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Economics Group

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Labor Market Still Strong, But That's Not the Fed's Concern

Overall the labor market is holding up, even if the pace of improvement is slowing. Employers added 164K jobs in July, while the unemployment rate was unchanged at 3.7% amid stronger participation. Wages rose 0.3%.

Labor Market Continues to Improve

At its meeting earlier this week, the FOMC characterized the labor market as "strong" and the July payroll report did nothing to dissuade that view. Employers added 164K jobs in July, nearly spot on with expectations.

Usually that would be a sufficient number of jobs to chip away at the unemployment rate, but the jobless rate remained at 3.7% as labor force participation edged up again. While the headline "U-3" unemployment rate remains a tick higher than its low of the current cycle, broader measures signal the labor market continues to tighten. The "U-6" measure, which includes workers marginally attached to the labor force and part-time workers who want full time work, fell to a new cycle low of 7.0%.

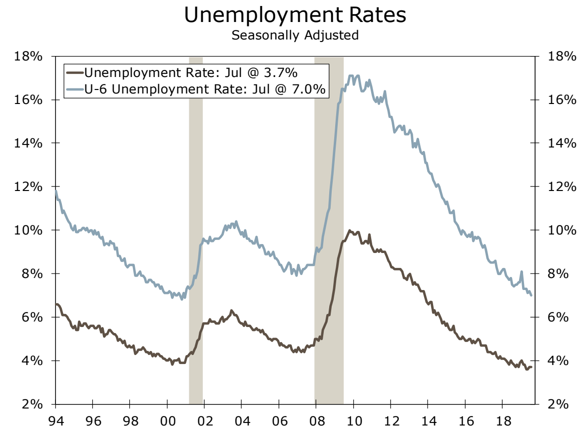
Further tightening in the labor market, however, will be gradual as the pace of job growth has slowed. Not only was July's 164K gain in payrolls down from June, but both June and May's gains were revised lower by a total of 41K jobs. That puts the three- and six-month averages of job growth around 140K, well below last year's average of 223K jobs.

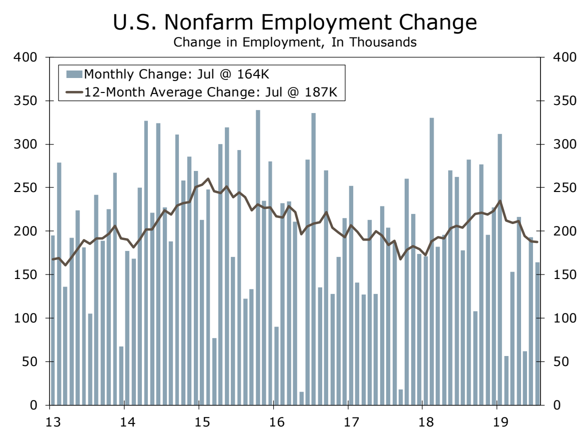
Somewhat surprisingly, manufacturing payrolls rose 16K in July, although that may have been boosted in part by seasonal effects at automakers. Given global headwinds, we would expect factory payrolls to lose steam in subsequent months. Service sector hiring eased up in July, with renewed weakness in transportation. Retailers and information firms cut jobs, but hiring in professional & business services and healthcare continued at a solid pace.

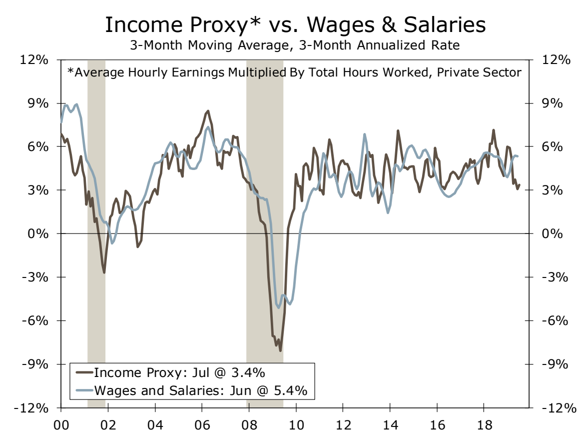
Average hourly earnings rose 0.3%, improving the 12-month change to 3.2%. That pace remains within the range of the past year, where earnings growth looks likely to stay in the near term. The share of small businesses planning to raise compensation fell to nearly a two-year low in July. More tariffs may threaten wage growth by squeezing businesses' costs.

Consumers are expected to do the heavy lifting for growth in the second half of the year as investment and trade are hampered by the ongoing trade war. Growth in labor income, however, suggests spending may moderate. While average hourly earnings ticked up in July, a decline in the average workweek and a slowing trend in job growth likely weighed on aggregate labor income. Tariffs of 10% on about $300 billion more goods—almost entirely on finished consumer goods this round—may further crimp that purchasing power.

Although the labor market's gains might not be as impressive as last year, overall job and income growth are holding up. But the labor market is not the Fed's primary concern at the moment. With wage growth showing few signs of sending inflation much above the current rate and trade-related uncertainty threatening to dent confidence, we still expect the FOMC will increase policy accommodation over the next few months.







Source: U.S. Department of Labor, U.S. Department of Commerce and Wells Fargo Securities

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