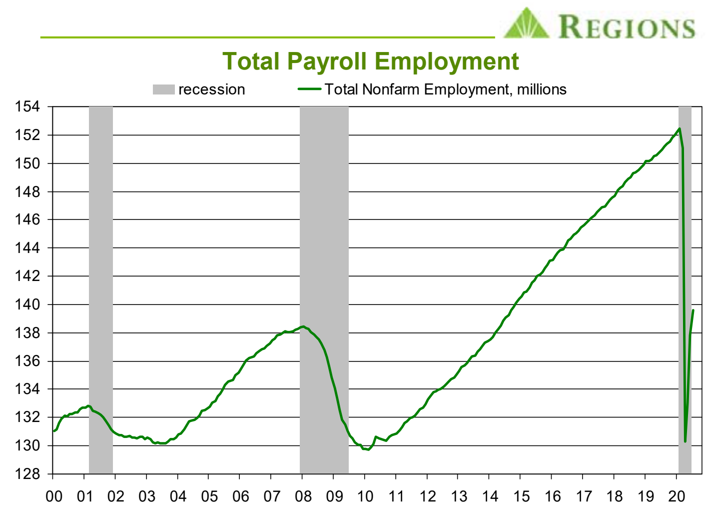
ECONOMIC UPDATE
REGIONS
August 11, 2020

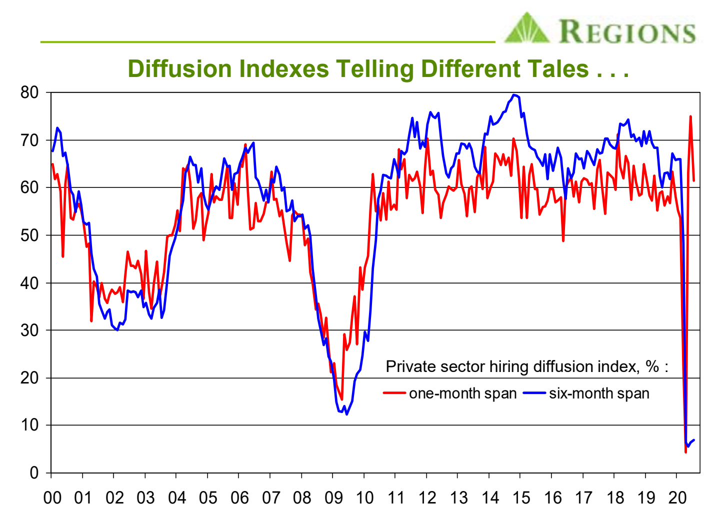
July 2020 Nonfarm Employment: Now Comes The Heavy Lifting

The July employment report was better than expected, and certainly better than feared, at least on the surface. Measured job growth was flattered by seasonal adjustment, and our sense is that the Paycheck Protection Program (PPP) continues to prop up measured job growth, which calls into question the durability of at least some portion of the job growth booked over the past three months. So, while it is clear that the labor market is healing, it nonetheless remains far from being healthy. Our sense is that progress will be harder to come by in the months ahead. In what follows, we take a more in-depth look at the July employment report than is possible to provide in our regular day-of-issue take on the monthly reports, and offer some observations on overall labor market conditions.

First, some simple bookkeeping. With total nonfarm employment having increased by 1.763 million jobs in July, nonfarm payrolls have risen by a total of 9.279 million jobs over the past three months, with private sector payrolls up by 9.435 million jobs and public sector payrolls down by 0.156 million jobs. The decline in public sector payrolls is understated, as measured July job growth amongst state and local governments (specifically, the education segment) was boosted by seasonal adjustment noise, with the seasonally adjusted data for August likely to show a sizable decline. Still, based on the data as reported, after accounting for the 22.160 million jobs shed during March and April and the jobs added in May, June, and July, total nonfarm payrolls are 12.881 million jobs below the level as of February 2020. As of July, the level of nonfarm employment stood at 139.582 million jobs, which is roughly the same level seen back in September 2014.



