STATE OF THE ECONOMY – A LABOR ECONOMIST'S PERSPECTIVE

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Dr. Chris Stoddard
Montana State University

Why is everything so confusing right now?

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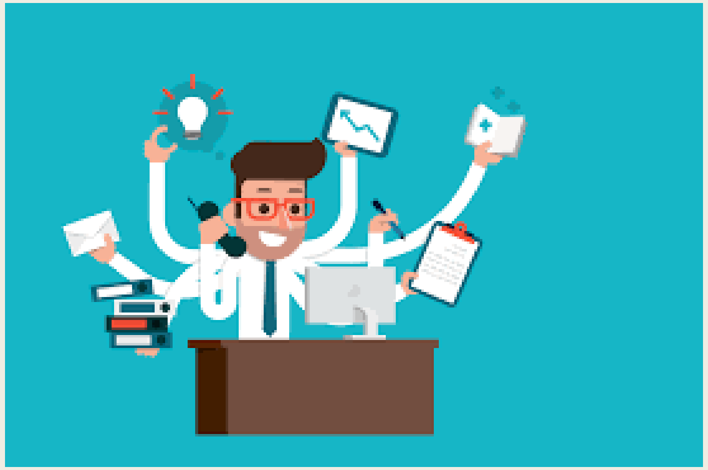
- Prices and wages have both risen rapidly lately
- Wage growth can be good (productivity), mixed (supply and demand changes), and bad (inflation)
- Rapid inflation is a spiral of higher prices and wages that erodes savings and messes with our decisions
- Is this temporary? Or is this inflation that the Federal reserve needs to fight?
- And will fighting it lead to unemployment/a recession?

Explanation #1: Productivity

Workers become more productive

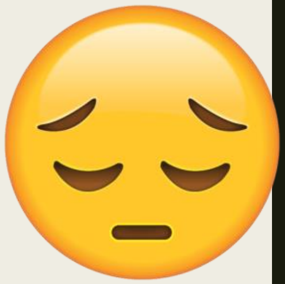


→ make more valuable stuff

→ Firms hire more people and pay them more (higher wages)

→ BUT prices *don't* rise because costs are lower!

Explanation #2: Demand is too high compared to supply



- Consumers want to buy more stuff.
- BUT Suppose there's not more stuff
- $$ chasing limited stuff → prices go up
- Firms try to expand production to meet demand → want to hire more workers→ Wages go up to draw workers in
- But are there more workers? Spiral

This is the concern about too much government stimulus

2:40

- https://youtube.com/clip/UgkxvcpxVv5AzMd5KvbxW24LF72Uf4Lv8nzW

So------*Is demand too high?*

- Limited supply chains relative to demand?
  - *Inflation will get better as supply chains resolve (cars)*

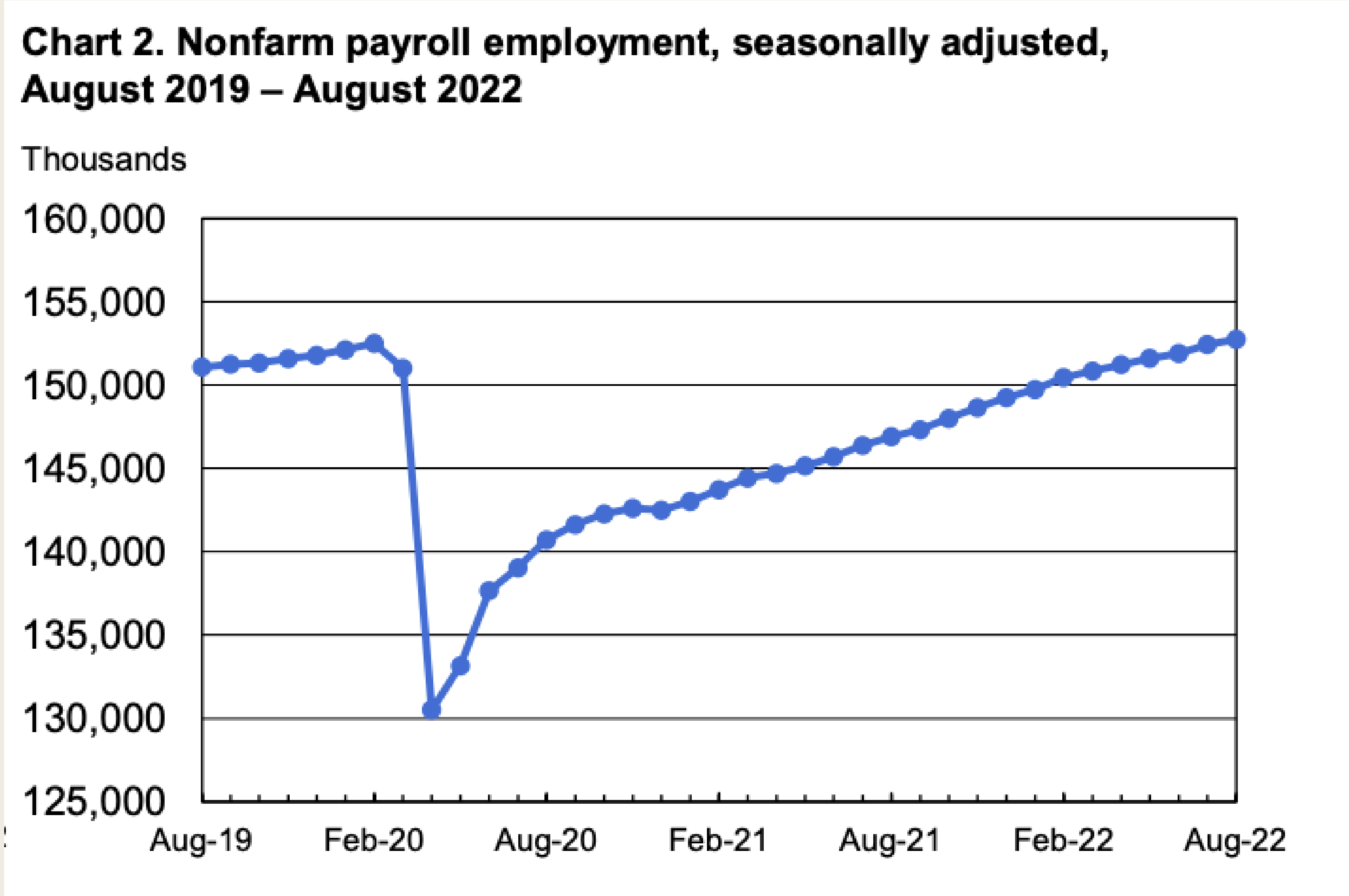
- Fewer workers willing to work?
  - *Inflation will get better as workers return*
  - *OR new equilibrium where prices and wages stabilize at a higher level*

- Too much stimulus led to more demand that economy can produce?
  - *Need to "cool off" the economy to fight persistent inflation. Main option is to reduce demand (Fed policy).*
  - *But—this might mean increasing unemployment in that fight*

How do we know which explanation it is?

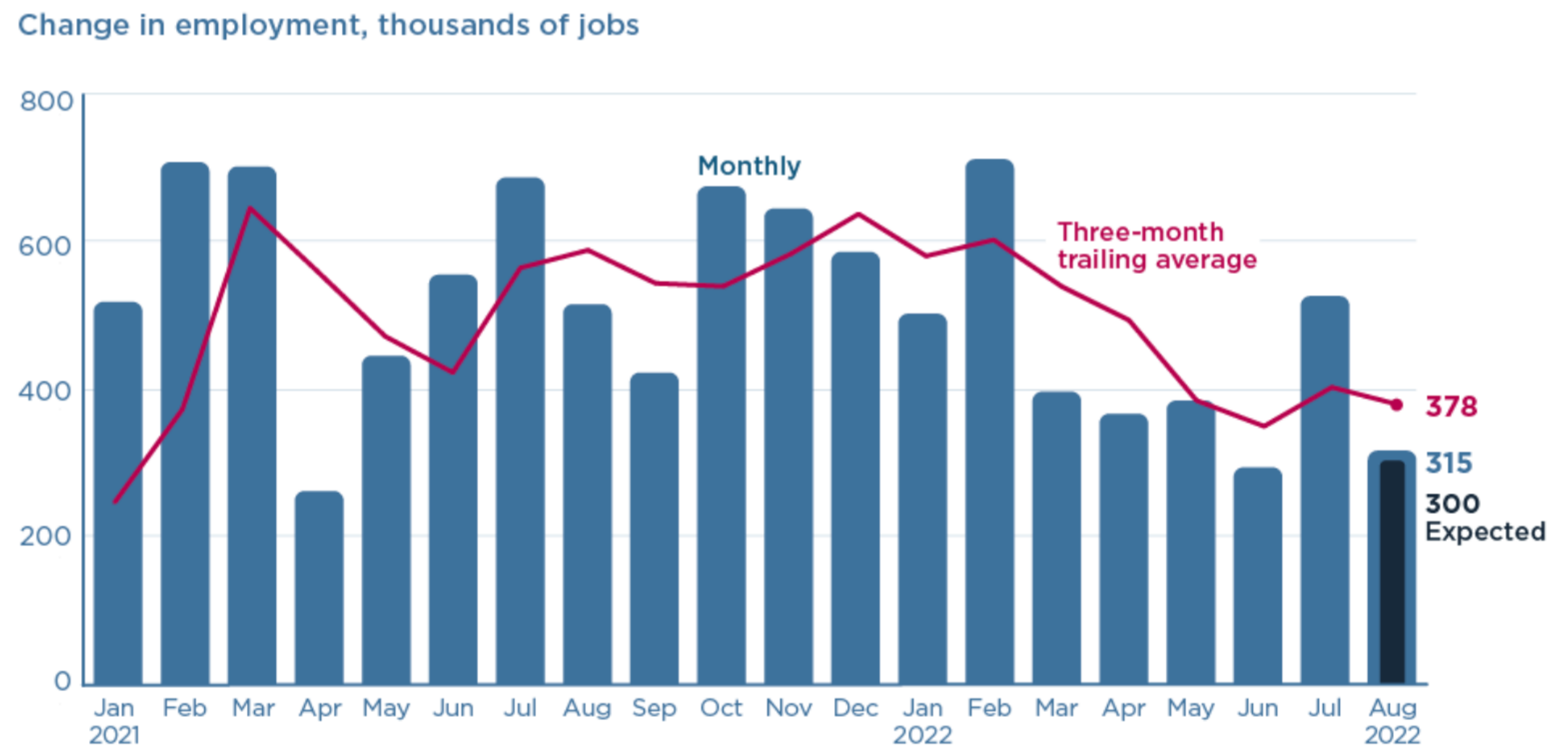
One thing economists are watching is the labor market

