Economic Indicator — December 8, 2023

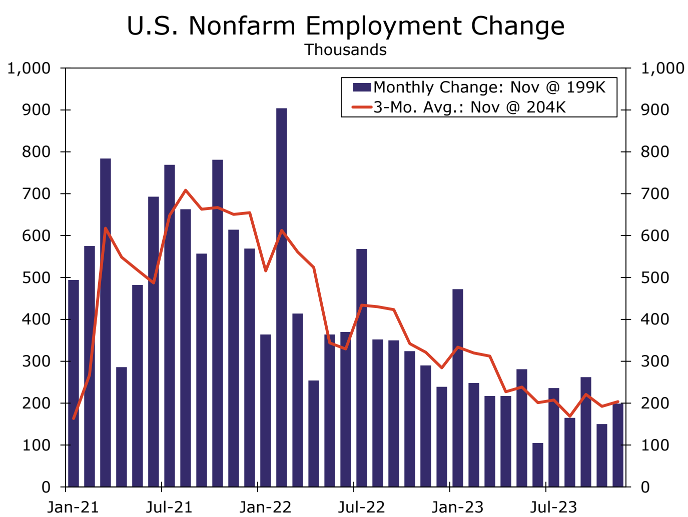
A Muddled Message From the November Jobs Report

Summary

The most closely watched numbers in the November employment report were strong. Job growth in November came in above consensus expectations, rising 199K. Even with the beginning and end of major strikes injecting some noise into monthly payroll changes since late summer, payroll growth has averaged 194K since August. The unemployment rate fell two-tenths of a percentage point to 3.7% in November, with robust labor force growth pushing the labor force participation rate back up to its cycle-high of 62.8%. Average hourly earnings growth also picked up a touch, rising 0.4% in November.

Yet despite the favorable monthly readings in November, the labor market clearly has cooled over the course of the year. Employment growth continues to come down from its post-pandemic boom, wage growth is slowing and labor turnover has receded as greener pastures at a new employer are not quite as enticing as they were earlier in the expansion. Beneath the headline figures, there are signs that the margins of the labor market are deteriorating, with job gains being more narrowly driven, temporary help employment declining and laid off workers taking longer to find new employment.

As we look to 2024, an improving inflation outlook and gradually softening labor market present balanced risks for the FOMC. We believe a continuation of these two trends will induce the FOMC to begin cutting the fed funds rate next summer.



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

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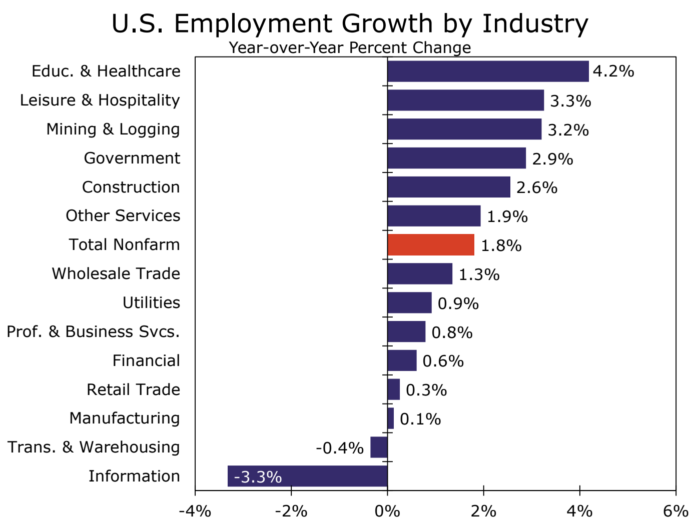
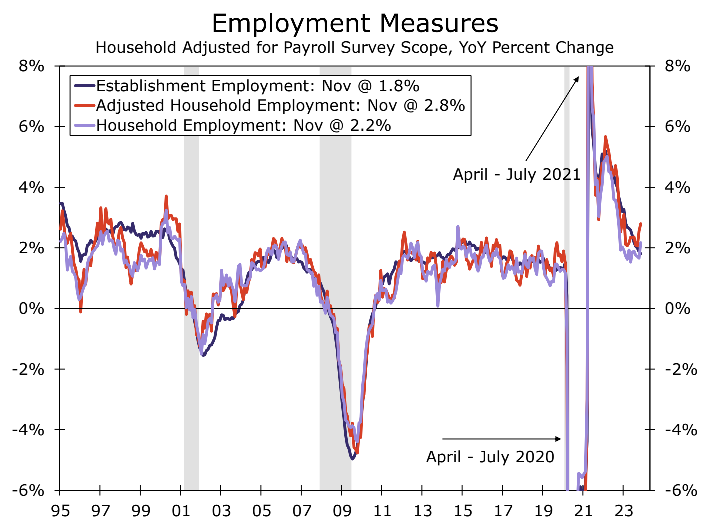
Payroll Growth Modestly Tops Expectations

The final employment report of 2023 came in a bit stronger than expected, although not enough to change the picture of a slowly softening jobs market. Nonfarm payrolls increased by 199K in November, just 16K above the Bloomberg consensus forecast for a 183K gain. Revisions to job growth in the prior two months were relatively modest, with a net downward adjustment of 35K. The end of the United Auto Workers and Screen Actors Guild strikes flattered the November payroll numbers after weighing on them over the previous few months. Motor vehicle and parts manufacturing employment jumped by 30K in the month, while motion picture and sound recording industries added 17K net new jobs.

