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Robust Employment in the US
— Will It Lead to Interest Rate Hike Within This Year? —

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The report on July employment situation in the US which was released on August 5th, showed a monthly increase of 255 thousands in the nonfarm payroll employment, far exceeding the market expectations, coupled with an upward revision of the May and June numbers. The statistics are believed to more accurately reflect the business conditions. Based on this report, some of the Fed members and economists have quickly started to voice for an additional raise of the interest rates.

However, according to "the probability of FOMC moves based on CME Group 30-day Fed Fund futures prices", which is also called a CME Group FedWatch Tool[1], more than half of the forecasters still see the Fed will leave the rate unchanged not only within this year but until the FOMC meeting scheduled on February 1st, 2017 (as of August 12th), although the probability for a rate hike increased a bit from the level before the payroll data release.

Two factors are involved in this different perception: "consistency of payroll data with other economic indicators" and "politics"

The fact that the movements of employment numbers are inconsistent with other economic indicators

The unemployment rate which was released at the same time with the employment statistics registered 4.9%, the same level as the previous month. Regarding this rate as evidence that the domestic labor market has been at full employment, some economists estimate that the monthly increase of nonfarm payroll employment (12 month moving average) will continue at around 200 thousands in the coming months. Incidentally, there were three periods in the past 40 years including the present one when the unemployment rate fell below 5%. The following table shows the relationship between unemployment rate and the number of long time unemployed (those jobless for 27 weeks or more).

1 http://www.cmegroup.com/trading/interest-rates/countdown-to-fomc.html

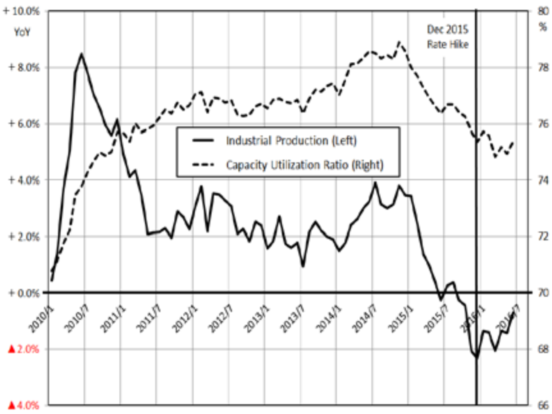
Terms of Unemployment Rate under 5%	Unemployment Rate of These Terms	Numbers of Long Time Unemployed
May 1997 ～ Sept 2001	3.8% ～ 5.0%	593thd ～ 1,078thd
June 2005 ～ Feb 2008	4.4% ～ 5.0%	1,078thd ～ 1,388thd
Oct 2015 ～ July 2016 (present)	4.7% ～ 5.0%	1,885thd ～ 2,213thd

The number of the long term unemployed in the current business cycle increased up to 6,800 thousands in April 2010, triggered by the Lehman financial crisis. Although those people have been decreasing since then along with the economic recovery, the numbers are still as much as two times of those in the previous two periods. The long term unemployed accounts for about 30% of the total unemployed and it will be somewhat unrealistic to assert that the present low unemployment rate of below 5% represents a tight demand in the labor market.

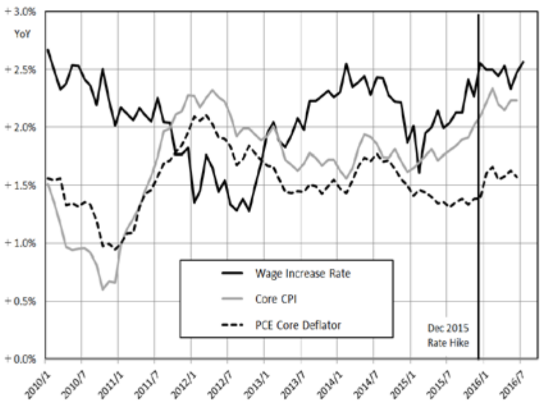
On the other hand, the production performance is not so good. Industrial production has risen from the bottom level it touched when the interest rate was raised previous time, but it is still in the negative range as compared to the corresponding months of previous year. Also capacity utilization ratio, which is regarded as a leading economic indicator, is on a falling trend due to decline of resource prices and others after a peak reached in the latter half of 2014 and it fails to take a chance of recovery even after the previous interest rate hike.

Furthermore, the rise of wages and prices is modest. After rising by about 30bp yoy in December 2015 in the aftermath of the interest rate hike, the wage increase rate has remained unchanged at +2.5% yoy. And, the PCE Core deflator, an inflation indicator on the demand side, is also hovering at around +1.6% yoy since the last rate hike.

Industrial Production and Capacity Utilization Ratio



Rise of Wages and PCE Core Deflator



（Data Source： Reuter Datastream）

Presidential election in November also poses another threat

Although the FRB is a perfectly independent institution from the government, and it is said not to be influenced by the political situation for the monetary policy decision, it emphasizes both the “dialogue with the market” and the “dialogue with the government” that have been inherited since the days of the former chairman Alan Greenspan.

In such an environment, a presidential election is to be held on November 8th. Already Mr. Donald Trump, a Republican candidate, strongly warns against the FRB rate hike, saying that "the US economy will be seriously affected if the dollar goes up with the Fed rate hike". With the supporting rate countervailing between the Republican (Mr. Trump) and the Democrat (Mrs. Clinton), a rate hike prior to the presidential election would involve substantial risk.

Incidentally, seven presidential elections were held since Mr. Greenspan took the post of FRB chairman in August 1987, on two occasions a rate hike was decided prior to the election between August and the middle of November (On two occasions the rate was cut and on the other three the rate remained unchanged). It is considered that the rate hikes could be smoothly made because the presidential candidate had a higher supporting rate than his opponent for long before he was formally elected as president. In 1988 Republican candidate George Bush (Senior), the then Vice President, was elected as president, and in 2004 Republican candidate Bush Junior was re-elected.

The statement of Chairwoman Yellen awaited

In conclusion, it would be reasonable to think that although the July employment numbers served as one of the factors that supported the rate hike, they were not strong enough to promote the early rate hike as the economy as a whole has shown mixed signals.

On August 26th, the FRB Chairwoman Janet Yellen is scheduled to make a speech at an Annual Economic Symposium in Jackson Hole in Wyoming which will be attended by many central bankers from many countries. Her speech is gathering much attention for clues whether the FRB is going to suggest an early rate hike in the wake of improved employment situation or it will maintain careful attitude with consideration for sluggish production/investment activities.

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