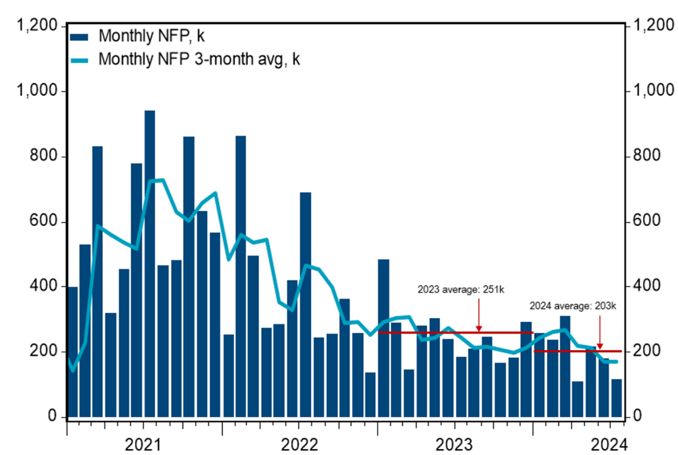
August 12, 2024

Economic INSIGHT

The Health of the Labor Market: Stabilization versus Weakness

The latest July employment report fell notably below expectations, buoying calls for the Federal Reserve (Fed) to take action in order to stem further potential weakness. In fact, amid rising fears of a more precipitous downturn in the labor market, some have called for a larger 50-basis-point (bp) cut at the Federal Open Market Committee (FOMC) meeting next month, or even an emergency reduction before then. But while hiring conditions have clearly cooled from peak levels, a less tight labor market is merely the desired effect of policy firming. In other words, one and a half years of rate hikes is finally having the intended consequence of slowing activity. Therefore, as San Francisco Fed President Mary Daly pointed out earlier this week, it's too soon to say whether there is real "weakness" in the labor market or if it is simply a reflection of "normalizing" conditions, as Fed Chairman Jerome Powell described it.

TOPLINE JOB CREATION



Source: Bureau of Labor Statistics/Haver Analytics

Nonfarm payrolls rose by 114,000 in July, well shy of the 175,000 rise expected and marking a three-month low. The three-month average, meanwhile, rose from 168,000 to 170,000 at the start of the third quarter with an average pace of 203,000 in 2024 compared to a 251,000 pace in 2023. Household employment, meanwhile, rose 67,000 in July following a 116,000 increase the month prior. Despite the recent loss of momentum from a more robust pace in the prior 12 months, on average the U.S. economy continues to create or replace more than 200,000 jobs on a monthly basis, a historically robust pace of payroll creation.

CATEGORIES OF JOB CREATION

Despite a relatively lower topline gain in July, job creation remains widespread across a number of key categories, reflecting a pickup in broad-based growth in Q2 and ongoing resilience of American businesses. Goods-producing payrolls increased by 25,000, while services payrolls rose 72,000 at the start of the third quarter. The latter follows

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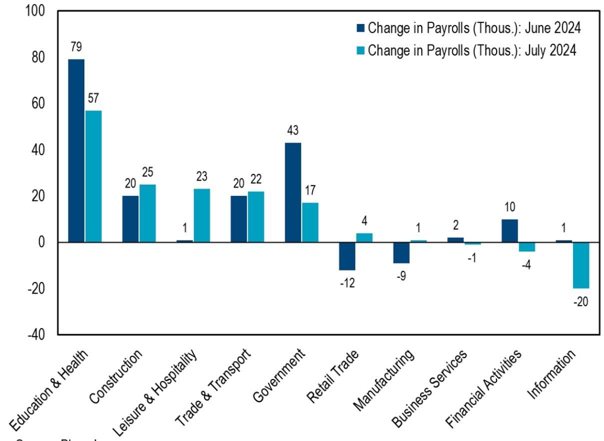
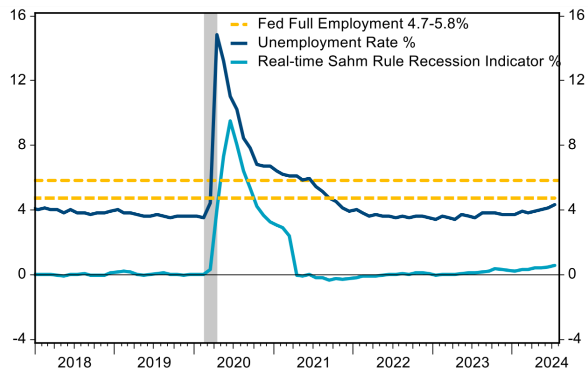
a 125,000 gain the month prior. Education and health payrolls led the gain in service-producing hires, up 57,000, down however from the 79,000 rise in June. Construction, leisure and hospitality, and trade and transport payrolls all showed gains, rising over 20,000 in July, with government payrolls up 17,000. Meanwhile, on the weaker side, business services payrolls fell 1,000, financial payrolls declined 4,000, and information payrolls dropped 20,000, the largest monthly decline since October.