Employment now above pre-pandemic levels



Bureau of Labor Statistics, Sept 2, 2022

Job growth remains strong

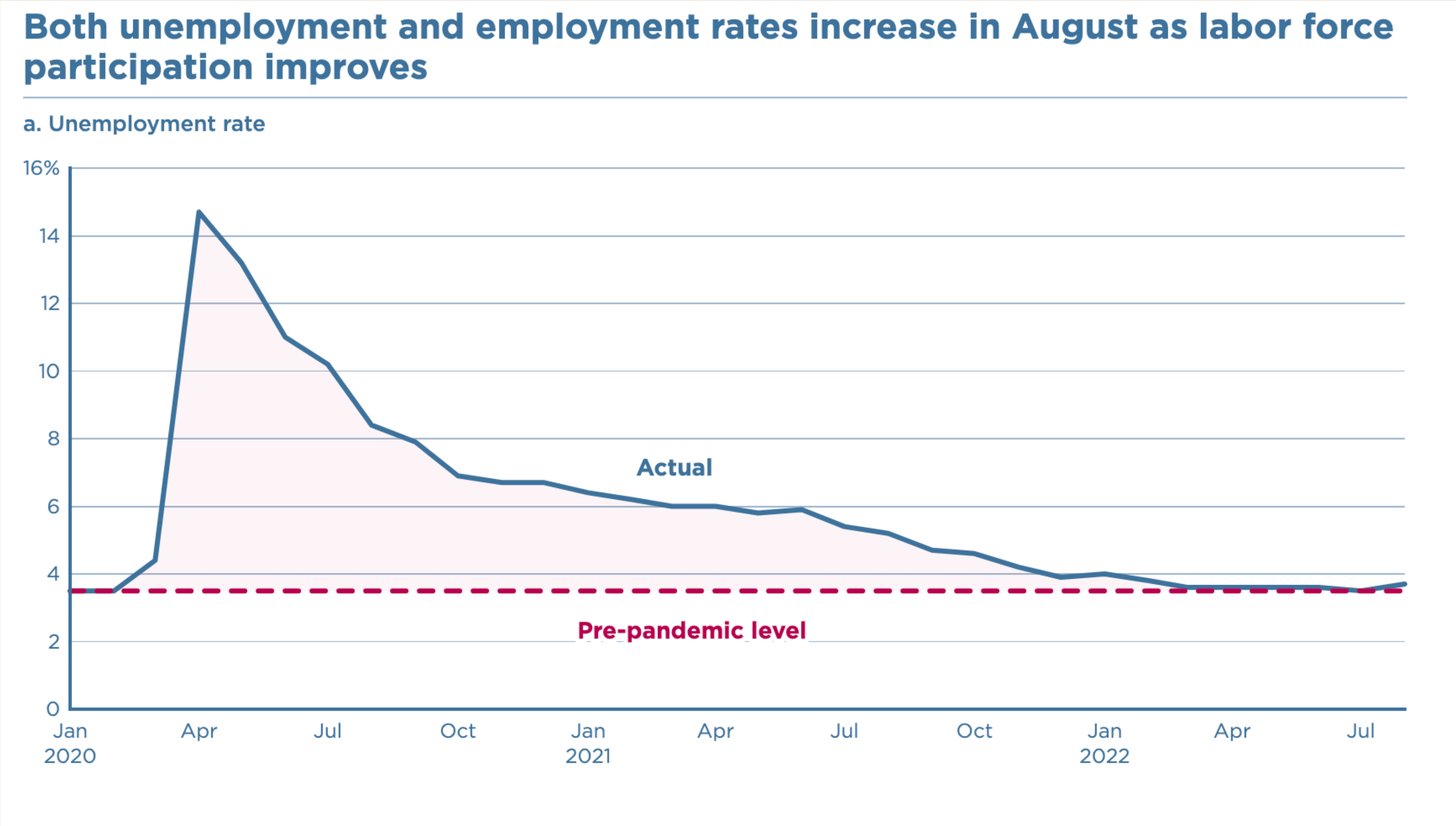


PIIE

Note: Data refer to nonfarm payroll employment, which excludes proprietors, self-employed, unpaid family or volunteer workers, farm workers, and domestic workers. Expected is consensus forecast from FactSet.

Sources: Bureau of Labor Statistics via Macrobond, FactSet, and authors' calculations.

