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Markets & Economies

Slower Jobs Growth in August Unlikely to Sway the Fed

The pace of job creation remains strong and labor cost pressures persist.

Giulio Martini, Partner, Director of Strategic Asset Allocation

The U.S. employment report for August, released by the Bureau of Labor Statistics on September 2, extended the tendency towards gradual normalization of the labor market—less net job creation and gently rising labor force participation—that has been evident for the past year. However, conditions remain clearly overheated and the August data will do little to resolve the debate over how much the Federal Open Market Committee (FOMC), the policy-setting arm of the U.S. Federal Reserve (Fed), should raise the target rate at its September 20–21 meeting, or how high rates will rise before it pauses.

A Closer Look at the Numbers

Payroll employment rose by 315,000 in August but downward revisions to prior months lowered the net gain to 208,000. While the August increase was well below the 504,000 average over the prior 12 months, it still represents a pace of job creation that is far too strong for the Fed to accommodate. For example, job gains averaged 168,000 in the previous business expansion, around half the increase just recorded. Even the prior expansion average would be too strong for the Fed to accept since it was enough to produce 2%+ gross domestic product growth and a declining unemployment rate.

The increase in the unemployment rate to 3.65% was accompanied by an increase in labor force participation to 62.4%. That matched the high for the current recovery first achieved last March.

Meanwhile, full-time employment has been declining; employment gains in the household survey are more than accounted for by more part-time jobs.

Average hourly earnings (AHE) rose only 0.3% in August. AHE growth is moderating and that should be good news on the inflation front. But more robust measures of labor costs—such as the quarterly employment cost index—have reported increasing wage pressure even as monthly earnings gains have slowed. Thus, the FOMC is unlikely to interpret the slowdown in monthly AHE as an indication of easing inflation pressure.

Even after a 0.1-hour decline in the average workweek in August, total hours worked rose at a 2.6% annual rate over the past three months. That's consistent with 3-4% GDP growth applying trend productivity gains to the increase in hours worked, a pace that is too rapid for the FOMC to put rate increases on hold. Moreover, the labor market has proven quite resilient; for example, jobs in construction, ground zero for sensitivity to rising interest rates, have continued rising in recent months.

Policy Implications

Inasmuch as none of the August employment data provided convincing evidence of an incipient reduction in upward pressure on labor costs, it's doubtful that the FOMC will interpret the data as heralding the slowdown in demand it has been trying to engineer. Thus, "outsized" increases in the fed funds rate—50-75 basis points—remain in play at the September meeting.

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Lord, Abbett & Co. LLC | 90 Hudson Street | Jersey City, NJ 07302-3973 | T 1.888.522.2388 | lordabbett.com

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