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Hints of Weakness in Hiring Support a Smaller Hike; Strong Wages Suggest a Higher Level of Policy

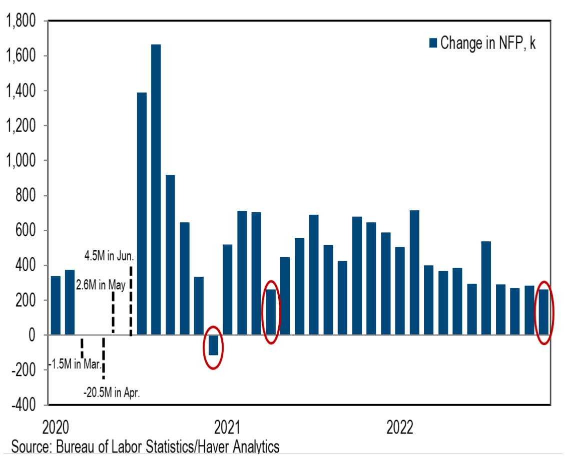
Economic **INSIGHT**

The latest employment report indicates the U.S. labor market remains stubbornly tight. With labor demand far outpacing labor supply, wage pressures have stayed elevated while the jobless rate remains near a five-decade low, despite nine months of policy accommodation removal. Of course, some metrics show the labor market may be less robust than headline figures suggest.

Looking out to next week's policy decision, the Federal Open Market Committee (FOMC) has indicated a willingness to pivot from supersized rate hikes to smaller, incremental increases. However, given the still-elevated level of inflation, coupled with ongoing headline "*strength*" in the labor market, the Federal Reserve (Fed) has indicated the peak level of the federal funds rate will be markedly higher than previously anticipated.

POSITIVE HEADLINE JOB CREATION, WANING MOMENTUM

Last month, nonfarm payrolls rose by over 260,000, far surpassing the 200,000 gain expected and marking the 23rd consecutive month of positive job creation. Additionally, October payrolls were revised higher for an upward gain of 23,000, totaling 284,000.



Source: Bureau of Labor Statistics/Haver Analytics

While the November rise was stronger than anticipated, it marks the weakest month of hiring since April 2021, which was the slowest pace since December 2020, when the economy was coming out of the government shutdown and shed 115,000 jobs. Additionally, while the average monthly employment gain remains positive, the momentum in hiring has slowed markedly from 539,000 at the start of the year to an average pace of "*just*" 272,000.

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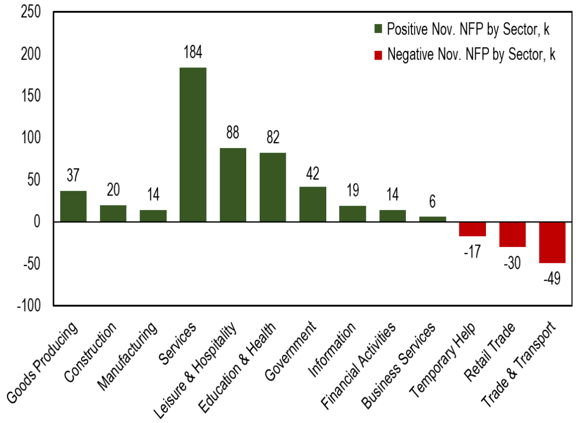
Looking beyond the headline read, additional unevenness in the labor market is revealed, with some sectors posting noticeably less robust job gains. In the details of the November report, private payrolls rose by 221,000, with goods-producing payrolls rising 37,000 and service-producing payrolls gaining 184,000. Leisure and hospitality were among the leaders, with additional gains in health and education as well as financial and businesses services. On the weaker side, trade and transport shed 49,000 jobs, reflecting a 30,000 decline in retail trade and marking the third consecutive month of negative job creation. Temporary help payrolls also dropped 17,000.



Source: Bureau of Labor Statistics

UNEMPLOYMENT METRICS UNDERREPORTING JOBLESSNESS?

Turning to the household survey, additional signs of weakness have begun to emerge in the assessment of the U.S. labor market. Instead of posting a sizable increase like payrolls, household employment reportedly fell by 138,000 in November following a 328,000 drop the month prior. Such a precipitous fallout of those in a position of employment would typically result in a rise in the unemployment rate, however, the labor force also declined markedly last month by nearly 200,000 workers. Thus, the unemployment rate remained steady at 3.7%, while dragging down the participation rate to a four-month low of 62.1%, stubbornly below the pre-COVID level of 63.4%.

Keep in mind, one has to be actively seeking employment to be counted as unemployed. In other words, it is very easy for the economy to lower the unemployment rate to zero if no one is looking for work, although this would hardly be the ideal scenario for longer-term growth as companies remain desperate to hire. That being said, reinstating sidelined workers, many of which were paid "*not to work*" during the pandemic, or returning to the traditional labor market participation structure will take time.

