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Break in Concentration?

The Jobs Outlook for Three Key Industries Driving Payroll Gains

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Summary

Overall job growth has remained robust over the past year. Nonfarm payrolls (NFP) have expanded by an average of 230K per month, bucking expectations for a sharp slowdown in the wake of the FOMC's rapid tightening in monetary policy. An outsized share of these gains have been concentrated in a few industries that have lagged the broader recovery and/or been more insulated from the Fed's efforts to tamp down demand. Specifically, the healthcare, government and leisure & hospitality sectors have accounted for 66% of job growth since last June even though they comprise just 36% of employment. These sectors' ability to plow ahead with hiring has offered an important source of support to income growth and consumer spending growth. How much more runway remains for these industries to buoy payroll gains?

- ***Healthcare:*** Healthcare payrolls have expanded by an average of 65K jobs per month over the past year, roughly three times the pace registered from 2017-2019. Solid demand growth resulting from higher rates of insurance coverage and rapid population aging is likely to keep headcount rising at a brisk clip. However, the industry's level of employment has returned to its pre-COVID trend, leaving less scope for "catch up" hiring to bolster its monthly run-rate ahead.
- ***Government:*** After an initially slow start in recovering jobs this cycle, the public sector has added an average of 51K jobs per month over the past year, far exceeding the 12K monthly average in the three years prior to COVID. The recent breakneck pace has come not only from the need to restaff but the *means* to do so. Yet while the finances of state & local government— which account for about 90% of public sector payrolls —are still strong overall, they have started to erode. With employment in the sector already back to its pre-COVID trend, some moderation in the monthly pace of hiring appears in store.
- ***Leisure & Hospitality:*** Having added an average of 35K jobs per month since last June, the leisure & hospitality sector has accounted for 15% of payroll gains. With employment in the industry still nearly one million workers below its 2017-2019 trend, we see room for this category to remain an outsized contributor to job growth in the months ahead. But slowing demand, the industry's dizzying jump in labor costs in recent years and room to extend existing workers' hours lead us to doubt that the trend in hiring can shift beyond its recent pace.

On net, we expect these three categories to continue to provide a sizable lift to the monthly rate of payroll gains that surpasses their pre-pandemic contribution and helps keep payroll gains afloat despite the current weight of monetary policy. That said, the gap between each of these industries' recent run-rate and their pre-COVID pace is likely to narrow ahead amid less scope for catch-up hiring, a less robust financial position and/or slowing demand. As such, they are likely to provide a smaller lift to the overall pace of job gains, raising the likelihood that payrolls growth slows more meaningfully ahead. We look for NFP gains to downshift to about a 150K monthly pace over the next 12 months amid a smaller contribution from recent industry standouts and diminishing appetite for employers to hire more broadly.

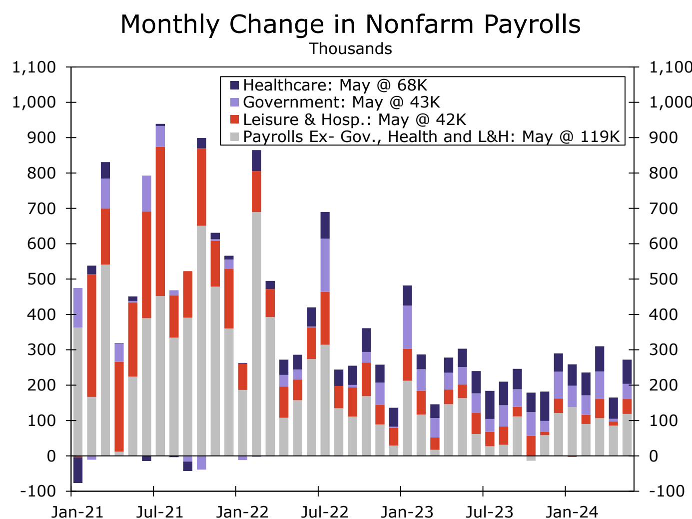
How Long Is the Runway for Outsized Job Gains of a Few Sectors?

