Economic Indicator — January 7, 2022

Both Presents and Coal in the December Employment Report

Summary

December's employment report once again fell short of the mark on payrolls, with just 199,000 new jobs added. But the headline miss detracts from details that show the labor market is unequivocally tight. The unemployment rate tumbled to 3.9% while average hourly earnings surprised to the upside with a 0.6% gain. This keeps the March FOMC meeting very much alive for a potential increase in the fed funds rate, even as the labor market's momentum is likely to get briefly tripped up by the recent surge in COVID cases.

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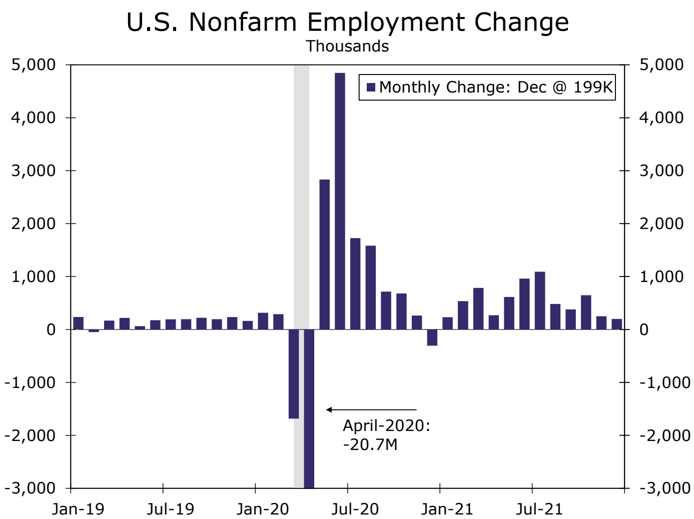
Another Headline NFP Miss Partially Offset by Upward Revisions

Nonfarm payrolls increased by 199,000 in December, well below the Bloomberg consensus forecast of 450,000 (Figure 1). Once again upward revisions to previous months helped to soften the blow as job growth over the previous two months was revised higher by a net 141,000.

A few sectors continued their strings of recent strength. Professional & business services employment increased by 43,000 and is now just about back to its February 2020 level. Transportation & warehousing hiring remained hot, increasing by 19,000, while leisure & hospitality posted a decent 53,000 job increase. Several key sectors saw roughly flat employment growth in December including retail trade, health care and government.

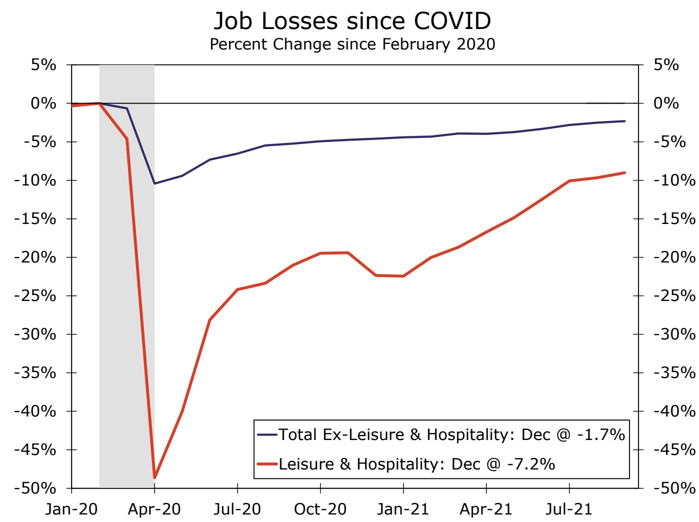
Employment in the leisure & hospitality industry is still 1.2 million jobs below its pre-pandemic peak (Figure 2), and the prospects for additional near term gains are muted given Omicron's potential impact on hiring in January. Even at December's pace of hiring it would take around two more years to fully recover all the jobs lost in that sector. About 22.4 million jobs were lost in the first few months of the pandemic, and December's job gains push the cumulative employment recovery up to 18.8 million, or 84% of the jobs lost. The leisure & hospitality sector accounts for about one-third of this employment gap.

