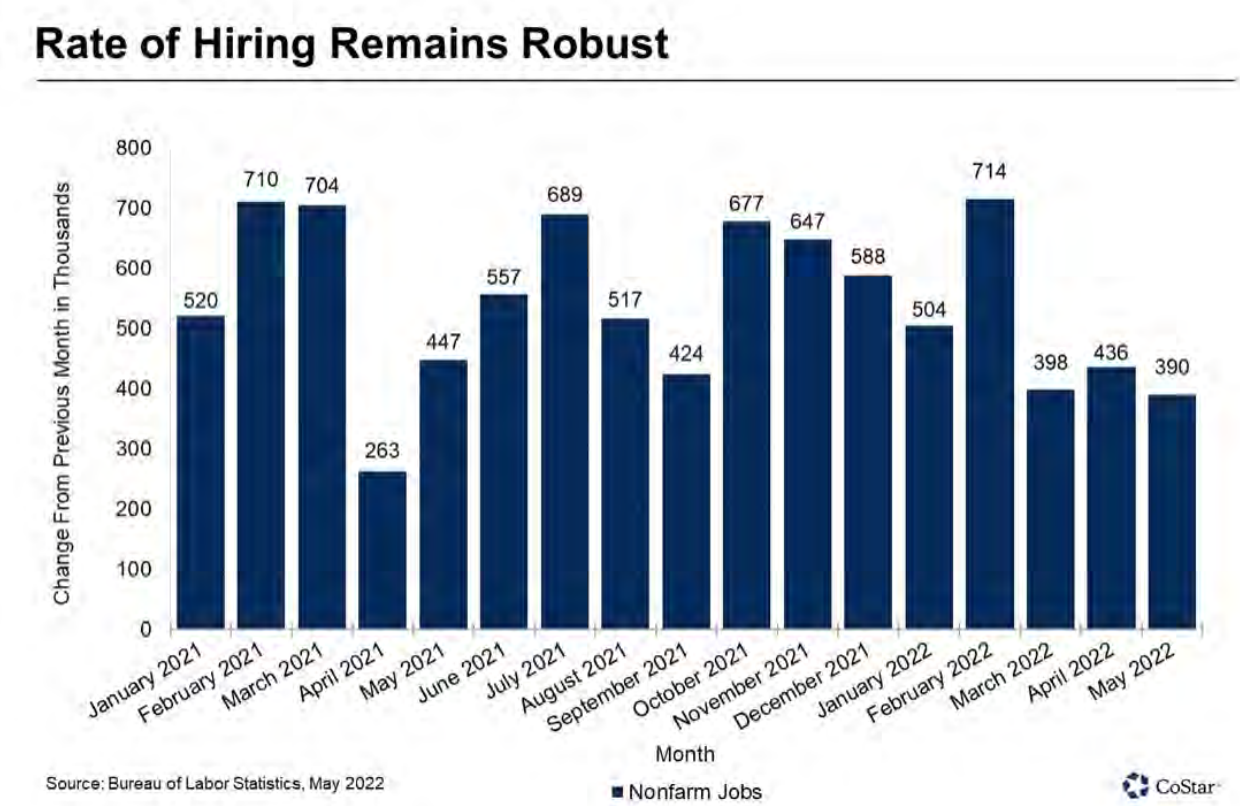
Wage Gains Slow, Making the Fed's Job Easier

