Datanote: US Employment Report, February

In one line: A snapshot of a prior age, before the shift in federal government policies undermined confidence.

- February payrolls rose by 151K, slightly below the consensus, 160K. The two-month net revision was -2K.
- The unemployment rate increased to 4.1%, from 4.0%, above the consensus, 4.0%.
- Average hourly earnings rose by 0.3%, in line with the consensus, 0.3%. Net revisions were

-0.11%.

February's data provide more evidence of solid private sector demand for labor, before the spike in economic policy uncertainty caused a sharp fall in business and consumer confidence. The 151K increase in payrolls was only slightly smaller than the 177K average rise in the previous six months, and the government was entirely responsible for that shortfall. Private payrolls excluding private education and healthcare rose by 67K, slightly above last year's average 47K increase. The 19K increase in construction payrolls indicates that fears that more frequent immigration spot checks at worksites would lead to labor shortages were overdone, and is consistent with our analysis that January payrolls were weighed down modestly by adverse weather.

The 11K increase in government payrolls was the smallest since April and well below the 35K average rise in the previous six months. Federal payrolls dropped by 10K, mostly reflecting the commencement of the hiring freeze in late January. The hit to payrolls from layoffs of federal employees instigated by DOGE likely lies almost entirely ahead. The reference period for February data was employers' pay period including the 12th of the month and most federal employees are employed on a bi-monthly basis, so they still counted on payrolls as long as they did some paid work on Monday 3rd or later. Meanwhile, state and local government education payrolls rose by 5K, continuing to show that the sector has been largely unaffected by some post-pandemic catch-up funding elapsing in late 2024.

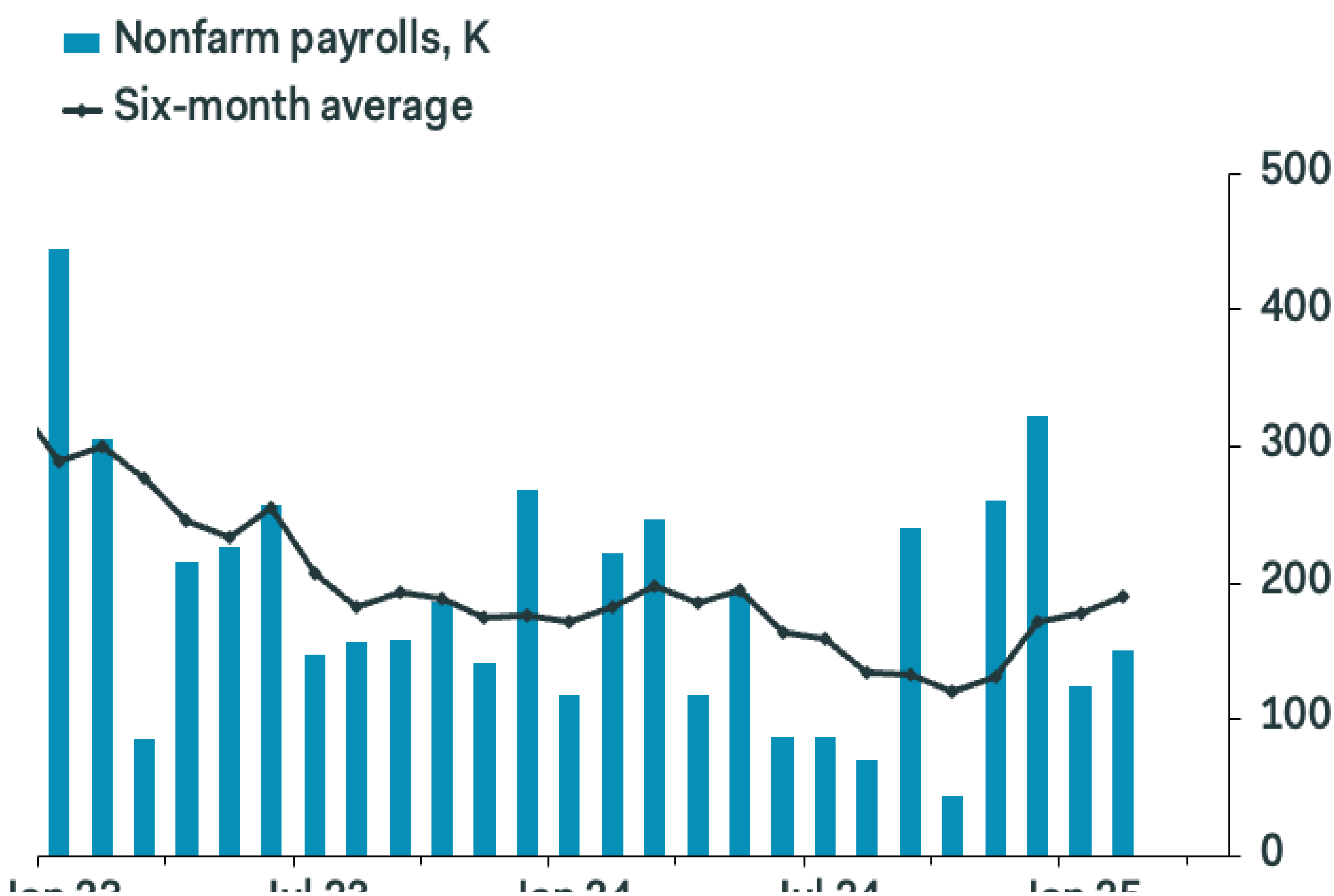
This time, we see little to suggest that recent payroll growth will be revised sharply downwards. The February seasonal was slightly less generous than in previous years, though that evolution looks warranted by underlying shifts in the unadjusted data. The response rate for the first estimate was relatively low at 68%, but it is no longer falling and revisions have been evenly balanced over the last six months.

