ECONOMIC UPDATE

REGIONS

June 5, 2020

May Employment Report: A Small Step Forward On A Long Road Back

- Nonfarm employment rose by 2.509 million jobs in May; prior estimates for March/April were revised down by a net 642,000 jobs
- Average hourly earnings fell by 1.0 percent in May; aggregate private sector earnings rose by 3.3 percent (down 6.03 percent year-on-year)
- The unemployment rate fell to 13.3 percent in May; the broader U6 measure fell to 21.2 percent

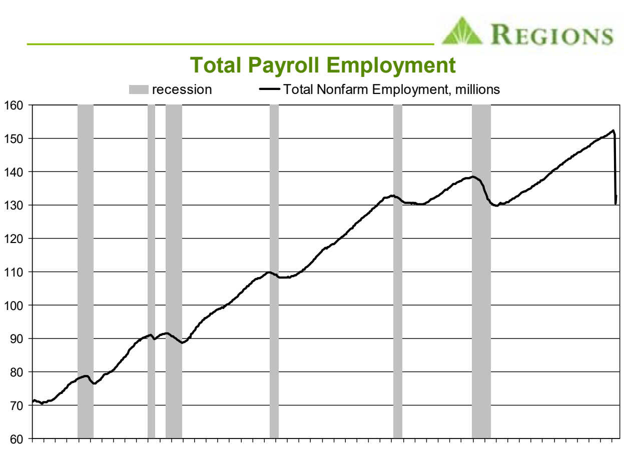
Total nonfarm employment rose by 2.509 million jobs in May, with private sector payrolls up by 3.094 million jobs and public sector payrolls down by 585,000 jobs. Prior estimates of job losses in March and April were revised to show a total of 642,000 more job losses for the two-month period than had previously been reported. The unemployment rate fell to 13.3 percent in May, while the broader U6 measure, which also accounts for underemployment, fell to 21.2 percent. Average hourly earnings fell by 1.0 percent in May, reflecting payback for an outsized increase in April, but despite hourly earnings falling, a longer average workweek and the gain in employment meant that aggregate wage and salary earnings rose sharply in May. To be sure, the May employment report was much stronger than anyone would have imagined, let alone forecasted, and in the immediate aftermath of the release of the report, some were pointing to it as "proof" that the "V-shaped recovery" is well underway. While we were as surprised as anyone else, our take is that the May employment report represents a small step forward on what we still think will be a long road back for the U.S. economy.

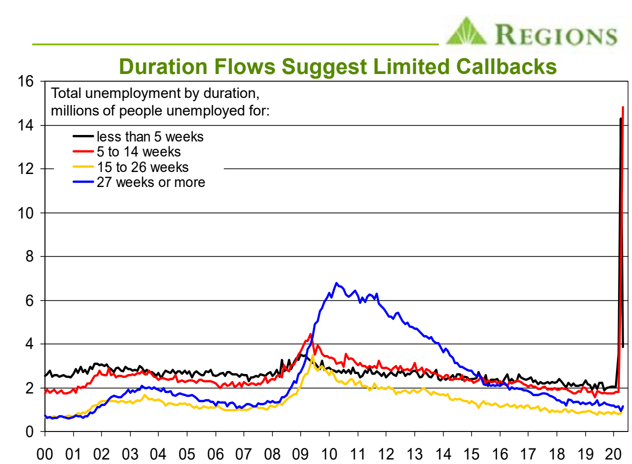
May's job gains were broad based across private sector industry groups, and those industries hit hardest by the sudden stop in economic activity in March and subsequent lockdowns registered some of the largest job gains in May. Payrolls in the leisure and hospitality services group rose by 1.239 million jobs in May following the loss of 8.282 million jobs over the prior two months. Education and health services added 424,000 jobs in May after having seen payrolls decline by 2.768 million jobs over the prior two months, and retail trade payrolls rose by 367,800 jobs in May after having declined by 2.371 million jobs over the prior two months. All in all, the 2.509 million jobs added in May are but a small down payment applied towards making up for the loss of 22.060 million jobs in March and April. That this down payment came earlier than we anticipated doesn't change that broader point.

