Economics

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Economic Indicator — May 7, 2021

Messy April Jobs Report Validates Fed's Plan to Wait to See Actual Progress

Summary

The bumpy road of fully re-opening an economy after a pandemic was on full display in April. Employers added just 266K workers, well short of consensus expectations. A number of factors weighed on the jobs recovery last month, but we suspect weakness is primarily attributable to shortages of both labor and physical inputs limiting activity and thereby hiring. Yet there were signs of the supply of labor improving, with the participation rate rising to 61.7%. We expect the jobs recovery to get back on track over the next few months, but this report underscores that the Fed will be patient for a while yet when it comes to scaling back accommodation.

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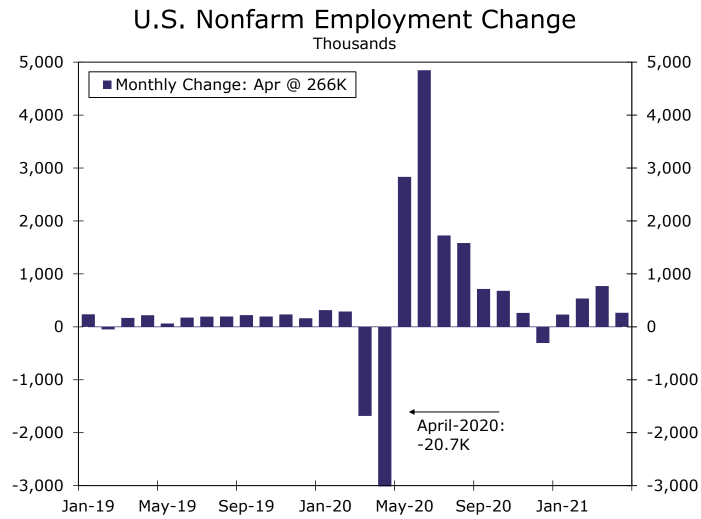
The Road to Recovery Is Bumpy

Today's report is a shining example of why the Fed is taking a more cautious approach to policy these days, waiting to see actual progress rather than taking forecasts to the bank. Employers added 266K new jobs in April, well short of consensus expectations for a gain of 1.0 million. Revisions were also negative (-78K on net for February and March). All told, payrolls remain 8.2 million below their pre-COVID peak.

A number of factors appear to be tripping up the jobs recovery at present. Businesses, particularly in goods-producing industries, have a bevy of challenges securing parts and materials for production. That has led to some production being temporarily idled, and is likely behind the 18K drop in manufacturing payrolls last month, including a 27K decline in employment at motor vehicles & parts manufacturers, which has been the poster-child for parts shortages.

However, job losses extended beyond manufacturing and suggest the reorientation back toward "normal" will not be smooth. Transportation & warehousing jobs declined by 74K, with couriers & messengers more than accounting for the drop (down 77K). Retail employment fell 15K with solid gains at sporting goods and apparel stores being more than offset by a 49K drop at grocery stores. Meanwhile, leisure & hospitality employment increased 331K as in-person services hit hardest by the pandemic continue to make a comeback. Further, school re-openings and an improving budget outlook also led to a solid gain in government employment (up 48K).

