ECONOMIC UPDATE
REGIONS
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July Employment Report: Inflated Headline Number, But Strong Details

- Nonfarm employment rose by 943,000 jobs in July; prior estimates for May/June were revised up by 119,000 jobs
- Average hourly earnings rose by 0.4 percent while aggregate private sector earnings rose by 0.9 percent
- The unemployment rate fell to 5.4 percent in July (5.393 percent, unrounded); the broader U6 measure fell to 9.2 percent

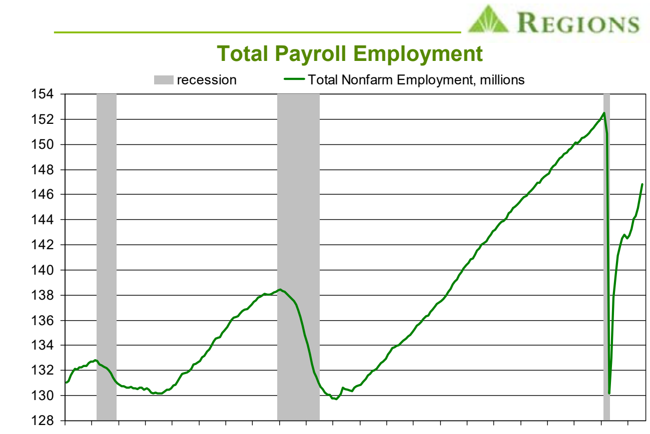
Total nonfarm employment rose by 943,000 jobs in July, close to our above-consensus forecast of 936,000, with private sector payrolls up by 703,000 and public sector payrolls up by 240,000 jobs. As with June, the reported increase in public sector payrolls in July is nothing more than seasonal adjustment fiction, stemming from layoffs in the education segment of state and local government being smaller than is typical for the month of July. To that point, while our forecast of total nonfarm job growth was close to the mark, we had anticipated a larger increase in private sector payrolls and a smaller increase in public sector payrolls than was actually the case. Be that as it may, the real story of the July employment report is how strong the underlying details are. For instance, prior estimates of job growth in May and June were revised up by a net 119,000 jobs for the two-month period, while the initial estimate of average weekly hours worked in June was revised higher, leading to a meaningful upward revision in private sector wage and salary earnings. July saw another solid increase, with average weekly hours holding at 34.8 hours and strong growth in hourly earnings and private sector payrolls. The unemployment rate fell to 5.4 percent, even lower than our below-consensus forecast of 5.6 percent, as a sizable increase in household employment overwhelmed a not so sizable increase in the labor force. Noisy headline number aside, the July employment report is a strong report, with the obvious caveat that the recent wave of COVID-19 cases largely came after the July reference period. Still, the July employment is a large step toward the FOMC's marker of "substantial further progress" in the labor market.

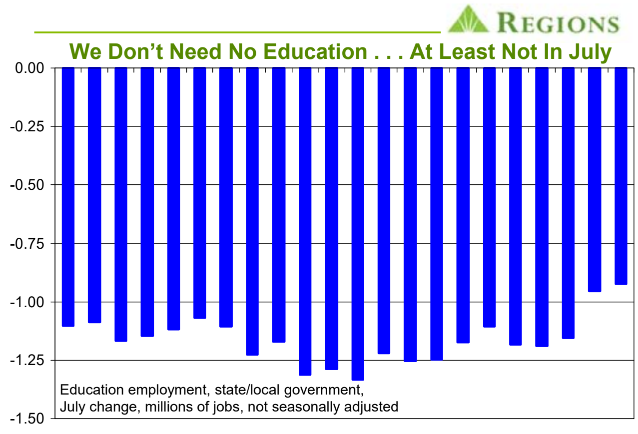
To our point about the reported increase in public sector payrolls, the not seasonally adjusted data show payrolls in the education segment of state and local governments fell by a combined 923,000 jobs in July. While this is a large number, it is considerably smaller than the typical July decline and is indeed the smallest July decline over the 2000-2021 period, as our second chart below illustrates. Last July's decline was also smaller than the typical July decline, and these deviations from typical patterns are a sign of the extent to which education payrolls were held down during the pandemic. With the seasonal adjustment factors geared for larger declines, the seasonally adjusted data are artificially boosted, such that on a seasonally adjusted basis education payrolls in state and local governments are reported to have risen by 222,000 jobs. Keep in mind that there could be payback in the months ahead, especially if the Delta variant of the COVID-19 virus delays the normal start of the school year.

Private sector payrolls rose by 703,000 jobs in July, with broad based hiring across the main industry groups, while the initial estimate for private sector job growth in June was revised up by more than 100,000 jobs. One factor in the low initial estimate was that the response rate to the June establishment survey was notably low, so some of those blanks were filled in by the July survey. As of July, the level of nonfarm employment is 5.702 million jobs below the pre-pandemic peak, with the deficit of 1.737 million jobs in leisure and hospitality services easily the largest of any of the main industry groups.

Aggregate private sector wage and salary earnings rose by 0.9 percent in July, but this comes after sizable upward revision to the initial estimate for June. This matters because with the generous fiscal transfers that were the key pillar of growth in personal income over much of the last 16 months largely having run their course, labor earnings will resume their normal role as the main driver of growth in personal income. Wage growth is broad based across private sector industry groups, which to a large degree reflects the difficulty firms are having in filling open jobs.

While household employment rose by over one million jobs in July, there is an element of payback here after the curious decline reported for June. While the 261,000 person increase in the labor force may seem small, gross inflows into the labor force remain well above pre-pandemic norms but exits, particularly amongst the employed, remain higher as well. This often overlooked dynamic figures to have a more lasting impact on the participation rate than other transitory factors now weighing on the participation rate, and could push the unemployment rate down faster than many are now anticipating will be the case.





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