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Less weak than at first glance

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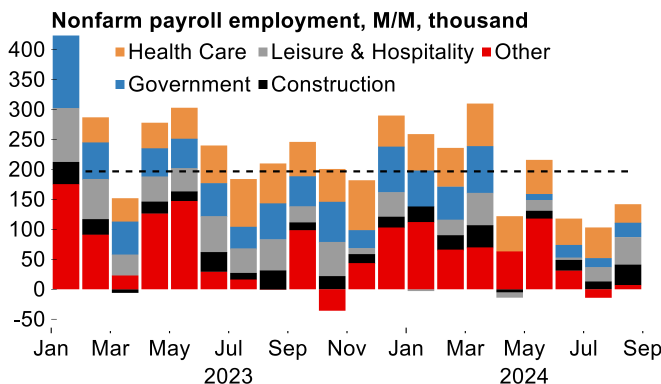
- Employment growth was slightly stronger in August compared to July, mostly from accelerated hiring in construction and leisure and hospitality industries, but it remains weak in industries outside of the “big four.” Most notable is professional and business services where growth has been virtually flat since the start of the year, but also where average weekly hours have been trending upward. Productivity growth in addition to more hours worked can help offset slower jobs growth, but this is not widespread across all industries.
- The unemployment rate fell to 4.2% in August, down slightly from 4.3% in July. As anticipated, temporary layoffs fell this month, offsetting most of the rise that occurred in July. The unemployment rate for prime-age workers was unchanged, but it grew significantly for younger workers (16-24). This rise was mostly driven by employed teenagers that left the workforce, rather than significant growth in the unemployment level. Without this anomaly, the unemployment rate would have fallen back to 4.1%, further diminishing the need for overly aggressive rate cuts.

More hours and higher productivity

Total nonfarm employment increased by 142,000 in August, up from the downwardly revised 89,000 jobs added in July, but below the pre-pandemic average of 197,000 jobs added per month from 2012-2019 (Chart 1).

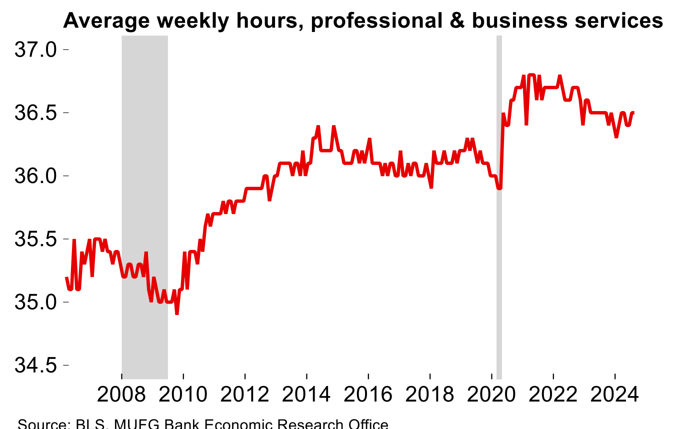
Most of the stronger growth can be attributed to an acceleration in construction (+34,000) and in leisure and hospitality (+46,000), but the general trend over the past few months remains the same. Jobs in the “big four” industries (highlighted in Chart 1) are being added at a robust rate, while the “other” industries are experiencing little to no growth (in aggregate).

Chart 1: Headline employment growth has been weaker than the pre-pandemic average for three consecutive months



Note: Dotted line shows 2012-19 pre-pandemic average
Source: BLS, MUFG Bank Economic Research Office

Chart 2: Average weekly hours worked in professional and business services is trending upward, while jobs growth is weak



Source: BLS, MUFG Bank Economic Research Office

This is especially true in the professional and business services sector, which comprises the largest share of overall employment and where jobs growth was only slightly above zero since the start of 2024. Normally, such weak growth would signal an upcoming contraction. Since the 1960s, every instance where the 6-month growth rate in professional and business services employment reached negative territory, it coincided with a recession. This relationship was broken after the pandemic, when growth was negative in both November and December. And though the growth rate is not negative now, it is far from robust.

