Economic commentary from the Investment Advisory Group

Another big upside surprise for July job growth, keeping the Fed's rate hikes front & center for markets

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Executive summary: U.S. payrolls jumped by 528,000, more than double the consensus of 250,000. Meanwhile, the unemployment rate edged down to 3.5%, a new low for the cycle.

The industry view was solid, with gains in all of the major industry groups. Within the report, there were more signs that the overheating conditions within the labor market continue to cool from the hard boil during 2021. For instance, average hourly earnings continued to slide on a year-over-year basis, and hours worked are unchanged for the past five months.

Ultimately, labor market conditions remain strong, pushing back firmly against the notion that the U.S. is in recession currently. Yet, it also means that the Federal Reserve (Fed) will continue front-end loading larger interest rate hikes. While there's a lot more data coming between now and the next Fed meeting on September 21, this certainly puts another three-quarter point (0.75%) rate hike on the table. At the very least, it upends the recent "Fed pivot" narrative that data has softened enough for the Fed to relax.

Alas, the tension between the possibility of additional supersized Fed rate hikes, tightening financial conditions, and other slowing economic data (especially housing) likely means bond and stock markets will struggle to digest this data.

Component	July	Prior month	Six-month average	Comment
Change in payrolls	528,000	398,000	465,000	Best month in five months. Upward revisions of 28K for May and June. Pre-pandemic 3-year average was 181K/mo.
Unemployment rate (U-3)	3.5%	3.6%	3.6%	The downtick in July is related to continued shrinking of the labor force, which fell for the third time in four months.
Labor force participation rate	62.1%	62.3%	62.3%	Ticked lower as older workers remain the biggest drag on the labor force participation rate due to retirements.
Average hourly earnings (YoY)	5.2%	5.2%	5.3%	Non-supervisory slipped to 6.2% YoY from a near-term high of 6.7% in March. Still, it remains well above the average of 3.3% during 2019.
Average weekly hours worked	34.6	34.6	34.6	It has held steady for five months, defying the talk of weakness. Manufacturing hours have stayed at 40.4 for three months.

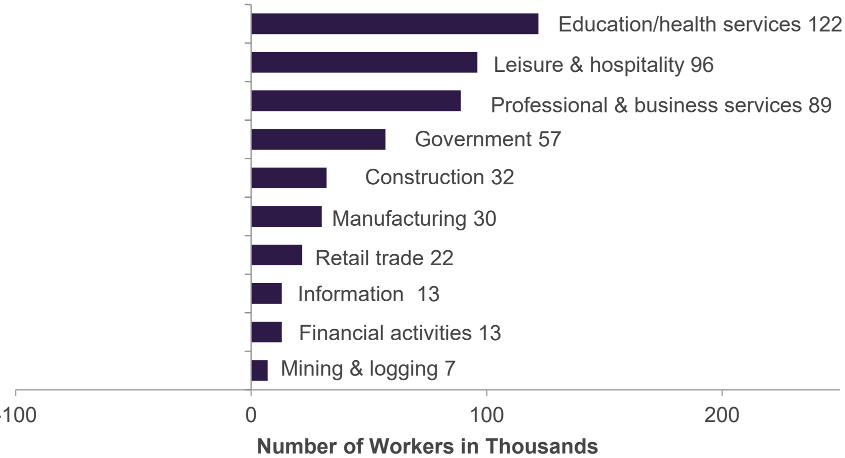
Sources: Truist IAG, Bloomberg, Bureau of Labor Statistics

A review of the major industry trends

Private payrolls increased by 471,000 workers, the largest increase in five months. Government payrolls rebounded strongly, up 57,000 after declining by 6,000 in June. Service-providing industries added 402,000 positions, while goods producers hired 69,000 workers.

All of the major industry groups added jobs during July.

Monthly change by major industry group (in thousands)



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

Health care was a big job contributor in July, adding 69,600 jobs, the most since the reopening months in the summer of 2020. This is a very good sign insofar as health care services account for roughly 25% of the total economy. Moreover, this segment has lagged the overall recovery, including three months of job losses during 2021.

