Economics

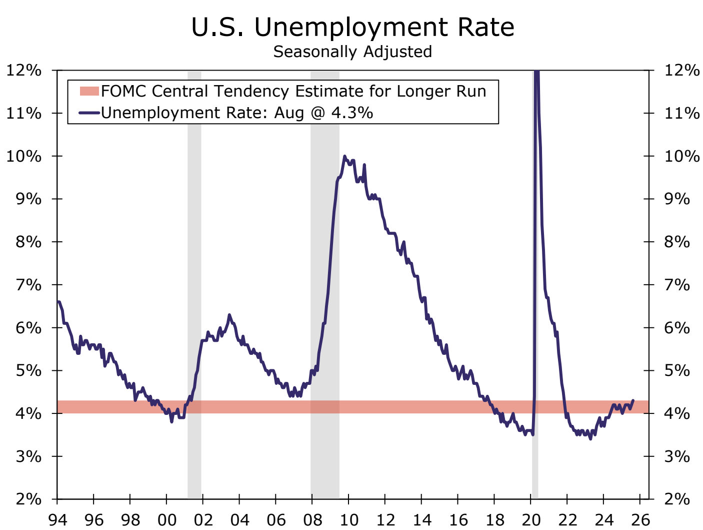
Economic Indicator — September 5, 2025

August Employment: Help Not Wanted

Summary

The August employment report was underwhelming and capped a summer of labor market doldrums. Nonfarm payrolls grew by just 22K in August, and some modest downward revisions to job growth in July and June pushed the three-month moving average on payroll growth down to a measly 29K. The hiring that did occur was very narrowly concentrated. The health care, social assistance, leisure and hospitality sectors added 75K jobs in August. Excluding these sectors, employment fell by 53K last month. In the household survey, the unemployment ticked up a tenth to 4.3%, the highest reading since October 2021.

Today's data, in conjunction with other labor market data received in recent months, suggest the labor market has hit stall speed. The weak pace of hiring and gradual uptick in the unemployment rate creates risks to the Fed's full employment mandate at the same time that inflation is creeping higher due to historically high tariffs. Faced with such a dilemma, we believe the FOMC will put more weight on rescuing the labor market and hope that tariff-induced inflation will fade in 2026. We look for a 25 bps rate cut at the upcoming FOMC meeting on September 17-18 followed by two more 25 bps rate cuts at the final two FOMC meetings of the year. We think the risks are skewed toward one or two more rate cuts at the first few FOMC meetings of 2026 as the Committee moves its policy rate toward a more neutral setting.



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

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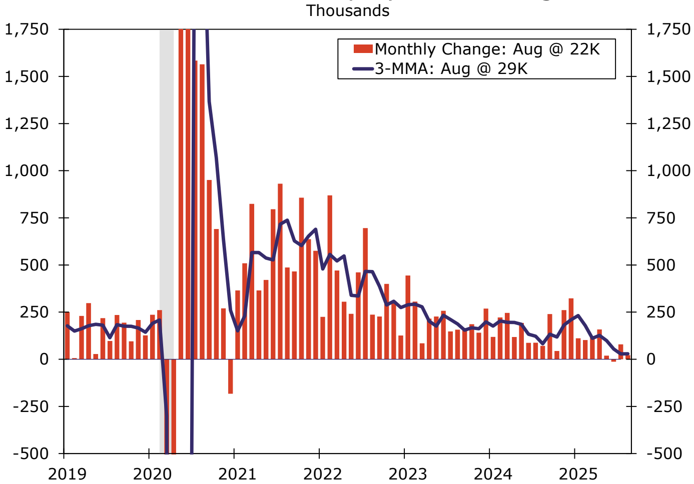
Weakness From All Sides

The jobs engine that has been integral to U.S. economic growth defying expectations for the past four years is stalling. Nonfarm payrolls rose just 22K in August, coming in below consensus expectations for a 75K gain. The pattern of previous months' gains being revised lower also continued, with a two-month net revision of -21K that included a revision that pushed employment growth in June into negative territory (-13K). With the response rate to this month's print the lowest for any August dating back to 2000s, the prospect for meaningful revisions the next two months is large. But even with elevated risk of further downward revisions, the recent pace of hiring is dangerously close to crossing into negative territory, where job market weakness quickly becomes self-reinforcing. Over the past three months, payrolls growth has averaged just 29K.

