WELLS FARGO

Economic Indicator — July 3, 2025

June Employment: Live to Fight Another Day

Summary

The headline employment data for June generally were encouraging. Nonfarm payrolls increased by 147K last month, clearing a relatively low consensus forecast of 106K. Revisions to job growth in May and April were modestly positive. The unemployment rate fell by one tenth to 4.1%, and in a separately released report, initial and continuing jobless claims were roughly unchanged in the most recent week for which we have data.

But, underneath the surface, the details were less encouraging and generally were consistent with a cooling labor market. The breadth of hiring was once again quite narrow. An unusually large jump in state and local government education employment (+64K) may be a seasonal quirk related to the end of the school year in June. Health care & social assistance and leisure & hospitality once again posted solid gains, but outside these sectors hiring in the rest of the economy was relatively flat. Furthermore, the decline in the unemployment rate was partially driven by workers leaving the labor force. The labor force participation rate fell to 62.3%, its lowest reading since December 2022.

Today's employment data make a rate cut at the July FOMC meeting quite unlikely, in our view. But, we think the ongoing cooling in the labor market should keep the Fed on track to start cutting rates at its September meeting. The rate path will be highly dependent on the path of inflation over the summer months as the FOMC attempts to discern the impact that tariffs are having on price growth. The June CPI report to be released on July 15 will be a critical piece of data on this front.

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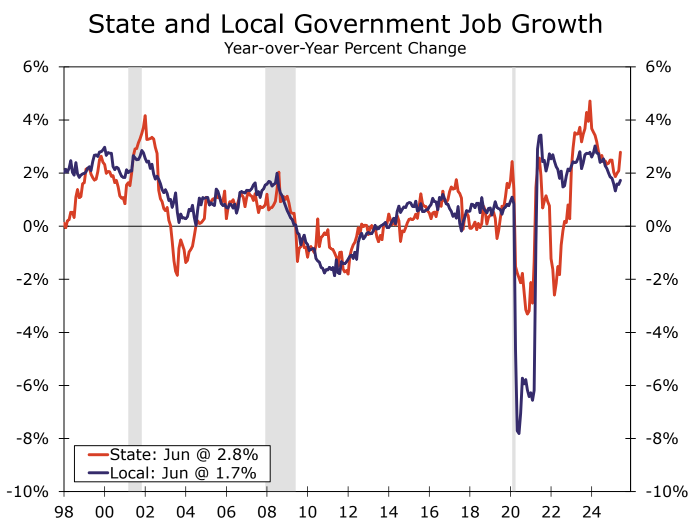
Another Headline Beat

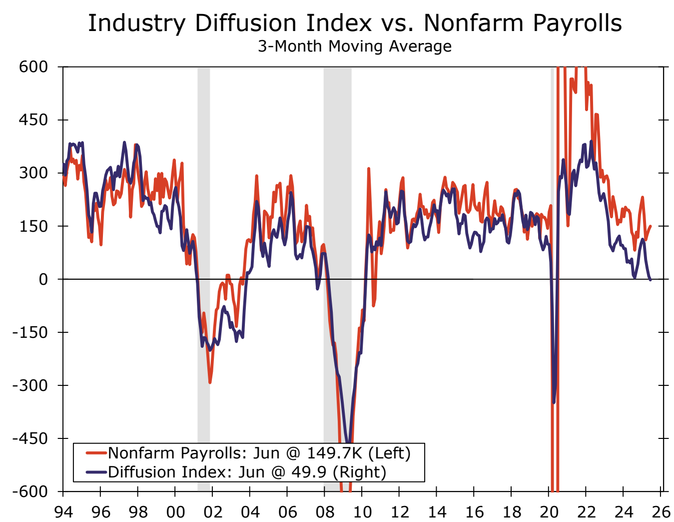
The June jobs report showed the labor market living to fight another day. Nonfarm payrolls rose 147K in June. The print comfortably exceeded the consensus expectation (106K), which was braced for a moderate gain amid an array of "soft" and lower-tier "hard" data showing labor conditions softening recently. The net revision to the prior two months data was also positive (+16K). The three-month average pace of payroll growth rose to 150K from 135K heading into the report.

Details of job growth, however, showed lingering signs of fragility. State and local government hiring rose 80K, accounting for more than half of June's gain. The bulk of the increase (64K) came from education, which likely reflected the relatively early timing of the survey week capturing employment before schools released for the summer. The timing quirk sets up payrolls in this space to fall in the July employment report. Meantime, federal government employment fell another 7K as layoffs continued and the hiring freeze instituted in late January remained in place.

