

# US Economic Comment

## UBS View: June & July Fed hikes are off the table

### Economics

#### Americas

#### All crossed up

A weak employment report for May was corroborated by weak ISMs. Employment and ISMs both now show downtrends since late last year plus particular weakness in May. However, the employment and ISM data continue to contrast with spending data: In Q1, GDP (spending) slowed sharply, while employment and ISMs held up better; in Q2, the opposite appears to be occurring, as spending data for April included real consumption beginning Q2 up at a 4 ½% annual rate.

The Fed was able to write off Q1 spending weakness as exaggerated because of Q1 GDP downward bias, temporary financial market and foreign strains filtering into spending, and the relative strength in employment, ISMs, and confidence. And Q2 spending data appeared to support their expectation of rebound. But the May employment and ISM data cut away some of those supports.

We do expect reversal of the latest employment and ISM weakening. But it will take some time for that reversal to be believable. In turn, we continue to expect that the Fed's next rate hike comes in September (with another following in December).

#### Payrolls and ISM disappoint

Payrolls expanded by just 38k in May but, with a net revision of -59k to April and March, the trend in payrolls now shows slowing—from 229k per month in 2015 to 196k in Q1 and 81k in Q2. The slowing in employment growth has reflected slower hiring rather than layoffs (claims have been stable). But even if May hiring weakness was (significantly) exaggerated, the suggestion is of faltering business confidence.

In May, manufacturing and related sectors (temporary help) fell by 31k versus a three-month average of -18k. Construction jobs were also weak, dropping 15k versus an average gain of 6k over the past three months. On the service sector side of the economy, the strike caused a temporary 34k drop in information jobs. In contrast, healthcare and education job growth accelerated.

The nonmanufacturing ISM index fell to 52.9 in May from 55.7, offering some corroboration of the weakness in the May payrolls report. The employment component fell into contractionary territory and the new orders and business activity indices suggested slower growth than they have been.

#### Unemployment rate fell 0.3 to 4.7%, but for the wrong reasons

Unemployment dropped to 4.7% from 5.0% but fell for the wrong reasons as the labor force contracted by 458k. Household employment grew by just 26,000 while the unemployed fell by 484,000 as workers left the labor force. The participation rate fell to 62.6% from 62.8%, vacillating around the 62.7% rate we see as appropriate given demographics and pre-crisis labor market preference trends.

#### Average hourly earnings hold up

Despite weak job gains average hourly earnings rose by 0.2% m/m and held at 2.5% y/y. Along with a steady (albeit downward-revised) workweek, this does offer a small silver lining to an otherwise weak report.

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### Employment Situation (8:30 am)

	Feb	Mar	Apr	May
<b>Payrolls (ch, 000s) (C)</b>	233	186	123	38
Government	11	19	-7	13
Private	222	167	130	25
Manufacturing	-16	-29	2	-10
Nat resources & mining	-17	-15	-11	-11
Construction	13	37	-5	-15
Wholesale trade	2	4	2	-10
Retail trade	52	42	-5	11
Trans & warehousing	0	6	10	-1
Utilities	2	-1	0	-1
Information	11	8	3	-34
Financial activities	8	14	18	8
Prof. & bus. services	35	31	55	10
Temporary help	-2	-2	5	-21
Educ. & health services	77	46	46	67
Leisure & hospitality	37	18	11	11
Other services	18	6	5	-1

### Employment Situation (8:30 am) continued...

	Feb	Mar	Apr	May
<b>Hours worked (%m/m)</b>	-0.4	0.1	0.1	0.1
Production	0.2	-0.2	0.0	0.0
Manufacturing	-0.6	-0.5	0.1	-0.2
<b>Average workweek (hrs) (L)</b>	34.4	34.4	34.4	34.4
Production	33.7	33.6	33.6	33.6
Manufacturing	41.8	41.7	41.8	41.8
<b>Avg. hrly earn. (%m/m) (Lg)</b>	0.1	0.2	0.3	0.1
<b>%y/y</b>	2.5	2.4	2.5	2.4
<b>Household survey</b>				
<b>Unemployment (%) (Lg)</b>	4.9	5.0	5.0	4.7
<b>Employment (ch, 000s)**</b>	530	246	-316	26
<b>Labor force (ch, 000s)**</b>	555	396	-362	-458
<b>Participation rate (%)</b>	62.9	63.0	62.8	62.6
<b>Pool of available labor (%)*</b>	8.3	8.3	8.3	8.1