Further complicating the unemployment picture is the lack of upward momentum in the jobless rate despite sizable layoff announcements from corporate America including household names such as Meta, Salesforce, and Twitter. Of course, layoffs from Silicon Valley and other industries where a significant amount of employees are on work or tech visas may result in "*underreporting*" of the unemployment statistics in part because many of those employees are not eligible for unemployment benefits. Thus, indications of job destruction – depending on the specifics of the scenario such as the location and type of workers – may have a limited impact on the headline read of joblessness and somewhat overshadow the "*real*" progress policy is making toward increasing unemployment.

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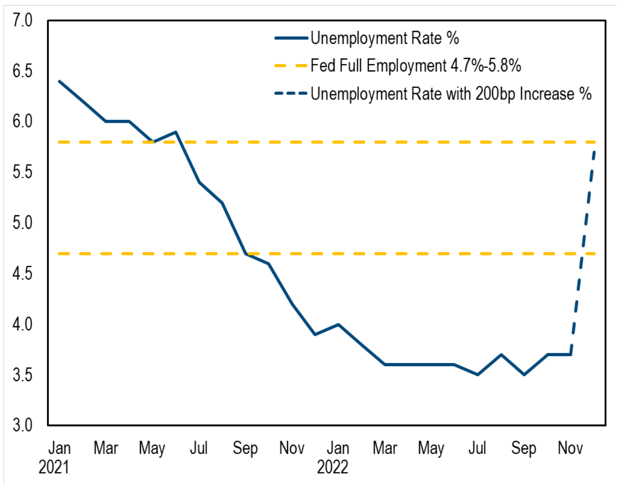
Looking forward, as layoffs continue to spread more rapidly across sectors of the economy, this will expectedly – eventually – translate into a more traditional upward trajectory in the unemployment rate. Additionally, as savings dry up and renewed fiscal stimulus falls short of expectations, at least some sidelined workers will presumably move back into the labor market, at least temporarily adding additional upward pressure to the unemployment rate as the pool of job seekers increases.

WAGE INFLATION

For now, with businesses facing 10.3 million vacancies in the labor market, reflecting a lack of able and willing bodies to fill the substantial level of job opportunities currently available, the cost of the increasingly scarce input – labor – remains elevated. While some businesses have turned to less traditional metrics to try to entice workers back into the office such as better healthcare, childcare, or even social gatherings – pizza parties or happy hours on Fridays – most are relying on the more traditional option of higher compensation.

After retreating slightly from 5.1% to 4.9% in October, average hourly earnings spiked 0.6%, double the rise expected. Year-over-year, wages rose 5.1% in November, a two-month high. The more recent backup in costs furthers the risk of igniting a wage-price spiral whereby higher wages force producers to raise prices, which forces employees to demand higher wages, which leads to higher prices and so on and so on. Additionally, the lack of clear downward directional momentum in costs as desired by the FOMC – and market participants alike – will only further underscore the lingering challenge to policy.

POLICY REMAINS FOCUSED ON INFLATION



Source: Bureau of Labor Statistics/Haver Analytics

Headline strength in hiring appears to be – at least somewhat – masking underlying weakness that is slowly emerging as the pace of job creation slows with some sectors already shedding jobs. Furthermore, while the unemployment rate remains near a five-decade low, several indications suggest the "*real*" unemployment rate may be markedly above the current 3.7% pace reported. Of course, if the unemployment rate were 100 or 200 basis points (bps) higher than currently reported, even at 5.7%, it would still be within the Fed's designated range of what is considered full employment, hardly the meaningful level of job destruction needed to tamp down wage pressures, which remain a key component of the broader inflationary story in the economy.

For the Fed, the latest read on labor market conditions, coupled with a larger-than-expected rise in wage growth, reinforces the need for policy makers to remain focused on taming inflation. Despite recent improvements in prices pressures retreating from earlier peak levels, there is still more work to be done. The Fed has insinuated a smaller rate hike may be appropriate next week and going forward to assess earlier policy initiatives; however, the terminal level of policy is likely to be notably above earlier forecasts, which have already been revised higher by 200 bps since March. Thus, the final Summary of Economic Projections (SEP) of the year could provide a further upward revision to the FOMC's current target level by another 100 bps (maybe more).

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[1] Employment estimates from the payroll survey are a count of jobs reported by employers. The household report provides an estimate of the number of persons employed through a self-reported survey.

[1] Recent layoffs announced by the tech industry include: Meta: about 11,000 jobs; Twitter: about 3,700 jobs; Lyft: around 700 jobs; Stripe: around 1,100 jobs; Coinbase: around 1,100 jobs; Shopify: around 1,000 jobs; Netflix: around 450 jobs; Microsoft: less than 1,000 jobs; Snap: more than 1,000 jobs; Chime: about 160 jobs.

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