Insight INVESTMENT

GLOBAL MACRO RESEARCH
US LABOUR MARKET IS FINELY BALANCED

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GLOBAL MACRO RESEARCH

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The US labour market has proved remarkably resilient this cycle, but the demand and supply of labour appears finely balanced and at risk of tipping into recessionary conditions. However, the Fed now appears to be focusing on supporting the labour market and we believe this will keep an economic 'soft landing' in sight.

EXECUTIVE SUMMARY

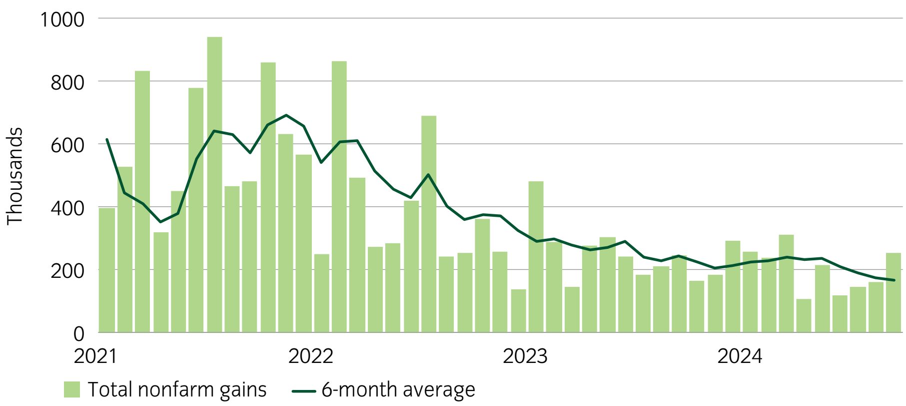
- While the economy continues to add jobs, the pace of job creation is slowing while unemployment is rising. The rising joblessness rate has even triggered a closely watched recession indicator with a near-perfect track record: the Sahm Rule.
- However, rising unemployment has so far mainly been due to an expansion in labour supply, rather than an increase in layoffs, which have remained relatively low.
- Moderating inflation is allowing the Fed to turn its attention to the labour market at a time when labour demand and supply conditions appear finely balanced. Although we expect the Fed to achieve an elusive 'soft landing', we cannot rule out the possibility that the Fed might already be behind the curve.

The Fed now appears to be focusing on supporting the labour market and we believe this will keep an economic 'soft landing' in sight.

THE US LABOUR MARKET DATA CONTINUES TO IMPRESS, BUT CAN IT LAST?

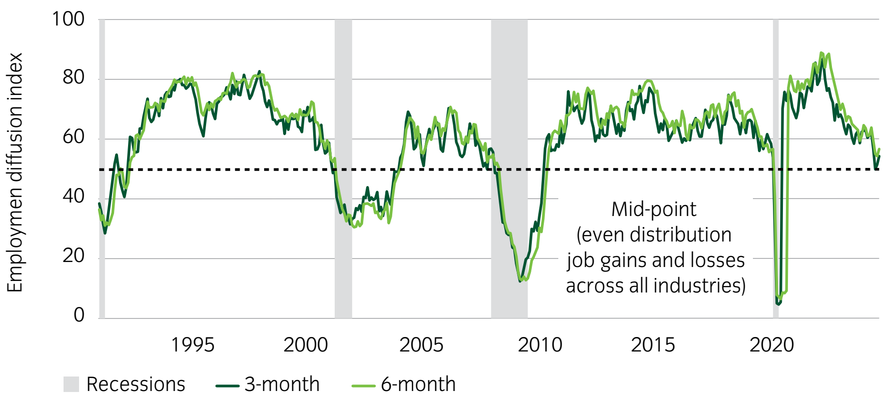
The labour market has exhibited remarkable resilience so far this cycle. Even though the most recent employment report showed that that the economy is still adding jobs at an impressive pace, the labour market has clearly shifted into lower gear (Figure 1).

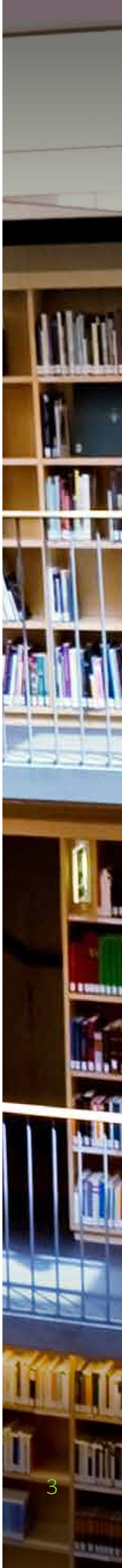
Figure 1: The labour market has shifted into lower gear[1]



Broadly speaking, labour market conditions also no longer appear tight. For example, hiring breadth (as measured by employment diffusion indices) has been narrowing rapidly, moving close to an even distribution of job gains and job losses across industries (Figure 2). Moreover, at the post-pandemic peak, there were two job openings for every unemployed worker. Now, there are only 1.1, consistent with pre-pandemic levels.

