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Strong headline growth but a weak underbelly

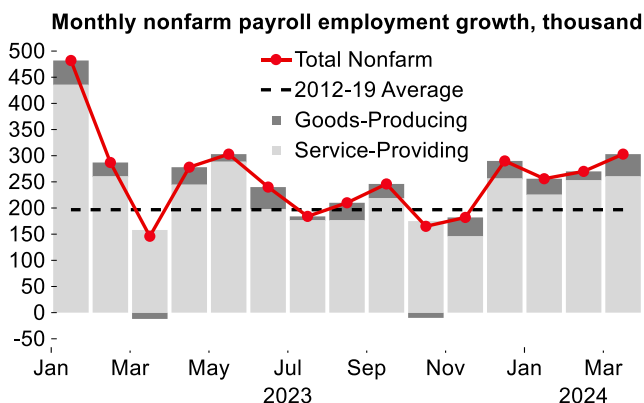
April 5, 2024

- Monthly employment growth continues to be dominated by four major industry groups, including noncyclical government and health care, construction, and leisure and hospitality. Growth in professional and business services, a historically reliable recession indicator, has been slow since 2023, both a reflection of hiring difficulties and weaker demand.
- Volatility in the unemployment rate is being driven by younger workers (16-24 years), but there is a relatively flat trend for prime-age (25-54 years) and older (55 and over) workers. So far, the rise in unemployment can largely be attributed to an expanding labor force, most of which are re-entrants to the labor force rather than first time job seekers.
- The quits rate has fallen below pre-pandemic levels, indicating loosening labor market conditions and fading bargaining power for workers. Despite elevated job openings, wage pressures are likely to subside in the coming months, given the strong positive correlation between quits and wage growth. This bodes well for services inflation, which remains elevated, but poorly for real income growth, which supports consumer spending.

Slow employment growth in cyclical industries

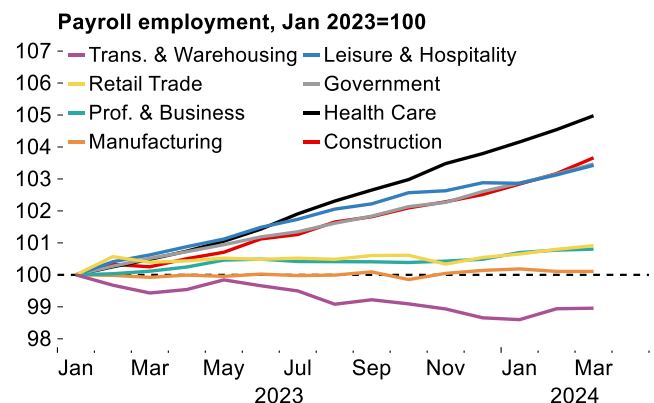
The labor market added 303,000 jobs in March, the largest monthly growth since May of last year (Chart 1). In continuation with the 2023 trend, the health care industry added the greatest number of jobs (+72,000), followed by government (+71,000), leisure and hospitality (+49,000), and the construction sector (+39,000). Fiscal policy has been driving growth in government employment and it has supported growth in construction spending, while demographic factors have been driving growth in health care. Recovery in home building has also been a big factor in the construction sector, and leisure and hospitality has finally reached pre-pandemic levels of employment.

Chart 1: Headline payroll employment growth remains strong, hovering above 250,000 monthly jobs added



Source: BLS, MUFG Bank Economic Research Office

Chart 2: Non-cyclical industries (i.e., health care & government) continue to drive much of the employment growth



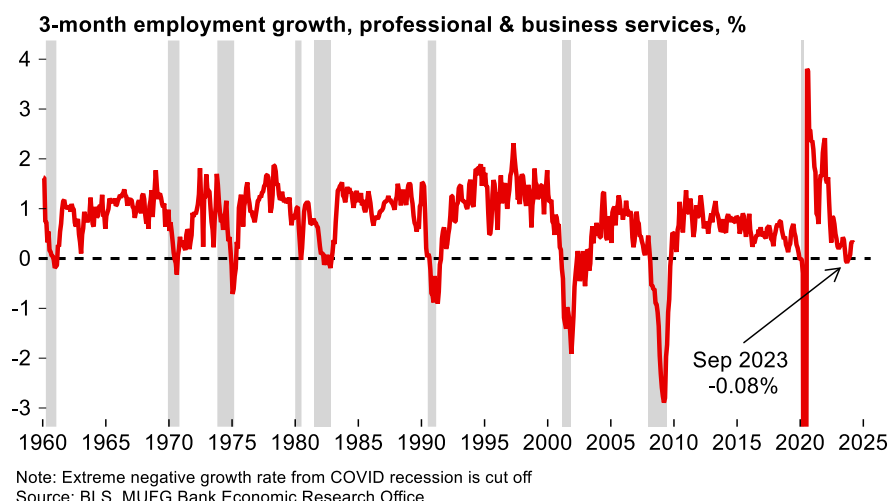
Source: BLS, MUFG Bank Economic Research Office

This industry composition of growth signals much weaker labor demand than the headline figure suggests (Chart 2). So far, the labor market is being carried by noncyclical industries (i.e., health care and government), where expansion has little correlation with overall economic conditions, and by idiosyncratic factors at the industry level (i.e., construction and leisure and hospitality).

For a more compelling indicator of labor demand in the US, look to the professional and business services sector where growth has been weak since the beginning of 2023. Historically, professional and business services is a reliable recession indicator. The US has entered or been in the middle of a recession in every instance where the 3-month growth rate became negative, except for this most recent period in September of last year (Chart 3).

This false recession signal can mostly be explained by labor shortages, considering that job openings rose while at the same time hiring fell, but weak growth overall is likely a sign that labor demand has significantly cooled in the US.