Based on the one-month hiring diffusion index, a measure of the breadth of hiring across private sector industry groups which we often refer to as one of our favorite "beneath the headlines" labor market indicators, hiring has been notably broad based over the past few months. After falling to an all-time low of just 4.3 percent in April, the one-month hiring diffusion index has risen sharply, climbing to 75.0 percent in June before settling back to a still-high 61.4 percent in July. There are reasons to believe, however, that hiring over the past three months has not been as broad based as implied by the one-month hiring diffusion index. The three broad private sector industry groups that were hit the hardest by the sudden stop in economic activity in mid-March – leisure and hospitality services, retail trade, and education and health services – have accounted for 70.2 percent of all private sector jobs added over the prior three months, after having accounted for 63.6 percent of total losses over March and April.



The BLS's hiring diffusion indexes are based on changes in employment in 258 distinct employment series (primarily 4-digit NAICS industries). Keep in mind that any diffusion index tells us the direction of change, but not the intensity of the change, in the variable it is tracking. The data suggest that, while a sizable share of industries have been adding, or adding back, workers over the past three months, the number of jobs added has been fairly subdued outside of the three broad industry groups cited above. We think it more

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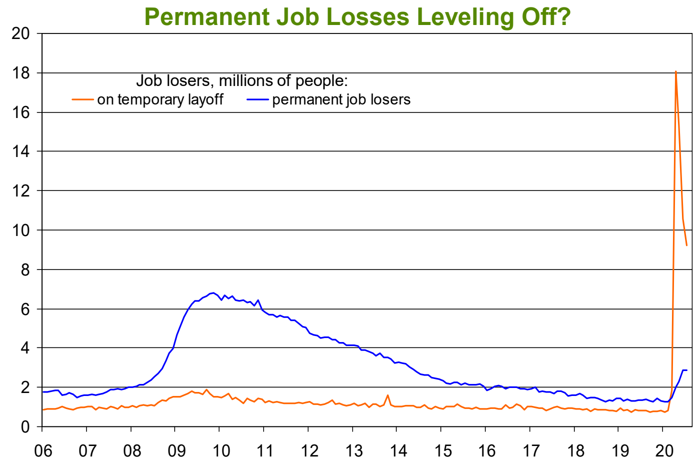
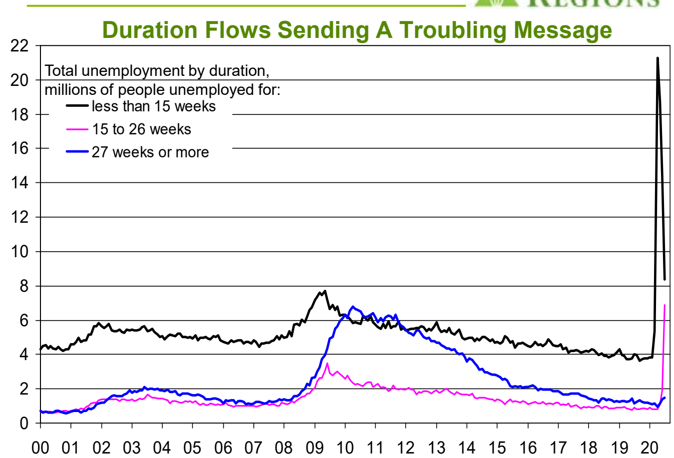
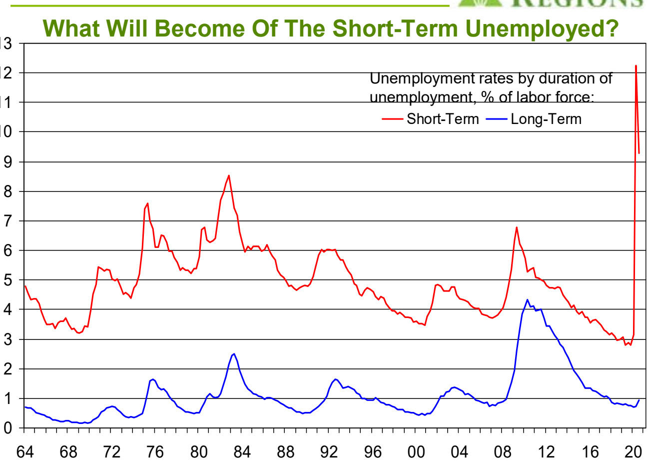
telling to look at the six-month hiring diffusion index as a snapshot of the damage inflicted by the pandemic and the efforts to stem its spread. The six-month hiring diffusion index, or, the net percentage of industries in which job counts were higher in the most recent months relative to six months earlier, stood at 7.0 percent as of July, meaning only a very small share of industries had more workers in July relative to January. While the one-month hiring diffusion index will bear watching in the months ahead, the six-month index may be a better marker of the extent to which the labor market, and the broader economy, are healing.



