Labor Market Outlook:

US Labor Market Keeps Cooling Without Tipping into Recession

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The U.S. labor market presents a paradox: substantial cooling with unemployment jumping from 3.5% to 4.3% in the last year, alongside robust economic growth and rising employment. This unusual dynamic stems partly from supply-side expansions—a surge in immigration, increased labor force participation, and significant gains in labor productivity—that have outpaced demand growth, creating a looser labor market despite economic strength.

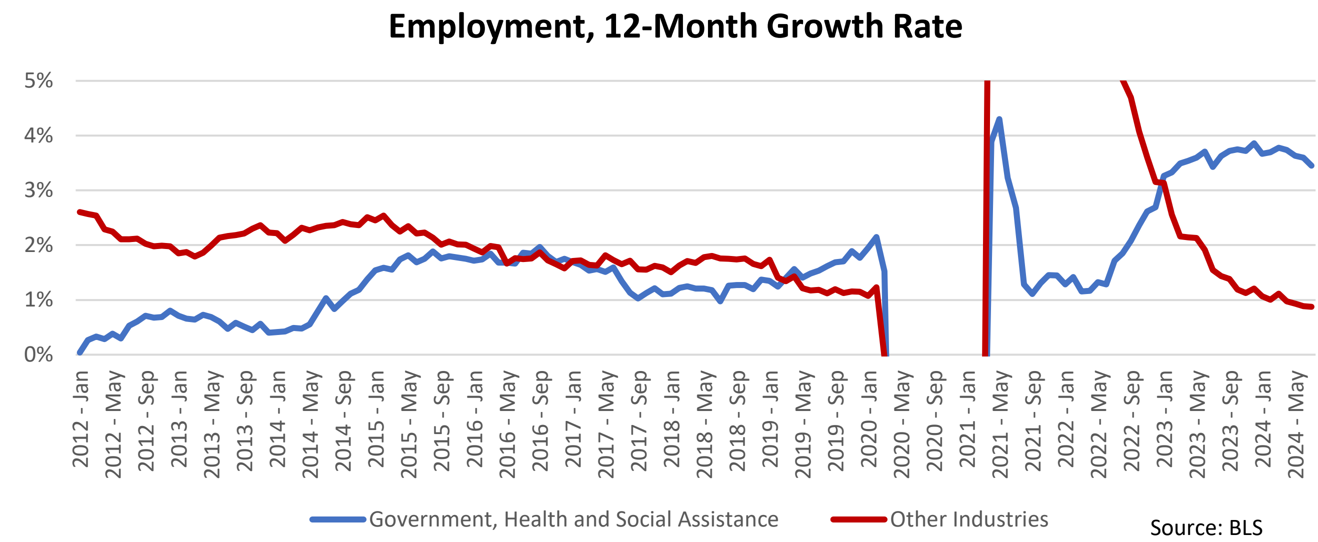
This dynamic adds to other key labor market data to suggest a gradual labor market cooling underway rather than an impending recession. Permanent layoffs remain stable, while most increases in unemployment stem from individuals re-entering the labor market. Wage growth, though decelerating, still outpaces pre-pandemic rates, with slowdowns primarily in highly educated sectors.

