BBVA RESEARCH

Economic Analysis

Job growth slows and participation rate falls in May

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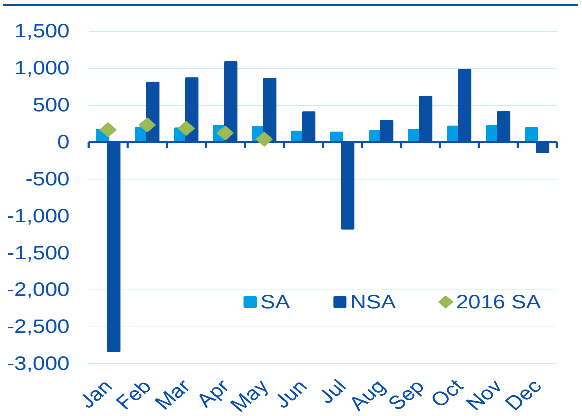
- **Nonfarm payrolls rose only 38K, the slowest seasonally-adjusted pace since September 2010**
- **Unemployment rate fell to 4.7% as the participation rate declined from 62.8% to 62.6%**
- **Average weekly earnings continued to increase, but less so than last month**
- **Weakness in payroll growth and the participation rate are not supportive of an immediate rate hike given the expected rise in economic uncertainty that may come from this report**

May's nonfarm payrolls rose much less than expected, up a mere 38K, with private payrolls up only 25K. Consensus estimate stood at 158K. The report shows a significant slowdown in labor market expansion and follows somewhat weak gains in April, which were revised down from 160K to 123K. March's payroll figure was also revised down, from 208K to 186K. The unemployment rate fell to 4.7%, compared to 5.0% in the previous two months, due to an unexpected fall in the labor force participation rate from 62.8% to 62.6% (consensus was for no change in the labor participation rate). The labor force participation, which reached an almost 38-year low in September, was increasing through March. The workforce shrank by 362K in April and 458K in May. Status flows show a sharp drop in the number of those finding a job that were not counted in the labor force, a trend that had been on the rise from September to February. This may be another indication that the pool of workers is shrinking, limiting hiring options during this prolonged period of business uncertainty.

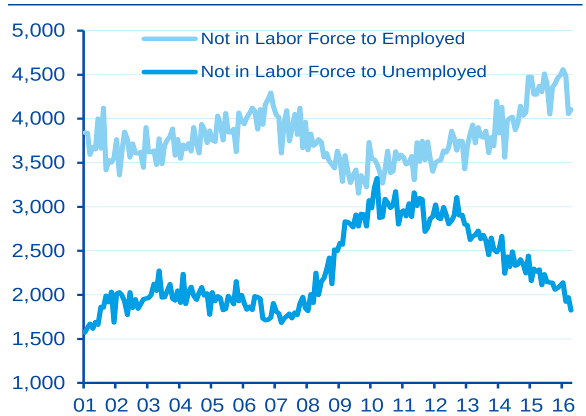
The slowdown in employment growth in May was to a large degree a result of a 36K decline in employment in goods-producing industries, reflecting ongoing weaknesses in mining and manufacturing and a surprise drop in construction employment. But the gains in services were not strong at all either – at 61K, they were the lowest since June 2012 (Chart 1). The decline in services employment was due to weakness in wholesale trade (-10.3K), utilities (-1.3K), information (-34.0K) and temporary help services (-21.0K). That said, multiple sectors still posted solid gains: retail trade (11.4K) financial activities (8.0K), education and health services (67.0K), the highest in seven months), and leisure and hospitality (11K).

Chart 1
Nonfarm Payrolls (2010-Present Avg MoM in K)



Source: Bureau of Labor Statistics & BBVA Research

Chart 2
Flows into the Labor Force (Thousands, SA)



Source: Bureau of Labor Statistics & BBVA Research

May's report is certainly disappointing, but it does not necessarily mean that labor market improvements are coming to an end. We are close to (if not already at) full employment, so a moderate slowdown in job growth from the +200K level would be a natural progression. Furthermore, there has been an outlier (extremely low figure) in the first half of almost every year since the recession – not always in the same month, but usually as a response to either weaker or stronger-than expected trends in the first quarter, depending on the seasonal adjustment factors. Despite this discouraging growth for May, we can still keep our heads high that job growth will rebound in the months ahead.

As a result of the still ongoing labor market tightening (albeit much less so), average weekly earnings increased 0.2% MoM, following the 0.35% increase in April. The average workweek remained flat at 34.4 hours. The index of aggregate weekly hours increased 0.1% MoM. These trends should support the firming up of inflation, as long as the gains in employment continue and consumer confidence does not deteriorate.

Slower employment growth and lower labor participation in May (specifically, the drop in ability of the labor market to employ people previously not in the labor force) combined with the low growth figures for the first quarter will weigh on the Fed when deliberating further interest rate hikes this year, although the growth in earnings should provide some encouragement. Although most Fed members are convinced that their maximum employment objective has mostly been met, May's employment report will most likely cause too much volatility and heightened uncertainty for the Fed to comfortably raise rates at their meeting in two weeks. Market expectations for a rate increase in June have dropped from near 30% to near 5% following this report. This does not bode well for the hawks at the Fed wanting to push this process along.

Our baseline scenario assumes 2% employment growth in 2016 (the average for the first four months is 1.85% YoY), down from 2.1% in 2015, with an average unemployment rate of 4.9% for the year. We see labor force participation at the very least stabilizing going forward. May's employment report, although much weaker than hoped for, is still consistent with this scenario, even though the risks are now tilted to the downside, especially keeping in mind the deterioration in business confidence in May compared to the previous two months and the persistently low business investment.