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Macro Strategy

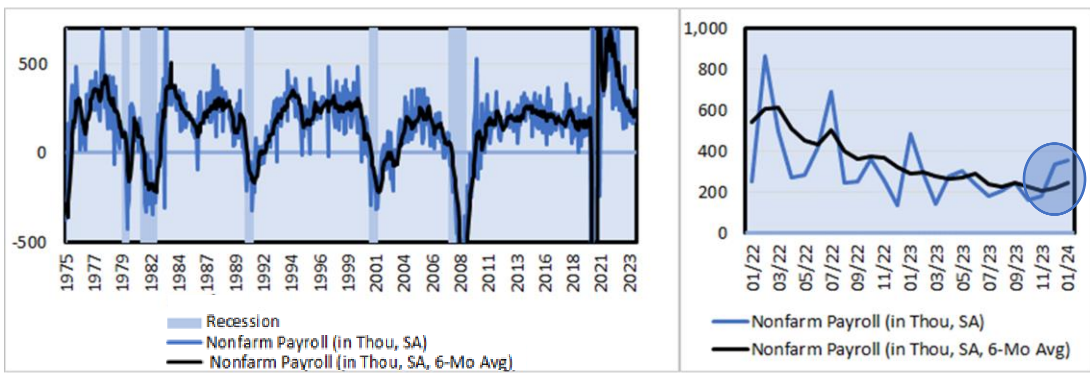
Employment Isn't As Good As The Headline Implies

The February employment report for January, at 353,000, blew away expectations of 175,000, and it followed 333,000 the month before. The unemployment rate was 3.7%, also ahead of expectations (3.8%).

Claims are also low, and both claims and the unemployment rate recently headed down.

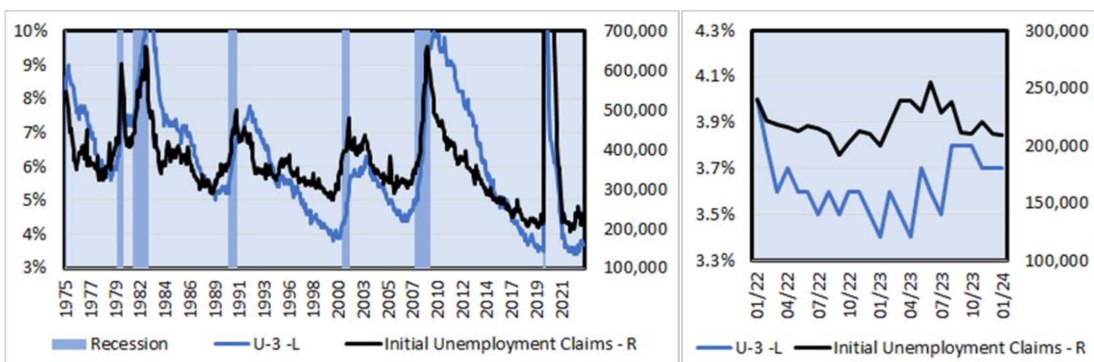
It seems that employment is on the right track, and financial markets have responded as the S&P 500 has surged, sentiment is up, volatility is down, and credit spreads have narrowed. But while the headline is strong, there are cracks beneath the surface. Remember, employment is a lagging indicator.

Headline Payroll Trends Look to Be Bottoming



ISS EVA, FactSet, DOL, NBER

Headline Weekly Claims and Unemployment Rate Low



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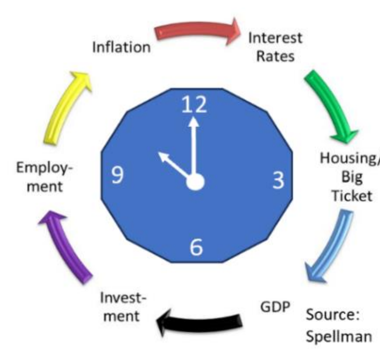
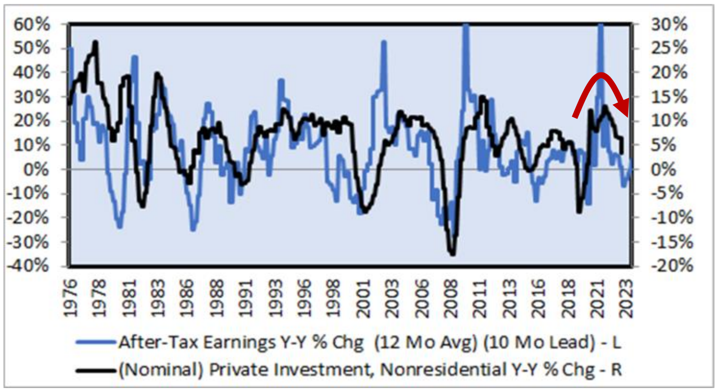
1. *Capacity utilization and the work week are down, which lead to slower payrolls gains and rising unemployment claims, respectively.*
2. *Job openings to the unemployed are moving to 1.0 and the hire rate is slowing.*
3. *More people are working part-time – not by choice – and continuing claims and the duration of unemployment turning worse.*
4. *Excess savings are essentially gone for mid- and lower-income consumers, and delinquencies are rising.*



