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The labor market is still too strong

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The November jobs report showed another month of strong employment and wage growth. The labor force participation rate for prime age workers fell for three consecutive months and the unemployment rate remains stubbornly low. Even though overall inflation measures are slowing, the robust labor market means that upward price pressures are still strong, especially in services. A soft landing is becoming increasingly unlikely for the Fed.

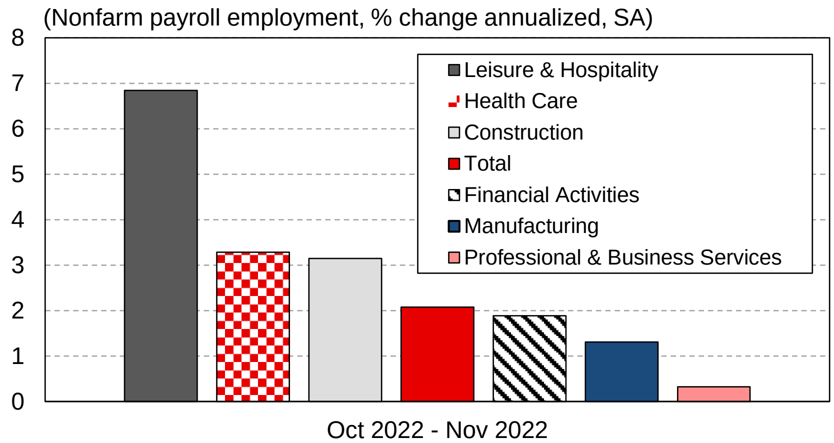
The labor market is not responding to the Fed

The US added 263,000 jobs in November, essentially the same as in September (+269,000) and in October (+284,000) of this year. This strong and consistent growth arrives at the back of slowing overall inflation figures. At a surface level, the signals appear mixed. Though upon further examination, we see just how persistent and sticky inflation in services is (see report), and a strong labor market in these industries is to blame.

The leisure and hospitality industry drove employment gains in November, adding 88,000 jobs, of which 62,000 were in food services and drinking places. Economic activity is slowly returning to city centers as offices re-open, helping prop up demand at local restaurants and bars. Overall employment in the leisure and hospitality industry is still down 5.8 percent compared to the pre-pandemic level (February 2020), suggesting that there is even more room for growth in the coming months.

The health care industry added 45,000 jobs in November, well above the average monthly growth of 9,000 in 2021. The health care industry is still, by many measures, understaffed so we can expect employment to continue to grow in this industry. Additionally, labor shortages are still severe in health care. As long as labor supply remains low, wage inflation of hospital workers will remain elevated, and it will likely feed into price inflation starting as early as 2023.

SERVICES INDUSTRIES LEAD JOB GAINS IN NOVEMBER

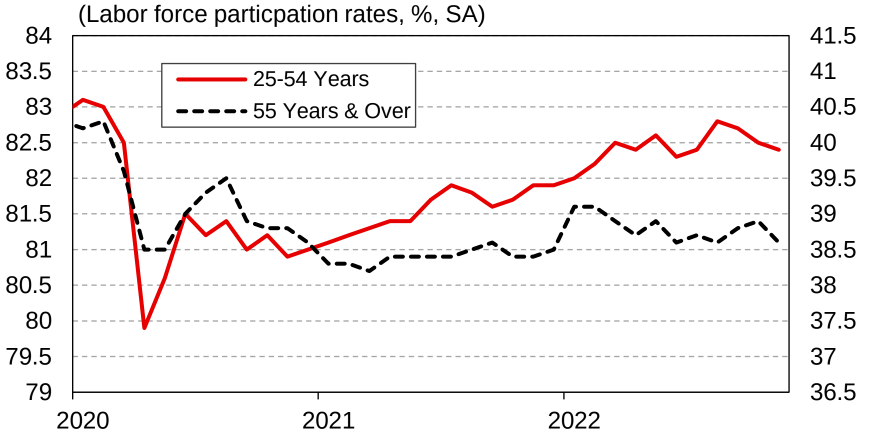


Source: BLS, MUFG Bank Economic Research

Participation rates are headed in the wrong direction

Labor force participation rates fell for both prime-age workers (25-55 years) and older workers (55 and above) in November. Especially problematic is the drop for those in their prime working years, which has seen declines for three consecutive months and comprises the largest share of the labor force. This demographic has lost 576,000 workers from the labor force in the last 3 months.

