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GLOBAL ECONOMICS

SCOTIA FLASH

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Contributors

Derek Holt
VP & Head of Capital Markets Economics
Scotiabank Economics
416.863.7707
derek.holt@scotiabank.com

Treasuries Rally on US Wages and ISM

- **On-consensus job gain was already priced post-ADP…**
- **...but wage growth wasn't as it decelerated…**
- **...nor was a disappointing US-services report…**
- **...all of which drove lower Treasury yields, a weaker dollar and higher S&P**
- **But underemployment is at an all-time low in a very tight labour market...**
- **…layoffs remain very low…**
- **…and caution toward lagging wage growth into 2023 should remain in place**
- **Why ISM-services should be discounted**

Nonfarm payrolls, m/m 000s // UR (%), SA, December:
Actual: 223 / 3.5
Scotia: 220 / 3.7
Consensus: 203 / 3.7
Prior: 256 / 3.6 (revised from 263 / 3.7)

Good enough wasn't quite good enough for markets, unless of course you're like many out there who may welcome lower borrowing costs and higher equities! Nonfarm payrolls landed roughly in line with consensus and this outcome was probably already priced given the market reaction post-ADP. What drove a strong double-digit rally across US Treasuries, however, were the dual effects of softened wage growth including negative revisions and then a disappointing ISM-services report that itself should be treated carefully. Fed funds futures moved closer toward a quarter point hike on February 1st and the terminal rate pricing slipped back slightly beneath 5% again.

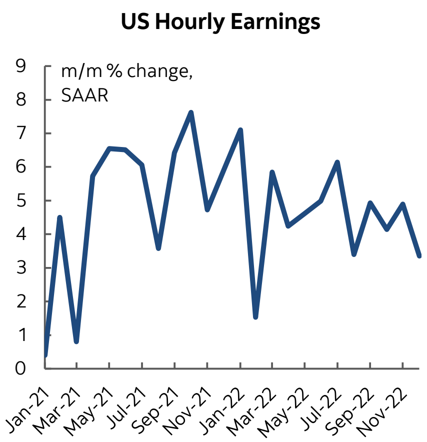
Payrolls were up by 223k in line with my estimate and not a statistically significant beat to the consensus estimate. There were minor negative revisions totalling -28k over the prior two months of estimates.

Wage growth ebbed to 0.3% m/m in December with the prior month's initially reported 0.6% rise revised down to 0.4%. That took the year-over-year wage growth rate down to 4.6% (5% consensus). Month-over-month seasonally adjusted wage growth at an annualized rate slipped to 3.4% and hence toward one of the lower readings this year (chart 1), with the usual caution not to get too carried away from any single month's surge or deceleration. Trend growth remains 4-handled on a three-month moving average basis. If that continues and if headline inflation eases this year then modest real wage gains may lie ahead for the average worker which could—even at these levels—set a floor on core inflation.

Breadth was solid (chart 2). Goods sectors added 40k jobs led by 28k construction jobs. Service sectors did the lion's share of the hiring as is typical and added 180k jobs. Within services, education/health was up 78k and leisure/hospitality was up by 67k with an assist from trade/transport (27k). Retail hiring has been soft at just 9k in December following three small previous declines. All of the job gain was in the private sector as government hiring was flat (+3k).

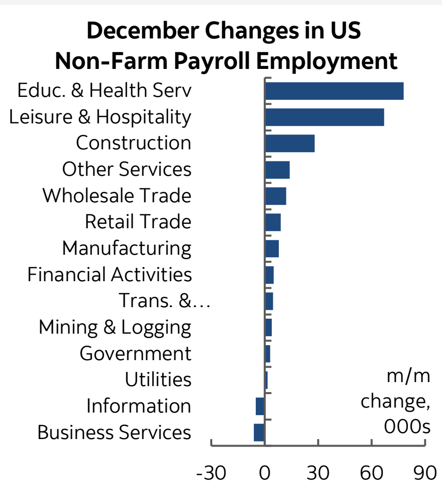
The unemployment rate fell to 3.5% and was revised lower to 3.6% the prior month from the initial 3.7%. It remains exceptionally low (chart 3). The UR is derived from the companion household survey that registered a whopping 717k job gain alongside a smaller but still large 439k increase in the size of the available pool of labour. Those who were arguing that the household sector is a better gauge of what's really going than

Chart 1



Sources: Scotiabank Economics, BLS.

Chart 2



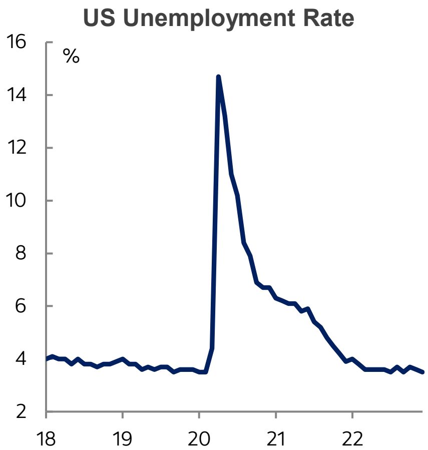
Sources: Scotiabank Economics, US BLS.

nonfarm payrolls after the household survey shed jobs in October and November are now scratching their heads.

