Economic commentary from the Investment Advisory Group

Crosscurrents aplenty as more jobs added in May but sizable jump in the unemployment rate

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Executive summary:

U.S. payrolls in May added 339,000, easily eclipsing the consensus of 195,000. That was coupled with upward revisions to the prior two months that added 93,000 jobs, pushing the six-month average up to 301,500.

Yet, there were clear signs of cooling. Most notably, the unemployment rate jumped by 0.3 in May to 3.7%. The monthly pace of average hourly earnings ticked down as did hours worked. Also, two of the ten major industry groups lost workers during the month, including manufacturing.

This is another perplexing jobs report, frustrating both the bulls and the bears. The crosscurrents in this report somewhat cloud the Federal Reserve's (Fed's) decision to hike rates in two weeks. Based strictly on job growth, another hike is warranted; however, there are two key inflation gauges coming ahead of the Fed's meeting on June 14th that will factor prominently in the "hike/pause" calculation. Given sluggishness in other economic data, we believe there's a high bar for a rate hike in June.

Component	May	Prior month	Six-month average	Comment
Change in payrolls	339,000	295,000	301,500	The pre-pandemic 3-year average was 177K/mo. Net revisions added 93K to March and April.
Unemployment rate (U-3)	3.7%	3.4%	3.5%	Largest monthly increase since the pandemic, up from the cycle low of 3.4%. Roughly 130,000 workers re-entered the workforce in May.
Labor force participation rate	62.6%	62.6%	62.5%	Remains 0.7 percentage points below the December 2019 level.
Average hourly earnings (YoY)	4.3%	4.4%	4.5%	The monthly pace cooled to 0.3%. The pace of non-supervisory workers ticked up to 0.5%, but the annual pace held steady at 5%.
Average weekly hours worked	34.3	34.4	34.4	Slipped to the lowest level since the pandemic. Manufacturing hours stayed at 40.1, while overtime hours rose to 3.0.

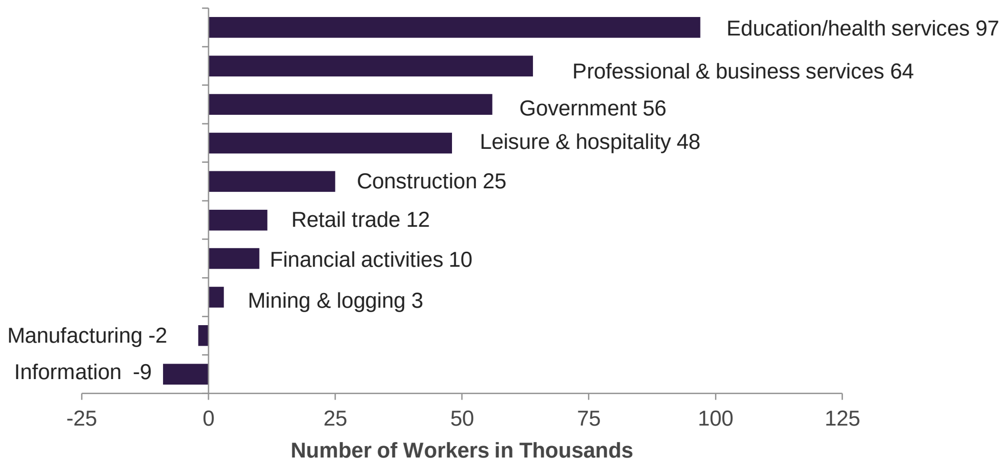
Data source: Truist IAG, Bloomberg, Bureau of Labor Statistics

A review of the major industry trends

Private payrolls increased by 283,000, while government payrolls added 56,000. Service-providing industries added 257,000 workers, the most in three months, and goods producers chipped in 26,000 workers.

Two major industry groups lost workers during the month.

Monthly change by major industry group (in thousands)



Data source: Truist IAG, Bloomberg, Bureau of Labor Statistics

Education/health care added the most jobs in May, with roughly three-quarters coming from health care. The remainder came from private education services.

The jobs added within professional & business services seemed to be spread fairly evenly across the subsectors, including accounting, consulting, and other business services. Temporary help services added 7,700 workers after declining in five of the prior six months.

Construction added 25,000, the most in four months and almost reaching the one-year high of 26,000. Much of the improvement was within residential building construction, which had not added workers in four of the prior six months.

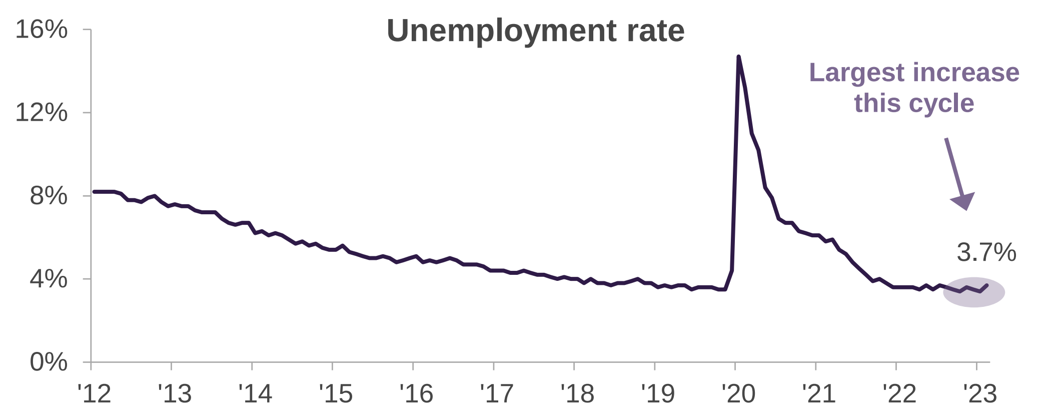
Unemployment rate jumped, while wages and hours worked cooled

The unemployment rate increased 0.3 to 3.7% in May, up from the cycle low of 3.4%, which was also the lowest level since May 1969.

