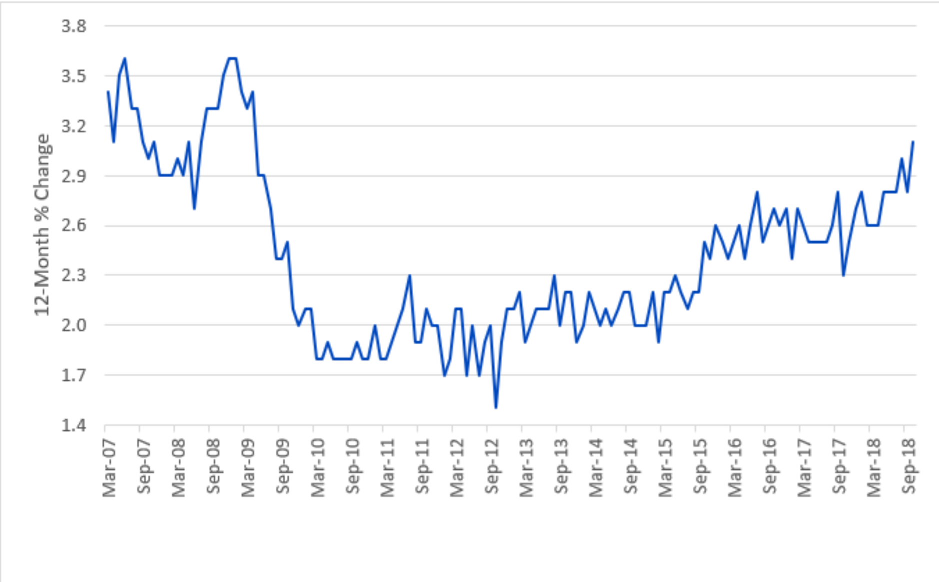
The calendar keeps flying by, and kicking off Q4 economic data, investors recently received the US October employment situation report. The money and bond markets have 'graduated' of sorts, and the typical headlines regarding the unemployment rate and new job creation have been rendered more secondary in importance at this point of the cycle, with wages now moving to centre stage. According to the latest jobs report from the Bureau of Labour Statistics (BLS), average hourly earnings (AHE), on a year-over-year basis, broke out of its recent range, begging the question; is US wage growth finally stepping out to the upside?

Without a doubt, the one 'sticking point' that seems to have alluded the US Federal Reserve (Fed) in their policy outlook has been the lack of any significant wage growth. Sure, the path of AHE has been on the positive side of the ledger, but the trajectory, or pace of the upside movement, has appeared to have confounded market participants.

Figure 1: Average hourly earnings



Source: Bureau of Labour Statistics, as of 2 November 2018

The graph above highlights how the year-over-year rate of increase for AHE had been locked in a rather narrow band of roughly +2.5%-+2.8% since the end of 2015. It seemed as if every time there was a surprise to the upside, the following month or so reversed this performance, rendering any unexpected gain as a 'false start'. However, over the last three months, the BLS has reported that the AHE annualized gain has twice hit the

'+3%' threshold, and in the case of the just released October data, the +3.1% increase represented the best showing since early 2009.

With two out of last three months producing '3' handles for AHE growth, investors may finally be witnessing the long-awaited upside momentum in wages. As we have seen in prior episodes, the trajectory may not always be a straight-up move to the upside, but it does look as if progress is being made on this front. The scope of wage growth throughout various industries was also encouraging, an important point to consider because it can help to rule out the dreaded 'aberrational' result which tends to ultimately get cancelled out in future reports.

Conclusion

While the United States Treasury (UST) market did sell-off a bit on response to this data, the back-up in the UST 10-year yield was not necessarily noteworthy, nor did it signal any newfound concerns on the inflation front just yet. Inflation expectations, as measured by 'breakeven' spreads were only modestly higher after the jobs report. The bond market and the Fed have been down this road before and will more than likely wait to see the 'whites of the eyes' of sustainable wage growth before responding. In fact, this is just the type of result the Fed has long been waiting for. However, developments on the wage front will need to be monitored closely, because any upside surprises to this data, or inflation in general, is not currently factored into UST 10-year yields.

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