\* People who want a job but have not looked for one in the past four weeks are not counted among the unemployed or in the unemployment rate. The "pool of available labor", a broader measure of unemployment, includes these job seekers as well as the officially unemployed. \*\*Adjusted by BLS for discontinuations caused by new population assumptions. Source: Bureau of Labor Statistics, UBS

### Nonmanufacturing ISM (C) (10:00 am)

Seasonally adjusted, unless marked otherwise	Feb	Mar	Apr	May
<b>Composite index</b>	53.4	54.5	55.7	52.9
Business activity (25%)	57.8	59.8	58.8	55.1
New orders (25%)	55.5	56.7	59.9	54.2
Employment (25%)	49.7	50.3	53.0	49.7
Supplier deliveries* (25%)	50.5	51.0	51.0	52.5
<b>Prices</b>	45.5	49.1	53.4	55.6
<b>Backlogs*</b>	52.0	52.0	51.5	50.0
<b>New export orders*</b>	53.5	58.5	56.5	49.0
<b>Inventory change*</b>	52.5	52.5	54.0	54.0
<b>Inventory sentiment*</b>	62.0	62.5	61.0	60.0
<b>UBS all-economy ISM**</b>	52.9	54.1	55.1	52.7
Manufacturing ISM	49.5	51.8	50.8	51.3
Nonmanufacturing ISM	53.4	54.5	55.7	52.9

Source: \* Not seasonally adjusted. \*\*Economy-weighted average of manufacturing ISM index (12% weight) and nonmanufacturing ISM index (88%). Source: Institute for Supply Management and UBS

### International Trade (U) (8:30 am)

	Jan	Feb	Mar	Apr
<b>Balance (\$bn)</b>	-42.3	-44.0	-35.5	-37.4
Goods	-63.7	-65.2	-57.4	-58.8
Services	21.4	21.2	21.9	21.4
<b>Exports (\$bil)</b>	179.8	182.2	180.2	182.8
<b>Imports (\$bil)</b>	222.1	226.2	215.7	220.2
Petroleum	11.4	10.2	9.8	10.3
Nonpetroleum	210.7	216.0	205.9	209.9
<b>Real goods bal. (2000\$bn)</b>	-61.7	-63.6	-56.1	-57.6
Exports	116.3	119.4	117.1	119.5
Imports	177.9	183.0	173.2	177.1

\*Estimates based on advance figures from May 25, 2016 U.S. International Trade in Goods. Source: Census Bureau, and UBS.

Note: To the extent possible, we identified reports as coincident (C), leading (L), and lagging (Lg) indicators of economic growth.

## Slowing labor input and aggregate earnings in Q2

Aggregate hours worked rose 1.7% at an annual rate in both Q4 and Q1, even as real GDP growth was slowing (to 1.4% in Q4 and 0.8% in Q1). So far in Q2, that labor input has risen at only a 0.3% annual rate (Apr-May vs Q1).

Based on April figures for consumption, exports, durables, and construction, Q2 real GDP growth would accelerate sharply from Q1's 0.8% annual rate. This suggests a higher productivity rate in Q2.

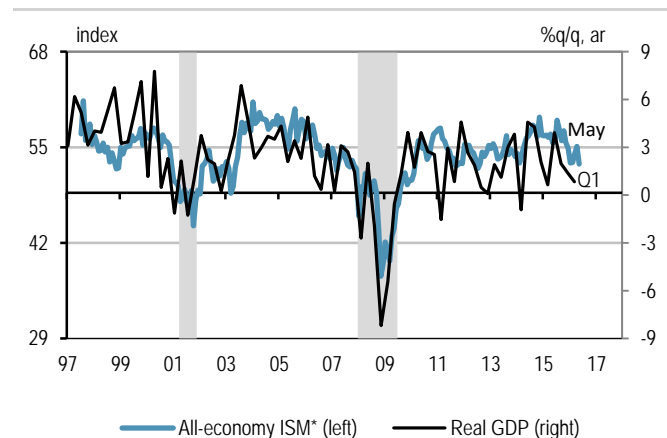
The spending figures also contrast with aggregate payroll earnings (payrolls \* hours \* average hourly earnings), which, after rising at a 4.1% annual rate in Q4 and a 4.4% pace in Q1, have slowed to a 2.7% pace so far in Q2.

