THE WEEKLY **U.S.** ECONOMIC MONITOR

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January's payroll report was wild, but the underlying story remains one of very strong labor demand.

Wage growth clearly is trending higher, despite January's modest month-to-month gain.

Manufacturing has probably not yet hit bottom; January's rise in the ISM index will reverse.

Behind the Wild, Unsustainable Jobs Numbers, Wage Gains are Rising

Where to start with the January employment report, where all the key numbers were off-kilter in one way or another? From a bird's-eye view first, the key message from the report is that labor demand is still very strong, suffering no discernible wobble in the wake of the drop in stock prices in Q4, and wage pressures continue to build. ***It's hard—no, make that impossible—to square the last two employment reports, since the December FOMC meeting, with the Fed's sudden swerve last week.***

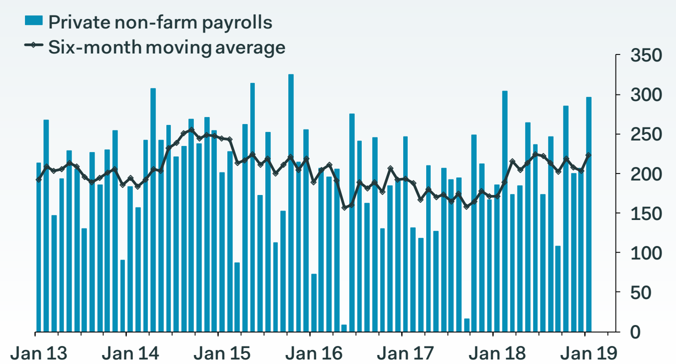
Job growth in the private sector has averaged 234K over the past three months, falling short of the pace implied by surveys. But that has been the case since late 2017, presumably because firms can't find all the people they want. It's always risky to over-analyze a single monthly payroll number—witness the 90K downward revision to December—but it looks to us like January enjoyed a substantial boost from warmer-than-usual weather, both in absolute terms and, more importantly, compared to December. Also, the increase in snow cover across the country between the December and January survey weeks was smaller than usual.

Our analysis suggests that these two factors alone could have accounted for as much as a third of the 296K jump in January payrolls. That chimes with the household survey, which reported that 143K fewer people than usual were kept from work by bad weather. In December, 49K *more* people than usual didn't work because of the weather. The +192K swing between the two months was the biggest since October 2017, in the aftermath of Hurricane Harvey.

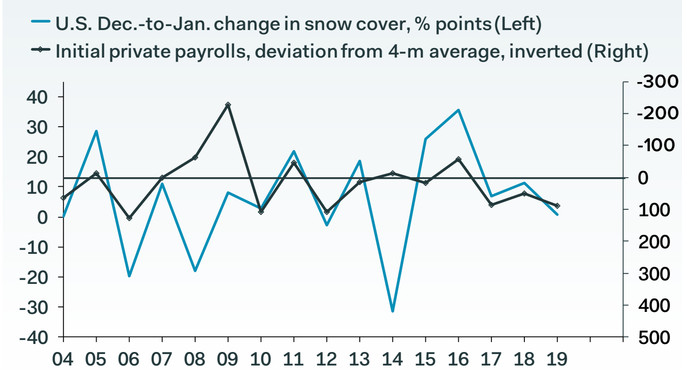
The unreliability of the household survey and the substantial differences in its coverage compared to payrolls means that we can't just subtract 192K from the January payroll number to arrive at an ex-weather estimate. But these data certainly support our view that the weather provided a substantial lift to January payrolls. If the true ex-weather number was 200K, that would still be a very respectable performance.

It's also possible that the ex-weather number was boosted by furloughed government workers taking part-time jobs. At the time of the survey, people did not know for sure that they would receive back pay. The household survey recorded a huge 491K jump in the number of people working part-time for economic

HEADLINE PRIVATE PAYROLLS STILL CHARGING



MILD WEATHER LIKELY BOOSTED JANUARY PAYROLLS



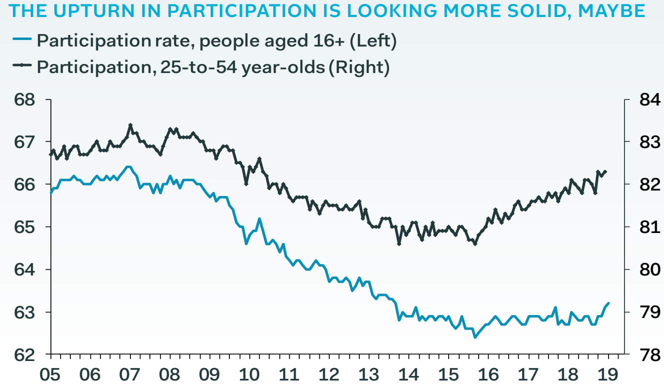
reasons—that is, not by choice—the biggest jump in more than six years. The payroll survey counts *jobs* rather than *people,* so government workers who temporarily had two jobs were counted twice. Note again, though, that we can't just plug household survey data into the payroll numbers, and we have no idea how many unpaid government contractors fell off payrolls, offsetting the increase among federal workers taking second jobs.