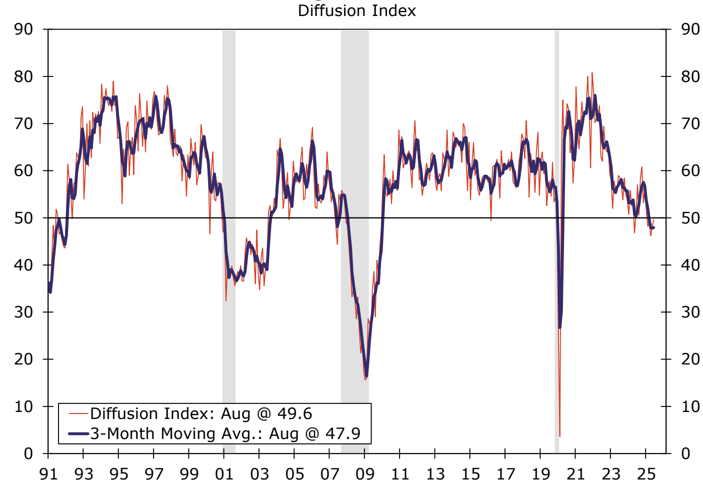
Weakness remains widespread across industries, making it difficult to drive a bounce-back in the near term. Government employment declined by 16K in August, as a 12K increase in local government jobs was not enough to offset further declines in federal employment amid the ongoing hiring freeze and a drop in employment at the state level. The tumult of trade policy is more clearly beginning to weigh on goods-related industries, with employment in manufacturing and wholesale trade each declining by 12K last month. "White collar" professional jobs have not been spared. Employment in information, finance and professional & business services all fell over the month. Once again, the entirety of net hiring could be chalked up to health care & social assistance, but even there, hiring is losing steam, with August's 47K rise the industry's smallest increase in three and a half years. While leisure & hospitality provided a lift this past month, the majority of industries continue to cut jobs. The diffusion index of industries adding jobs was below 50 for a fifth consecutive month, an unprecedented stretch outside of recessions and recoveries.