But Latest Data Hints Inflation Still Running High

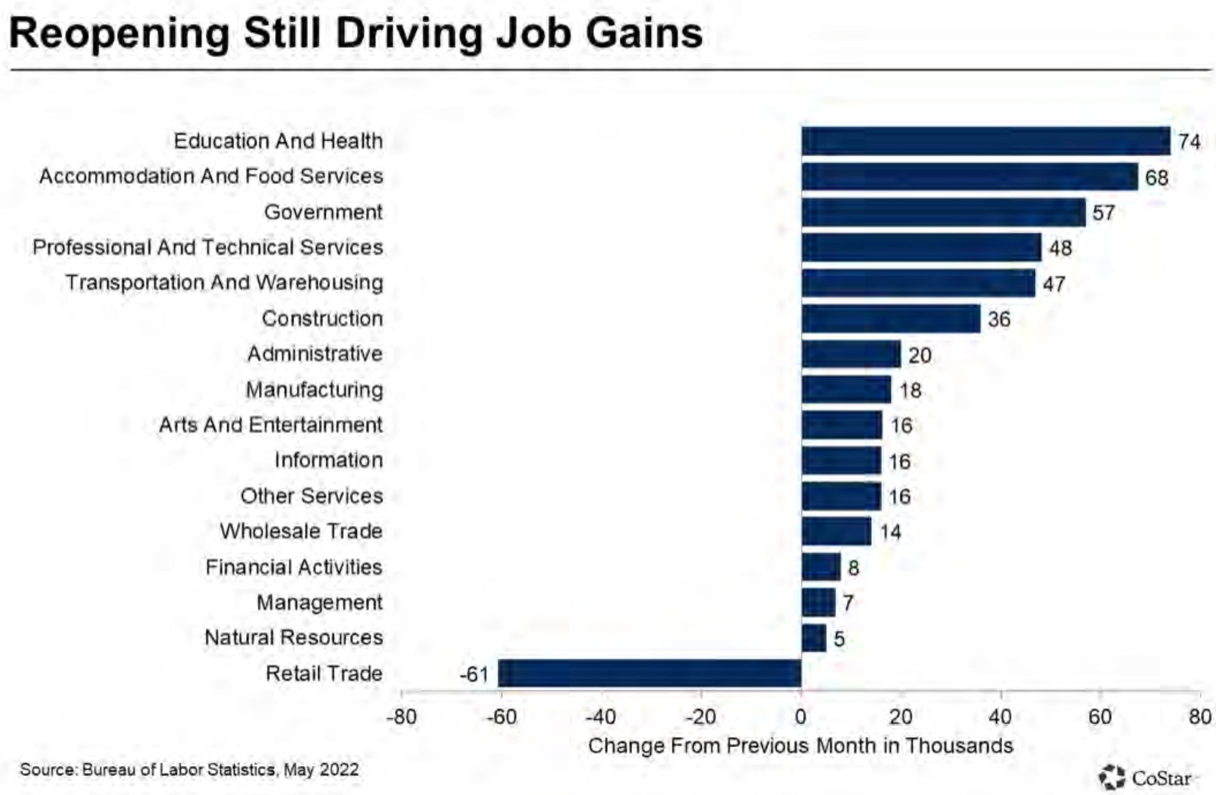
By Christine Cooper and Rafael De Anda

Last week's federal employment situation report hints that inflation is still running high, albeit decelerating. Job growth slowed and the labor market remains tight, yet earnings only grew in a handful of low-wage sectors.

Nonfarm jobs grew by 390,000 positions in May, the fewest jobs added over a month since April 2021. Still, monthly job gains have more typically been between 100,000 and 200,000 during previous periods of economic recovery or expansion, suggesting that we remain in recovery mode from the pandemic, and firms continue to hire at an extraordinary rate.



While job gains overall generally correlate positively with inflation, the composition of those increases tends to be quite diverse. Shortages of physical goods in the face of strong consumer demand have been one of the key factors driving inflation, so an uptick in manufacturing hiring would imply that shortages could soon ease and prices could come down. However, hiring in the manufacturing sector in May was only modest, with just 18,000 positions added. The sector is still 17,000 positions below its pre-pandemic staffing level.