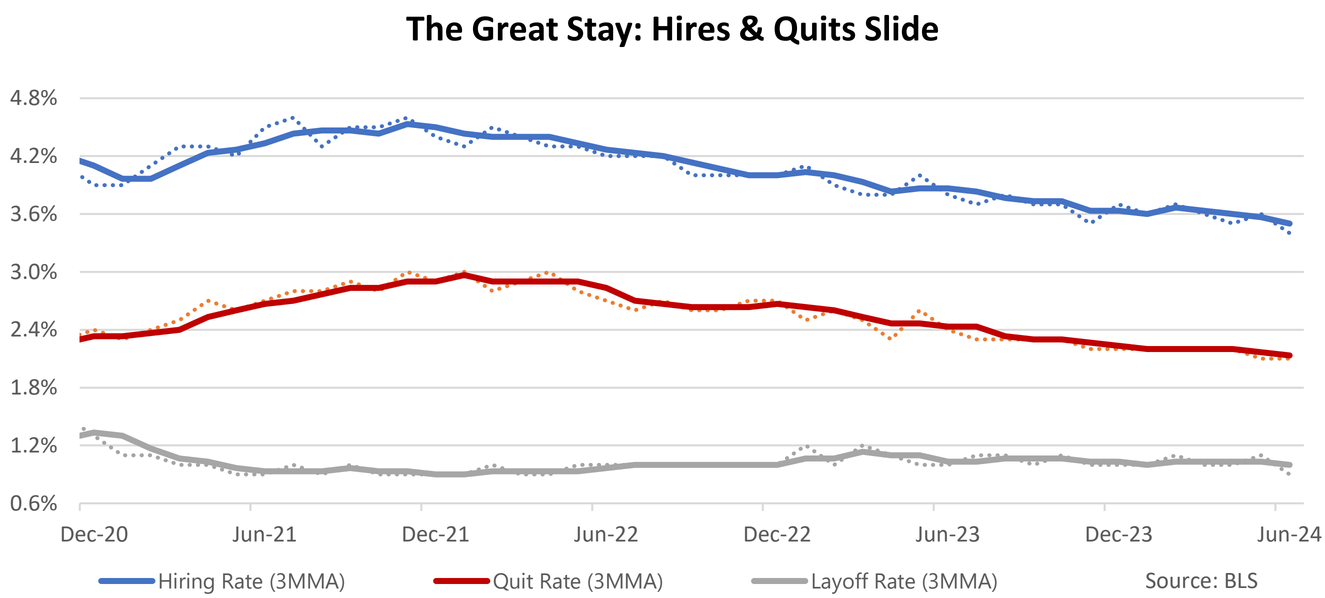
However, this trend is precarious. Labor-market indicators are nonetheless moving in the wrong direction, raising the risk of a more rapid and disorderly contraction. Without a change in monetary policy, the probability of a recession will likely continue to rise as the supply-side tailwinds that have propelled the economy begin to wane in coming months.

Current Labor Market Conditions

The U.S. labor market has cooled substantially since the pandemic, with wage growth slowing and turnover falling. The rise in the unemployment rate from 3.4% in April 2023 to 4.3% in July 2024 has heightened recession fears. Historically, such increases often precede larger-scale joblessness characteristic of recessions, triggering a pullback in consumer spending that, in turn, sets off job cuts as demand contracts. This dynamic underpins popular rules of thumb like the famous Sahm Rule, which holds that a recession has usually started when the unemployment rate's three-month moving average exceeds its lowest point in the previous 12 months by half a percentage point or more. That threshold was passed in July.

More broadly, the labor market data has been moving in an increasingly unfavorable direction. Recent months have seen slower employment gains and declining hires and quits, indicating employer caution and worker hesitancy. While employment in government, health, and social assistance sectors is booming—keeping overall job growth robust—the private, for-profit sector is experiencing a slowdown.





But while many labor market indicators are moving in the wrong direction, many are not—including important signals of labor supply and employment.

