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On the May Jobs Report: What Labor Shortage?

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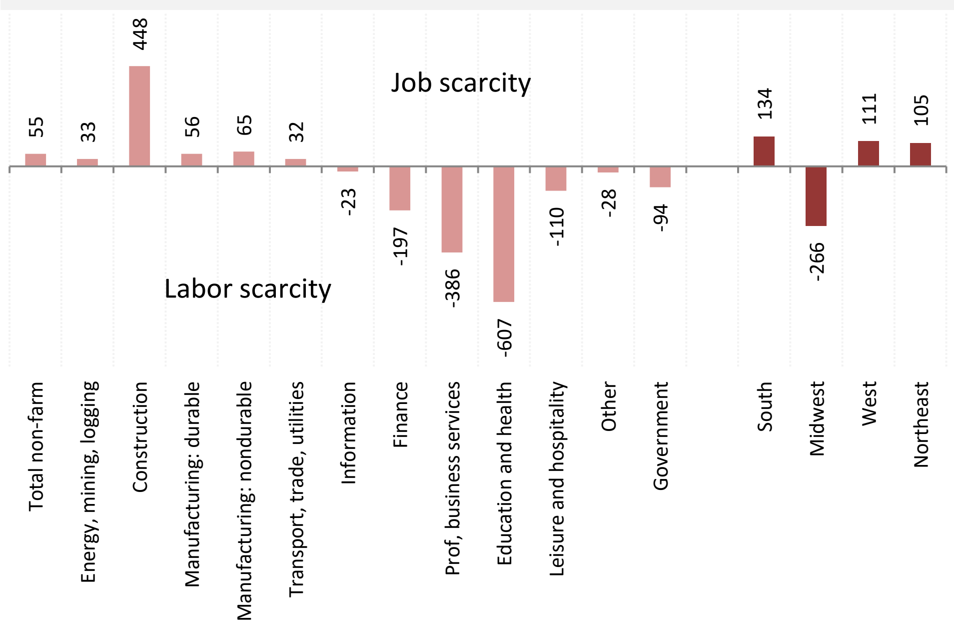
Donald Luskin

Even at 3.8% unemployment, the labor market is looking more "mid-cycle" than "end-of-life."

This morning's May Employment Situation report with 223,000 net payrolls was a strong beat versus consensus for only 190,000, all the more so because of net positive revisions of 15,000 to the prior two months. It's a little out-of-pattern in the sense that most surprises over the last year or so have been misses, and inexplicable shortfalls versus our index of contemporaneous labor market indicators – but this time that index pointed to only 180,000 net payrolls. *This was a very solid jobs report, about in the middle among all the May reports during this business cycle expansion, seemingly remarkable given the age of the expansion and all the talk about a "labor shortage"* (see "Data Insights: FOMC Minutes" May 23, 2018) *with the unemployment rate at a new cycle low of 3.8%.*

- *The downtick in the unemployment rate was achieved legitimately* – that is, it was not driven by shrinkage of the labor force. Employment increased by 293,000 persons, and unemployment decreased by 281,000, with the labor force actually growing slightly by 12,000.

US jobs, opens less unemployed Thousands **By industry** **By region**



Source: BLS, TrendMacro calculations

Update to strategic view

US MACRO, US FED: A beat for payrolls, even on top of small positive revisions. It's a little strong compared to other contemporaneous labor market data, but it's about time we had an anomalously good month after so many anomalously bad ones. The usual sluggish earnings growth shouldn't change the Fed's outlook. The new low for the unemployment rate does not imply a critical labor shortage. Data shows shortages in some industries and regions, surpluses in others. The open rate is still below the highs seen in most expansions, and the "Beveridge Curve" shows unemployment still falling linearly with the rising open rate – looking more "mid-cycle" than "end-of-life." We calculate the economy today is still 1.4 million jobs from maximum employment.