Indicators Suggest Deterioration Still Coming

Typically, when earnings roll over, capital spending growth declines. This cycle is no different. Over the last year, capital spending growth has been high, but the year-over-year change has been slowing as earnings growth turned negative and companies cut costs to meet earnings expectations. Analysts expect earnings to rebound in 2024, but will capital spending rise given that capacity utilization is deteriorating (despite good real GDP growth)? High demand (GDP) growth is normally associated with high-capacity utilization, but it's falling. Perhaps too much capital was added in the last two years as firms "deglobalized" and/or built extra capacity for "just-in-case" inventory.

EPS Growth (Low) Leads Cap Ex Spending (Slowing)



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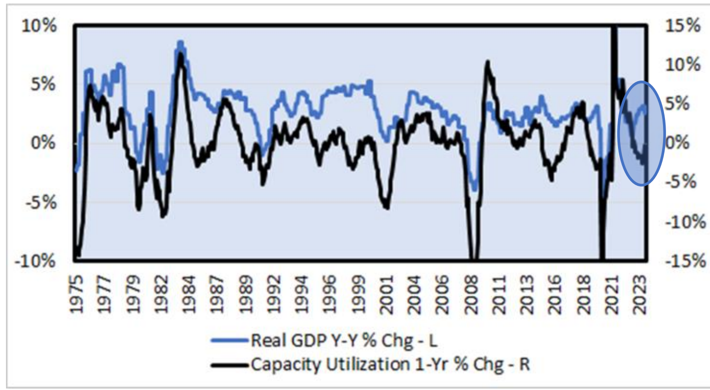
Economy Drives Utilization, Except Now

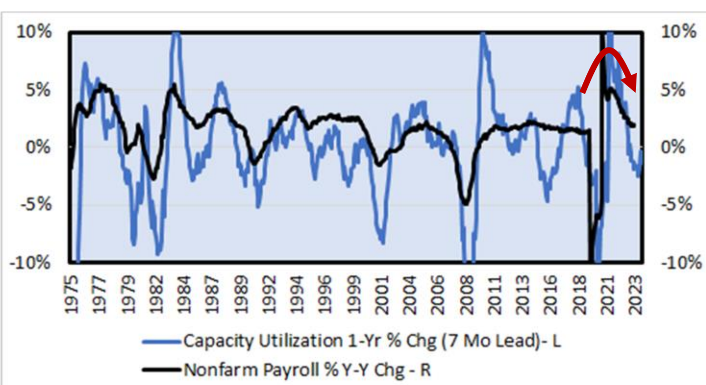


ISS EVA, FactSet, BEA, Federal Reserve System

A lower change in utilization normally leads to slowing payroll growth, and the change in utilization is negative. While the jobs number was high in January, the employment growth rate was only 1.9%, much lower than the last two years. It's still healthy compared to historic numbers (2000s), though.

Perhaps more concerning is that the work week continues to decline, and it tends to lead claims higher. Employers may reduce hours before cutting employees, or lower hours could be a function of employees not wanting to work more, but other statistics suggest this is not true.

Capacity Utilization (Fading) Leads Employment



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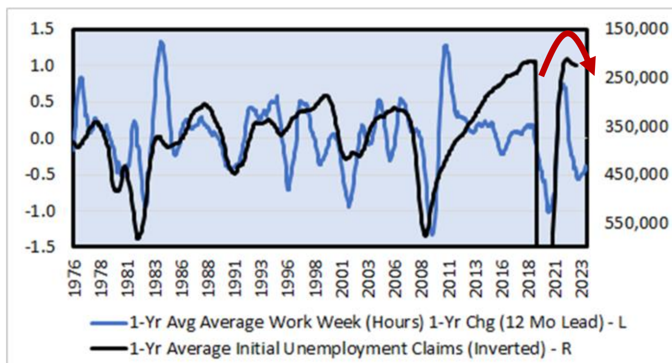
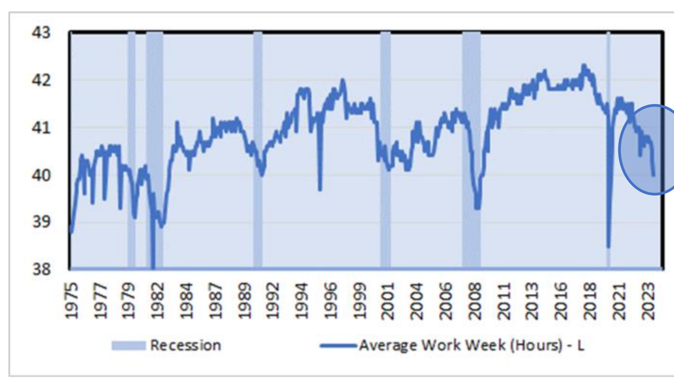
Work Week (Declining) Leads Claims





