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Weekly Commentary

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Labor market paradox

One of the more misunderstood economic data points is the unemployment rate. While a high rate is a sign of strife in the labor market and probably indicative of a struggling economy, an increase can actually be a good omen. When people previously discouraged about their prospects to the point of not actively looking for work file for unemployment benefits, the rate rises. This is what happened in August, as the Department of Labor announced Friday it increased from 3.5% to 3.8%.

The other part of the jobs report that can be counterintuitive is the number of additional hires that nonfarm companies make each month. A lower number might seem bad, but it could indicate employers have right-sized their workforce to fit economic conditions. A smaller number likely means the U.S. economy is approaching a Goldilocks zone. With only 187,000 new jobs added in August, and the country averaging just 150,000 over the last three months, it does appear we are headed in that direction. This is great news for a Federal Reserve that thinks the economy is too hot to pull inflation down to its 2% target.

Also good news is that wage growth is slowing. Policymakers don’t want people to earn less, but think the best case scenario is one in which pay raises either equal or modestly exceed inflation. Over the last several quarters, wage growth has surpassed inflation by more than the Fed is comfortable with. But it cooled slightly in August, rising only 0.2% from July and 4.3% over the last year. This is another reason policymakers likely will forgo a rate hike at the September FOMC meeting as they wait to assess the impact of their tightening cycle.

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