August 5, 2016

ANOTHER GREAT JOB MARKET REPORT IN JULY POINTS TO CONTINUED ECONOMIC GROWTH THROUGHOUT 2016

SUMMARY

- The U.S. economy added 255,000 jobs in July, far more than expected, with upward revisions to job growth in May and June.
- The unemployment rate held steady at 4.9 percent in July, with big increases in both the household measure of jobs and the labor force.
- Job gains were broad-based across industries, with the exception of mining.
- Average hourly earnings rose 0.3 percent and the average workweek lengthened, so there was a big 0.8 percent increase in labor market income in July. This will power growth in consumer spending.
- The labor market is in very good shape in mid-2016.
- The U.S. trade deficit widened more than expected in June. Trade will be a drag on growth in the second half of 2016.
- The next increase in the federal funds rate is likely to come in December.

Employment growth was much stronger than expected in July, with payrolls up by 255,000; this was well above the consensus forecast of 175,000 and PNC’s forecast of 160,000. There were also upward revisions to job growth in May to 24,000 (from 11,000) and June to 292,000 (from 287,000), for a combined upward revision of 18,000. The three-month moving average of job growth in July was a very good 190,000, which is all the more remarkable given that it includes the very weak May number (see Chart 1). Job growth through the first seven months of 2016 has averaged 187,000, a slowing from 229,000 in 2015, but still very solid.

July private-sector employment was up by 217,000, well above the ADP figure of 179,000. State and local government jobs were up by 35,000, with much of that in education, and federal government jobs were up by 3,000.

The July unemployment rate held steady at 4.9 percent. The number of people who reported having jobs in the household survey (different from the survey of employers) rose by a whopping 420,000 in July, with the monthly average household job gain in the first seven months of 2016 a very good 227,000; this is better than household survey job growth in 2015 of an average of 201,000 per month. The labor force grew by a large 407,000 in July, after an increase of 414,000 in June; this followed big declines in April and May. The monthly average labor force gain in the first seven months of 2016 was 208,000, a big vote of confidence in the job market. The number of unemployed fell by 13,000 in July as more people got jobs than entered the labor force. The labor force participation rate rose by 0.1 percentage point to 62.8 percent in July; it is up from a cyclical low of 62.4 percent in September, but remains well below its pre-recession level (see Chart 2).

The broader U-6 unemployment rate (unemployed, “underemployed” and too discouraged to even look for a job) rose by 0.1 percentage point in July to 9.7 percent, reversing its June decline; it is down from a peak of 16.9 percent in late 2010. Part-time jobs for economic reasons (“involuntary part-time jobs”) rose by 97,000 in July, but this followed a huge decline of 587,000 in June; part-time jobs for economic reasons were down 360,000 in July from a year earlier. Voluntary part-time jobs rose by 212,000 in July and were up by 854,000 from a year earlier. Fed Chair Yellen closely watches the extent of involuntary part-time employment, and the big decline over the past year is another indication of a tightening in the labor market. That the unemployment rate held steady in July because of large increases in both household employment and
the labor force is a big positive for the job market.

The breadth of payroll job growth in July was widespread across both services and goods-producing industries. Mining jobs fell by 7,000, the twenty-second straight monthly decline totaling 222,000 jobs lost, or one quarter of industry employment. Manufacturing jobs rose by 9,000, the second consecutive increase, and construction jobs rose by 14,000, although June was revised lower to a small decline. Private service-producing industries added a strong 201,000 jobs in July. This included gains of 70,000 in professional/business services (including a rise of 17,000 temp jobs), 36,000 in eds and meds, 29,000 in trade/transportation/utilities, 45,000 in leisure/hospitality services, and 18,000 in financial activities; employment was flat in information services. The diffusion index, which measures the breadth of job growth, rose from 61.8 in June to 63.7 in July, its highest reading since February 2015.

Average hourly earnings rose 0.3 percent in July and were up 2.6 percent from one year earlier. Wage growth continues to accelerate as the labor market tightens. Also, the average workweek rose to 34.5 hours in July. Combining 255,000 new workers, a rise in average hourly wages, and a longer average workweek (total hours worked rose by 0.5 percent), workers’ earned income rose 0.8 percent in July, the biggest one-month jump since July of last year. The July CPI was likely flat (reported on August 16) as gasoline prices fell about 3 percent over the month, so workers’ real income rose by 0.8 percent in July.

Consumer spending is remaining solid: July unit vehicle sales were very good at a 17.9 million annual rate, near the average in the second half of last year.

Taken all together, a second straight increase in payroll employment of well above 200,000, upward revisions to job growth in May and June, broad-based job growth across industries, increases of better than 400,000 in both household employment and the labor force, a solid gain in average hourly earnings, a longer average workweek, and a moderate rise in workers’ average wages constitute a second straight great jobs report. Payroll job growth has slowed in 2016 from 2015 as the labor market has tightened, but the very weak May report was an aberration. Continued job and wage gains are powering consumer spending growth, in turn driving the U.S. economic expansion in mid-2016.

The nominal trade deficit widened more than expected in June, to $44.5 billion, from $41.0 billion in May. The consensus was for a $43.0 billion June deficit. After narrowing in early 2016, the trade deficit has begun to widen again. Exports rose 0.3 percent from May to June, to $183.2 billion, while imports rose 1.9 percent, to $227.7 billion.
billion. Some of the increase in imports came from higher oil prices over the month.

Trade will remain a near-term drag on the U.S. economy. The dollar, which was already strong, strengthened even further against other currencies in the wake of the vote in the United Kingdom to leave the European Union (Brexit). The U.K. looks to be falling into recession as a result of Brexit, and growth in the euro zone is set to slow as well. Global growth remains weak, with soft growth in China and commodity-producing economies suffering because of weaker demand and lower prices.

Still, the strengths of the U.S. economy will more than outweigh the drag from trade, and the expansion will continue through the rest of 2016. Consumer spending and housing will be the primary growth drivers for the U.S. in the near term.

The strong July jobs report ups the odds of a near-term federal funds rate hike. An increase at the Federal Open Market Committee’s September 20-21 meeting is still unlikely, given the weak second quarter GDP report (just 1.2 percent annualized growth, on the heels of even weaker growth in the first quarter and fourth quarter of 2015); a rate hike is also unlikely at the FOMC’s following meeting, which is a week before the presidential election. But conditions are falling into place for a rate increase at the FOMC’s December 13-14 meeting. The fed funds futures market is pricing in a 46.5 percent probability of at least one rate increase by the end of this year, up from 32.1 percent yesterday.

The S&P 500 rose about 0.9 percent on expectations of stronger growth given the July jobs report, although the price of a barrel of West Texas Intermediate crude fell slightly. The 2-year Treasury note rate was up by about 7 basis points to 0.73 percent, and the 10-year rate was up by 8 basis points to 1.59 percent, on increased expectations of tighter monetary policy. The dollar strengthened against most currencies, including the euro, British pound, Canadian dollar, and yen.

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![Chart 2: Improving Labor Force Participation Rate a Positive, But Still Down Sharply From Before Recession](chart)

**Chart source:** Bureau of Labor Statistics

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