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Labor demand may be weaker than it seems

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- Payroll employment expanded at what would be considered a healthy pace in December, consistent with the monthly growth average from 2012-2019. However, employment in the household survey contracted, pushing the employment-to-population ratio down to one percentage point below the pre-pandemic level. When adding job openings, the growth trend in overall labor demand is weaker than it was in 2019.
- In addition to demand being potentially weaker than the headline number suggests, labor supply continues to fall short. The unemployment rate remained at 3.7% in December as growth in the labor force slowed, and the labor force participation rate continues to trend downward after peaking this past summer. Labor shortages will keep unemployment relatively low even with an expected slowdown in economic growth in 2024.

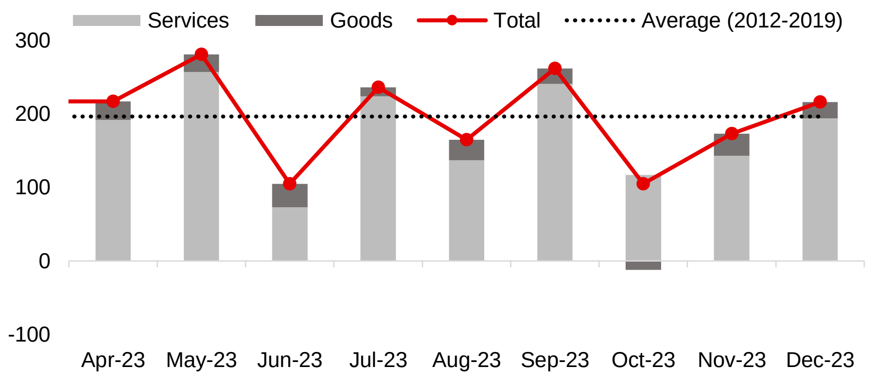
Headline payrolls show strong growth

Nonfarm payroll employment grew by 216,000 in December, slightly above consensus forecasts and consistent with the pre-pandemic average. Most job gains occurred in government (+52,000) and health care and social assistance (+59,000) industries where growth is least correlated with overall economic conditions. Jobs growth was small in professional and business services (+13,000), an industry that has historically represented the health of the labor market well from a recession and expansion standpoint.

Construction employment was strong in December (+17,000) and continues to trend upward, in part from stabilizing mortgage rates and manufacturing re-shoring efforts. Leisure and hospitality also continues to add jobs (+40,000), as the industry slowly recovers employment lost as a result of the pandemic.

Over the past 6 months, the major industries with the most growth were health care and social assistance (2.4%), construction (1.3%), and leisure and hospitality (1.2%). Industries with the greatest declines were transportation and warehousing (-1.2%), information services (-1%), and professional and business services (-0.3%).

Jobs growth has been in-line with the pre-pandemic average
Nonfarm payroll employment growth, thousands



Source: BLS, MUFG Bank Economic Research

Household survey shows weaker labor demand

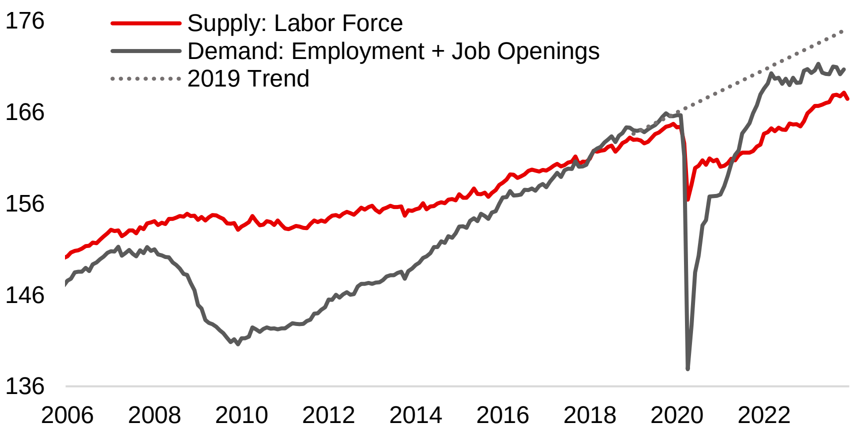
The industry composition of nonfarm payolls suggests that labor demand is likely weaker than the headline figure shows. Most growth is occurring in industries where shortages are strongest (e.g., construction) or where growth is least correlated with economic conditions (e.g., government and health care).

The household survey paints an even weaker picture, where employment contracted in December and has a slower growth trend. From a monthly growth perspective, payroll employment figures are less volatile than the household survey, generally allowing for a more reliable indicator month-to-month. However, the household survey allows for a better comparison relative to labor supply since household employment, the labor force, population estimates, and the unemployment rate are all sourced from the Current Population Survey (CPS).

Both the employment-to-population ratio and the current low unemployment rate reflect a labor market being driven by low supply as opposed to excess demand. The employment-to-population ratio has yet to fully recover from the pandemic and it dropped to 60.1% in December, 1 percentage point lower than the February 2020 level. The unemployment rate did not exceed 3.9% in 2023 and deviations around the current 3.7% were mostly a result of changes in the size of the labor force. The labor force participation rate peaked this past summer and has since been trending back downward for prime-age and older workers.

Adding job openings to CPS employment and we see a weaker growth trend in labor demand today than in 2019. Yet, despite the weaker growth from the household survey or even the potential weakness in payrolls at the industry level, demand is still well above current labor supply levels. The source of labor shortages today, and the wage pressures that come with it, is largely from supply growing too slowly as opposed to demand growing too rapidly.

Low labor supply continues to be the driver of labor shortages, as opposed to excess demand
Labor demand and supply, millions



Source: BLS, MUFG Bank Economic Research

Growth in immigration has slowed and labor force participation rates have been stagnant, which will help keep labor supply and the unemployment rate relatively low despite an expected slowdown in consumption and economic growth in the first half of 2024.

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