US Labor Market Watch

Is the Labor Market showing warning signs?

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There are still no signs of a sharp slowdown in the labor market, but it has weakened somewhat more than it looks at first glance

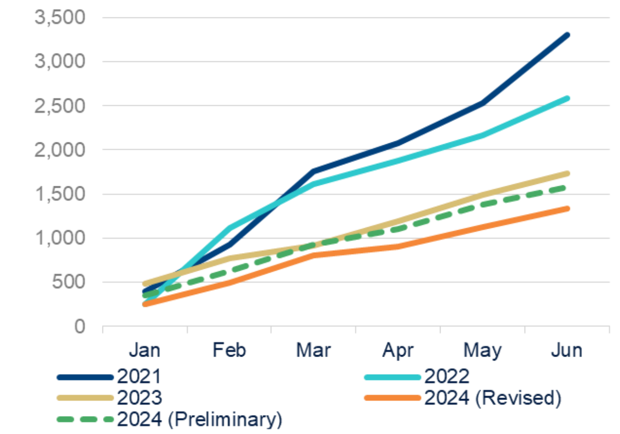
- Private nonfarm payrolls grew somewhat above consensus expectations in June, with 206,000 new jobs recorded. However, this increase was offset by downward revisions for April (-57,000) and May (-54,000), resulting in a total adjustment of 111,000 fewer jobs than previously reported. These frequent downward revisions since last year confirm that the labor market has generally been coming into a better balance, with more moderate job creation levels and an unemployment rate (UR) now close to the long-term trend.
- From January to June, recorded job creation reached 1.3 million new jobs, a pace around ¼ slower (23.2%) than last year. This slower pace, together with frequent downward revisions to monthly job creation numbers points to a labor market that is still solid but not overly tight. Another relevant fact is that a significant portion of the dynamics in private payroll creation has been driven by sectors such as healthcare and government rather than by strong cyclical employment resulting from excessive demand. These trends are consistent with the moderate growth shown by the GDP this year.
- Somewhat weaker demand in the labor market along with more supply, are behind the slow but steady increase in the UR, which has gradually risen to its long-term level (4.1% vs. 4.2%). Admittedly, most of this increase has come from a higher participation rate (more supply in the labor market), but after the recent uptick, UR is now approaching the threshold of the Sahm rule, which identifies the beginning of a recession when the three-month average UR increases by at least 0.50 percentage points from the lowest level in the previous 12 months. In this context, the rule would trigger in early September if the unemployment rate increases by 0.1 percentage points per month in the next two months (July and August).
- However, there are some elements to consider. First, the labor force participation rate significantly increased in July (277,000), influencing unemployment. Additionally, the NIFB survey's May Employment report showed a growth of one percentage point in the percentage of businesses planning to increase employment compared to the previous month, breaking (temporarily?) the downward trend. Furthermore, the decline in the job openings rate halted in May (rebounding 0.1 percentage points) and is still 0.9 percentage points above the level recorded in May 2020, when demand fell due to the pandemic. Overall, other timely indicators continue to point to a labor market coming into better balance.
- Average hourly earnings rose 0.3% month-on-month in June, leaving the annual growth rate at 3.9%. The three-month annualized rate fell to 3.6% from 4.0%, and we think it is set to ease further in the following months.
- All in all, The labor market remains solid and has come into a better balance, but it has weakened recently somewhat more than it looks at first glance, with more moderate job creation levels, a slowly increasing UR driven mostly by supply factors, and a quits rate which has remained steady after falling somewhat below

pre-pandemic levels at the end of last year. This has contributed to more moderate wage increases, which, in our view, are set to ease further. Although some warning signs are starting to emerge, a clear downturn in the labor market is not yet evident. Supply-related factors have elevated the unemployment rate, but there are no clear signs of a strong deceleration on the demand side. Having said this, the Fed is likely to increasingly focus on the labor market to be alert for any signs of a clearer weakening and stay ahead of the curve instead to start easing policy when it is too late.

- There are still no apparent signs of a strong slowdown in the labor market, so it will probably continue to grow at a moderate pace unless the economy weakens more than we expect, affected by high interest rates. In our view, as long as the Fed starts to ease policy soon (in September), the UR is still unlikely to increase markedly, driven by a sharp drop in demand. Considering that we now anticipate a somewhat higher GDP growth rate this year, we think the UR is set to close the year close to current levels (at 3.9%), still around long-term average levels, unless either labor supply continues to creep higher or demand starts to weaken more rapidly than we now anticipate.

