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Conflicting Signals Point to Hawkish Pause

The May employment report is a tale of two halves — one that is super strong and another that is fairly soft. On the strong side, **nonfarm payrolls jumped a much larger than expected 339k**. And this was after 93k in upward revisions, which effectively negated most of the previous report's downward revisions. The Street has now underestimated payrolls for 8 straight months.

Jobs gains were relatively broad-based, as the one-month diffusion index crept back above 60% versus 59% previously. Hiring in private education and health services (97K) produced the biggest increase in hiring, followed by professional and business services (64k) and then leisure and hospitality (64k).

Over the last three months, nonfarm payrolls increased 283k, which is up from 253k in April. The May data snapped a string of reports showing slowing job gains that began in March 2022. Does this represent a shift in underlying trend? We do not believe so.

The grinding rise in initial jobless and continuing claims suggests that hiring demand is still moderating. Even though temporary help services registered an 8k increase last month, it followed three consecutive declines and five declines in the last six months. Now for the other half of the report.

The unemployment rate rose a statistically significant 0.3% to 3.7%, the result of a 310k decline in employment and 440k increase in unemployment. Remember the unemployment rate is constructed from the Household Survey, a completely different sample than the payroll data which are constructed from the Establishment Survey. Over the last three months, Household employment is up just 135k versus 298k previously.

The nonfarm workweek unexpectedly slipped a tenth to 34.3 hours, which had the effect of lowering the May index of aggregate hours 0.2% at an annualized rate *below* Q1 2023. Unless productivity soars this quarter, these hours figures point to another disappointing quarter for real GDP (and GDI) growth.

Average hourly earnings were up an in-line 0.3% but April was revised a tenth lower, so the year-over-year rate drifted downward from 4.4% to 4.3%. Critically, **there remains little evidence that sub-4% unemployment is generating meaningful wage pressure** which will not go unnoticed by Fed policymakers. Notably, data this week on productivity and labor costs showed just a 2% increase in Q1 worker compensation last quarter, which kept its year-over-year rate steady at a low 3%. So, what is the Fed going to do given today's conflicting labor market signals?

The substantial disparity within the May employment data — strong payrolls and weak everything else, tells us the **Fed will skip hiking rates on June 14th**. Instead, policymakers will bide time to see how previous tightening actions play out in the economy and financial markets. The Fed will repeat the need to remain vigilant and leave the option open to hike rates next month if the data warrant such a move. Stay tuned.

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