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Economic Research

Economic Briefing

US labor market softens markedly

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Dr. Christoph Balz
Bernd Weidensteiner

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The US labor market gives cause for concern. Only 114 thousand new jobs were created in July and the unemployment rate has continued to climb significantly to 4.3%. At the same time, wages are rising more slowly. This suggests that the Federal Reserve will now focus more on its employment mandate than on the inflation target. The first interest rate cut is likely to take place at the next FOMC meeting in September.

The data …

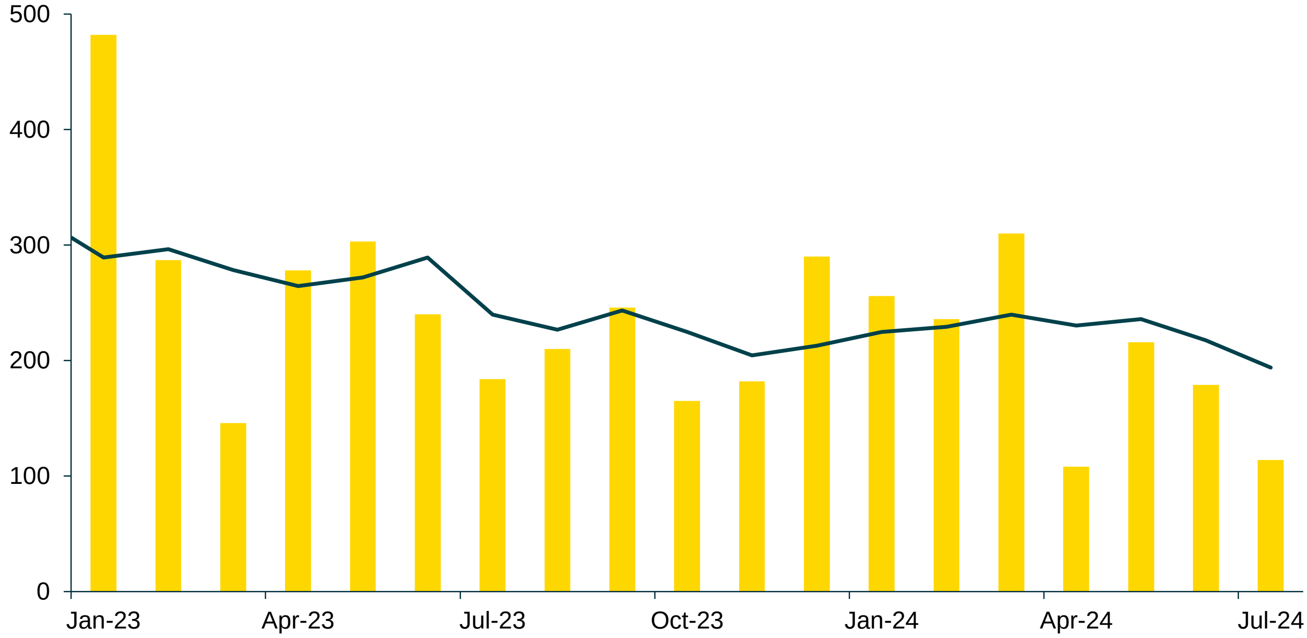
In July, job growth in the US amounted to 114 thousand, which is significantly less than expected (consensus and Commerzbank forecast: 180 thousand). In addition, the data for May and June were revised downwards by a total of 29k. The unemployment rate surprisingly rose from 4.1% to 4.3% (consensus and Commerzbank forecast: 4.1%).

… and the background

There is nothing to gloss over, the US labor market is weakening merkedly. The increase in employment in July was significantly lower than in the first quarter, for example, even if there was a slightly lower increase of 108 thousand in April (Chart 1). At the same time, the average work week was reduced, meaning that fewer hours were worked overall than in June. At the same time, wage growth is declining. Average hourly earnings are only 3.6% higher than a year ago. This means that wages are rising only slightly more than before the pandemic, when they increased by 3% to 3.5%.

Chart 1 - Employment growth slowing

nonfarm payrolls, month-on-month change in thousands. Line: six-month moving average



