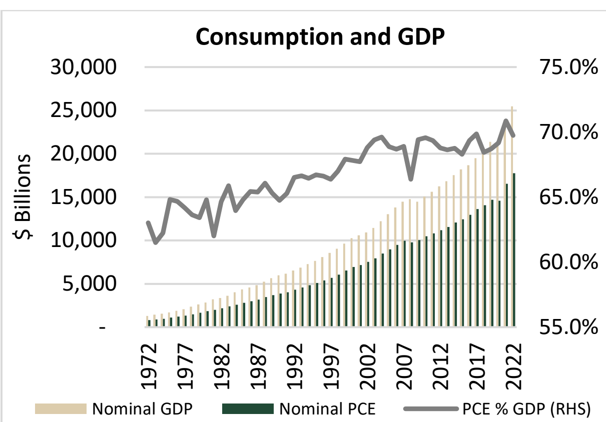
The US Labor Market

The purpose of this white paper is to outline the key components of the US labor market, its importance to the economy, highlight key trends and their potential economic implications.

Key components

The US Bureau of Labor Statistics (or BLS) is charged with compiling employment data. We will briefly cover some of the main components that feature in this paper. The **labor force** is defined as the number of people aged 16 years and older both employed and unemployed. The **participation rate** represents the labor force as a percentage of the civilian noninstitutional population. Every month, usually on the first Friday, the BLS releases a range of job data including the change in employment, or **non-farm payrolls**, the **unemployment rate,** or number of people unemployed as a percentage of the labor force and change in **average hourly earnings**. In addition, the BLS provides a monthly **job openings and labor turnover survey** (or JOLTS report) with a one-month lag. All this data is closely observed by financial market participants and policy makers.

Importance to the economy



Source: Bureau of Economic Analysis

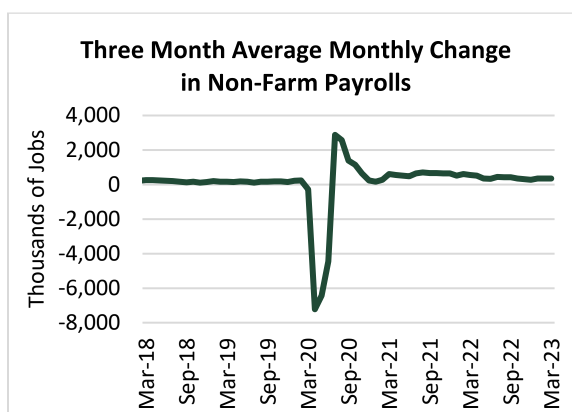
The US economy is often referred to as a 'consumer-driven' economy. We can quantify this through the Personal Consumption Expenditure (or PCE) component of Gross Domestic Product (or GDP). Over the past 50 years, PCE has risen from 61.5% of GDP to almost 70% today. Since job security and wage growth play a key role in household consumption decisions, the labor market is integral to the performance of our economy.

In addition, wages are an important driver of inflation. Inflation measures such as the Consumer Price Index (or CPI) can be broken down into three broad categories: durable goods, housing, and non-housing related services. The last category comprises approximately 30% of the current CPI basket and includes services like travel and entertainment whose price is very closely linked to wages since labor makes up a large portion of their cost.

Finally, monetary policy is heavily influenced by the labor market. Since the Federal Reserve has an official dual mandate to maximize employment and ensure price stability, it must pay very close attention to job and wage trends.

Labor market trends

We separate labor market trends into short term, cyclical trends, and long-term, structural trends. Recently, there have been references by market commentators and policy makers about labor market conditions being 'tight' or data exhibiting strong levels of demand for workers but limited supply. This has kept wages elevated with average hourly earnings currently growing in the mid-4% area, on a year-on-year basis, compared to the low-3% area pre pandemic.



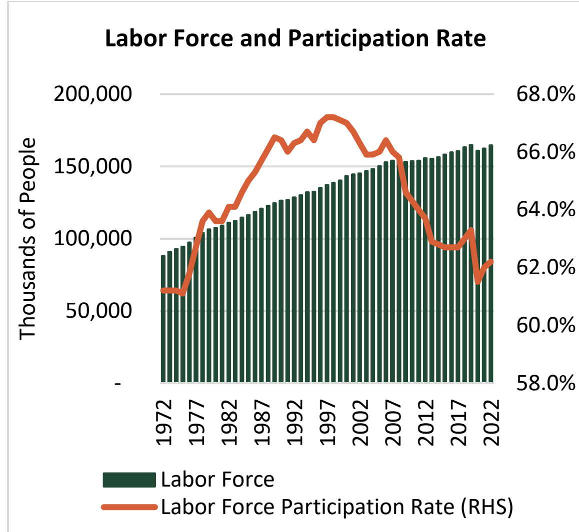
Source: Bureau of Labor Statistics

As of the latest payroll report for March 2023, the US economy is creating 355,000 new jobs each month using the trailing three-month average. Even the six-month average, at 320,000, points to a job market with strong momentum. The unemployment rate is also close to a record low, at 3.5%. For context, almost 22 million jobs were lost during just the first two months of the pandemic, and it was not until mid-2022 they were fully recovered. One can think of the 3 million jobs created since then as part of a 'catch-up' to the pre-pandemic trend level of growth of around 2 million jobs per year.

