

Economic Update

June Employment Report: Unemployment Rate Declines Despite Lackluster Job Growth

Morningstar Investment Management LLC

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Dominic Pappalardo

Chief Multi-Asset Strategist
Morningstar Wealth

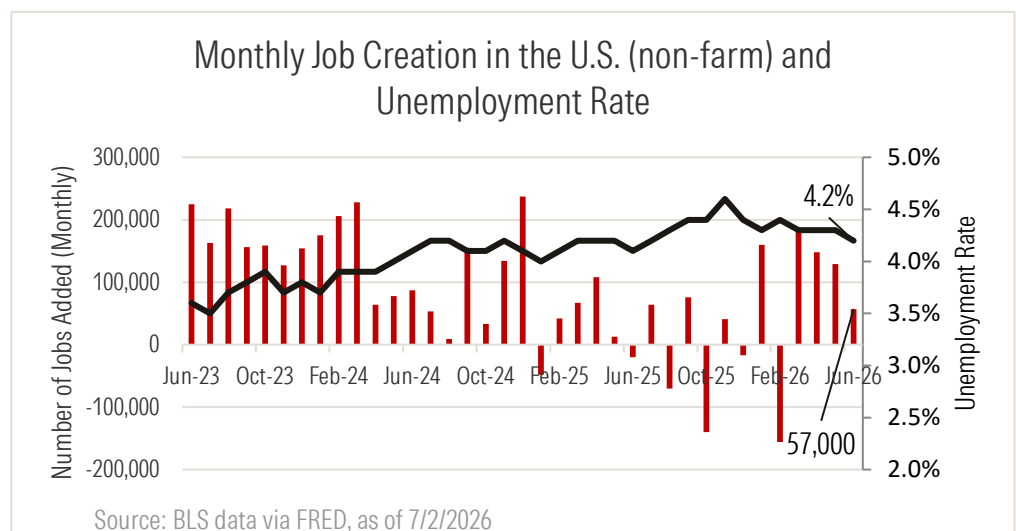
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Key Takeaways

- Today's release of the June employment report showed non-farm payrolls increased by 57,000, well below the expected 115,000 additions. Revisions to the last two months' data were strongly negative with April's total lower by 31,000 to 148,000 and May's total lower by 43,000 to 129,000.
- The unemployment rate declined to 4.2%, from 4.3%, while wages rose in line with expectations of 3.5% year-over-year, representing a 0.3% increase for the month.
- Labor market participation declined to 61.5%, representing the lowest level since March of 2021.

Summary

Today's employment report showed that 57,000 jobs were added in June, falling well short of expectations, as the Dow Jones forecast predicted an addition of 115,000 new jobs. The unemployment rate fell to 4.2%. Wage growth was in line with expectations, as average hourly earnings rose by 0.3% for the month, bringing the annual rate up to 3.5%, slightly below the current headline inflation rate. The 57,000 job additions is the lowest monthly growth since February.



Perhaps more importantly, the two previous months' job additions were revised substantially lower by a combined 74,000. May's total fell by 43,000 to 129,000, and April's total decreased by 31,000, to 143,000. These revisions bring the three-month average increase down to 110,000 new jobs per month, substantially less than average of 188,000 following last month's release, but still relatively healthy

given declines in immigration. However, when netting out June's additions and April & May's downward revisions, the total net number from today's report was a disappointing -17,000 jobs.

Market Reaction

While Equity markets are rallying strongly today, I'm not sure the report is the sole driver of the current bullishness. Today's report wasn't strong enough nor weak enough to trigger a marked reaction across risk markets in my view, perhaps the lack of any negative surprise was enough to spur the current risk-on mentality. None the less, per the Morningstar Style Box, as of 9:00am CDT, all segments of the market are positive, with small-caps leading the way.



Interest rates are mixed following the report, with the 2-Year Treasury yield dropping by 0.03% while longer rates are nudging higher as the 30-Year Treasury yield is up by 0.02% leading to yield curve steepening. The decline on the short end, while small, may signal some belief that this weaker than expected report may reduce the likelihood of a Fed rate hike later this year. Perhaps this lean towards lower interest rates is helping to fuel the stock market rally.

Breaking Down the Headline Number

Job additions largely came from the private sector in June, with 49,000 coming from non-government enterprises. Hiring in the healthcare sector remained strong, adding an additional 22,000 new positions although that represents fewer than the previous few months. Conversely, the leisure and hospitality sector showed a loss of 61,000, which is surprising given that we're in the busy summer travel season, and the World Cup is in full swing. This is a sharp reversal to last month's report in which the sector added a shockingly high 70,000 jobs. Perhaps there were month over month timing anomalies causing unusual swings in data. The decline in this sector also explains nearly the entire difference between the reported headline number of 57,000 new jobs vs the estimate of 115,000, in other words, had this perplexing decline not occurred, the headline number would have been right at the estimate.

The labor force participation declined once again to 61.5% in June. The decline in this measure is the main driver for the decrease in the unemployment rate as fewer participants translates to a lower rate

for the same number of jobs. Declines in this measure have been concerning, as it is currently at the lowest rate since March of 2021. The continuing decline in the number of full-time workers is partially a result of decreased immigration rates, but also because more people are working part-time, perhaps not by choice. The U.S. Bureau of Labor Statistics' measure of discouraged workers and those holding part-time roles declined slightly for the second consecutive month, down to 7.9% from May's 8.1%—while higher than historical averages, this trend is a positive signal for job seekers.

For Additional Information

+1 (800) 886-1749

wealth.us@morningstar.com

mp.morningstar.com

Looking Ahead

CME Fed Funds' futures show there is now a 78% probability that the Fed will hike rates before year-end, slightly lower than the 83% seen yesterday confirming the weak jobs print is impacting expectations on the Fed's willingness to hike rates. I'd speculate that had the June report delivered another upside surprise, or if backward-looking revisions were not so starkly negative, the probability of a hike would have moved closer to 100%. One month ago, there was only a 54% probability of a hike priced in.

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