Research Institute - Insight

7th July 2023

5.45 minute read | #US / #Labour Market / #Monetary Policy

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Payrolls in five charts – Slower, but not slow

June payrolls showed clearer signs that private sector hiring is slowing. However, this deceleration is not sharp enough to prevent the Fed from hiking at its July meeting, and a further slowdown, which we anticipate, will likely be needed to stop them from moving up again in September.

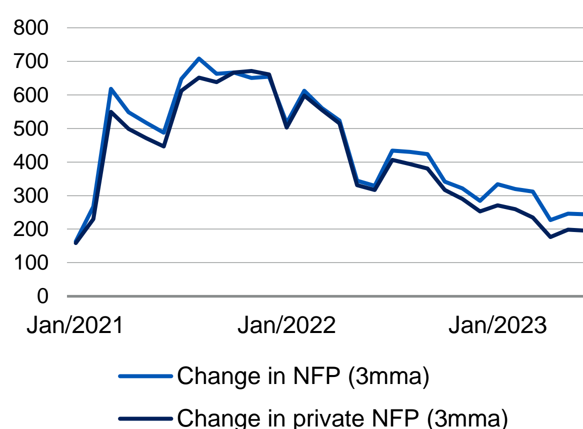
Key Takeaways

- Payrolls finally disappointed in June, following a run of 14 consecutive upside surprises. Considering the downward revisions to May/April data, and excluding strong government hiring, the weaker trend in private sector employment growth is becoming clear.
- However, hiring is not slow. The run rate of payrolls is around 200k per month – still well above what is required to loosen labour market conditions.
- Indeed, strong employment growth and tepid participation helped partially reverse the surprise increase in unemployment last month. The labour market clearly remains very tight.
- This continues to drive strong wage growth. We didn't put much weight on the deceleration in average hourly earnings (AHE) earlier this year, and the recent rebound suggests this was noise rather than signal.
- The June employment report is less puzzling than the May one, with employment trends across the household and establishment surveys matching more closely, and hours worked rebounding to rates consistent with slow but positive GDP growth.
- Today's report adds to the conviction that the Fed will return to tightening in July (25bps), following a brief June pause, with employment growth still too strong and the labour market too tight.
- This will be the final hike this cycle, if we are right that we will see further signs of slowing activity. But if the economy is more resilient than we anticipate, a September raise is very likely.

Clearer signs of cooling at last

In June, we finally saw payrolls disappoint after a long run of upside surprises. The headline came in at 209k, below consensus expectations of a 230k gain. Moreover, there were material downward revisions to May and April data, which add to the slower hiring story. When we take out government hiring, which has been on a tear over the past six months, the trend in private sector employment looks even softer. While it seems clearer from this report that payrolls are declining, it is worth emphasising that this is not slow employment growth (see Figure 1).

Figure 1: Clearer signs of slowing in private payrolls



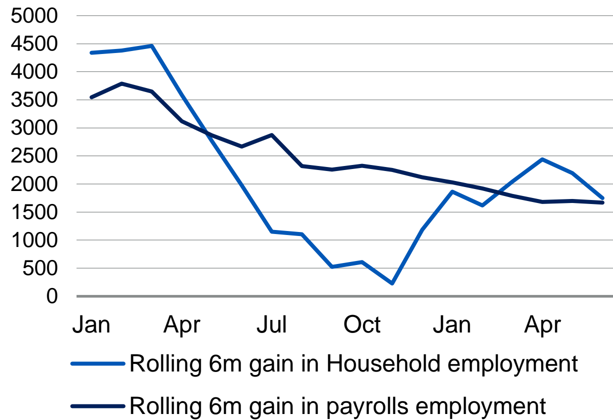
Source: BLS, Haver, abrdn, July 2023

Fewer puzzles in this report

In last month's payrolls reaction note, we spoke at length about the weaker trend in employment in the May household survey.

This discrepancy corrected somewhat in today's data release, with household employment rebounding by 273k. Indeed, cumulative job gains across the two measures over the past six months are now almost identical, with the greater volatility in the household measure clearly shown in this chart (see Figure 2). June data should ease concerns that the payrolls survey might be significantly overstating job growth on account of the model it uses to adjust for business startups and failures.

Figure 2: The household and establishment (payrolls) surveys provided a more consistent message in June.

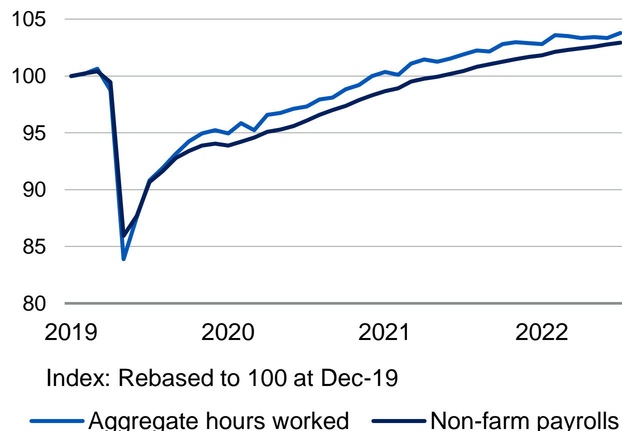


Source: BLS, Haver, abrdn, July 2023

A rebound in hours worked better matches our judgement that US growth has not yet stalled

Similarly, the May payrolls release showed a concerning decline in hours worked, which did not look consistent with other Q2 data that point to slow but steady growth in the US economy. In June we saw quite a smart rebound in aggregate hours, with these up 0.4% month over month, bringing the 3-month annualised rate up to a more respectable 1.8% over Q2 as a whole. Not too far off where our GDP tracking estimate is currently running.

