PANTHEON MACROECONOMICS

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Much of the spike in January hourly earnings likely will reverse in February, regardless of the trend.

We still expect wage gains to reach 3½% by the end of this year, but the path will not be smooth.

Lower-paid people have seen their bargaining power diminish; is that about to change?

Higher-Paid People Drove up January Wages, but Data are Noisy

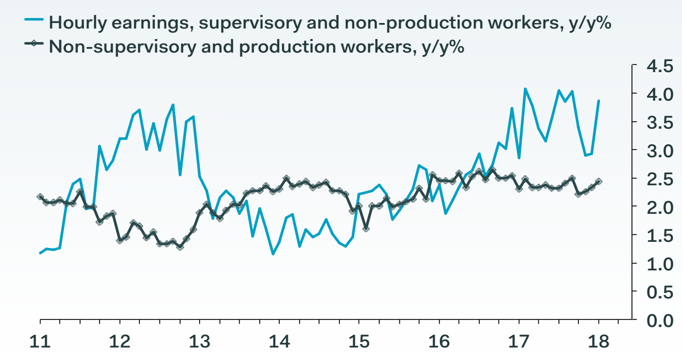
Given the light flow of data this week we want to go back for a closer look at the market-shattering January hourly earnings data. Long-time readers will know that we have been warning for some time that the wages numbers were an accident waiting to happen, and we remain of the view that the *medium-term* risk clearly is to the upside. What is not clear to us, though, is that the January number will be followed immediately by a steadily rising trend. ***Indeed, we would not be at all surprised if January's uptick in wage growth were to be reversed in February.*** We're sticking to our forecast that wage growth will reach 3½% by the end of this year, but the path to this rate likely will be winding and uneven.

The 0.34% month-to-month increase in private sector average hourly earnings for all employees, which lifted the year-over-year rate to 2.9% from 2.6%, was unevenly distributed. Wages for non-supervisory and production workers rose only 0.13% month-to-month, and 2.4% year-over year. These people account for just over 82% of the private sector, so that means wages for supervisory and non-production workers must have risen by a hefty 0.80%, lifting their year-over-year rate to 3.9% from 2.9% in both November and December. *That sounds like a dramatic upturn, but the trend has been running in the high threes for some time now; our first chart shows that the numbers late last year were at the low end of the range.*

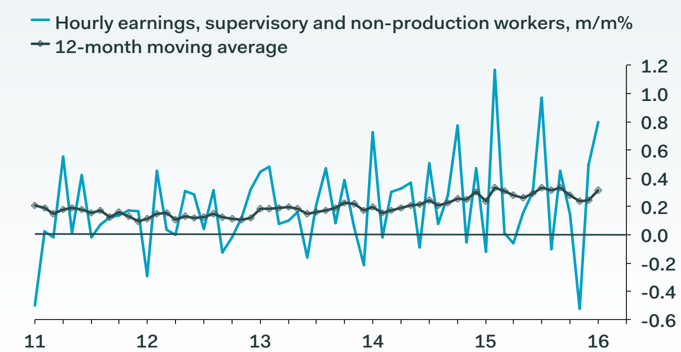
If repeated over a full year, January's monthly jump in supervisory/non-production workers' earnings would generate a 10.0% increase, but that's not going to happen. The month-to-month data are very volatile, because bonuses, commissions, and other incentive pay comprise a much bigger share than for non-supervisory staff. Outsized monthly gains are not unusual; indeed, supervisory wages rose by 1.0% in July last year and 1.2% in February. The trend rate of increase is just over 0.3% per month, as our next chart shows, so we think a hefty dose of mean-reversion this month is a decent bet.

This suggests that February will see a month-to-month gain in total hourly earnings of only 0.2% at best, which would nudge the headline year-over-year

SUPERVISORY WORKERS DROVE JANUARY'S RISE IN WAGE GAINS...