Unemployment is low



Conclusion: the job market is *tight*

- But—the market is in a lot of upheaval in ways employment numbers don’t show

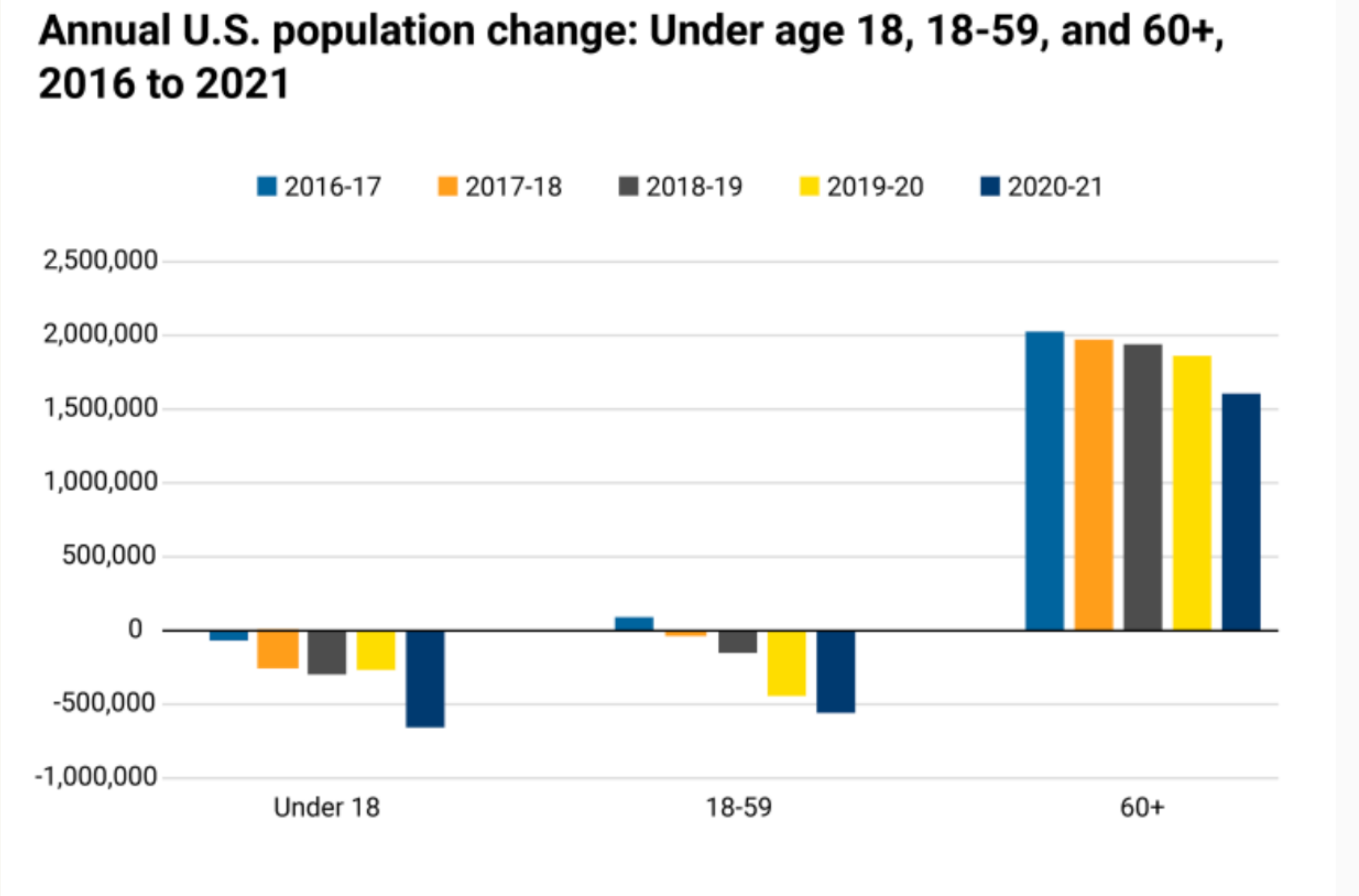
The Job Market Upheaval

- Labor force is smaller BUT number of jobs are rising

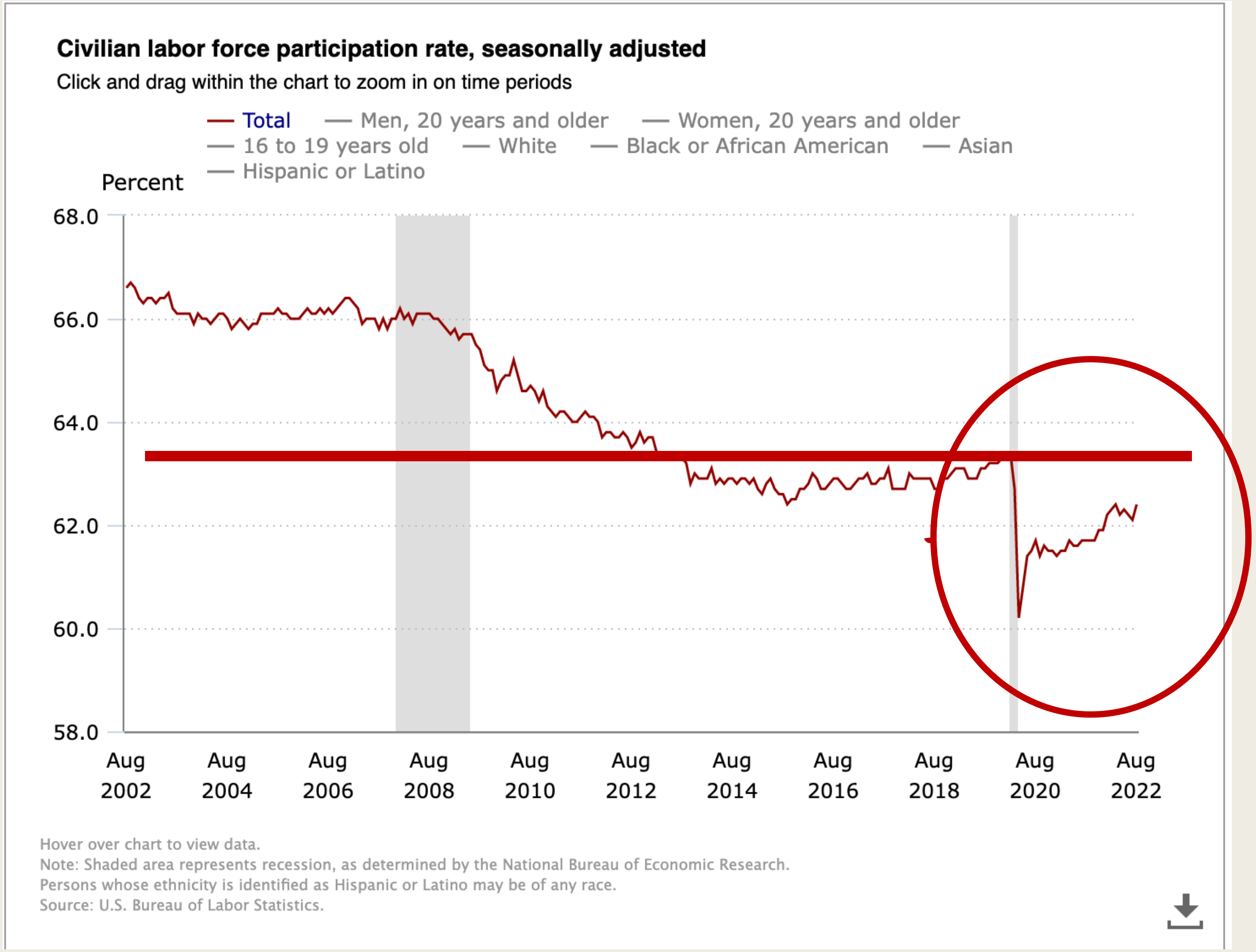
  Four sources:
  - *Lower population—250K deaths for 18-64*
  - *Less immigration*
  - *Older population*
  - *Lower LFP for those still of working age (but mostly those 55+)*

- Great Reshuffling: quits and moves

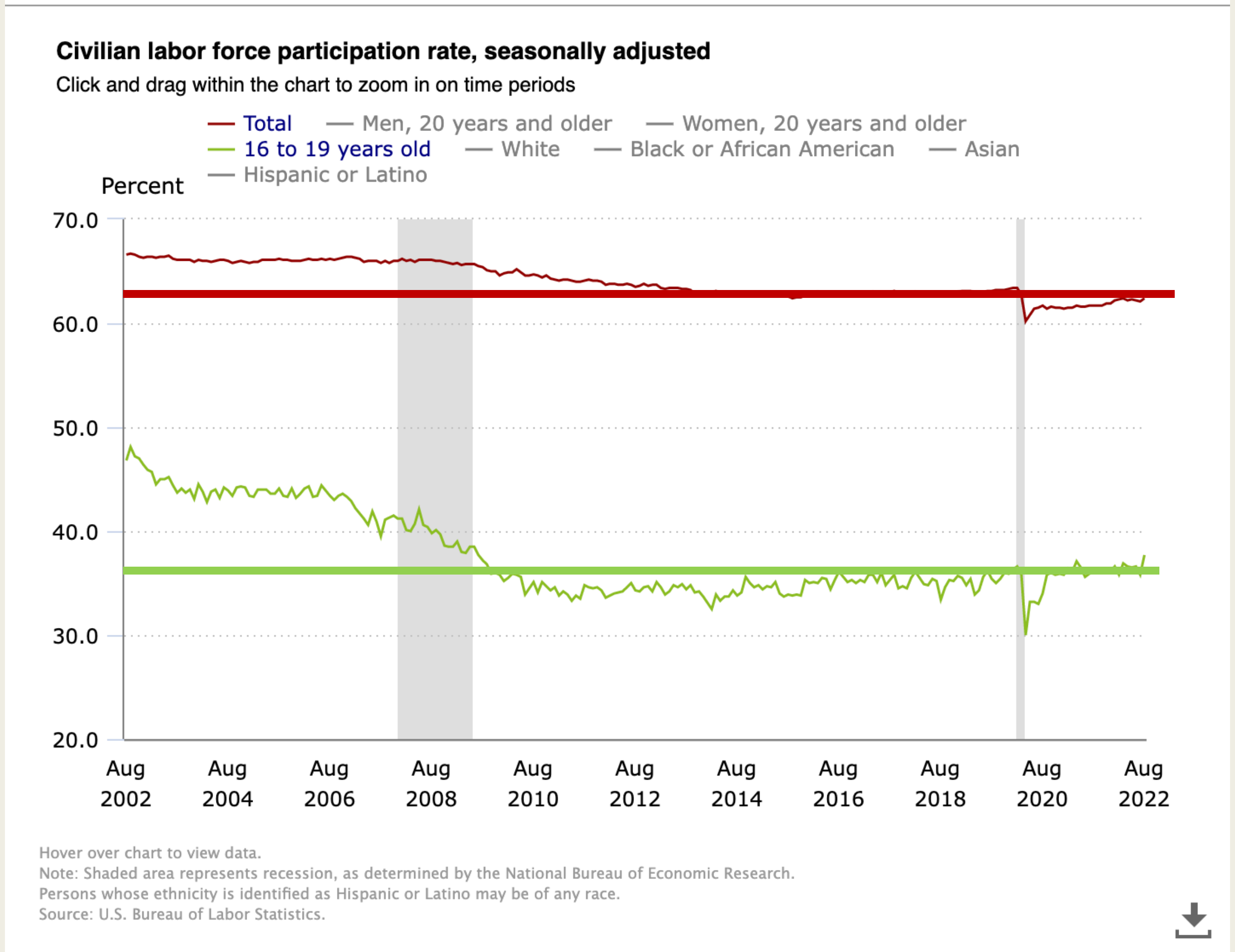
Aging America is leading to a tighter labor market. This is the biggest story.