May's increase in employment reflects the easing of restrictions on economic activity that had been in place since mid-March along with the effects of the PPP program that resulted in workers who had been put on furlough being brought back on to payrolls – keep in mind that these workers would have been paid even if they did not actually work, which helps account for the seeming disparity between the headline job growth number and what, for the nation as a whole, were but limited steps to bring economic activity back online.

The unemployment rate fell to 13.3 percent as the increase in household employment was much larger than the increase in the labor force. Still, BLS notes that, as in March and April, reporting errors mean that the reported U3 unemployment rate is understated, with BLS noting that the U3 rate would be roughly three percentage points higher in the absence of these errors. The broader U6 measure fell from 22.8 percent in April to 21.2 percent in May. In addition to a still-high level of unemployment, the U6 measure is also being held up by the number of those working part-time for economic reasons, which stood at 10.633 million in May, down only slightly from 10.887 million people in April. As a reminder of the high degree of labor market turnover beneath the headline numbers, the number of those who lost a job or completed a temporary assignment fell to 18.291 million in May from 20.626 million in April. Of those who lost a job in May, 83.88 reported they were on temporary layoff, down from 87.6 percent in April but still far above what historically would have been considered a "normal" share. In May, 70.8 percent of those unemployed had been so for between 5 and 14 weeks, whereas in April those who had been without a job for less than 5 weeks far and away accounted for the largest share of the unemployed. The migration across duration buckets will help gauge the extent to which those who had been put on temporary layoff are getting their jobs back.

While not dismissing the better than expected May data, we do think it should be put in proper context. Though the brief but violent downturn seems to have run its course, layoffs nonetheless remain elevated even as others are called back to work. As such, it will be some time before the level of employment returns to where it was prior to the downturn.





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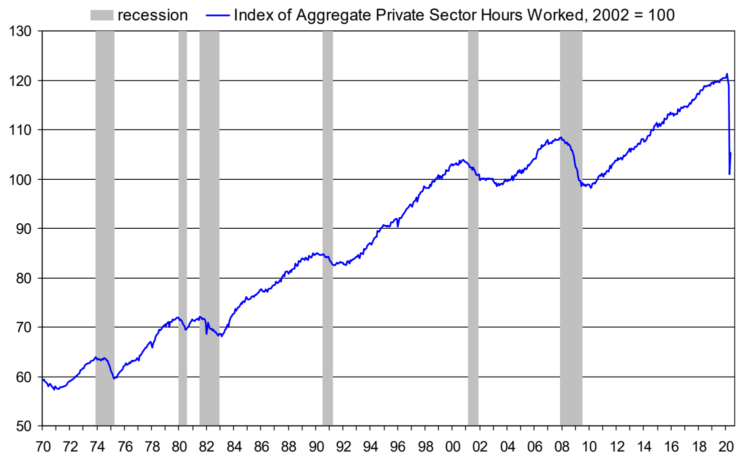
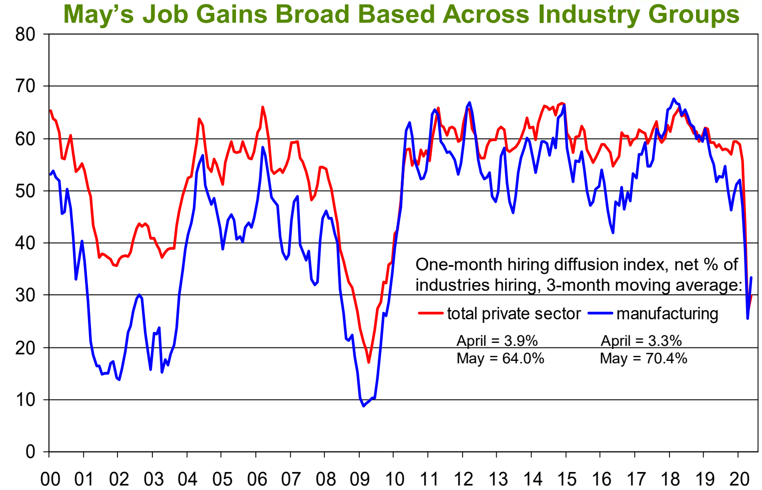
Aggregate Private Sector Hours Worked



