PANTHEON MACROECONOMICS

Datanote: US Employment Report, July

In one line: This week's Fed inaction was a mistake; the case for 50bp in September is strong.

- July payrolls rose 114K, below the consensus, 175K. The net revision was -29K.
- The unemployment rate increased to 4.3%, from 4.1%, well above the no-change consensus.
- Average hourly earnings rose by

0.2%, below the consensus, 0.3%. The net revision was -0.03%.

July’s poor employment report leaves the Fed looking woefully behind the curve with its decision to hold rates this week, and suggests that the outcome of September's meeting now is finely balanced between 25bp and 50bp easings. Private payrolls rose by just 97K—the least since March 2023—and private payrolls excluding private healthcare and education rose by a mere 40K, dragging down the three-month average growth rate to its lowest pace since Covid. The weakness was broad-based and unattributable to one-time factors, such as the weather: the long-lagged effect of excessively tight monetary policy is to blame.

Admittedly, just 57% of businesses in the BLS' sample responded in time for the first estimate, well below the 68% average of the previous 10 Julys, so revisions could be large. Revisions have been biased downwards lately—the latest estimate average payroll gains in the 12 months to June is 26K lower than the initial estimate—perhaps because struggling businesses are slower to respond.

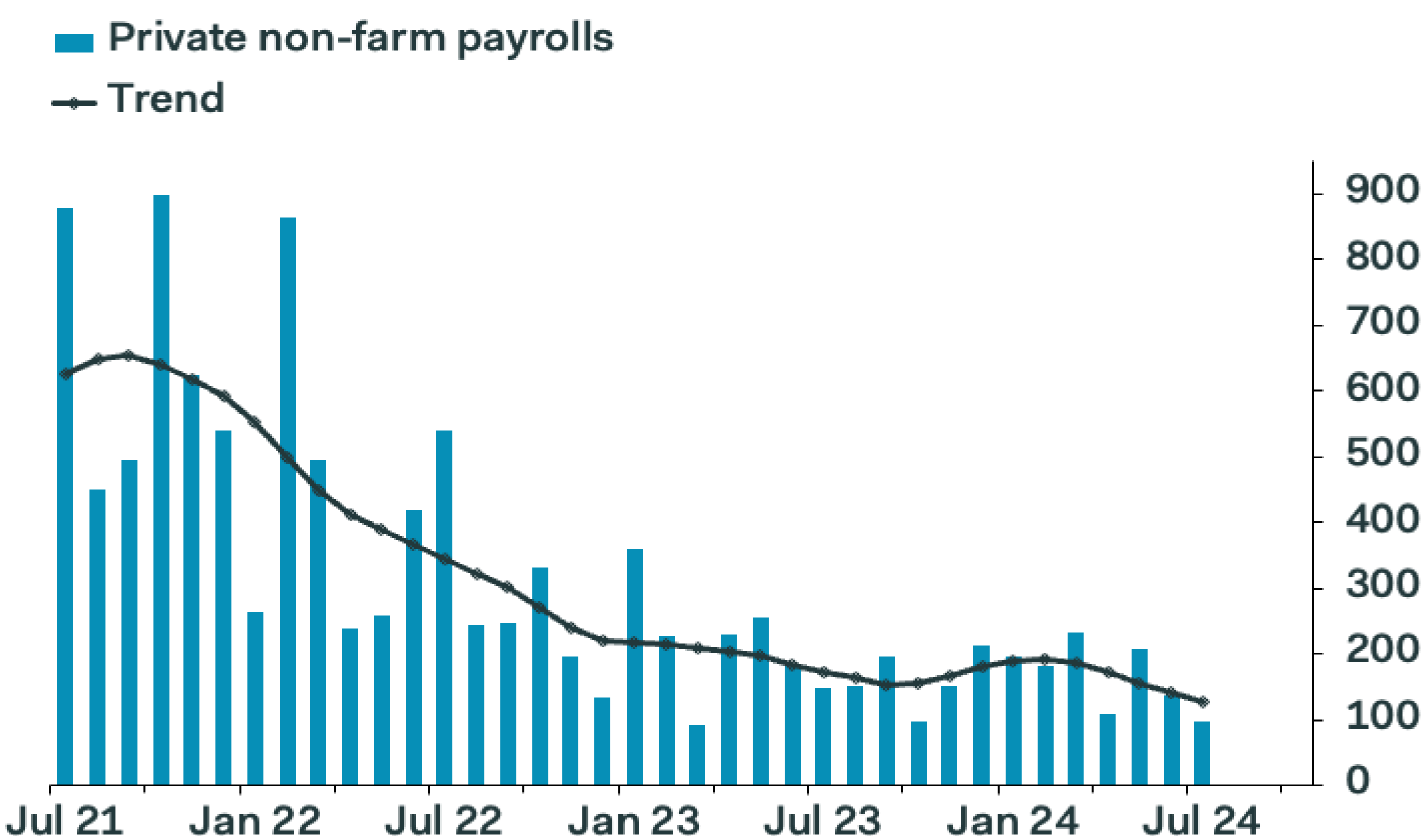
Looking ahead, we expect the trend in job growth to continue to deteriorate. NFIB hiring intentions remain consistent with a further slowdown in growth in private payrolls, even though it has recovered a bit since the spring. In addition, jobless claims have picked up over recent weeks, job openings are back to pre-Covid norms, and households have become more fearful that unemployment will rise. The real interest rate for corporate borrowing now is so high that an intense round of cost-cutting, including layoffs, likely lies ahead. Meanwhile, growth in state and local government revenues has petered out, signalling a stalling in government hiring.