Labor Force Participation rate has declined



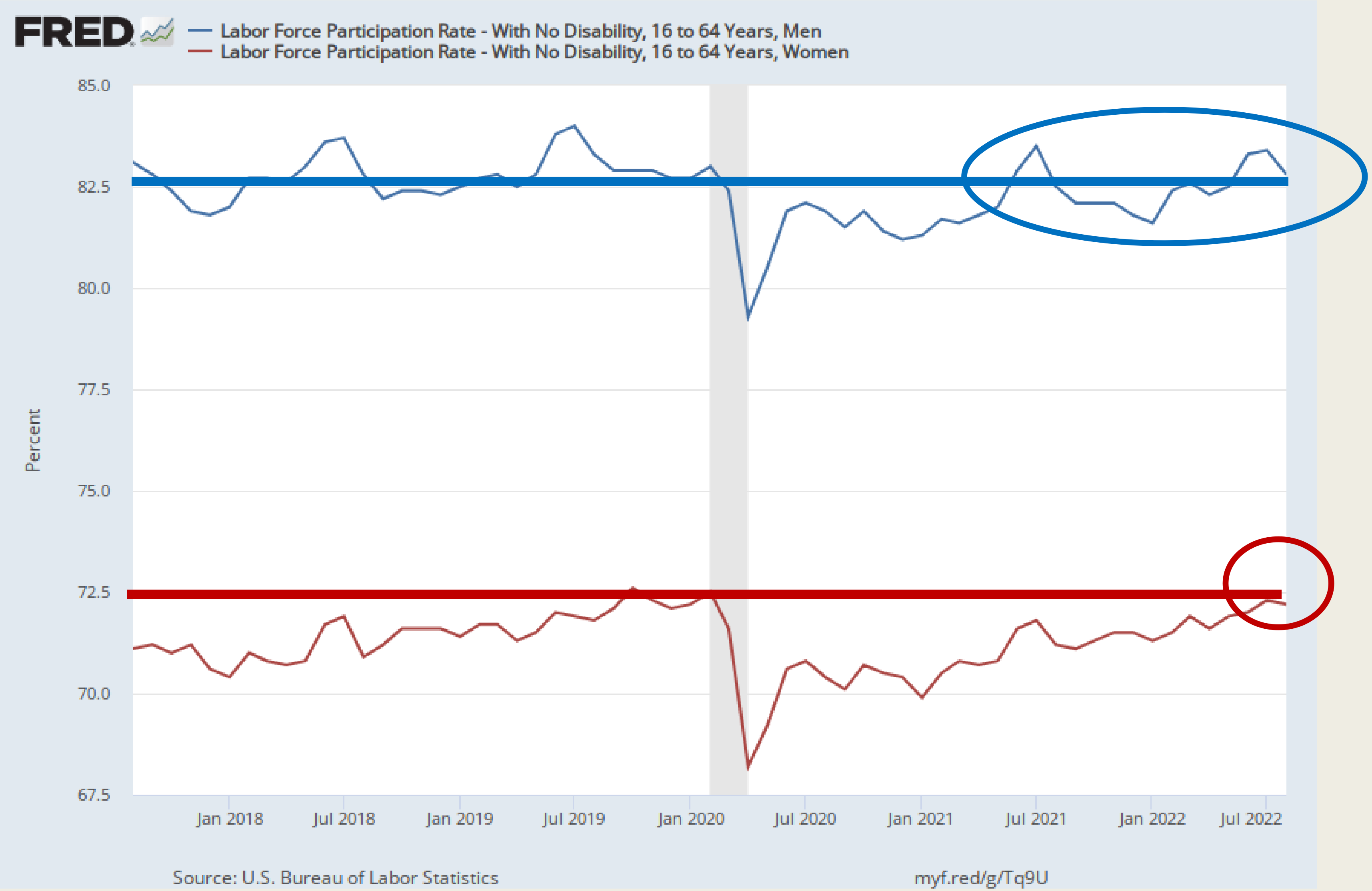
Who “Doesn’t want to work?” Not teens



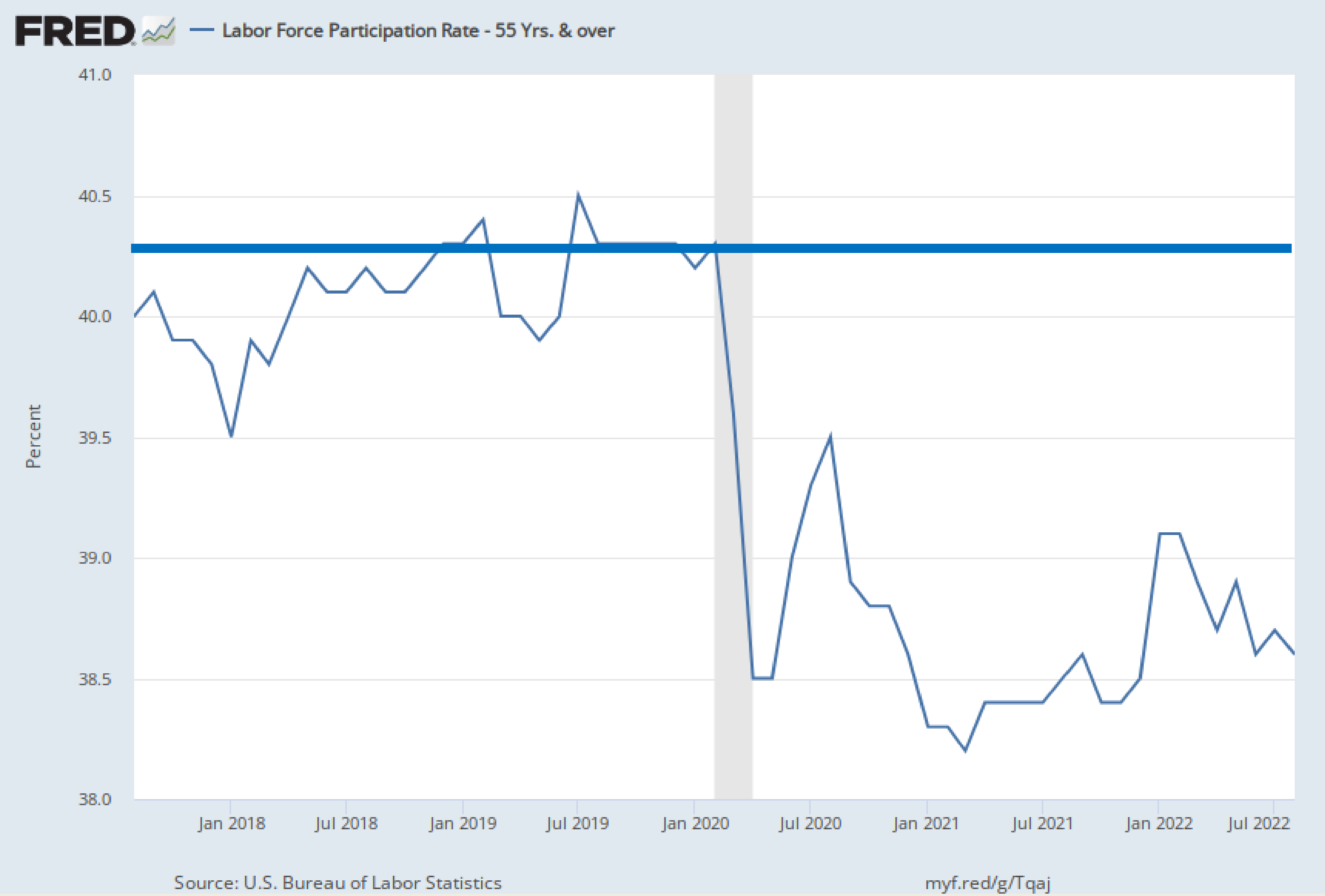
Aug 2022--37.7%

Aug 2019--35.4%

Non-disabled men & now women are back



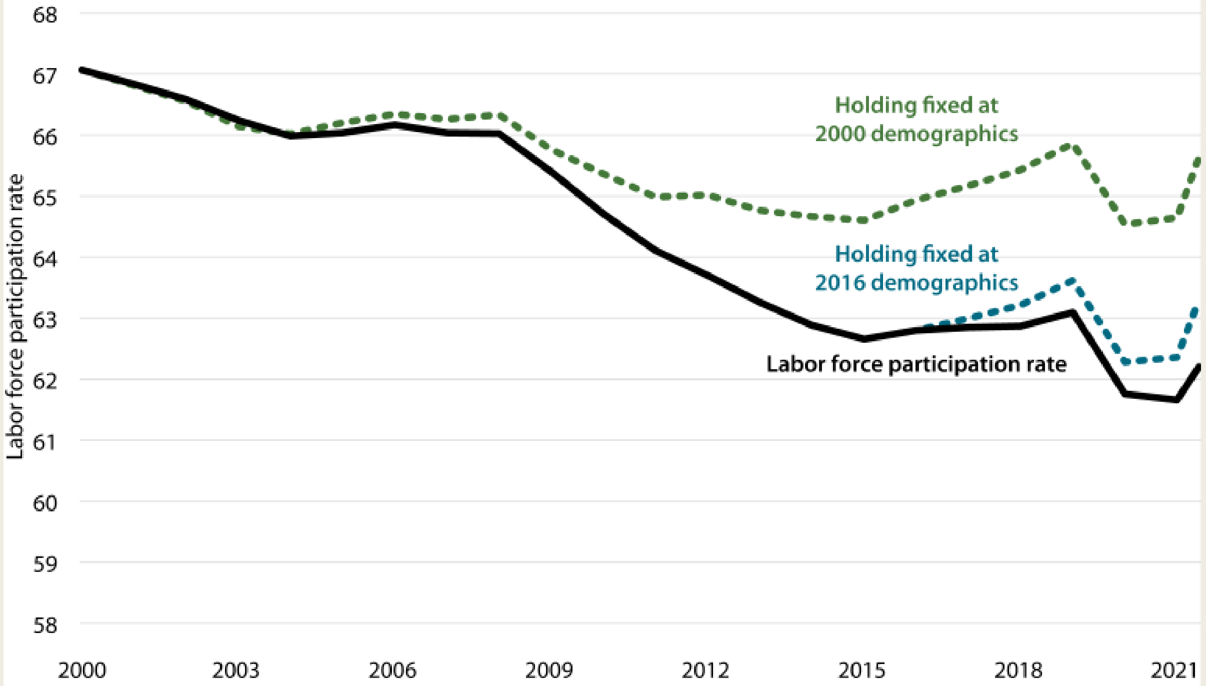
So who's not back?   Older people



Partly older workers are getting older, partly older workers of each age less likely to work

FIGURE 2.

Labor Force Participation Rate vs Counterfactual Scenarios That Keep Age, Education, and Sex Unchanged



Source: Bureau of Labor Statistics n.d.; authors' calculations.
Note: Annual labor force participation rate averages are used through 2021; 2022 is the June monthly rate. To calculate the contribution of each group's