After consistent downward revisions, job creation does not look as strong

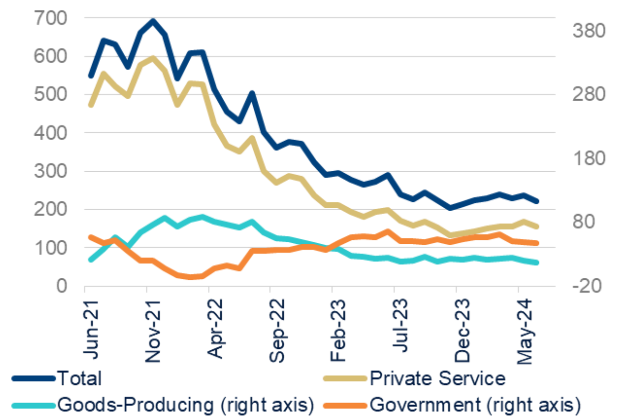
Figure 1. **NONFARM PAYROLL EMPLOYMENT (THOUS, CUM. MoM, SA)**



Source: BBVA Research based on data by Haver Analytics.

Albeit at first glance, total employment growth seems to point to continued strength…

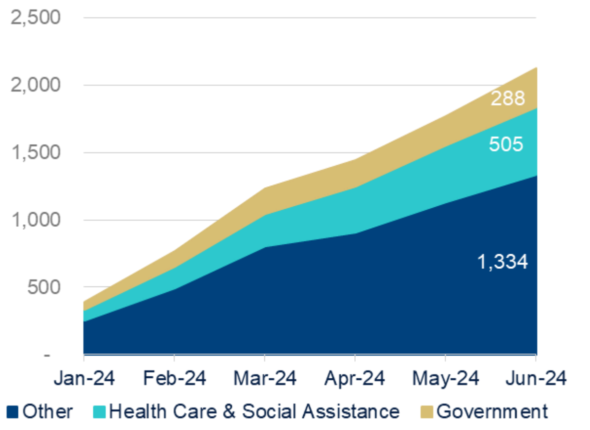
Figure 2. **NONFARM PAYROLL EMPLOYMENT (THOUS, MOVING AVG. 6 MONTHS, SA)**



Source: BBVA Research based on data by Haver Analytics.

… non-cyclical employment's relative importance has been steadily increasing…

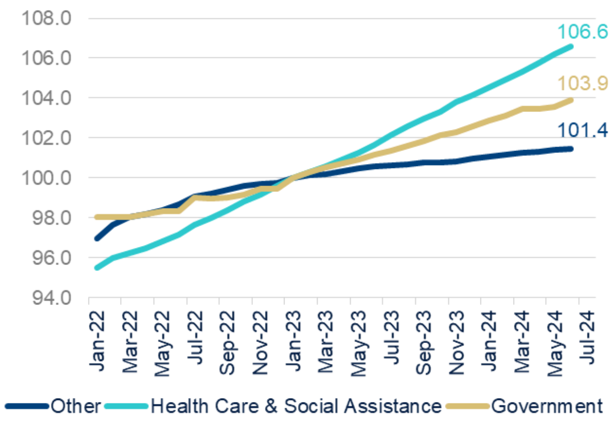
Figure 3. **NONFARM PAYROLL EMPLOYMENT (THOUS, CUM. MoM, SA)**



Source: BBVA Research based on data by Haver Analytics.

… while weaker cyclical employment adds to evidence of softer GDP growth

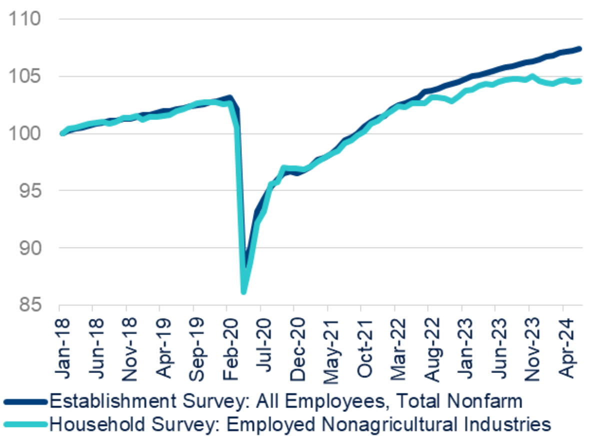
Figure 4. **NONFARM PAYROLL EMPLOYMENT (INDEX JAN/2023=100, SA)**



Source: BBVA Research based on data by Haver Analytics.