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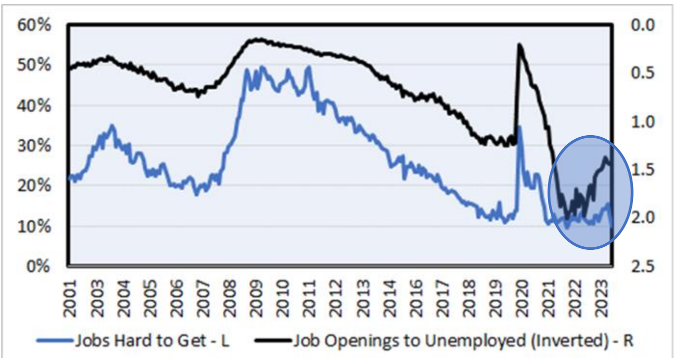
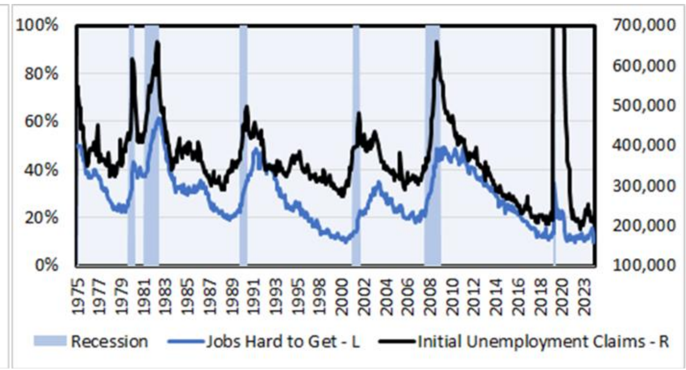
When Will Unemployment Begin to Rise?

Excess demand from stimulus and perhaps nine other drivers discussed in The Case for a Soft Landing kept the economy afloat in 2023. Financial conditions eased despite higher short-term rates. But soon conditions may change. Employment has been buoyed by excess demand for labor, as shown in the job openings-to-unemployed ratio. We only have 20+ years of data for this statistic, but you can see it is correlated with the "Jobs Hard to Get" survey, which is correlated with claims on a longer-term basis. "Jobs Hard to Get" is low because there is an excess of job openings (1.4 openings to 1 unemployed).

Job Openings to Unemployed Rapidly Declining





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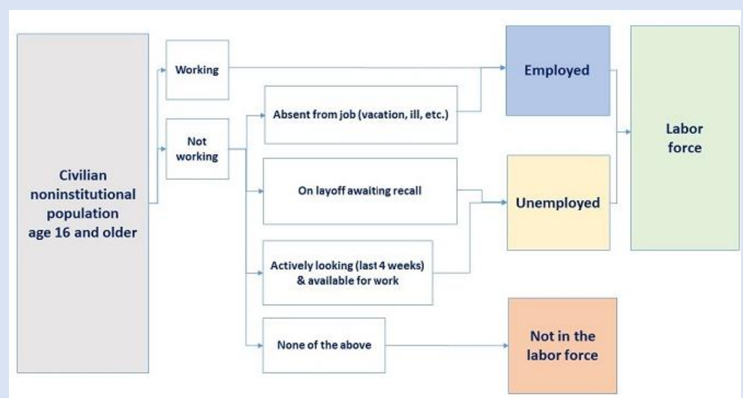
Job openings to unemployed is a function of how fast the economy is growing (demand for labor) and how quickly the labor force is expanding. The latter is a function of working-age population growth and the participation rate.

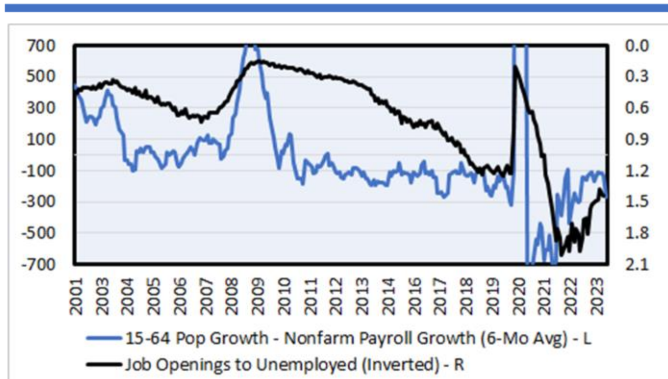


Source: BLS

Working-age population growth to payroll growth (six-month average, as payroll is volatile) is becoming more balanced; however, something happened in January. Payroll advanced 854,000 faster than the working-age population. In December, there were 2.8 million more job openings than unemployed, so at this pace it takes only three to four months for the job market to balance.

