Economic Analysis

August Employment Report Supports a September Rate Hike, but There's No Guarantee

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- **Nonfarm payroll growth increased only 173K, but was offset by revisions to June and July**
- **Wages increased 0.3%, the fastest monthly pace since January**
- **The unemployment rate fell to 5.1%, in line with the Fed's long-run outlook**

August's employment report has enough positive aspects to support a rate hike in the next few weeks, but it all depends on which key data points the FOMC members choose to absorb. Lower-than-expected job growth alongside healthy wage growth and a drop in the unemployment rate to 5.1% send mixed signals on how the Fed will interpret the news. The question remains how much weight the Fed will place on positive labor market data and whether or not this will outweigh their more skeptical views on inflation and global market instability.

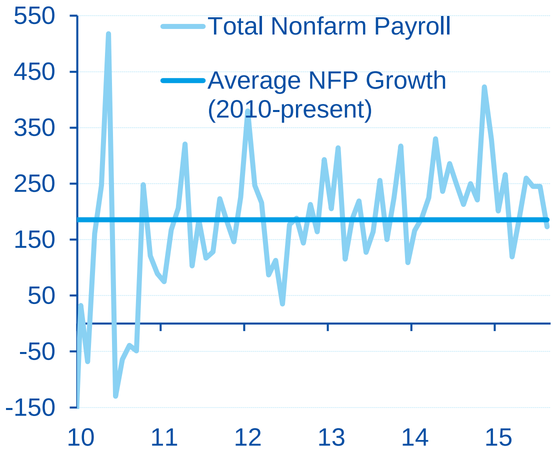
Nonfarm payrolls increased a disappointing 173K, with private payrolls up a mere 140K. However, August tends to be a weird month when it comes to the employment report, and the past few years have shown significant revision after the first release. Furthermore, payrolls for June and July were revised up a combined 44K, to 245K each month. Thus, we are not too concerned with the initial reading below 200K for August.

Average hourly earnings increased 0.3% for the month, the fastest pace since January, and held steady at 2.2% YoY growth for the second month in a row. While this may be too little too late to encourage a September rate hike, it at least hints that wage growth is moving in the right direction. Stronger wage growth is also a good sign for the inflation outlook. The Fed wants to feel "reasonably confident" that inflation will move toward their target in the mid-run, and as Vice Chair Stanley Fischer noted, "because monetary policy influences real activity with a substantial lag, we should not wait until inflation is back to 2% to begin tightening." In this case, positive wage data for August may be just enough to convince the Fed to increase rates now before wages and (core) inflation accelerate even more in the coming months.

The most encouraging news for the Fed is the drop in the unemployment rate to 5.1%, which is officially in line with their longer run outlook (5.0-5.2%). Despite the fact that falling labor force participation has contributed significantly to this decline in unemployment, it is hard to deny the obvious improvement at face value. Even the U-6 unemployment rate (which includes total unemployed plus the marginally attached and those employed part-time for economic reasons) has fallen to its lowest level since before the crisis.

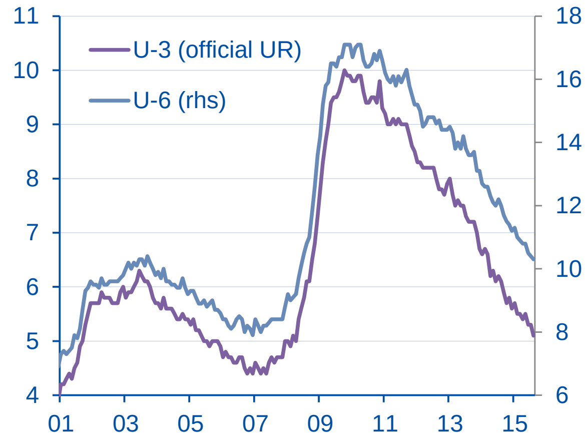
If the Fed truly believes the latest labor market data, they should not hesitate to begin the normalization process as soon as possible. Unfortunately, other economic developments, particularly the vulnerable situation in global financial markets, have become an unwanted distraction from the Fed's dual mandate. August's unemployment rate may be additional support for those FOMC members who were already in favor of a September liftoff, but the most dovish members may still need more convincing.

Chart 1
Nonfarm Payrolls (MoM Change, Thousands)



Source: BLS & BBVA Research

Chart 2
Unemployment Rate (%)



Source: BLS & BBVA Research

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