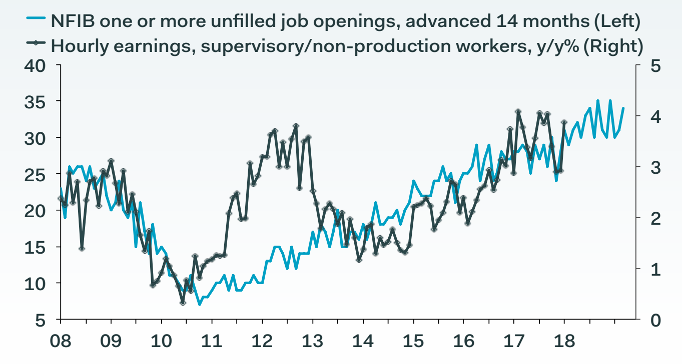
...BUT THEIR EARNINGS ARE VERY VOLATILE MONTH-TO-MONTH



rate back down to 2.7%. Not quite panic over, but the chances of avoiding a three-handle for a few more months are good. That would give markets more time to absorb the idea that the Fed is serious about gradual policy normalization, but is not close to panicking.

Looking further ahead, we think the trend in supervisory/non-production workers' wage gains will run close to February's pace, at about 4%. That implies no further acceleration, consistent with the message from the NFIB survey's jobs-hard-to-fill measure, shown in our next chart. The survey has done a decent job in predicting wage growth for higher-paid people, with the exception of an unsustainable burst of wage gains in 2011 and 2012, before the sequestration process in government spending slowed the economy quite sharply in fiscal 2013.

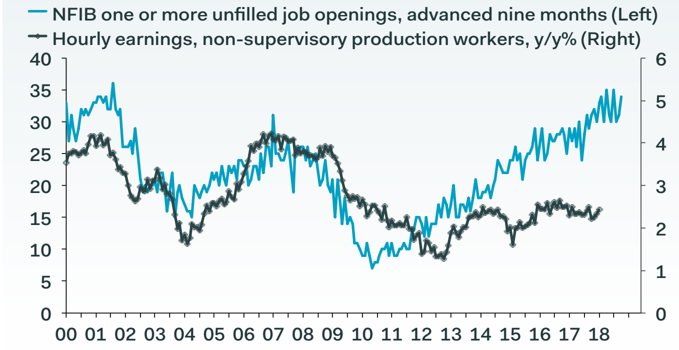
SOME HIRING MEASURES ARE OFF THE CHARTS...



Contrast this with the story among lower paid non-supervisory and production workers, where wage growth continues to trail well behind the pace implied by the survey. Both sets of workers have seen real wages rise in recent years, but the message here is that higher-skilled people have retained much of their bargaining power in the wake of the 2008 crash, while the lower paid have not. This might be a story about increasing automation, globalization, and declining union membership and power, but none of these things started in late 2014, when wage growth began definitively to underperform the pace implied by the NFIB survey.

At that time, economic growth was under pressure from the meltdown in oil prices, which boosted

...BUT OUR CORE HIRING INDEX IS MERELY VERY STRONG



consumers' spending power but triggered a sharp and sustained weakening in capital spending, and a slowdown in hiring. This is all now reversing, and we are *hopeful*—but not more than—that this will be reflected in due course in faster wage gains among the lower paid. Further declines in unemployment would help, by making qualified staff at all levels harder to find.

In the meantime, though, we doubt that January's upside surprise in wage growth marks the start of a rapid acceleration. The February wages numbers, in our view, are more likely to induce a sigh of relief in markets. ***But they won't stop the Fed hiking in March, and we're sticking to our forecast of four hikes this year.***

Claims, Kashkari today won't change the story

Today brings the weekly jobless claims numbers and a speech, at 9.00 Eastern, from the very dovish Neel Kashkari, Minneapolis Fed president. We expect him to sound a bit less dovish, after last week's data. As far as we can tell, the trend in claims continues to fall, slowly, though after the noise over the holiday season we can't yet be completely certain. Whether the trend is at 238K or 232K doesn't make much difference to the big picture, though; what matters is that the pace of layoffs is extraordinarily low and shows no sign of turning up. That doesn't *guarantee* strong payroll numbers—claims tell us nothing directly about hiring—but it's certainly consistent with the idea that labor demand is robust, and that firms are reluctant to let people go unless they have no choice.

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THIS WEEK IN BRIEF

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

Monday, February 5

• D: ISM Non-manufacturing (1)/10:00 EST
The headline index rose to a new cycle high of **59.9,** from 56.0 in December. It tends to lag the rate of growth of core retail sales by roughly a month, so the strengthening in sales at the end of last year explains the jump in the index. The employment index jumped to a record high and now appears consistent with labor demand running at about 400K per month. That can't happen; the pool of labor just isn't big enough.

Tuesday, February 6

• Redbook Chain Store Sales (2/3)/9:00 EST
Same-store sales growth nudged down again, surprisingly to **3.0%** year-over-year from 3.2% last week. This is near the bottom of the range of the past few months, suggesting that consumers' spending has not maintained its frantic Q4 pace.