More forward-looking employment indicators suggest this strong demand may continue. The most recent JOLTS report for February showed 9.9 million current openings, down from the recent record of 12.0 million but still higher than levels experienced before the pandemic, of around 6-7 million.

At the same time, the supply of workers has been declining in terms of both the rate of growth of the labor force *and* the participation rate. Over the past five years, for example, the labor force has grown by an average of just 0.5% per year and the participation rate declined from 63.0% to 62.2%. While the pandemic impacted the availability of workers, trends had been deteriorating long before.

Labor force growth declined from almost 3% per year in the 1970s to around 1% by 2000. After the financial crisis, growth decelerated further below 1% to where it is today. The main driver has been the decline in population growth which should continue as fertility rates fall and the population ages. That places more importance on immigration to support labor force growth. Data from the US Census Bureau shows that since peaking in 1998 at 6.5% of the population, net migration has fallen to below 3%. Nonetheless, by 2030, net migration is expected to outstrip the natural increase in the population (births less deaths).



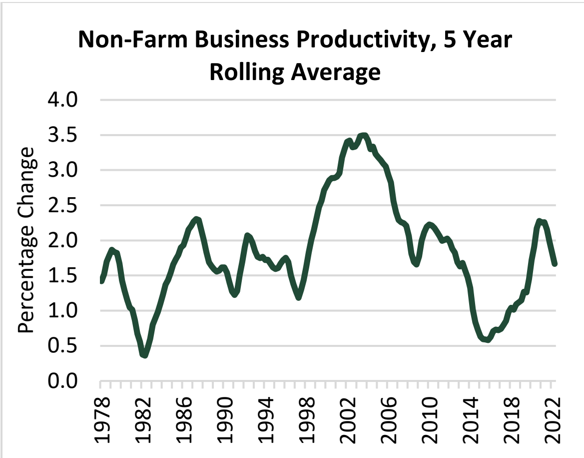
Source: Bureau of Labor Statistics

The participation rate steadily climbed until the turn of the century when it peaked around 67% and has fallen steadily since. The main explanation is the retirement of Baby Boomers, those born between 1946-1964 and the largest faction of the population, which should continue through the 2020's. Of greater concern is the fact that more and more prime working age men are dropping out of the workforce.

According to the BLS, the participation rate for the male 25–54-year-old cohort fell from 95% in 1973 to 92% in 2000 to 89% today. There are many explanations for this including a decline in marriages and increase in the number of males cohabiting with parents and receiving financial support, and a growing prevalence of drug addiction and mental illness.

Economic implications

As demand for labor fluctuates with the economic cycle, it seems structural forces may keep labor supply constrained. All else equal, this may continue to place upward pressure on wages and inflation in the absence of a rise in **productivity**. The BLS measures productivity through the ratio of real output to hours worked in the non-farm business sector.



Source: Bureau of Labor Statistics

Historically, productivity has fluctuated in waves over long periods of time. During the late-1990 to early-2000 period, for example, the introduction of the internet helped fuel a surge in productivity which then declined for the next ten years. A possible explanation for the decline is the rise of China. China joined the World Trade Organization in 2001 and businesses started to outsource more of their manufacturing capacity due to cheap labor, diverting investment from the US.

More recently, unit labor costs have been rising in China which has coincided with an uptick in US productivity. New technologies such as 5G, cloud computing and artificial intelligence (A.I.) could see a continued improvement. Furthermore, concerns over supply chain security may also drive more investment in US manufacturing capacity.

Conclusions

- Labor markets are likely to remain tight in the near-term supporting household consumption and economic growth but also keeping wages elevated.
- Demographic trends should continue to limit labor force growth in the future and increase worker bargaining power.
- This may result in more restrictive monetary policy than in the past decade, including interest rates remaining higher for longer.
- Technological advances such as A.I. could help drive higher productivity growth and mitigate worker shortages.

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Questions?

Please contact Chandler at info@chandlerasset.com, or toll free at 800-317-4747 with any questions or to learn about investment management solutions for public entity investment programs.