Economics

Economic Indicator — July 5, 2024

June Employment: From Sizzle to Fizzle

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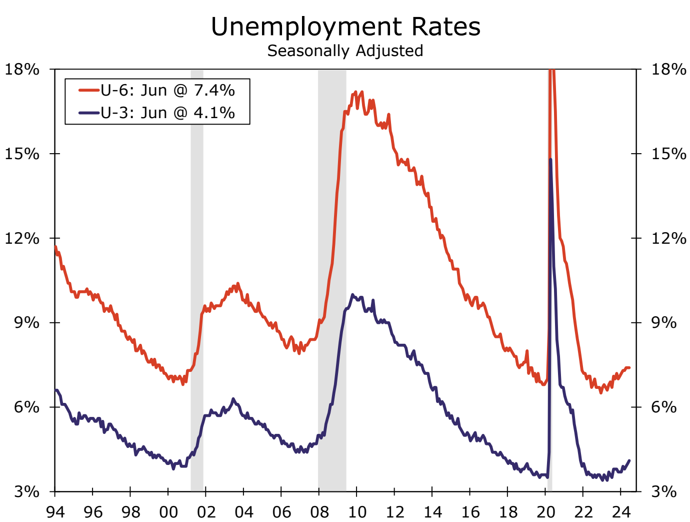
Summary

Nonfarm payrolls gains were solid in June, rising 206K, but the underlying details of today's employment report clearly signal that the U.S. labor market is softening. June job growth topped consensus forecasts by 16K, but this was more than offset by 111K of downward revisions to job growth in April and May. The composition of job growth continues to be led by sectors that are less cyclically sensitive. Nearly 75% of June's employment growth could be attributed to government (+70K) and health care & social assistance (+82K). The separate household survey also showed a cooling labor market. The unemployment rate once again ticked higher to 4.1%, above both its post-pandemic low (3.4% in April 2023) and its pre-pandemic average (3.7% in 2019).

The cooling in the labor market extends beyond just the data released in the monthly employment report. The number of job openings per unemployed person is back to its pre-pandemic level, while the share of workers quitting their jobs and small business hiring plans are below pre-pandemic averages. Wage growth remains a bit elevated compared to 2019, but we believe this indicator will continue to slow with a lag. The slower inflation data over the past couple months, when paired with the softening labor market, bolster the case for the FOMC to begin reducing the fed funds rate as early as its September 18 meeting. Our forecast remains for two 25 bps rate cuts this year at the September and December FOMC meetings.

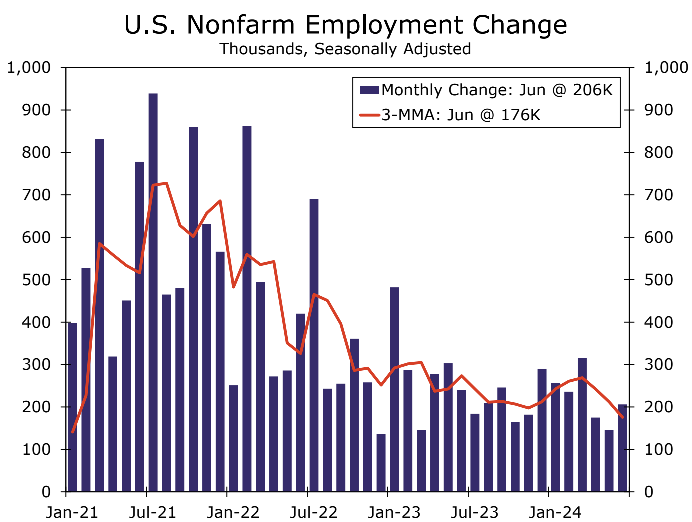


Source: U.S. Department of Labor and Wells Fargo Economics

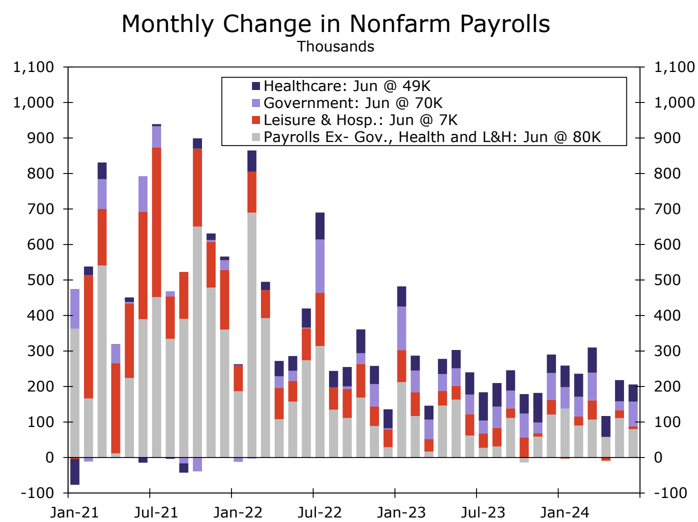
Labor Market Loses Some Heat at the Start of Summer

Nonfarm payroll growth topped expectations in June, but the headline beat masked what was broadly an underwhelming reading for the U.S. labor market. Employment as measured by the establishment survey increased by 206K jobs in June, 16K stronger than the Bloomberg consensus forecast (chart). However, payroll growth in the prior two months was downwardly revised by 111K. The downward revisions pushed down the three-month moving average of job growth to 176K per month, the slowest pace since January 2021.

