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PREVIEW: US Nonfarm Payrolls (July 2022) will be released on August 5th at 13:30BST/08:30EDT

The US economy is expected to add 250k nonfarm payrolls in July, with the pace of payroll additions cooling again amid tight labour market conditions. The unemployment rate is expected to be unchanged at 3.6%. Traders will use the data to shape expectations of how the Fed will set policy at its September meeting; the central bank is in a data-dependent, meeting-by-meeting mode, as it focusses on bringing inflation back to target. Accordingly, any upside surprise for the headline and wages will give the central bank scope to move rates higher by a larger increment in September, whereas any downside surprise to the headline may indicate that the slowing growth momentum has crept into Q3, and any downside surprise in the wages component may allow the central bank to revert to a smaller increment of rate hikes.

Policy Significance:

Fed officials have been looking through recent growth data that showed the US economy contract for two consecutive quarters, which some define as a 'technical' recession. Policymakers have argued that US economic performance is not consistent with recessionary conditions, with their case heavily premised on job gains being robust in recent months, and the unemployment rate remaining low.

July's data will perhaps carry more weight than in recent months since it could be more influential in determining the outcome of the September FOMC meeting. The Fed has indicated that it is now setting policy on a meeting-by-meeting basis, where incoming data will be the basis of its policy decisions; that said, the central bank has also suggested that inflation remains its primary policy focus, and it is prepared to take monetary policy into restrictive territory to cap the upside surge in prices, and accordingly, the central bank is still expected to aggressively tighten rates, with many officials noting that there is much work to be done to bring inflation back down.

Currently, money market pricing for the September FOMC meeting is split between a rate hike of 50bps or 75bps from the current 2.25-2.50% neutral level; beyond September, markets are betting that rates will rise to 3.25-3.50% by year-end, before easing to 2.75-3.00% over the course of 2023.

Payroll Growth:

The US economy is expected to add 250k nonfarm payrolls in July, the slowest rate of monthly job additions since December 2020, and below recent averages too (for reference, the 3-month moving average is 375k; the 6-month average is 457k, which is also the monthly average of 2022; and the 12-month average is 524k). The unemployment rate is forecast to remain unchanged at 3.6%.

The July jobs report will also give us a glimpse of how the key initial data prints from Q3 are shaping up, and whether there was anything more to the 'technical' weakness seen in Q2. If the headline were to significantly top the consensus estimate, it would add fuel to the argument that the labour market remains strong, and provide the Fed with scope to lift rates by a larger increment if it deemed necessary.

Conversely, a downside surprise would add to arguments highlighting slowing growth momentum in the US, and embolden those who have suggested that the central bank will need to lower rates next year to support an economy that is falling into a recession.

Wage Inflation:

Average hourly earnings are expected to rise by 0.3% M/M in July, matching the rate of the prior month, while the annual measure is seen easing by 0.2ppts to 4.9% Y/Y. Analysts have recently noted that various measures of wage growth are sending conflicting signals: the component within the jobs report has been easing in the first half of the year, but the Atlanta Fed's Wage Growth Tracker has been rising, for instance.

In terms of the Fed's own focus, at his post-meeting press conference in July, Chair Powell flagged the Employment Cost Index series as a key metric that officials would consider when setting policy.

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And within the Q2 ECI report, the wages and salaries component, which analysts use as a gauge of labour market tightness, rose by 1.6% on a three-month seasonally adjusted basis, picking-up from the previous 1.3%; at an annualised rate, this equates to around 6.5% Y/Y, according to Pantheon Macroeconomics. “Wage gains at this pace are far too high for the Fed, because they would require implausible rapid productivity growth in order to be consistent with the inflation target in the medium-term,” it said, “a lot more data will be released before the September Fed meeting, but this is not a great start for investors looking for the Fed to slow the pace of tightening.”

Going forward, Goldman Sachs expects wage growth to begin slowing, and offers three reasons to support this argument: 1) the firmness in wage growth last year and early 2022 was likely a reflection of one-off factors related to the pandemic that are no longer relevant, 2) the breadth of wage gains has fallen in recent months, 3) forward-looking wage growth expectations have started to moderate.

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