Surprise Supply-Side Expansion

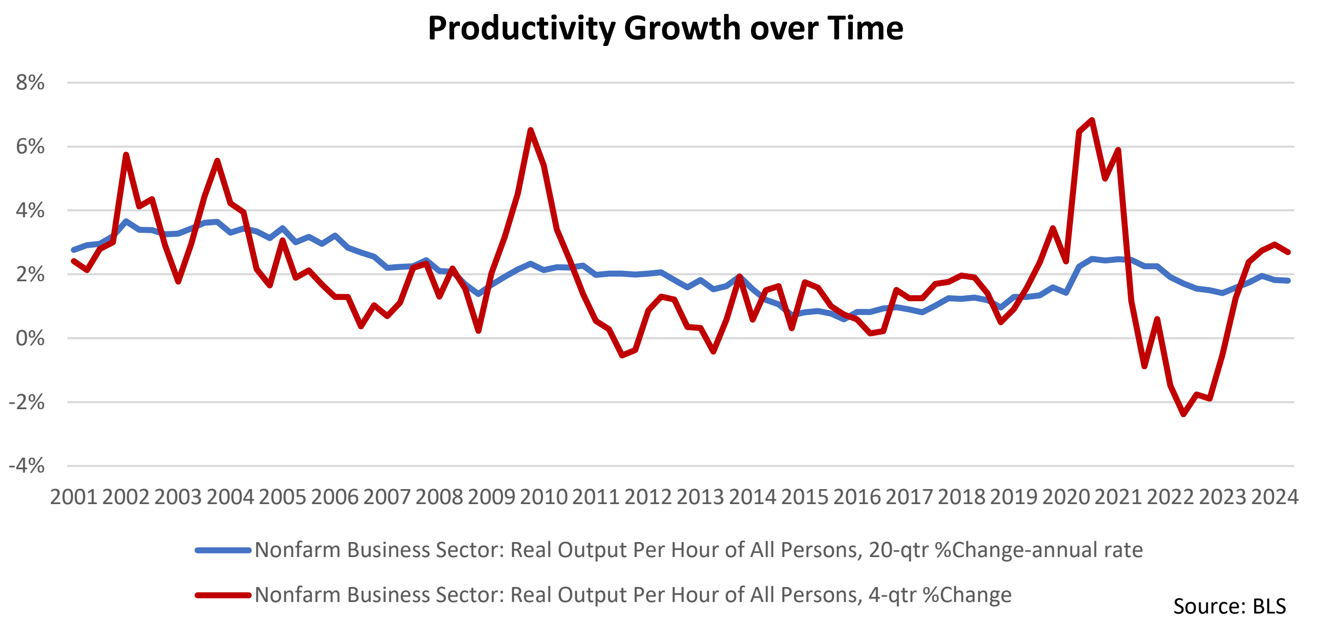
An unusual pattern has emerged: the unemployment rate has risen significantly—and the labor market has shown signs of cooling—but at least as of June 2024, the economy was not slowing down. Key indicators such as consumer spending, business investment, international trade, and government spending showed no substantial weakness.