Looking through the strike-induced noise, employment growth was carried by a handful of industries in November. Health care employment posted another strong gain of 77K, while government employment growth continued its hot streak with 49K new jobs added in the month. Job growth was also solid in social assistance (+16K) and bars and restaurants (+38K). Holiday hiring was underwhelming with a 38K decline in retail employment and a smaller 5K dip in transportation and warehousing. Employment in construction, professional and business services and financial services were all roughly flat in the month.



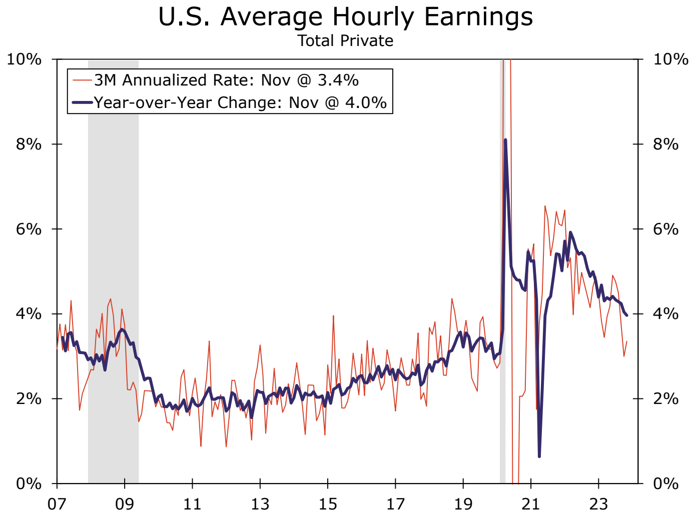
Source: U.S. Department of Labor and Wells Fargo Economics



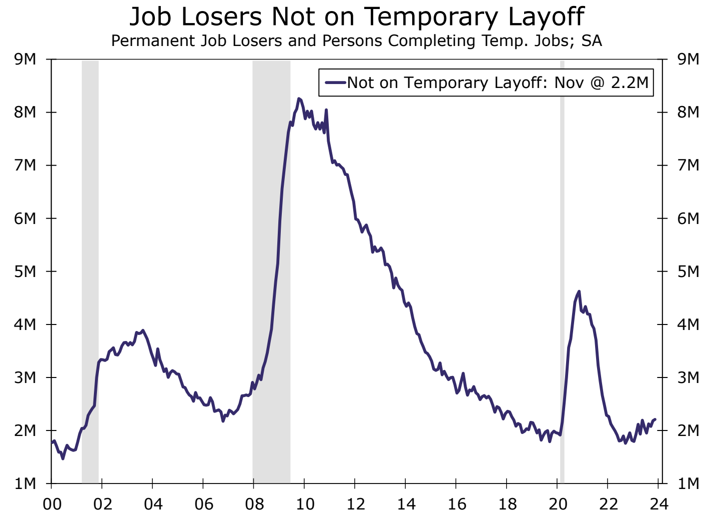
Source: U.S. Department of Labor and Wells Fargo Economics

The separately reported household survey showed a more robust pace of hiring in November. Household employment jumped 747K, which outpaced a 532K gain in the labor force. This sizable labor force increase pushed the participation rate back up to 62.8%. While household employment growth, even adjusting for its differing scope from the establishment survey, is recently running above nonfarm payroll growth, it comes after a period in which household employment lagged the payroll survey (chart). We give more weight to the larger and less volatile payroll survey, which shows hiring continues to decelerate on trend. Nevertheless, the picture from the household survey continues to be one of a tight jobs market with November's sizable increase in household employment helping to reduce the unemployment rate to a four-month low of 3.7%.

Average hourly earnings (AHE) further demonstrates that the labor market is cooling gradually. AHE rose 0.4% in November, which was a tick stronger than expected. However, the year-over-year rate of AHE was unchanged at 4.0% compared to 5.0% this time last year. Further moderation in the year-over-year rate is in train with the three-month annualized pace of AHE running at 3.4% (chart) —a rate that, if sustained, would be consistent with the Fed's inflation target once accounting for the recent trend in productivity growth.



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



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

Labor Market and Inflation Risks Are Balanced, For Now

As 2023 comes to a close, the labor market is ending the year in a different place than it started. Although job gains, the unemployment rate and wage growth remain strong in an absolute sense, directionally conditions have softened compared to one year ago. Nonfarm payrolls have increased by an average of 204K over the past three months, 117K slower than the pace that prevailed this time last year. Beyond the headline, labor turnover has slowed, and wage growth appears more restrained.

Employers have shed temporary help jobs as demand has weakened on the margin and reduced the need for temp workers to plug the gap. A shorter average workweek this year further illustrates weakening demand for labor beyond the slower monthly pace of payroll gains. And while strong growth in the labor supply has been an important factor in the rise in the unemployment rate this year, rising ranks of permanent job losers have also contributed (chart).

When paired with an inflation outlook that has become more benign, we believe the U.S. economy is entering 2024 with risks that are balanced for the labor market and inflation. Over the past couple years, the risks clearly have been tilted towards a labor market that is too tight and inflation that runs well above the Federal Reserve's target. With balanced risks, the odds of another rate hike appear remote, and the debate has shifted to assessing the timing of the first rate cut. We believe continued softening in the labor market and more progress on the inflation front will prompt the FOMC to initiate the first rate cut next summer.

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