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## Labor shortages are likely distorting signals

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- November payroll employment growth was strong by historical standards, consistent with the pre-pandemic average. Employment rebounded in the auto sector after conclusion of the UAW strikes, similar to what happened after the last strike in 2019. Healthcare has been a big contributor to employment growth in 2023, but the industry is a relatively poor indicator of overall economic conditions. Professional and business services has historically been a more reliable business cycle indicator, but negative growth over the past 3 months has not signalled a recession, and job openings are rising for the industry. Labor shortages are likely distorting what would otherwise be reliable labor market indicators.
- Younger workers (16-24 years) pushed the unemployment rate back down to 3.7% in November, just as they drove the rise to 3.9% in October. The labor force participation rate was little changed and it has been essentially flat since August. Despite emerging weakness in the labor market, conditions are still tight and market expectations of a Fed rate cut in March seems too optimistic.

### Conflicting industry data

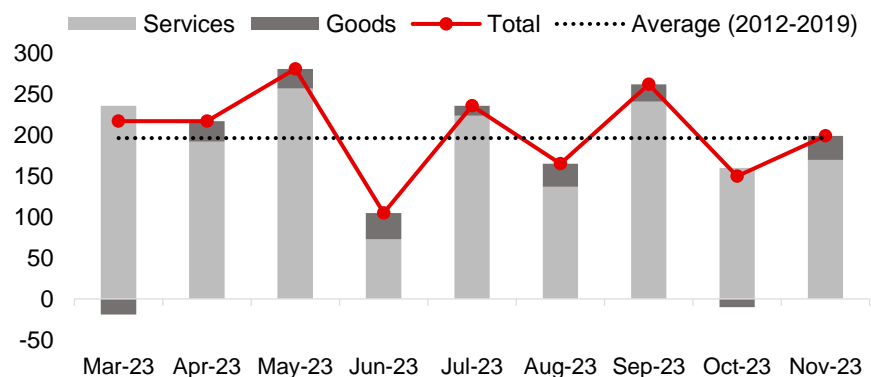
Nonfarm payroll employment grew by 199,000 in November, consistent with the pre-pandemic average of 196,000. There was a rebound in the goods sector where 29,000 jobs were added. The auto sector was a big contributor, adding 30,000 jobs in November after losing 33,400 jobs in October from the UAW strikes. Just like in the aftermath of the 2019 strikes, the auto sector was able to re-coup jobs lost.

The services sector as a whole was also strong, but the industry breakdown shows some weakness. Healthcare and leisure and hospitality are the only private services industries whose employment level has grown since August (1.2% and 1% growth respectively). From this perspective, the labor market appears much weaker than the headline figure suggests.

It's no surprise that leisure and hospitality continues to grow, since employment is still 158,000 below the pre-pandemic level. And the persistent growth in healthcare (1.1 million jobs above the pre-pandemic level) tells us little about the state of the economy.

### Jobs growth has been in-line with the pre-pandemic average

Nonfarm payroll employment growth, thousands



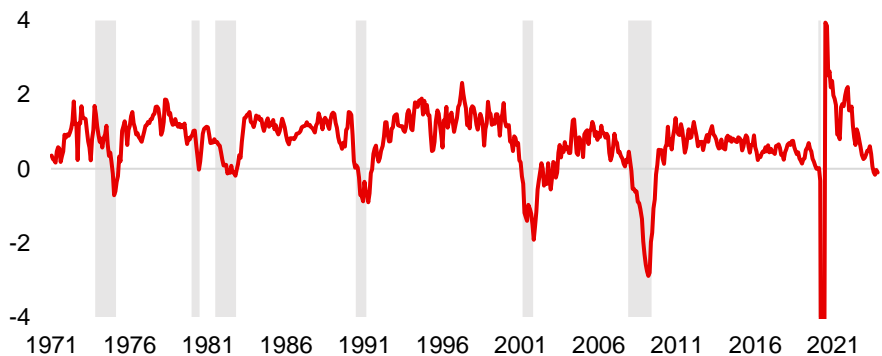
Source: BLS, MUFG Bank Economic Research

Broadly speaking, changes in the healthcare industry are not indicative of overall economic conditions. The relationship between the business cycle and the healthcare labor market is weaker than most other industries given the inelasticity of demand for health services and the role that Medicare and Medicaid play in the United States. Healthcare employment tends to be more resilient during economic downturns and growth doesn't necessarily imply a strong economy.<sup>1</sup>

The professional and business services sector has historically been much more reliable at assessing whether the economy is or isn't in a recession. Since 1970, every episode of negative employment growth (on a 3-month basis) meant that the US was in a recession. If this relationship were to hold today, that would mean that the US entered a recession in August of this year.