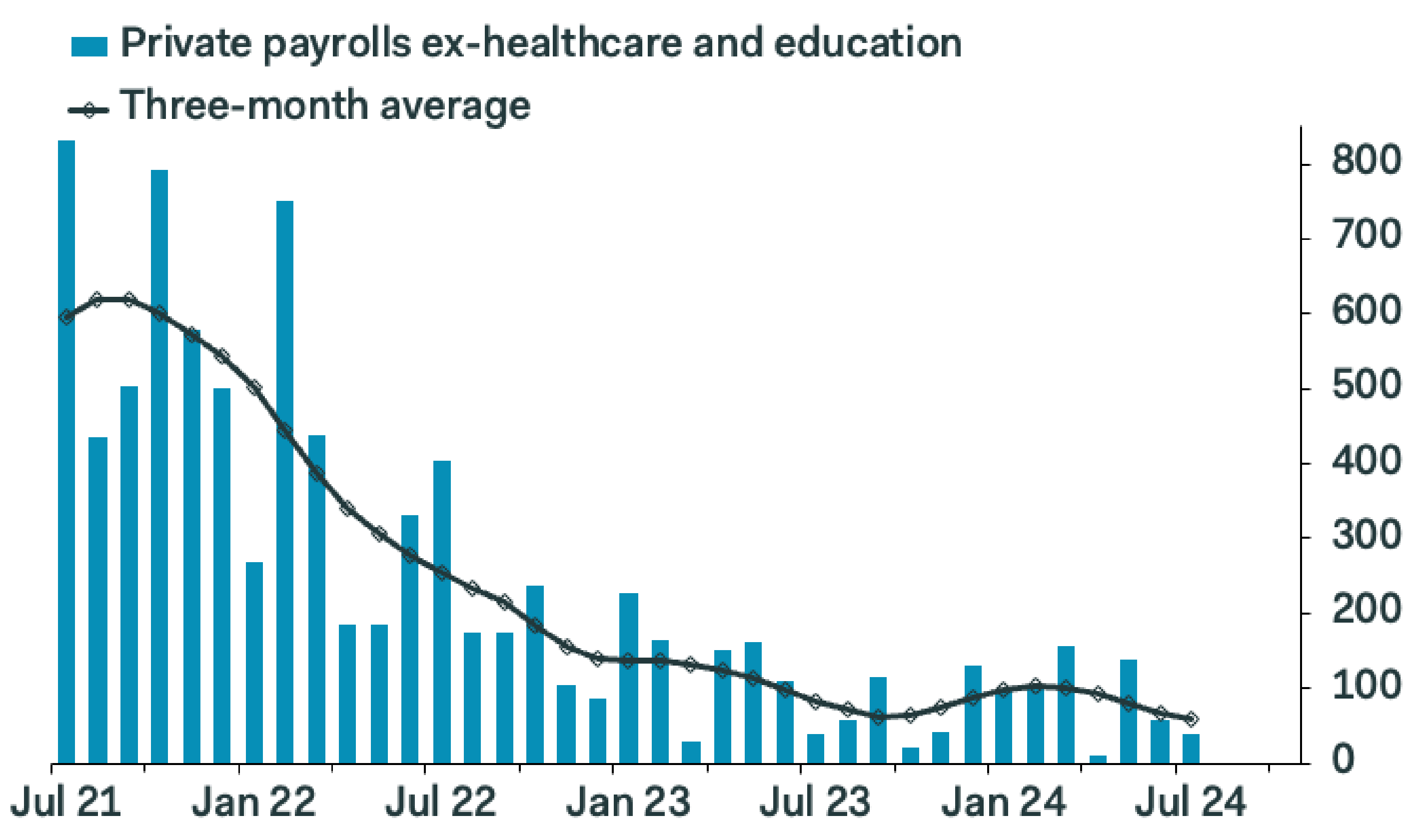
The 0.6pp increase in the unemployment rate over the last six months passes the threshold for statistical significance at the 90%

