ECONOMIC UPDATE

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August Employment Report: No Dog Days For The Labor Market This August

- Nonfarm employment rose by 201,000 jobs in August; prior estimates for June/July were revised down by a net 50,000 jobs
- Average hourly earnings rose by 0.4 percent; aggregate private sector earnings rose by 0.5 percent in August (up 5.1 percent year-on-year)
- The unemployment rate was unchanged at 3.9 percent in August (3.853 percent, unrounded); the broader U6 measure fell to 7.4 percent

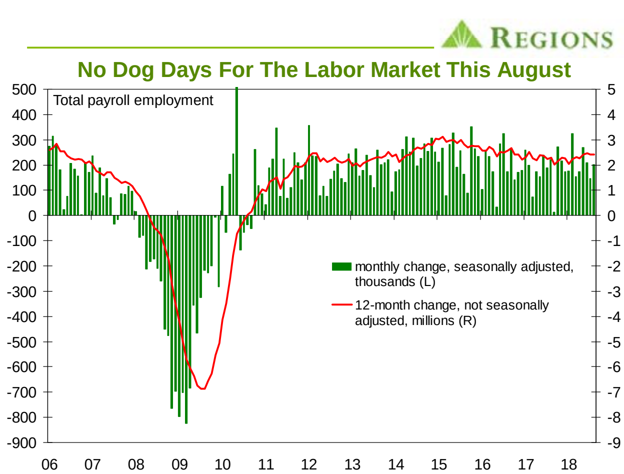
So much for the "August effect." Total nonfarm payrolls rose by 201,000 jobs in August, topping the consensus forecast of a 190,000 job increase and our forecast of a 173,000 job increase. As we noted in our weekly *Economic Preview*, since 2000 the initial estimate of August job growth has been revised up by an average of 55,000 jobs (first to third estimates), mainly due to what is typically a low response rate to the August establishment survey. Our forecast was predicated on the August effect holding this year. At 76.6 percent, however, the response rate this August is the second highest of any August on record. All of which leaves August job growth about where we thought it would be absent the August effect. The unemployment rate held at 3.9 percent, and the broader U6 measure, which also accounts for underemployment, fell to 7.4 percent, the lowest since March 2001. Average hourly earnings posted a 0.4 percent increase, leaving them up 2.9 percent year-on-year.

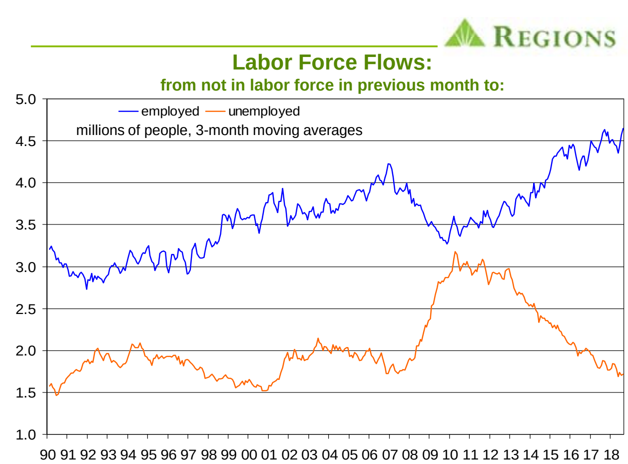
One troublesome detail in the August employment report is that prior estimates of job growth in June and July were revised down by a net 50,000 jobs for the two-month period, most of which came in the manufacturing sector, with a net downward revision of 31,000 jobs. The initial estimate for August shows factory payrolls fell by 3,000 jobs, with the one-month hiring diffusion index for manufacturing falling to 52.6 percent, the lowest since May 2017. While the temptation for many will be to attribute the reported decline in manufacturing payrolls in August to mounting global trade tensions, we're not going to make that leap just yet, particularly given continued growth in new export orders as reported by the ISM. This isn't to dismiss concerns over trade tensions, but instead to simply note the August employment number is at odds with other data points pertaining to the manufacturing sector.

Both the labor force and household employment declined by better than 400,000 persons in August, which the instant "analysis" attributed to the deep scars remaining on the labor market from the 2007-09 recession. This is yet another illustration of how actually looking at the details of the data is useful in, you know, interpreting the data. On a not seasonally adjusted basis, 1.923 million people between the ages of 16 and 24 left the labor force, the largest decline on record for the month of August. This simply reflects the timing of the school year, as in a typical year you see more people in this age cohort exit the labor force in September. The decline this August swamped the seasonal adjustment factors, leading to the decline in the headline number – a similar effect is seen in the data on household employment. As such, the reported decline in the labor force in August isn't a story about people displaced from the labor force despite some leaping to that conclusion based on the headline number. That the decline in August was so large implies the decline this September will be far smaller than normal, which will likely lead to a large increase in participation amongst this age cohort in the seasonally adjusted data, which will likely bias the estimate of the total labor force higher

The data on labor force flows should lay to rest concerns about labor force participation. As seen in our chart below, over 4.5 million people per month continue to transition from not being in the labor force in one month to being employed in the following month, an exceptionally strong number even when scaled to the size of the labor force. This of course can't go on forever, but we think it does have longer to run and which will, the jump in August notwithstanding, continue to weigh on growth in hourly earnings. Wage growth in August was strong in construction and transportation/warehousing, sectors in which labor shortages have been most pressing. Again, we won't make any sweeping conclusions as to what the jump in hourly earnings in August may or may not mean to the FOMC, and will instead point to what over the past few quarters has been better than 5.0 percent growth in aggregate wage and salary earnings, which is far more significant than growth in hourly earnings. Growth in aggregate wage and salary earnings continues to easily outpace inflation and underpin steady growth in total personal income.

At some point labor supply constraints will become more broadly binding and the pace of job growth will slow. We don't think this point will come until sometime in 2019, and for now the labor market remains rock solid.





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