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Making sense of September's job growth

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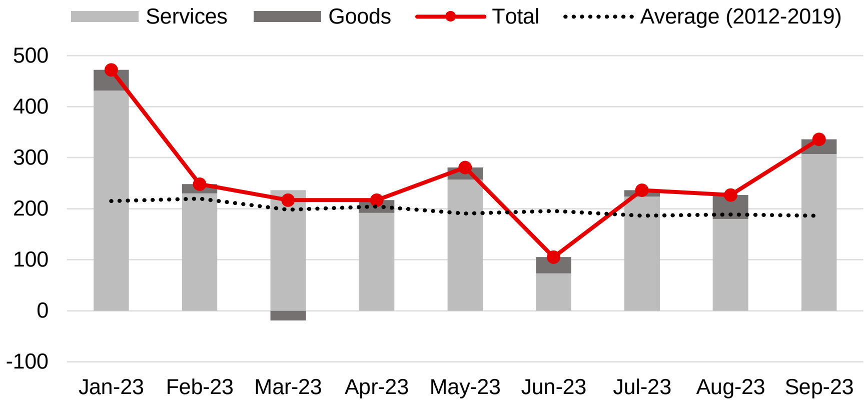
- The labor market was thought to be cooling, but it picked up steam with employment growth accelerating in September and job openings expanding in August. This could be explained by a host of reasons: the neutral rate is higher than previously thought, productivity growth is falling again, or there is significant noise in the data. All this uncertainty is helping to drive up bond yields, which is potentially more consequential than how the Fed will respond at the next FOMC meeting.

Widespread job gains

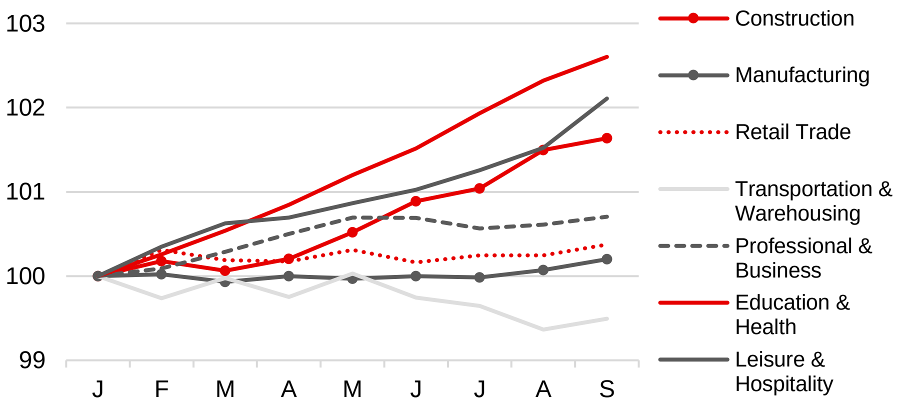
Employment growth accelerated in September with several industries adding jobs. The leisure and hospitality industry led employment growth, adding 96,000 jobs in September, followed by education and health services (+70,000 jobs), professional and business services (+21,000 jobs), and retail trade (19,700). Goods industries also expanded, with manufacturing adding 17,000 jobs and construction adding 11,000 jobs. Even transportation and warehousing industries gained employment, reversing the trend of 3 consecutive monthly job losses.

Monthly job gains accelerated to an 8-month high
Nonfarm payroll employment growth, thousands



Source: BLS, MUFG Bank Economic Research

Employment is up in most industries from the start of 2023
Nonfarm payroll employment, Jan 2023=100



Source: BLS, MUFG Bank Economic Research

August job openings also accelerated (data lag employment numbers by 1 month) to a level not seen since May of this year. This coincides with an August increase in the number of unemployed, keeping the unemployed to vacancy ratio at 1.5. Hiring, quits, and layoffs were all little changed in August.

For the labor force, the September unemployment rate was unchanged at 3.8%, with both the size of the labor force and number of unemployed rising by 0.1%. The September labor force participation rate was also unchanged, with both prime-age (25-54) and older workers (55 & older) staying at their August level, at 83.5% and 38.8% respectively.

Many potential explanations, but little evidence to support them

Before this month's data releases, several signs pointed to a cooling labor market – monthly job growth was near the pre-pandemic average, the unemployment rate jumped to 3.8%, and hiring and quits were both slowing. There are a variety of explanations for this latest reversal, but unfortunately, there is little evidence that would support any justification with certainty.

The explanation that most likely has some degree of influence is that monthly jobs data can be very noisy. This is especially true in today's economic climate where July's employment growth was revised downward in the August data release, only to be revised upward in the September release. The magnitude of revisions has also been historically large in some months. Adding to this noise are seasonal factors. Seasonal factors are calculated based off historical data, but consumer behavior may have changed slightly since the pandemic, making it harder to fully account for seasonal behavior.

Other explanations are much more speculative, especially given the lack of a trend showing re-accelerating growth. Labor productivity, for instance, could be to blame for September's strong growth but the evidence is not there, yet. Since the second half of 2021, productivity growth was trending downward and was negative for all of 2022 and for Q1 2023. Only in Q2 of this year did the trend reverse and annual productivity growth became positive.

If labor productivity were to fall again, it could potentially result in stronger than expected job gains since employers need more workers to cover their output needs. Unfortunately, productivity data are only published quarterly and with a much greater lag. The impact that labor productivity had on September's data would also be difficult to isolate even when Q3 numbers are released.

Another potential explanation is that the neutral rate is higher than previously thought. If robust jobs growth continues into Q4 of this year, it would suggest that the current level of interest rates is not restrictive enough. And for that to be the case, that would mean that the short-term neutral rate (the rate at which monetary policy is not expansionary nor contractionary) has risen and that further hikes might be needed by the Fed. Estimates of the neutral rate, though, are highly uncertain, and like productivity, they are only calculated quarterly.

Assuming the neutral rate has risen would indeed be speculative, especially since one month of data does not constitute a trend, but that hasn't stopped bond markets from reacting. The 10-year treasury yield surged to 4.858% after September's jobs data were released, likely a response to the uncertainty of today's labor market, the short- and long-term neutral rate, and how the Fed will respond.

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