ECONOMIC UPDATE
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## May Employment Report: U.S. Growth Story Hasn't Changed

- Nonfarm employment rose by 223,000 jobs in May; prior estimates for March/April were revised up by a net 15,000 jobs
- Average hourly earnings rose by 0.3 percent; aggregate private sector earnings rose by 0.5 percent in April (up 5.0 percent year-on-year)
- The unemployment rate fell to 3.8 percent in May (3.755 percent, unrounded); the broader U6 measure fell to 7.6 percent

Total nonfarm employment rose by 223,000 jobs in May, slightly more than our above-consensus forecast of 218,000 jobs, with private sector payrolls up by 218,000 jobs and public sector payrolls rising by 5,000 jobs. Prior estimates of job growth in March and April were revised up by a net 15,000 jobs for the two-month period. The unemployment rate fell to 3.8 percent on a slight decline in labor force participation, with the broader U6 rate, which includes unemployment and underemployment, falling to 7.6 percent, the lowest reading since May 2001. Average hourly earnings rose by 0.3 percent, good for a 2.7 percent year-on-year increase, while aggregate private sector wage and salary earnings were up 0.5 percent, leaving them up 5.0 percent year-on-year. The May employment report is a timely reminder that, headline noise and market volatility notwithstanding, the growth story in the U.S. economy hasn't changed.

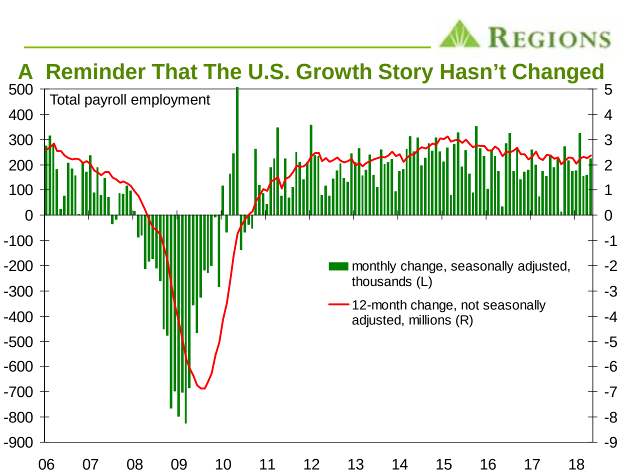
After taking in the headline numbers on the May employment report, we went straight to our favorite beneath the headlines metric – the hiring diffusion index, which measures the breadth of hiring across private sector industry groups. We had been concerned with the notable declines in the one-month hiring diffusion index in March and April, given that one hallmark of the current expansion has been how broad based job growth has been, in stark contrast to the years leading up to the 2007-09 recession. In the May report, prior estimates of the hiring diffusion index for both March and April are revised higher, and the May reading came in at 67.6 percent, with the sub-index for the manufacturing sector rising to 63.8 percent. To us, that hiring remains this broad based this long into an expansion – May marks a record 92nd consecutive month of job growth – is the most meaningful sign of the economy's underlying health.

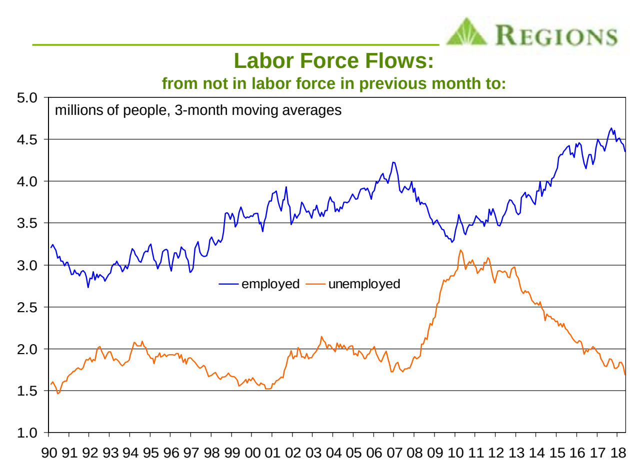
Job growth in May was led by education & health services (39,000), business services (31,000) retail trade (31,000), and construction (25,000). Though off the pace seen over recent months, manufacturing payrolls rose again in May, with the addition of 18,000 jobs meaning that over the past 12 months manufacturing has added 259,000 jobs. As we noted in our weekly *Economic Preview*, one factor behind our above-consensus forecast for headline job growth was that the harsh "winter" weather seen across parts of the U.S. during April held down hiring in weather sensitive industries, for which we expected to see payback in the May data, which turned out to be the case.

We are a bit surprised by the 0.3 percent increase in average hourly earnings in May given that the survey period fell early in the month, which tends to bias hourly earnings growth lower. In any event, May's increase puts hourly earnings up 2.7 percent year-on-year, in line with the pace seen over the past six months but still shy of the pace of growth one would expect with a sub-4.0 percent unemployment rate. Though often overlooked, growth in aggregate wage and salary earnings, which accounts for the number of people working, the number of hours they work, and what they earn for each hour worked, is of far more relevance than hourly earnings growth alone. In May, aggregate earnings amongst private sector workers posted a solid 0.5 percent increase and are up 5.0 percent year-on-year. There is room for improvement here, but more so from hours worked than hourly earnings. with average weekly hours still below what we would be seeing were we truly at full employment. In other words, if firms really were pressed for labor input, they have ample capacity to increase the hours worked by their current workforces.

As a general rule we do not pay too much attention to the month-to-month changes in the labor force, as this is a highly volatile number. We do, however, pay far more attention to the detail on labor force flows. One key number is the number of people who transition from not in the labor force one month to in the labor force in the next month, the vast majority of whom are employed upon entry. On average, over 4.3 million people per month transition from not in the labor force to employed; as seen in our chart below, this is a notably high number and we've argued this inflow has acted as a brake on wage growth, and will continue to do so.

The May employment report is a timely reminder that, headline noise notwithstanding, the U.S. economy remains firmly on track.

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