U.S. Nonfarm Employment Change



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

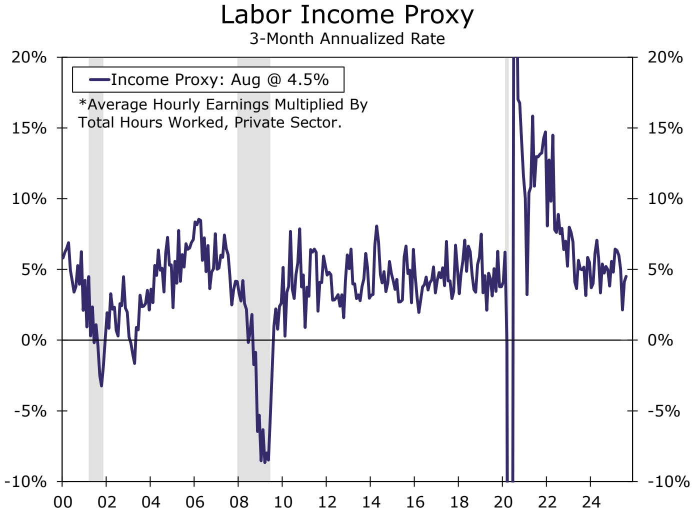
Industries Adding Jobs Over Past Month



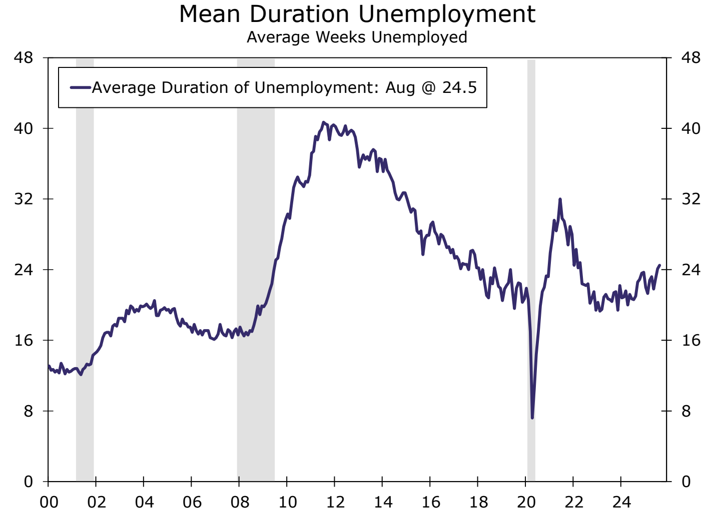
Source: U.S. Department of Labor and Wells Fargo Economics

The household survey of employment also highlighted the labor market's increasingly fragile position. Employment as measured by the more volatile household survey rose by 288K in August, but that was essentially a reversal of a 260K decline in July. The number of unemployed workers rose 148K over the month, which taken together with the rise in employment reflected the labor force participation rate moving up a tenth to 62.3%. The slight rebound in participation underpinned the further rise in the unemployment rate, which rose to 4.32% in August, up from 4.248% in July. The unemployment rate is now at its highest level since October 2021 and is at the top end of the range of what the FOMC considers to be consistent with its "maximum employment" mandate.

The volatility inherent in the household survey makes us doubtful that the rise in participation is indicative of a sustainable improvement in labor supply growth. When smoothing through the household survey's annual population controls, we estimate the labor force has only grown 0.1% over the past year, much softer than the official reading of 1.4%. Stricter immigration enforcement has likely reduced new entrants to the workforce, but poor hiring prospects have contributed as well. The average duration of unemployment rose to 24.5 weeks in August, the longest since mid-2022. Lengthening unemployment spells can discourage prospective workers from continuing to seek employment. This dynamic has been captured in the trend rise in the labor underutilization rate (the U-6), which rose to 8.1% in August, its highest since late 2021.



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



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

Sluggish growth in the labor supply has helped to keep wage growth solid. Average hourly earnings rose 0.3% in August, matching consensus expectations, but a strong 0.5% reading for wage growth in August 2024 pushed the year-over-year reading down to 3.7%. With labor productivity growth up 1.5% over the past year, this pace of wage growth is still broadly consistent with 2% consumer price inflation. Aggregate hours worked were flat in August and have contracted at a 1% annualized pace over the past three months. This combination of subdued growth in hours worked, but solid wage growth has kept our proxy for total labor income growth consistent with a real consumer spending pace of 1%-2%.

The labor market is in a precarious position. The unemployment rate is now one-tenth above the median "longer run" estimate from the FOMC's most recent Summary of Economic Projections. The three-month moving average on nonfarm payroll growth has dropped to a measly 29K, and the breadth of hiring across industries is unusually narrow. Furthermore, next week's preliminary benchmark revision is also likely to suggest that the recent pace of payroll gains has been even weaker than the 53K monthly average registered since April. And while the unemployment rate is up only a tenth over the past year, the participation rate has tumbled 0.4 percentage points over the same period, underscoring a deterioration in labor demand.

We believe this puts the FOMC in a position where it will imminently start cutting the federal funds rate. We look for a 25 bps rate cut at the upcoming FOMC meeting on September 17-18 followed by two more 25 bps rate cuts at the final two FOMC meetings of the year. We think the risks are skewed toward one or two more rate cuts at the first few FOMC meetings of 2026 as the Committee moves its policy rate toward a more neutral setting of 3.25%-3.50% or so. The uptick in inflation from tariffs probably will keep the FOMC from cutting rates faster. The core PCE deflator, the Fed's preferred measure of inflation, has risen 2.9% over the past year and at a 3.0% annualized pace over the past three months, and we expect a similar pace of inflation in the coming months. But even with inflation still roughly a percentage point above the central bank's target, we think the Committee will grit its teeth and engage in a rate cutting cycle in the hope that it can forestall additional labor market weakness and tariff-induced inflation will fade in 2026.

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