The Slow Burn

Nonfarm payrolls rose a stronger than expected 253k in April, but this was after a large 149k in downward revisions to the previous two months. Jobs are still trending lower, evident from the three-month moving average which fell to 222k from 295k in March. This is the smallest gain since January 2021 (163k). Importantly, job creation will continue to slow both in lagged response to monetary tightening and the ongoing crisis in commercial banking which has not yet been felt in the broader economy.

Good-producing jobs were up 33k after falling 17k in March as construction (15k), manufacturing (11k) and mining (7k) all increased. Private service-producing jobs were up 197k led by the professional and business services category (43k), leisure and hospitality (31k) and financial activities (23k).

Government employment rose 23k which meant private payrolls increased 230k after increasing only 123k in March. Over the last three months, private payrolls averaged 182k which is also the smallest increase since January 2021 (159k). We project this downward momentum to accelerate.

Furthermore, it is worth highlighting the narrowness of recent payroll gains. This weakening in job breadth can be seen in the diffusion index of employment (see chart below) which registered 57.4% last month compared to 57.0% previously. The current level is at the bottom end of a longer-term 15-year range. This speaks of weakening future labor demand, which is also consistent with temporary employment. “Temps” fell 23k last month, the fifth decline in the last six months.

For the Fed, an unexpected decline in the unemployment rate back to a five-decade low (3.4% vs. 3.5% previously) combined with an unexpected 0.5% in average hourly earnings compared to a 0.3% in March trumps the underlying fissures in the payroll data. Consequently, Fed policymakers will likely (for now) believe this past week’s rate hike was warranted given a historically tight labor market and wage growth that remains well in excess to productivity growth. This leads us to our last and most important point.

Over the last five quarters, real GDP has risen a meager 0.9% annualized pace. Yet, the unemployment rate has declined half of percentage point during this time. This tells that trend GDP growth has collapsed, consistent with a record plunge in productivity growth. Given the Fed’s fixation on the output gap as the primary determinant of inflation, policymakers may think they need to keep rates restrictive to open enough slack to push core prices lower. This would be a big policy error as it would produce a much deeper downturn.
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