MARKET SIGHT LINES

Headwinds to the Jobs Recovery?

By Michael O'Keeffe, *Chief Investment Officer*

The Federal Reserve (Fed) pursues a dual mandate with the goals of price stability, or keeping inflation under control, and maximum sustainable employment. We've recently talked a lot about inflation, so in this week's Sight|Lines we review employment, discussing some related headwinds and tailwinds to the jobs recovery.

A Look Back

Let's start with a look back to the beginning of the pandemic as our starting point. In February 2020, the unemployment rate sat at a record low 3.5%. Weekly jobless claims averaged 212,000 per week over the first two months of 2020, and nonfarm payrolls, representing about 80% of the workers contributing to U.S. gross domestic product (GDP), peaked at 152.5 million in February 2020.

Then the pandemic hit, and businesses began shutting down. Employment was hit hard. The unemployment rate jumped to 14.8% in April. The weekly jobless claims averaged 3.5 million in March and April. And nonfarm payrolls fell to 130 million in April 2020. Think about this last figure. For a measure designed to include all workers except "proprietors, private household employees, unpaid volunteers, farm employees, and the unincorporated self-employed," over 22 million jobs were lost in such a short period of time.

The U.S. and state governments moved quickly to lend support to those impacted. Support included enhanced unemployment benefits, relief checks, enhanced child tax credits, an eviction moratorium, and monetary easing from the Federal Reserve.

Recovery So Far

We've seen a jobs recovery. Unemployment now sits at 5.2%, which is, notably, below the 5.9% average over the last 20 years. Weekly jobless claims have fallen to 310,000 this week, and nonfarm payrolls have risen to over 147 million as of August. So, by this measure, we've recovered about 17 million of the jobs lost and are about 5.4 million below the previous record. So, as I've said often, we've made good progress, but we have more to do.

Let's also look at the hardest-hit industries. Understandably, the leisure and hospitality and trade, transportation, and utilities industries were hit extremely hard, with the shutdowns affecting those businesses and their ability to keep employees. They each lost 8.4 million and 3.4 million jobs, respectively. But the good news? The leisure and hospitality industry has recovered 6.5 million jobs, and trade, transportation, and utilities has recovered 2.9 million jobs. Again, good progress, but more to do.

When we look forward, the Fed is forecasting an unemployment rate of 4.5% at year-end 2021. So, further recovery is expected.

Headwinds...and Tailwinds

Government support has gone a long way to help those unemployed as a result of the pandemic shutdowns. But we've learned that as the recovery progresses, these enhanced benefits have been a bit of a headwind to the jobs recovery. Businesses are having a hard time finding workers, as seen by the recent PMI reports and the Labor Department's Job Openings and Labor Turnover Survey, or JOLTS report, which indicated there are 10.9 million jobs available, 2.5 million more than the number of currently unemployed. Some preliminary studies have shown that continuing unemployment claims have fallen faster in states that ended their enhanced unemployment benefits earlier this summer.

> "Of course, timing is everything, and the process of reentering the market will likely be slower than usual. Typically, in anticipation of benefits expiring, workers would be expected to begin to look for employment and time his/her start date with an end to benefits. This time around, however, because benefits were so generous coupled with the rent moratorium and the additional checks arriving in mailboxes, thanks to the new enhanced child tax credit benefit, many have accumulated enough wealth to last for at least some time even in the absence of the enhanced unemployment benefit program. Additionally, given the rise in wages and the heightened demand for workers, many are convinced it will be relatively easy to find employment on a moment's notice, eliminating, or at least lessening, the need for a preemptive search."

The ending of assistance programs, coupled with the reopening of schools and child care centers, should be a catalyst for more workers to return to the labor force this fall and ease the labor shortage. However, a potential long-term issue is the reduction in workers as baby boomers retire early (2.5 million have retired since the start of the pandemic), leading to imperfect job matches and, in some industries, prolonged shortages. For example, there are just over 1 million people unemployed in the education and health services industry, but at the end of July there were close to 2 million job openings.

Economic and Market Implications

The continued employment recovery is a key consideration for the remainder of the year. More individuals working leads to higher potential GDP, which should translate to higher revenue and earnings for companies. Conversely, an elevated unemployment level can be a headwind to the U.S. economy as consumer demand may be impacted. The Fed has indicated that should the economy grow as anticipated, it could be appropriate to start reducing the pace of asset purchases this year. From the last Federal Open Market Committee meeting we learned that the Fed believes that the standard of "substantial further progress" toward the maximum employment goal had not yet been met. Most analysts believe that the Fed will begin tapering later this year/early next year.

Conclusion

The Federal Reserve pursues a dual mandate with the two goals of price stability, or keeping inflation under control, and maximum sustainable employment. Keeping a focus on this second goal is important as we make our way through this robust recovery.

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