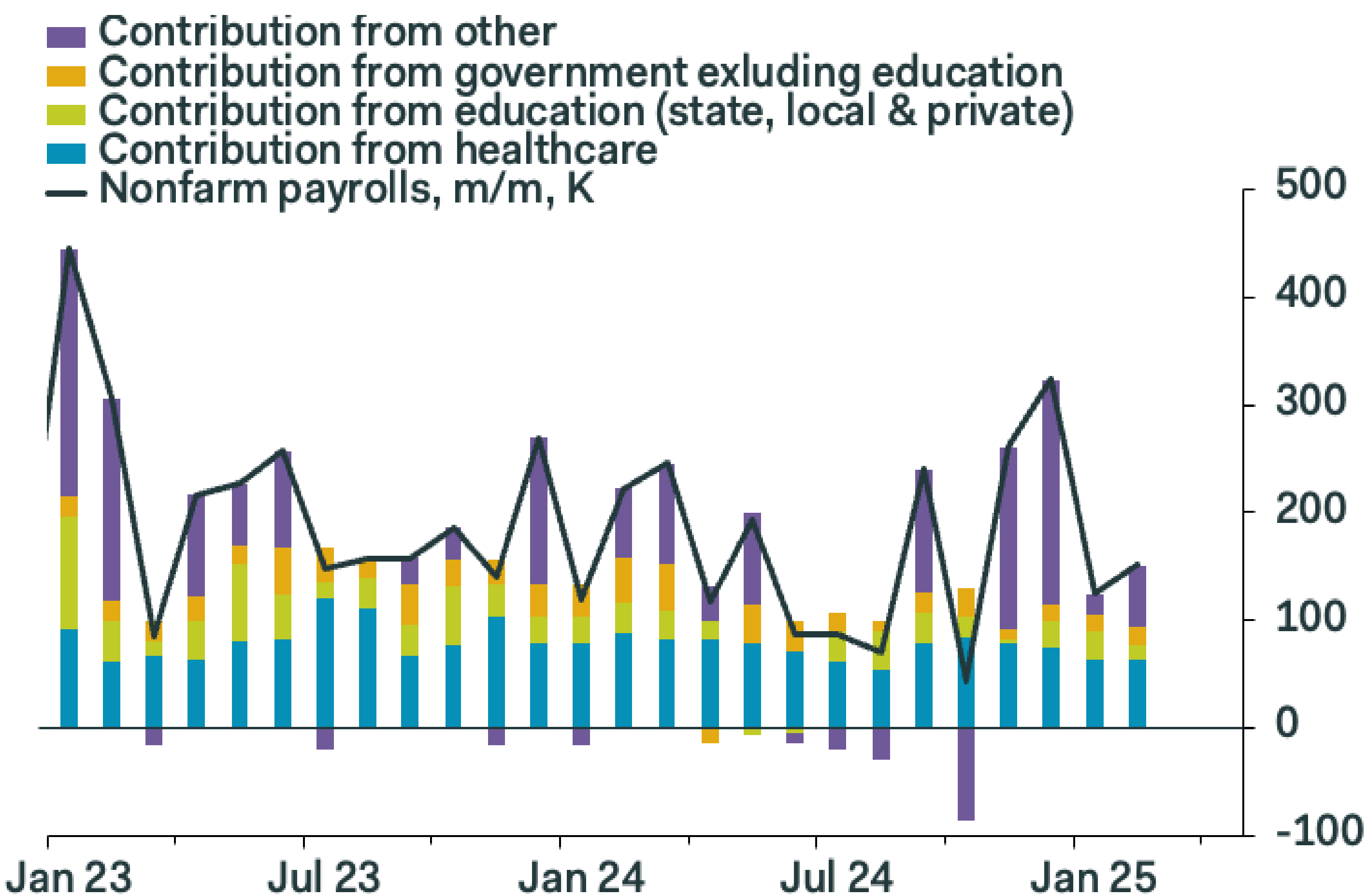
Meanwhile, the 0.1pp rise in the unemployment rate is statistically insignificant, as are most month-to-month changes in the household survey metrics, given its tiny sample size. Nonetheless, both WARN and Challenger data point to a further rise in private sector layoffs to come in March, and growing anxiety in the consumer confidence surveys about the future health of the labor market usually is a reliable sign of rising joblessness to come too. Accordingly, we continue to think that the unemployment rate will trend up to about 4.5% by the end of this year, pressuring the Fed to ease policy.