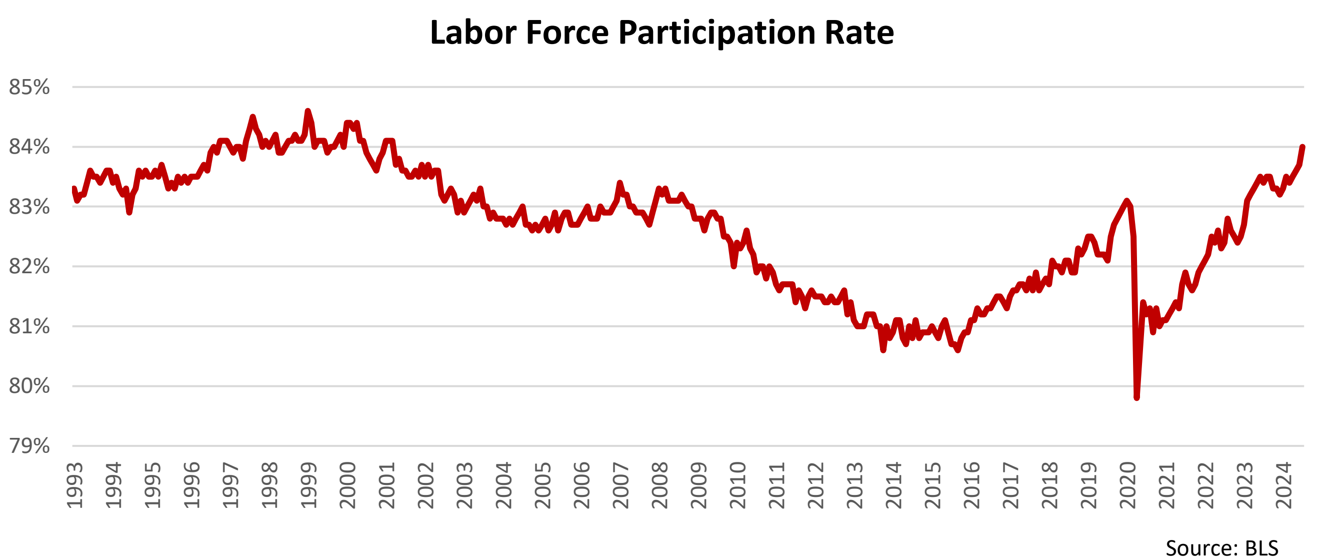
The Unemployment Rate

Source: BLS

A deeper analysis of the data reveals how joblessness increased even as the economy grew at a robust pace. In the past year or two, the U.S. workforce capacity has rapidly expanded due to three major trends:

- Increased Immigration from the Southern Border: A notable rise in immigration, highlighted by a surge in apprehensions at the southern border, has driven an increase in the U.S. labor force.
- Higher Labor Force Participation Among Prime-Age Workers: The labor force participation rate—the share of the population that is working or looking for work—for the 25-54 age group rose from 82.4% in July 2022 to 84.0% in July 2024, its highest level since 2001.
- Boost in Labor Productivity: Over the past four quarters, labor productivity has grown 2.7%, well above pre-pandemic trends. This rapid increase in productivity means employers need fewer workers to meet demand.

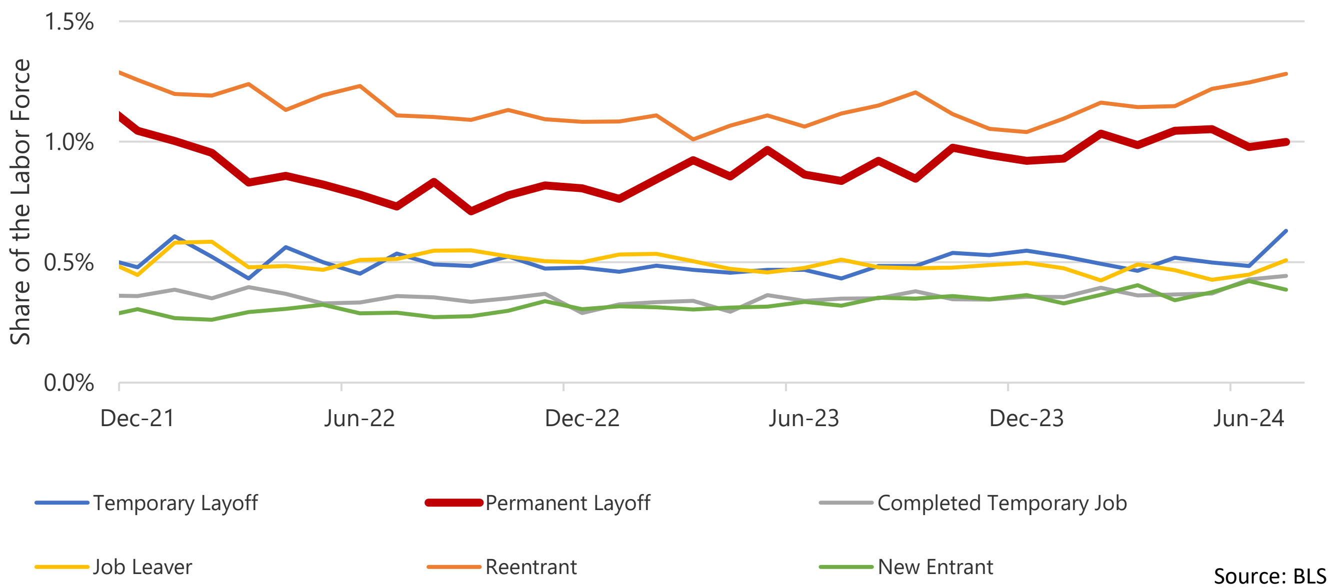




Labor Market Cooling, Not Freezing (Yet)