The increase in aggregate hours worked in May did not come close to reversing the staggering decline seen in April. Through May, aggregate hours worked in Q2 were tracking for an annualized decline of 35.8 percent. The annualized rate is the basis on which changes in aggregate hours map into annualized changes in real GDP from a supply-side perspective. This is consistent with what we and many others expect to be an annualized contraction in real GDP of more than 30 percent in Q2.

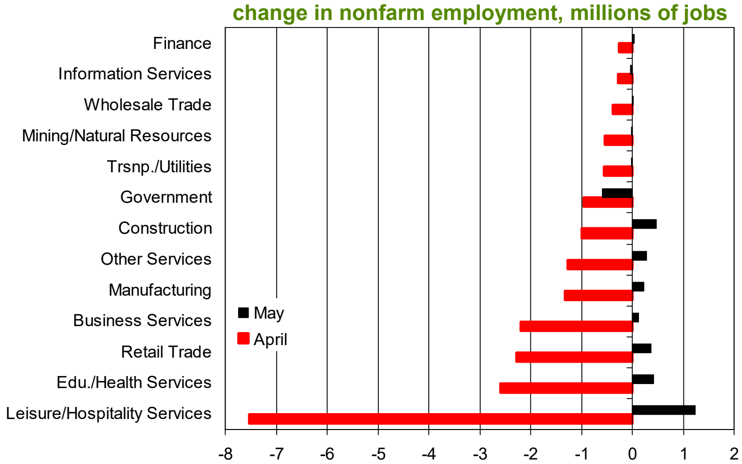
May's Job Gains Broad Based Across Industry Groups



After the vast majority of private sector industry groups shed workers in April, May saw broad based job gains across the private sector. While the breadth of hiring says nothing of the intensity of hiring, the rebound in the hiring diffusion index was nonetheless encouraging. This could be the template for the next several months – broad based but somewhat restrained hiring as firms feel their way though what is a starkly different economic landscape than that which prevailed prior to the COVID-19 virus.

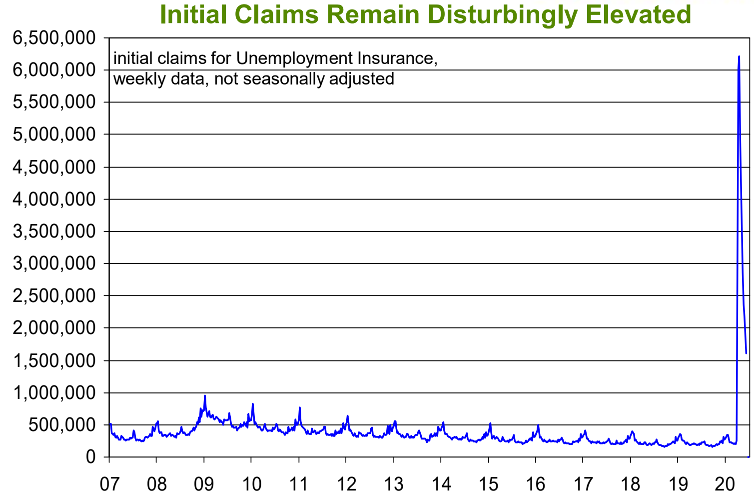
May Reverses Some Of The Damage

change in nonfarm employment, millions of jobs



April saw payrolls decline in each of the 13 broad industry groups. Though public sector payrolls fell in May, most of the broad private sector industry groups added jobs, led by those having been the hardest hit in April. The magnitude and distribution of job gains will bear watching over coming months. We do not yet know the extent to which May's job gains were driven by the PPP as opposed to actual increases in the level of activity that led firms to add to payrolls, and it will take a few months before we have a better read on this.