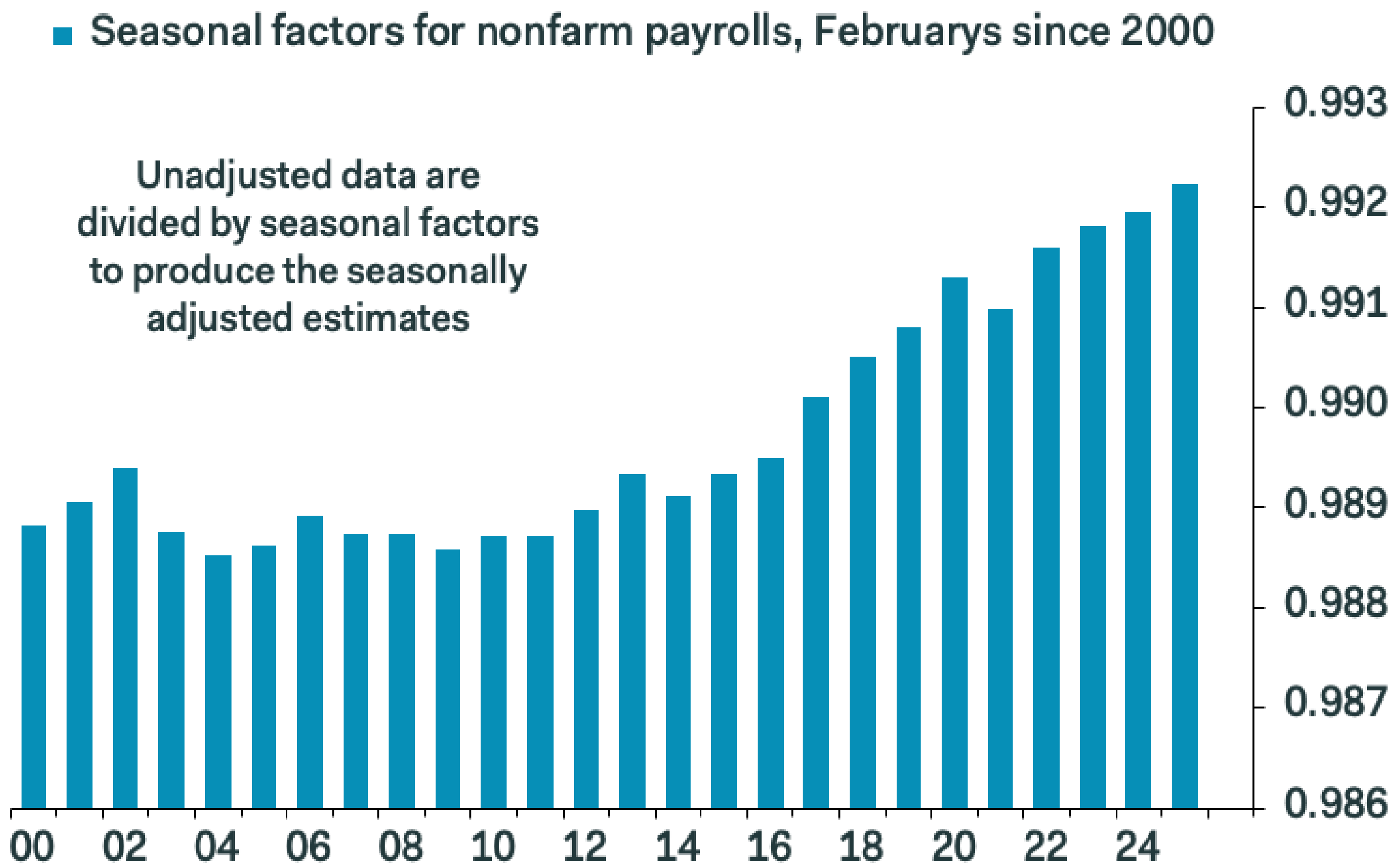
Elsewhere, the relatively muted 0.28% gain in average hourly earnings—along with the downward revision to January's growth in AHE, to 0.42% from 0.48%—provides some reassurance that underlying wage growth remains fairly weak. Stronger wage growth in January at least partly reflected a dip in hours worked, as heavy snowfall prevented many employees from making it to work. Hours worked did not tick back up last month, probably because the weather remained poor and prevented roughly the same number of workers from making it to work. That indicates a strong chance of even softer wage growth in March. Year-over-year growth in AHE edged up to 4.0% in February, from 3.9%, but that partly reflects base effects linked to a small 0.20% increase in February 2024. The slight reacceleration in wage growth late last year now looks far more like just noise in the numbers.

