Economic Analysis

Strong Jobs Boost Probability for December Liftoff

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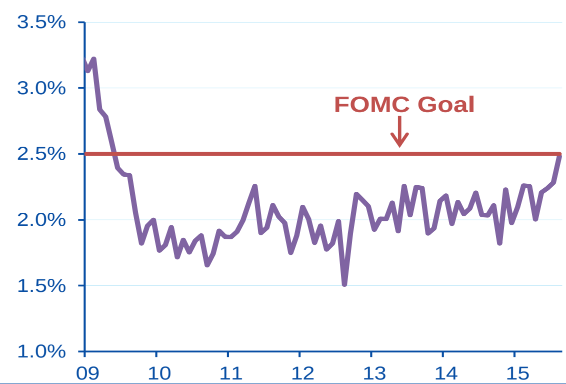
- **October's 271K jump in nonfarm payrolls pushed the unemployment rate down to 5.0%**
- **Wage growth hit the Fed's goal at 2.5% for the first time since July 2009**
- **Implied probability for December rose to 70%, but delay to 1Q16 is not out of the question**

October's employment report has wiped the slate clean, offsetting the underwhelming job growth seen in August and September. While we had expected job growth to jump back above 200K for the month, the 271K gain was much higher than anyone had predicted. Leading the 268K rise in private payrolls was a healthy gain in retail hiring, up 44K in time for the holiday shopping season. Hiring was also strong in education and health services (57K), leisure and hospitality (41K), and construction (31K). Manufacturing remains weak, showing no change in employment following consecutive declines in the previous two months.

The boost in job growth was enough to push the unemployment rate down to 5.0% on its own, as the participation rate remained unchanged at 62.4%. This drop in unemployment, along with a welcome jump in average hourly earnings (up 0.4% MoM), suggests that labor market slack continues to decline. Wage growth on a YoY basis hit 2.5% for the month, reaching the FOMC's goal for the first time since July 2009. Furthermore, October's decline in involuntary part-time employment calms some worries on more structural issues that are lingering in the labor market.

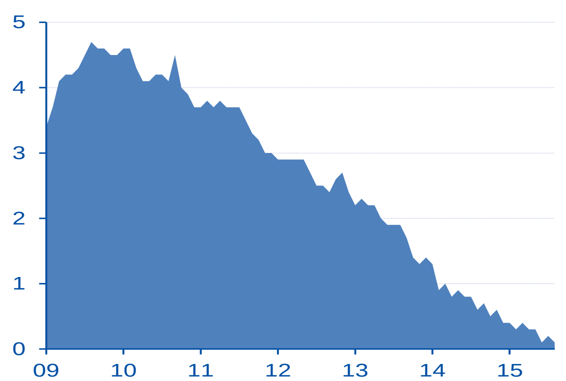
On the surface, October's labor market improvement and the FOMC's more hawkish statement a few weeks ago point more confidently towards a federal funds rate hike in December. Markets are certainly preparing themselves for such a move, with the implied probability from fed funds futures rising from 36% prior to the October FOMC statement to 50% immediately after the announcement. With this strong employment report for October, the probability for a December move is up to 70%. This helps the Fed feel more confident that a rate hike at the end of the year won't completely surprise markets.

Chart 1
Average Hourly Earnings (YoY % Change)



Source: BLS & BBVA Research

Chart 2
FOMC Target Gap: Unemployment Rate (Actual UR – Long-Run FOMC UR Forecast, pp)



Source: BLS, FRB, & BBVA Research

While it may seem that October's jobs report is a surefire sign of a December liftoff, we are not completely convinced. This has happened before, with stronger-than-expected job growth throughout most of the past year hinting at Fed action. Still, the Fed held off on increasing rates, focusing more on their concerns about low inflation. The jump in wage growth in October is another check mark on the FOMC's watch list, but it likely won't be enough to influence all dovish members to feel "reasonably confident" that inflation is moving back towards their target. Furthermore, we can't ignore the fact that other economic reports have not been very encouraging, especially data coming out of manufacturing and other export-oriented industries. Regardless, October's FOMC statement made it clear that the Fed is still ready to consider a rate hike by the end of the year, and Chair Yellen has confirmed that December will be a "live meeting". Waiting until December may have been their plan all along, yet we cannot completely rule out the possibility for further delays into 1Q16, depending on how data evolve throughout the next month.