Three to four months assumes working-age population growth stays negative; what's the cause – immigration or a fluke in OECD data or demographics or something else? US Border Patrol saw a 50% decline in crossings in January versus December and a record number of people are hitting 65 this year (the "silver tsunami"). Using 139,000 – the six-month average of working-age population less payroll growth – or the December rate (258,000), the time to 1 job opening per 1 unemployed is 20 or 11 months out, respectively. The time frames to 1.0 assume the participation, hiring, quits, and firing rates are unchanged, but the first three are declining. It also assumes all who join the working-age population work, which is too high (the participation is about 80%), but I am also using non-farm payrolls (80% of payroll), so these offset.

Growth in Working Population Less than Jobs



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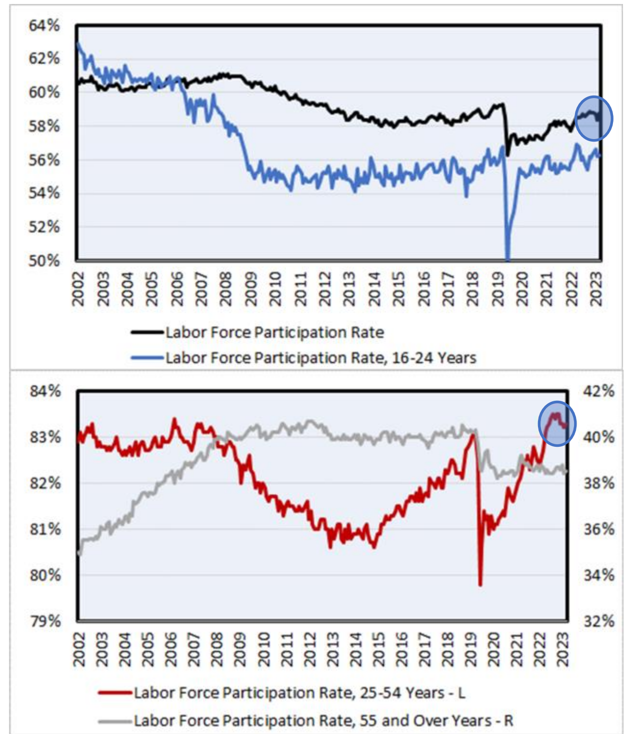
Participation, Hiring, and Quits Rates All Declining

The labor force is a function of the working-age population and the participation rate.

The labor force has declined for three of the last four months, according to the Department of Labor. The six-month average of the labor force growth versus non-farm payroll growth was -221,000 in January. The rate is even more negative because [non-farm payrolls exclude 20% of jobs, including farming, private households, proprietors, non-profit employees, and active military]. At an adjusted rate, the labor force balances (jobs openings to unemployed at 1.0) in 10 months, assuming the participation rate stays constant.

After a rapid rise post-COVID-19, the participation rate is declining. This is mostly due to a drop for 25–54-year-olds. It hit a cycle high last year, but maybe those workers are getting tired? The 16-24-year-old rate is still below what it was in the early 2000s but has been rising since 2010 (can it really go higher?). I'd not expect the 55+-year-olds' rate to race back as they continue to age, and many dropped out of the labor force during COVID-19.

Participation Rate Recently Down

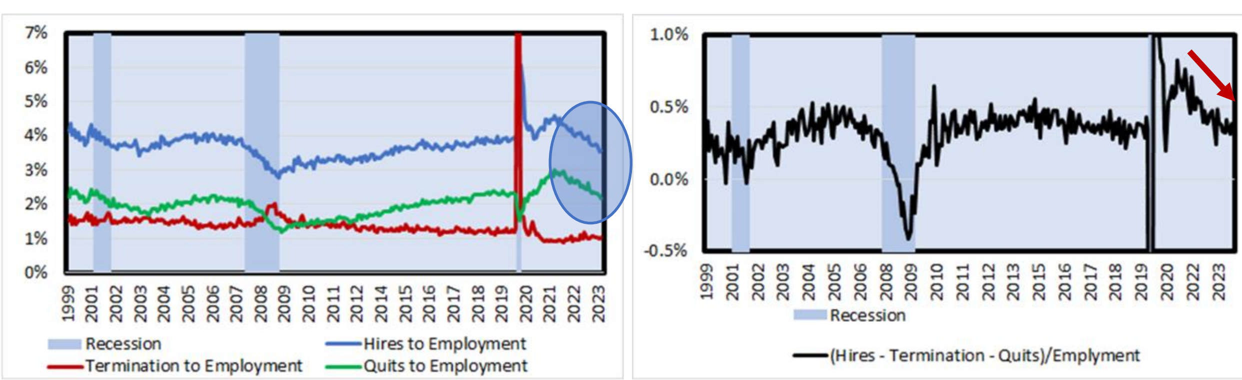


ISS EVA, FactSet, DOL

The hiring rate is rapidly declining. This normally occurs during or leading into recessions. Or maybe the hiring rate is simply declining because fewer people are quitting? The "Great Resignation" period of 2020-21 resulted in a spike of hiring and quits. The firing rate remains low, but that may be due to the excess demand (the high job-opening-to-unemployment ratio). In any case, the net hires – termination – quits level, as a percentage of employment, has been heading down.

