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MARKET SIGHT LINES

Three Cracks in the Strong Labor Market

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The Federal Reserve (Fed) sets monetary policy in consideration of its dual mandate for maximum employment and stable prices. For some time, the economy has been out of balance, with a very strong labor market and higher inflation. As the Fed hiked rates to cool inflation, the labor market has remained strong. But some data from the last few months is signaling the job market may be weakening.

In this Sight|Lines, we summarize three cracks that are emerging in an otherwise strong job market.

THE TAKEAWAY: THE STRONG JOB MARKET WEAKENS … SOME.

Three key data series show that the strong job market has weakened some. In summary:

- Nonfarm payrolls continue to expand, albeit at a much slower pace than earlier this year and last year.
- The unemployment rate rose meaningfully in August.
- The number of job openings has fallen materially since the beginning of the year.

A very strong job market has contributed to an active consumer and a stronger-than-expected economy.

IN-DEPTH: THE JOB MARKET CONTINUES TO EXPAND, THE UNEMPLOYMENT RATE JUMPS, AND THE NUMBER OF JOB OPENINGS IS FALLING … SO, THE STRONG JOB MARKET WEAKENS SOME.

Three key data series show that the strong job market has weakened some. Going deeper:

- Nonfarm payrolls, which measures the number of workers in the U.S. (excluding farming, private households, proprietors, nonprofit employees, and active military), pace of expansions have slowed recently:
  - Nonfarm payrolls grew by 187,000 in August, above the 170,000 consensus estimate. However, the prior two months were revised lower by 110,000, a sign of a slowdown in hiring.
  - This measure averaged 183,000 from May-August 2023, much slower than the average of 289,000 from January-April 2023. And in 2022, on average, nonfarm payrolls grew by 412,000 each month.

    - The data reflects a slowdown in positive job growth momentum.
- Another closely watched data series is the unemployment rate:
    - This measure hit a historic low of 3.4% in January and has averaged 3.5% January-July.
    - In August, this measure jumped to 3.8% from 3.5% in the prior month.
    - The number of unemployed persons increased by 514,000, with most of those being people who have come back into the labor force.
    - This pattern is reflected in another broader measure of unemployment called U-6, which captures the total unemployed plus those who are underemployed, marginally attached to the labor force, and have given up looking for jobs. This figure jumped from 6.7% in July to 7.1% in August.
- The number of job openings has remained at high levels, but is falling:
    - The U.S. Bureau of Labor Statistics (BLS) reported 11.2 million job openings last December.
    - BLS reported a preliminary figure for July of 8.8 million, a decline of 2.4 million this year.
    - Consider the number of job openings to the number of unemployed. Last July, this ratio sat at 2.0, or the idea that there were two jobs for every person looking for work. That reflects a tight job market. In July, this ratio fell to 1.5, and given a trend of fewer job openings and higher unemployment, we expect this ratio to fall further in August.

Given a very strong job market, the U.S. consumer remains active and confident, translating to better-than-expected economic growth. But we've seen three cracks developing in the strong job market, which should ease inflationary pressures further and may translate to a slowing economy.

CONCLUSION

The Fed has been focused on its dual mandate, hiking rates to cool inflation while keeping an eye on a very strong job market. In fact, our central bank has sought to soften the job market, as a tight job market is known to contribute to inflationary pressures. And over the last few months, we've seen three cracks develop in the strong job market, which may allow the Fed not to hike rates further.

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