Source: Bloomberg

UNEMPLOYMENT RATE

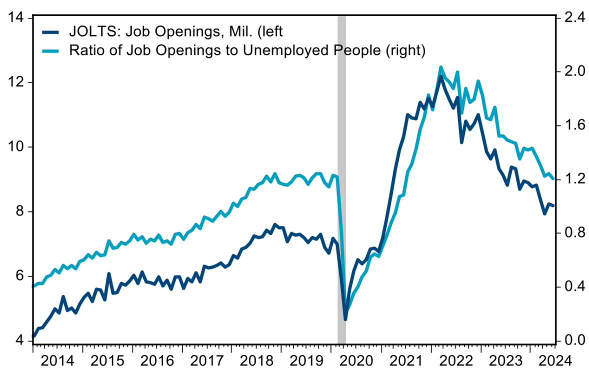
Remaining below 4% for more than two years, the unemployment rate ticked up to 4.3% in July, the highest level since October 2021. While a notable increase from a low of 3.4% in April 2023, at 4.3% the jobless rate remains solidly below the lower bound of the Fed's full employment range (4.7-5.8%). Furthermore, while the 53 bps increase in the three-month average of the unemployment rate from the cycle low to present does trigger the Sahm Rule, the recession "prediction" tool has never been tested in an economy with over 8 million job openings.



Sources: Bureau of Labor Statistics, Haver Analytic

JOB OPENINGS

According to the latest Job Openings and Labor Turnover Survey (JOLTS), total job openings fell from 8.23 million to 8.18 million to in June. While a two-month low, with over 8 million job vacancies, labor demand continues to grossly outpace labor supply, perpetuating the assessment of tight(ish) labor market conditions and supporting the notion of ongoing hiring gains. That being said, there has been a welcomed narrowing of that gap with outstanding openings down from a peak of 12.2 million in March 2022 and the ratio of openings to unemployed subsiding back to a pre-pandemic level (1.2).



Source: Bureau of Labor Statistics/Haver Analytic

JOBLESS CLAIMS

Initial jobless claims fell by 17,000 from 250,000 (the highest level in a year) to 233,000 in the week ending August 3, a one-month low and the largest decline in nearly a year. At 233,000, this remains in line with the longstanding range of 187,000 to 261,000

GLOSSARY

ECI – Employment Cost Index

FOMC – Federal Open Market Committee

ISM – Institute of Supply Management

JOLTS – Job Openings and Labor Turnover Survey

NFP – Nonfarm Payrolls

QoQ – Quarter over Quarter

SA – Seasonally Adjusted

YoY – Year over Year

since the start of 2022, and furthermore reduces concerns of a more sizable trend of layoffs. The four-week average, on the other hand, increased from 238,000 to 241,000. Continuing claims, a measure of the total number of people receiving unemployment benefits, meanwhile gained momentum, rising from 1.74 million to 1.88 million in the week ending July 27.

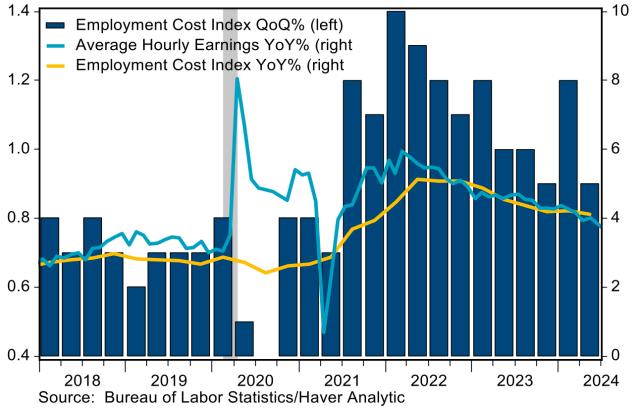
EMPLOYMENT COMPONENT

ndustry employment remains solid, but increasingly volatile, with a notable loss of momentum in particular categories. According to the latest Beige Book, "Several Districts reported declines in employment in the manufacturing sector due to slowdowns in new orders. Skilled-worker availability remained a challenge across all Districts; however, several Districts reported some improvement in labor supply conditions."

Manufacturing, which has been hardest hit by changing spending patterns from both a nominal reduction in outlays as well as a preference for services over goods, has seen a more precipitous decline in activity and employment. Employment, as reported in the Institute of Supply Management (ISM) Manufacturing Index, fell nearly six points to 43.4, the lowest reading in four years, perpetuating concerns of a further cool down in at least the goods-producing labor market. Services activity and hiring, on the other hand, has broadly remained in positive territory (a reading above 50); the ISM Services Index employment component rose five points in July to a reading of 51.1, the highest reading in 10 months.

EARNINGS

An ongoing divide between labor demand and labor supply has perpetuated solid wage growth. While momentum has waned from an earlier peak of 8% in April 2020, a roughly 4% increase in earnings continues to offer welcome support to the American consumer. Average hourly earnings rose 0.2% in July, a tenth of a percentage point less than expected and following a larger 0.3% increase in June. Year-over-year,



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wages rose 3.6% at the start of Q3, down from a 3.8% gain in June and the smallest annual increase since May 2021. Additionally, the Employment Cost Index (ECI), which measures both wages and benefits, rose 0.9% in the second quarter, slightly less than the 1.0% gain expected and the smallest increase in two quarters. On an annual basis, the ECI rose 4.1%, down minimally from the 4.2% annual gain in the first quarter.

BOTTOM LINE

Holding rates steady in July, the Federal Reserve opened the door to a potential rate reduction in September if incoming data gives policy makers confidence that a sustainable disinflationary trend has taken hold. Despite stopping short of a commitment to a rate reduction in the coming weeks, investors nevertheless are pricing in as many as four potential 25 bps cuts by year-end, with some calling for a larger 50 bps reduction to start, or even an emergency reduction ahead of next month's FOMC decision.

The latest July jobs report fell short of expectations, with topline headline hiring cooling and an uptick in the unemployment rate. This in turn buoyed investors' concerns the Fed is falling behind the curve and more significant weakness is on the horizon. However, while employment gains have clearly slowed from earlier peak levels, labor market metrics remain solid. This is potentially a reflection of normalizing conditions as opposed to an early warning sign of an ensuing collapse in employment.

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