Besides, the increasing gap between surveys also suggests the labor market is weakening

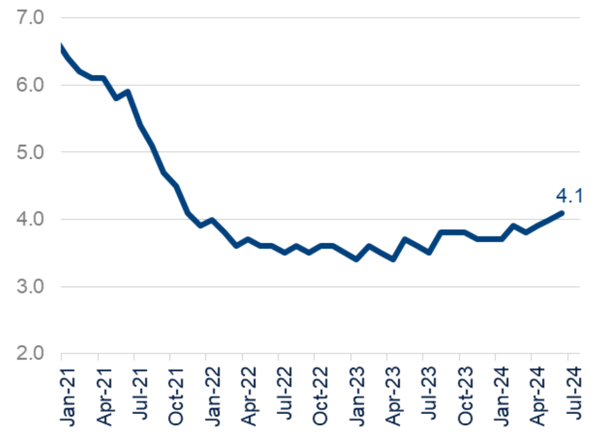
Figure 5. **TOTAL EMPLOYMENT (INDEX JAN/2018=100, SA)**



Source: BBVA Research based on data by Haver Analytics.

A 0.1pp increase in the UR per month in the next two months would trigger the Sahm rule on recessions*

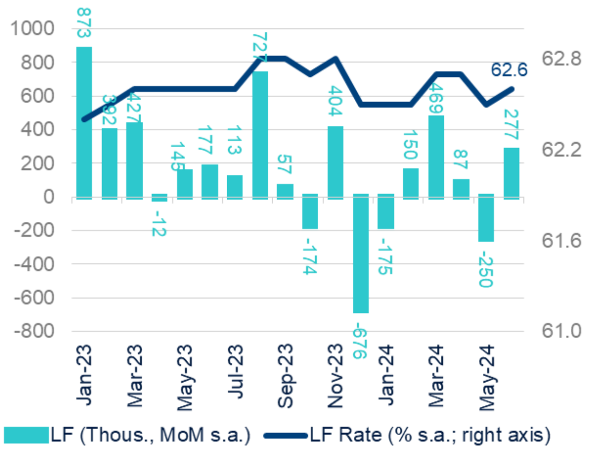
Figure 6. **UNEMPLOYMENT RATE (% OF LABOR FORCE, SA)**



Source: BBVA Research based on data by Haver Analytics.
* When the three-month moving average of the jobless rate rises by at least a half-percentage point from its low during the previous 12 months, then a recession has started.

Admittedly, most of the increase in the UR has come from a higher participation rate*...

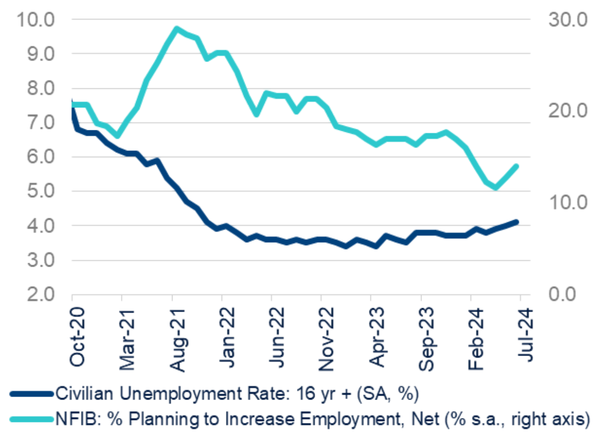
Figure 7. **LABOR FORCE**
(NET VARIATION AND % OF LABOR FORCE, SA)



Source: BBVA Research based on data by Haver Analytics.
* i.e., more supply, not significantly weaker demand

… and other timely indicators continue to point to a labor market coming into better balance