The U-6 underemployment rate that includes, among other things, discouraged workers who have dropped out is also low at 6.5% which is an all-time historical low. The job market is super tight.

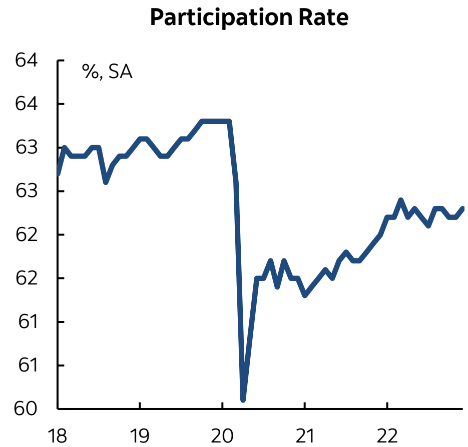
That said, the participation rate is still meaningfully lower than pre-pandemic levels (chart 4) which some may take as evidence for the 'don't-want-to-work' political narrative, while others may take as reflective of multiple changed circumstances in the pandemic.

Chart 3



Sources: Scotiabank Economics, BLS.

Chart 4



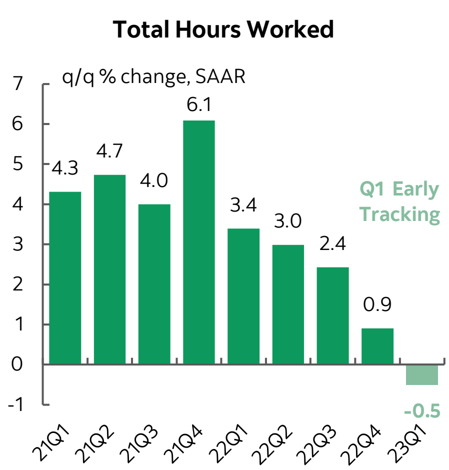
Sources: Scotiabank Economics, BLS.

Hours worked fell by 0.1% m/m for the second consecutive drop. Growth in hours worked is definitely slowing in the US economy with nothing baked into Q1 by way of the hand-off effect (chart 5). That's a negative for GDP growth barring a sizeable improvement in productivity growth.

All the headlines about layoffs are not really a significant drag thus far. There has been a mild pick-up in permanent layoffs alongside no real trend change in temporary layoffs, but both remain very low (chart 6). I realize that layoffs are painful to those who are affected and that's unfortunate especially at the relatively concentrated sectors that are driving much of this. My point, however, is that in the US and also north of the border (chart 7), there isn't much evidence that the numbers we're dealing with so far are terribly material in the grand context of the sheer size of the job market.

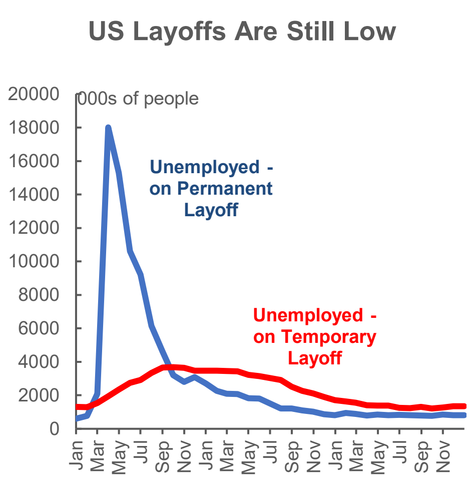
On ISM's disappointing drop (49.6 from 56.5, 55 consensus), I would advise caution. A caution around this is that while it's seasonally adjusted, I'm not especially surprised to see weaker than normal new orders that dragged down the headline reading after holiday sales were front loaded relatively early in the season compared to prior years. Core retail sales growth was very strong in August through October and then softened in November. Seasonality is likely messed up. Maybe consumers shopped earlier than usual and maybe sales promotions/campaigns were more aggressive earlier than usual A further caution is that ISM-services employment slipped into slight contraction at a sub-50 reading, yet we just got a pretty strong reading on service sector employment that challenges the credibility of what purchasing managers are either seeing in their worlds or the nature of the report itself.

Chart 5



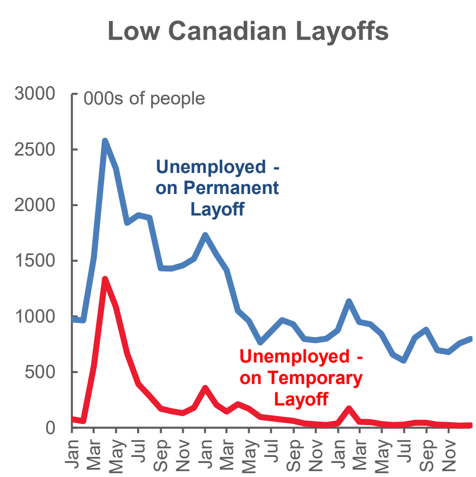
Sources: Scotiabank Economics, BLS.

Chart 6



Sources: Scotiabank Economics, Statistics Canada.

Chart 7



Sources: Scotiabank Economics, Statistics Canada.