Louisiana Corporate Credit Union
ECONOMIC & FINANCIAL DIGEST
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Volume 24 August 2016

# Workers Regaining Bargaining Muscle

The June 23 decision by U.K. citizens to exit the European Union adds another layer of uncertainty to the global economic landscape. Like any unexpected event, the surprising vote in favor of Brexit sent shockwaves through the financial markets for a few days. But fears of the apocalypse quickly subsided as investors realized that this was not a Lehman Brothers moment that would derail the U.S. recovery, much less bring on a global financial crisis. Still, with Europe already coping with weak growth, policy makers overseas will have to work even harder to keep the region from falling into a recession. At the very least, the process by which Britain decouples itself from the E.U. may be messy with myriad unanticipated consequences.

At the margin, the episode poses a modest downside risk for the U.S. economy. Slower growth overseas as well as the stronger dollar will cut into American exports, putting another burden on the struggling manufacturing sector. But exports account for a small fraction of total activity in the U.S., which is much more reliant on domestic sources for growth. Happily, conditions on the home front look much more promising than they did a month or so ago, when an abrupt slowdown in job creation suggested the economy was faltering. As it turns out, the setback was more of a blip than a trend, as job growth surged in June, blowing out expectations and sending pessimists to the sidelines.

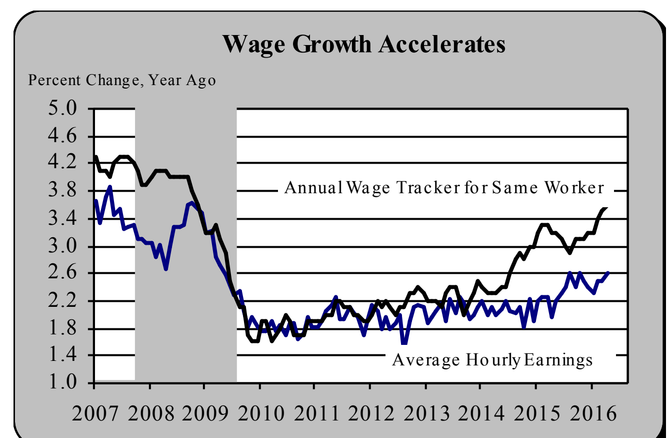
That said, just as the May setback overstated the weakness in the job market, the resurgence in June exaggerates its strength. The increase in jobs is still outpacing population growth, but by a slimmer margin than over the past several years. That's to be expected. As the economy moves closer to full employment, it becomes increasingly harder to squeeze out as many new jobs as before. More important, slower job growth does not necessarily lead to slower economic growth. The economy rebounded smartly in the second quarter from the tepid first-quarter pace, despite the slowdown in jobs. But to sustain momentum over the second half of the year, worker pay needs to speed up. As long as aggregate purchasing power is rising, consumer spending – the economy's main growth driver—will remain healthy and more than offset the drag from sagging exports. Happily, workers are regaining more bargaining power, thanks to a tightening labor market which is starting to translate into fatter paychecks.

### *Wages Picking Up*

Despite an eye-opening 287 thousand surge in nonfarm payrolls in June, it was not enough to compensate for the abrupt slowdown in job growth over the previous two months, particularly in May when payrolls were virtually unchanged. Hence, the economy generated an average of 147 thousand jobs a month in the second quarter, down from a 197 thousand monthly average in the first quarter and well short of the 229 thousand in 2015. It remains to be seen if the economy can still create jobs anywhere close to 200 thousand a month going forward with the unemployment rate already below 5 percent and most of the slack wrung out of the labor market.

But even if the second-quarter pace of job growth is sustained, that should be enough to keep up with population growth and prevent the unemployment rate from rising. The question is, will it be enough to finally jumpstart the long-elusive acceleration in wages that earlier strong job growth failed to bring about? Since the recovery began seven years ago, average hourly earnings have increased at an annual rate of just over 2 percent, a lackluster pace that has restrained consumer spending throughout the upturn. The pace has picked up slightly to 2.6 percent since late last year, but that's still far less than the average hourly increases workers were getting prior to the recession.

However, workers may be faring better than these numbers suggest. Keep in mind that demographic forces are changing the composition of the labor force, with aging baby boomers retiring in increasing numbers and replaced by younger workers. Since older workers earn more than millennials, this rotation weighs down average wage growth. An alternative measure compiled by the Federal Reserve Bank of Atlanta tracks wage growth for a worker on the same job over the course of a year, which gives a better sense of the bargaining clout of existing workers. In June, the median wage increased by 3.6 percent from a year ago, which



is much closer to the prerecession pace than the average increase in wages.

### *Too Many Idled Workers.*

The decent increases shown by the median wage tracker is more consistent with a tightening labor market. For years, economists were perplexed that the solid payroll increases were hardly moving the wage needle, Even the growth in median wages barely moved until early 2015, when the annual rate finally crossed the 3 percent threshold. In retrospect, however, the lagging behavior of wages should come as no surprise, as companies had little incentive to give workers larger pay hikes.