Despite widespread signs of the labor market cooling off this past year, nonfarm payroll growth has remained robust. Nonfarm payroll (NFP) growth has averaged 230K per month since last June, only modestly below the past cycle's best 12-month stretch of 260K per month, and far surpassing most economists' expectations, including our own.[1] The firm pace of hiring has stemmed in part from overall economic activity weathering the FOMC's aggressive efforts to corral inflation better than anticipated. However, it also reflects the ongoing strength in hiring among a few industries that have lagged the broader jobs recovery and/or been more insulated from the Fed's efforts to tamp down demand.

Specifically, the healthcare, government and leisure & hospitality sectors all have continued to add jobs over the past year comfortably above their pre-pandemic paces. Together, they have accounted for 66% of job growth since last June even though they comprise just 36% of total employment (Figure 1). These sectors' ability to plow ahead with hiring has bolstered income and spending growth at a time when many other industries have struggled with the rapid tightening of monetary policy and shift in spending patterns as the pandemic shock fades. While these three industries were initially stragglers in recouping jobs lost from the pandemic, all have now seen employment surpass its pre-COVID peak (Figure 2). How much more runway remains for these industries to buoy payroll growth?

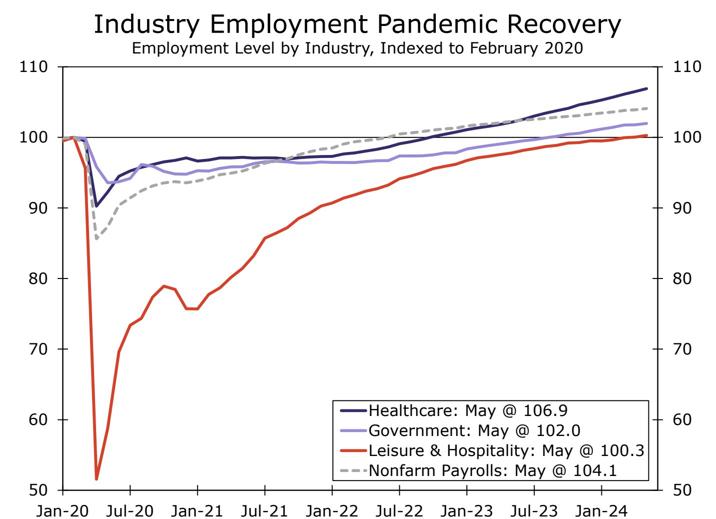
The healthcare, government and leisure & hospitality sectors have accounted for 66% of job growth since last June despite comprising 36% of total employment.

Figure 1



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

Figure 2



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

Healthcare: Staffed Back Up, but Strong Tailwinds to Further Demand

The impressive rise in healthcare employment over the past year can largely be boiled down to restaffing efforts after the industry's delayed recovery this cycle, combined with strong secular tailwinds to healthcare demand. Early in the pandemic, fears of contracting COVID-19 led patients to forgo discretionary care while providers faced the same concerns and/or burnout from the intensity of caregiving during a pandemic. But the healthcare industry's employment recovery kicked into high gear in early 2022 and has shown few signs of slowing since. Healthcare has led hiring among major industries over the past year, with payrolls expanding by 782K to account for nearly 30% of all job gains since last May (the industry comprises 11% of total payroll employment).

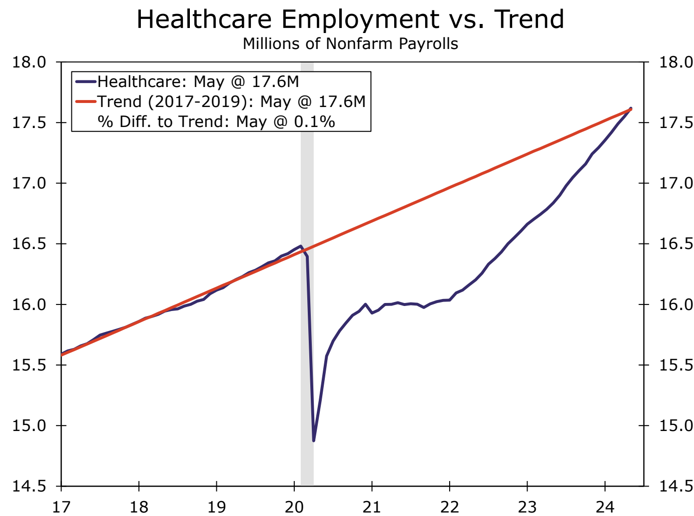
Employment in the healthcare industry is now back to the level it would have been if hiring had continued at its 2017-2019 pre-pandemic pace, suggesting there is less scope for catch-up hiring to contribute to the monthly pace of job gains ahead (Figure 3). At the same time, average weekly hours in the industry have fallen back to pre-COVID levels, pointing to a diminishing need to bring on additional workers to lighten the load of existing overstretched staff.