Figure 2: Hiring breadth is narrowing[2]

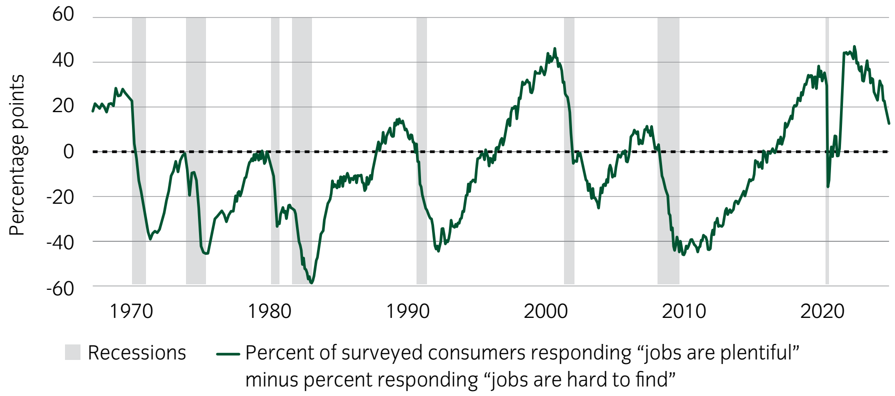




[1] Bureau of Labour Statistics, Macrobond, Insight, October 2024.
[2] Bureau of Labour Statistics, Macrobond, October 2024.

This is feeding into consumer confidence, with fewer consumer survey respondents noting that jobs are "plentiful" and more stating they are instead "hard to find" (Figure 3).

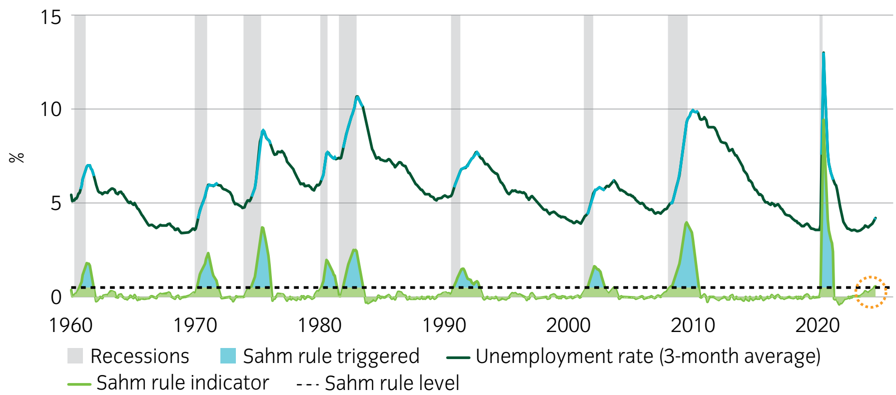
Figure 3: Americans' assessment of the labour market is decidedly less optimistic[3]



THE LABOUR MARKET COULD BE AT RISK OF HITTING A TIPPING POINT

The unemployment rate stood at 3.4% in early 2023 but has since risen to 4.1% (with a brief stop at 4.3% in July 2024). This pick-up even triggered a recession indicator with a near-perfect track record: the "Sahm rule". According to the rule, the economy is likely in a recession when the three-month average unemployment rate rises by 0.5% or more from its 12-month low. As of October, this difference is at 0.5%, despite a slight retracement in unemployment over the past two months (Figure 4).

Figure 4: The "Sahm rule" indicator highlights the risk of a tipping point in unemployment[4]



