Chart of the Month

September 2016

The Federal Open Market Committee (FOMC) met last week and decided to leave the federal funds rate unchanged at 1/4 to 1/2 percent. The Committee stated that the case for an increase has "strengthened" but opted to "wait for further evidence of continued progress" toward its objectives of maximum employment and stable prices (defined by the Fed as 4.5%-5.0% unemployment and 2.0% inflation).

While the futures market had placed even odds on the FOMC raising the funds rate, we were not surprised by the decision to stay the course for now. We have been in the "lower for longer" camp since the last recession and remain steadfast in our belief that interest rates are unlikely to move materially higher any time soon.

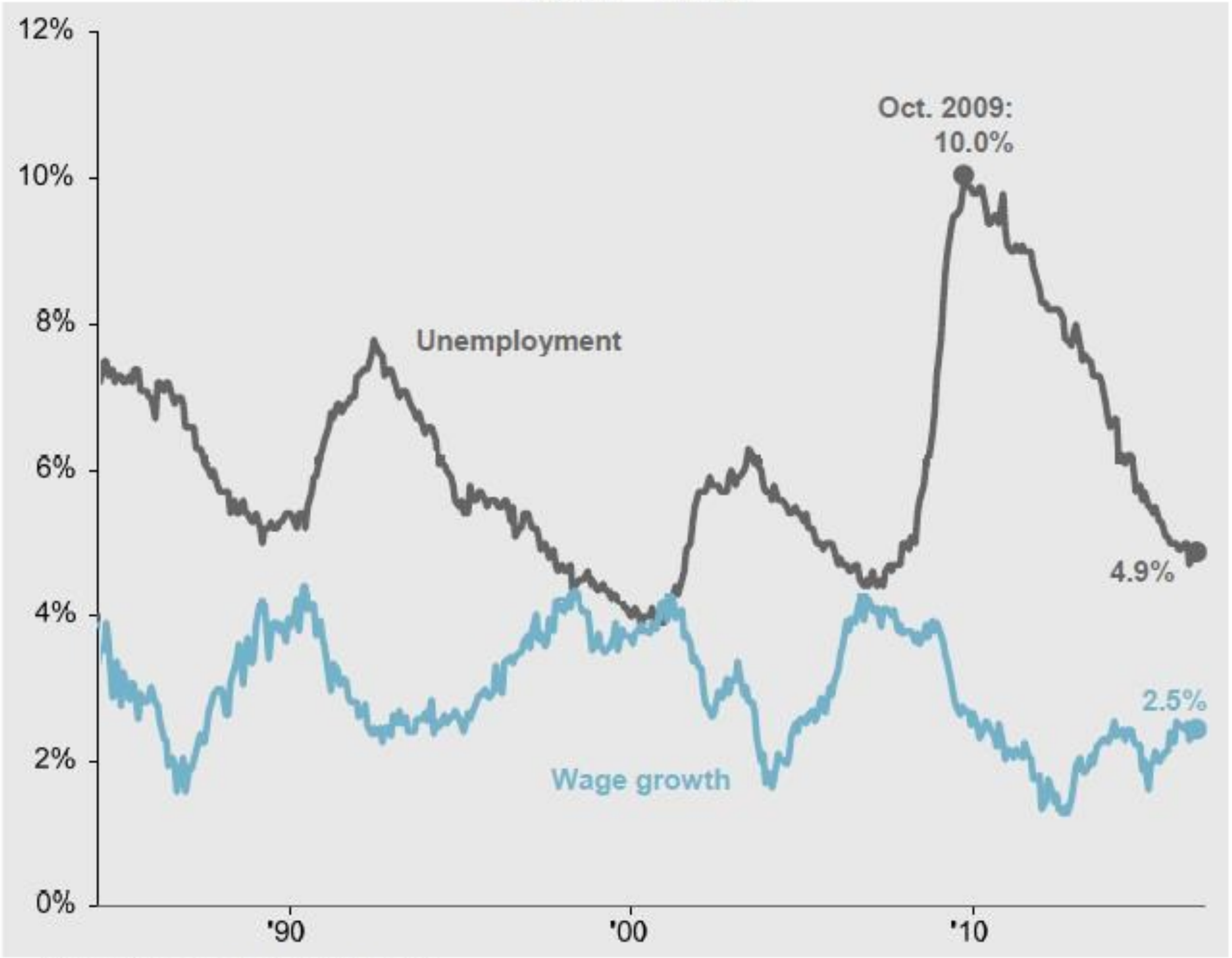
As shown in the chart below, the unemployment rate is currently 4.9%. Although more than halved from the prior peak of 10.0% in October 2009, the rate still remains above the previous two troughs of 4.4% in 2006-07 and 3.8% in 2000. Therefore, it would seem that there is room for the unemployment rate to drop even further. Meanwhile, the year-over-year change in average hourly earnings has been 2.5%, which is 1.2% above the lows in 2012 but nearly 2.0% below the past several peaks.

The lagging growth in wages is an indicator that the labor market may not be as strong as the unemployment rate would suggest. Government benefits and an aging workforce have reduced labor force participation (also known as the employment-to-population ratio) to 59.7%, down from a high of 64.7% in 2000 and still within the post-recession range of 58.2%-59.9%.

Our takeaway from these statistics is that there is little or no reason for the Fed to raise interest rates more than, say, 1/4 percent per year (as it did last December) until the unemployment rate and wage growth move closer to converging at or near 4.0%.

The next meeting of the FOMC is on November 1-2. We would be shocked if the Committee agreed to raise the fed funds rate a week before the election. As a result, we believe that interest rates will remain steady until at least the following meeting on December 13-14, one that will also include a Summary of Economic Projections and a press conference by Janet Yellen.

UNEMPLOYMENT RATE AND WAGE GROWTH
1986 – 2016



Source: Bureau of Labor Statistics

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