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Interpreting The US Jobs Data

Household and Establishment Surveys Diverge

- Blowout headline jobs number and higher AHE suggest strong labor market
- But unemployment data from the household survey show job losses
- We still see CAD downside after Bank of Canada rate cut last week

Ambiguous Jobs Report

The US employment situation report for May released last Friday provided a contradictory look at the labor market, even though markets interpreted it hawkishly – yields and the dollar both rising. That shows focus on the blowout headline number for nonfarm payrolls (NFP) and higher average hourly earnings (AHE). The former, at +272k, handily beat expectations for 180k, and the latter rose to 4.1% y/y from 3.9% y/y in April. Despite stronger data from the establishment survey, we can't help but notice and point out other elements of the report which in our view suggest that some weakening in the labor market is at hand.

The establishment survey, which produces the headline NFP figures, also showed rather broad-based sectoral hiring, with most industries showing increases in employment. It was generally strong. The household survey, from which the unemployment rate and other employment status information is derived, was rather weak, however.

- The number of people reported to be employed actually fell by an eye-opening 408k, the biggest monthly drop since December of 2023. All told, employment as measured by the household survey has fallen over 800k since November 2023.
- Unemployment rose by 157k in May, bringing the total increase in unemployment since last July to over 700k people.
- Combined with a monthly decline in the total labor force of around 250k, the unemployment rate, which measures the ratio of unemployed persons to the size of the

labor force, increased from 3.9% to 4.0%. This is not the kind of increase in the unemployment rate that would be considered acceptable, since it was driven more by higher unemployment (as cited above) than by a larger labor force.

There has been quite a “wedge” opening up between total employment as reported by the establishment and household surveys. The chart below shows cumulative job gains since December 2022 as reported by each survey. There is now a difference of nearly 2.5 million jobs created over that period between the two surveys.

Establishment vs. Household Survey Data Wedge

Source: BNY Mellon Markets, Bureau of Labor Statistics

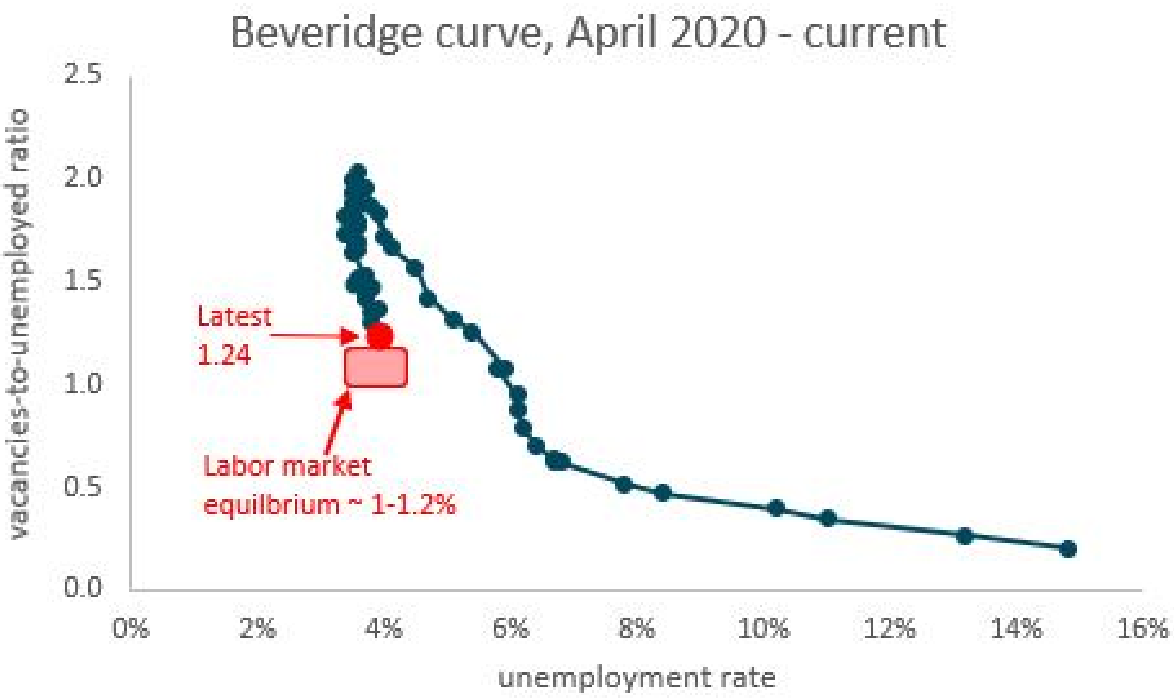
It has been proposed that some of this disparity is due to a surge in immigration over the past year (up an estimated 1.1 million since 2023). Immigrants with jobs are said to be picked up by the establishment survey better than in the household survey. However, even if every immigrant who entered the country wound up working, that would be insufficient to explain the gap. We therefore find the immigration explanation insufficient to reconcile the divergence in employment as measured by the two surveys.