Since the downward trend in the hiring rate doesn't appear to be abating, this could move up the date of when job openings-to-unemployed crosses the 1.0 threshold. At that point or soon before, we can expect layoffs to rise. Furthermore, as one of my students pointed out (his name is Ethan Huber…sorry, he has a job, but other great students are available…), [many of the higher profile layoffs (Meta, etc.) are in high-paying technology jobs,] which could have a trickle-down impact on overall demand. High-earner spending results in jobs for others, so layoffs in this space may reduce employment for others.

Hiring and Quits as a Percent of Employment are Down (Typical of Recessions)



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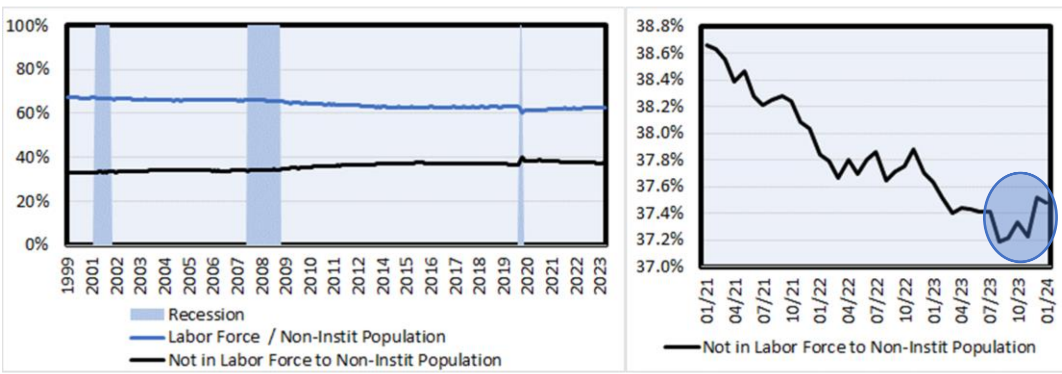
Cracks Below the Surface (Headlines)

Besides immigration, demographics, and participation, another reason the labor force may be declining is simply because people have given up looking for a job. The percentage of the civilian population that is not in the labor force bottomed at 37.2% in November and rose to 37.5% in January (see page 3 for definitions of the labor force). This does not seem like much, but if those people were in the work force then that would mean that 674,000 more jobs would have been lost, or the weekly claims would have been 56,000 higher. The 1-year average (using month ends) of weekly claims is 224,000, so 56,000 more is 25% higher.

Hiring and Quits As a Percent of Employment Are Down



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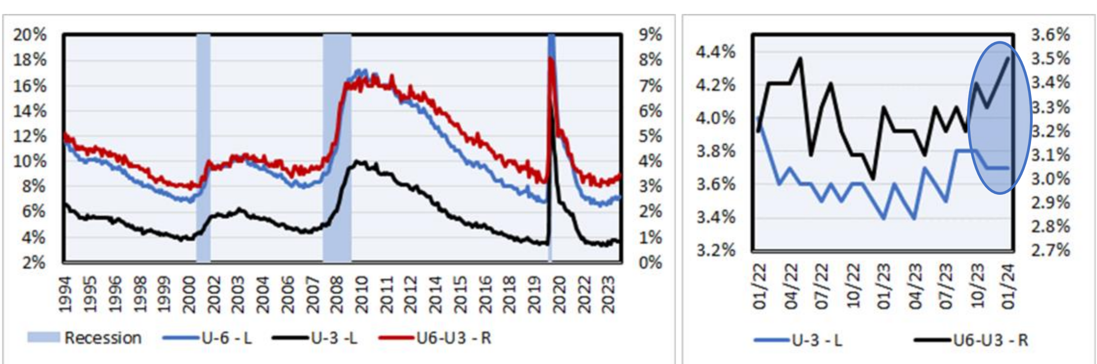
The Bureau of Labor Statistics (BLS) has several definitions of unemployment. The one that makes the headlines is the U-3, or total unemployed as a percent of the labor force, but other definitions can provide insight. Normally, the various rates of unemployment are correlated, but the broader definitions tend to rise more when the economy weakens. The broader definitions include discouraged workers, marginally attached workers, and part-time workers who wish they were full-time. You can see that, despite the U-3 unemployment rate declining in the last six months, the U-6 is rising, and the gap between the two spiked higher in January.

