February 2, 2018

Why US Wage Growth Accelerated

United States, Nonfarm Payrolls (000s) / Unemployment rate (%) / wages y/y (%), January:

Actual: 200 / 4.1 / 2.9

Scotia: 200 / 4.0 / 2.5

Consensus: 180 / 4.1 / 2.6

Prior: 160 / 4.1 / 2.7 (revised from: 148 / 4.1 / 2.5)

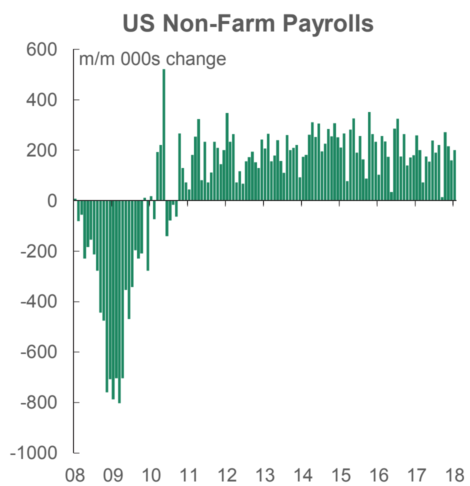
- Wage growth accelerated to 2.9% y/y and smashed consensus expectations to tie with wage growth in December 2016 for the fastest of the cycle dating back to the previous high in June 2009. The USD rallied to stronger on the day while 2 year Treasury yields spiked higher in the aftermath. I'm cautious regarding the acceleration in wage growth for reasons that are now worth diving into below.
- I know everyone focuses upon the year-ago percentage change in average hourly earnings using the seasonally adjusted series (SA) and that's the measure the BLS emphasizes in its write-up and the measure that consensus estimates. But with some exceptions explained below, it's usually the case that the technically better way of doing year-ago percentage changes is to compare seasonally UNadjusted (NSA) months since technically we're comparing like-for-like months during the calendar year when seasonal influences should be comparable.
- Now herein lies the rub. In year-ago terms, seasonally UNadjusted wage growth *fell* to 2.2% y/y from 2.7% the prior month instead of the rise in y/y SA wages to 2.9% y/y from an upwardly revised 2.7% y/y (was previously 2.5%). It's often impure to do year-ago percentage changes using SA series because by definition there shouldn't be seasonality in year-ago like-for-like comparisons.
- First, how big of a deal is this before I turn to possible explanations? This is the widest gap in the y/y SA wage growth print versus y/y NSA wage growth estimate since July as the table below illustrates. It wasn't an issue for months so we may have become somewhat complacent toward the issue at hand. Note that it was also a huge issue last January but in the opposite direction.

	y/y SA wages	y/y NSA wages	diff
Jan-2017	2.4	3.2	-0.8
Feb-2017	2.7	2.7	0.1
Mar-2017	2.6	2.6	0.0
Apr-2017	2.5	3.2	-0.7
May-2017	2.5	1.8	0.7
Jun-2017	2.5	2.4	0.1
Jul-2017	2.5	3.3	-0.8
Aug-2017	2.6	2.6	0.0
Sep-2017	2.8	2.8	0.0
Oct-2017	2.3	2.3	0.0
Nov-2017	2.5	2.4	0.1
Dec-2017	2.7	2.7	0.0
Jan-2018	2.9	2.2	0.7

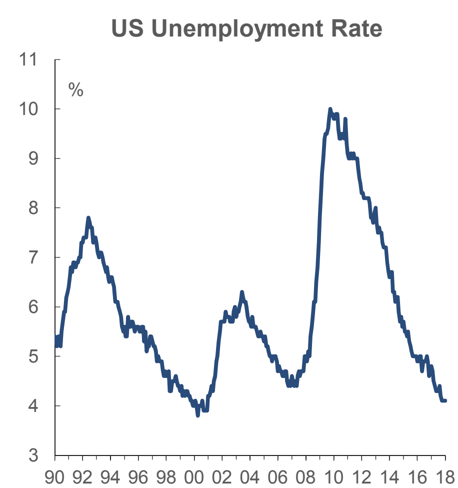
- Now for the 'why' part. The month-ago seasonally unadjusted wage gain was quite strong at 1.2% m/m which was the biggest since last July.

CONTACTS

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



Sources: Scotiabank Economics, BLS.



Sources: Scotiabank Economics, BLS.

- Secondly, one reason to compare year-ago wage numbers in seasonally adjusted terms is to control for calendar effects and how they can impact the nonfarm reference period and pay period swings from year to year. For instance, some months—even when the same month from year to year—may have four weeks in the pay period whereas some may have 5 weeks. This was not a factor this time around as January 2018 and January 2017 both had four weeks in the pay period. So this sometimes culprit is not worthy of further consideration for present purposes.
- One difference this time, however, is that there were 11 calendar business days captured in the January 2018 reference period whereas there were 10 days last January. Data is seasonally adjusted for these variations from year to year but note that this is one of the effects being relied upon to get the deviation between the year-ago SA and year-ago NSA wage growth numbers as the latter would be unaffected by this issue in a strict year-over-year comparison.
- Revisions are the other effect being relied upon to report faster wage growth. Re-benchmarking that alters the number of employees can by corollary influence the average wage growth number. This process is described here for the current revisions and for those who may be interested. The point to emphasize is that revisions through annual benchmarking exercises were a contributing factor behind faster wage growth. By how much? December 2016 wage growth was revised down by 0.2% and January 2017 wage growth was revised down by 0.1% y/y and so a lower jumping off point for year-ago wage comparisons in January 2018 and revision effects to December 2017 were part of the reason for accelerated wage growth and the upward revision to the prior month.
- In all, it is worth being cautious when faster wage growth is reported as a function of re-benchmarking and factors like changes in the precise number of calendar business days leading up to the reference period.
- As for other components of the report, they were generally strong but not entirely so.
- Hours worked fell 0.5% m/m. That wipes out some of the gains of the past three months. Wages may have accelerated depending upon the sensitivities explained above, but incomes in aggregate were dented by working fewer hours. It's wages times hours that gets people paid.
- By sector, services added 139k jobs and goods producing industries added 57k. Within goods, construction was up 36k but manufacturing was also up 15k. Within services, there were five fairly diversified sources of gains: education/health (+38k), leisure/hospitality (+35k), trade/transport (+34k) and business services added 23k.
- The unemployment rate was flat at 4.1%. It is derived from the companion household survey that showed a job gain of 409,000 offset by a bigger gain in the size of the labour force (+518,000).
- The private sector added 196,000 jobs and therefore accounted for the whole tone of the headline rise. Government added 4k entirely through the federal government as state/local was flat (-1k).