MARKET STRATEGY VIEWPOINT

How Tight is the U.S. Labor Market?

February 27, 2019

Unemployment Rate Low, Labor Force Participation Stabilizing

The high number of job openings, low unemployment, and signs some are returning to the labor force are variables indicating a tight labor market.

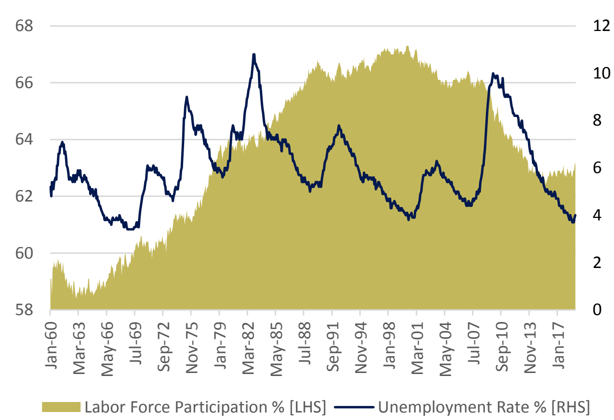
We have heard, and engaged in, some considerable discussion of late regarding the overall health of the U.S. labor market. No doubt the unemployment rate is currently low, but with wage gains still modest at this point in the business cycle, some are questioning the labor market's underlying strength.

We believe relatively weak wage growth and the declining share of U.S. labor income as a percent of GDP has to do with technology advancement, weak productivity growth, and education. It has less to do, we believe, with a condition of underlying slack in the labor market. In fact, we would label current conditions in the labor market as tight. This is a function of a low unemployment rate for those who are in the labor force and signs the labor force participation rate is stabilizing and perhaps beginning to rise just a bit.

The labor force participation rate is the total labor force as a percent of the working age population.

The last point speaks to some indications more people are in fact coming back into the labor force as jobs vacancies are plentiful. According to the U.S. Bureau of Labor Statistics, U.S. job vacancies are the highest they have been in 18 years. Meanwhile, the labor force participation rate has been declining precipitously over that same time. The drop in participation is likely due to workers retiring or leaving the labor force for other reasons. Of late however, the participation rate has stabilized and begun to improve just slightly (Figure 1), as workers find jobs more plentiful and perhaps the idea of employment more satisfying.

Figure 1: U.S. Unemployment Rate and Labor Force Participation
Source: U.S. Bureau of Labor Statistics



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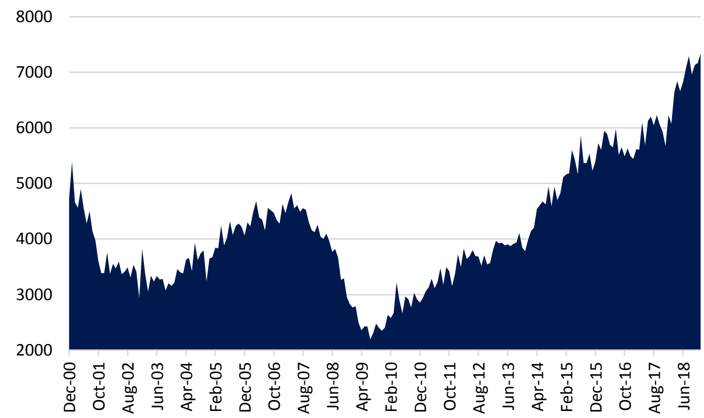
We believe an increase in the labor force participation rate would be good news for the economy overall.

Today, indications are there is very little slack in the labor market, although that could change based on either economic slowing or more people re-entering the labor force. While economic conditions have been slowing a bit it has yet to materially effect companies' hiring pace. And it appears there are enough open jobs at the moment (Figure 2) to absorb any near-term increases in the labor force participation rate.

Figure 2: U.S. Job Openings (000's)

Source: Bureau of Labor Statistics



So What is Holding Down Wage Growth?

We believe the relative lack of wage growth in this cycle is primarily a function of low labor productivity (Figure 3) and the increased take-up of technology in business processes. The latter likely helps streamline manufacturing and services company operations and reduce demand for human capital. The productivity issue is easy to deduce from Figure 3, as companies are getting less marginal utility out of an economic unit of labor. As a consequence of the decreased utility, companies may be more prescriptive about their hiring and their salary allowances may be limited.

We believe policies to improve U.S. education could benefit wages and the U.S. labor income share over the long term.

On a secular basis, the lack of increased wages is also a function of the U.S. education system, in our view. We submit that a unique policy effort to increase the U.S. rate of college graduation would positively impact aggregate wage levels. While college graduation rates have improved over time, we believe a policy focus on the culture of education (not just a bigger education budget) could lead to larger increases in college participation, materially improve the labor income share of GDP, and positively impact the economy overall.

Figure 3: U.S. Nonfarm Labor Productivity - YoY % Chg
Source: Bureau of Labor Statistics

Low productivity is holding down cyclical wage growth.

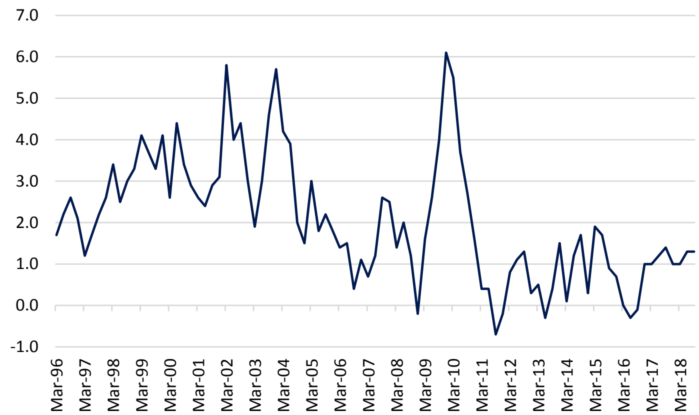
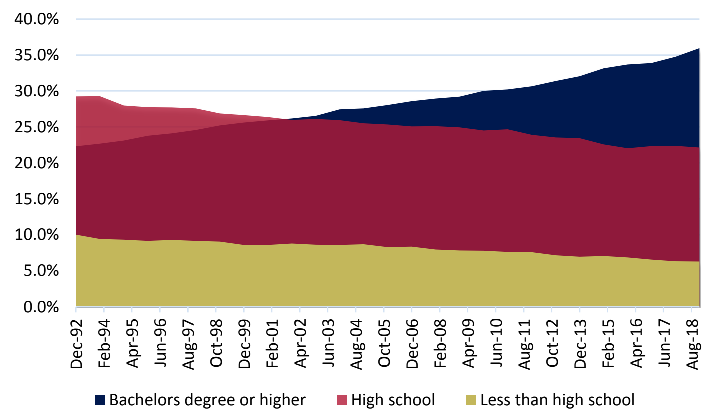


Figure 4: U.S. Labor Force by Education Level
Source: Bureau of Labor Statistics



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