PROGRESS HAS STALLED FOR LABOR FORCE PARTICIPATION RATES

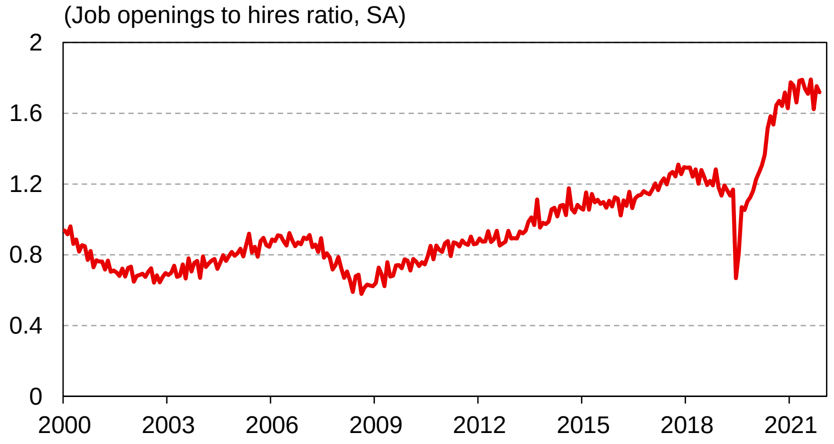


Source: BLS, MUFG Bank Economic Research

The labor market remains very tight and though signs of loosening exist, the rate is far too slow. The unemployment rate stayed at 3.7 percent in November, continuing to hover near historic lows. Job openings fell by 353,000 in October, largely correcting for the growth in September of 407,000. There is certainly a downward trend in vacancies in the second half of 2022, but the trend in the job openings to hires ratio (a proxy for average time to fill an open position) is essentially flat. This suggests that employers are still having difficulty filling open positions and there continues to be a strong disconnect between labor supply and demand.

The quits rate is slowly coming down, now at 2.6 percent in October. While promising, the rate is still high enough to place upward pressure on wages and subsequently prices. The layoffs rate is unchanged at 0.9 percent, despite reports of significant layoffs at large tech firms. Employment in the information sector of the economy has far exceeded pre-pandemic levels, and reports of mass layoffs in 2022 appear more reflective of over-hiring that occurred in 2020 and 2021.

THE AVERAGE TIME TO FILL A POSITION REMAINS NEAR HISTORIC HIGHS



Source: BLS, MUFG Bank Economic Research

A soft landing is becoming increasingly unlikely

It remains unclear as to whether labor demand can significantly fall without impacting the unemployment rate. Since labor demand far exceeds supply, a cooling labor market can theoretically see job openings fall without a significant rise in the unemployment rate. Though, given the high degree of employment mismatch and uneven dispersion of employment growth that existed over the last two years, it seems unlikely.

A soft landing is increasingly unlikely for the Fed as the labor market appears undeterred by interest rate hikes so far. Even with moderating inflation, the strong labor market means the Fed will likely maintain additional interest rate increases, with a 50-basis point hike as the consensus at the next FOMC meeting in December.

The Federal Funds target rate is expected to reach and stay at 4.75-5.00 percent in early 2023. Much of the impact of interest rate hikes will not feed into the labor market until later in the year, with MUFG Bank now forecasting the unemployment rate to reach 4.9 percent by the fourth quarter of 2023.

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