Weekly Economic Update—July 6th, 2021

All eyes were on the monthly jobs report this week, the signature release that best describes the health of the economy and the pace at which it is moving towards maximum employment, one of two ultimate objectives of the Federal Reserve– the other being stable inflation around 2 percent. While the report contains some murky details, there is little question that things are moving in the right direction. At the same time, it provides no compelling reason for the Fed to alter its policy intentions, at least over the next few months. The economy is healing at a steady pace, but the wounds are still visible and workers have a ways to go before recovering the job losses during the pandemic.

Overall, the economy added a hefty 850 thousand jobs in June, the largest increase since last August, and up from a 583 thousand gain in May. In normal times, that would be considered an eye-opening increase beckoning corrective measures from policy makers to stave off an inflation outbreak. But these are not normal times. The economy is navigating bumps in the road as it continues to reopen from lockdown conditions and strives to recover the 22.4 million jobs destroyed by the pandemic. Hence, even after fourteen months of outsized employment increases, there are still 6.8 million fewer workers holding jobs than there were prior to the pandemic. The unemployment rate, at 5.9 percent in June, remains well above the pre-pandemic level of 3.5 percent.

That said, the jobs shortfall and elevated unemployment rate is not a demand issue. Companies are feverishly striving to hire workers, as a record 9.3 million positions are waiting to be filled. The key restraint is one of supply. For a variety of reasons, workers are remaining on the sidelines, keeping a lid on the labor force participation rate. The share of the working age population either holding a job or looking for one remains at a low 61.6 percent, well below the 63.4 percent in January of last year. That 1.8 percent shortfall represents over 4 million missing jobs. People are returning and entering the workforce at a fairly steady pace, averaging 2.7 million a month over the past year and 2.8 million in June. But in one of the more striking developments last month, 942 thousand workers voluntarily left their jobs, the highest number of exiting workers since 2016.

It's unclear but highly likely that the surge in workers leaving their jobs reflects an abundance of job openings that is encouraging people to quit and move to other positions. That's consistent with earlier Labor Department figures from the JOLTs survey showing a jump in the quit rate. Until these job leavers land a new position, they are considered unemployed and underpin a higher jobless rate than would be the case if they remained put. Importantly, this "frictional" or transitory spate of joblessness is directly related to the low labor force participation rate. After all, it is the labor shortage that is stoking the high turnover rate among workers amidst a rapidly growing reopening economy.

The overarching question is, why are so many workers remaining on the sidelines? There is no simple answer, but neither is there a shortage of reasons to explain the stubbornly low participation rate. They include lingering health concerns, which may well be exacerbated by the spreading delta variant of the virus; child care responsibilities until schools fully reopen in the fall; expanded unemployment benefits that are deterring some people from taking low paying jobs, and a wave of early retirement, reflecting surging stock and property values that have bolstered the balance sheets of aging boomers.

However, those restraints are becoming less binding, and they should continue to ease in coming months. With most of the adult population having received at least one dose of the vaccine, health fears are subsiding. Day camps are reopening, and schools will soon be welcoming students back, lessening the burden of child care for working parents. Enhanced jobless benefits provided by the Federal government will expire in September, and at least half of the states have already opted out of the program. Some early retirees may rejoin the workforce if the job market heats up and employers offer attractive pay packages to lure experienced senior workers back to the fold.

Still, it will take time to unshackle the labor market from these restraints, so the road over the balance of the year will be bumpy at best. To get a sense of how rapidly the job market is healing, perhaps the most relevant sector to keep an eye on is leisure and hospitality. The pandemic lockdown last year dealt the harshest blow to this sector, and the reopening process is providing it with the biggest lift. Indeed, jobs at restaurants, bars and amusement parks surged by 343 thousand last month, contributing more than 40 percent to the entire increase in payrolls. That's an outsized contribution from a sector that only accounts for 10 percent of total employment. Despite this rapid rebound in hiring, however, employment in leisure and hospitality still remains 2.2 million below pre-Covid levels. That's the largest shortfall of any sector and the one that is most affected by the restraints on labor supply noted above.

