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US Labor market: Cracks beneath the surface

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Employment change (thousands, unless otherwise noted)	Feb 23	Jan 23	Dec 22	Nov 22	Oct 22
Unemployment rate (%)	3.6	3.4	3.5	3.6	3.7
Avg. hrly earn all (Monthly % Chg)	0.2%	0.3%	0.4%	0.4%	0.4%
Avg. wkly hour all (Monthly % Chg)	0.0%	0.9%	0.1%	0.1%	0.4%
Nonfarm employment	311	504	239	290	324
Total private	265	386	232	228	299
Goods-producing	20	51	36	41	57
Construction	24	35	26	19	17
Manufacturing	-4	13	6	14	37
Priv. Serv providing	245	335	196	187	242
Wholesale trade	11	9	10	0	16
Retail trade	50	34	27	-46	-6
Transp. & Warehousing	-22	16	0	-37	20
Information	-25	-20	-9	13	3
Financial	-1	5	4	11	18
Business services	45	53	23	0	36
Temporary help	7	15	-55	-49	10
Education, health	74	107	71	95	85
Leisure, hospitality	105	114	58	123	61
Government	46	118	7	62	25
Federal Government	7	7	1	2	4

Source: Haver Analytics

- Following a blowout start to the year, the US labor market lost momentum in February, and revealed signs that suggest a further slowing is in store ahead. The 311K jobs gained were above the 225K expected by the consensus, and miles above the 100K pace that Powell has cited as being consistent with sustainably on-target inflation, but the upside was partly negated by a negative 34K revision to the prior two-month job tally. Beneath the surface, wage growth slowed to 0.2% m/m (vs. 0.3% expected), the unemployment rate ticked up to 3.6% (vs. 3.4% expected), and aggregate hours worked dropped by 0.1%. With a strong headline employment gain contrasted with a deterioration in the detail, next week's CPI report will be key for tipping the scales on a 25 or 50bp hike at the March FOMC.
- Job gains were helped by the tick up in the participation rate, with the leisure and hospitality sector leading the charge. Although headcounts in that industry are still 410K below pre-pandemic levels, slower demand for discretionary services ahead as higher interest rates weigh on demand should help bring the sector into better balance. Hours worked for both supervisory and production employees dropped sharply in February, a sign that

demand could have dwindled in the month, and that the current hiring doesn't represent new demand for labor, but a filling of past job vacancies, in line with the drop in job vacancies seen in the sector at the end of January.

- Extending recent strength, the education and health care industry was the second largest contributor to employment growth. Hiring in that sector could continue to be supported by investment from state and local governments that are flush with cash, as payrolls remain well below their pre-pandemic trend in that industry.
- Headcounts continued to increase in the interest-sensitive construction sector, and even real estate eked out a small gain. These industries were understaffed a year ago, so the hiring we're seeing now likely isn't indicative of a pickup in demand for their output. Moreover, the softening in residential construction payrolls always lags the deterioration in homebuilding, so softness is imminent in that sector. It's also likely that employers could be more reluctant to let staff go given the challenges faced with recruiting during the pandemic.
- Layoff announcements in the tech and media sectors seemed to start to come to fruition, as information payrolls fell by 25K, and there were some layoffs within the broader professional and technical services industry. Still, most of the impact of layoff announcements has yet to be seen but will likely materialize by the April data. Job openings are still elevated in professional services, suggesting that some of the laid off employees will be able to find work elsewhere relatively quickly.
- We expect demand for discretionary goods to wane ahead, and although retail trade payrolls accelerated in February, hours worked were down sharply. The drop in transportation and warehousing employment is also in line with flagging demand in cyclical sectors, highlighted by the drop in manufacturing payrolls and hours worked despite the improvement in supply chains.
- The 0.1% drop in aggregate hours worked included large drops in both higher-value added goods sectors and lower-value added services, but a solid start to the year still suggests a healthy GDP advance so far in the first quarter.
- The household survey showed a more moderate 177K gain in jobs, with a tick up in the participation rate resulting in a climb in the unemployment rate to 3.6%. Encouragingly, the prime-age (25-54 years) participation rate jumped to 83.1, from 82.7, reaching its pre-pandemic level for the first time since then, and suggesting that a drawdown in savings may be encouraging more people to enter the workforce. That is helping to alleviate labor shortages, and putting downwards pressure on wage growth, which the Fed will view favorably.

Implications & actions

Re: Economic forecast — The mixed signals in this report leave next week's CPI data as a key tipping factor towards either a 25bp or 50bp hike at the next FOMC. Beyond that, there are nascent signs of activity waning, especially within the context of higher initial jobless claims in early March, but policymakers will need to see more definitive signs of a cooling before pausing rate hikes.

Re: Markets — Yields and the USD fell slightly following the data, given the pockets of weakness, but the market reaction was limited by the anticipation of next week's CPI data as a bigger factor in the rate hike call for the March FOMC.

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