Hiring and Quits as a Percent of Employment are Down



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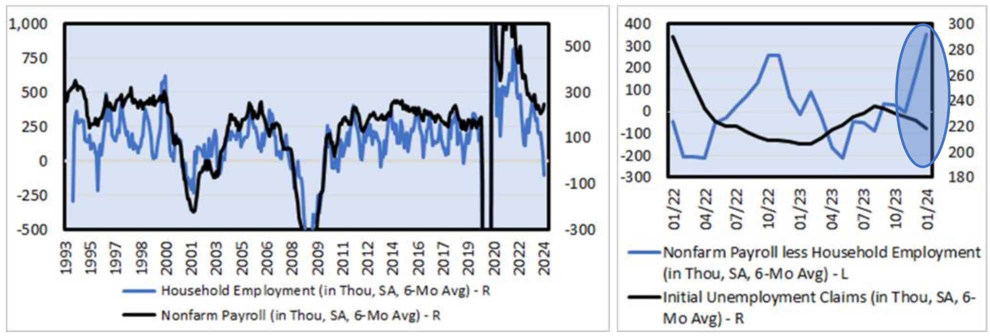
Unemployment Definitions (quoting BLS)

- U-3, total unemployed, as a percent of the civilian labor force (this is the definition used for the official unemployment rate);
- U-4, total unemployed plus discouraged workers, as a percent of the civilian labor force plus discouraged workers;
- U-5, total unemployed, plus discouraged workers, plus all other marginally attached workers, as a percent of the civilian labor force plus all marginally attached workers; and
- U-6, total unemployed, plus all marginally attached workers, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all marginally attached workers.

Cracks Below the Surface (Headlines)

Each month, there are two U.S. jobs reports. One is the household survey and the other is the payroll survey. The payroll survey is from a representative sample of businesses and the household survey is a representative sample of the civilian noninstitutionalized population. The one that gets the most attention is the payroll survey, which has been hot (ignoring the cracks). As the Bureau of Labor Statistics (BLS) notes, typically they move together, but recently they have diverged. The household survey is weak and declining while the payroll survey is up. A comparison of the surveys is provided by BLS here.

Household Survey Down While Employment Survey Up



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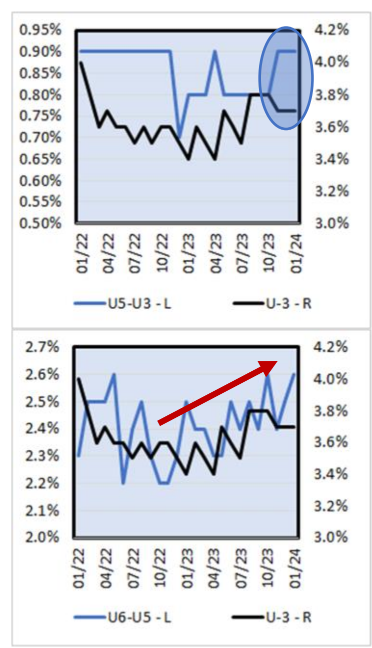
The main difference between the two surveys is the payroll survey counts the number of jobs, whereas the household survey counts the number of people employed. If a person has two jobs, that person only counts once in the household survey, but twice in the payroll survey. In December and January, the household survey shrank by 1.2 million total! The difference between the two surveys were 1.1 million in December and about 800,000 in January. There could be two reasons that people are taking on more than one job. Perhaps it is because the labor market is weak and employers are reluctant to hire full-time, or perhaps it is because the job market is strong and employers will allow someone to work part-time (and people may need to do so given high inflation and declining savings). While the household survey is quite volatile and the discrepancy between the surveys could be an aberration, other indicators suggest the reason for the divergence is a weakening job market.

The difference between the U-5 and U-3 unemployment rates is that the U-5 includes discouraged or otherwise marginally attached people who did not look for a job in the last four weeks (the requirement to be counted as unemployed). This difference was 0.7% in December 2022 when the U-5 was 4.2% and the U-3 was 3.5%; it has now has risen to 0.9% while the U-5 is 4.6% and up 0.4% while the U-3 is 3.7% and up 0.2%.

U-6 less U-5 unemployment includes part-time workers who would like to work full-time. This rate was 2.2% in November 2022 and is 2.6% now, and was up in January.

Furthermore, continuing claims are rising behind a shortened work week.