The good news for these workers is that the intense competition for their services as the economy reopens is boosting their compensation. Average hourly earnings for leisure and hospitality workers jumped by 1.0 percent in June, more than three times the increase for all workers. Compared to a year ago, their earnings surged by 7.1 percent compared to 3.6 percent for all workers. Before getting too excited about this disparity, it's important to note that leisure and hospitality workers toil for exceptionally low wages relative to their colleagues in other sectors -- $18.23/hr versus an average of $30.40/hr for all workers. So there is still a considerable amount of catching up to do. That said, the gap should continue to narrow over the foreseeable future. The largest fraction of small businesses plans to lift wages over the next three months than any time on record, according to the latest survey by the National Federation of Independent Businesses.

Job creation across services industries other than leisure and hospitality also regained healthy momentum. Retail employment registered a sturdy 67 thousand gain as improved health conditions are bringing consumers back to brick-and mortar stores. The professional and business services sector saw a sizeable rebound in employment of 72 thousand, the strongest advance since March. Within the sector, temporary help services (+33 thousand) added the most jobs since February. Given the difficulties to find qualified workers, employers may be turning to temporary staffing options. Education and health services continue to recover steadily, adding another 59 thousand. Educational employment registered another 39k advance, while healthcare and social assistance employment saw a broad-based advance of 20k. Within the healthcare sector, child day care services employment (+25k) rose by the most since July 2020, a sign that the ongoing constraint from childcare disruptions on the supply of labor may be easing.

Overall, a healthy 66.1 percent of industries expanded payrolls last month, with the broadest gains occurring among service-providing companies. One disappointing item is the persistent softness in goods employment, which saw a modest 20 thousand gain in June following a 19 thousand increase in May. The construction sector saw a third-consecutive contraction, with payrolls down 7 thousand as it contends with significant supply constraints, including the high cost of lumber. Meanwhile, factory hiring posted a modest 15 thousand advance as it remains constrained by the ongoing global shortage of semiconductor chips that is crimping production capacity, especially in the auto sector.

Conversely, the government sector, which created 188 thousand jobs, gave an artificial boost to the overall jobs tally last month thanks to some faulty seasonal adjustments. In particular, the seasonal factors expect the number of teacher jobs to fall significantly as the school year ends in June. But because schools were shut down for most of the winter, that drop-off did not occur, which boosted the seasonally adjusted total. Hence, fully 230 thousand additional teacher jobs on the state and local levels were reported last month, a bulge that clearly was not an actual event.

Not surprisingly, the financial markets responded favorably to the jobs report. Stocks continued to rally as the report indicated that the economy remained on a firm upward trend, but not torrid enough to force a swifter reaction from the Fed. The bond market also reacted positively, with Treasury yields slipping despite the uptick in worker earnings. While the 3.6 percent annual increase in hourly earnings looks impressive, it's important to note that the year-over-year comparison is greatly exaggerated due to the large monthly declines reported in June of last year. We expect the supply of labor to gradually expand and catch-up with demand in coming months, which should ease upward pressure on wages.

FINANCIAL INDICATORS

INTEREST RATES	July 2	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.04	0.06	0.02	0.14
6-month Treasury bill	0.05	0.06	0.04	0.16
3-month LIBOR	0.14	0.15	0.13	0.31
2-year Treasury note	0.24	0.28	0.15	0.16
5-year Treasury note	0.86	0.93	0.78	0.29
10-year Treasury note	1.44	1.53	1.55	0.68
30-year Treasury bond	2.05	2.15	2.23	1.43
30-year fixed mortgage rate	2.98	3.02	2.99	3.07
15-year fixed mortgage rate	2.26	2.34	2.27	2.56
5/1-year adjustable rate	2.54	2.52	2.64	3.00
STOCK MARKET				
Dow Jones Industrial Index	34,786.35	34,433.84	34,756.39	25,827.36
S&P 500	4,352.34	4,280.70	4,229.89	3,130.01
NASDAQ	14,639.43	14,360.39	13,814.49	10,207.63
COMMODITIES				
Gold ($ per troy ounce)	1,788.20	1,781.80	1,894.10	1,772.90
Oil ($ per barrel) - Crude Futures (WTI)	75.08	74.00	69.38	39.85

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
ISM Manufacturing Index (June)	60.6	61.2	60.7	61.1
Consumer Confidence Index (June)	127.3	120.0	117.5	110.3
Nonfarm Payrolls (June) - 000s	850	583	269	543
Unemployment Rate (June) - Percent	5.9	5.8	6.1	6.1
Participation Rate (June) - Percent	61.6	61.6	61.7	61.5