Figure 3: Rebound in hours worked is another signal we are not at a turning point just yet

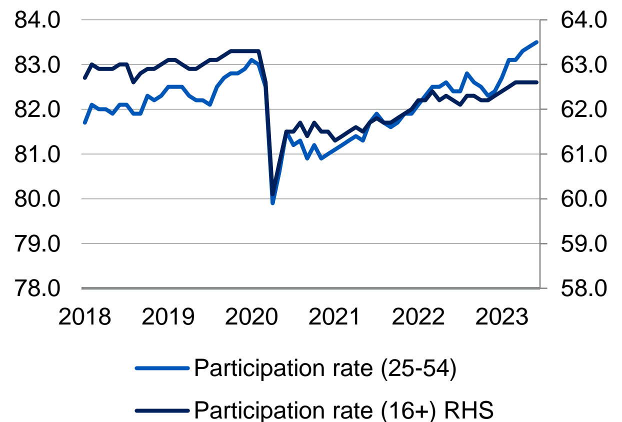


Source: BLS, Haver, abrdn, July 2023

The labour market still looks very tight

We saw another impressive gain in prime age participation in June, and we have to go back 20 years to see stronger activity among this group. Workers are likely being pulled into the labour force due to strong employment prospects and wage growth. But demographics are clearly pushing in the other direction of labour supply, as an ageing population shifts people into lower participation age ranges. This is why the broader participation rate has moved sideways over recent months (see Figure 4). This supports our view that there is limited scope for rising labour supply to help ease labour market imbalances in the US, even if population growth has been improving.

Figure 4: Participation recovery complete?



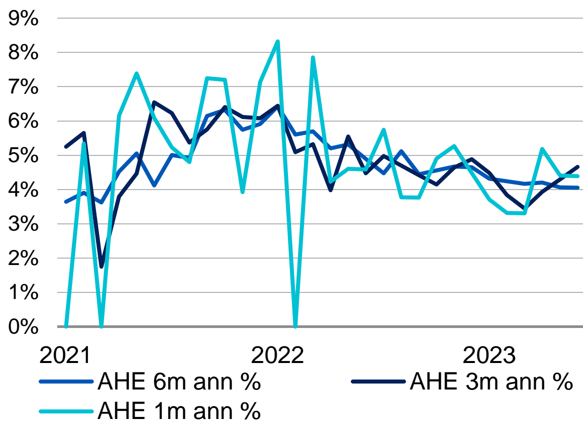
Source: BLS, Haver, July 2023

Indeed, the combination of strong employment growth, and weaker labour force growth, meant that the unemployment rate fell to 3.6% in June. This reverses some of the surprise 0.3pps increase in May and reinforces the idea that the labour market remains tight.

Wage growth reaccelerating – or AHE quirks?

Average hourly earnings (AHE) came in at 0.4% month over month, and seems to have reaccelerated over Q2. The 3-month annualised growth rate is now at 4.5%, well up from the 3.5% reported back in March (see Figure 5).

Figure 5: Slowdown in AHE has evaporated



Source: BLS, Haver, July 2023

It is worth flagging, as always, that this is our least preferred measure of US wages given its compositional issues. And indeed, we suspect the reacceleration is picking up changes in the patterns of hiring, such as slowing (lower paid) services employment, as opposed to a genuine acceleration in composition-adjusted wages over this period.

However, some Fed speakers have remarked on the improvement in AHE trends, and this is an indicator that the market watches closely. Therefore, the pick-up in AHE is important to the extent that it might dash hopes of a more benign trend in wage growth. AHE growth at a 4.5% annualised rate is still too hot to be consistent with the Fed's inflation target. And our preferred measures of wages (the Atlanta Fed wage tracker and the Employment Cost Index), which have more robust methodologies, suggest these continue to come in at even hotter rates.

What does this mean for the Fed?

The good news for the Fed is that payrolls do seem to be slowing, with the downward trend in private payrolls matching some other labour demand indicators such as openings and hiring rates in the JOLTs survey, hiring intentions in (some) private sector surveys, trends in hours worked and a very gradual drift higher in claims.

The bad news is that employment growth needs to slow a good deal more. Job gains of 200k per month are above average historically – particularly at this stage of the cycle with unemployment rates low. And, if we are right that there is limited room for labour supply to expand further, these run rates are nowhere near soft enough to deliver the material loosening in labour market conditions needed to ease wage growth, which remains too hot.

This explains why following a brief June pause the Fed will return to hiking in July, barring any shocks in next week's CPI report.

Thereafter the outlook is less certain. In our base case, we expect building evidence of slowing demand, including a further decline in payrolls growth, to persuade the central bank to go on hold from September onward, ahead of the recession we expect to hit around the turn of the year.

But it is certainly possible that growth and the labour market remain more resilient in the summer, which would bring a final September hike firmly into play.

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