One of the more striking elements of the recent labor market data is the share of job losers who report they are on temporary layoff as opposed to having lost their jobs permanently. For instance, in April, 78.28 percent of job losers reported they were on temporary layoff, the first time in the history of the data, which go back to 1967, that the share of those reporting they were on temporary layoff was greater than the share reporting a permanent job loss. That share has since fallen but, at 56.46 percent in July, remains notably elevated. It bears noting that the BLS normally attaches a six-month window to temporary layoffs, i.e., one had to expect to be recalled to their job within six months to be classified as being on temporary layoff, but over recent months that time frame requirement has been suspended. Additionally, there are signs of reporting errors in the data over the past five months, i.e., people incorrectly reporting their status as "on temporary layoff."

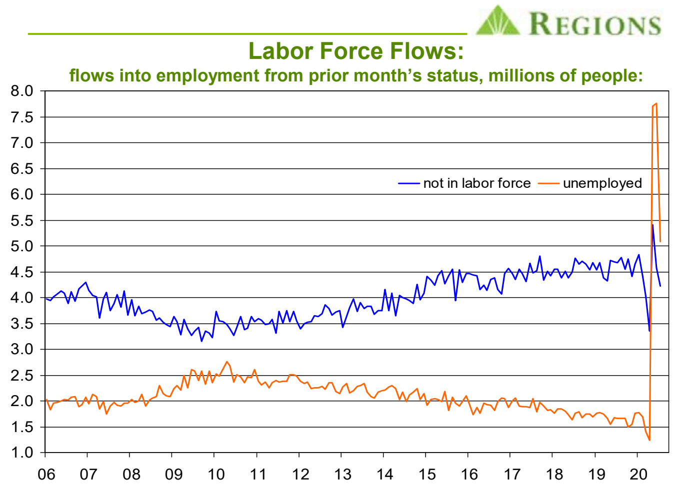
Even so, the temporary/permanent split is striking. At the same time the number of temporary layoffs, again, as reported by respondents to the BLS's household survey, was receding from April's peak, the number of those reporting a permanent job loss was increasing, though did hold steady at 2.88 million people in July. What is harder to tell from the data, however, is whether some of those who had initially reported being on temporary layoff changed their status to show a permanent job loss, and we do not know the extent to which coming months will see what started as temporary layoffs morph into permanent job losses. Over coming months, then, the data on permanent job losers will be the more important of the two series.





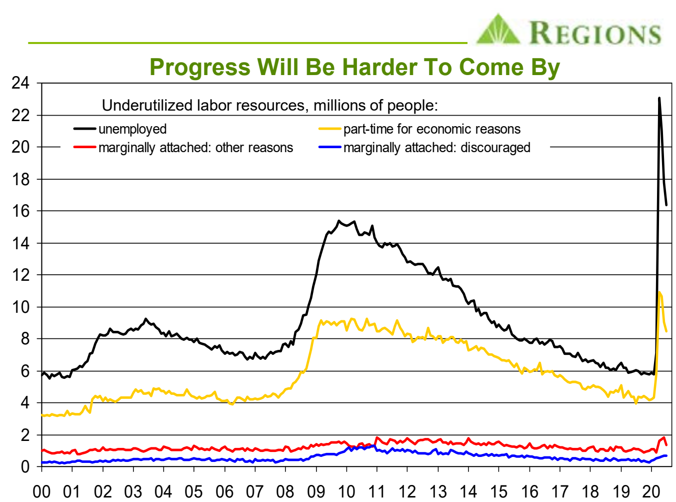
Along those same lines, the flows of unemployment across duration buckets suggest an increasing number of those who have lost jobs over recent months face longer stretches of joblessness than would have initially been assumed. As seen in the first chart above, the number of those unemployed for less than 15 weeks has fallen sharply since peaking at 21.287 million people in April; as of July, this number stood at 8.731. Though a large share of this decline reflects people either finding new jobs or being recalled to their last job, a significant number have migrated into the unemployed for 15-to-26 weeks bucket. This number increased to 6.864 million people in July, up sharply from 0.833 million people in April, indicating a troubling degree of persistence of unemployment. Note that the upturn in long-term unemployment, i.e., the number of those unemployed for 27 or more weeks, does not directly reflect job losses tied to the pandemic; the first of those to lose jobs back in March would not yet have been out of work long enough to have transitioned into this bucket.

