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IS THE US ENTERING WAGE NIRVANA?

More than a quarter of American states and several US cities started 2016 by raising the minimum amount employers in their jurisdictions pay workers, yet the US federal minimum wage has remained at $7.25 since 2009. Does this mean US wage inflation is finally present? Portfolio manager Dave Daglio considers its importance to the state of the US economy.

A total of 14 individual states implemented minimum wage increases in January, ranging from a dollar per hour rise in California and Massachusetts – where the minimum wage is now $10 per hour – to a five cent rise to $8.55 in South Dakota. The cities of Seattle, San Francisco and Los Angeles are also raising minimum wages to as much $15 per hour.

These government-mandated increases follow voluntary wage hikes last year by companies that employ large numbers of low-wage workers including Walmart and McDonald's. But while these boosts in wages, as well as protests[1]across the country calling for "living wages", have attracted media attention, their economic significance should not be overstated. The states and cities raising their minimum wages are followers of a broader trend rather than drivers of a change in the direction of the US economy. Many observers including investors, business owners and policymakers currently expect increased broad-based wage inflation as the US economy continues to grow, unemployment declines and employers raise pay to compete for and retain workers who see increasing options in a tightening labour market.

"All of the leading indicators of wage inflation are already in place," says David Daglio, US portfolio manager at The Boston Company[2]. "The best lead indicator is the current unemployment rate which is quite low. The number of people quitting their jobs is at an incredibly high level, which shows confidence in finding a new job is too. As investors, we also consider future expectations and whether you look at small business leaders' sentiment or the percentage of employers giving raises, all indicators point to higher wages in the future."

Daglio notes that moderate increases in wages have historically been strongly positive for equity markets, but he adds the broad trend toward higher pay is likely to put pressure on some corporations' profits. "Wage inflation hits margins hardest in areas like retail where it makes it more difficult for companies to pass on their increased costs. Normally, when you begin to see strong wage increases, retailers struggle with operating margin improvement. In other sectors such as technology and energy, though, the cost of labour is a smaller share of profit, so wage inflation is less concerning."

Of course, equity investors are not the only ones preoccupied with US wage trends. Federal Reserve policymakers closely watch employment and inflation as they set interest rates. "Historically, as wage inflation has approached 3%, the Fed has tightened policy and we have generally seen a peaking of the business cycle, says Daglio. "It looks like we're entering a period of nirvana but the risk is the economy accelerates through that very quickly. Employment is always the most important thing the Fed looks at and the direction of wages is a vital signal for them about the health of the labour market." For now at least, employees and investors alike are benefitting as US economic growth continues.

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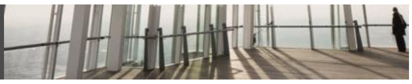
[1] America.aljazeera.com/opinions/2015/6/is-the-fight-for-15-the-next-civil-rights-movement.html

[2] **BNY Mellon Investment Management EMEA Limited ("BNYMIM EMEA") is the distributor of the capabilities of its investment managers in Europe, Middle East, Africa and Latin America. Investment managers are appointed by BNYMIM EMEA or affiliated fund operating companies to undertake portfolio management services in respect of the products and services provided by BNYMIM EMEA or the fund operating companies. These products and services are governed by bilateral contracts entered into by BNYMIM EMEA and its clients or by the Prospectus and associated documents related to the funds.**



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