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Little give in the labor market

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- Employment growth remained strong in May for both goods and services industries, while the unemployment rate ticked up to 3.7%. Labor force participation rates continued along the same trend, increasing modestly for prime-age workers while remaining flat for older workers. While the overall labor market remains strong, manufacturing appears to be the chink in the armour. Growth in manufacturing employment has been flat in 2023 with no indication of a rebound anytime soon.
- Job openings rebounded and hiring accelerated in April. The vacancy to unemployed ratio now stands at 1.8, suggesting a very tight labor market. Despite all of this, the Fed may still pause additional interest rate hikes at the next FOMC meeting to gauge the impact of monetary policy lags.

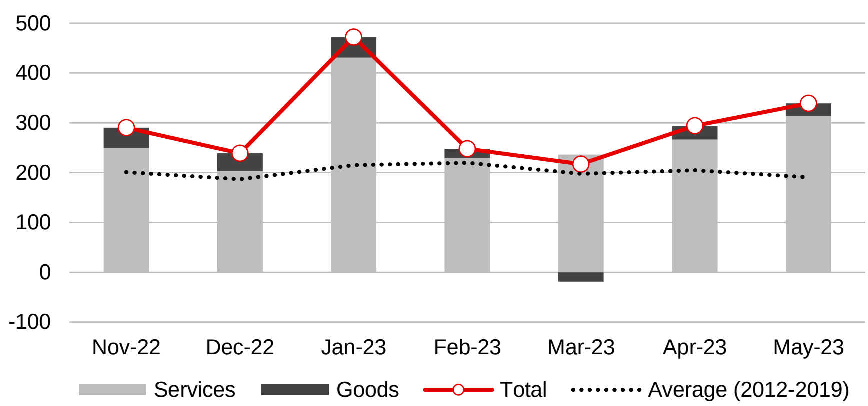
Jobs continue to be added in the labor market

Once again, the labor market has defied expectations, adding 339,000 jobs in May, following an upwardly revised growth of 217,000 jobs in March and 294,000 jobs in April. Employment is expanding at a historically strong rate, despite the rapid monetary tightening cycle that started over a year ago.

Professional and business services continued to expand, adding 64,000 jobs in May. Government also had a robust expansion, adding 56,000 jobs. Employment in the health care industry is above pre-pandemic levels, but jobs continue to be added (+52,000 in May). Given low substitution and inelastic demand in health care, along with an aging population, we can expect further long-term growth.

The most evident cracks in the labor market are in manufacturing, where employment growth has been essentially flat for all of 2023. This is perhaps unsurprising given how consumption and durable goods orders have been slowing for months. The information sector has also exhibited signs of a recession, but employment in the industry resembles more “normalizing” rather than cooling, and the industry is much smaller than manufacturing (2% vs 8% of employment). Employment in manufacturing will likely be one of the first major industries to crack in the event of a recession.

Strong growth in both services and goods industries in May
Nonfarm payroll employment growth, thousands



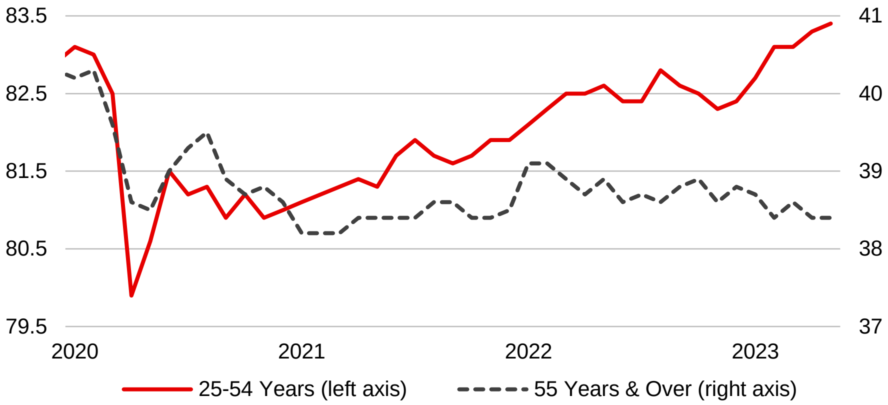
Source: BLS, MUFG Bank Economic Research

The unemployment rate ticked up to 3.7% in May, driven by a 7.8% increase in the number of unemployed. This is the largest monthly increase in the number of unemployed persons since the start of the pandemic, but the unemployment rate remains within the 3.4-3.7% range since March of last year.

The labor force participation rate remained at 62.6% in May. The participation rate for prime-age workers (25-54) rose again to 83.4% and is above the pre-pandemic rate and trend. However, this growth was offset by flat growth in participation rate of older workers (55 and over), which stands at 38.4%.

Older workers are showing no signs of returning

Labor force participation rates by age group, %



Source: BLS, MUFG Bank Economic Research

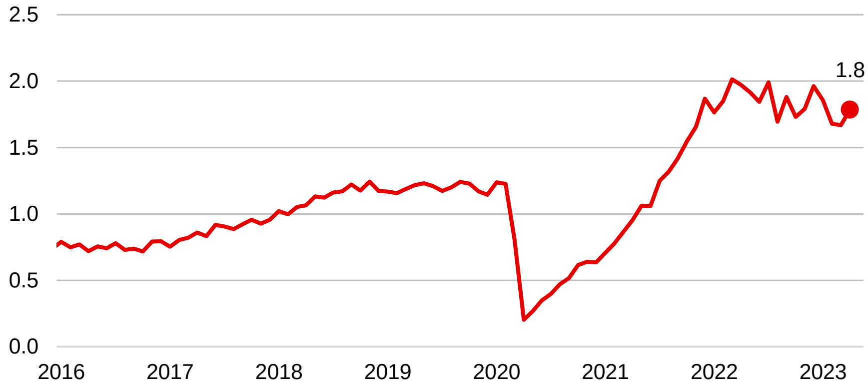
Rebounding labor demand

Job openings rebounded in April, increasing by 358,000. This increase follows 3 consecutive months of sizable declines totalling 1,489,000. Job openings have certainly fallen from their peak but remain very elevated both in level and in relation to unemployment. The vacancy to unemployed ratio stands at 1.8 as of April 2023, down from its peak of 2.0 in April of last year, but well above the pre-pandemic level of 1.2. The labor market remains very tight as demand for workers continues to exceed supply.

The last few months had many hopeful that the labor market may exhibit an "immaculate cooling" where labor demand falls with no impact on the unemployment rate. Unfortunately, there still exists a significant degree of employment mismatch in the labor market, especially considering the disproportionate impact that rising interest rates have had across industries. By most metrics, today's labor market is still inefficient at allocating workers across industries and geography. And combined with April's increase in job openings, an "immaculate cooling" is appearing increasingly unlikely.

Labor demand rebounded in April

Vacacy to unemployed ratio



Source: BLS, MUFG Bank Economic Research

The Fed may skip hiking in June

Despite the continued strong labor market in May and high levels of inflation presented by both the CPI and PCE, the Fed may still pause interest rate hikes in June's FOMC meeting. Fed officials have been signalling that a pause may be necessary to assess the impact of "long and variable lags" with which monetary policy operates. Estimates point to a 14-to-18 month lag from when interest rates begin to rise and when the impact is felt in the broader economy. This would make June an opportune time to pause hikes.

However, we can expect the Fed to remain hawkish in their commentary. Given the strength of the labor market and the upward pressure it places on prices, the Fed is likely to explicitly state that further interest rate hikes are still possible, even with a pause in June.

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