Economic Indicator — June 6, 2025

May Employment: Good Enough

Summary

The May jobs report was on the softer side, but it was more of a caution sign than a flashing red light in our view. Nonfarm payrolls increased by 139K in May, 13K better than the consensus forecast was expecting, but a combined -95K downward revision to job growth in April and March overshadowed the beat. The industry composition of employment growth pointed to resilience in health care but weakness in more cyclically-sensitive industries like manufacturing, trade and temporary employment. In the household survey, the unemployment rate rose on an unrounded basis from 4.18% to 4.24% amid sizable outflows from the labor force.

Today's employment report is strong enough in our view to keep the FOMC on hold for at least a couple more meetings as higher tariffs have reignited concerns about inflation. That said, with both the soft and hard data on the labor market showing employment conditions softening, we still expect the FOMC to be cutting later this year.

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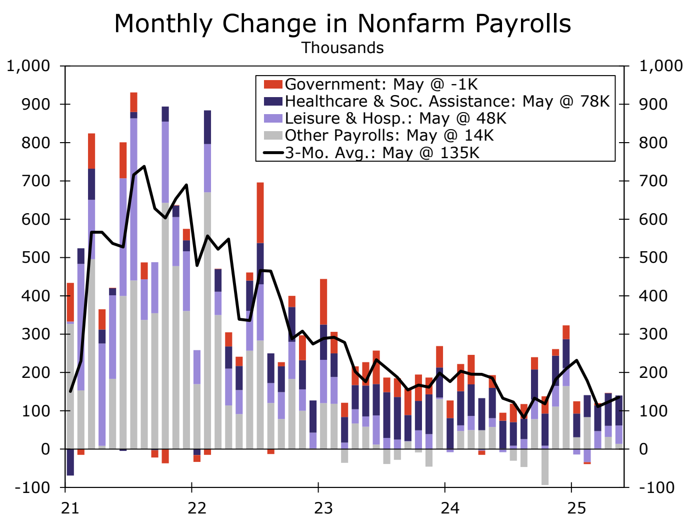


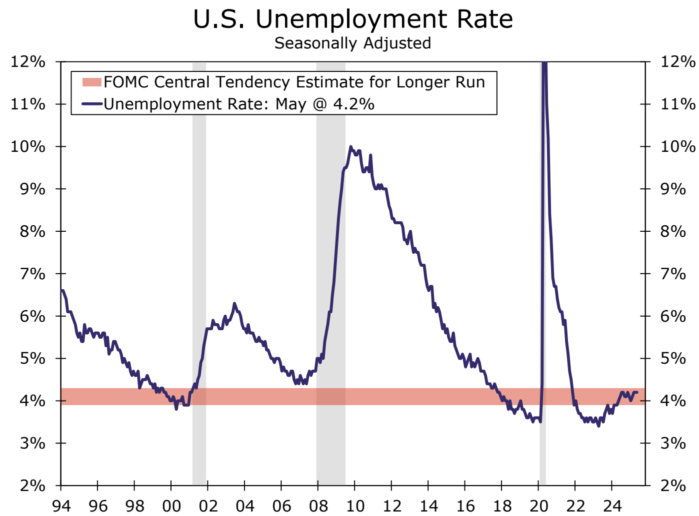
Source: U.S. Department of Labor and Wells Fargo Economics

A Gilded Jobs Report

The labor market is treading water. Nonfarm payrolls expanded by 139K in May, a touch stronger than expected. Despite the headline beat, significant downward revisions to job growth in March (-65K) and April (-30K) lowered the three-month moving average of employment growth to 135K, down from 155K headed into today's report.

The industry composition of job growth illustrates increasing fragility. Hiring in leisure & hospitality (+48K) and healthcare & social assistance (+78K) accounted for 91% of the total job gains, punching well above their share of total employment and increasingly becoming the lone sources of job creation (chart). Elsewhere, layoffs and an ongoing hiring freeze weighed on federal government payrolls, which slipped 22K over the month. More cyclically-sensitive industries also showed softness as the growth outlook has clouded. Temporary employment slipped 20K, while manufacturing, retail trade and mining jobs also declined. The lack of broad-based hiring led the diffusion index down to 50, its lowest since July (chart).