changing participation rate to the overall change in the labor force participation rate, we follow the decomposition method described in Aaronson et al. 2006.

THE HAMILTON PROJECT
BROOKINGS

The Job Market Upheaval

- Labor force is smaller BUT number of jobs are rising

  Four sources:

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  - *Less immigration*
  - *Older population*
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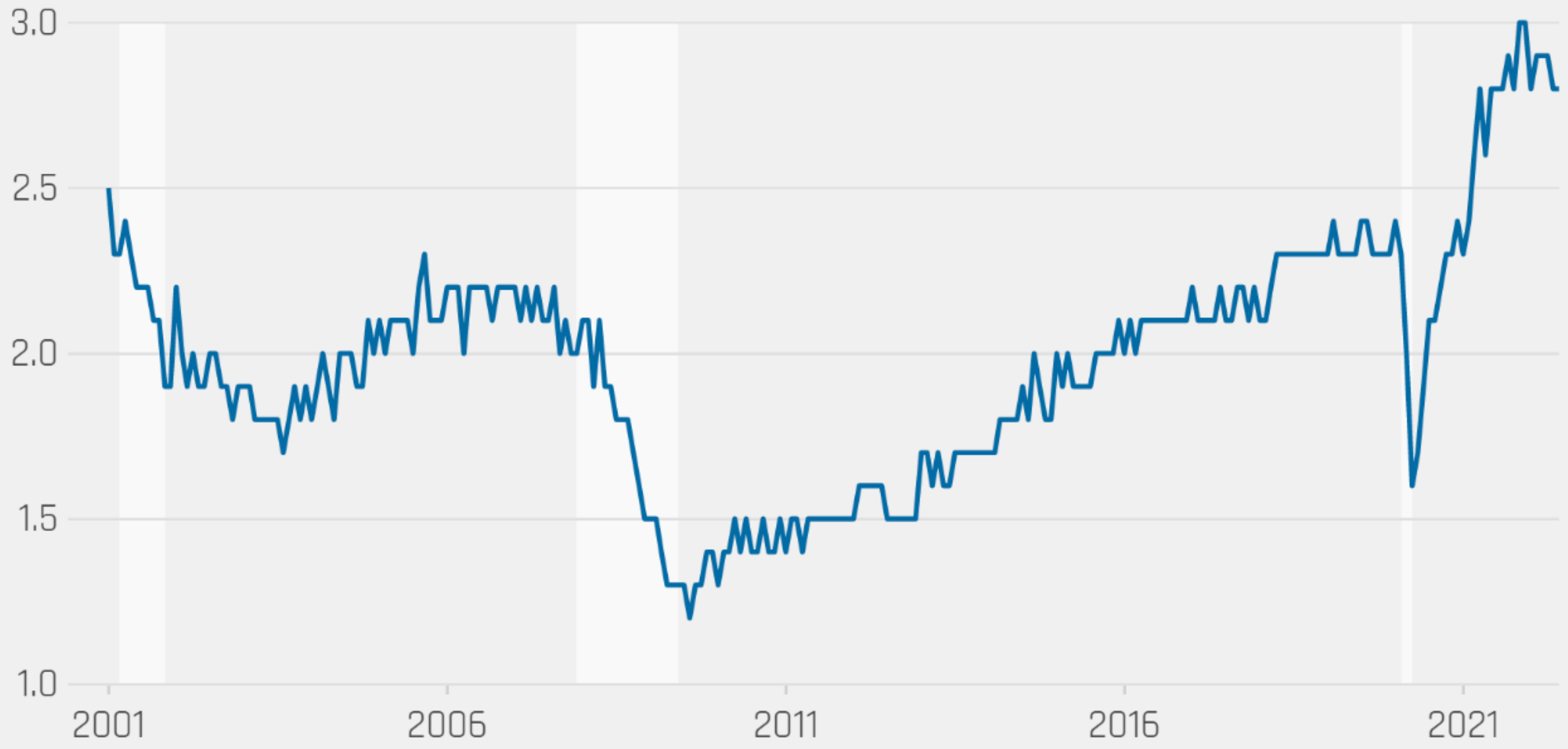
- Great Reshuffling: quits and moves

Tight market leads to reshuffling

Quits as a percent of total U.S. employment, 2001–2022. Recessions are shaded.



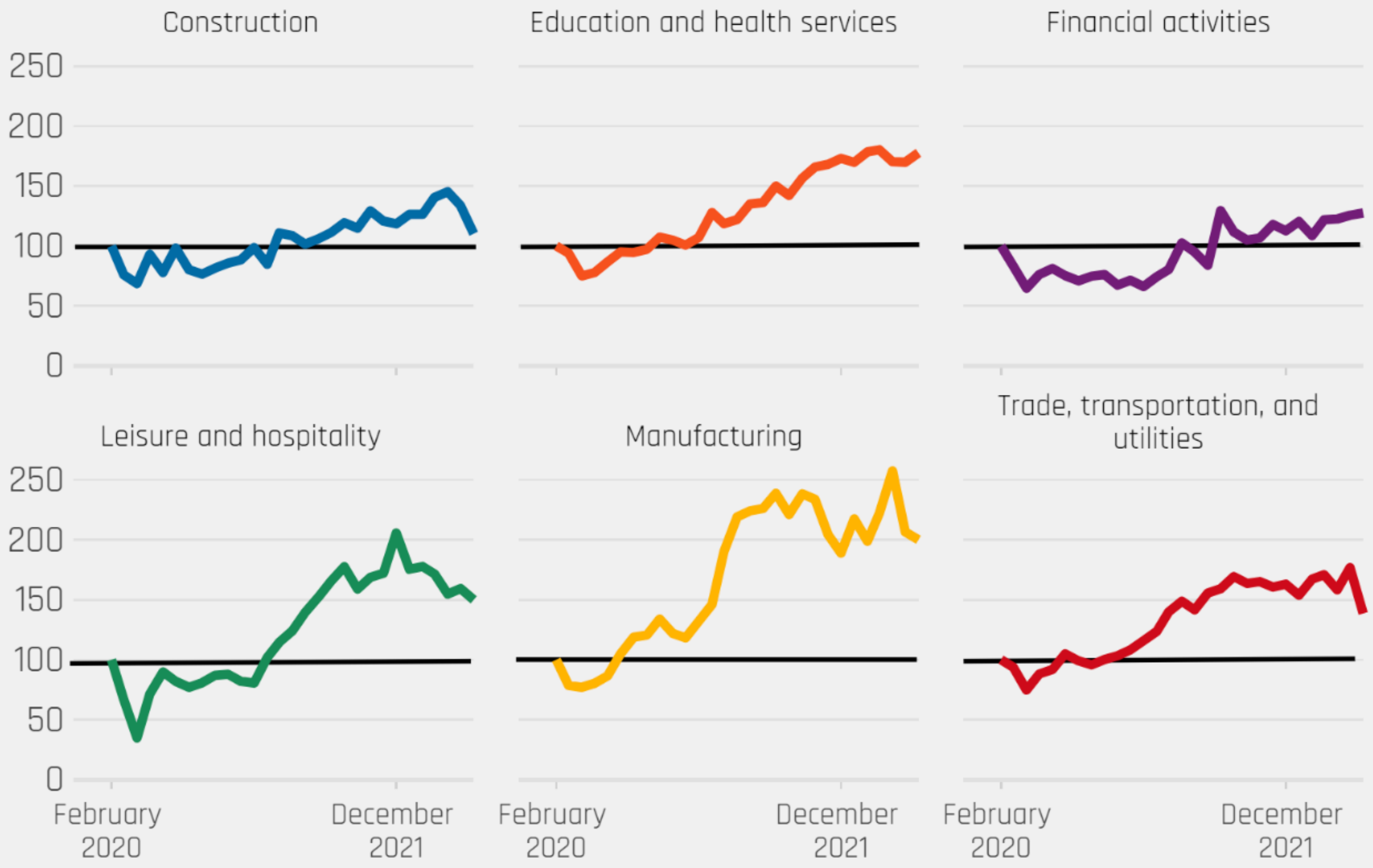
Source: Job Openings and Labor Turnover Survey, data series JTS00000000QUR

