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Unsurprising recovery in jobs growth

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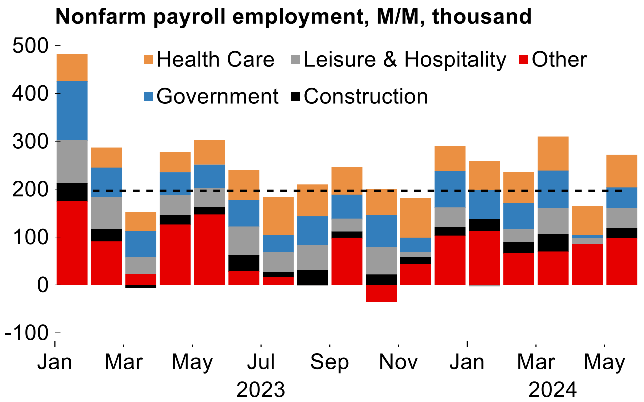
- Nonfarm payroll employment growth predictably accelerated in May, with jobs growth recovering in government, leisure and hospitality, and construction. These three industries, plus health care, have sustained strong headline employment growth since 2023, but growth in "other" industries is below the pre-pandemic average. Much of this weakness has come from the professional and business services sector, where jobs growth has been historically weak and is increasingly less concentrated in nonsupervisory positions.
- The unemployment rate ticked up to 4%, with younger workers driving much of the increase. Though volatile, the increase in unemployment for younger workers may be a leading indicator for the second half of 2024. Additionally, the participation rate of prime-age workers is trending upward again, but growth is being offset by a decline in participation of older workers.
- The job openings rate has fallen to near the pre-pandemic level, and the quits rate continues to hover below it. Some of this drop in vacancies is in response to lower turnover, and the ratio of job openings to separations indicates that labor demand is still relatively high. The current state of the labor market lowers the likelihood of a rate cut before Q4 2024.

Recovery in 3 of the "big 4" industries

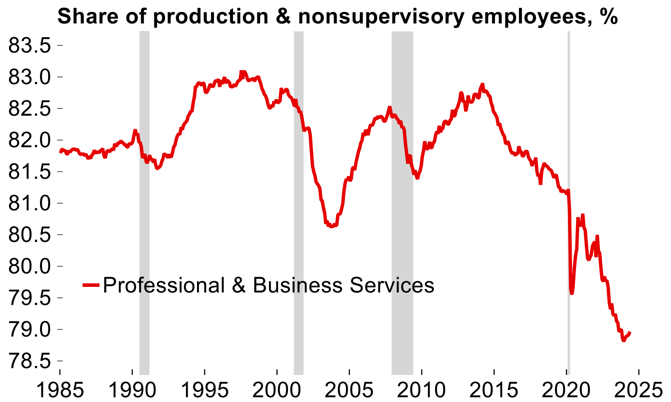
The labor market added 272,000 jobs in May, up from a downwardly revised 165,000 in April (Chart 1). Though growth well exceed consensus forecasts, much of this acceleration should have been expected. As discussed in the review of April's jobs report, the drop last month almost exclusively came from 3 of the "big 4" industries that have sustained employment growth since 2023. Predictably, growth reversed in May.

Chart 1: Employment growth in government, leisure and hospitality, and construction recovered in May



Source: BLS, MUFG Bank Economic Research Office

Chart 2: The share of nonsupervisory jobs has fallen dramatically in professional and business service industries



Source: BLS, MUFG Bank Economic Research Office

Jobs growth accelerated in government, with 43,000 jobs added in May compared to the uncharacteristically low 7,000 added in April. For context, government added an average of 52,000 jobs a month over the past 12 months. Similarly, growth accelerated in leisure and hospitality and construction, in line with the average monthly growth over the past 12 months. Health care continued to be strong, adding 68,000 jobs in May, compared to 60,000 in April. These "big 4" industries continue to dominate nonfarm payroll employment growth.

The labor market is considerably weaker in the "other" industries, where in aggregate, monthly job growth has not exceeded the pre-pandemic average since May of last year. This month (May 2024), the "other" industries added 98,000 jobs compared to an average of 111,000 jobs from 2012 to 2019.

Slower than average growth in professional and business services is, in no small part, to blame. At the risk of sounding like a broken record, employment growth in this industry is a potent indicator of the health of the broader economy. And though growth accelerated slightly in May, it has been consistently weak over the past 12 months.

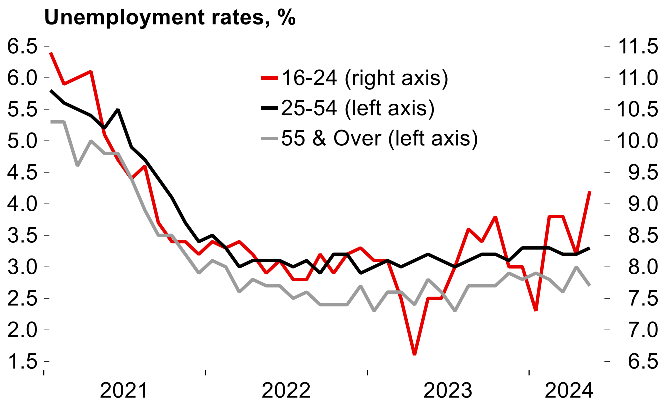
It's not entirely clear when this weakness in professional and business services will become evident in the broader economy. Some of the slow growth can be explained by labor shortages, but there is likely some material weakness present in the labor market that has yet to fully manifest. One example is the declining share of production and nonsupervisory workers relative to all employees.