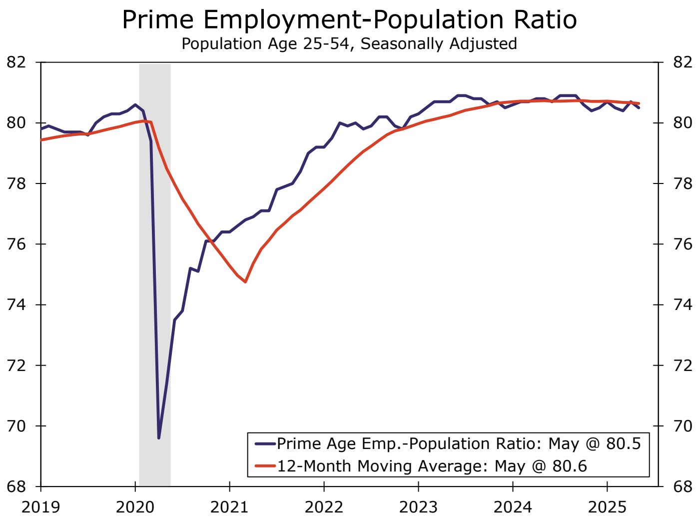
Source: U.S. Department of Labor and Wells Fargo Economics



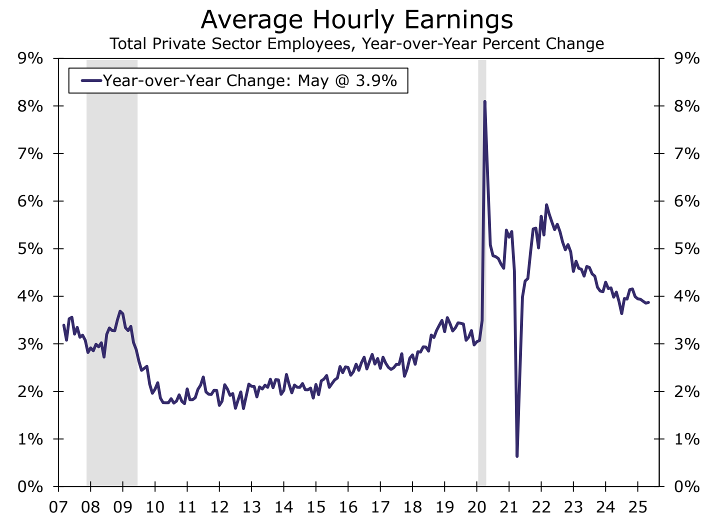
Source: U.S. Department of Labor, Federal Reserve Board and Wells Fargo Economics

The household survey offered additional evidence that the labor market is cooling on trend. The unemployment rate held steady to the first decimal at 4.2%, but on an unrounded basis it rose from 4.18% in April to 4.24% in May (chart). The details were not much more encouraging. A large decline in household survey employment (-696K) was mostly driven by outflows from the labor force (-625K), with a modest increase in the ranks of the unemployed (+71K). The "prime age" employment population ratio, which measures the share of 25-54 year olds with a job, fell two-tenths in May and is now one-tenth below its average over the past year (chart). The rise in unemployment, decline in the labor force and drop in the employment rate are broadly consistent with a labor market that is still cooling, albeit at a very gradual pace.

Average hourly earnings surprised to the upside, rising 0.4% in the month and 3.9% over the year, but we doubt that the FOMC is worried about inflationary pressures stemming from faster wage growth (chart). The gradual but ongoing softening in the labor market likely will prevent a sustained acceleration in wages, in our view. Furthermore, earnings growth that is just below 4% is still broadly consistent with 2% inflation plus the trend in labor productivity growth, the latter having risen at an annualized rate of 1.8% over this business cycle.



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



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

Accounting for the revisions and the narrow breadth of gains, the May Employment report looks similar to other indicators showing that the labor market is struggling amid the tumult of the current policy environment. After signs of a pickup early in the year, "soft" data such as purchasing managers' surveys, small business hiring plans and consumers' assessment of job availability have all deteriorated over the past few months. Lower-tier "hard" data from JOLTS and Indeed show employers' interest in hiring trending lower. Net job gains have continued as the policy uncertainty that has made firms cautious to hire has also made them cautious to let go of workers. But, the gradual increase in initial jobless claims over the past year and new challenges to the growth outlook suggest this steady-state is at risk.

We expect today's employment report is strong enough to keep the FOMC in wait-and-see-mode for at least a little while longer. Higher tariffs are keeping concerns about inflation elevated, and after more than four years of above-target inflation, Committee members are cautious to assume the impact will be short-lived. With inflation expected to move up in the coming months, we suspect the FOMC will need to see more marked, and sustained, weakness in employment before reacting to deteriorating labor market conditions. Our base case forecast laid out in early May projected 100 bps of easing from September through year-end. We still feel good about the FOMC remaining on hold until September, but we think the risks are skewed toward 50-75 bps cuts rather than 100 bps. We will await next week's critical CPI data before making an official change to the forecast, but in the near term we think the FOMC will continue to sit tight.

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