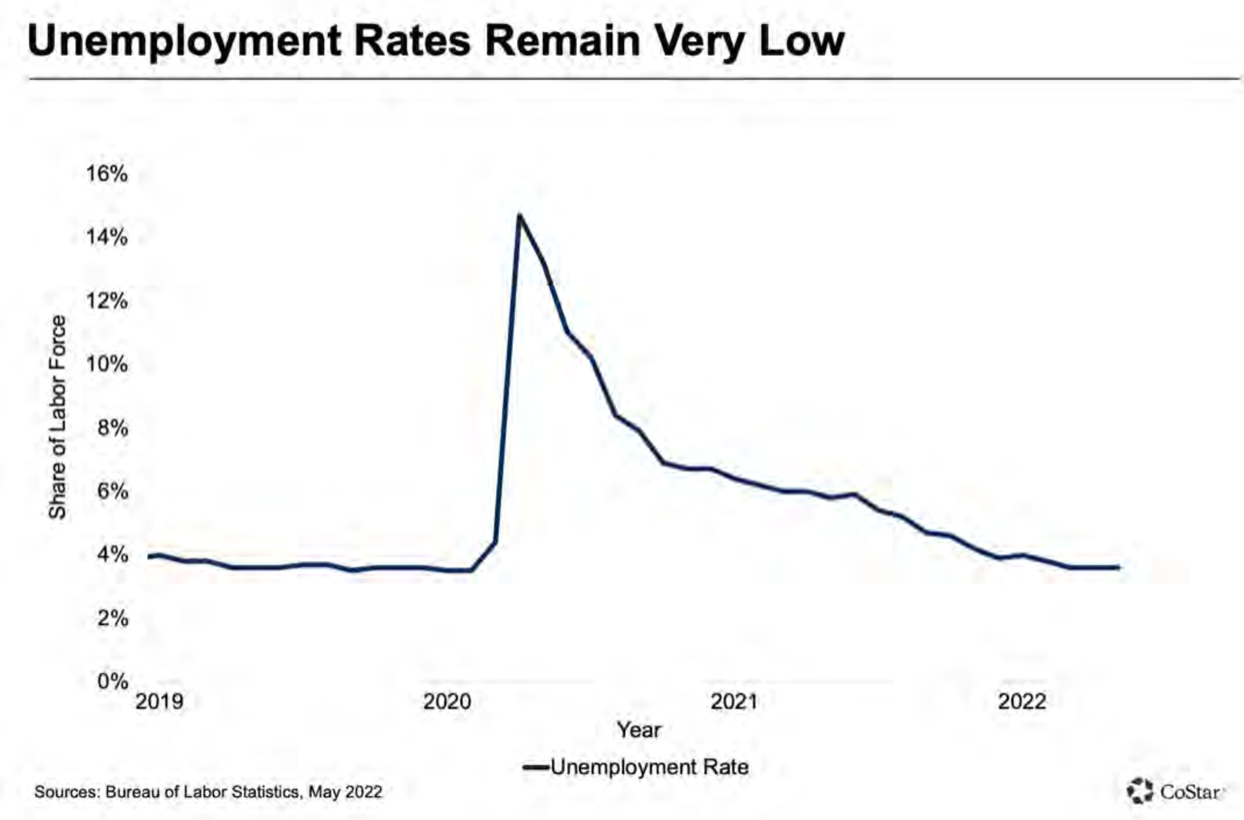
To be fair, the shortage of many goods is due to supply chain bottlenecks and a lack of imports as countries that we have relied on for decades grapple with COVID-related shutdowns and restrictions, and more recently with the war in Europe. With these interruptions gradually easing, we can expect to see factory jobs continue to climb and inflation on this front to moderate.

Efforts to reopen the economy have also been driving prices higher as pent-up demand for travel and services is finally being unleashed while staffing levels simultaneously remain low. Firms in this sector have been bringing workers back, but at persistently slow rates. Leisure and hospitality employment grew by 84,000 positions, with more than half of those jobs at bars and restaurants. The sector as a whole is still 1.3 million positions short of its February 2020 level.

While many workers remain out of the labor force, others who had worked at leisure and hospitality jobs in the past appear to have maneuvered into jobs in other sectors where employers typically provide better compensation, benefits, career growth opportunities and flexibility in telecommuting. Among these sectors, the professional and business services sector, which includes professional and technical services, management and administrative services, has experienced the most growth, adding 75,000 positions in May and now with 821,000 more jobs than in February 2020 levels.

Jobs Aplenty

The household survey continues to show that just about everyone who wants a job can have one. The unemployment rate remained 3.6% for the third consecutive month, just a tick higher than its pre-pandemic level. And May marked the seventh consecutive month for which the unemployment rate stood below 4.5% — roughly the natural rate of unemployment.



Meanwhile, the labor force overall has grown by 3.6 million workers during the past 12 months. That annual gain is nearly four times faster than the average for any year between 2010 and 2019. Women have been slow to return to work as child and family care has prevented many from returning. But much of the increase in the labor force in May was due to women coming back to the job market, with about two-thirds of them finding work. The labor force participation rate of women 16 years or older was 57% in May from 56.6% in April and 57.9% in February 2020, an encouraging development.

On the flip side, earnings growth was mild in May, which may provide the biggest support to the Federal Reserve as it undertakes a drastically hawkish shift in policy to combat rising inflation. Average weekly earnings grew by 0.3% in May for the second consecutive month. On a year-over-year basis, average weekly earnings growth of 4.3% marks the slowest rate of growth since January.

The slowdown offers some relief to fears of an impending spiral upward of wages and prices, which once entrenched can generate prolonged inflation, as experienced in the 1970s. In that experience, rising prices were finally defeated by the aggressive monetary tightening initiated by the Fed chairman at the time, Paul Volcker, who hiked rates to a hair-raising 20%, pushing the economy into a deep recession. With wage gains today still modest, there is no evidence that a wage-price spiral is emerging yet, giving the Fed more time to engineer a soft landing.