There is less scope for further pandemic-related catch-up hiring in healthcare.

However, there remain plenty of tailwinds to healthcare hiring. Increased access to medical insurance through public programs and employers in the strong jobs market have offered a recent lift to demand.[2] Meantime, the rapid aging of the U.S. population continues to provide a long-term, acyclical source of demand to the healthcare industry. Overall, job openings show that demand for healthcare workers remains elevated relative to both the industry's pre-pandemic baseline and other industries

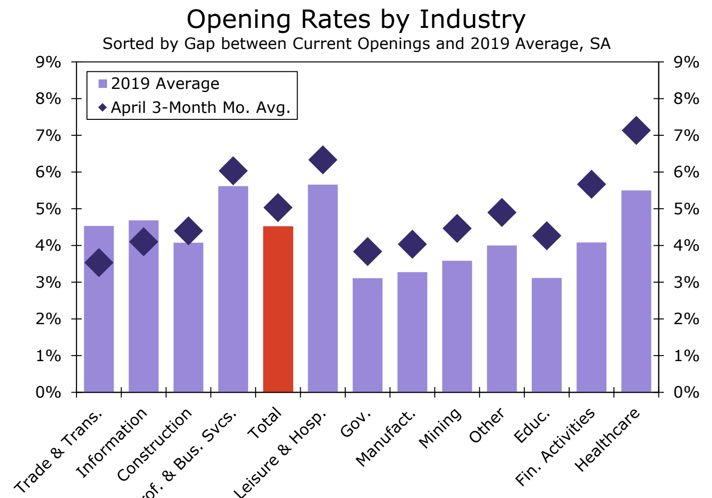
([Figure 4](#)). As such, we would expect healthcare hiring to remain robust compared to the ~25K average monthly pace that prevailed in the years immediately preceding the pandemic, even as improved staffing levels lead to a downshift from the 65K average monthly pace of the past year.