Instead, the upturn could simply mean that the long-term unemployed have been unable to find jobs to the same extent as was the case prior to the pandemic, as the labor market progressively tightened over what, at over 11 years, was the longest U.S. economic expansion on record. Over coming months, it will bear watching whether, or to what extent, any decline in the "short-term" unemployment rate, i.e., unemployed for fewer than 27 weeks, reflects more people finding jobs or more people transitioning into "long-term" unemployment, i.e., unemployed for 27 weeks or more.



Each month the BLS reports data on labor force flows, which track changes in labor force status from one month to the next. In any given month, only one-third of the household survey turns over, i.e., reflects new respondents, while the other two-thirds of respondents are tracked in successive months. This allows BLS to track changes in labor force status, i.e., not in the labor force, employed, unemployed, or exiting the labor force. With the smaller sample size, the data on labor force flows are inherently more volatile than the other labor force series, but we have always found great value in tracking the trends in the flows data.

The chart to the side shows flows into employment amongst those who in the prior month were either not in the labor force (blue line) or unemployed (orange line). Note that, after having steadily trended lower over the prior expansion, the number of those transitioning from unemployed in one month to employed in the following month spiked to over 7.0 million in both May and June, before settling back to 5.08 million in July. The sudden upturn mostly reflects those who had lost a job in March or April having either found a new job or being recalled to their former job. That this number fell sharply could reflect the increased difficulty the recently unemployed may have in finding a new job or the lower likelihood of them being recalled to their former job over the months ahead, hence this number will bear watching. Additionally, after having risen steadily over the course of the prior expansion, the number transitioning from not in the labor force in one month to being employed in the following month fell sharply in March and April, which is not surprising given the economic backdrop. It could be that many of those who lost a job in March or April reported that they had left the labor force, perhaps thinking it unlikely actively looking for work would have been fruitful or simply awaiting recall from their former employer, which would help account for the spike in this series seen in May and June. But, this number fell sharply in July, and also bears watching over coming months. Over the prior expansion, we saw the steady upward trend in this series as a testament to the degree to which improving labor market conditions amidst a record-long expansion were drawing people back into the labor force. It could be some time before we see a repeat of those circumstances.



Just as we started, we'll end with some bookkeeping. The chart to the side shows the total number of, in former Fed Chairwoman Janet Yellen's term, underutilized labor recourses. The sum of these four groups is the numerator in the calculation of the broader "U6" rate, which accounts for both unemployment and underemployment. In February, there were 11.599 million people either unemployed or underemployed, and this number spiked up to 36.176 million in April. Though having since fallen, standing at 26.808 million in July, the number of underutilized labor resources remains significantly elevated, and our sense is that subsequent declines will be more gradual going forward. Two things to watch will be the rate at which the number of those involuntarily working part-time will fall – note how long after the end of the 2007-09 recession it took for this number to fall back to the pre-recession level – and whether, or to what extent, the number of "discouraged workers" continues to rise.

In short, our sense is that while the past three months marked a meaningful start, in terms of repairing the damage done to the labor market by the COVID-19 virus and the efforts to stem its spread, further gains will be harder to come by in the months ahead. That the past few recessions, none of which came close to the magnitude of the 2020 recession, were followed by frustratingly slow recoveries in the labor market suggests we have a very long, and likely very bumpy, road ahead of us.

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