The labor force added 130,000 workers in May and has increased by 2.3 million in the past six months. The labor force participation rate held steady at 62.6% for the third consecutive month. However, it remains 0.7 percentage points below the December 2019 level.

Hours worked—officially known as average weekly hours worked for all employees—fell to 34.3, which is in-line with the pre-pandemic 10-year average. Within manufacturing, hours worked ticked down to 40.2 but overtime hours rose to 3.0 from 2.9. Both remain roughly in-line with their respective long-term averages.

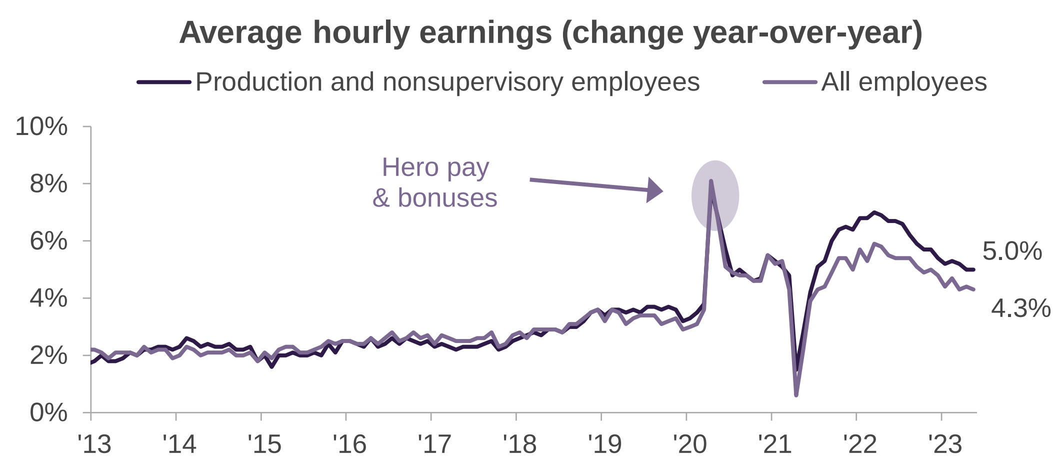
The unemployment rate jumped 0.3 in May to 3.7%, the largest monthly increase since the pandemic.



Data source: Truist IAG, Bloomberg, Bureau of Labor Statistics

Average hourly earnings cooled somewhat in May, rising 0.3% month over month, down from 12-month average of 0.4%. The annual pace increased 4.3% from a year ago as it continued to steadily decline from the 2022 peak of 5.9% in July '22. Despite the recent cooling, it remains well above the pre-pandemic 10-year average of 2.4%.

The annual pace of average hourly earnings continued to cool in May.



Data source: Truist IAG, Bloomberg, Bureau of Labor Statistics

The pace of average hourly earnings for rank & file workers—officially known as production & nonsupervisory employees—rose 0.5% during May. It rose 5.0% on a year-over-year basis, significantly above its pre-pandemic rate of 3.2%. This is important since production & nonsupervisory employees are the bulk of all employees and where most of the dramatic post-pandemic wage gains have been concentrated.

Our take

This is another perplexing jobs report, frustrating both the bulls and the bears. The resilience of the headline jobs growth is hard to argue with, averaging more than 300,000 over the past six months, which is significantly above the pre-pandemic average of 177,000. So too the broad-based nature of the major industry composition indicates a solid economy.

Yet, the signs of cooling are also quite evident, including the rise in the unemployment rate of 0.3 to 3.7% in May. A rise of 0.5 is a recession flag in and of itself. It was coupled with a downtick in average hourly earnings and hours worked. Moreover, weekly jobless claims and continuing claims are grinding higher after bottoming in the third quarter of 2022.

Similarly, other sources are reporting labor market softness. For instance, fewer workers are voluntarily quitting as the so-called quit rate was 2.4%, practically down to the pre-pandemic level. The Challenger job cut announcements are averaging 83,500 per month year-to-date in 2023, significantly above the 2022 average of 30,300. Small business hiring plans are trending lower, according to the National Federation of Independent Businesses (NFIB), as are the number of respondents saying positions are hard to fill.

We believe this report somewhat clouds the Fed's decisions to hike rates on June 14. Based strictly on headline job growth within this report, which included adding roughly 125,000 more jobs per month than the pre-pandemic average, another quarter-point hike (0.25%) appears to be warranted.

But the rate decision isn't solely predicated on job growth. Other indicators remain sluggish at best, while others are outright weak. For instance, two separate manufacturing gauges showed continued weakness in May. The Institute for Supply Management (ISM) Manufacturing Index contracted for the seventh straight month, which signifies a decrease in manufacturing activity. Moreover, the S&P Global's U.S. Manufacturing Index also dropped in May, contracting for the sixth time in seven months.

Two key inflation gauges, the Consumer Price Index and the Producer Price Index, will be released just ahead of the Fed meeting. We believe those two reports will factor prominently in the Fed's "hike/pause" calculation. It's quite possible that the Fed will weigh the evidence and won't raise rates, choosing instead to wait for further confirmation that inflation has sufficiently cooled. On the other hand, financial conditions have eased slightly in recent weeks, so the Fed may want to send a clear signal that it prefers keeping conditions tight to definitively slay inflation for this cycle. Ultimately, we believe there's a high bar for a rate hike in June.

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