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US Labor market still too hot for Fed's comfort

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Employment change (thousands, unless otherwise noted)	May 22	Apr 22	Mar 22	Feb 22	Jan 22
Unemployment rate (%)	3.6	3.6	3.6	3.8	4.0
Avg. hrly earn all (Monthly % Chg)	0.3%	0.3%	0.5%	0.1%	0.6%
Avg. wkly hour all (Monthly % Chg)	0.3%	0.3%	0.2%	0.4%	0.0%
Nonfarm employment	390	436	398	714	504
Total private	333	405	385	704	492
Goods-producing	59	69	85	114	32
Construction	36	0	22	54	6
Manufacturing	18	61	58	50	26
Priv. Serv providing	274	336	300	590	460
Wholesale trade	14	23	26	27	13
Retail trade	-61	12	-23	111	121
Transp. & Warehousing	47	46	4	74	53
Information	16	15	18	0	5
Financial	8	35	11	29	2
Business services	75	49	94	87	88
Temporary help	19	7	8	28	28
Education, health	74	60	51	101	33
Leisure, hospitality	84	83	104	124	138
Government	57	31	13	10	12
Federal Government	5	-1	-2	-1	3

Source: Haver Analytics

- Hiring slowed slightly in the US in May, but it remained too hot for the Fed’s comfort. The 390K gain in jobs was above the consensus expectation of 320K, and was supported by broad-based gains, with the leisure and hospitality sector being the single largest contributor. Average wage growth remained at a 0.3% monthly pace (vs. 0.4% expected), failing to keep pace with recent price increases, and putting downward pressure on purchasing power and potentially future inflation. The participation rate increased by a tick, and a slower employment gain on the household survey left the unemployment rate unchanged at 3.6% (vs. 3.5% expected). Overall, with hiring remaining at a solid pace, we’re clearly still on track for 50bps rate hikes at the next two FOMC meetings. We’ll need to see employment gains running well below the current pace to prevent the further tightening in labor markets that the Fed wants to avoid.
- Surprisingly, the renewed supply chain disruptions resulting from lockdowns in China and the softness in construction activity tied to higher interest rates didn't hold back hiring in the related sectors, as goods-producers created 59K jobs during the month. While industrial construction should get a lift as the pandemic continues to fade, new homebuilding

will be limited ahead by the rise in mortgage rates. With the price of oil supported by the EU's decision to ban Russian oil imports, employment in the oil and gas sector could also receive a lift ahead.

- Private service employers added 274K jobs, with education, health, and business services adding to the strength in the leisure and hospitality sector. The Omicron sub-variant wave has dented demand for dining out lately, but given the depth of the labor shortage being faced in that industry, it's not likely to impact hiring in June. Hiring in state and local government educational services also continued to recover, which added 51K jobs. Overall, non-farm payrolls remain 822K jobs short of pre-pandemic levels, although that masks divergences across industries, as leisure and hospitality payrolls are still 1.3mn below February 2020 levels.
- Wage growth remained at a 0.3% monthly pace, which has left it lagging price increases and has resulted in an erosion in purchasing power. The erosion in real incomes could have helped increase participation, which rose by a tick to 62.3%. That's still well below the 63.4% rate that prevailed pre-pandemic. That's due to an acceleration in retirements, and looking at the prime-age (25-54 years) employment-to-population ratio, which stands at 80.0 vs. 80.5 pre-pandemic, there doesn't appear to be as much room for further, robust job gains.
- A more moderate 321K gain in jobs on the household survey left the unemployment rate unchanged at 3.6%, just a tick above pre-pandemic levels. Fewer employees reported working remotely due to Covid in May, and fewer people reported being prevented from searching for jobs due to the pandemic. However, that could change in June given the recent spread of the Omicron subvariant. Some pockets of weakness in the report included a 295K increase in the number of people working part-time due to hours being cut as a result of business conditions. As a result, the U-6 measure of unemployment, which includes marginally attached workers and those employed part-time for economic reasons, ticked up to 7.1%. Still, that's only a tick above its pre-pandemic level.
- Aggregate hours worked rose by a healthy 0.3% on the month, which was entirely accounted for by an acceleration in the high-productivity goods-producing side of the economy. That leaves hours tracking at a similar pace to the prior quarter, at around 3.5%. While last quarter that didn't prevent a fall in GDP, as productivity was deeply negative, it would be unusual for that to be repeated, suggesting that GDP growth in 3.5% range for the quarter looks reasonable.

Implications & actions

Re: Economic forecast — Employment gains could continue to be helped by an increase in the participation rate as real incomes are eroded by inflation, and the Fed will clearly remain on course to raise rates by 50bps at the next two FOMC meetings to try and prevent a further tightening in the labor market.

Re: Markets — Yields received a lift from the upside surprise in the employment gain, but the USD didn't see a sustained reaction.

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