So—LOTS of Openings

Both from new positions and from quits

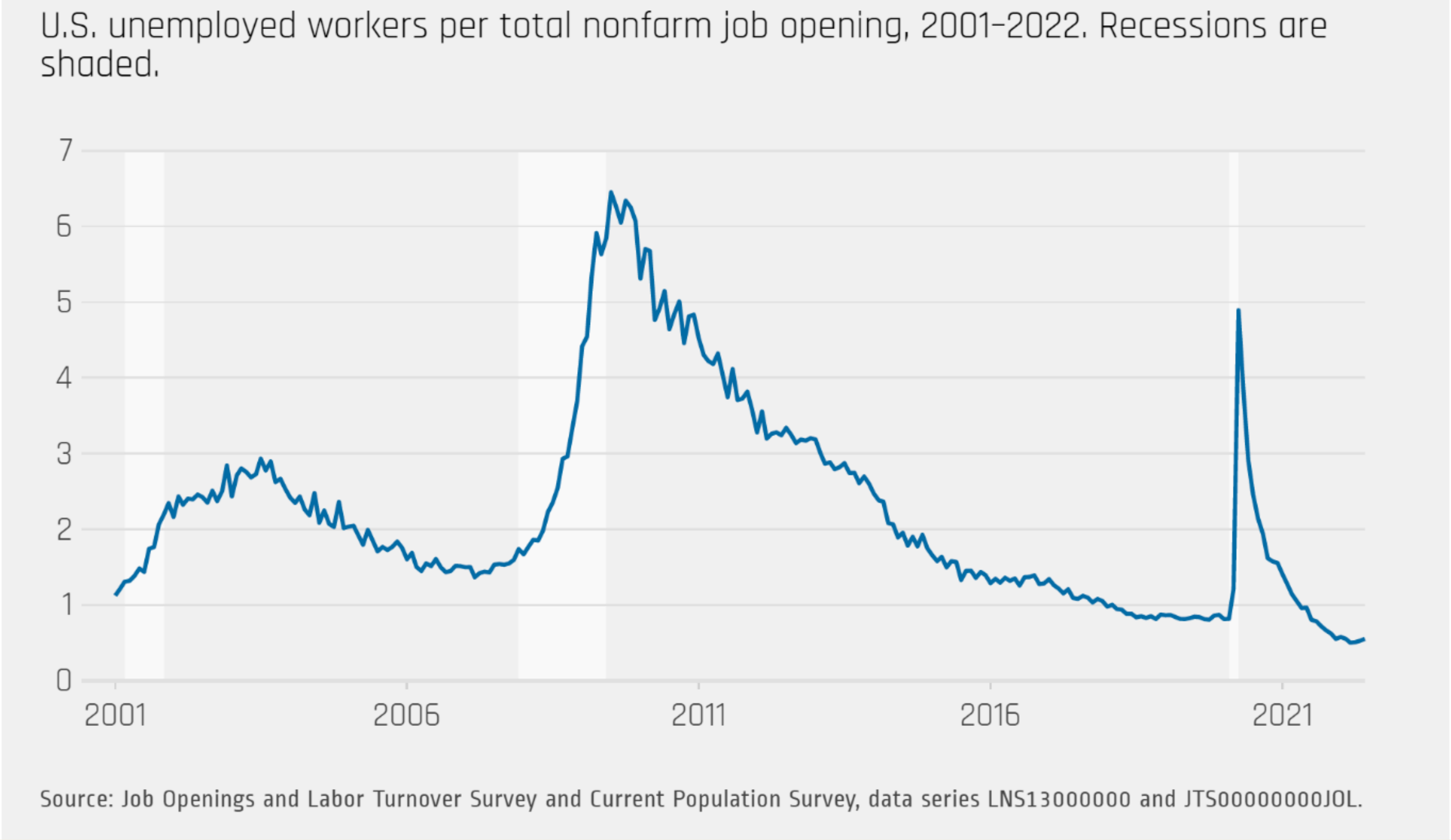
In most industries, job openings are above their pre-pandemic levels

Job openings by selected major U.S. industries, indexed to job openings in February 2020

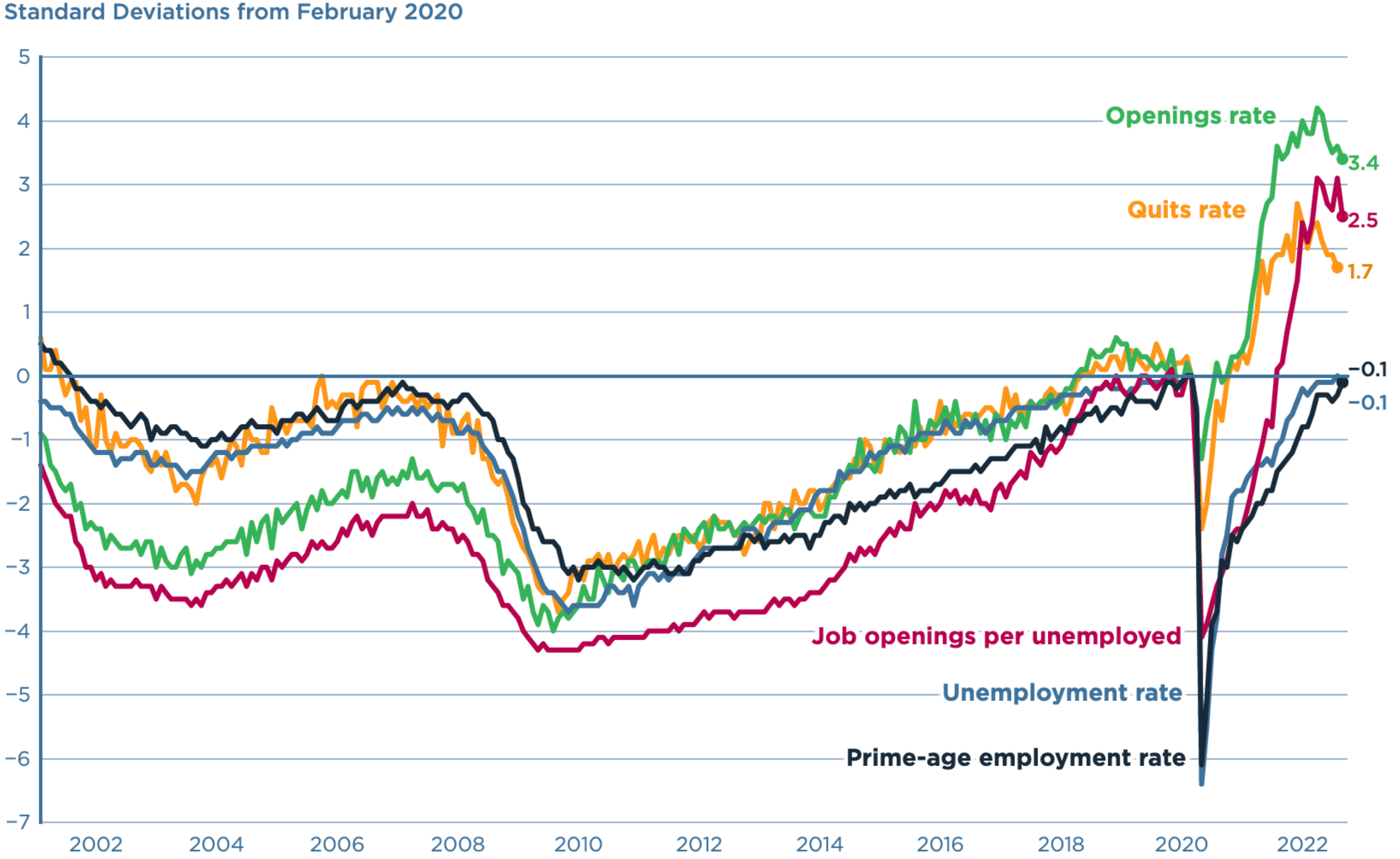


Source: Job Openings and Labor Turnover Survey and Current Population Survey. Series IDs JTS230000000000000JOL, JTS300000000000000JOL, JTS300000000000000JOL, JTS510099000000000JOL, JTS600000000000000JOL, JTS700000000000000JOL.

