



Employment report

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EY Parthenon
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Labor market at critical juncture

- ▶ The weak July jobs report points to a material deterioration in labor market conditions, in line with several other labor market indicators. The economy added a weaker-than-expected 114,000 jobs last month with job gains concentrated in health care, leisure and government. Wage growth eased markedly to 3.6% while hours worked fell 0.3% to a post-recession low. The closely watched unemployment rate rose 0.2 percentage point (ppt) to 4.3%, its highest level since October 2021.
- ▶ The softness in payrolls was concentrated in the services sector with employment falling across the information, finance, and professional and business services sectors. Health care employment contributed more than half of the total jobs gain despite posting its weakest gain since December 2022. Goods employment rose, solely driven by stronger construction hiring as manufacturing payrolls barely increased. Government payrolls saw a modest increase, reflecting stronger local education jobs.
- ▶ The unemployment rate rose 0.2ppt to 4.3%, triggering the Sahm rule and reaching its highest level since October 2021 – well above its post-pandemic low of 3.4% in April 2023. While the recent uptrend is concerning and points to a pickup in layoff activity, it also partly reflects the fact that more people are entering the labor force and joining the ranks of the unemployed.
- ▶ Indeed, the labor force participation rate rose 0.1ppt in July to 62.7%, slightly below its cycle high of 62.8%. Importantly, the participation rate for prime-age workers (those aged 25 to 54) rose from 83.7% to 84%, the highest level since March 2001.
- ▶ Wage growth eased in July, signaling weaker employee bargaining power and wage growth compression efforts. Average hourly earnings grew a modest 0.2% month over month, and wage growth eased 0.2ppt to 3.6% year over year – the slowest pace since May 2021 and a pace in line with the pre-pandemic peak of February 2019. Wage growth is arguably below the pace consistent with the Fed's 2% inflation target given productivity growth is hovering around 2.5%. And leading indicators, such as the quits rate, point to further moderation.
- ▶ Overall, the labor market is sending some concerning signals. Other cracks have been apparent across a wide array of labor market data, including falling quits and hiring rates, declining hours worked, and a visible uptrend in unemployment claims. Against this backdrop and given fresh evidence of receding labor cost pressures, the case for an imminent start to the easing cycle is very strong.
- ▶ With the Federal Reserve increasingly attuned to the risk of an unnecessarily sharp labor market slowdown and Fed Chair Jerome Powell stating this week that he doesn't want to see the labor market weaken materially, the die is cast for a September cut. Still, today's data will bolster concerns that the Fed has fallen behind the curve. Markets are now pricing in more than four rate cuts by year-end and over 80% odds of a rate cut of 50 basis points in September.



In the details

Private employers curbed their hiring in July and added only 97,000 jobs, following a 136,000 gain in June. Factoring the downward payroll revisions in May and June, the private sector added an average of 146,000 jobs over the past three months, the slowest pace since January 2021.

Job growth was significantly less broad-based with the employment diffusion index – a measure of how many private sector industries are adding jobs – declining to 50%, which is the lowest level for this measure outside of the pandemic recession since May 2016. The three key engines of job creation – health care and education, leisure and hospitality, and government – continued to drive job growth in July, but at a slower pace. Together, they added a total of 97,000 jobs last month, compared to 123,000 in June.

The health care and social assistance sector continued to add jobs at a solid pace, with employment in the sector rising by a robust 64,000. Employment of educational workers fell by 7,000 in July and has been trending lower since January, with 23,000 fewer educational workers employed in July than at the start of the year. Meanwhile, employment in the retail sector rose by only 4,000 as slower consumer demand and a more cautious stance from retailers is curbing hiring efforts.

Employment in the leisure and hospitality sector saw a moderate 23,000 increase in payrolls following a 1,000 gain in June. Within leisure and hospitality, the advance was mostly driven by a 20,000 increase in employment at food and drinking places – a sign that consumers are still dining out even if some may be trading in expensive restaurant meals for less expensive dining options.

The professional and business services sector surprised on the downside with a 1,000 contraction in payrolls that comes on the heels of a mere 2,000 gain in the prior month. The overall services payrolls gain was further restrained by payroll declines in information and finance, which shed 20,000 jobs and 4,000 jobs, respectively.

On the goods front, the 25,000 advance in employment was entirely driven by stronger construction employment, which climbed by 25,000, while manufacturing payrolls barely grew and mining employment slightly fell. Factory hiring has remained sluggish over the past year as soft global activity, tight lending standards and still high real interest rates continue to weigh on the sector.

Government employment made a modest contribution to the overall employment gain by adding 17,000 jobs in July, in line with the 18,000 average job gain over the prior three months. The increase was led by a 26,000 increase in local educational employment, which received a boost from positive seasonal factors as fewer teachers than anticipated fell off the payrolls for the summer months. Still, the gain was offset by weaker employment in other local government occupations.

Looking ahead, we expect the labor market to maintain enough positive momentum to carry the consumer throughout the rest of the year, though the risks to the labor market and consumer outlook have risen. The combination of softer consumer demand, reduced pricing power and lower profitability will lead companies to maintain a cautious approach with hiring and wage increases, with job growth likely to maintain a below trend pace heading into 2025 and the unemployment rate likely to rise further toward 4.5% by year-end.

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