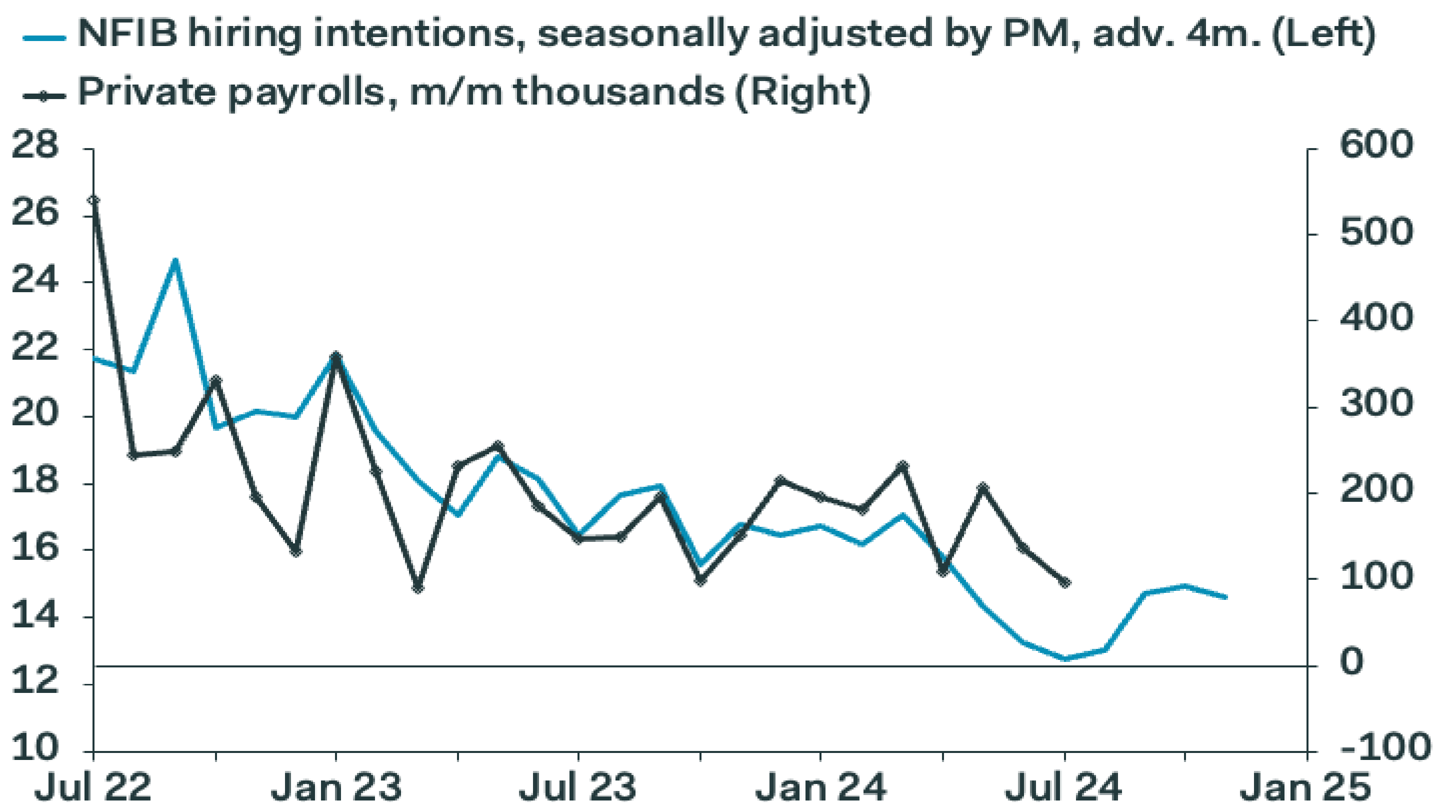
confidence level, and the 0.5bp increase in its three-month average from its low in the previous 12 months means that the Sahm rule has been triggered. The rule observes that a recession usually has begun when the unemployment rate has increased by 0.5pp on that basis. We doubt that the economy is in recession now, given that the increase in the unemployment rate has been driven by rapid growth in the workforce and much slower - but not negative - employment growth, rather than mass layoffs. Nevertheless, the labor market no longer is tight, and a further rise in the unemployment rate from here would lift it materially above the Fed's estimate of its long-term neutral rate, 4.2%, which in turn would be consistent with below-target inflation pressures. Remember too that the June SEP showed unemployment flat at 4.0% through the end of this year; we said at the time that this forecast was preposterous, and so it has proved, in just two months.