Initial Claims Remain Disturbingly Elevated



Despite being down sharply from their recent peak, initial claims for Unemployment Insurance (UI) benefits remain disturbingly elevated. In the 12-month period ending with February, initial claims averaged just over 216,000 per week. While some have referred to the recent decline as a "green shoot," we instead remain concerned that layoffs continue to top one million per week. It could be that initial claims will decline more sharply over coming weeks as more economic activity comes back online, but until we see that, we'll hold off on any talk of green shoots.

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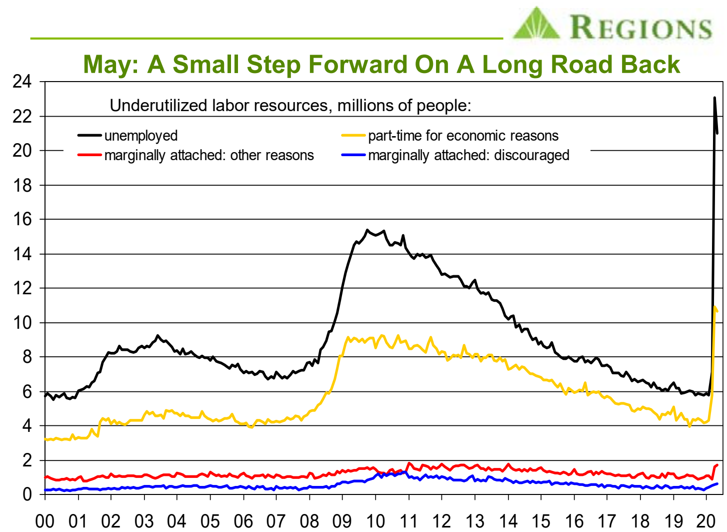
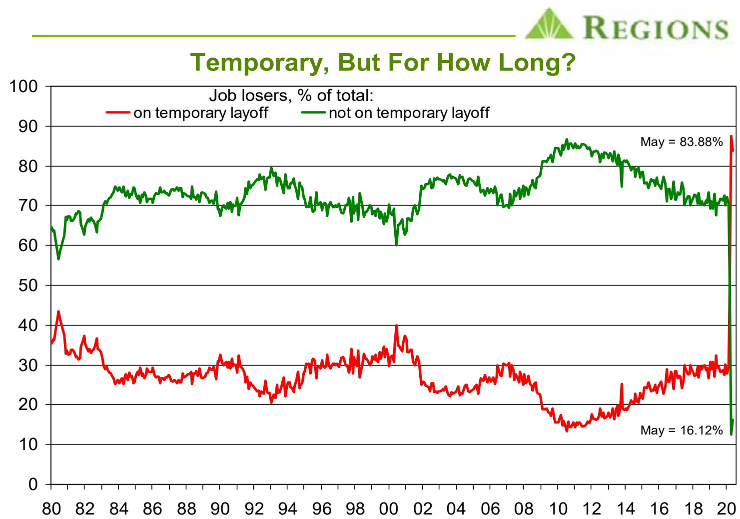
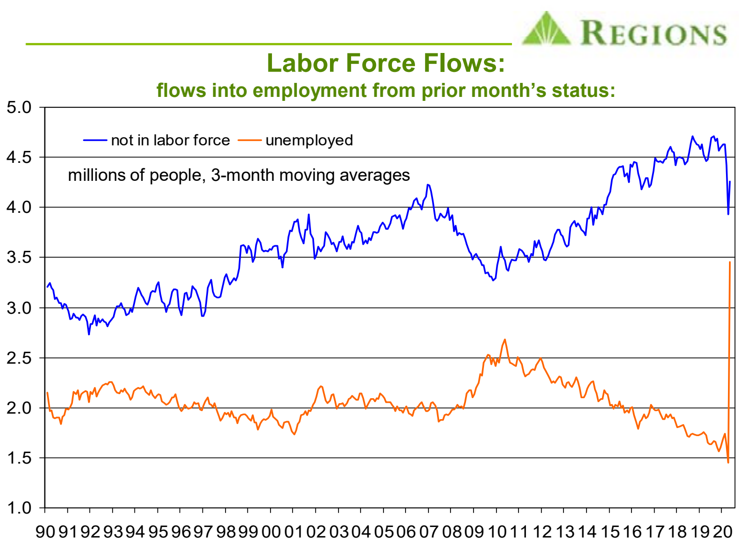


