Job growth weaker than expected in September, keeping the Fed on hold in October

Headlines

- **The economy added 29k jobs in September, well below expectations and accompanied by downward revisions to prior months**. This brings the three-month moving average of job gains to 51k, right about where we think it needs to be to keep the unemployment rate stable. Private sector job growth was stronger at 46k in September, as weakness in local government hiring weighed on overall job gains.

- **The unemployment rate came in at 4.18%, relatively unchanged from 4.14% in August, but enough to round up to 4.2%.** This is in line with what the Fed views as full employment. Higher labor force participation, rather than weaker employment gains, put upward pressure on the unemployment rate in September. Overall, we would describe the unemployment rate as stable at around 4.2% over the past three months.

- **Average hourly earnings increased at just a 1.6% annualized pace in September**, dragging six-month annualized wage growth down to 2.5%. That's now firmly below pre-pandemic levels, signaling that the labor market is clearly not yet a source of inflationary pressure.

- **This is a dovish jobs report and supports our view that the Fed is unlikely to raise rates in October**. We still believe the underlying trend in the labor market is somewhere between stable and re-accelerating, however, and that inflation prints in the coming months will require the Fed to hike at least two more times, once in December and again next March.

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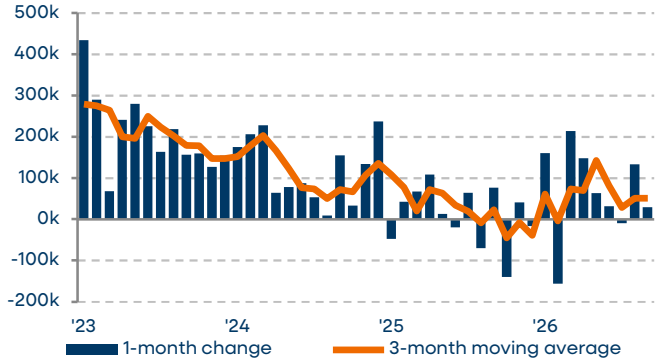
Economy added 29k jobs versus 90k consensus

Job growth came in significantly below expectations in September, increasing by just 29k against an expectation of 90k. This was somewhat surprising, as almost all of the higher-frequency indicators pointed to the labor market firming in September. ADP payroll employment came in above expectations, and unemployment insurance claims continued to improve markedly through the month.

Figure 1: Nonfarm payroll job growth

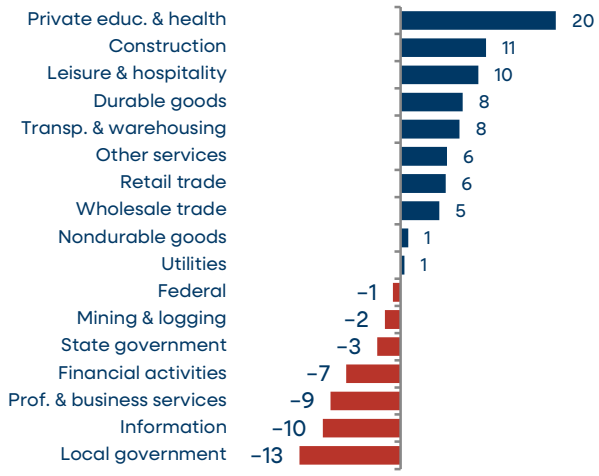


Sources: BLS, PNC

In addition to weaker-than-expected job gains in September, prior months' job gains were revised down by a cumulative 60k, dragging the three-month moving average of job gains to 51k. Seasonal-adjustment quirks and low response rates could be partly to blame for the volatility but the underlying job trend is broadly consistent with ADP.

It is also at roughly the level of job gains we think is needed to keep the unemployment rate steady in the near term, as slower labor force growth and weaker net immigration have lowered the "breakeven" level of employment growth. Job gains were concentrated in Education/Health Care (20k), Trade/Transportation (18k), and Construction (10k).

