Economic Analysis

Positive June employment report overshadowed by worsening health crisis

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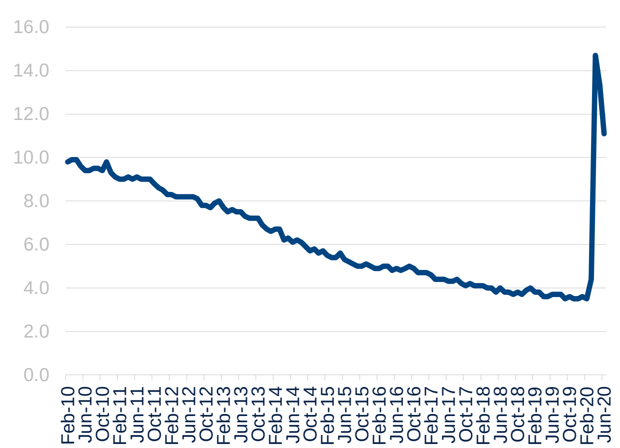
As we expected, in June, the economy showed further signs of strengthening with the labor market adding 4.8M jobs, after adding a revised 2.7M jobs in May. The lifting of stay-at-home orders in a handful of major cities and accelerated relaxation of distancing measures in Sunbelt states drove the gains and led to a 2.2pp reduction in the unemployment rate (UR) to 11.1%.

While overall unemployment rates have declined, there remain significant disparities among groups. For those without a high school diploma, the UR in June stood at 16.6%, which is 2.5x higher than someone with a college degree. Similarly, the UR for women was 1pp higher than males at 11.2% despite the fact that both genders had identical unemployment rates of 4.0% in February, suggesting women continue to shoulder the burden during the pandemic.

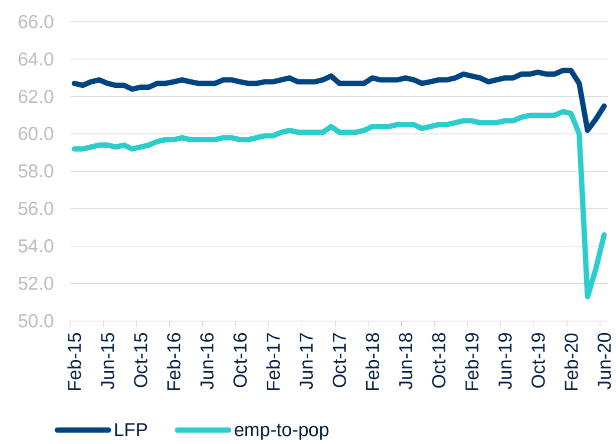
In addition, the UR was 15.4% for Blacks, 13.8% for Asians, 10.1% for Whites and 14.5% for Hispanics. Moreover, for those 20-24 years old, the UR stood at 19.8% or 2x higher than those 25 years and over. These trends reflect the more pronounced impact of the pandemic in industries with a higher concentration of minorities, women, less-educated, younger and lower-wage workers.

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



Source: BBVA Research & BLS

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



Source: BBVA Research & BLS

Despite the improvements, there are still 12M more people unemployed today than was the case in February, or around 7.6pp higher in terms of the UR. Moreover, at 61.5% the participation rate remains 1.9pp below its February level while the employment-to-population ratio stood 6.5pp lower at 54.6%. In addition, misclassification of workers who were reported as being employed but absent from work rather than unemployed on temporary layoff continued to factor into the estimate of the number of unemployed. That said, better guidance to surveyors and data aggregation suggests that the misclassification declined to 2M workers from 4.9M in the previous month. This led to around a 1pp miss in terms of the estimate. However, although the number of people not in the labor force declined by 1.5M in June, there are still 5.2M more people that have left the labor force relative to February. Combining both of these effects, misclassification and not in the labor force, the adjusted unemployment rate is 15.1%