The broader question now is why jobs growth is so weak for these key industries outside of the "big four." In professional and business services, job losses in the temporary help industry have negatively impacted growth, but even excluding this sub-industry, growth has not been particularly strong. At the same time, consumer spending growth has been strong, especially in the services sector, credit conditions remain relatively loose despite elevated interest rates, and corporate profit margins remain historically high. Broadly speaking, the economy has been expanding at a healthy pace, but that is not reflected in the labor market as of late. One potential explanation is the rise in average weekly hours and labor productivity.

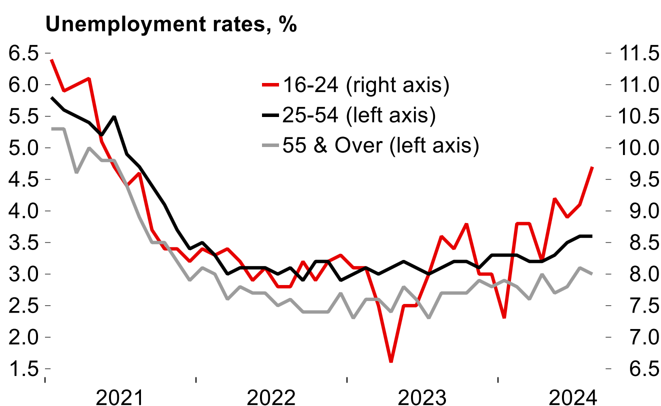
Shown in Chart 2, average weekly hours in professional and business services have been trending upward since the start of 2024, and they remain well above pre-pandemic levels. More working hours for many of these office jobs can help offset weaker jobs growth and combined with overall labor productivity growth (output per hour), economic growth can be sustained with slower employment growth.

Now, this is far from a definitive explanation of the current situation. Average working hours are not increasing in all industries, and labor productivity growth, though strong at 2.7% Y/Y as of Q2 2024, is likely not evenly distributed across all sectors. This may also be the end of the pandemic recovery, where industries that "over hired" are now slowing down. Indeed, the current labor market is not expanding at the rate it was at the beginning of this year, but other economic indicators do not point to a contraction. There are likely other causes, such as improvements in productivity and growing working hours that were highlighted, which can help explain why employment growth was especially weak this past summer.

Volatile unemployment rate

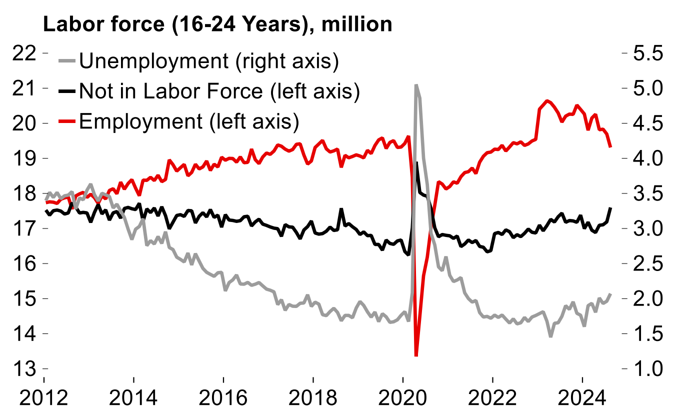
In August, the unemployment rate fell slightly to 4.2%, down from 4.3% in July. Unsurprisingly, the rise in temporary layoffs from July was largely reversed. The unemployment rate of prime-age workers (25-54) was unchanged at 3.6% in August, but it rose dramatically for younger workers (16-24) to 9.7% (Chart 3).

