Economic Indicator — January 10, 2025

December Employment: Just Right

Economist(s)

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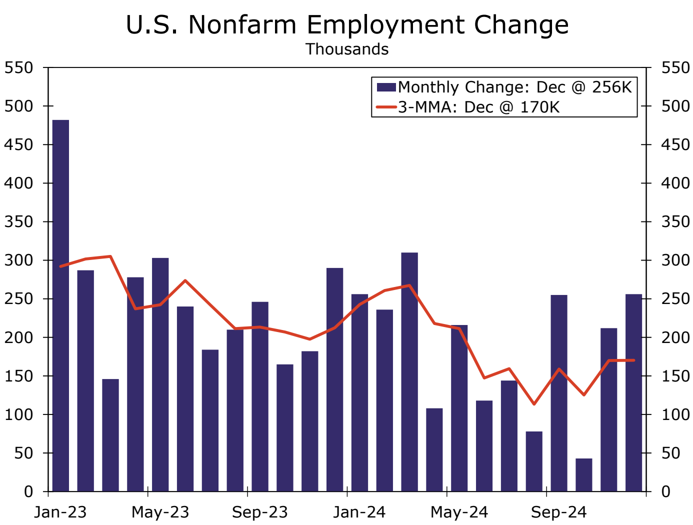
Summary

The employment data for December pointed to a resilient U.S. labor market. Nonfarm payrolls rose by 256K in the month, topping consensus expectations by nearly 100K. Over the past three months, nonfarm payroll growth has averaged 170K, a solid pace of hiring that should be fast enough to keep the unemployment rate relatively steady. To that end, the unemployment rate fell by one-tenth to 4.1% and is right in the sweet spot of the Fed's projections for a "not too hot" and "not too cold" labor market. Similarly, wage growth of 3.9% is roughly consistent with an eventual return to the Fed's 2% inflation target after accounting for 2% labor productivity growth seen over the past year.

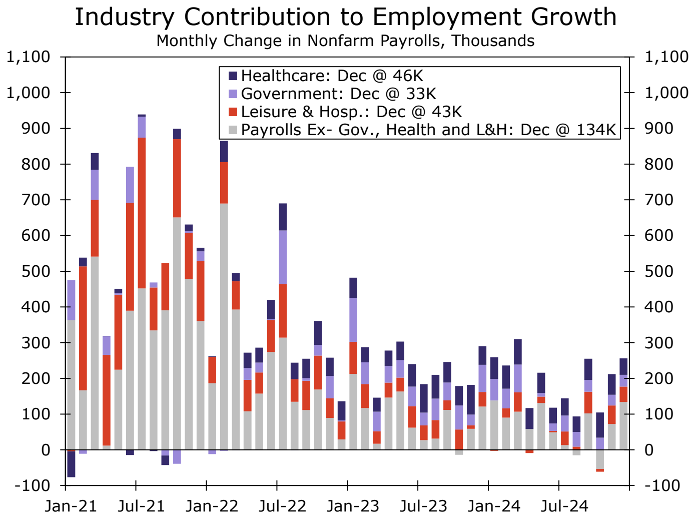
The FOMC made clear at its December meeting that it would take additional progress on moving inflation back to 2% before future rate cuts materialized, assuming that the labor market remained in a healthy position. Today's employment data should give policymakers more confidence in that assumption. A solid pace of hiring as measured by the nonfarm payrolls figures, when paired with an unemployment rate that has been relatively flat since the summer, likely will push the central bank to be patient with future rate cuts. We still expect the FOMC to cut rates again at some point this year as it searches for the neutral rate, but a rate cut at its meeting on January 29 is off the table, and March looks increasingly unlikely as well.



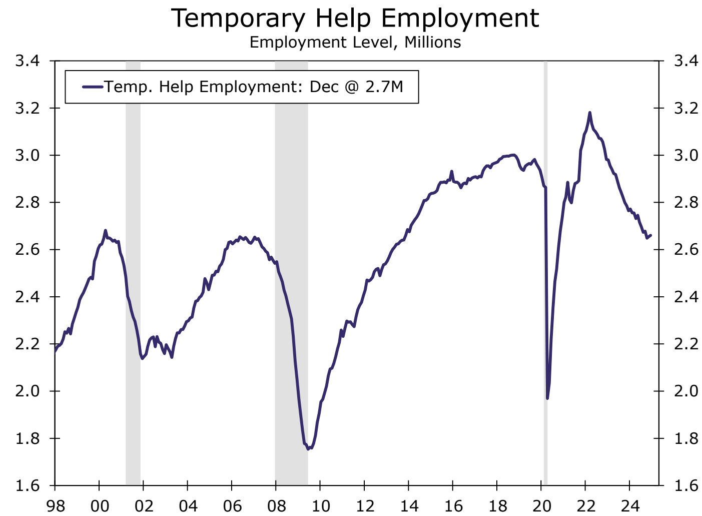
Source: U.S. Department of Labor and Wells Fargo Economics

A Strong Finish to 2024

Nonfarm payrolls capped 2024 on a high note, growing by 256K in December, well-above the Bloomberg consensus forecast of 165K. Revisions to job growth in the prior two months were relatively minor, with just an 8K downward revision to employment for October and November. This leaves the three-month moving average on nonfarm payrolls at a solid 170K per month. Job growth was once again tilted somewhat toward the less cyclically-sensitive industries that dominated employment growth in 2024 (chart). Healthcare & social assistance (+70K), leisure & hospitality (+43K) and government (+33K) accounted for 57% of the job growth in the month despite these industries only accounting for 40% of total employment. Elsewhere, retail employment bounced back (+43K) from a weak November (-29K), while manufacturing employment remained in the doldrums, falling 13K in the month. Temporary help services employment rose by 5K, the second straight month of growth and the first back-to-back gain in this sector since March 2022 (chart).