Private sector hiring rose only 74K, the smallest increase since last October when hurricanes led to a temporary stalling in job growth. Gains slowed in healthcare & social assistance and leisure & hospitality, while employment fell in professional & business services, manufacturing and wholesale trade. On net, more industries reduced employment, leading the diffusion index to sink below 50 and register its lowest three-month average since 2007 outside a recession (chart). While slower labor supply growth due to immigration is reducing the number of jobs needed each month to keep the unemployment rate steady, a broader mix is needed for a durable expansion.



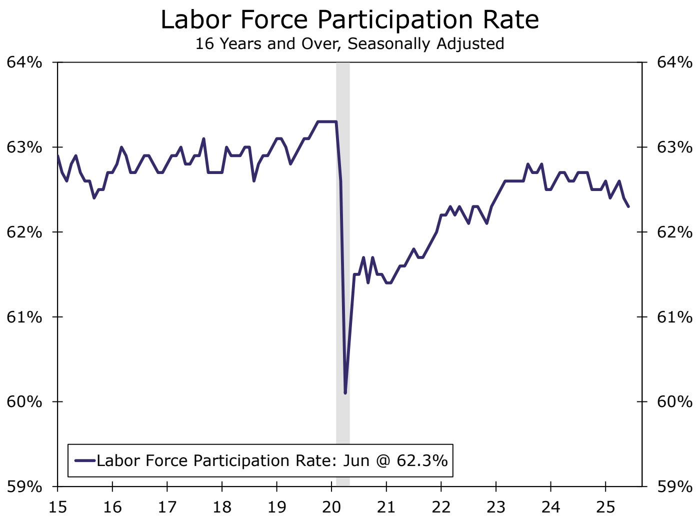
Source: U.S. Department of Labor and Wells Fargo Economics



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

The household survey highlighted some crosscurrents beneath the surface. While the unemployment rate slipped a tenth to 4.1% in June, the decline was partially driven by a 130K drop in the labor force. As a result, the labor force participation rate slipped to 62.3%, its lowest since December 2022 (chart). The pullback in participation reflects loosening attachment among recently laid off workers, as well as new and returning workers, who have had a difficult time finding new work. In short, a portion of the decline in the official unemployment rate was caused by an unhealthy driver.

The labor market's gradual loosening has allowed wage growth to cool. Average hourly earnings rose a weaker-than-expected 0.2% in June, running a touch behind its 12-month trend. The muted rise in hourly earnings led the year-over-year percent change down to 3.7%, its lowest since last summer (chart). The ebb has helped to quell overall employment cost growth at a time when firms are facing rising cost pressure for physical inputs amid tariffs. The wage counterbalance, combined with still-solid labor productivity growth, has likely played a role in keeping consumer price inflation at bay recently, underscoring that the labor market is not a source of inflationary pressure at present.



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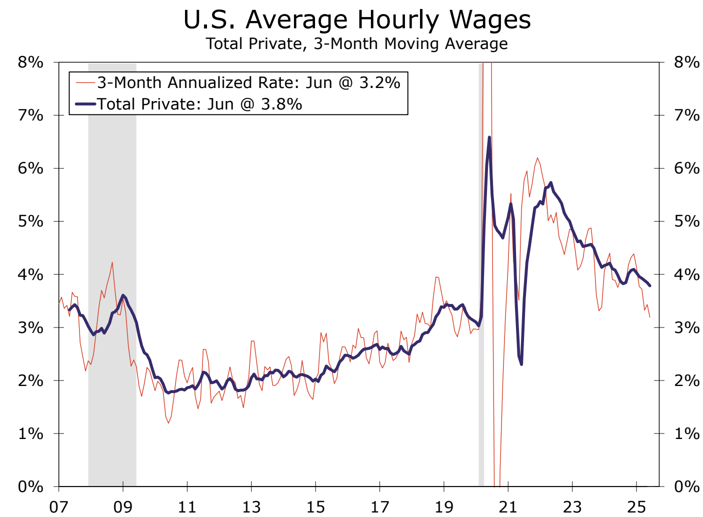

Source: U.S. Department of Labor and Wells Fargo Economics

Today's data make it very unlikely that the FOMC will cut the federal funds rate at its next meeting on July 29-30, in our view. Despite our reservations about the labor market data when looking under the hood, a three-month moving average on nonfarm payroll growth of 150K and an unemployment rate of 4.1% is good enough to keep the Fed on hold for another meeting. That said, if the trend continues to be one of gradual labor market cooling, and if the inflation data only rise modestly in the months ahead due tariffs, we think the FOMC will start cutting rates at its September meeting. We will be looking to the next CPI report to be released on July 15 to discern the impact that tariffs are having on price growth.

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