**Our all-economy ISM employment index fell 3 pts to 49.7 in May, signalling contraction in job growth and echoing the weakness in the employment report.**



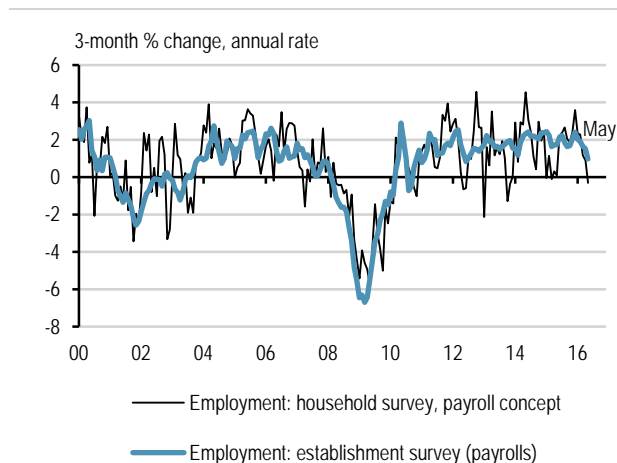
Source: Institute of Supply Management, Bureau of Labor Statistics and UBS.

**Our all-economy ISM index is at a level consistent with a real GDP growth trend of around 2.5%.**



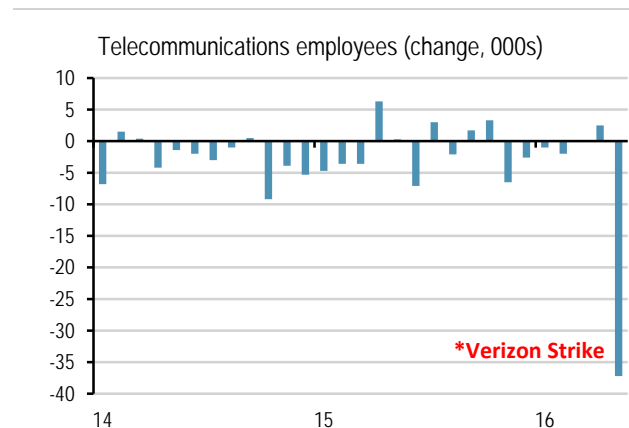
Note: Shaded areas mark recessions. \* Economy-weighted average of manufacturing ISM index (12% weight) and nonmanufacturing ISM index (88%).  
Source: Institute of Supply Management, Bureau of Economic Analysis and UBS

**Both household and establishment surveys show slowing employment growth since December.**



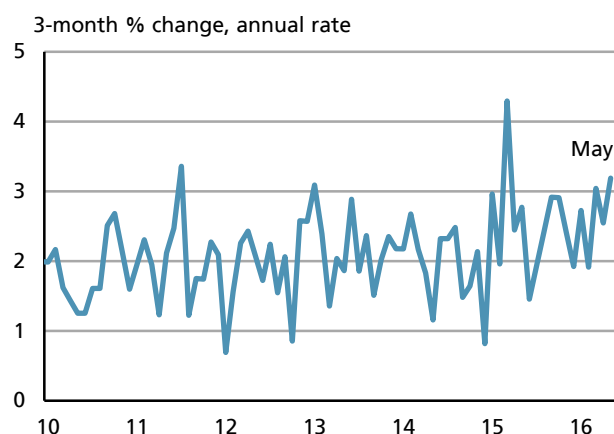
Source: Bureau of Labor Statistics and UBS.