Figure 3



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

Figure 4

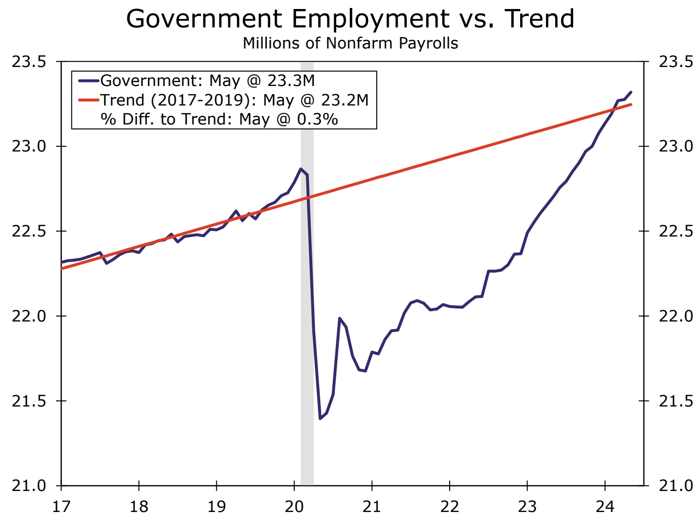


Source: U.S. Department of Labor and Wells Fargo Economics

Government: Strong S&L Finances Leave Gas Left in the Tank

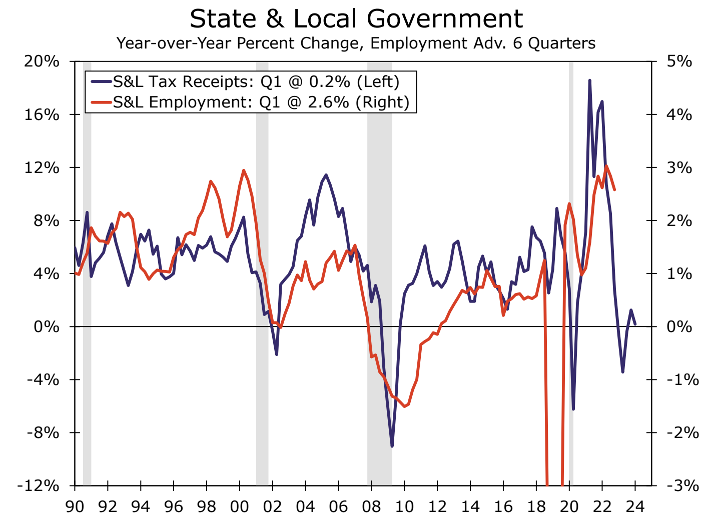
Government hiring also still looks to have some wind left in its sails that bodes well for overall payroll growth. Over the past year, government payrolls have risen an average of 51K per month compared to 12K in 2017-2019. Total government employment is now slightly (+0.3%) above the level implied by its pre-pandemic trend ([Figure 5](#)), although state & local employment, which accounts for about 90% of government payrolls, remains a touch below its pre-pandemic trend level (-0.2%).

Figure 5



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

Figure 6



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

After an initially slow recovery, the rapid clip of government hiring over the past two years has been driven not only by the need to restaff following 2020's job losses, but the *means* to do so. State & local (S&L) government revenues bounced back quickly from the COVID recession. The sharp rebound in total employment, asset prices and spending lifted tax receipts. Meantime, pandemic-related grants to S&L governments from various federal aid packages equated to about one-quarter of annual tax

revenues. The Government Accountability Office estimates that through last September, just over half of those funds had been spent.[3] The improved financial picture has extended to S&L balance sheets, where the median value of rainy day funds as a share of expenditures has grown to 12.3% compared to 7.9% in FY-2019, and pension funding is at its highest point since 2007.[4]

Yet, while the financial conditions for government hiring remain supportive overall, they have started to erode, as we discussed in a report late last year. S&L tax revenue growth has slowed sharply since 2022, with receipts up just 0.2% over the past year (Figure 6). Like households' excess liquidity, COVID-era funds also continue to be spent down with each passing month and have offered a one-time windfall rather than a reoccurring source of revenue. As a result, we see room for the public sector's contribution to the monthly tally of net payroll gains to slow from the lofty ~50K monthly pace averaged over the past year in the coming quarters, although we doubt the trend will slow all the way back to the ~12K monthly pace registered in the late 2010s in the near term given the absolute strength of S&L finances.

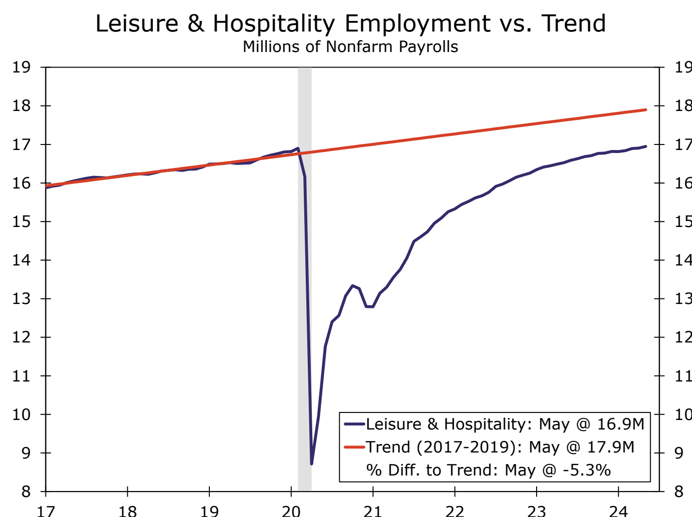
The financial conditions for government hiring remain supportive overall but have started to erode.

Leisure & Hospitality: Further Ground to Recover, but a Hard March Ahead

The leisure & hospitality industry has been another standout for its notches added to the payrolls board over the past year. Employment has grown slower than in healthcare and the government (as well as construction), but its large size (11% of payrolls) has meant that its above-average pace of hiring over the past 12 months (+2.5% vs. 1.8% for all payrolls) has still given a meaningful lift to total payroll gains. Unlike healthcare and government, there remains a large deficit between the current level of leisure & hospitality employment and the level implied by the industry's pre-COVID trend, equal to 952K jobs (Figure 7). Thus, there appears to be quite a bit of runway for payroll gains to continue near their recent pace purely on the basis of “normalization.”

