

AGRON NICAJ
US Economist

Economic Research Office

anicaj@us.mufg.jp

MUFG Bank, Ltd.
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The labor market is not responding to the Fed

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The Fed has been hiking interest rates at a pace not seen in over 40 years, but the labor market has been largely unaffected. Wages, job openings, and employment have either continued to grow or have remained elevated. The October jobs report does not reflect a cooling labor market, but rather one that is “normalizing” and distributing jobs growth more evenly across industries.

Employment growth continues to be strong

Nonfarm payroll employment increased by 261,000 in October, following an upwardly revised increase of 315,000 in September. So far in 2022, monthly employment gains have exceeded expectations nearly every time, with no exception this month. The labor market added an average of about 539,000 jobs in Q1, 349,000 in Q2, and 381,000 in Q3 of 2022. Jobs growth in October is hardly reflective of a cooling labor market, especially considering the possibility of an upward revision next month.

The unemployment rate ticked up to 3.7 percent in October, consistent with normal variability in 2022. The labor force participation rate is little changed for both prime-age workers (25-54 years old) and older workers (55 and older).

Confusing noise with signal is a risk when tracking monthly movements in labor market data. There were some signs of a cooling labor market last month, notably with job openings. But vacancies bounced back in September, recovering nearly half of what was lost in August. So far, rising interest rates have not begun to have an impact in the labor market, as it remains historically very tight.

Given the strong labor market, inflation is likely to remain elevated well into 2023. Labor shortages are driving strong wage growth, applying further upward price pressures. Additionally, very low unemployment translates to elevated aggregate demand, which the Fed is keen on lowering. More interest rate hikes are likely in 2022 and early 2023.

Cross-industry employment growth is becoming less dispersed

Perhaps what is changing is the level of employment mismatch. Since the pandemic, employment growth has varied significantly across industries. In the beginning stages, goods industries added jobs while services struggled, then services industries made an inevitable return as consumption habits shifted.

This allowed for high levels of employment mismatch where workers took up jobs in industries that they were not previously employed in. This type of cross-industry mismatch is reflected in the dispersion of employment growth. Historically, the rate of dispersion in the US labor market (calculated as the weighted standard deviation of 12-month employment growth across 14 industries) is around 2 percent. The higher the rate, the more variability there is in jobs growth from one industry to the next.

Cross-industry employment growth tends to rise during recessions as some industries are inevitably more impacted, and then trend back downward immediately after. The COVID-19 recession, however, had a longer lasting impact. The rate of dispersion is still above 2 percent, but it is finally trending downward. This may suggest that employment growth is “normalizing” across industries.

JOBS GROWTH IS BECOMING LESS DISPERSED ACROSS INDUSTRIES



Note: Calculated as the weighted standard deviation of 12-month employment growth across 14 industry sectors

Source: BLS, MUFG Bank Economic Research

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