Not many people unemployed compared to openings



Multiple measures indicate labor markets remain very tight, but they differ over how tight



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Notes: Measures standardized using standard deviation from 2001 through 2018 and indexed to equal 0 in February 2020. Prime-age employment is the share of the civilian population aged 25-54 that is employed. Unemployment rate is the U-3 unemployment rate. The quits rate is quits divided by total nonfarm employment. The openings rate is openings divided by the sum of total nonfarm employment and openings. Job openings for August 2022 are estimated based on Indeed Hiring Lab job postings. The unemployment rate is plotted so that higher values correspond with a greater degree of labor market tightness, consistent with other measures.

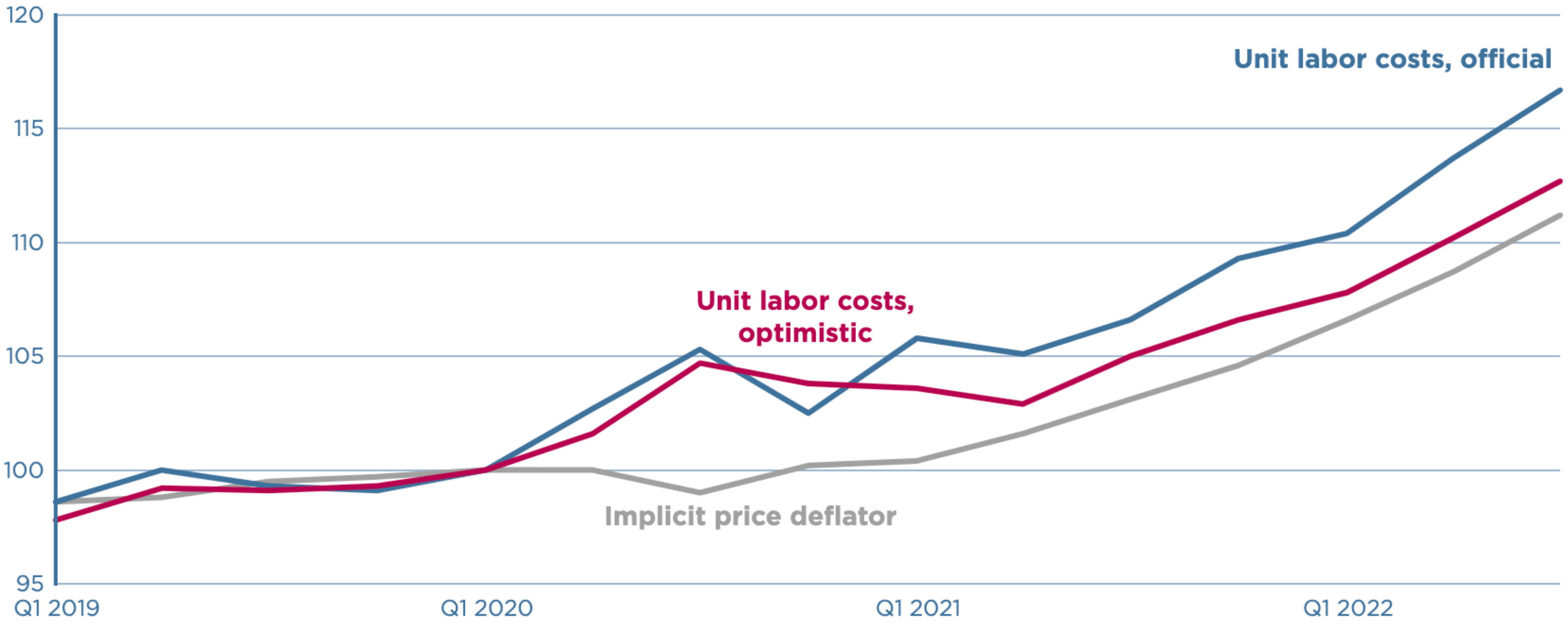
Source: Bureau of Labor Statistics and Indeed Hiring Lab via Macrobond; authors' calculations.

Labor market going forward

- Some longer-term change—immigration, population, ageing of population
- Some short term—Great Reshuffling more than Great Resignation
- Some we don’t know--Will LFP rates continue to recover or not? Women returned, will the 55+ return or not?
- What does this mean for wages?

Unit labor costs have risen much faster than prices over the pandemic period

Nonfarm business sector unit labor costs and prices (index, Q4 2019 = 100)



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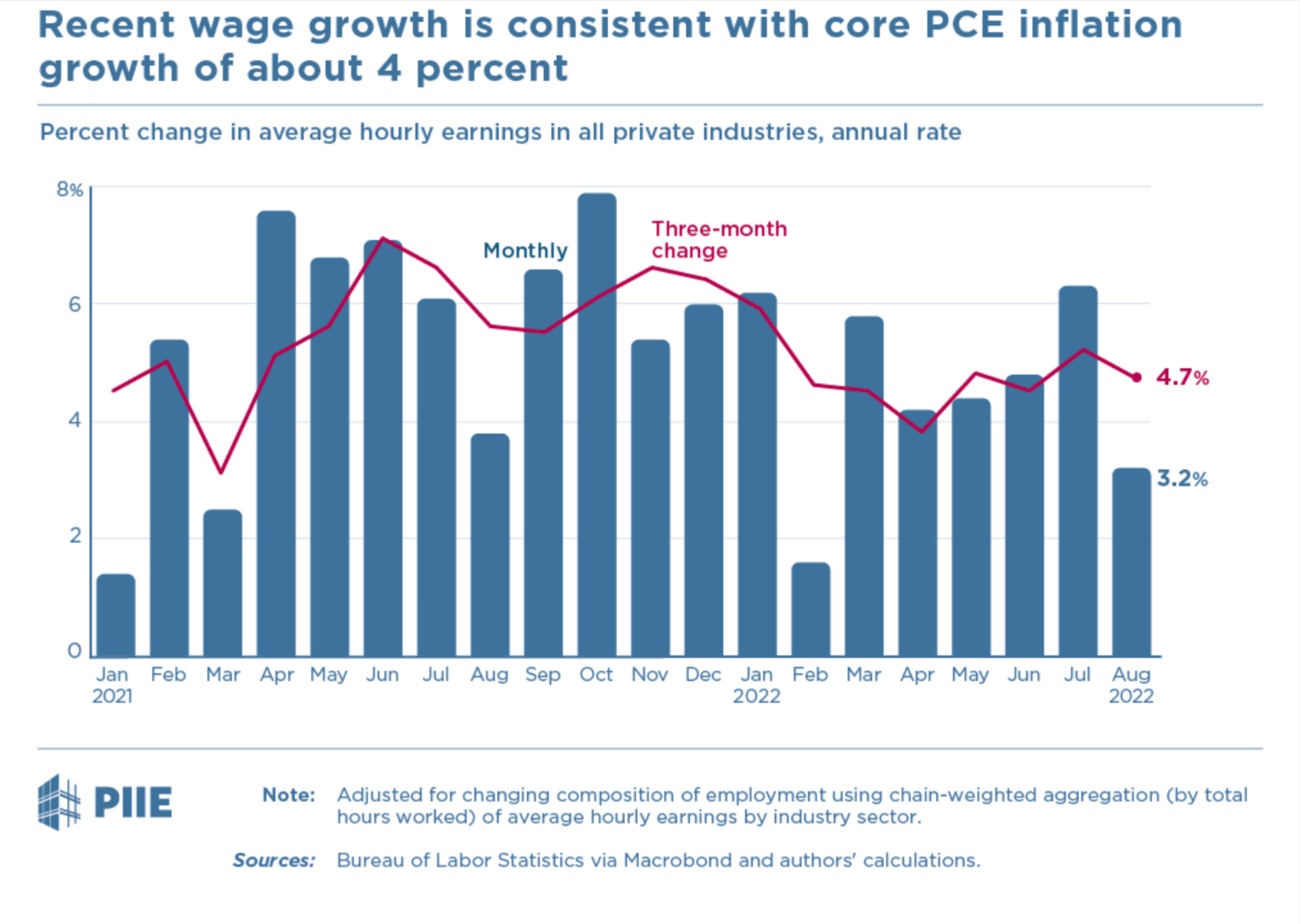
Notes: Data refer to nonfarm business sector unit labor costs and prices. Unit labor cost is the increase in compensation above productivity. Optimistic adjusts output by the ratio of real GDI to real GDP.

Source: Bureau of Economic Analysis and Bureau of Labor Statistics via Macrobond; authors' calculations.

Wages


Recent wage growth is consistent with core PCE inflation growth of about 4 percent
Percent change in average hourly earnings in all private industries, annual rate
8%
6
4
2
0
Monthly
Three-month change
4.7%
3.2%
Jan 2021
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
Jan 2022
Feb
Mar
Apr
May
Jun
Jul
Aug 2022
PIIE
Note: Adjusted for changing composition of employment using chain-weighted aggregation (by total hours worked) of average hourly earnings by industry sector.
Sources: Bureau of Labor Statistics via Macrobond and authors' calculations.

