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In Cyclical Jobs We Trust

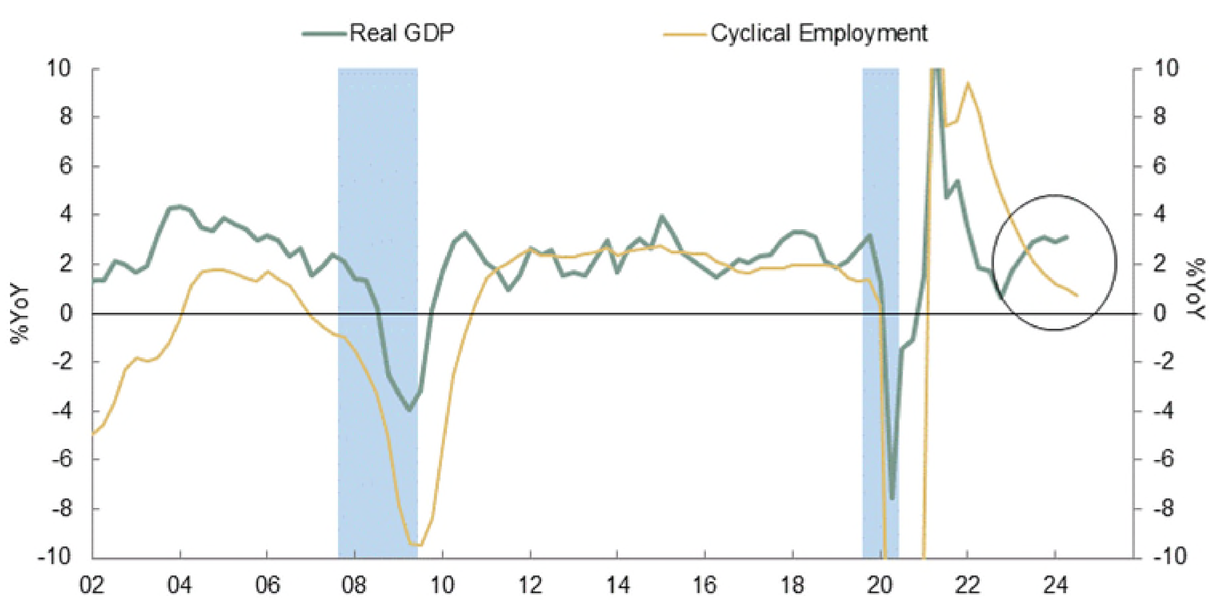
Job creation is rapidly slowing. **Over the past three months, nonfarm payrolls have risen just 116k on average**. This compares to 211k at this point last year and 451k the year before. However, it is likely that these recent gains are also overstated considering that the BLS revised down its level estimate of March 2024 employment by 818k. Market participants will not know for sure until the January 2025 employment report is released next February. Either way, the initially reported monthly employment figures are not fully capturing the weakening jobs market.

This downtrend in hiring is expected to continue. **The cyclical (or discretionary) areas of the economy are at the biggest risk for job loss**. These sectors includes employment in manufacturing, residential construction, restaurants, and hotels. Combined these industries employ nearly 31 million people or roughly one-quarter of all jobs. In the chart below, we show the aggregate year-over-year growth rates in these sectors versus overall real GDP growth.

At first blush, it is clear that both series are highly correlated, closely trending upward and downward together. Additionally, the labor series also has a high beta, meaning it moves lower than real GDP when the economy is slowing and tends to increase more than GDP when the economy is improving. But the most distinguishing characteristic of the chart is the divergence that has emerged over the past six quarters. The data are moving in different directions.

Cyclical employment and real GDP were trending downward together in 2021 and for most of 2022. But employment continued to soften in Q4 2022 while the rate of real GDP growth bottomed. Since then, the slowdown in cyclical hiring has persisted while real GDP growth has accelerated. In Q2 2024, cyclical employment was up just 1.0% from its year earlier level while real GDP was up 3.2% from its year earlier level. The current gap is unusually wide. Excluding the pandemic, the spread is the widest since Q4 2010 which was when the economy was just entering its expansionary phase after only a modest recovery from the prior deep downturn. Employers were especially cautious even though the economy was growing again.

But today's discrepancy is different. Although there are many possible explanations for this, our best guess is that **weakening cyclical employment is foreshadowing a broader slowdown**, notwithstanding what appears to be solid growth in real GDP.



Source: BEA, BLS, Haver, SMBC Nikko

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