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July Employment Report: Evidence Of Further Cooling In Labor Demand

- › Nonfarm employment **rose** by 187,000 jobs in July; prior estimates for May and June were revised **down** by a net 49,000 jobs
- › Average hourly earnings **rose** by 0.4 percent, while aggregate private sector earnings **rose** by 0.3 percent (up 5.7 percent year-on-year)
- › The unemployment rate **fell** to 3.5 percent in July (3.495 percent, unrounded); the broader U6 measure **fell** to 6.7 percent

Total nonfarm employment rose by 187,000 jobs in July, short of what we and the consensus expected, with private sector payrolls up by 172,000 jobs and public sector payrolls up by 15,000 jobs. Our forecast anticipated private sector payrolls rising by 179,000 jobs, so our miss on headline job growth mostly reflects a smaller than expected increase in public sector payrolls. Prior estimates of job growth in May and June were revised down by a net 49,000 jobs, with May’s increase now put at 281,000 jobs, down considerably from the original estimate of 339,000 that we from the start flagged as suspiciously large. Amid the ongoing deceleration in job growth, which we’ve noted was neither surprising nor concerning, we have pointed to three disturbing elements in the data, two of which stand out in the July data. Job growth was less broadly based in July, while the average length of the workweek dipped down to 34.3 hours, yielding the fourth decline in aggregate private sector hours worked in the past six months. As for the third disturbing element, the number of people working part-time due to slack business conditions fell in July but nonetheless remains well higher than was the case at the start of the year. The unemployment rate fell to 3.5 percent, matching our below-consensus forecast, with the labor force participation rate holding at 62.6 percent. Average hourly earnings rose by 0.4 percent, but thanks to the shorter workweek aggregate private sector earnings rose by just 0.25 percent, leaving them up 5.7 percent year-on-year, the smallest such increase since March 2021. As has routinely been the case since the onset of the pandemic, July saw a notably low response rate to the BLS’s establishment survey – 67.7 percent, which is the lowest July response rate since 2008 – suggesting some play in the initial estimate of July job growth. Recall that an extraordinarily low response rate was a key reason we flagged the initial estimate of May job growth as being suspicious. Either way, the July employment report brings evidence of further cooling in labor demand consistent with a slowing economy.

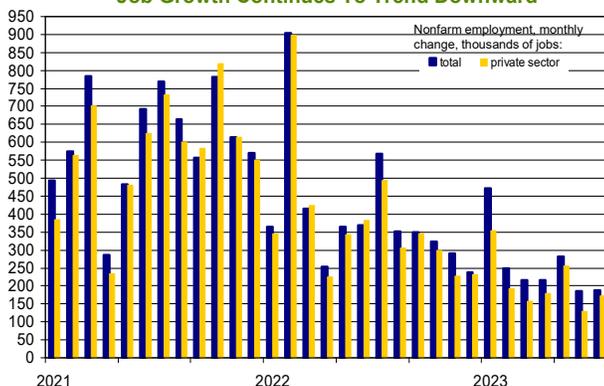
The one-month hiring diffusion index, a measure of the breadth of job growth across private sector industry groups, fell to 57.2 percent in July and, as seen in our second chart below, has drifted into the lower end of

the range that prevailed in the years prior to the pandemic. We’ve often noted that we see the breadth of job growth as a gauge of any expansion’s sustainability, so further declines in the diffusion index would be a red flag not to be ignored. To our point, health care has assumed the role of the main driver of job growth and saw payrolls rise by 63,000 jobs in July. Finance (+19,000), construction (+19,000), leisure and hospitality services (+17,000), and retail trade (+8,500) chipped in as well. It is, however, worth noting that the not seasonally adjusted increase in leisure and hospitality services payrolls was much smaller than the typical July increase, held down by a decline in restaurant jobs, which could be a sign of fraying in discretionary services spending. It is also worth noting that payrolls in transportation and warehousing services fell on a seasonally adjusted basis, reflecting declines in warehousing and delivery services in the unadjusted data. This segment has been weak for the past several months, in part reflecting shifts in consumer spending patterns. Note that any fallout from Yellow Corporation shuttering operations will turn up in the August data, with a potential impact of around 30,000 jobs.

The broader U6 measure, which accounts for both unemployment and underemployment, fell to 6.7 percent in July from 6.9 percent in June on a decline in the number of those working part-time for economic reasons. This number includes those doing so due to slack business conditions, a series that is volatile from month-to-month but, as noted earlier, the number of people in this category remains easily above that seen at the start of 2023. Combine this with the establishment survey data showing notable softening in aggregate private sector hours worked and you have clear evidence of diminishing demand for labor. While there is likely some degree of labor hoarding on the part of firms, the ISM’s July survey of the manufacturing sector is a sobering reminder that, absent evidence of a pick-up in final demand for goods and services, labor hoarding can and will turn into layoffs in short order.

The combination of smaller job gains and falling aggregate hours worked is leading to steady deceleration in growth of aggregate private sector earnings, which in turn will take a toll on growth in personal income.

 **REGIONS**
Job Growth Continues To Trend Downward



 **REGIONS**
One-Month Hiring Diffusion Index