So—are higher wages leading to inflation?

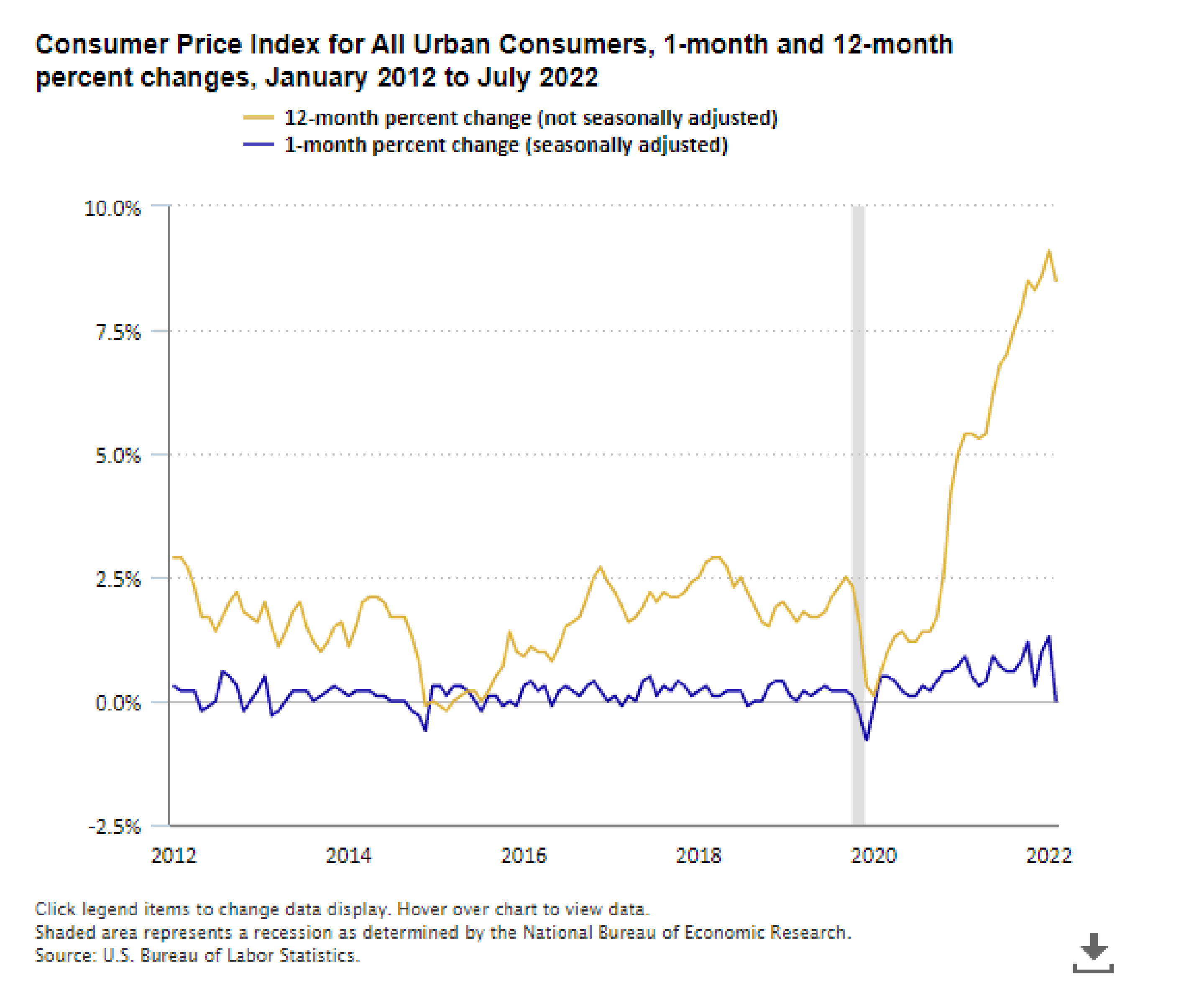
Inflation

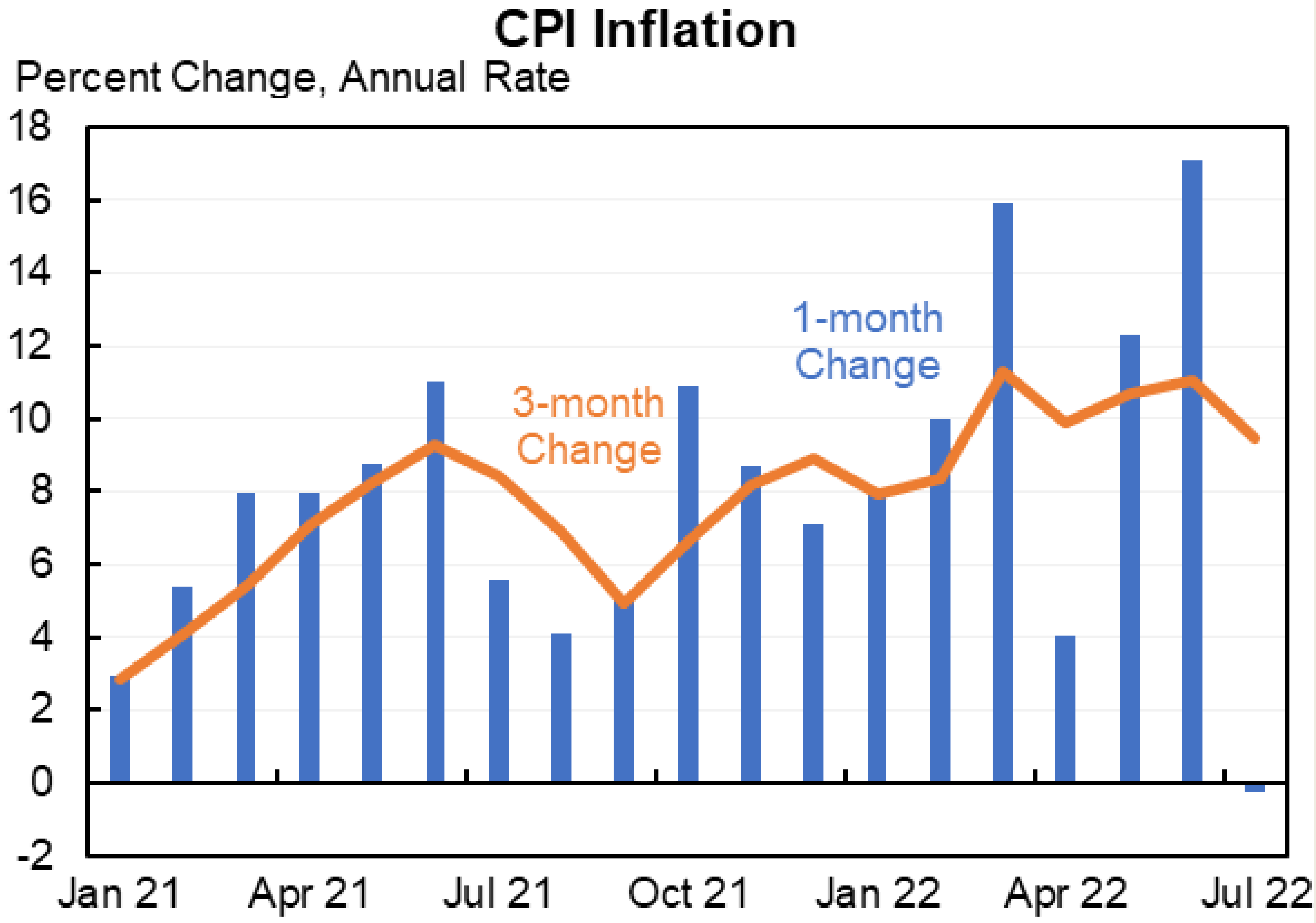
Rapid inflation

→spiral of higher prices and wages

→erodes savings

→ distorts decisions





Source: Bureau of Labor Statistics via Macrobond; author's calculations.

Current thoughts

Prob inflation will ease 😊

- Labor market looks very far from recessionary--closer to an unusual boom than a recession
- Some inflation was transitory supply shocks and gas prices
- Expectations seem to be that inflation will come down--“anchored”—which is good if true

Prob controlling inflation means more unemployment 😔

- A lot of labor market tightness
- Looking at median inflation suggests widespread price increases
- Unlikely for inflation to come within 1 percentage point of the Federal Reserve’s target.

On September 13, at 8am EST, the U.S. Bureau of Labor Statistics will release the Consumer Price Index (CPI) report for the month of August. This will be among the more important data releases in September for financial markets.

Inflation is very closely watched currently. Not only has inflation prompted much higher interest rates, but Fed Chair Powell made clear in an August speech that the Fed is unlikely to ease up on rate hikes until they are very confident that U.S. inflation is well under control. Powell noted that even the positive report for CPI in July was insufficient to give the Fed confidence that inflation was truly heading back to the Fed's 2% target.