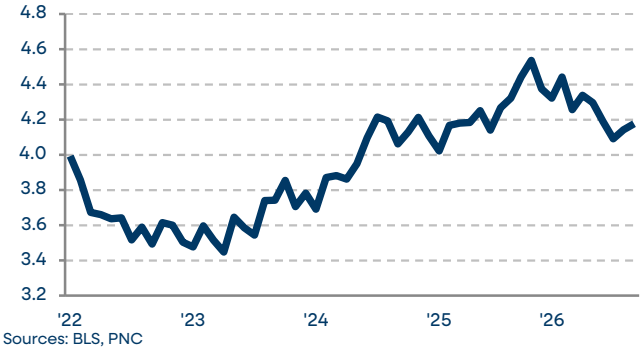
Figure 2: September job growth ranked by sector



Sources: BLS, PNC

Unemployment rate at 4.2%, similar to prior three months

Figure 3: Unemployment rate (%)

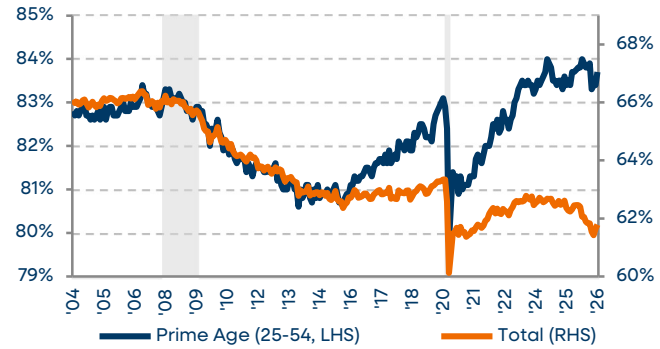


Sources: BLS, PNC

While payrolls disappointed to the downside, data from the household survey was more encouraging. Rising labor force participation was enough to push the unemployment rate modestly higher to 4.18% in September from 4.14% in August. The unemployment rate has hovered around 4.2% for the last several months, in line with the Fed's view of full employment and with our view that the

economy is adding just enough jobs to keep the unemployment rate stable. Also encouraging was a decrease in the underemployment rate to 7.6% from 7.7% previously.

Figure 4: Labor force participation rate (%)



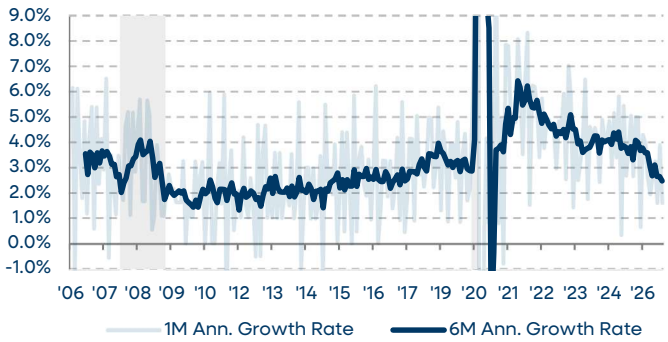
Sources: BLS, PNC

Wage growth continues to decelerate

Average hourly earnings increased at just a 1.6% annualized pace in September, dragging six-month annualized wage growth down to 2.5%. That's now firmly below pre-pandemic levels, signaling that the labor market is clearly not yet a source of inflationary pressure. The number of hours worked, however, continues to strengthen, putting upward pressure on aggregate payroll income. Aggregate payroll income is one of the best indicators of overall demand in the economy and continues to grow at roughly a 5% pace.

The combination of slower wage growth and rising hours presents a possible Goldilocks scenario for a Fed eager to get inflation in check. Labor demand remains solid without generating inflationary pressure, while a potential pickup in productivity growth could help reconcile the strength in labor income with third-quarter GDP growth tracking above 3%.

Figure 5: Average Hourly Earnings Growth



Sources: BLS, PNC

This print likely keeps the Fed on hold in October, more hikes to come

Absent a very concerning inflation print later this month, this report should be enough to put to bed the idea of an October rate hike. The Fed has been trying to determine whether the labor market is somewhere between stable and reaccelerating, and this report lands firmly in the "stable" camp. We still think the underlying trend is that the labor market is heating up, however, and that inflation prints over the coming months will force the Fed to hike rates at least two more times, once in December and again in March.

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