Chart 3: Jobs growth has been weak in the professional and business services sector, a historically reliable recession indicator



Younger workers and re-entrants are driving the unemployment rate

The unemployment rate nudged up to 3.8% in March, mostly driven by growth in the supply of younger workers in the labor force (Chart 4). The unemployment rate has hovered between 3.0-3.2% for prime-age workers (25-54) since 2023, and between 2.3-2.9% for older workers (55 and older).

Chart 4: Younger workers (16-24) introduce volatility to the national unemployment rate

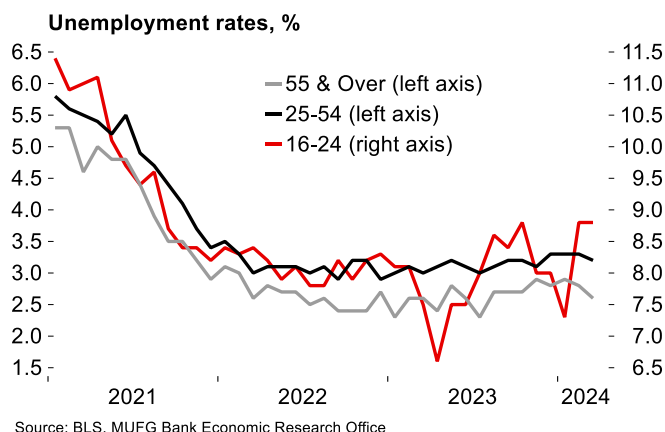
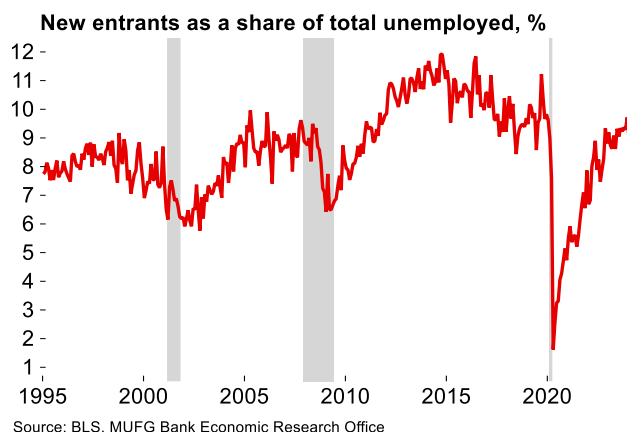


Chart 5: Those looking for their first job (foreign born and native) still comprise a relatively small share of all unemployed persons



So far, growth in the unemployment rate has largely been due to growth in the labor supply, where individuals entered into the labor force as unemployed and seeking work. And of those entering the labor force, the majority are re-entrants that have past work experience, but had existed the labor force for a period of time. This includes workers that left the labor force for school and then later rejoined, or those that retired early and decided to return to work. New entrants, which includes native- and foreign-born workers with no previous work experience, still comprise a relatively small share of the total unemployed (Chart 5), but there was a significant jump in March.

Quits rate is a leading indicator of wage growth

In aggregate, workers have significantly less bargaining power now than they did in the past 2 years, evidenced by a sharply declining quits rate. The quits rate has fallen below the pre-pandemic level, which is expected to have implications for wage growth over the next 6-10 months. Shown in Chart 6, the quits rate and wage growth have a strong positive correlation, with quits acting as a leading indicator of about 8 months. This is welcomed news on the inflation front, specifically for services inflation where wages apply strong upward price pressures.

Layoffs remain historically low but have trended upward from the lows of 2021. This slight upward trend is expected to continue, with the data being further supported by private sector measures of job cuts (Chart 7). Challenger, Gray, and Christmas show a sudden rise in announced job cuts beginning in 2024, though the series does not necessarily lead JOLTS layoffs.

Chart 6: Declining quits rates will expectedly impact wage growth in the next 6-10 months

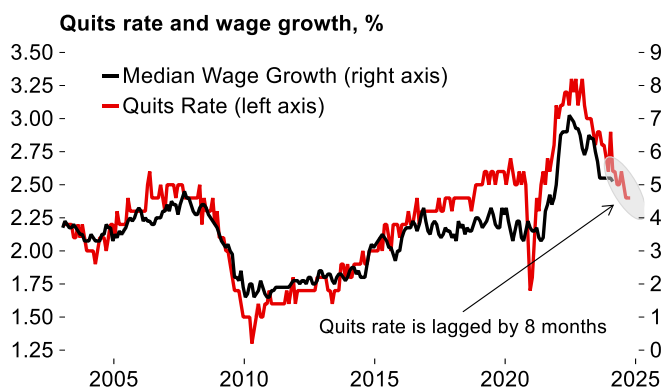
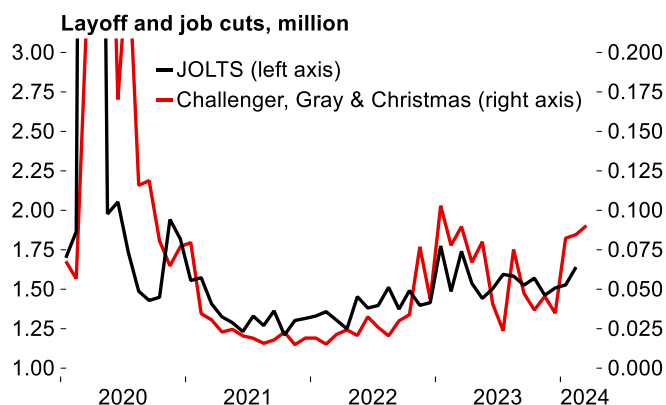


Chart 7: Growth in announced job cuts supports the slow but continued rise in JOLTS layoffs



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