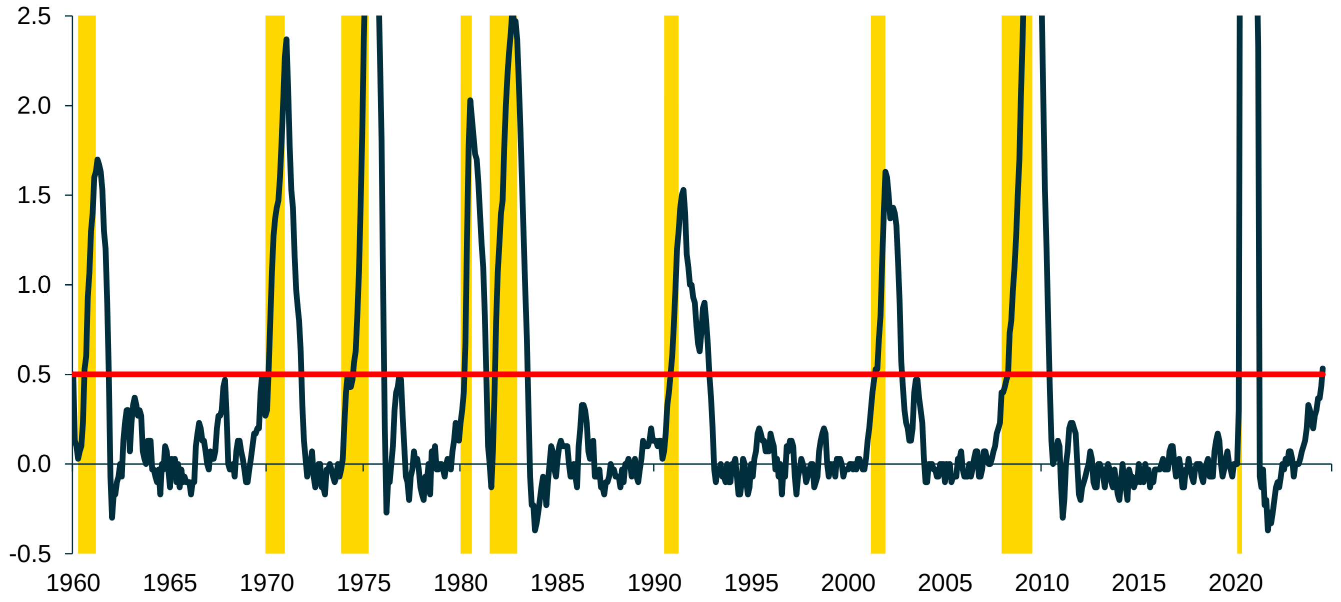
Source: BLS, S&P Global, Commerzbank Research

At the same time, the unemployment rate continues to climb. According to a rule established by economist Claudia Sahm, a recession is imminent if the three-month average of the unemployment rate rises by 0.5 percentage points or more from the low reached in the previous twelve months. The increase is now 0.53 percentage points, meaning that the recession threshold has been reached (Chart 2). This is a warning sign, even if the rise in the unemployment rate is probably partly due to increased immigration. The number of people in the labor force (employed plus unemployed) rose by 420 thousand in July.

We see the data as consistent with our view that the US economy is slowing down due to high interest rates. However, we still believe it is more likely that a recession can be avoided. After all, financing conditions are not dramatically difficult, judging by the record high share prices, the low risk premiums on corporate bonds and the banks' lending conditions, which have recently tended to apply the brakes less strongly.

Chart 2 - Sahm rule hits critical level

Sahm rule signals the start of a recession when the 3-month moving average of the unemployment rate rises by 0.50 percentage points (red line) or more relative to its low during the previous 12 months. Based on real-time data. Recessions shaded.



Source: FRED Federal Reserve Bank of St. Louis, Commerzbank Research

Labor market moves to the top of the Fed's agenda

Fed Chairman Jerome Powell already made it clear at this week's press conference: The US central bank is starting to worry about the labor market. For a long time, a slowdown in the labor market was in the Fed's interest in order to bring excessive inflation back under control. This has apparently been achieved, and the Fed no longer considers the labor market to be a significant source of inflation. Powell therefore emphasized that a further significant slowdown in the labour market would not be in the Fed's interest. However, today's data suggests that such a slowdown is on the horizon. A rate cut at the next meeting in September is therefore practically sealed.

Of course, one should not read too much into one month's data. And Powell relativized the Sahm rule as a recession indicator on Wednesday. The Fed will look at the "totality of the data" in order to reach a verdict. However, it is clear that the Fed will now focus on the labor market as part of its risk management approach to monetary policy. The only question is how quickly and how low it will cut key interest rates in order to prevent the economy from sliding into a recession – which is not apparent in the economic data despite weaker *growth* in many indicators.

Table 1 - US employment report

	Jul-24	Consensus	Jun-24	May-24	Apr-24	six month average
Nonfarm payrolls	**114**	180	179	216	108	194
Unemployment rate	**4.3**	4.1	4.1	4.0	3.9	4.0

Source: BLS, Bloomberg, S&P Global, Commerzbank Research

Analysts

Dr. Christoph Balz
Senior Economist
+49 69 9353 45592
christoph.balz@commerzbank.com

Bernd Weidensteiner
Senior Economist
+49 69 9353 45625
bernd.weidensteiner@commerzbank.com

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Commerzbank Offices

Frankfurt	**London**	**New York**	**Singapore**
Commerzbank AG	Commerzbank AG	Commerz Markets LLC	Commerzbank AG
DLZ - Gebäude 2, Händlerhaus	PO BOX 52715	225 Liberty Street, 32nd floor,	128 Beach Road
Mainzer Landstraße 153	30 Gresham Street	New York,	#17-01 Guoco Midtown
60327 Frankfurt	London, EC2P 2XY	NY 10281-1050	Singapore 189773
Tel: + 49 69 136 21200	Tel: + 44 207 623 8000	Tel: + 1 212 703 4000	Tel: +65 631 10000