Hiring in the leisure & hospitality industry continued to rebound, adding 96,000 workers during the month. That was the most in four months. More than three-quarters (73,900) were hired within restaurants and bars.

Construction added 32,000 jobs during July, which defies the nearly-universal weakness within housing-related data for the past few months. Roughly one-third (11,200) were hired by residential specialty trade contractors, while another third were hired by commercial specialty trade contractors (non-residential). Both have reportedly been struggling to retain workers in the past year.

Otherwise, employment showed little change over the month in other major industries, including professional & business services.

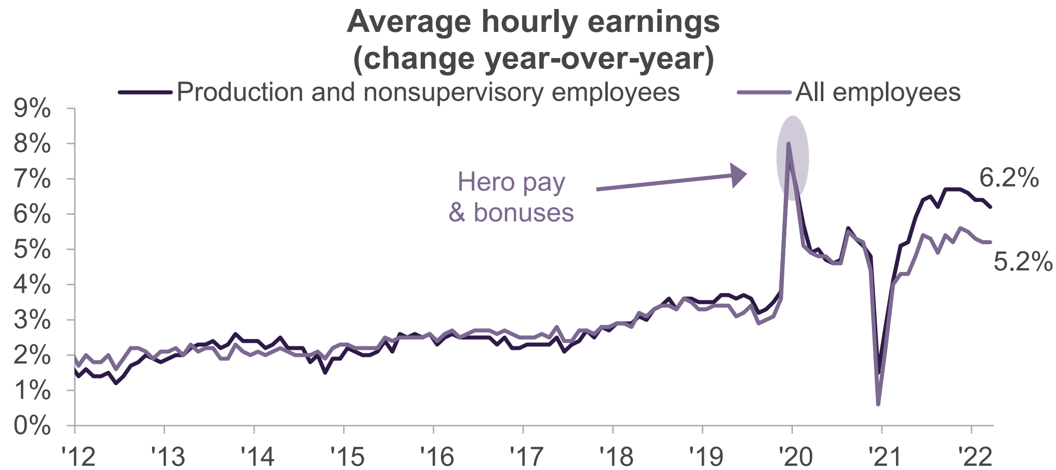
Lastly, the U.S. has now surpassed the pre-pandemic total number of jobs. At just over two years (27 months), the speed of the job recovery has been nothing short of remarkable considering that it took 3.8 years following the mild 2001 recession and 6.5 years following the Great Financial Crisis. That said, it will take further job growth to get back to the pre-pandemic trend – in other words, the total number of jobs we “should” have had the economy not experienced the pandemic.

Wage growth and hours worked continue to slip from very high levels in 2021

Wage growth increased as average hourly earnings rose 5.2% from a year ago, more than double the 2.4% average for the decade before the pandemic (2009 through 2019). But, it hasn't increased in four months, and is down from 5.6% in March.

For rank & file workers (officially known as production & nonsupervisory employees), the pace of average hourly earnings slipped on both a month-over-month (up 0.4% vs. 0.5% in June) and year-over-year basis (up 6.2% vs. 6.4% in June). It, too, remains significantly above its pre-pandemic 10-year average of 2.4%. This is important since production & nonsupervisory employees are the bulk of all employees and where most of the dramatic recent wage gains have been concentrated.