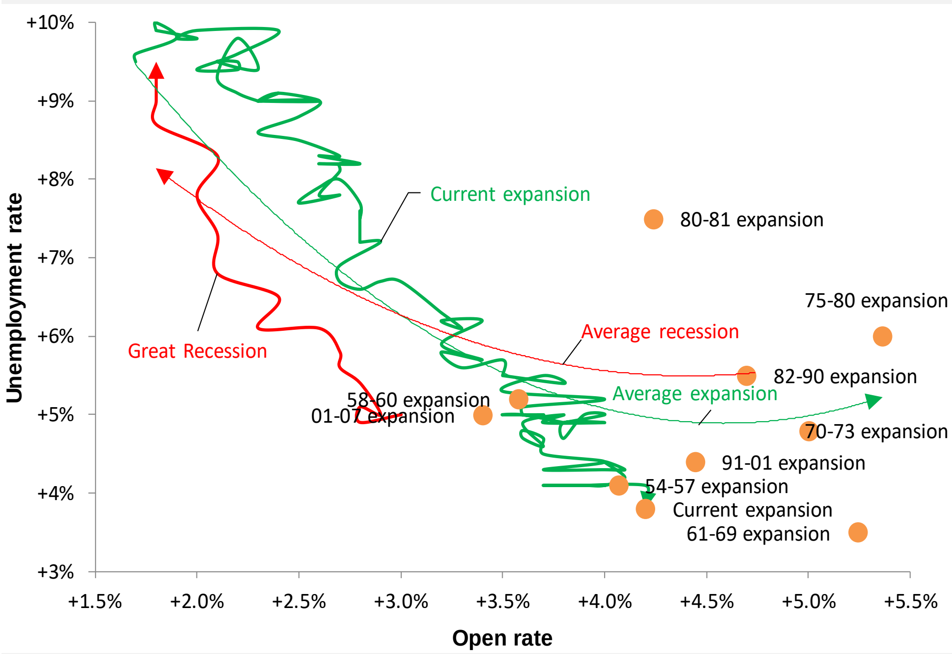
[Strategy dashboard]

- *The 0.3% increase in average hourly earnings is only the mid-to-high side of the sluggish data over the last several years – not enough in and of itself, as an indicator of labor market tightness, to change the Fed's views.*

The Fed notwithstanding, at this point there is beginning to emerge a legitimate question of whether there are enough American workers available to accommodate increasing economic growth. This issue comes up now in almost every client conversation. How different things are today compared to just a year or two ago, when the question instead was whether robots had already created a world of permanent job shortages.

- By the numbers, you can certainly see what appears to be evidence of a labor shortage. The Department of Labor's Job Openings and Labor Turnover Survey (JOLTS) report, the most recent of which is for March, shows that *there are 6.469 million open jobs – which, compared to the same month's jobs report, suggests there is an opening for all but 55,000 of the 6.524 million unemployed* (please see the chart on the previous page).
- *But this seeming labor shortage is very situational.* There is a wide dispersion of job scarcity versus labor scarcity between industries and across regions (again, please see the chart on the previous page).
- The sheer aggregate number of open jobs implies an "open rate" of 4.2% (that is, openings divided by the sum of employment and openings). That's a record for this business cycle expansion – but it isn't in and of itself evidence of a labor shortage. *The open rate has been far higher in the majority of post-war expansions* (please see the chart below).
- And we must bear in mind that *the number of unemployed, against*

US Beveridge Curve From 1954-57 expansion to present



Source: BLS and Valetta (2005), TrendMacro calculations

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which the number of openings is compared, ignores the large number of persons who have dropped out of the official labor force over the last decade, who constitute an invisible reservoir of labor supply that can be called forth in response to the right incentives.

- Compelling evidence that this is factor is in play now comes from examining the so-called "Beveridge Curve" (named, weirdly, after the British socialist William Beveridge who never drew the curve or wrote about it). It plots the relation of the unemployment rate to the open rate – revealing, at first order, the fairly obvious truth that a *high* open rate is associated with a *low* unemployment rate in expansions, and a *low* open rate is associated with a *high* unemployment rate in recessions.
- In the typical case, as the business cycle ages, the unemployment rate hits an irreducible minimum, while the open rate continues to rise (please see the thin green line, curving down-and-to-the-right in the chart on the previous page). This would be the portrait of employers trying to grow their businesses, crashing against the impenetrable wall of no available workers.
- *The Beveridge Curve for the present expansion looks as though we are still mid-cycle – with the unemployment rate falling linearly with the rising open rate* (please see the thick green line in the chart on the previous page). *This implies that the unemployment rate is not as low as it appears, most likely because the number of unemployed persons in its denominator is larger than it appears, (because there are still many workers outside the measured labor force).*
- *Despite the very low 3.8% official unemployment rate, based on the demographics of both aging and educational attainment, we think the US economy today is still 1.4 million jobs from maximum employment.*

Bottom line

A beat for payrolls, even on top of small positive revisions. It's a little strong compared to other contemporaneous labor market data, but it's about time we had an anomalously good month after so many anomalously bad ones. The usual sluggish earnings growth shouldn't change the Fed's outlook. The new low for the unemployment rate does not imply a critical labor shortage. Data shows shortages in some industries and regions, surpluses in others. The open rate is still below the highs seen in most expansions, and the "Beveridge Curve" shows unemployment still falling linearly with the rising open rate – looking more "mid-cycle" than "end-of-cycle." We calculate the economy today is still 1.4 million jobs from maximum employment.