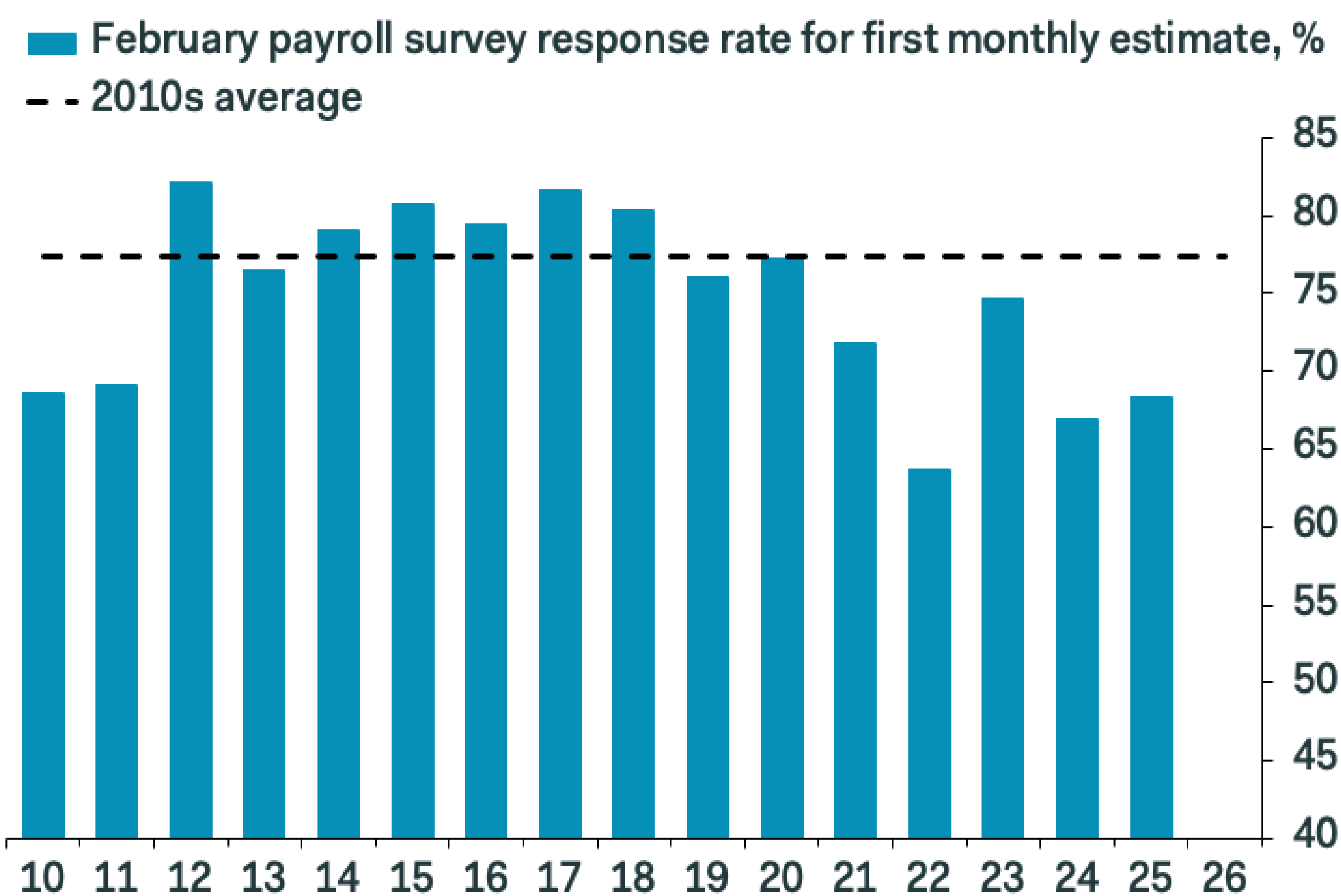
In any case, the only measure of wage growth that the Fed takes seriously is the mix- and sector-adjusted employment cost index, which continued its gradual slowdown in Q4. Moreover, the most reliable leading indicators of underlying wage growth since the pandemic—such as the JOLTS quits rate—still indicate a further slowdown over the next few quarters.