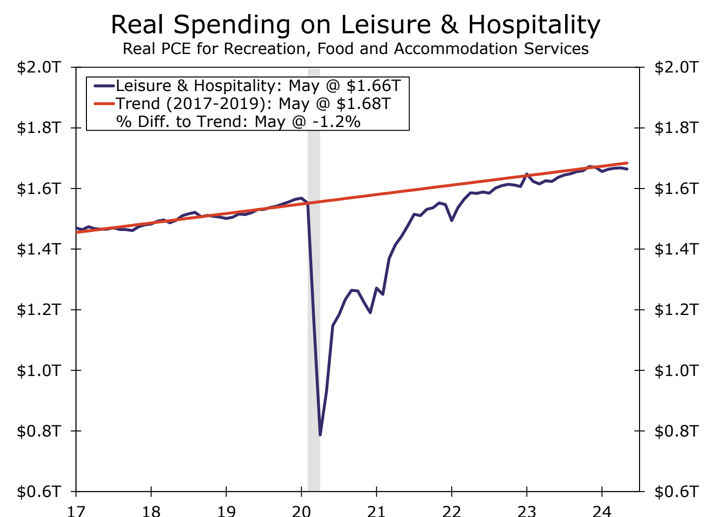
Leisure & hospitality employment has yet to recover fully from the pandemic.

Figure 7



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

Figure 8



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

That said, there are some hurdles to leisure & hospitality employment snapping back all the way to the level implied by its prior trend. First, the average workweek in the leisure & hospitality industry remains low and below its pre-pandemic level, which suggests that employers could meet additional demand by giving existing workers more hours, rather than adding headcount. Second, employers in the leisure & hospitality industry may be somewhat more judicious in their hiring after average hourly earnings surged 30% since early 2020—seven percentage points more than the next biggest jump among major industries—and focus more on ways to increase productivity among existing workers. In particular, rising labor costs could move firms to automate tasks previously completed by employees, especially as the technology has become more widespread in the restaurant industry.[5] Third, the recent slowdown in inflation-adjusted spending already points to demand for the industry's services losing some steam. While employment in leisure & hospitality is still lagging below its 2017-2019 trend, spending on recreation and food & accommodation services when measured on the same basis has mostly recovered (Figure 8).

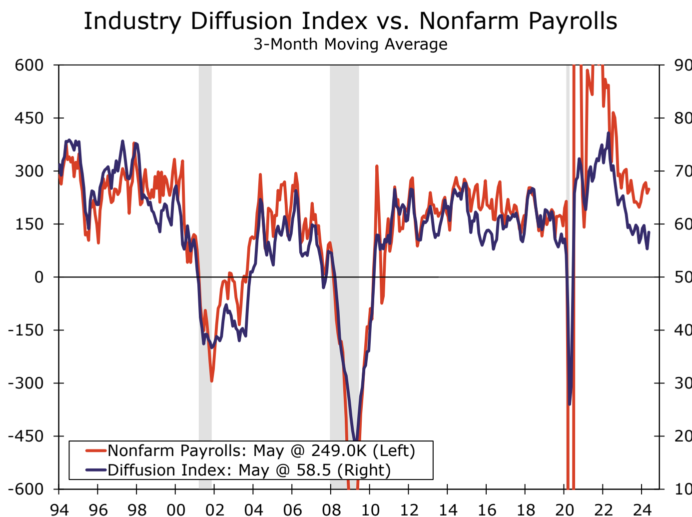
A number of hurdles may prevent leisure & hospitality employment from snapping all the way back to the level implied by its pre-pandemic trend.

Amid these hurdles, job openings for leisure & hospitality workers has cooled and remain only slightly above the industry's 2019 rate (refer back to Figure 4). We expect leisure & hospitality employment to continue to expand around its 35K monthly clip of the past year given that the level of employment remains so far below its pre-pandemic trend and a looser labor market makes it easier for the below-average wage industry to hire. However, slowing demand, the dizzying jump in labor costs in recent years and room to extend existing workers' hours lead us to doubt that the trend in hiring can shift beyond its recent pace in the months ahead.