Another explanation for the divergence could be the so-called “birth-death” model, which estimates the number of net new businesses created. It's lagging the actual economy, with more businesses closing than being created. This should catch up in time, and we expect the number of new jobs from the establishment survey to adjust lower in the future.

Other indicators have also suggested a slowing labor market, for example, the JOLTS data (job openings and labor turnover) also released last week. From the JOLTS survey we estimate that the ratio of job openings (labor demand) to the number of people unemployed (labor supply) is now down to 1.24, compared to 2.0 in March 2022 (has been declining steadily since). Historical analysis suggests that a ratio of about 1.0-1.2 can be considered an equilibrium value, so by this measure, we're seeing the labor market coming into better balance between supply and demand (using the Federal Reserve's characterization). Below is our latest version of the Beveridge curve, which plots the unemployment rate on the horizontal axis and the ratio of vacancies to unemployment on the vertical axis.

Despite the outsized rise in payrolls last month, our assessment of the totality of the jobs data is that the labor market is indeed coming into balance. If the Fed recognizes this, we think officials will overlook the large NFP print and remain focused on inflation data over the coming months. We still believe the FOMC is on track to cut rates in September, but those inflation data will be key. The May CPI and PPI reports are up next, the former to be released on the morning of the FOMC rate decision Wednesday afternoon.

Labor Market Reaching Equilibrium?



Source: BNY Mellon Markets, Bureau of Labor Statistics

Bank of Canada Sparks Move Lower in CAD

In this section we turn to Canada, where the central bank last Wednesday became the first in the G7 to cut rates; the European Central Bank followed a day later. Our view on the Canadian dollar is negative, and although it did weaken on the day of the Bank of Canada's action, we see it declining further.