Employment growth was once again carried by less cyclically sensitive industries, a theme we discussed in a report published this week (chart). Government employment rose by 70K, above the average monthly gain over the past year of 49K. The end of the school year can sometimes create some seasonal noise in government hiring this time of year, but excluding education, government employment still rose by 53K jobs. Health care & social assistance employment jumped by 82K, while employment in the leisure & hospitality industry rose by a smaller 7K. Elsewhere, employment swings were relatively restrained. Construction employment growth continues to be solid and registered 27K in the month, but beyond that most industries were either modestly down (manufacturing -8K, retail -9K) or only modestly up (financial services +9K, information +6K). Temporary help employment fell a precipitous 49K in June and is down 515K from its peak in March 2022 in another sign that labor demand is weakening.



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

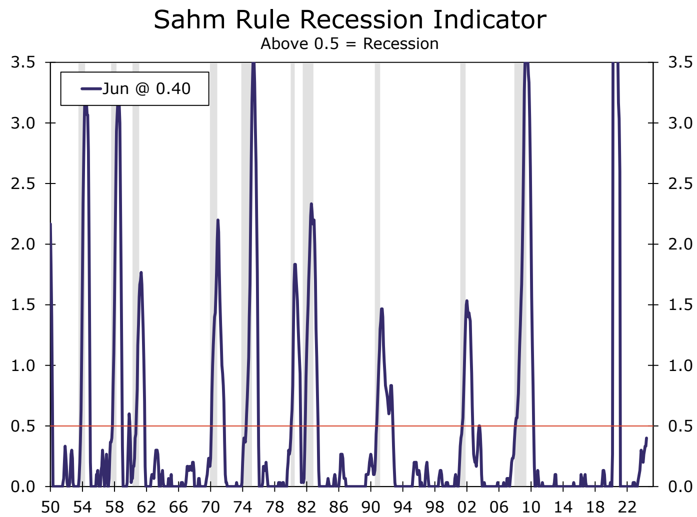


Source: U.S. Department of Labor and Wells Fargo Economics

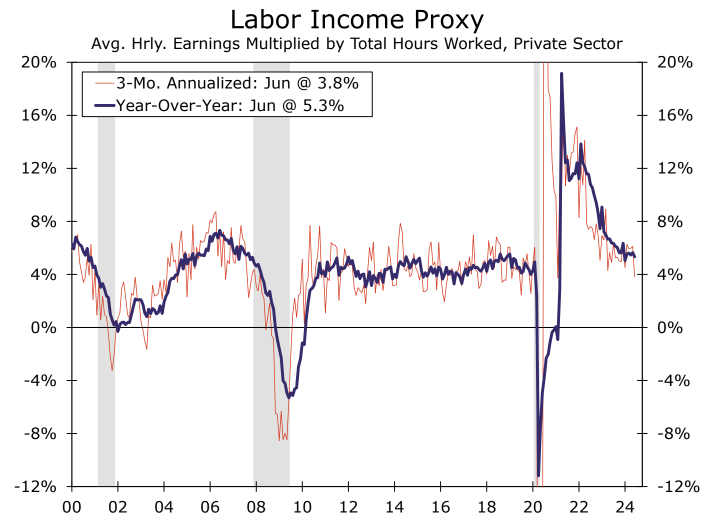
The more tenuous picture of the labor market was also reflected in the household survey. The unemployment rate rose to 4.1%, up from the recent low of 3.4% in April 2023 to reach a two-and-a-half-year high. While the household measure of employment rebounded partially in June (+116K), it was not enough to absorb entrants into the labor supply (+277K), leading to a larger rise in the number of unemployed workers (+162K).

The unemployment rate vacillates little when the economy is in an expansion, which makes an upturn in it notable as momentum in the labor market can be difficult to change once established. The recent increase has not triggered the widely watched Sahm rule (chart), which finds that the economy is in a recession if the three-month average of the unemployment rate is 0.5 points above its low of the past the 12 months. Yet it underscores a marked deterioration in labor conditions that is not reflected in the payroll survey.

More temperate wage gains are following in the wake of the softer jobs market conditions (chart). Average hourly earnings advanced 0.3% in June, driving the year-over-year gain to a three-year low of 3.9%. That still keeps average hourly earnings outpacing inflation over the past year. However, the moderation in hiring alongside nominal wage growth points to aggregate income derived from the labor market slowing more sharply, which is likely to keep downward pressure on overall consumer spending and inflation.



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



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

Nonfarm payrolls have been somewhat of an outlier among jobs market data that otherwise have shown a clear softening in labor conditions over the past year. Today's nonfarm payroll data are now better aligned with other labor market indicators signaling that the jobs market has cooled off materially. The pace of payroll gains remain solid and, along with a low layoff rate and still-elevated opening rate, point to the jobs market remaining in decent shape overall. However, the direction of travel for the labor market is clearly one of deterioration. By a number of measures, the jobs market is not only softer than it was a year or two ago, but weaker relative to its pre-pandemic state. The overall unemployment rate as well as under-employment rate are sitting above 2019 levels, while the share of workers quitting their jobs, the level of temporary help workers and business hiring plans remain below their pre-COVID marks.

With so much heat having already been removed from the labor market, weakening is starting to look less like "normalization" and is becoming a more pointed concern. With the downward trend in inflation seemingly back on track, the softening in the labor market bolsters the case for the FOMC to begin reducing the fed funds rate as early as its September 18 meeting. Our forecast remains for two 25 bps rate cuts this year at the September and December FOMC meetings.

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