Economic Analysis

May employment figures suggests recovery underway

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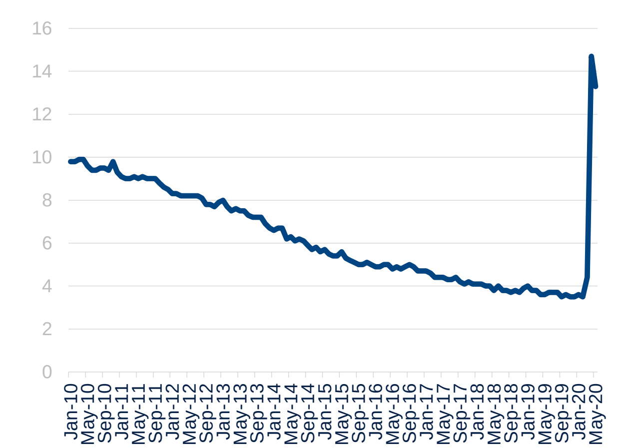
With 2.5M jobs being added and the unemployment rate (UR) declining 1.4pp to 13.3% in May, it seems fair to assume that the economy has reached bottom and the recovery is underway. Moreover, labor force participation rose 60bp to 60.8% while the employment-to-population rose 1.5pp to 52.8%, after plunging to the lowest level on record, which was alarming considering the differences in the composition of the labor force today relative to the post-WWII era.

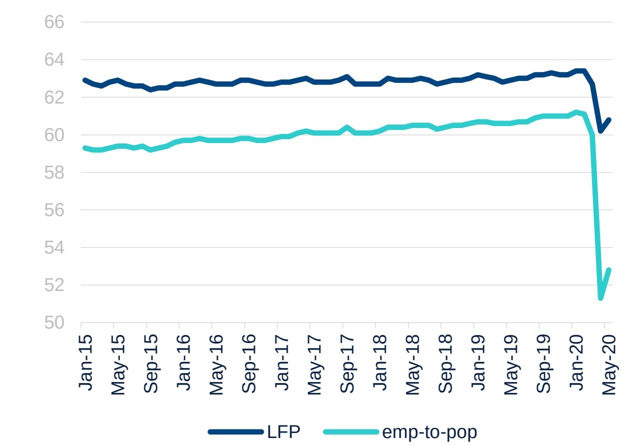
Broader measures of labor market utilization such as the number of workers that were out of the labor force but want a job declined by 954K while U-6 declined from 22.8% to 21.2%. Accounting for the unusual number of people that have left the labor force since February and workers that should have been classified as unemployed on temporary layoffs, suggests that the unemployment level and rate stand at around 32.6M and 19.8% vs. 39M and 23.6% last month, respectively.

Figure 1. **Unemployment Rate,** (%)



Source: BBVA Research, BLS & Haver Analytics

Figure 2. **Labor Force Participation and Employment-to-population** (%)

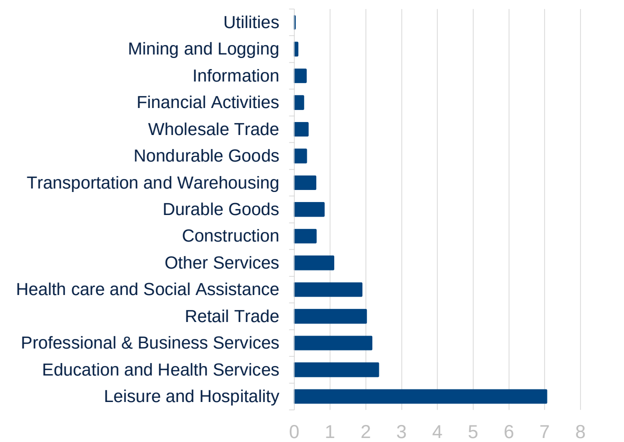


Source: BBVA Research, BLS & Haver Analytics

Consistent with the headline figures, the industry-level disparities signaled a turning point in the economy with the magnitude of recovery reflecting the impact that relaxation of stay-at-home orders and less intensive voluntary social distancing had on certain industries. For example, employment in leisure and hospitality increased 1.2M after declining by over 8M in March and April whereas employment in professional and technical services only increased 39.8K, after only losing 550K jobs during the same period. In addition, government support programs like the SBA PPP appear to have been effective in incentivizing rehiring even if firms are not seeing a pickup in revenues. For example, sectors that saw strong job gains included construction (464K), ambulatory health services (376K), retail(368K), manufacturing (225K), and administrative and waste services (109K). Unlike many industries that benefited from the improved level of activity, the Oil & Gas sector continued to face headwinds from the low commodity price environment with an additional

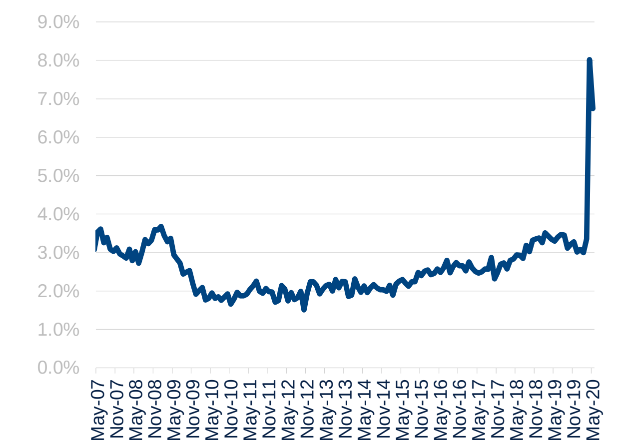
6.9K job losses in May. Air transportation is also struggling to adjust to the new Covid-19 normal, shedding an additional 50K jobs. State and local school closings also weighed heavily on government payrolls, accounting for 373K loses out of a total drop of 585K.

Figure 3. **Cumulative Industry Job Losses** (Million, March-May)



Source: BBVA Research, BLS & Haver Analytics

Figure 4 **Average Hourly Earnings** (year-over-year %)



Source: BBVA Research, BLS & Haver Analytics

In terms of wages, average hourly earnings fell 1.0% after rising 4.7% in April and 0.6% in March. The nontrivial decline underlies the inflows back into the labor force and rise in employment, which are concentrated in lower-paying industries. While average hourly earnings were up 6.8% year-over-year, the auspicious readings on wages are likely to give way to a more negative environment for wage growth, which will be adversely impacted by excess labor supply and the ongoing economic headwinds.

Notwithstanding a resurgence in the number of cases and a renewed need to implement compulsory social distancing, we expect conditions in the labor market to continue improving. We expect around 10M net jobs and the UR to decline to around 6.5% by the end of the year. That being said, it could take many years for nonfarm payroll to return to pre-Covid levels. In addition, incoming epidemiological data and rising number of cases suggests that a quick return to normalcy is unlikely. In fact, there remains a risk that a second wave in 2H20 could jeopardize the labor market recovery and increase the risk that the pandemic could lead to permanent economic damage or a jobless recovery. For the Fed, the former would suggest staying the course and managing the crisis with its expanded set of tools. The latter could require a more forceful response and increase the likelihood that the accommodative conditions will remain for a prolonged period of time.

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