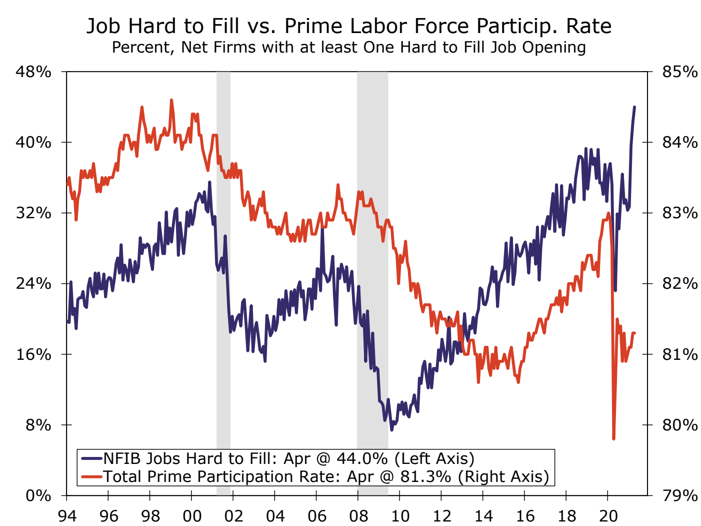


Source: U.S. Department of Labor and Wells Fargo Securities

Labor Demand Is Back, But Supply Lagging

As torrid a pace the economy has grown over the past couple months, it could be even stronger. Most of the focus on supply-side constraints to growth this year has been on shortages of parts and materials, but labor has also been a headwind. Today's report confirms what many companies have been highlighting—they can't get the help they need. Job openings have made a full recovery and the share of businesses reporting at least one job opening hard to fill rose to another record high in April. What gives?

There are likely a number of factors constraining a more robust return to work, including the aforementioned supply issues weighing on hiring and a mismatch between workers' skills and job openings. That said, the labor force participation rate inched higher to 61.7% for the total population, but remained unchanged for prime age (25-54) workers. The employment-population ratio also eked out a modest gain in a more telling sign that the labor market recovery is still underway, even as the unemployment rate ticked up to 6.1%.



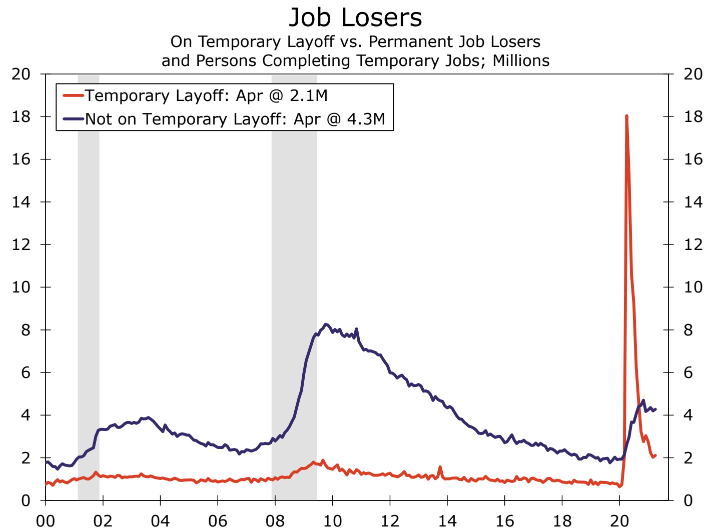
Source: U.S. Department of Labor, NFIB and Wells Fargo Securities

The slow return of workers at a time when demand is booming is generating more wage pressures that are notably stronger than the recovery and early expansion of the past cycle. Average hourly earnings (AHE) rose 0.7% in April. Although AHE continue to be distorted by the sharp compositional shifts in employment caused by the pandemic, last week's Employment Cost Index showed labor costs in Q1 rising the most in 14 years. While we do not expect wage growth is about to take off, the stronger trend already this cycle feeds into our expectations that inflation is likely to settle at a higher rate after it pops this year.

Recovery Should Get Back on Track

Fully re-opening an economy after a pandemic is not a seamless process. Temporary layoffs helped employers quickly restaff last spring, and are still rather high. But most unemployed workers are now permanent job losers, or re-entrants to the labor force. Advertising positions, interviewing and onboarding new employees takes more time. With individual circumstances also preventing workers from rejoining the workforce in one fell swoop, the pace of hiring has been restrained.

We expect the jobs recovery to get back on track over the next few months. Other data point to hiring progressing at a solid clip, including PMI indices on employment, consumers' views of the job market via the labor differential, declining jobless claims, rising job openings and hiring plans from small businesses. We expect the jobs recovery to still be historically fast given the solid demand outlook, but it will not be without friction.



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

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