Still an Outsized Source of Hiring, but a Smaller Lift Ahead

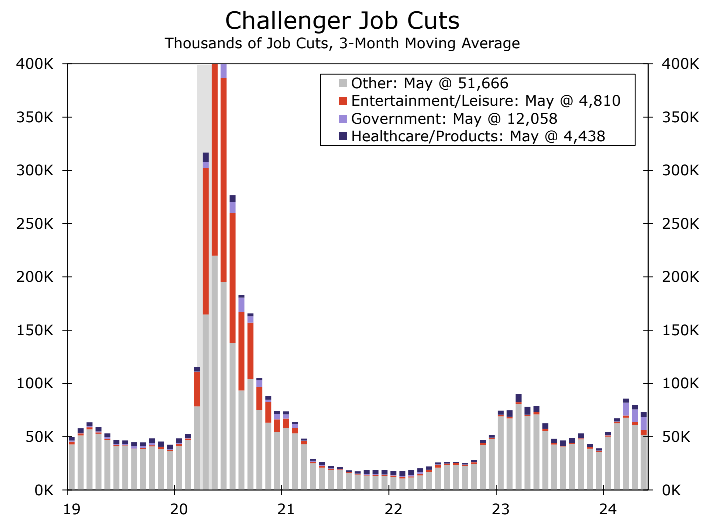
Strength in healthcare, government and leisure & hospitality hiring over the past year has allowed total nonfarm payrolls to continue to expand at an impressive pace. The robust gains relative to other industries and the pre-COVID period has offered an important source of support to income growth and consumer spending growth. Yet the concentrated degree of hiring has masked a more fragile foundation for overall job growth. A narrowing in the breadth of industries adding jobs, as has been the case over the past year, has typically been accompanied by a slowdown in total employment (Figure 9). This has made the outlook for the recent outsized industry drivers of job gains crucial to understanding how long payroll growth can continue to seemingly defy the gravity of tighter monetary policy.

Figure 9



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

Figure 10



Source: Bloomberg Finance L.P. and Wells Fargo Economics

We see scope for the healthcare, government and leisure & hospitality sectors to remain a ballast to payroll gains in the coming months, as the tailwinds driving each have yet to peter out. That said, the favorable dynamics lately propelling strong gains in each industry—including the need to re-staff to meet the bounce back in demand and rapid improvement in S&L finances—have started to fade. Layoff announcements among the set have started to creep higher in a further sign hiring conditions for these recent stalwarts are also starting to deteriorate (Figure 10). Thus, we expect to see the contribution to total payroll gains from these three categories moderate in the months ahead.

The likely moderation in the contribution of these three industries to total monthly payroll gains will make it necessary for hiring in other industries to strengthen to maintain the recent rate of overall growth in hiring.

Such a moderation will make it necessary for hiring in other industries to strengthen to maintain the recent rate of overall payroll growth. Yet there are growing signs of employers becoming less interested in hiring broadly, including the decline in job openings across industries, drop in hiring plans among small businesses and upward drift in layoffs. As a result, what has felt like a gravity-defying pace of payroll gains the past year is likely to return to Earth over the second half of the year and into 2025. After increasing an average of 230K jobs per month over the past year, we look for NFP gains to downshift to about a 150K monthly pace over the next 12 months amid a smaller contribution from recent industry standouts and diminishing appetite for employers to hire more broadly amid a restrictive monetary policy environment.

Endnotes

1 – In the June 2023 Bloomberg US Economic Survey, the median quarterly estimate for the monthly pace of job growth between Q3:23-Q2:24 averaged 18K. (Return)

2 – U.S. Department of Health and Human Services. "National Uninsured Rate Remains at 7.7 Percent in the Fourth Quarter of 2023." May 29, 2024. (Return)

3 – U.S. Government Accountability Office. COVID-19 Relief: State and Local Fiscal Recovery Funds Spending as of September 30, 2023. GAO-24-107472. April 10, 2024. (Return)

4 – The National Association of State Budget Officers. Spring 2024 Fiscal Survey of States. June 12, 2024. (Return)

5 – See Brent Meyer and Daniel Weitz. "The Impact of Automation on Firm Performance and Expectations." Federal Reserve Bank of Richmond. March 27, 2024. (Return)

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