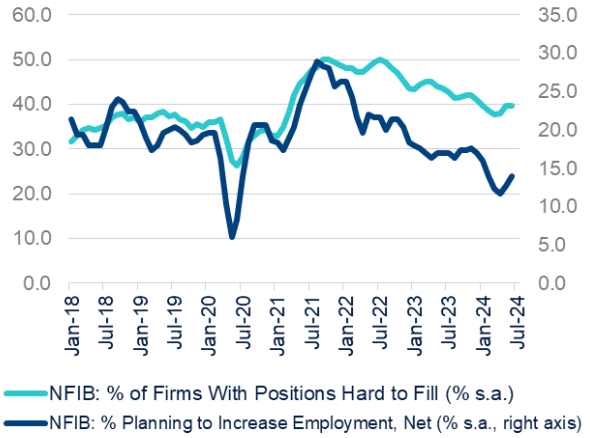
Figure 8. **UNEMPLOYMENT RATE AND NFIB: SMALL BUSINESS ECONOMIC TRENDS**
(% OF LABOR FORCE AND %, SA)



Source: BBVA Research based on data by Haver Analytics.

Despite last month's uptick, plans to hire workers remain on a gradual downward trend

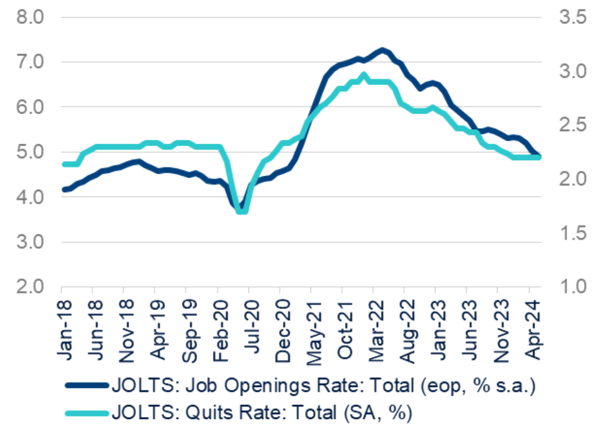
Figure 9. **NFIB: SMALL BUSINESS ECONOMIC TRENDS** (%)



Source: BBVA Research based on data by Haver Analytics.

The private quits rate has been broadly unchanged this year, which, together with…

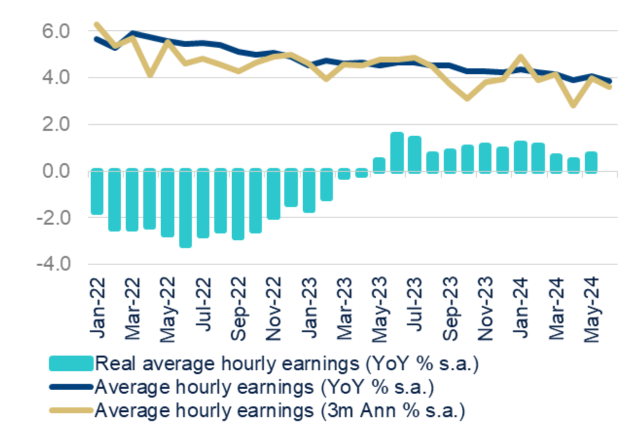
Figure 10. **JOB OPENINGS AND QUITS RATE**
(%)



Source: BBVA Research based on data by Haver Analytics.

… lower job openings point to softer wage growth ahead

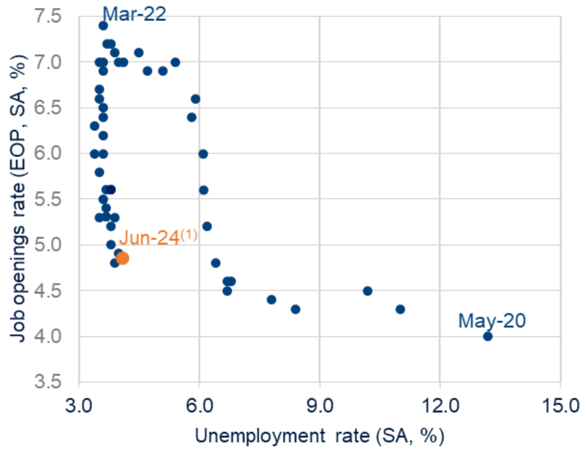
Figure 11. **AVERAGE HOURLY EARNINGS** (ANNUAL VAR. %, SA)



Source: BBVA Research based on data by Haver Analytics.
* Weighted Overall: 3-MMA of Median Wage Growth (NSA, Y/Y %Chg)

Although the UR has inched up slowly, the move along the Beveridge Curve has been small

Figure 12. **THE BEVERIDGE CURVE** (%, SA)



Source: BBVA Research based on data by Haver Analytics.
(1) Forecast

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