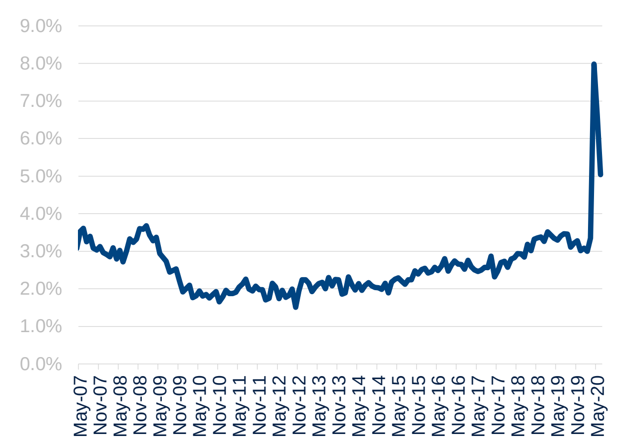
The industry labor market churn continues to reflect the resumption of activity and the change in preferences and behaviors. For example, employment in leisure and hospitality increased by 2.1M, which accounted for 40% of the overall gains, with 1.5M coming from food service and drinking places, 353K in amusement, gambling and recreation, and 239K in accommodation. In addition, jobs increased in retail (740K), healthcare (358K), education (93K), manufacturing (356K), professional business services (306K), construction (158K) and financial activities (32K).

To the downside, employment continued to weaken at the state and local levels on account of the stressed budgets and dire fiscal position of many municipalities with 25K job losses over-the-month. Similarly, the weak oil price environment continued to weigh on the mining sector with employment falling by 10K over-the-month, of which 7K came from support activities.

Figure 3. **Cumulative Industry Job Gains (Million, April-June)**

Source: BBVA Research & BLS

Figure 4. **Average Hourly Earnings (YoY%)**



Source: BBVA Research & BLS

These trends suggest that the recovery will remain highly uneven. First, some industries experiencing minor disruptions or even benefiting from the crisis, such as couriers and messengers, warehousing and data processing will continue to experience steady improvements. A second group, accounting for most industries, will experience a stable recovery that will allow them to return to pre-crisis levels in coming quarters. However, for other industries such as clothing stores, sightseeing, and performances and live events, the recovery could be slow and painful with a high probability of permanent or long-lasting effects from the pandemic.

With respect to wages, after experiencing a surge in March, average hourly earnings declined again in June by 1.2%. That being said, supply-side pressures and the nature of the crisis which has disproportionately impacted lower income occupations continues to buoy wages, which remain 3.0% higher than February levels. In terms of the industry level trends, wage growth remains strong relative to the pre-Covid trend in other services, financial activities and retail trade whereas sectors such as mining, transportation and warehousing, leisure and hospitality, manufacturing and construction have decelerated, likely underpinned by lower wage earners returning to their jobs.

Today's report confirms that a nontrivial rebound in activity occurred in 2Q20, implying that the economic pain may be more moderate than some had anticipated. This provides a strong signal that both monetary and fiscal policy actions have been effective. For the Fed, this means less pressure to deviate from their plan, as they continue shifting their support from Wall St. to Main St. For Congress, the pressure to take further action is also lower although another round of fiscal support of around $1tn could still happen. Congress needs to extend unemployment benefits that expire at the end of July, and provide federal aid to states and local governments to offset the sharp drop in revenues and thus avoid a similar response in spending.

However, in the past few weeks, the health crisis has deteriorated significantly in the Sunbelt, thereby increasing the uncertainty surrounding the near-term economic outlook for the U.S. economy. This has also caused states with more favorable conditions to alter their reopening plans and limit domestic travel, as we head into the summer tourism season. As such, there is a growing probability that the momentum built over the past two months will start to slow. In fact, if hospitalizations and infectious rates continue to rise and ICU capacity reaches critical levels, there is a chance that states will reinstitute some of the more draconian isolation measures.

While some sectors that are less sensitive to more restrictive voluntary and involuntary social distancing such as manufacturing, construction and professional services may continue to improve in spite of rise in Covid-19 case numbers, areas such as retail and leisure and hospitality are at risk of backsliding, potentially erasing the significant gains in employment in May and June. If uncertainty remains extremely elevated and downside risks begin to materialize, the pressure for the Fed and Congress to take bolder actions will intensify.