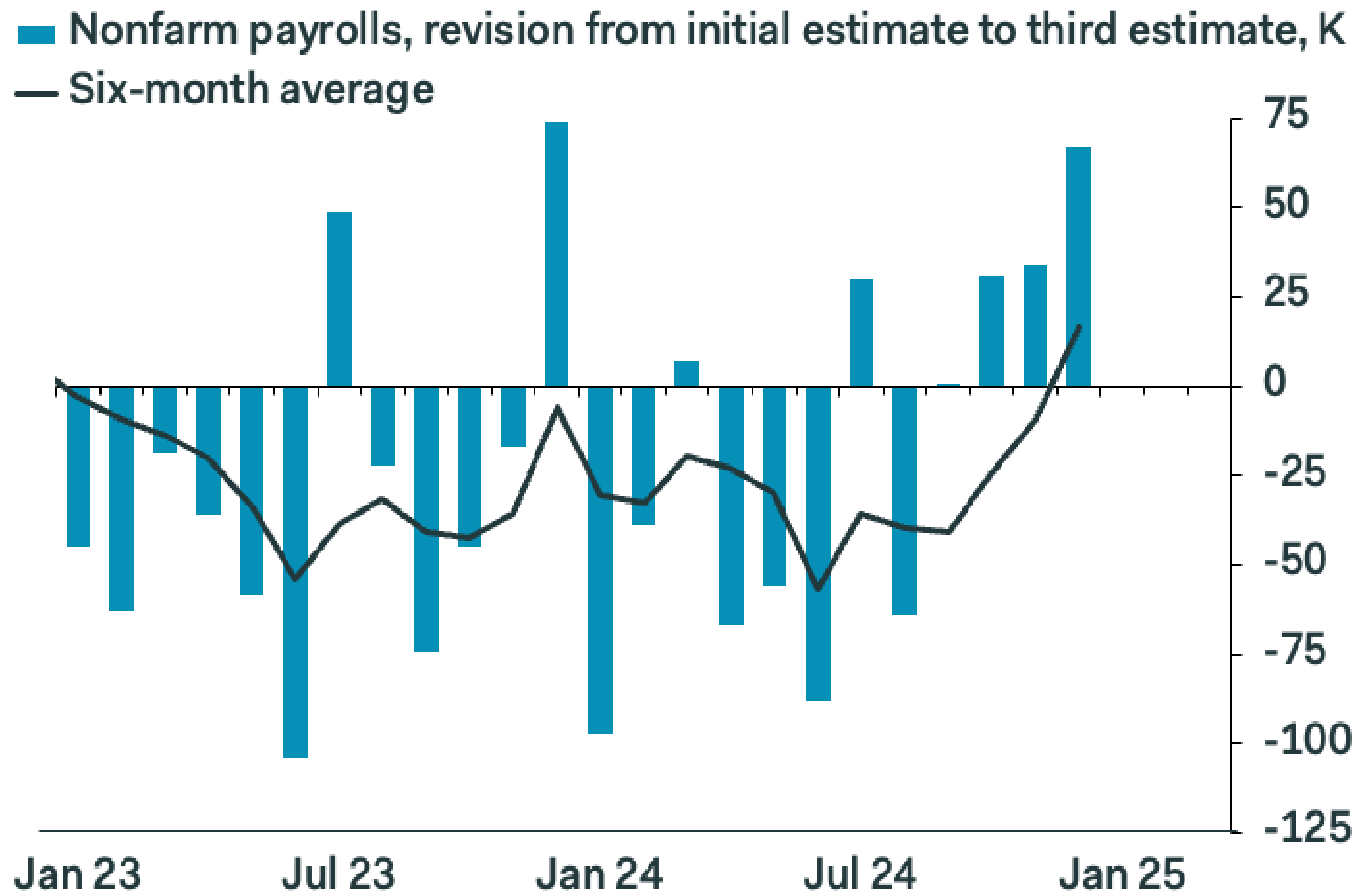
Looking ahead, however, we continue to expect growth in payrolls to slow to a 100-to-125K range in Q2 and Q3. Businesses will respond to extraordinarily high economic policy uncertainty by pausing hiring and investment. The cost of external finance also remains a big headwind to expansion for many firms, especially small businesses that have to pay 9% interest on short-term bank loans. These pressures emerged in the S&P Global composite PMI survey and most of the regional Fed surveys for February. Note too that the hiring intentions index of the NFIB Small Business Survey fell by three points to +15 in February and has returned to its October level, despite the strong Republican sympathies of the panelists. Meanwhile, the three-year long period of catch-up growth in healthcare payrolls—which accounted for 45% of overall payroll growth in 2024—looks set to draw to a close, now that the ratio of JOLTS job postings to employment in the sector has returned to its pre-Covid norm. Meanwhile, federal payrolls likely will fall at a faster rate in March, given that most comprehensive tallies of federal employees laid off as part of the DOGE cost-cutting drive stand a little above 30K, and Challenger reported 62K total layoffs across all government. Accordingly, we continue to think that the FOMC will ease policy by 75bp this year, starting in June, though an earlier easing in May will be on the table if business and consumer confidence continues its precipitous descent.