These effects will all reverse in February, and our tentative forecast for this month is just 125K. That would look like a sharp slowdown, but it would leave the three-month average at a robust 209K. If we'd been offered that when the stock market was in free fall in the Q4, we would have taken it, very happily.

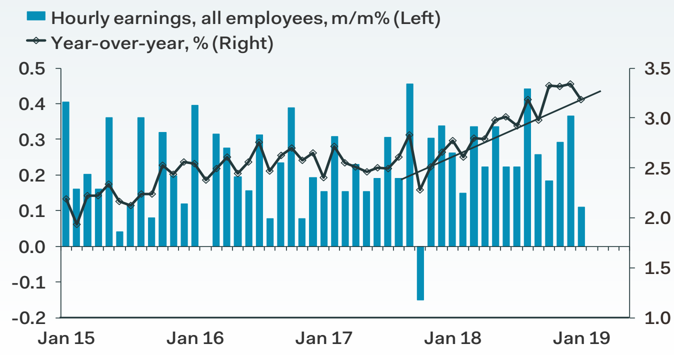
The odd-looking combination of very strong payroll numbers and an uptick in the unemployment rate—it has now risen three tenths from its 3.7% November low—is due to a reported increase in the participation rate. It's still too soon to say with certainty that the increase, shown in our next chart, represents a sustainable upturn. Even if it does, we'd be *amazed* if the recent rate of increase—0.5 points in the past four months—could continue. *In other words, we're sticking to our view that the unemployment rate will fall further this year.* It's just not possible, in our view, for the trend in labor force to run at 200K per month for long.

To be clear, even if the unemployment rate remains at 4%, or even nudges a bit higher, it's unlikely materially to change the trajectory of wage growth. January's modest 0.1% increase in average hourly earnings is irrelevant; the numbers are erratic, and December's increase was an above-trend 0.4%; we expected a correction. ***The key point here is that the trend in wage growth is rising.*** In the three months to January, AHE rose 3.3%, compared

THE UPTURN IN PARTICIPATION IS LOOKING MORE SOLID, MAYBE



THE TREND IN WAGE GROWTH IS GRINDING HIGHER

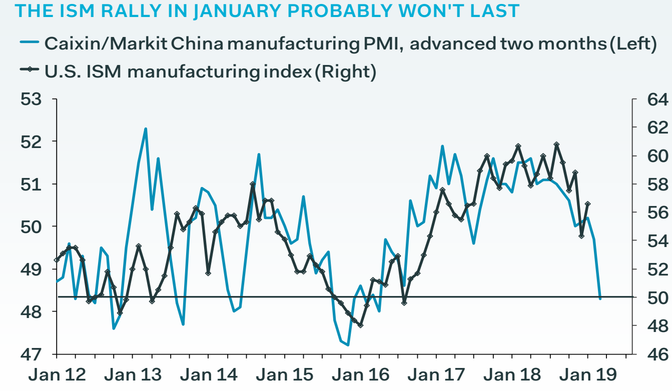


to 2.6% in the same period last year. If this pace continues, wage growth will hit 4% by early next year. *This means either that the Fed is about to break with its history in a very big way, or they're going to be raising rates a good deal more than they—and the markets—think.* We're going with the latter.

The ISM hasn't hit bottom, despite January's gain

Three other economic reports were released Friday—November construction, and consumer sentiment and the ISM manufacturing survey for January—and, like the payroll number, they all beat consensus. We're amused by the juxtaposition of a run of positive surprises and the Fed's unexpected swerve into full-on dovishness, but we'd be surprised if the ISM, in particular, marked a real bottoming. *The message from China's PMI numbers, especially the Caixin measure, which probably better reflects the true state of the private sector, is that a further slowing in U.S. manufacturing is likely.*

THE ISM RALLY IN JANUARY PROBABLY WON'T LAST



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THIS WEEK IN BRIEF

Note: "**D**" prefix denotes Datanotes for these releases.

