Research Institute - Insight

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Payrolls in 5 Charts – Another blockbuster

Payrolls have delivered another huge upside surprise in May. While the details of the report were mixed, we don't think these undermine the overriding message that the labour market remains very strong. Overall these data should ease near-term recession fears, and support the case for more Fed tightening.

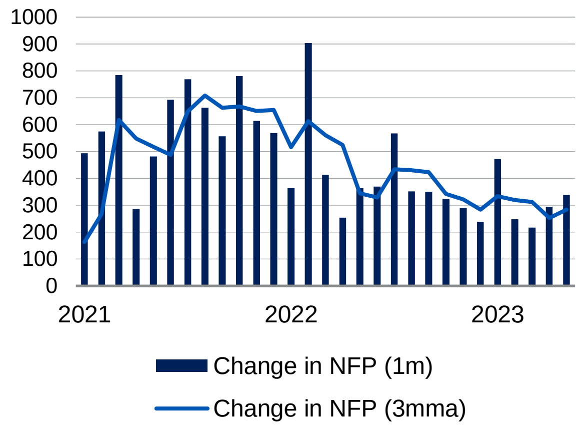
Key Takeaways

- Payrolls delivered another huge upside surprise in May, with a blockbuster 339k increase pushing back on fears that a recession might be imminent.
- Clouding this headline was a drop in employment in the household survey, and a rise in the unemployment rate to 3.7%. Historically this measure has been better at capturing turning points in the labour market.
- Scratching beneath the surface, this divergence was driven by a large drop in self-employed workers and employees on unpaid leave. Absent these, the gap between the two surveys evaporates.
- Weak self-employment likely reflects a normalisation in the post-pandemic labour market. This makes us more confident the household survey is not yet signalling a weaker underlying labour market environment.
- Elsewhere, the recovery in participation stalled. An ageing workforce and already high prime participation suggest there is limited scope for a further recovery in labour supply.
- Average hourly earnings data were soft, and are not far from inflation target-consistent rates. But our preferred measures of wage inflation show a far less benign trend.
- Overall, the Fed will probably see today's report as further evidence that the labour market remains robust, even if aspects were mixed.
- These data won't change the Fed's plan to pause in June, but at the margin they support another hike.

Another month, another beat

Non-farm payrolls beat expectations for a 14th consecutive month, rising by 339k in May (see Figure 1). Adding to the strong tone of the report were revisions to March and April data to show payrolls 90k higher than previously thought. This was the strongest reading since January, and at face value, pushes back very strongly against the fear that the economy might be in, or on the verge of, recession.

Figure 1: Payrolls growth still robust



Source: BLS, Haver, abrdn, June 2023

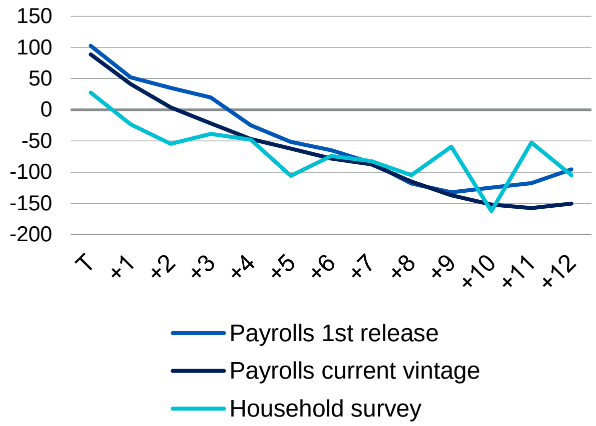
But the household survey told a different story

The household report painted a different picture. Employment was down 310k in May according to this survey, which uses a broader definition of employment, but is built from a notably smaller sample.

Divergence between the household and establishment surveys is not unusual, and we typically prefer the payrolls measure as its larger sample size makes it less volatile. However, there is a concern that payrolls can be less accurate around turning points, given their reliance on a birth-death model to account for business start-ups and failures.

Looking back across past recessions (1990, 2001, 2008), household employment data was on average softer in the six months leading up to recession than the 1st payrolls estimates, with some of this gap having been revised over time to show weaker hiring.

Figure 2: Average employment growth across the 1990, 2001 and 2008 recessions (t= start date of the downturn)

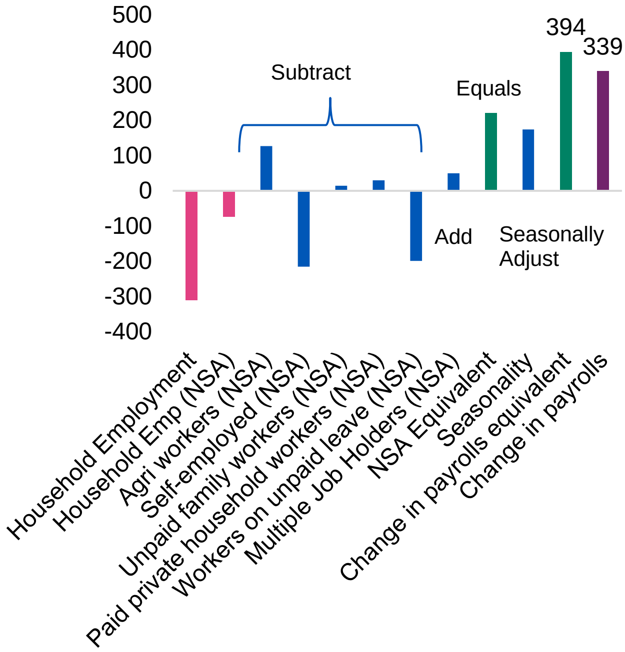


Source: BLS, Haver, abrdn, June 2023

Scratching beneath the surface, self-employment explains the gap between surveys

The household measure captures a broader range of employment and can be adjusted to more closely match the payrolls indicator. On this basis, household employment was up nearly 400k, which is obviously more consistent with the upbeat payrolls. Interestingly, this adjustment allows us to see what is causing the gap between the two headline measures, with large drops in self-employment and employees on unpaid leave responsible (see Figure 3).