Chart 3: The unemployment rate is flat for prime-age workers but has risen significantly for younger workers



Source: BLS, MUFG Bank Economic Research Office

Chart 4: Employed teenagers that left the labor force drove the unemployment rate higher



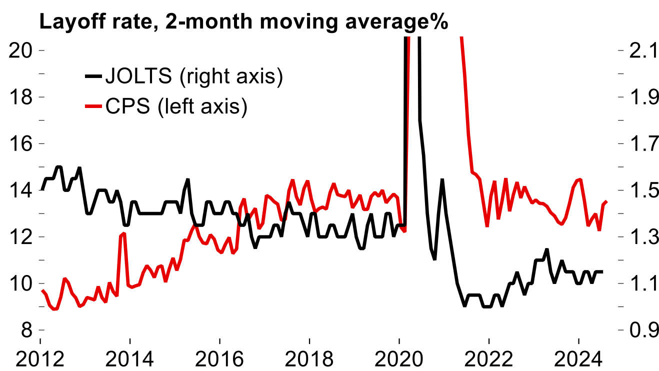
Source: BLS, MUFG Bank Economic Research Office

Though significant, this rise will likely not be consequential. Shown in Chart 4, the unemployment level for younger workers increased only slightly, but the drop in the labor force was substantial. This led to both a drop in the labor force participation rate of younger workers and a rise in the unemployment rate. This was mostly concentrated in teenagers (16-19), where the drop in employment was met with an equal drop in the labor force. In other words, teenagers with jobs left the labor force.

This is far from indicative of a weakening labor market. If it weren't for the unusual drop in the labor force of younger workers, the unemployment rate would have fallen to 4.1% in August, instead of only 4.2%. Additionally, prime-age workers comprise the majority of the labor force, and the slow rise in unemployment over the past six months has largely been due to growth in the labor supply from immigration (i.e. new entrants) and growth in participation rates (i.e. re-entrants). Job losses and layoffs remain low by historical standards.

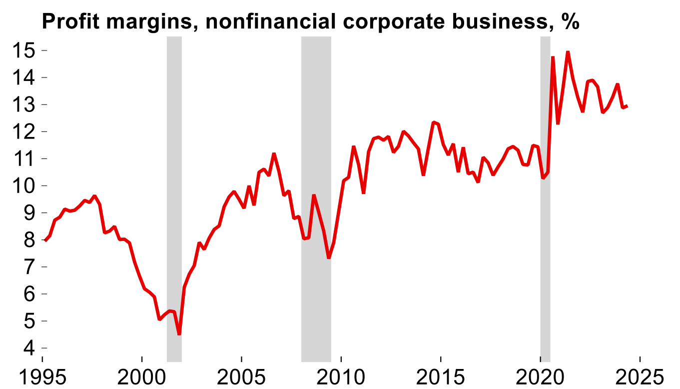
Shown in Chart 5, the layoff rate, both from the JOLTS establishment survey and the CPS household survey, remains low. In the case of JOLTS layoffs, they remain historically low and well below the pre-pandemic rate. In the CPS, job layoffs as a share of total unemployed remains in line with the pre-pandemic average.

Chart 5: Layoffs from both the household and establishment survey remain low by historical standards



Note: CPS rate calculated as layoffs as a share of total unemployed. JOLTS rate calulated as layoffs as a share of total employed for private industry.
Source: BLS, MUFG Bank Economic Research Office

Chart 6: Historically high corporate profit margins suggests that companies have little reason to start cut costs significantly



Note: Ratio of corporate profits after tax with IVA & CCAdj to gross value added
Source: BEA, MUFG Bank Economic Research Office

The general trend in the labor market is more characteristic of normalizing rather than weakening. This is both true of slower employment growth and the rise in the unemployment rate. In aggregate, businesses are not in a position where cost cutting measures are necessary. Shown in Chart 6, corporate profit margins remain historically high as of Q2. Combined with strong consumer spending data in Q2, and looser than average credit conditions, the economic situation remains consistent with a "soft landing" scenario.

As the labor market normalizes and inflation trends toward the 2% target, it is only natural for the Fed to begin normalizing interest rates toward the long-run neutral rate that is likely below 3%. But as of now, there is little reason that the Fed should cut rates more aggressively than 25 basis points in September.

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