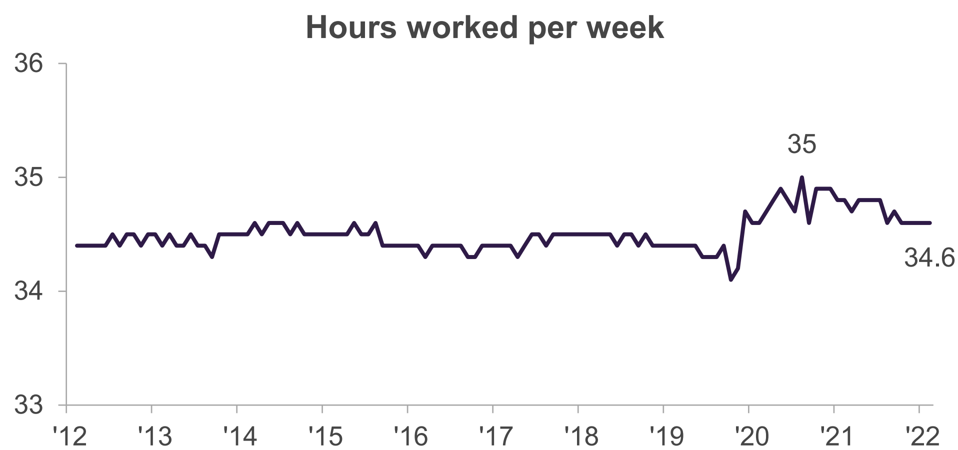
Average hourly earnings for production & nonsupervisory employees have steadily declined since March.



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

Hours worked—officially known as average weekly hours worked for all employees—have also gradually declined since 2021, when they peaked at 35.0 hours in January 2021. They have held steady at 34.6 for the past five months, heading back towards the pre-pandemic 10-year average of 34.4. Within manufacturing, hours worked and overtime hours have already returned to their respective long-term averages; hours worked have stayed 40.4 for the past three months.

Hours worked have flattened out and are unchanged for the past five months.



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

Our take

The labor market didn't get the memo that it's supposed to be weak. In fact, not only is it not weak, July saw the most hiring in five months – and that was with very strong headwinds; most notably, the spike in gasoline prices above $5 per gallon nationally in June. Indeed, the labor market is pushing back strongly against the notion that the U.S. is in recession currently.

There have been 3.3 million jobs created in 2022, or an average of 470,000 per month. That's more than 3.5 times the long-term monthly average of 125,000. These are not the hallmarks of a weak economy and the U.S. has never had a recession while maintaining such strong job growth.

Of course, employment is a lagging indicator and doesn't tell us much about the future. Thus, it could be a Wile E. Coyote moment for employers, whereby the coyote continues running before he looks down and realizes he ran off a cliff. At this point, we doubt that is the case, particularly as many of the activity indicators remain solid, albeit down from extremely strong readings in 2021. Among those indicators are new orders for durable goods, which hit another fresh all-time high, retail sales generally, and travel and service-related metrics. Moreover, the aforementioned gasoline prices have retreated quickly, falling about 18% since topping $5 per gallon during June. Conversely, there are plenty of signs of weakening demand, especially within housing.

More importantly, this report upends the recent "Fed pivot" narrative that data has softened enough for the Fed to stepdown interest rate hikes or even pause. In our view, the Fed will continue with larger interest rate hikes in the near term. Aside from a nearly-unanimous tone from Fed officials recently, the Fed is informed by the missteps of the "stop-go" monetary policy of the 1970s, when it halted the inflation fight too soon, which then took years and more extreme action to finally regain control under legendary Fed Chairman Paul Volcker.

The Fed isn't overly dependent on one report nor data series. There are many more economic data points that will be released between now and the next Fed meeting on September 21. The key data will be another jobs report (August) and two more months of inflation data (July and August). Still, this report most certainly puts a three-quarter point (0.75%) rate hike on the table in September, although there are numerous plausible alternate paths (0.50% at both the September and November meetings, etc.).

Alas, the crosscurrents continue and our warning that it would be difficult to get a "clean" view of the economy has materialized. On balance, we think it's possible that the U.S. can power through much of the crosscurrents, but not all of them. That points toward a slowing U.S. economy or prolonged sluggishness until these crosscurrents abate. Whether that's officially labeled a recession remains to be seen.

The tension between the possibility of additional supersized Fed rate hikes, tightening financial conditions, and other slowing economic data likely means bond and stock markets will struggle to digest this data until there's more clarity.

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