Economic Analysis

Labor Market Conditions Weaken in September

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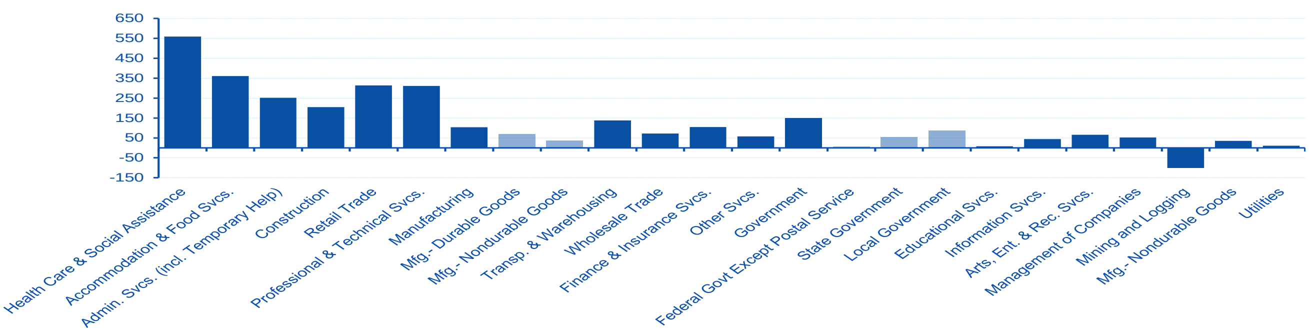
- **Nonfarm payrolls disappointed at only 142K in September and a revised 136K in August**
- **Wage growth and labor force participation deteriorated, hurting the Fed's outlook**
- **Data rule out an October liftoff and reduce the probability for December**

September's jobs report was not the confidence boost we were hoping for to close out the third quarter. In fact, the disappointing figures suggest that maybe the Fed was right to delay the rate hike after all. Nonfarm payrolls fell way below consensus expectations, up a mere 142K, following a significant downward revision to August's already discouraging data (from 173K to 136K). Even more surprising was the weakness in private payrolls, at only 118K in September and revised down from 140K to 100K in August. Mining and manufacturing were the weakest in the bunch, down 10.3K and 9K, respectively. Strong government hiring throughout the past few months occurred mostly at the state and local level, with a large portion in educational services.

Yellen and her FOMC colleagues were hoping for "some further improvement" in the labor market, though they did not have payroll growth in mind when addressing their remaining concerns. The falling participation rate, low wage growth, and elevated involuntary part-time employment continue to weigh on the labor market outlook. In September, the participation rate declined to 62.4%, the lowest since October 1977. Average hourly earnings were unchanged following relatively strong growth in the summer months. September did see a drop in the number of those working part-time for economic reasons, though levels remain far above pre-crisis norms.

Now that the Fed is back to worrying about headline data, the chances of delaying liftoff past December seem more likely. After's today's disappointing employment report, federal funds rate futures suggest a 30% probability for a December rate hike, down from about 40% prior to the data release, and near 0% for October. Although the unemployment rate held at 5.1% in September, the Fed seems willing to make continuous adjustments to their long-run projections until they start seeing further signs of reduced slack in the labor market (i.e. wage growth). Unfortunately, September's data resets all the progress made over the past year and ensures that the Fed will need at least another few months before feeling comfortable enough for a rate hike.

Chart 1
12-Month Nonfarm Payroll Growth (SA, Thousands)



Source: BLS & BBVA Research