True, the unemployment rate had fallen steadily, from a 10 percent cycle peak in 2010 to 5.7 percent by early 2015. But the sizeable payroll increases in 2014 and 2015 had barely made a dent in the huge pool of potential workers who dropped out of the labor force both during the Great Recession and early recovery period. Indeed, the slide in the labor force participation rate from 66.2 percent to 65.7 percent during the downturn actually accelerated after the recession ended, plunging to 62.4 percent in the fall of 2015 – the lowest since the late 1970s.

In other words, the number of adults exiting the labor force swelled by 10 million during the first 6 years of the recovery. While about half of those dropouts were aging boomers taking permanent retirement, that still left another 5 million or so on the sidelines that could return if job prospects were attractive enough. With so many potential workers competing for jobs, companies had a deep pool to tap into, not to mention the huge number of underemployed workers in part-time jobs that would prefer full time positions. Needless to say, this huge supply of idled labor greatly diluted the bargaining power of existing workers.

### *Diminishing Slack*

However, the sustained increases in payrolls in 2014 and 2015 gradually soaked up this pool of available workers. The labor force participation rate stopped falling in 2015 even as the unemployment rate continued to fall to its current 4.9 percent. Not all of the slack has been wrung out for sure. There are still too many workers in part time jobs and a stubbornly high level of long-term unemployed persists. A stronger economy would no doubt soak up much, although not all, of this remaining slack.

That said, the anecdotal evidence as well as the data are confirming the enhanced worker bargaining power that historically comes with a tightening labor market. In recent months, an array of high-profile companies, including Starbucks and JP Morgan, have announced that they are voluntarily giving sizeable raises for entry-level workers. A number of airlines are offering incentives to recruit newly licensed pilots, paying hefty signing bonuses and offering to finance required training. And workers that had for years stayed glued to their jobs out of insecurity are increasingly hopping to other companies. Indeed, the number of workers quitting their jobs has nearly doubled from its recovery low and is hovering near the levels that prevailed at the peak of the last expansion.

These raises are coming at just the right time for budget-strapped workers whose purchasing power had benefited from low inflation and plunging gasoline prices in recent years. Oil prices have rebounded from their lows and the costs of other essentials, most notably rents and medical expenses, are increasing more rapidly than other goods and services. Simply put, with unions no longer as important as they once were in the wage-setting process, a tighter labor market is the biggest ally of workers when it comes to bargaining power.

### *Inflation Worries Unfounded*

We suspect that economy will continue to deliver a decent – but not great – performance over the second half of the year, paced by consumer spending. If that's the case, the labor market should also remain vibrant, churning out enough jobs to eat further into slack and keep upward pressure on wages. With domestic conditions underpinned by firming fundamentals, the uncertainties over the growth-retarding effects of Brexit should fade. That, in turn, could well increase the odds the Fed will lift interest rates before the end of the year, something that was deemed improbable a month or so ago.

One reason that Fed is more likely to take action is that stronger pay increases instills more confidence that the inflation rate will finally move up to its 2 percent target after four years of wallowing below that threshold. Indeed, some of the more hawkish Fed officials will no doubt clamor for a rate hike sooner than later to prevent an unwanted inflation breakout that would bring on a growth-killing monetary crackdown. In point of fact, overly restrictive monetary policies have been the catalyst for several postwar recessions.

While the likelihood of a rate hike this year is greater now than a few months ago, the Fed will clearly probe cautiously towards tightening policy. True, upward wage pressure is a time-honored harbinger of higher inflation. But remember, it has taken seven years to finally move the wage needle and the link between wages and inflation is much looser when there is still so much slack in the product markets. Not only is the domestic economy running well below its output potential, there is an even greater oversupply of goods overseas competing with American products. The U.S. is far removed from the deflation threat of earlier in the recovery, but it still faces strong disinflationary headwinds from a weak deflation-prone global economy. What's more, inflation rarely gains traction unless it is fueled by rising inflationary expectations among households and businesses, and there is little evidence that is happening. Instead of worrying about its inflationary implications, policy makers should welcome the nascent increase in wage growth as the main catalyst that will sustain consumer spending and keep the economy from succumbing to the global headwinds.