**The Verizon labor strike cut payrolls by 35k in May.**



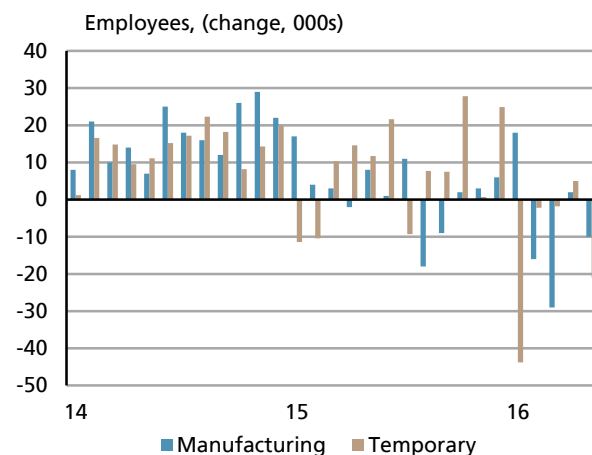
Source: Bureau of Labor Statistics and UBS.

Even amid slower hiring, average hourly earnings have been accelerating. They rose to 3.2% pace on a 3-month annualized basis in May.



Source: Bureau of Labor Statistics and UBS.

Particular weakness within the manufacturing and (related) temp help sectors in May.



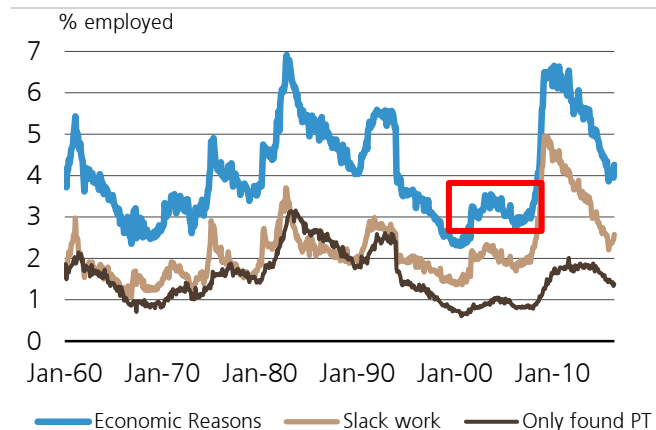
Source: Bureau of Labor Statistics and UBS.

**The below-consensus payrolls print was largely driven by a slowdown in construction and retail trade hiring.**

Average monthly change, 000's	2013	2014	2015	Q2 15	Q3 15	Q4 15	Q1 16	Mar	Apr	May	Apr/May vs. Q1
<b>Payrolls</b>	193	251	229	251	192	282	196	186	123	38	-115
Government	-6	11	8	10	15	1	14	19	-7	13	-11
Private	198	240	221	241	177	281	181	167	130	25	-104
Manufacturing	11	17	2	2	-5	4	-9	-29	2	-10	5
Nat resources & mining	2	3	-11	-13	-10	-10	-15	-15	-11	-11	4
Construction	18	30	25	18	8	49	23	37	-5	-15	-33
Trade, transport and utils	43	43	38	40	26	42	55	51	6	0	-52
Information	4	1	3	5	5	-1	6	8	3	-34	-22
Financial activities	7	11	12	12	12	12	13	14	18	8	0
Prof. & bus. services	46	53	52	75	40	66	21	31	55	10	11
Temporary help	12	14	8	16	2	18	-16	-2	5	-21	8
Educ. & health services	22	40	58	63	58	62	50	46	46	67	7
Health care	13	23	39	46	42	40	39	33	36	46	2
Leisure & hospitality	40	37	37	33	40	45	30	18	11	11	-19
Other services	6	6	5	5	2	11	7	6	5	-1	-5
Household survey employment*	116	230	208	130	73	329	464	411	412	413	3
Payrolls equivalent portion	92	254	225	255	238	421	140	286	-293	-105	-339

\*Adjusted by BLS for discontinuations caused by new population assumptions. Source: Bureau of Labor Statistics and UBS

**While elevated relative to pre-crisis levels, the current share of involuntary part-time workers is close to longer-term averages—suggesting less slack in the labor market.**



Source: Bureau of Labor Statistics and UBS.

**Recent downward trend in the non-manufacturing ISM index.**



Note: Shaded areas mark recessions. Source: Institute of Supply Management and UBS

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