Marginally Attached and Forced Part-Time Work Rising



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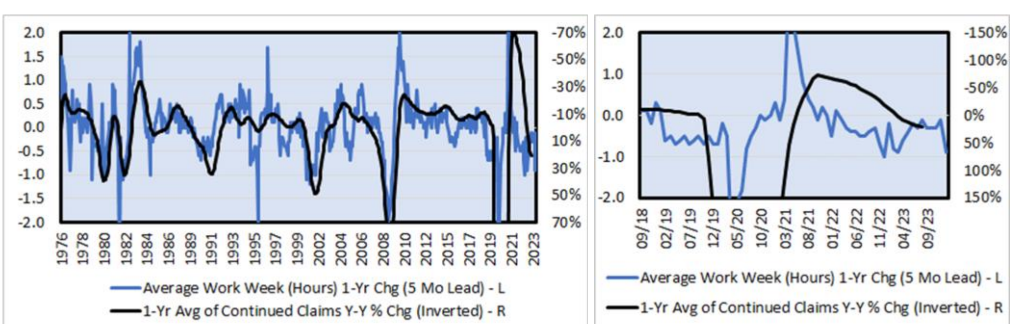
Continuing Claims Are Up, Consistent with Declining Work Week



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Cracks Showing in Spending?

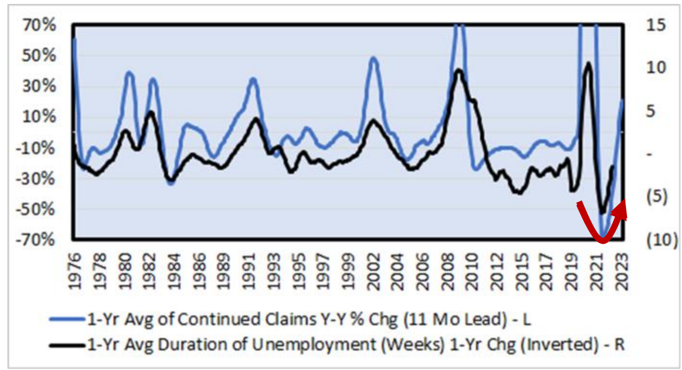
Thus far, job trends have not been surprising. Everything has followed the normal ebbs and flows of the economy. What threw off many economic models is they did not account for the high job openings to unemployment ratio (and savings). It's now declining. Retail sales in January were below expectations – due to weather or the slowing job market?

The prior page shows that the work week leads continuing claims by 5 months, and continuing claims are rising. Continuing claims lead the duration of unemployment by 11 months, and it is right on schedule (growing). Higher continued claims, longer time to find a new job, and more part-time work (not by choice), means the consumer is weakening. Although don't forget savings: excess savings from stimulus spending and inability to spend during COVID-19 helped consumers' balance sheets and spending in 2023. But the Fed estimates (December) that the remaining excess savings is only $98 to $650 billion (down from over $2 trillion).

Consumer credit growth is starting to slow. This may be because of a weakening position as described above, or due to interest rates being up to 21.5% in November from 14.6% in February 2022. It could also be due to slowing personal consumption spending despite rising real wage growth from lower inflation (inflation slows following slowing GDP growth).

Before 2020, rising net worth was associated with lower savings. People's faith in a soft landing may propel the market higher, which then allows people to spend more and save less, which then keeps the economy afloat. This feedback loop may work as long as people are convinced that they will not lose their jobs; thus, cracks in employment matter.

Continued Claims Lead Duration of Unemployment



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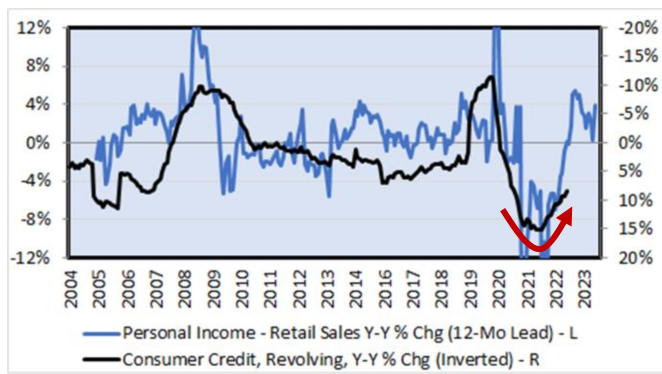
Credit Card Debt Is Growing but Decelerating, and Personal Income Growth Less Retail Sales Growth Dropped to Zero in December Before Jumping in January Due to -0.2% Retail Sales Growth



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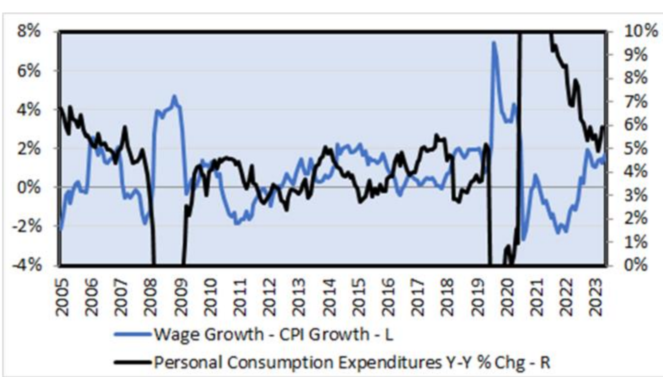
Positive Real Wage Growth Not Necessarily Good for Personal Consumption Expenditures