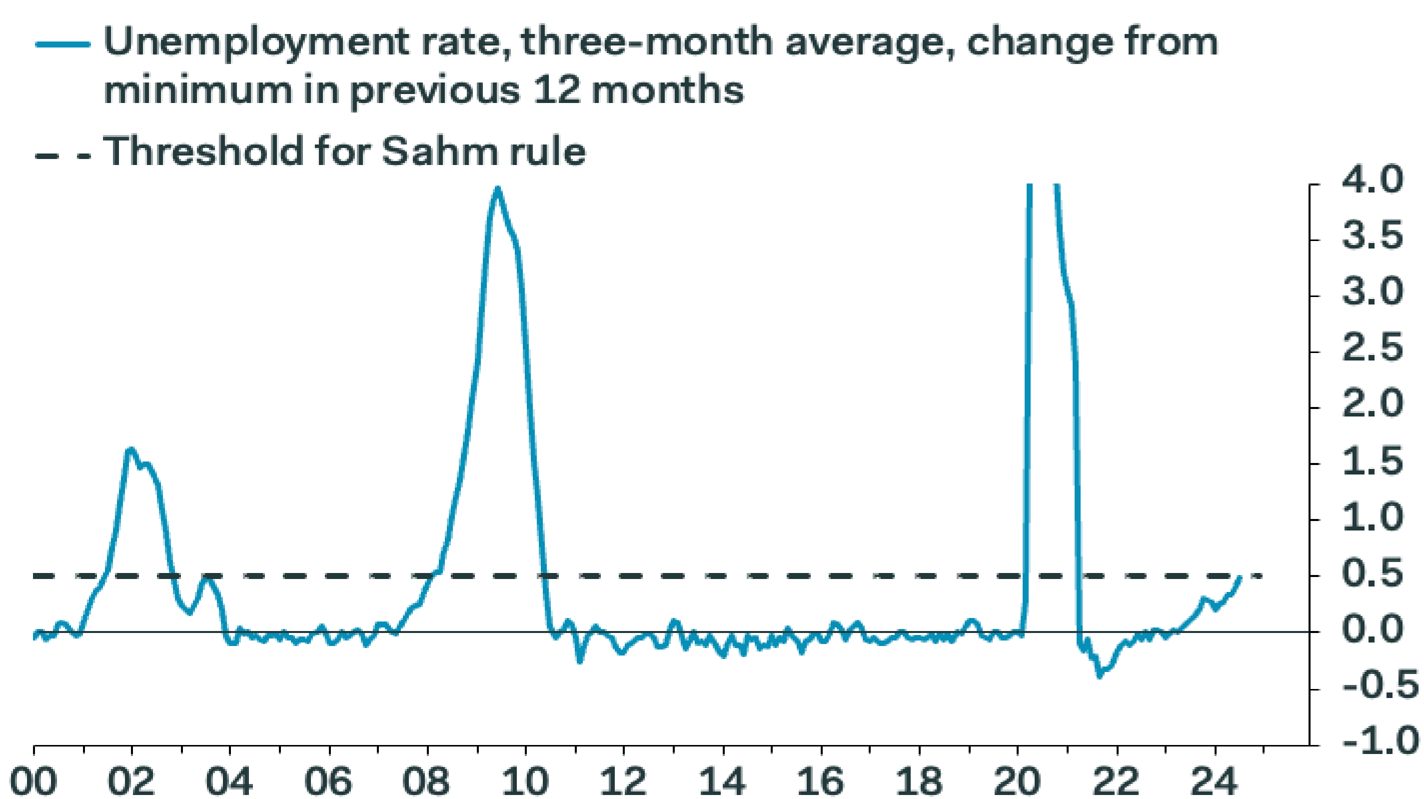
Meanwhile, the subdued increase

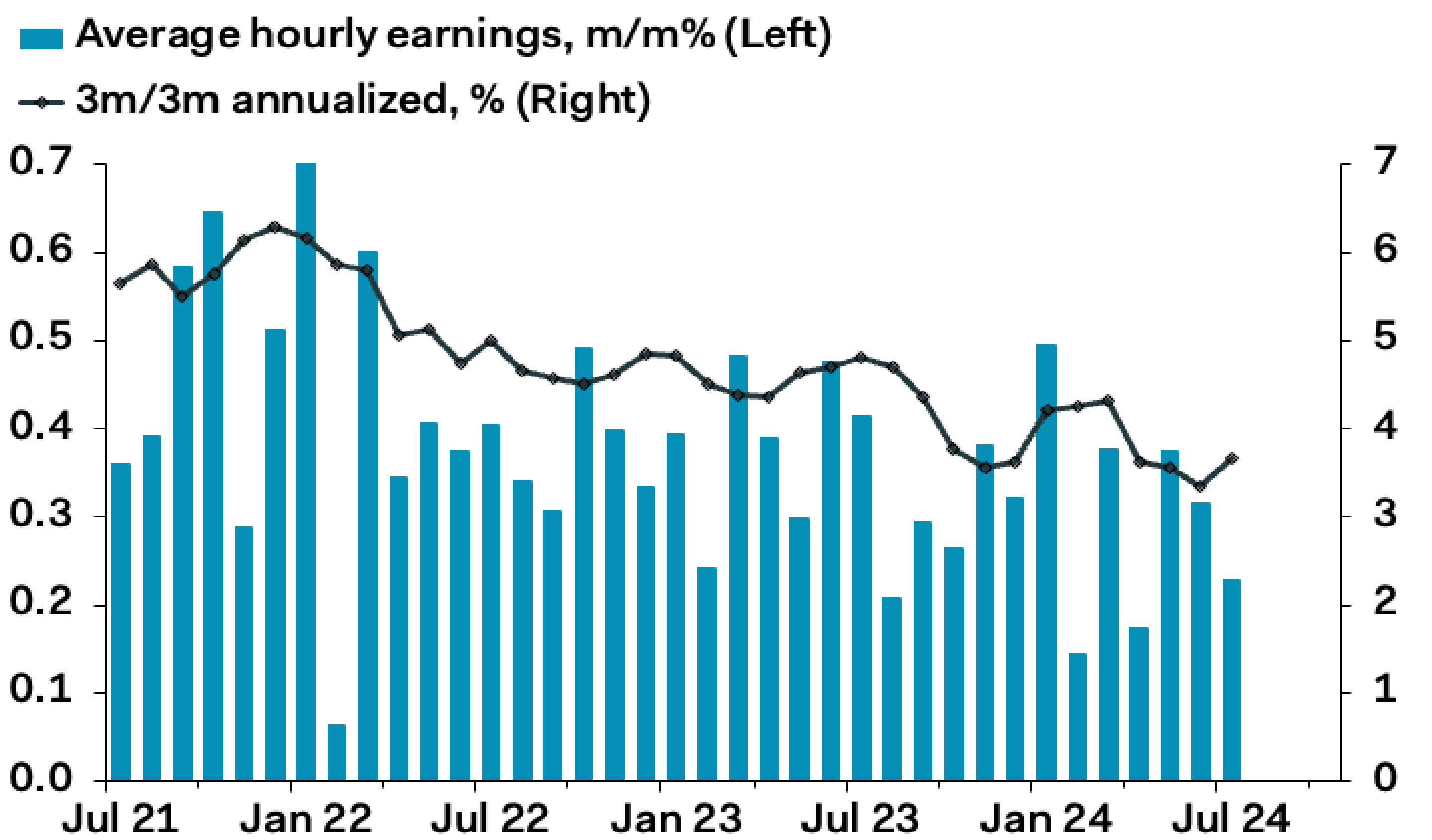
in average hourly earnings likely is partly the product of a long-standing calendar quirk. The level of AHE usually is depressed if the 15th—pay day for employees paid semi-monthly—is on Monday or Tuesday after the payroll survey week. Employers should report pay earned for any work done in the survey week, regardless of when the employee is paid, but in practice some firms report only wages paid during the reference week. We expect an above-trend 0.4% increase in AHE in August, as this calendar quirk reverses. Don't forget, too, that the AHE data are not mix-adjusted and often revised substantially, so the Fed will welcome July’s print only tentatively. Nevertheless, the further slowdown in unit labor cost growth in the first half of this year, the soft Q2 ECI, and the emergence of more labor market slack since then, means the Fed should have few concerns now about sticky inflation pressures.


Private non-farm payrolls
Trend
900
800
700
600
500
400
300
200
100
0
Jul 21
Jan 22
Jul 22
Jan 23
Jul 23
Jan 24
Jul 24

