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January Employment: Labor Market Looking Good After Revisions Look Back

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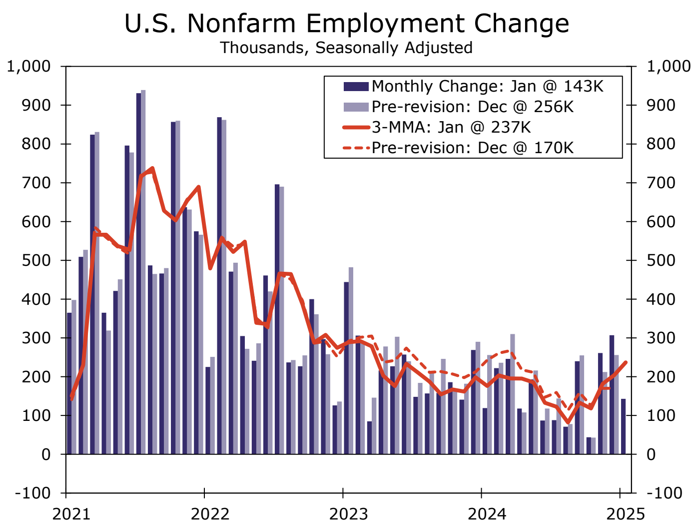
Summary

The 143K rise in nonfarm payroll employment in January came in a little light of expectations, but upward revisions to recent months' hiring and a decline in the unemployment rate to an eight-month low of 4.0% show the labor market remains on solid footing.

On balance, today's employment data, which included annual revisions, should give the FOMC confidence that it can maintain the federal funds rate at its current level for the foreseeable future. A small swoon in the labor market occurred throughout the first half of 2024 as nonfarm payroll growth slowed sharply and the unemployment rate ground modestly higher. But, the more recent data are indicative of a labor market that has regained its footing. This suggests that the tail risk of a sharp deterioration in the labor market has diminished, and as a result the FOMC can wait to see how the Q1 inflation data and economic policymaking play out before taking further action on the federal funds rate.



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

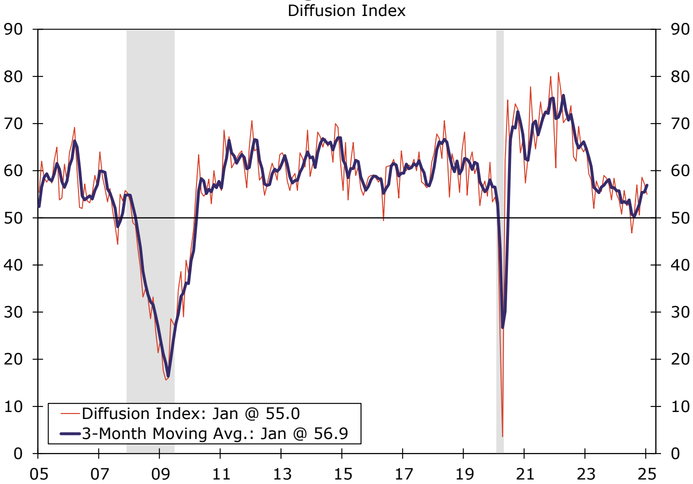
Through Revisions, Recent Trend in Hiring Firmer

Nonfarm payrolls increased by 143K in January, coming in below consensus expectations for a 175K monthly gain. The miss in January was more than offset by upward revisions to job growth in the prior two months. Employment growth in November and December was upwardly revised by a combined 100K. Health care, social assistance and government once again led the charge on employment growth, with those three sectors accounting for 98K of the net new jobs added in January. Amid a slew of headlines about employment reductions by the federal government, it is important to remember that the bulk of government employment is at the state and local level. State and local government employment, which accounts for just shy of 21 million jobs, rose by 23K in January. Federal government employment, which totals just 3 million jobs, rose by 9K in the month. Elsewhere, retail trade rose by 34K in what was the second consecutive strong reading, but several other sectors saw small declines or muted gains including construction (+4K), manufacturing (+3K), leisure and hospitality (-3K) and professional and business services (-11K).

Today's release also included annual revisions to the establishment survey's employment figures. The annual benchmarking revised down the level of payroll employment in March 2024 by 589K, or -0.4%. Although smaller than the preliminary estimate, this marked the largest downward adjustment since 2009. Payrolls in the 12 months through March 2024 are now reported to have increased by an average of 197K per month compared to the previously reported pace of 242K. Revisions to employment growth after March 2024 left the level of employment broadly unchanged, with slower growth in the middle of the year offset by faster employment growth toward the end of 2024. The three-month moving average on nonfarm payroll growth was just 82K in the June to August period, much weaker than the 237K average registered over the most recent three months.