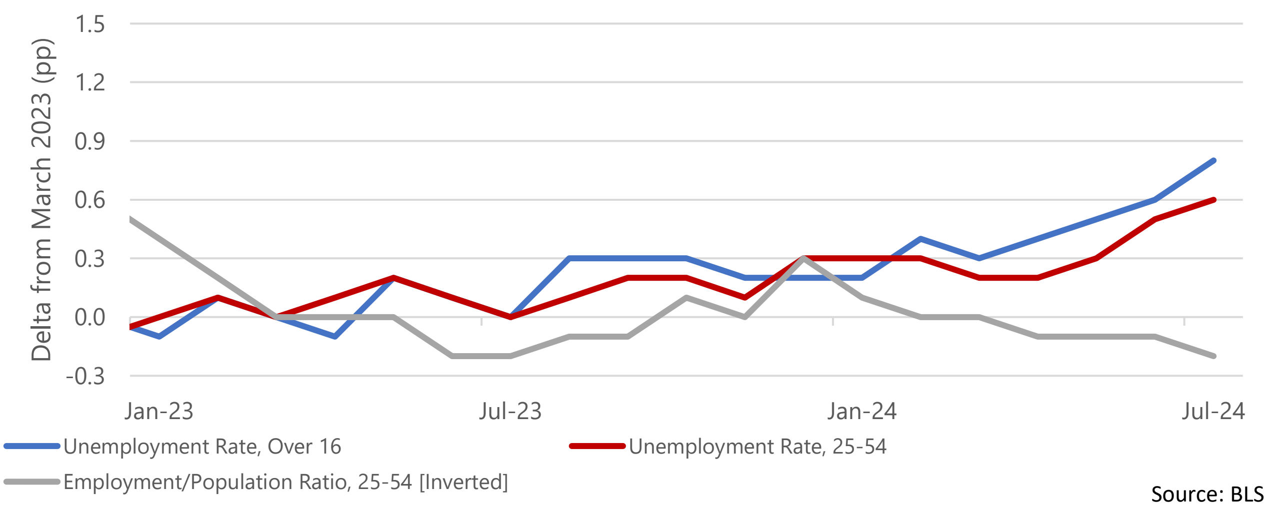
The underlying drivers of joblessness aren't following typical pre-recession patterns. The share of people out of work due to permanent layoffs—which usually rises sharply shortly before a downturn hits—has been stable in recent months. Most of the increase has been driven by a gradual increase in individuals still looking for a job after only recently re-entering the workforce, which isn't necessarily worrisome since it isn't a clean signal of labor demand. July's large surge was almost entirely the result of an unusual—and likely ephemeral—jump in temporary layoffs.