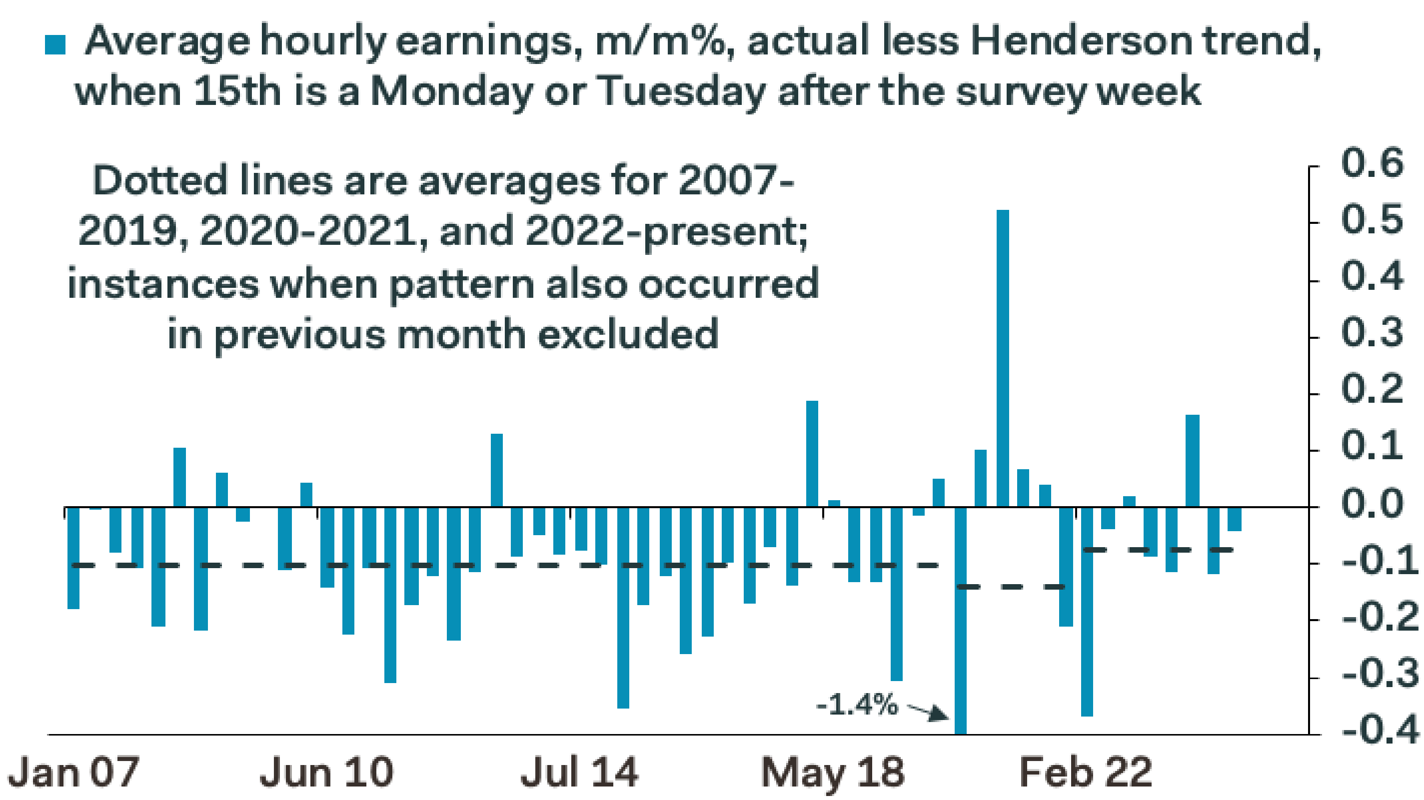

Private payrolls ex-healthcare and education
Three-month average
800
700
600
500
400
300
200
100
0
Jul 21
Jan 22
Jul 22
Jan 23
Jul 23
Jan 24
Jul 24


NFIB hiring intentions, seasonally adjusted by PM, adv. 4m. (Left)
Private payrolls, m/m thousands (Right)
28
26
24
22
20
18
16
14
12
10
600
500
400
300
200
100
0
-100
Jul 22
Jan 23
Jul 23
Jan 24
Jul 24
Jan 25


Unemployment rate, three-month average, change from minimum in previous 12 months
Threshold for Sahm rule
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
-0.5
-1.0
00
02
04
06
08
10
12
14
16
18
20
22
24



Average hourly earnings, m/m% (Left)
3m/3m annualized, % (Right)
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0.0
7
6
5
4
3
2
1
0
Jul 21
Jan 22
Jul 22
Jan 23
Jul 23
Jan 24
Jul 24



Average hourly earnings, m/m%, actual less Henderson trend, when 15th is a Monday or Tuesday after the survey week
Dotted lines are averages for 2007-2019, 2020-2021, and 2022-present; instances when pattern also occurred in previous month excluded
0.6
0.5
0.4
0.3
0.2
0.1
0.0
-0.1
-0.2
-0.3
-0.4
-1.4%
Jan 07
Jun 10
Jul 14
May 18
Feb 22