# KEY ECONOMIC AND FINANCIAL INDICATORS

## FINANCIAL INDICATORS*

| | June | May | April | March | February | January | December | 12-Month Range High | 12-Month Range Low |
|---|---|---|---|---|---|---|---|---|---|
| Prime Rate | 3.50 | 3.50 | 3.50 | 3.50 | 3.50 | 3.50 | 3.37 | 3.50 | 3.25 |
| 3-Month Treasury Bill Rate | 0.27 | 0.27 | 0.23 | 0.29 | 0.31 | 0.26 | 0.23 | 0.31 | 0.02 |
| 5-Year Treasury Note Rate | 1.17 | 1.30 | 1.26 | 1.38 | 1.22 | 1.52 | 1.70 | 1.70 | 1.17 |
| 10-Year Treasury Note Rate | 1.64 | 1.81 | 1.81 | 1.89 | 1.78 | 2.09 | 2.24 | 2.36 | 1.64 |
| 30-Year Treasury Bond Rate | 2.45 | 2.63 | 2.62 | 2.68 | 2.62 | 2.86 | 2.97 | 3.11 | 2.45 |
| Tax-Exempt Bond Yield | 3.20 | 3.29 | 3.30 | 3.38 | 3.30 | 3.41 | 3.57 | 3.82 | 3.20 |
| Corporate Bond Yield (AAA) | 3.50 | 3.65 | 3.62 | 3.82 | 3.96 | 4.00 | 3.97 | 4.19 | 3.50 |
| Conventional 30-Year Mortgage Rate | 3.57 | 3.60 | 3.61 | 3.69 | 3.66 | 3.87 | 3.96 | | |
| Dow Jones Industrial average | 17755 | 17692 | 17844 | 17302 | 16300 | 16305 | 17543 | 17927 | 16300 |
| S&P 500 Index | 2084 | 2067 | 2076 | 2022 | 1918 | 1918 | 2054 | 2099 | 1918 |
| Dividend Yield (S&P) | 2.17 | 2.16 | 2.18 | 2.17 | 2.31 | 2.28 | 2.30 | 2.31 | 2.07 |
| P/E Ratio (S&P) | 19.5 | 19.4 | 19.2 | 19.1 | 17.6 | 17.7 | 18.6 | 19.5 | 17.4 |
| Dollar Exchange Rate (vs. Major Currencies) | 89.7 | 89.8 | 89.4 | 91.5 | 93.2 | 95.3 | 94.1 | 95.3 | 89.4 |

* Monthly Averages

## ECONOMIC INDICATORS

| | June | May | April | March | February | January | December | 12-Month Range High | 12-Month Range Low |
|---|---|---|---|---|---|---|---|---|---|
| Housing Starts (In Thousands) | 1189 | 1135 | 1155 | 1113 | 1213 | 1128 | 1160 | 1213 | 1073 |
| New Home Sales (Thousands of Units) | | 531 | 586 | 522 | 525 | 526 | 538 | 586 | 457 |
| New Home Prices (Thousands of Dollars) | | 290 | 320 | 298 | 311 | 291 | 299 | 320 | 289 |
| Retail Sales (% Change Year Ago) | 2.7 | 2.2 | 2.9 | 1.7 | 3.6 | 2.8 | 2.8 | 3.6 | 1.6 |
| Industrial Production (% Change Year Ago) | -0.7 | -1.4 | -1.4 | -2.0 | -1.4 | -1.4 | -2.3 | 0.4 | -2.3 |
| Operating Rate (% of Capacity) | 75.4 | 74.9 | 75.2 | 74.8 | 75.6 | 75.7 | 75.4 | 76.7 | 74.8 |
| Inventory Sales Ratio (Months) | | | 1.40 | 1.41 | 1.41 | 1.41 | 1.40 | 1.41 | 1.37 |
| Real Gross Domestic Product (Annual % Change) | | | | 1.1 | | | 1.4 | 3.9 | 1.1 |
| Unemployment Rate (Percent) | 4.9 | 4.7 | 5.0 | 5.0 | 4.9 | 4.9 | 5.0 | 5.3 | 4.7 |
| Payroll Employment (Change in Thousands) | 287 | 11 | 144 | 186 | 233 | 168 | 271 | 295 | 11 |
| Hourly Earnings (% Change Year Ago) | 2.6 | 2.5 | 2.5 | 2.3 | 2.4 | 2.5 | 2.6 | 2.6 | 2.0 |
| Personal Income (% Change Year Ago) | | 4.0 | 4.4 | 4.6 | 4.2 | 4.4 | 4.3 | 4.7 | 4.0 |
| Savings Rate (Percent of Disposable Income) | | 5.3 | 5.4 | 6.0 | 5.7 | 5.7 | 5.3 | 6.0 | 5.0 |
| Consumer Credit (Change in Mil. Of Dollars) | | 18558 | 13396 | 29438 | 13847 | 13317 | 5974 | 29438 | 5974 |
| Consumer Prices (% Change Year Ago) | 1.0 | 1.0 | 1.1 | 0.9 | 1.0 | 1.4 | 0.7 | 1.4 | 0.0 |
| CPI Less Food & Energy (% Change Year Ago) | 2.3 | 2.2 | 2.1 | 2.2 | 2.3 | 2.2 | 2.1 | 2.3 | 1.8 |
| Wholesale Prices (% Change Year Ago) | 0.3 | -0.1 | 0.0 | -0.1 | 0.0 | -0.2 | -1.0 | 0.3 | -1.6 |

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