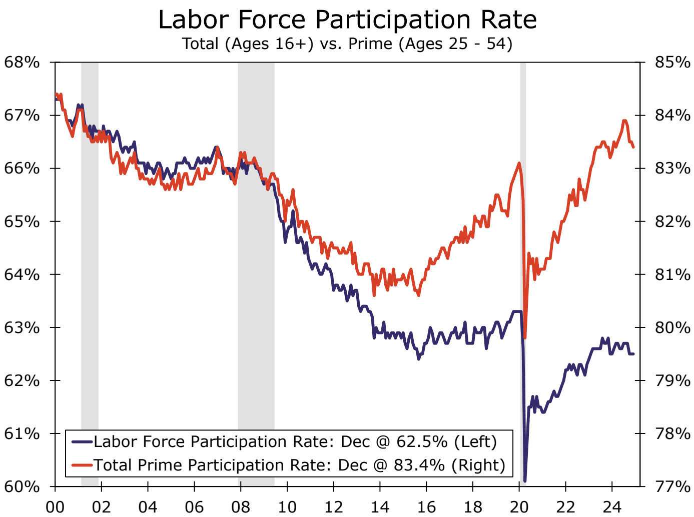
Source: U.S. Department of Labor and Wells Fargo Economics



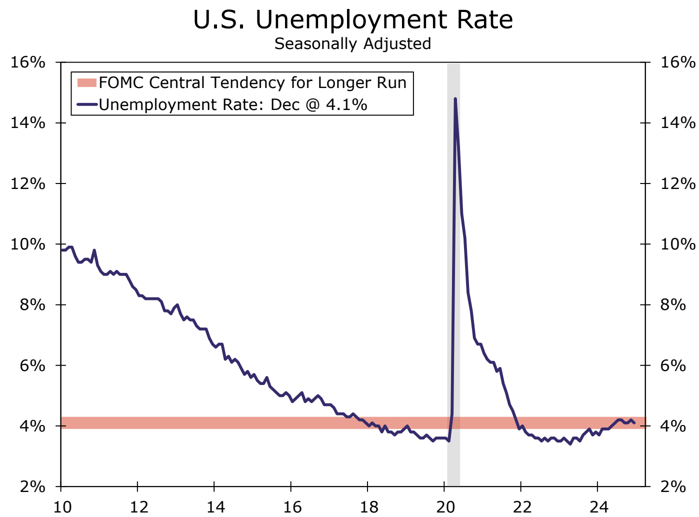
Source: U.S. Department of Labor and Wells Fargo Economics

The household survey also pointed to more resilience in the labor market. The unemployment rate unexpectedly fell to 4.1% from 4.2%. That still leaves it up from the 3.7% rate at the start of the year, but new seasonal adjustment factors show a somewhat more gradual trek higher over the course of 2024. December's dip in the jobless rate came as the household measure of employment jumped 478K, eclipsing the 243K rise in the labor force. Despite last month's increase, labor force growth slowed to 0.6% in 2024 from 1.7% in 2023 as the post-pandemic rebound seems to have run its course and fewer job opportunities have reduced the "pull" factor to join the labor force. The overall participation rate has been bound in the range of 62.5%-62.8% for nearly two years now, while the climb in the participation rate for those in their "prime" working years (25-54) shows signs of topping out (chart).

The more balanced state of the jobs market has helped to cool wage growth without it slowing sharply and threatening real income growth. Average hourly earnings rose 0.3% in December. On a year-ago basis, AHE growth dipped back down to 3.9%, keeping it above the past cycle's peak (3.6%) and consumer price inflation (2.7%).



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



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

Looking at 2024 as a whole, the story of the jobs market last year was one of cooling but not collapsing. Nonfarm payrolls averaged 207K per month through the first half of the year, but 165K in the second half. From the Fed's perspective, the unemployment rate started the year in "too hot" territory at 3.7%, but it has cooled to "just right" at 4.1% in December (chart). Layoffs remain low, but the rate at which firms are hiring has slowed to crawl, making it more difficult for unemployed workers to find a job. The ranks of permanent job losers have risen 10% over the past year as a result, with the average duration of unemployment lengthening. Wage growth has slowed to below 4%, although that still leaves it strong enough to translate into real earnings gains.

We expect to see the jobs market cool only modestly further in 2025. Payroll gains are likely to ease a bit more as readings of labor demand remain near multi-year lows and a moderation in the labor force makes it somewhat harder to hire. Slower growth in the labor supply, however, should keep the unemployment rate from rising materially. We look for payroll growth to average around 120K this year, with the unemployment rate hovering around 4.2-4.3%.

This controlled descent should keep the FOMC on course to cut the fed funds rate a bit more in 2025 in an effort to return policy to a more neutral stance. In the near term though, the Fed is in no rush to make further adjustments. A "skip" at its upcoming January 29 meeting seems all but assured, and a March rate cut looks increasingly unlikely as well. It will take a further slowdown in inflation or much weaker labor market data for the FOMC to resume cutting rates over its next few meetings.

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