ECONOMIC UPDATE

REGIONS

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May Employment Report: Normal Volatility, Or Something More Ominous?

- Nonfarm employment rose by 75,000 jobs in May; prior estimates for March/April were revised down by a net 75,000 jobs
- Average hourly earnings rose by 0.2 percent in May; aggregate private sector earnings rose by 0.3 percent (up 4.7 percent year-on-year)
- The unemployment rate was unchanged at 3.6 percent in May (3.602 percent, unrounded); the broader U6 measure fell to 7.1 percent

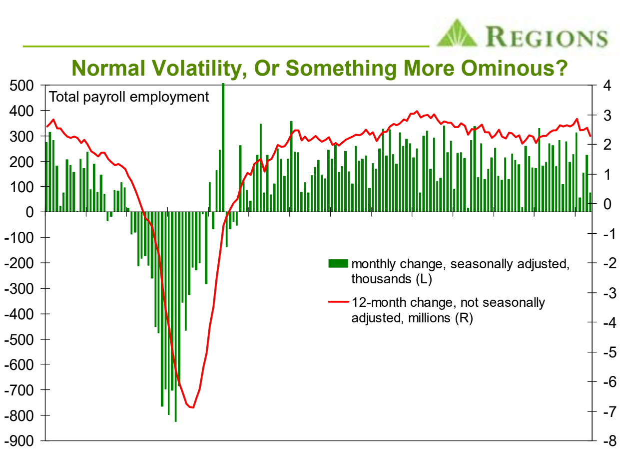
Total nonfarm employment rose by 75,000 jobs in May, a much smaller gain than we or the consensus anticipated, with private sector payrolls up by 90,000 jobs and public sector payrolls falling by 15,000 jobs. As if to add insult to injury, prior estimates of job gains in March and April were revised down by 75,000 jobs. The unemployment rate held at 3.6 percent while the broader U6 rate fell to 7.1 percent on a decline in the number of people working part-time for economic reasons. Average hourly earnings grew by 0.2 percent, a bit lighter than we expected, which yields a year-on-year increase of 3.1 percent. Between the downward revisions to the data for March and April and the weak May print, private sector payrolls have risen by an average of 189,000 per month over the past 12 months. What remains to be seen, however, is whether the sharp slowdown in the pace of hiring in May reflects month-to-month volatility that is common in the economic data, or whether it marks a sharp and sudden deceleration in the pace of overall economic growth.

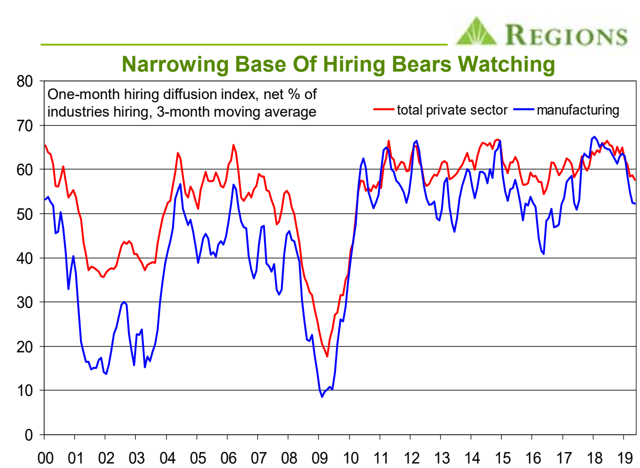
One reason we expected a much larger increase in nonfarm payrolls in May is that there was an extra week between the April and May survey periods, which suggested that some hiring that would have otherwise been captured in the June data would have been pulled forward. But, the not seasonally adjusted data for May show smaller than normal job gains in construction, leisure & hospitality services, and retail trade. As such, the seasonally adjusted data show construction payrolls went up by only 4,000 jobs while payrolls in leisure & hospitality services rose by 26,000 jobs, and payrolls in retail trade fell by 7,600 jobs. Store closings, including Payless and Dress Barn, help account for the smaller than normal increase in retail trade hiring on a not seasonally adjusted basis. More broadly, flooding across parts of the U.S. may have also held down seasonal hiring. The number of people either not at work or who worked only part-time hours were higher than normal for the month of May.

This by no means accounts for all of the weakness in job growth in May, but it does go to our point about normal month-to-month volatility in the data. More notable is that hiring was less broad based across private sector industry groups in May than in any month over the past two years. The one-month hiring diffusion index, which we often refer to as our favorite beneath the headlines labor market indicator, slipped to 54.8 percent in May. At the same time, the intensity of hiring fell in May, with industry groups such as business services, education & health services, and financial activities posted job gains well below their recent run rates. Some are pointing to this as a sign that firms simply cannot find enough qualified workers to hire, which while a convenient explanation does not necessarily make it a correct explanation. After all, it does not seem plausible, at least to us, that firms across various industry groups requiring various skill sets all run out of workers to hire at the same time. Labor supply constraints would help explain a steady deceleration in the pace of hiring, not the slamming on of the brakes seen in May.

Some are also pointing to rising trade tensions as having weighed on hiring in May. That trade tensions ratcheted up in May likely had little impact on the May job growth numbers, but it is plausible to argue that the cumulative effects of lingering trade tensions are becoming more apparent in the employment data. Not only has the pace of job growth in the manufacturing sector slowed to a virtual crawl, but we are now seeing a slowdown in hiring in transportation/warehousing/distribution, which reflects a softening freight market. This is clearly an area of concern, as signs point to this weakness intensifying over coming months which, at some point, has to spill out into the broader economy. Another marker to watch is hiring amongst motor vehicle manufacturers, as a slowing pace of unit sales will mean cuts in employment and production.

We routinely note that the economic data do not move in smooth, straight lines, and a glance at our first chart below illustrates this point. This does not mean the weak print on the May employment report can be dismissed out of hand, particularly given clear signs of a weakening industrial sector. A low jobless rate, elevated consumer confidence, and firmer wage growth suggest the broader economy is still on firm footing, but a similarly weak June employment report would be an ominous sign.





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