Nonfarm payrolls, K
Six-month average
500
400
300
200
100
0

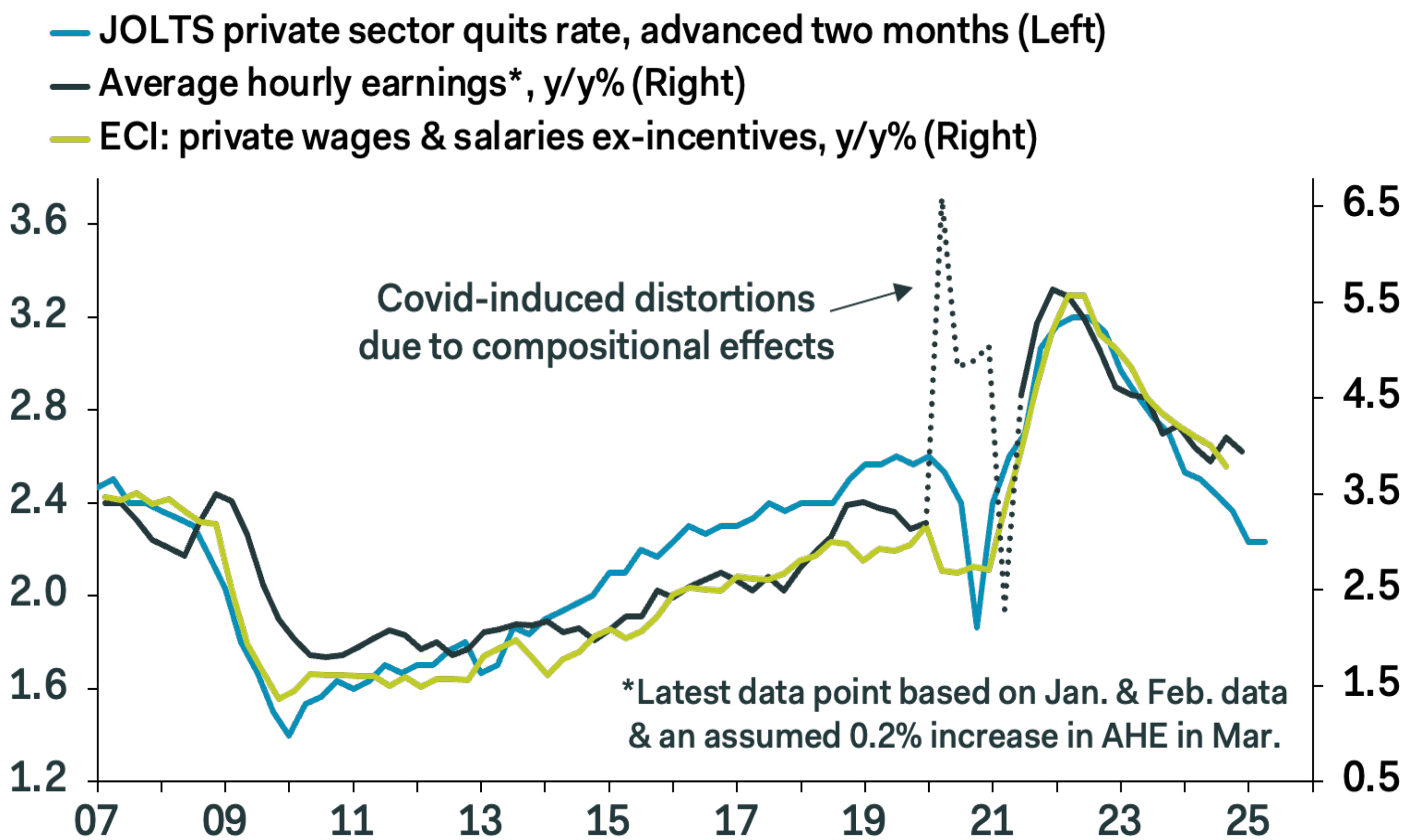

Contribution from other
Contribution from government exluding education
Contribution from education (state, local & private)
Contribution from healthcare
Nonfarm payrolls, m/m, K
500
400
300
200
100
0
-100
Jan 23
Jul 23
Jan 24
Jul 24
Jan 25


Seasonal factors for nonfarm payrolls, Februarys since 2000
Unadjusted data are divided by seasonal factors to produce the seasonally adjusted estimates
0.993
0.992
0.991
0.990
0.989
0.988
0.987
0.986
00 02 04 06 08 10 12 14 16 18 20 22 24


February payroll survey response rate for first monthly estimate, %
2010s average
85
80
75
70
65
60
55
50
45
40
10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26


Nonfarm payrolls, revision from initial estimate to third estimate, K
Six-month average
75
50
25
0
-25
-50
-75
-100
-125
Jan 23
Jul 23
Jan 24
Jul 24
Jan 25


Unemployment rate, %
4.4
4.2
4.0
3.8
3.6
3.4
3.2
Jan 22
Jul 22
Jan 23
Jul 23
Jan 24
Jul 24
Jan 25


JOLTS private sector quits rate, advanced two months (Left)
Average hourly earnings*, y/y% (Right)
ECI: private wages & salaries ex-incentives, y/y% (Right)
Covid-induced distortions due to compositional effects
*Latest data point based on Jan. & Feb. data & an assumed 0.2% increase in AHE in Mar.
3.6
3.2
2.8
2.4
2.0
1.6
1.2
6.5
5.5
4.5
3.5
2.5
1.5
0.5
07
09
11
13
15
17
19
21
23
25