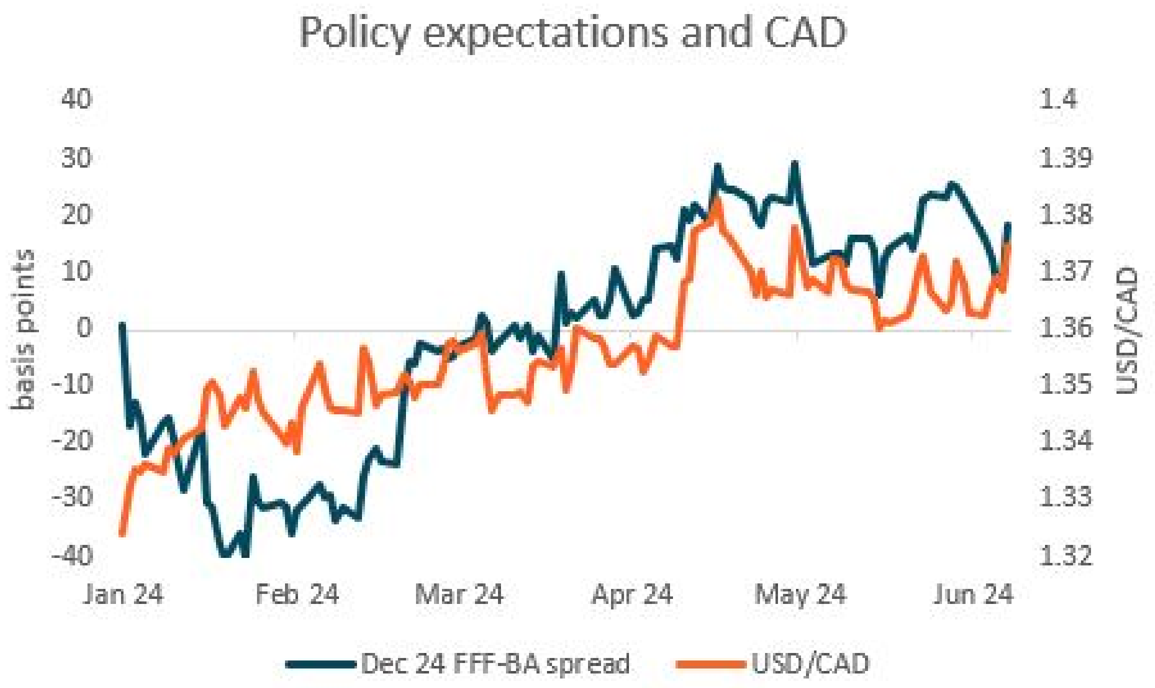
Justifying the rate decision as a response to a welcome decline in inflation and an outlook that sees inflation falling further, BoC Governor Macklem affirmed that if further progress on inflation is realized, “it is reasonable to expect further cuts to our policy interest rate.” We think this condition will be fulfilled and that we will indeed see additional cuts out of Ottawa.

The average of the two core inflation measures in Canada is now down to 2.75% after reaching highs of nearly 5.5% in mid-2022. Inflation ex housing, which excludes higher mortgage interest costs thanks to higher rates, is now down to just 1.2%, indicating that price pressures are indeed fading.

Forward curve pricing for the BoC indicates expectations of two more rate cuts by the end of the year, bringing the overnight rate – now 4.75% post-cut – down to 4.25%. That’s a faster pace of decline than is priced into the US curve, which has about 1.5 cuts (of 25bp each).

The chart below shows that the difference between December 2024 Federal funds futures and similarly dated Canadian bankers’ acceptances has been closely linked to USDCAD movements so far this year. Even though we expect the Fed to start cutting in September, we expect Canada rates pricing into 2025 to be more dovish and aggressive, with the Fed going slower and probably eventually settling into a relatively higher terminal rate.

Rate Expectations To Diverge Further, Bring USDCAD Higher



Source: BNY Mellon Markets, Bloomberg

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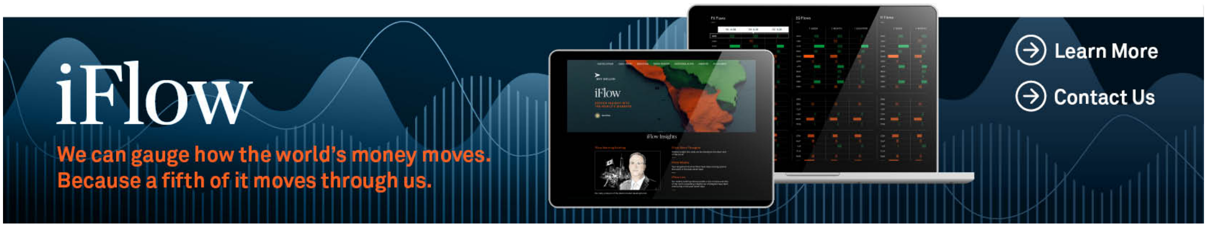

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