A Viewpoint from Joshua N. Feinman

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In a nutshell

- Labor markets retain strong momentum, and are still tight, belying fears of a slowdown.
- The government shutdown pushed up the unemployment rate, but even accounting for that, there are signs that the tightening of the labor market may have slowed due to rising participation.
- Labor markets may not have breached sustainable levels of full employment as some had feared.

U.S. Employment Report

Belying fears of a slowdown, the employment report for January was robust, and together with the partial rebound in the ISM manufacturing index[1] suggests the U.S. economy got off to a good start in 2019 – despite the government shutdown, the turbulence in financial markets late last year, and global weakness.

Nonfarm payrolls rose a super-charged 304,000 in January, and even with downward revisions of 70,000 to the prior two months this left the level of payrolls firmly above expectations, and the underlying pace of job growth strong (241,000 over the past three months, 232,000 over the past six), with gains widespread across industries. Note that the government shutdown did not affect the establishment survey used to derive estimates of nonfarm payrolls, average-hourly earnings, and the workweek. Annual benchmark revisions were slight, and reaffirmed that after moderating somewhat in 2015 to 2017, job growth reaccelerated over the past year or so.

The average workweek was unchanged in January, and together with the strong growth in jobs pushed the index of aggregate hours worked up 0.3%, putting it on track for a strong gain in the first quarter.

Average hourly earnings rose a modest 0.1% in January, though this followed a strong 0.4% in December and an upward revised 0.3% in November. The gain over the past 12 months slipped to 3.2%, albeit from an upward revised cycle high of 3.3% in December. Together with other indicators of labor costs – in particular, the slightly softer Employment Cost Index (ECI) for the fourth quarter – this reinforces the message that labor costs are still accelerating, but moderately, and to a pace that is broadly consistent with, but not threatening a material overshoot, of the U.S. Federal Reserve's (Fed's) inflation target.

Unlike the establishment survey, the household survey (used to derive estimates of the labor force and the unemployment rate) was affected by the government shutdown. For example, the headline unemployment rate (U3) rose 0.1% to 4.0% in January, but that increase was due to furloughed government workers being misclassified as unemployed. Even adjusting for that, though, the unemployment rate has edged up slightly over the past couple of months. But it is not because of a slowing in the household survey's estimates of employment gains, which have been robust. It is because the labor force has grown even faster, reflecting an uptick in the participation rate, which has edged slightly above the upper end of the range it has been in for the past few years. Increasing participation among prime-age people (likely lured by improving job prospects) has recently slightly exceeded the effects of retiring baby boomers, slowing the tightening of labor markets.

[1] ISM Manufacturing Index is based on surveys of more than 300 manufacturing firms by the Institute for Supply Management.

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That is been evident also in broader measures of labor utilization like the U6[2]; even adjusting for the government shutdown – which was largely responsible for the U6's 0.5% spike in January, reflecting not only furloughed government workers being misclassified as unemployed, but also private-sector government contractors forced to work part-time – the U6 has shown signs of levelling off.

The bottom line is that labor markets retain strong momentum, and are still tight. But there are increasing hints that they may yet have a bit of room to run; not indefinitely at anything close to their recent pace, but perhaps a bit more than had been anticipated – or at least, that they may not have breached sustainable levels of full employment as some had feared. This offers the Fed still more reason to be patient; not only to see how the "crosscurrents" clouding the outlook play out, but also to probe further where the economy's limits may be. Limited inflation pressures reinforce the case for forbearance. Though we still think that labor markets will have to moderate before too long, and that some slight, additional rate hiking from the Fed will be needed to effect that moderation, there is no sense of urgency, and a wider range of potential plausible outcomes. The Fed is on hold at least until summer.

[2] U6 extends the unemployment rate U3 by discouraged workers and those who work part-time, but seek full-time employment.

Glossary

Baby boomers

Baby boomers are people born approximately between the years 1946 and 1964, i.e. during the baby boom after World War II.

Employment Cost Index

The **Employment Cost Index** measures the growth in U.S. employee compensation in wages and benefits.

Headline unemployment rate (U3)

Official unemployment rate (U3) occurs when people are without jobs and they have actively looked for work within the past four weeks.

Inflation

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U.S. Federal Reserve Board (the Fed)

The **U.S. Federal Reserve Board**, often referred to as "**the Fed**", is the central bank of the United States.

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