**Jobs growth in professional and business services has historically been a reliable recession signal**

*3-month employment growth, professional & business services, %*



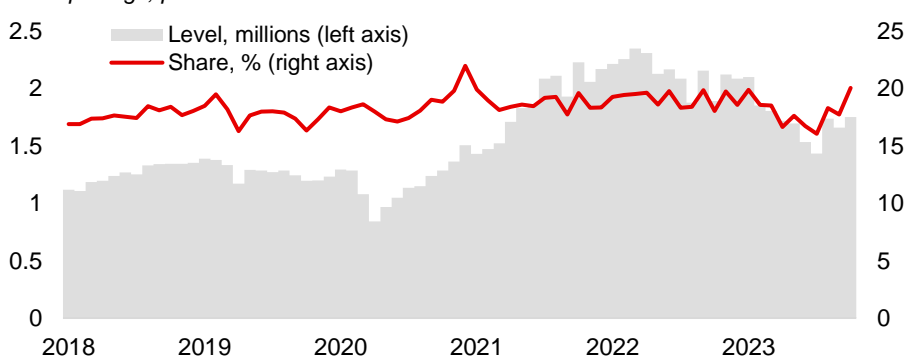
Source: BLS, MUFG Bank Economic Research

But we know from strong Q3 GDP and consumer spending growth, along with very low unemployment, that the US is not in a recession. The question is, why has the relationship broken? It is likely a combination of “normalizing” where growth is coming down to the pre-pandemic trend and acute labor shortages in professional and business services.

October's JOLTS report showed a stark decline in overall job openings (-617,000) and in the vacancy to unemployed ratio (down to 1.3 from 1.5), but a sizeable share of the drop came from the health care sector (-236,000). And like employment, this may not have implications for the broader economy. For professional and business services, the number and share of vacancies has actually been growing despite no jobs growth.

**Vacancies are rising for professional and business services despite declining employment**

*Job openings, professional & business services*



Source: BLS, MUFG Bank Economic Research

<sup>1</sup> Dillender, M., Friedson, A., Gian, C., & Simon, K. (2021). Is Healthcare Employment Resilient and "Recession Proof"? Inquiry : a journal of medical care organization, provision and financing, <https://doi.org/10.1177/00469580211060260>

The dynamic where jobs growth is near zero or slightly negative, while job openings is positive is likely a symptom of labor shortages and hiring difficulties. One indicator reflects weakness while the other strength in demand. Additionally, both quits and hiring accelerated in October for professional and business services after months of being mostly flat, reflecting more turnover in the industry.

“Cooling” is still an appropriate description of labor demand, but too much optimism about labor shortages is not warranted given the industry composition of vacancies and the little change that we’ve seen in total hiring, quits, and layoffs over the past few months. Nonfarm payrolls on their own don’t paint a fully accurate picture of the labor market given the severity of shortages.

### **A less reactive Fed**

Younger workers (16-24 years) drove the unemployment rate down to 3.7% in November after pushing it up to 3.9% in October. Younger workers comprise the smallest share of the labor force and the number of unemployed is much more volatile for this age group. However, we do expect the unemployment rate to begin to rise heading into 2024 as interest rates feed into the broader labor market. Even with persistent labor shortages, some weakness is apparent in November’s jobs report.

Even so, markets are still likely too optimistic about rate cuts next year. Deflation in China is supporting core goods disinflation here in the US, but domestic demand side pressures from the labor market and consumer spending are still present despite emerging weaknesses. The Fed is more willing to accept overtightening than risk a resurgence in price growth. Only a significant slowdown in economic output or a shock would trigger the Fed to cut rates, and it seems unlikely that this will happen by March. We expect the Fed to begin cutting rates no sooner than June of next year, coinciding with an expected slowdown in GDP.

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