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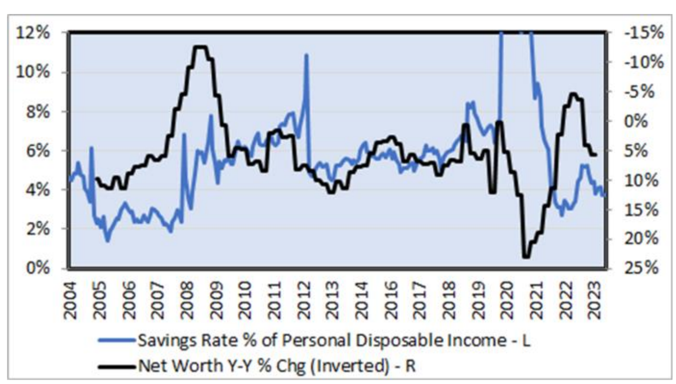
Savings Rate Low but Net Worth Growth Up



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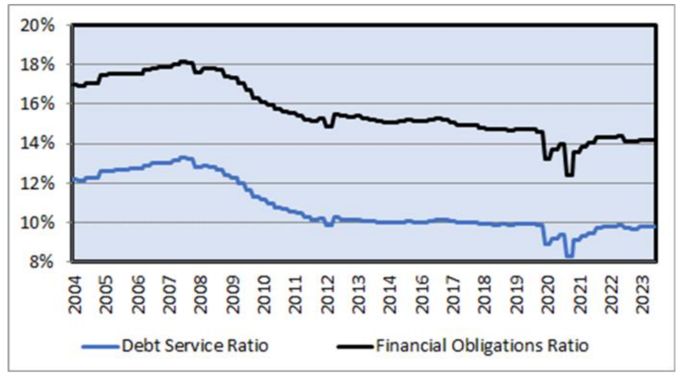
Cracks Showing in Delinquencies

Importantly, the financial obligation ratio (FOR) and debt services ratio (DSR) are still low. The FOR measures household debt payments, rents, auto payments, homeowner insurance, and tax payments as a percentage of disposable income. The DSR just includes debt payments. So, it looks like consumers are still well off.

FOR Is Still Low



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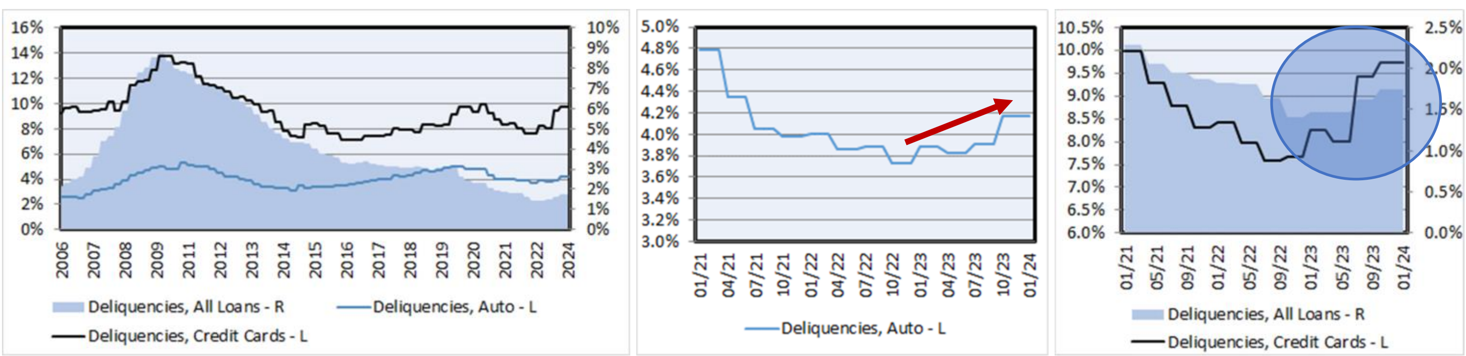
Then why are cracks appearing in the form of delinquencies? Perhaps excess savings is depleted for mid- to low-income groups. While some have claimed that consumers have tons of cash available to spend, remember that prices have also risen and perhaps willingness to spend is a function of income. If this is the case, then note that the [Richmond Fed showed that by Q1 2023 lower- and lower-middle income groups had a lower ratio of liquid assets to income than they did in Q4 2019] and the ratio probably continued to deteriorate over the last year.

Consumer Delinquencies Are Rising



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If you have questions, don't hesitate to contact me. Love to chat. Also, if you are looking for a super-star student with a good attitude for an internship or a full-time role, I'll find you someone.

Have a good day!

Coach

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