Figure 1



Source: U.S. Department of Labor and Wells Fargo Economics

Figure 2



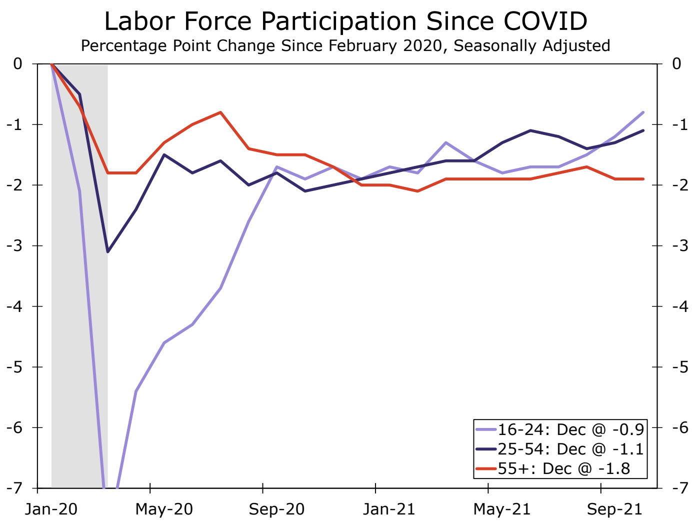
Source: U.S. Department of Labor and Wells Fargo Economics

Labor Supply Still a Binding Constraint on Job Growth

The near-term path of employment growth depends firmly on the availability of labor, as job openings and hiring plans indicate demand for workers remains robust. December's report underscored that workers are only likely to trickle back into the jobs market as reasons for sitting out, like financial cushions, health concerns and childcare issues do not unwind all at once. The labor force rose by 168,000 last month. That was not enough to move the needle on the total labor force participation rate, but the prime participation rate ticked higher, led by an increase in women ages 25-54 (Figure 3).

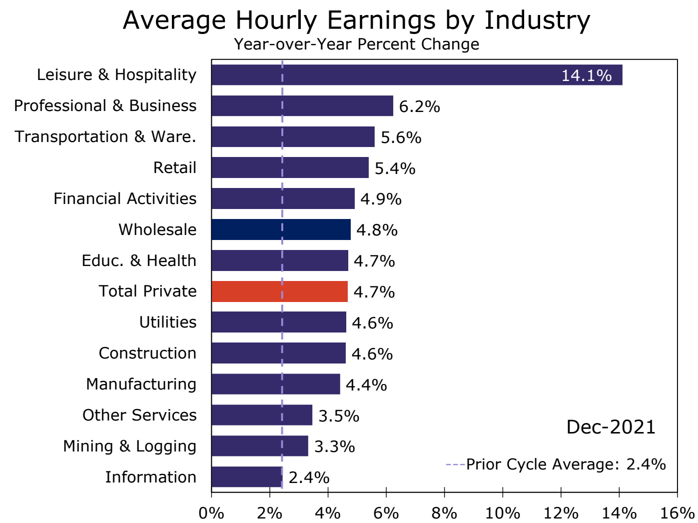
But similar to November's report, the household measure of employment painted a significantly rosier picture of the jobs' market's momentum. Household employment jumped by 651,000, leading to another sharp reduction in unemployment. The unemployment rate tumbled to 3.9%, which puts it at the lower end of the Fed's estimated range of what constitutes "normal." If a sub-4.0% unemployment rate was not enough to relay that the jobs market was not already tight, another solid rise in average hourly earnings (AHE) supports the case. AHE rose 0.6%, keeping the year-ago rate elevated at 4.7% (Figure 4).

Figure 3



Source: U.S. Department of Labor and Wells Fargo Economics

Figure 4



Source: U.S. Department of Labor and Wells Fargo Economics

FOMC Hawks Soar Over Choppy Waters

Today's report brings the labor market closer to maximum employment, the last condition to meet before the FOMC raises interest rates after December's meeting confirmed the inflation side of their mandate had been more than met. A stronger December employment report would have given the Fed more cushion to look through a potential slowdown in hiring in January from the recent surge in COVID cases. However, the hit to hiring may not be as bad many fear. January is by far the biggest month of the year for layoffs, but with businesses and schools generally understaffed, separations could prove far fewer than in recent years as firms and governments hang on to more workers than usual. If true, this would result in a positive tailwind from the seasonal adjustment in the January report, and this could partially offset the hit to new hiring from the recent rise in cases.

Markets have been eyeing a fed funds rate hike as early as March following the Fed's recent hawkish pivot, and this report should do nothing to dissuade that as a real possibility. We are not completely sold that a rate increase will occur at the March FOMC meeting, but the meeting will clearly be "live" for potential action. And even if the Fed takes a pass on March, rate hikes seem all but certain shortly thereafter. We will release our updated economic outlook, as well as our new fed funds forecast, in our Monthly Economic Outlook report next week.

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