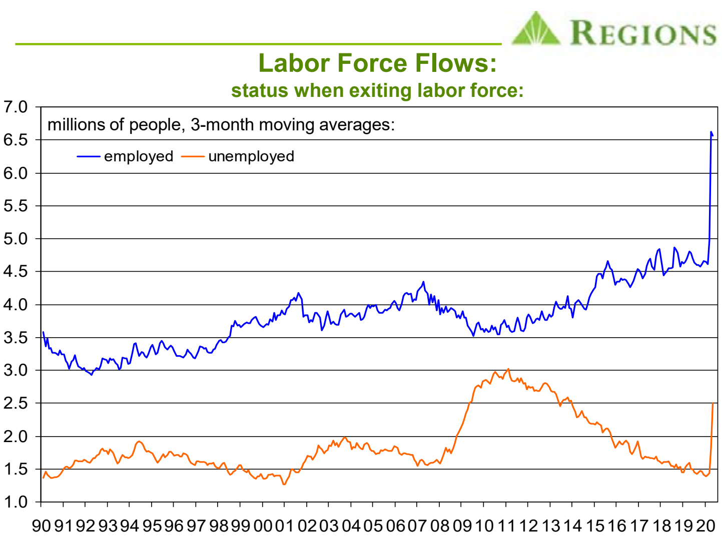
The impact on the labor market of the COVID-19 virus and the efforts to stem its spread goes beyond the number of people who have lost their jobs. Many remain employed but have had their hours cut, leading to a reduction in their total earnings. Many job losers have not begun to look for a new job given the extent to which large swaths of the economy are still shuttered, as reflected in the jump in the number of those marginally attached to the labor force. It took years to pare down the labor market slack stemming from the 2007-09 recession – how long will it take this time around?



As in April, the vast majority of those who lost a job in May reported they were on temporary layoff as opposed to having lost their job permanently. Going forward, the question is the extent to which these temporary layoffs are just that, as opposed to turning into permanent job losses. While lending programs aimed at small and mid-sized businesses are intended to keep this from becoming the case, it is too soon to assess their effectiveness, especially since the recovery in the broader economy is likely to be slow and uneven.



The data on labor force flows show most of those who became employed in May after having been either not in the labor force or unemployed in April came from the ranks of the unemployed. This suggests a sizable number of those who were laid off in April were brought back to work in May, though this does not come close to making up for the more than 20 million people who lost a job in April. Prior to March, flows from not in the labor force to employed had been notably strong, a measure of the recovery will be whether, or when, we see this strength return.



Prior to March, the number of people transitioning from employed in one month to out of the labor force in the next month had been steadily increasing, mainly reflecting older workers retiring. At the same time, fewer and fewer of the unemployed were dropping out of the labor force as steadily tightening labor market conditions enabled more of them to find jobs. Over the past three months, many of those who lost their job dropped out of the labor force completely, reflecting widespread shutdowns. It remains to be seen if those departures will prove transitory or permanent

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