• D: International Trade (12)/8:30 EST
The deficit rose to **$53.1B** from $50.4B, worse than implied by the advance data, thanks to a downward revision to goods exports and an unexpected dip in the services surplus. Q4 core imports rose at a 20.5% annualized rate, which cannot be sustained, while the ISM survey points to stronger export growth.

• JOLTS (12)/10:00 EST
The number of job openings dipped to a seven-month low of **5,811K** from an upwardly-revised 5,978K.

• James Bullard speech/8.50 EST
Mr. Bullard said the Fed "doesn't need to do much" by way of rate hikes, and that the Fed's dotplot "may be less useful now". Clear?

Wednesday, February 7

• Robert Kaplan speech/6.00 EST
"It would be wise for us to be removing accommodation in a patient and balanced manner."

• Mortgage Applications (2/2)/7:00 EST
The purchase index was little changed at **255.4.** A very persistent seasonal problem likely will push it down over the next few weeks.

• Bill Dudley speech/8.30 EST
The stock drop has "virtually no" impact on the economic outlook.

• Charles Evans speech/10.15 EST
The Chicago Fed president is very dovish, and still thinks rates shouldn't rise until mid-year. But he has no FOMC vote this year.

• John Williams speech/17.20 EST
The San Fran Fed president is unlikely to have changed his view that four hikes probably will be needed this year.

Thursday, February 8

• D: Jobless Claims (2/3)/8:30 EST
Our take on the seasonals suggest claims will be unchanged at **230K.** Incredibly, the trend appears to have slipped to new lows, below 235K. **Consensus: 235K.**

• Neel Kashkari speech/9.00 EST
Another uber-dove, but he has no vote this year and he acknowledged last week that the labor market is tightening.

Friday, February 9

• Wholesale Trade (12)/EST
We expect no change from the preliminary estimate, **0.2%,** with all the increase in durable goods, up 0.4%. Non-durable inventories dipped by 0.2%. **Consensus: 0.2%.**

• Esther George speech/21.00 EST
Anything other than a hawkish speech from the Kansas City Fed president would be a huge surprise.

THIS WEEK'S FUNDING

Monday 5	Auction: four-week bills Auction: $48B 3-month, $42B 6-month bills
Tuesday 6	Auction: 4-week bills Auction: $26B 3-year notes (settles Feb. 15)
Wednesday 7	Auction: $24B 10-year notes (settles Feb. 15)
Thursday 8	Announcement: 3-month, 6-month bills (Feb. 12) Announcement: 30-year TIPS (Feb. 15) Auction: $16B 30-year bonds (settles Feb. 15)
Friday 9	Nothing

PANTHEON'S FINANCIAL FORECASTS

		End-month:			
	4:00pm Wed.	**Mar**	**Jun**	**Sep**	**Dec**
Fed funds target	1¼-to-1½	1½-to-1¾	1¾-to-2	2-to-2¼	2¼-to-2½
2-yr	2.14	2.10	2.20	2.40	2.60
10-yr	2.84	2.70	2.80	3.00	3.20
30-yr	3.12	3.00	3.20	3.40	3.50
Curve 10-2	70	60	60	60	60
Curve 30-2	98	90	100	100	90
S&P 500	2,682	2,850	2,850	2,800	2,700
Dollar/Yen	109.5	116	118	118	118
Euro/Dollar	1.23	1.22	1.20	1.18	1.15
Sterling/Dollar	1.39	1.40	1.38	1.38	1.38

PANTHEON'S ECONOMIC FORECASTS

GDP	Q1	1.4%	2015 year:	2.6%
	Q2	3.1%	2016 year:	1.6%
	Q3 third	3.2%	2017 year:	2¾%
	Q4 forecast	2.7%	*2018 year:*	*2¾%*
	Q1 forecast	*2-to-3%*	*2019 year:*	*1%*
	Q2 forecast	*3%*		

CPI Dec. 0.1% (2.1% y/y); core 0.3% (1.8% y/y)
Jun. 2018 forecast: 2.9% y/y; core 2.4% y/y
Dec. 2018 forecast: 2.5% y/y; core 2.6% y/y

Unemployment: June 2018: 3.7%; December 2018: 3.3%.

Federal budget: FY 18 forecast: -$600B (3.0% of GDP)