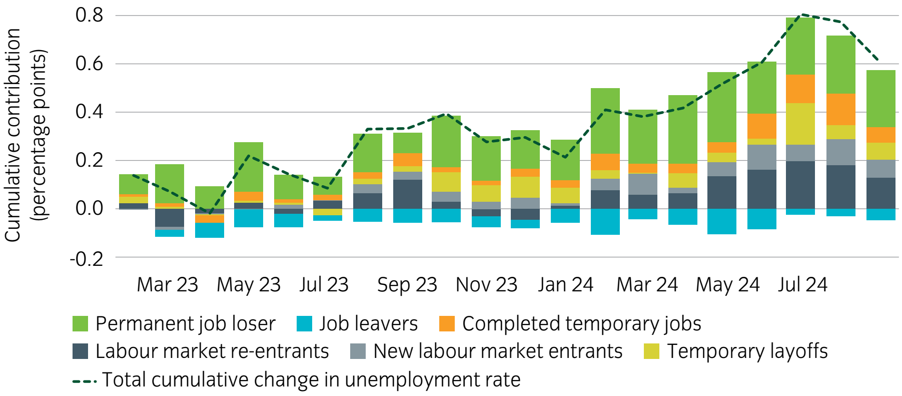
However, there are reasons to be skeptical of the Sahm rule in the current environment.

The intuition behind it is that 0.5% represents a tipping point that triggers feedback loops of impaired consumption and additional job losses. But this implies that layoffs would need to be the primary factor initially driving the unemployment rate higher.

[3] Confidence Board, October 2024.
[4] Bureau of Labour Statistics, Macrobond, Insight calculations, October 2024.

However, over the current episode, a significant contributor to the increase in the unemployment rate has been expanding labour supply (new entrants to the labour market as well as labour market re-entrants). Layoffs have not significantly risen over the last few months (Figure 5).

Figure 5: Temporary layoffs and labour market re-entrants drove some of the pick-up in unemployment rate[5]

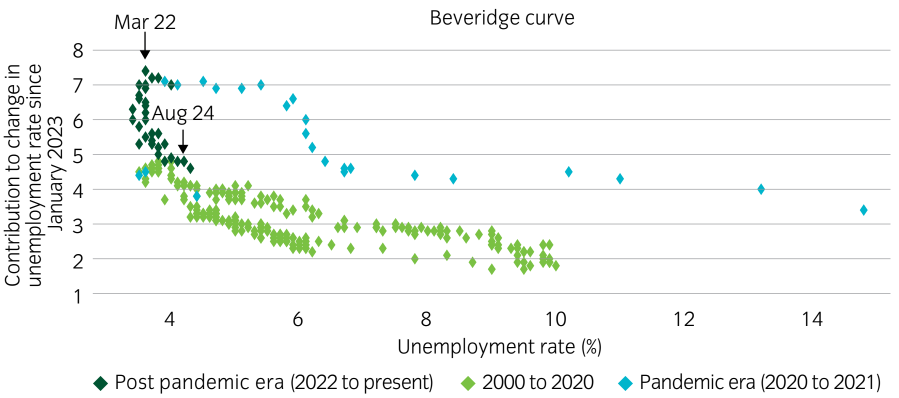


Nonetheless, if feedback loops have not yet been triggered, there may still be a point at which they can be.

Anecdotal evidence indicates that businesses have already curtailed hiring and implemented cost-cutting measures, such as reduced hours worked and a pullback on temporary workers. In the past, declines in temp employment usually preceded those in the broader labour market.

Furthermore, when we examine the connection between the demand and the supply of labour using the "Beveridge" curve, we are currently at a point on the downward-sloping curve where additional labour market moderation will probably require a higher unemployment rate (Figure 6).

Figure 6: Further labour market moderation may require a higher unemployment rate[6]



[5] Bureau of Labour Statistics, October 2024.
[6] Bureau of Labour Statistics, Macrobond, Insight, September 2024.

THE FED TO THE RESCUE?

As inflation has eased, the Fed has increasingly turned its attention from inflation to the labour market.

At the Federal Open Market Committee (FOMC) meeting in September 2024, the FOMC declared it has “gained greater confidence that inflation is moving sustainably toward 2%” and is “strongly committed to supporting maximum employment”.

The result has been the start of the Fed’s rate cutting cycle, which started with 50bp cut, not the 25bp that much of the market was anticipating. We saw this as an ‘insurance cut’, focused squarely on helping prevent the labour market from deteriorating into recessionary conditions. Chair Powell indicated a willingness to cut faster if “the labour market were to slow unexpectedly.”

With a Fed focused on supporting the labour market, we expect it to ultimately succeed in engineering a soft landing. Falling rates may help consumers unlock value from their homes, such as through more affordable equity lines of credit and refinancings. It may also help increase home-buying and associated demand for durable goods.

CONCLUSION: A SOFT LANDING IS STILL IN SIGHT, BUT THERE ARE RISKS TO THE DOWNSIDE

Our base case remains for a soft landing, but we expect some turbulence along the way. We believe that the Fed will continue to normalise interest rates in quarter-percentage points increments, but we do not rule out a more aggressive rate-cutting pace if the labour market deteriorates more rapidly.

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