Industries Adding Jobs Over Past Month

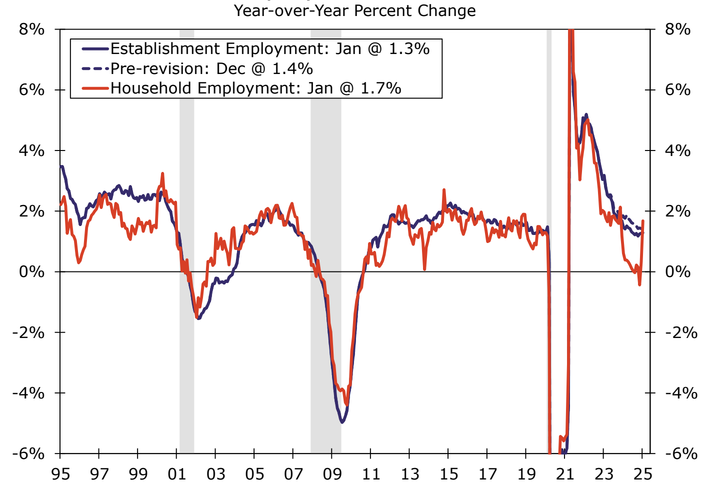
Diffusion Index



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

Employment Growth

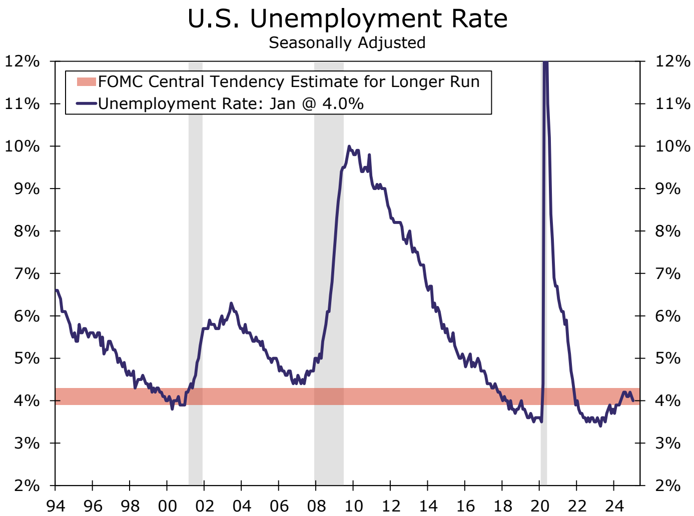
Year-over-Year Percent Change



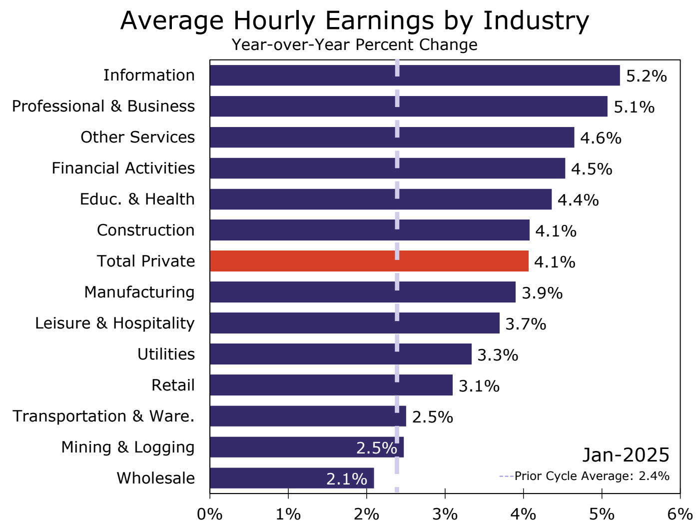
Source: U.S. Department of Labor and Wells Fargo Economics

The January household survey also included its annual update to the population controls, which are used to weight the survey sample to reflect of the size and composition of the working-age population. Incorporating a new methodology to better account for net immigration, the update led to a 2.9 million upward shift in the civilian noninstitutional population, as well as increases in the labor force (+2.1M), employment (+2.0M) and unemployment (+100K). Since the standard practice of the BLS is not to update historical data, the month-to-month and even year-to-year comparisons of the level of household employment or labor force growth are ineffectual. That said, the downward revision to payrolls and lift to the level of household employment goes a long way in narrowing the gap between the two surveys' indications of employment growth the past year (chart).

Importantly, key ratios within the household survey are less affected by the population controls, since both the numerators and denominators are impacted. However, they can be swayed by the population control updates if the labor characteristics of the "newly found" population differ enough from the existing population. To that end, the unemployment rate fell to an eight-month low of 4.0% in January from 4.1% in December. Absent the population control effects, the BLS reports the unemployment rate would have fallen a little more (-0.2 percentage points) than the actual data reported. After a foreboding march higher through the first half of last year that was a major factor in the FOMC cutting rates, the unemployment rate is now back near the bottom end of the range most Committee members think is needed to achieve its inflation target over the long run (chart).



Source: U.S. Department of Labor, Federal Reserve Board and Wells Fargo Economics



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

Benchmark revisions usually have a minimal impact on average hourly earnings. Although the industry composition of employment was little changed in the March 2024 benchmark, wage growth looks somewhat firmer than previously thought. Incorporating revisions, average hourly earnings (AHE) rose 4.1% year-over-year in the fourth quarter, a tenth stronger than initially reported. AHE growth picked up in January, rising 0.5% over the month, which was strong enough to hold the year-over-year pace steady at 4.1% (chart). The overall strength in wages has helped to keep aggregate income growth running above consumer price inflation, which will be supportive of consumer spending in the coming months.

Labor Market Data To Keep the Fed on Hold

Today's employment data should push the FOMC to remain on hold for the foreseeable future. Nonfarm payroll growth over the past couple of years was not quite as strong as previously reported, but it still represents a robust pace of labor market expansion. More importantly, the recent data point to a strong pace of job growth in recent months, as evidenced by a three-month moving average of 237K on nonfarm payrolls. Admittedly, this may be overstating the underlying strength due to the weak strike- and hurricane-related October number falling out of the average, but even adding it back in, the four-month moving average is a solid 189K. The household survey further reinforces this recent strength. The 4.0% unemployment rate registered in January is the lowest it has been since May 2024.

Tariffs are looming on the horizon and present a potential threat to U.S. economic growth of which the FOMC is cognizant. Furthermore, many FOMC participants still seem to believe that the current target range for the federal funds rate is above the "neutral" rate that neither stimulates nor slows the economy. Thus, our base case for two 25 bps rate cuts in September and December remains consistent with an extended pause followed by a couple more rate reductions from the FOMC. That said, the risks to this forecast appear tilted toward less easing in light of the labor market's resilience and the potential upside risks to inflation.

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