Monday, February 4

• Factory Orders (11)/10:00 EST
The 0.8% increase in durable goods orders points to a **0.4%** rise in total factory orders. **Consensus: 0.3%.**

• Mester Speech (2019 non-voter)/19:30 EST

Tuesday, February 5

• Redbook Chain Store Sales (2/2)/9:00 EST
Sales growth has reverted to its prior trend after its holiday season record high, 9.8% year-over-year. We expect little change from last week's **5.8%,** which is still very healthy in the context of flat goods prices and the continuing shift from physical chainstores to the web.

• D: ISM Non-manufacturing Survey (1)/10:00 EST
The index tends to track the rate of growth of core retail sales. December sales have not yet been released because of the shutdown but surveys point to a very strong performance. Accordingly, we look for the ISM non-manufacturing index to rise to about **59** from 57.6. **Consensus: 57.0.**

Wednesday, February 6

• Mortgage Applications (2/1)/7:00 EST
We expect little change in the purchase applications index after last week's elevated **262.7.** The trend is rising.

• D: Productivity and Unit Labor Costs (Q4)/8:30 EST
This release will be incomplete due to delays caused by the government shutdown. Our forecast of a 2.7% rise in non-farm GDP should combine with a 1.7% increase in hours worked to generate a **1.0%** rise in productivity. We think compensation per hour rose at a 3.5% rate, so we look for a **1.8%** increase in unit labor costs. **Consensus: N/A.**

• D: International Trade (11)/8:30 EST
Our analysis of flows through major container ports suggests that the headline deficit rose to **$56B** from $54.6B. **Consensus: $54B.**

Thursday, February 7

• D: Jobless Claims (2/1)/8:30 EST
Claims should drop back to about **225K** after last week's leap to a 12-month high of 253K. The seasonals are wild in the early part of the year; the trend probably remains stable at 210-to-220K. **Consensus: 223K.**

• Kaplan Speech (2019 non-voter)/9:15 EST

• Clarida Speech (permanent voter)/9:30 EST

• Consumer Credit (12)/15:00 EST
We expect a move towards mean reversion, with the stock of credit rising by **$18B**, after $22.4B in November. The trend has picked up in recent months. **Consensus: $15.3B.**

• Bullard Speech (2019 voter)/19:30 EST

Friday, February 8

• Daly Speech (2019 non-voter)/13:15 EST

THIS WEEK'S FUNDING

Monday 4	Auction: $45B 3-month, $39B 6-month bills
Tuesday 5	Announcement: four-week bills, eight-week bills Auction: $38B 3-year notes (settles Feb. 15)
Wednesday 6	Auction: $27B 10-year notes (settles Feb. 15)
Thursday 7	Auction: four-week bills, eight-week bills Announcement: 3-month, 6-month bills (Feb. 12) Announcement: 30-year TIPS (Feb. 14) Auction: $19B 30-year bonds (settles Feb. 15)
Friday 8	Nothing

PANTHEON'S FINANCIAL FORECASTS

		End-month:			
	4:00pm Fri.	**Mar**	**Jun**	**Sep**	**Dec**
Fed funds target	2½-to-2¾	2½-to-2¾	2¾-to-3	3-to-3¼	3¼-to-3½
2-yr	2.50	2.60	2.90	3.20	3.10
10-yr	2.68	2.80	3.10	3.50	3.00
30-yr	3.03	3.10	3.20	3.40	2.75
Curve 10-2	18	20	20	30	-10
Curve 30-2	53	50	30	20	-45
S&P 500	2,704	2,700	2,750	2,750	2,650
Dollar/Yen	109.5	112	112	112	114
Euro/Dollar	1.15	1.15	1.15	1.17	1.20
Sterling/Dollar	1.31	1.35	1.36	1.38	1.40

PANTHEON'S ECONOMIC FORECASTS

GDP	Q1	2.0%	2015 year:	2.6%
	Q2	4.2%	2016 year:	1.6%
	Q3 third	3.4%	2017 year:	2.3%
	Q4 forecast	*2.7%*	*2018 year:*	*3.0%*
	Q1 forecast	*1%*	*2019 year:*	*2.2%*
	Q2 forecast	*3%*		

CPI	Dec. -0.1% (1.9% y/y); core 0.2% (2.2% y/y)
	Mar. 2019 forecast: 1.6% y/y; core 2.1% y/y
	Sep. 2019 forecast: 1.9% y/y; core 2.5% y/y

Unemployment: March 2019: 3.7%; September 2019: 3.5%.

Federal budget: FY 19 forecast: -$950B (4.5% of GDP)