Figure 3: Explaining household survey weakness



Source: BLS, Haver, abrdn, June 2023

Self-employment boomed during the pandemic, rising by close to a million jobs, before giving back this ground steadily over recent months. The initial bounce likely reflected a reaction to layoffs in early 2020 and a shift into the gig economy, alongside more practical issues around work during the pandemic, such as childcare.

An easing of these dynamics therefore might not tell us that the labour market is rolling over. But rather represent a post-pandemic normalisation. This means we are not yet too concerned the drop in the household survey employment might be telling us that labour demand is weakening quickly.

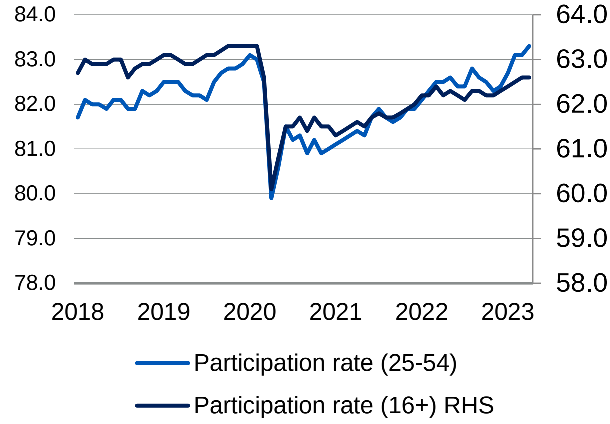
Is the labour supply recovery running out of steam?

One of the features of the strong labour market over recent months has been a long awaited pickup in labour supply. This has been driven by faster population growth – as immigration rebounds in the post-pandemic era – and rising participation. But how much more juice is there in the rising participation story?

The headline participation rate is still 0.7pps below its pre-pandemic level, suggesting room for further recovery. But, the prime-age participation rate is above this benchmark, as a very strong labour market attracts workers. The upshot is that lower participation is likely being driven by demographic trends, as people retired early during Covid and the population in general continues to age.

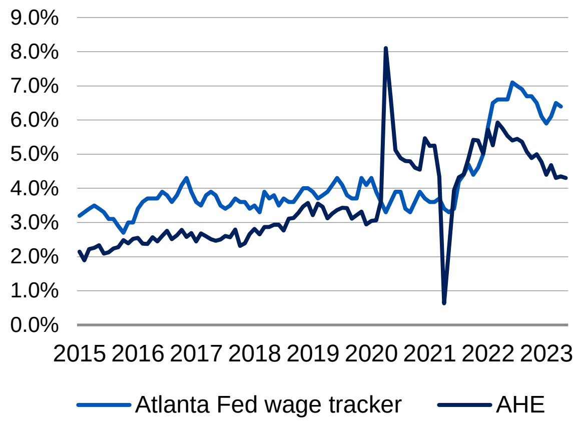
This makes us think we will not see further significant increases in labour supply help ease a very hot labour market. Weaker employment demand is critical for addressing this imbalance.

Figure 4: Participation recovery complete?



Source: BLS, Atlanta Fed, abrdn as of June 2023

Figure 5: Wage growth remains inconsistent with Fed's inflation target



Source: BLS, Haver as of June 2023

Wage growth is subdued, but watch the Atlanta Fed measure instead

Average hourly earnings came in at just 0.3% month over month, with revisions to past data lowering the profile of wage growth over recent months. According to this measure wage growth is running around the 4% mark in both three- and six-month annualised terms. A rate that would not be too far away from that potentially consistent with the Fed's inflation target. Albeit, probably still a bit too high given weak productivity dynamics post-pandemic.

The bad news for the Fed is that we don't have a great deal of faith in this measure. Average hourly earnings can be affected by more concentrated hiring in either lower or higher pay jobs. This pushes the average earnings numbers mechanically lower or higher depending on where job growth was strongest. Our preferred wage indicator, the Atlanta Fed measure wage tracker, follows pay for specific roles across time, and composition adjusts this sample to match the patterns of employment across the economy. This measure has come off its peak, but still shows wages running far too hot.

What does this mean for a data-dependent Fed?

The Fed has signalled a pause in policy tightening in June, and these data are unlikely to shift that well telegraphed thinking.

But what about policy beyond this meeting? Certainly there are some mixed messages in the report, with a blockbuster headline payrolls gain clouded somewhat by a weaker household survey, rising unemployment and softer wage growth. However, it is likely that the overall take away at the central bank will be that labour demand remains very robust, easing short-term recession fears.

The upshot is that this supports a resumption of tightening after the June meeting, supporting the 25bps hike we have pencilled in for the July FOMC meeting. We will be watching the June meeting closely for signals that this move is coming, particularly around member's projections for interest rates in the dot plot.

If the labour market remains robust, there is a risk that the central bank is forced to do more in September or beyond. However, we do expect cracks to start to emerge in the macro outlook on this horizon, which will keep the Fed on hold, ahead of a downturn starting around the turn of the year that will quickly switch the onus to easing in 2024.

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