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ECONOMIC COMMENT – NOVEMBER 9, 2015
WHAT WILL THE FED DO?

News that private nonfarm payroll employment in October posted a robust – and better-than-expected – gain of 268,000 has clearly increased the likelihood of a Federal Reserve rate increase in December. However, the month-to-month volatility in job growth makes it very difficult to determine the underlying trend of employment growth. Put another way, does October's gain represent a significant strengthening of the job market or an aberration in a slowing trend of hiring by U.S. companies?

Consider, for example, that the October increase in retail trade was 44,000 compared with an average of 5,000 in August and September. Likewise, the 31,000 increase in construction employment was well above the average of 10,000 in the previous two months. Can or will employment in a handful of service-related industries continue to increase at anything like the pace recorded in October? Bear in mind that close to 52% of the increase in October's payroll employment was concentrated in just three industry groups: retail trade, health care, and accommodation and food services.

With such a large percentage of October's job increase concentrated in what are generally low-wage industries, it is not surprising to find that average weekly earnings of all employees on private nonfarm payrolls were only up 2.2% from a year earlier, which after adjusting for the rise in prices indicates a real gain in earnings of something less than 1%. As we have noted before, the anemic growth of weekly earnings is, in our view, likely to act as a constraint on consumer spending for goods and services over the immediate months ahead. Despite all the headlines, therefore, we believe that October's employment gain was indeed something of an aberration and will, in our opinion, be followed by much smaller increases over the balance of this year – and into 2016. The likelihood that November's employment report will show a significantly smaller increase in jobs than the 268,000 reported in October should not, in our judgment, deter the Federal Open Market Committee from raising interest rates at its next meeting. Indeed, it seems almost inconceivable that the Federal Reserve will continue to hold off raising interest rates at its December 2015 meeting. With the economy at or close to full employment – the jobless rate has been reduced to 5% – and the rate of inflation widely expected to shortly reach the Fed's goal of 2%, the time has surely come, if it has not already passed, for the Federal Reserve to recognize the economic progress that has been made since 2009 – and begin to raise interest rates. Arguably the likelihood of a 25 or 50 basis point increase in the funds rate will have little more than symbolic importance. Of much greater significance will be the speed and magnitude of future increases. We are still a long way from the normalization of monetary policy.

Norman Robertson