Unemployment by Cause



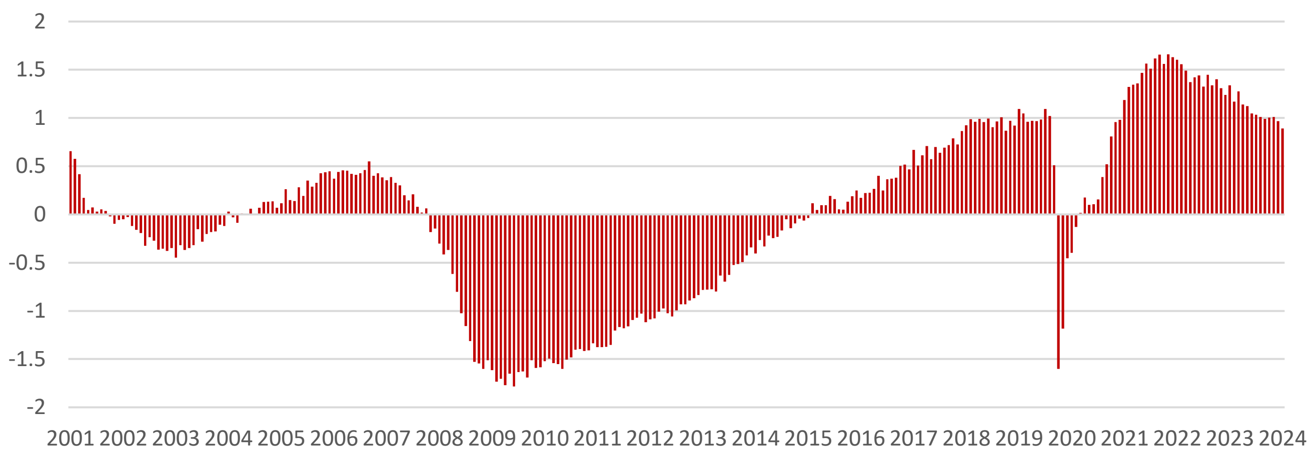
One of the best overall indicators of labor market health, the prime-age employment-population ratio—which measures the share of the population aged 25 to 54 that is working—is at a 23-year high and has not shown any signs of decline. (Though pessimists might note that the ratio is no longer rising.) In a typical downturn, we would see a simultaneous rise in unemployment and drop in employment. But that's not happening.

Employment & Unemployment Disagree



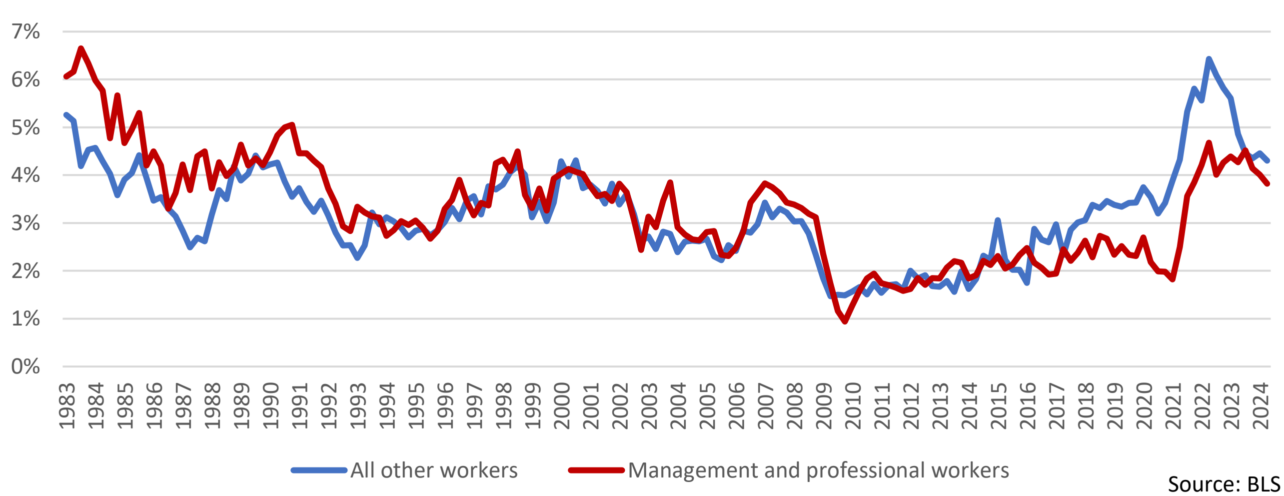
Other indicators that are worrisome at first glance look more benign when viewed in more detail. While the accompanying Labor Market Tightness Index illustrates a continuing decline, conditions are still tighter than at most points in the last two and a half decades.