Shown in Chart 2, nonsupervisory employees make up a historically small share of all employees in the professional and business services industry. Historically, significant declines were a symptom of a recession, where less experienced nonsupervisory roles were more likely to be eliminated. Since 2022 however, the share has been falling at a rapid rate, but jobs growth has been positive. It's not entirely clear what is driving this trend. It could be another sign of underlying weakness, or it could reflect a shift in labor demand to more experienced workers.

Slowly but surely, growth in unemployment

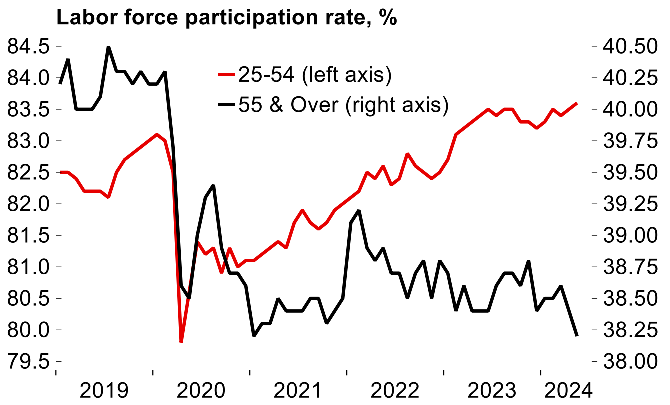
The unemployment rate ticked up to 4% in May, with an increase in the unemployment level of younger workers (16-24) driving much of the increase (Chart 3). Historically, significant jumps in unemployment of younger workers preceded the rest of the labor market, but extreme volatility since 2023 makes it difficult to isolate signal from the noise. There is, however, a small upward trend in the unemployment rate for prime-age (25-54) workers that is expected to continue heading into the second half of 2024.

Chart 3: The unemployment rate ticked up to 4%, driven by a rise in unemployment of younger workers



Source: BLS, MUFG Bank Economic Research Office

Chart 4: The participation rate of prime-age workers is trending upward again, but falling for older workers



Source: BLS, MUFG Bank Economic Research Office

Growth in the size of the labor force is expected to be a significant driver of the unemployment rate, with both new and re-entrants pushing up the unemployment level. This is expected to help push the unemployment rate up to 4.2% by Q4 of this year, with the major risk to this outlook being slower than anticipated growth in labor force participation and immigration.

So far, signs still point to a growing labor force as the participation rate of prime-age workers, the largest share of the labor force, returns to an upward trend. However, the participation rate of older workers unexpectedly fell in May to the lowest level since January 2021, and growth in the foreign-born population has slowed. It's not entirely clear how, or if, immigration policy will change in the months leading up to the November presidential election, but it will likely have implications for the size of the labor force (though there is evidence that current estimates undercount the size of the incoming immigrant population).

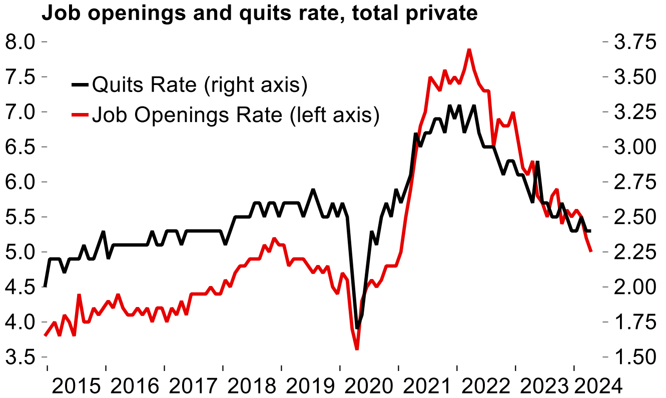
Lower employee turnover

The job openings rate fell considerably over the past 2 months, reversing the stagnant trend that started in October of last year (Chart 5). Both the job openings rate and number of vacancies are now close to reaching the pre-pandemic level (2018-19 average). Despite this however, the labor market is still far too tight.

Some of this drop in job openings is in response to lower employee turnover, with the quits rate having fallen below the pre-pandemic level (Chart 5). Fewer workers leaving translates to fewer openings to fill "existing" demand. Job openings in relation to quits and other separations (ratio of job openings to total separations) can be a proxy for "new" demand, which is trending downward, but remains firmly above the 2018-19 average (Chart 6).

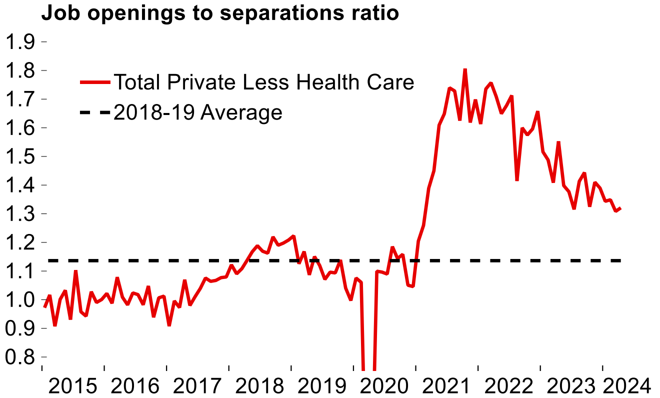
May's jobs report shows a labor market that is still too tight and wage growth that is too high (average hourly earnings is hovering around 4%). This lowers the likelihood of a Fed rate cut before Q4 of this year.

Chart 5: The job openings rate is nearing the pre-pandemic average, while the quits rate has fallen below it



Source: BLS, MUFG Bank Economic Research Office

Chart 6: Jobs openings relative to separations indicates elevated levels of labor demand



Source: BLS, MUFG Bank Economic Research Office

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