Labor Market Tightness Index



And though wage growth is decelerating, it continues to outpace the usual rates. The June Employment Cost Index, the best measure of wage growth in the US, confirms that wages are slowing down. However, wages growth among management and professional workers—a highly educated group that accounts for most of the US economy's labor costs though they constitute approximately 40% of the workforce—has driven much of the overall slowdown this year. That dynamic contrasts with what we saw in 2022 and 2023, when slowing wage growth was predominantly observed in roles that do not require a bachelor's degree, including manual services, blue-collar jobs, and sales and office support. Despite the slowdown, wages for both groups are still growing at a faster pace than before the pandemic.

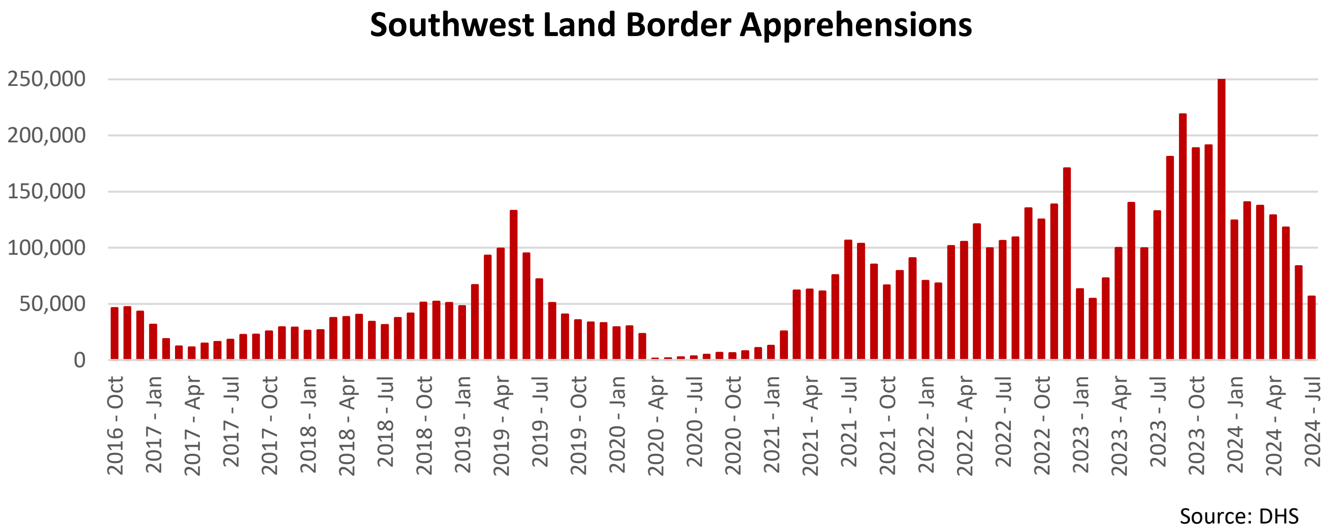
Growth in Salaries and Wages (Employment Cost Index)



Source: BLS

Looking Ahead

On balance, this data is consistent with a labor market that is gradually cooling rather than facing imminent recession. But the boost to labor supply has likely run its course: recent months have shown a slowdown in border apprehensions, and it seems improbable that the labor force participation rate will keep expanding at such a rapid pace. With economic growth poised to slow, the labor market will likely continue to cool.



With the data moving in the wrong direction, there's always the risk that gradual cooling turns into a rapid, disorderly contraction. The probability of recession has increased and will likely continue to rise, barring a change in monetary policy from the currently restrictive rate. Fortunately, with inflation getting closer to the Federal Reserve's target, help may be on the way. At his press conference in early August, Fed Chair Powell indicated that reductions in the key policy rate may begin as soon as September.