US Labor Market- An Enigma

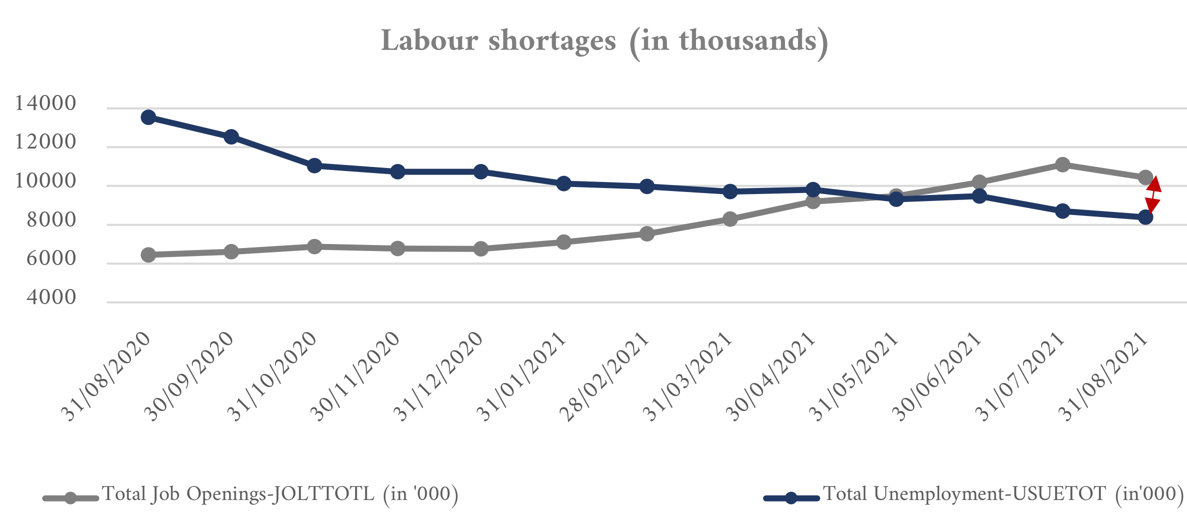
The news has been awash with global reports of shortages. The US particularly, is feeling the impact of a labor shortage. In early September, the US concluded its pandemic related federal unemployment benefits, expecting an end to the lockdown. With schools and childcare services reopening, it would allow those with children to either return to work or seek active employment. That was the plan. However, the reality is that this has not materialized.

Many questions surround the tightness in the US labor market such as why has this happened, will it continue and what impact will this have on the economy? A lot has been spoken about the tightness (shortages) in the US labor market. In this memo we will try to demystify the same.

Current state of US Labor Market

The current state of the US labor market can be best expressed by the chart below (**Chart 1**). This plots the total job openings, that tracks the number of specific job openings in an economy (JOLTTOTL Index), against the total unemployment (USUETOT Index). For the month of August 2021, JOLTTOTL Index had a reading of 10,439 (in thousands) against an unemployment reading of 8,384 (in thousands), signifying labor shortages. The September 2021 reading for the USUETOT came at 7,674 (in thousands) aggravating the shortage experienced by the employers.

Chart 1: Total Job Openings Vs Total Unemployment (in thousands)- Labor Shortage



Source: Bureau of Labor Statistics, Bloomberg, Lighthouse Canton dt. 24th Oct 2021

While the chart above also depicts falling unemployment, a good sign for the economy, the fall is not uniform across industries and that is the crux of the problem. The table below (**Table 1**) dissects the unemployment across sectors. This provides much-needed clarity to the disparity across industries. The industries highlighted in grey below, contribute the most to the overall unemployment rate.

Table 1: Unemployment % across industries

US UNEMPLOYMENT RATE ACROSS INDUSTRY (% Non-Seasonally Adjusted)

	Sep-21	Aug-21	Jul-21	Jun-21	May-21	Apr-21	Mar-21	Feb-21	Jan-21	Dec-20	Nov-20	Oct-20	Sep-20	Aug-20
Unemployment Rate	**4.6**	**5.3**	**5.7**	**6.1**	**5.5**	**5.7**	**6.2**	**6.6**	**6.8**	**6.5**	**6.4**	**6.6**	**7.7**	**8.5**
Nonagricultural Private Wage and Salary	4.6	5.2	5.5	6.0	5.7	6.0	6.6	6.8	7.1	6.7	6.5	6.8	8.0	8.8
Mining, Quarrying, and Oil and Gas	7.3	10.2	8.9	10.3	9.6	14.3	15.0	19.3	14.2	13.1	19.2	13.8	14.9	12.4
Construction	4.5	4.6	6.1	7.5	6.7	7.7	8.6	9.6	9.4	9.6	7.3	6.8	7.1	7.6
Manufacturing	3.9	3.6	4.2	5.4	4.8	5.8	5.2	4.8	4.7	4.3	4.7	5.2	6.2	6.7
Durable goods	3.9	3.3	3.8	5.7	5.0	5.5	4.6	4.4	4.2	3.5	4.3	4.6	5.7	6.5
Nondurable goods	3.8	4.2	4.8	4.8	4.3	6.3	6.4	5.4	5.6	5.5	5.4	6.3	7.1	7.0
Wholesale and retail trade	**5.7**	**6.1**	**6.0**	**6.2**	**6.6**	**6.2**	**6.7**	**6.8**	**6.9**	**5.5**	**6.0**	**6.5**	**7.8**	**8.3**
Transportation and Public Utilities	**5.4**	**5.9**	**6.8**	**6.0**	**7.2**	**6.8**	**8.3**	**8.4**	**8.2**	**8.4**	**8.0**	**7.9**	**9.8**	**11.3**
Information	4.0	4.4	5.6	6.1	5.8	5.9	6.6	6.2	7.4	6.4	8.2	5.8	8.6	8.6
Financial Activities	2.5	3.2	3.0	3.4	3.0	2.7	3.4	3.7	3.4	3.1	3.5	3.8	4.4	4.2
Professional and Business Services	4.4	4.6	5.1	5.2	5.4	5.9	6.7	6.8	6.8	6.1	5.9	6.1	6.7	7.2
Education and Health Services	3.3	4.3	4.4	4.4	3.4	3.4	3.8	3.7	4.3	4.1	3.7	4.2	5.1	6.3
Leisure and Hospitality	**7.7**	**9.1**	**9.0**	**10.9**	**10.1**	**10.8**	**13.0**	**13.5**	**15.9**	**16.7**	**15.0**	**16.3**	**19.0**	**21.3**
Other Services	4.2	5.0	4.9	5.4	5.3	6.2	6.7	7.7	8.8	7.4	8.1	8.3	9.2	9.1
Agriculture and related private wage and	5.0	5.7	7.6	7.5	8.4	8.9	7.3	10.5	9.4	11.0	8.4	6.3	5.0	5.6
Government	2.4	3.6	4.1	3.5	2.2	2.3	2.7	2.8	3.0	3.2	3.4	3.2	4.1	5.7
Self-employed workers, unincorporated, and	4.1	4.9	4.9	5.9	5.3	5.6	4.4	6.5	6.2	6.7	5.9	6.1	6.7	6.8

Source: Bureau of Labor Statistics, Bloomberg, Lighthouse Canton dt. 24th Oct 2021

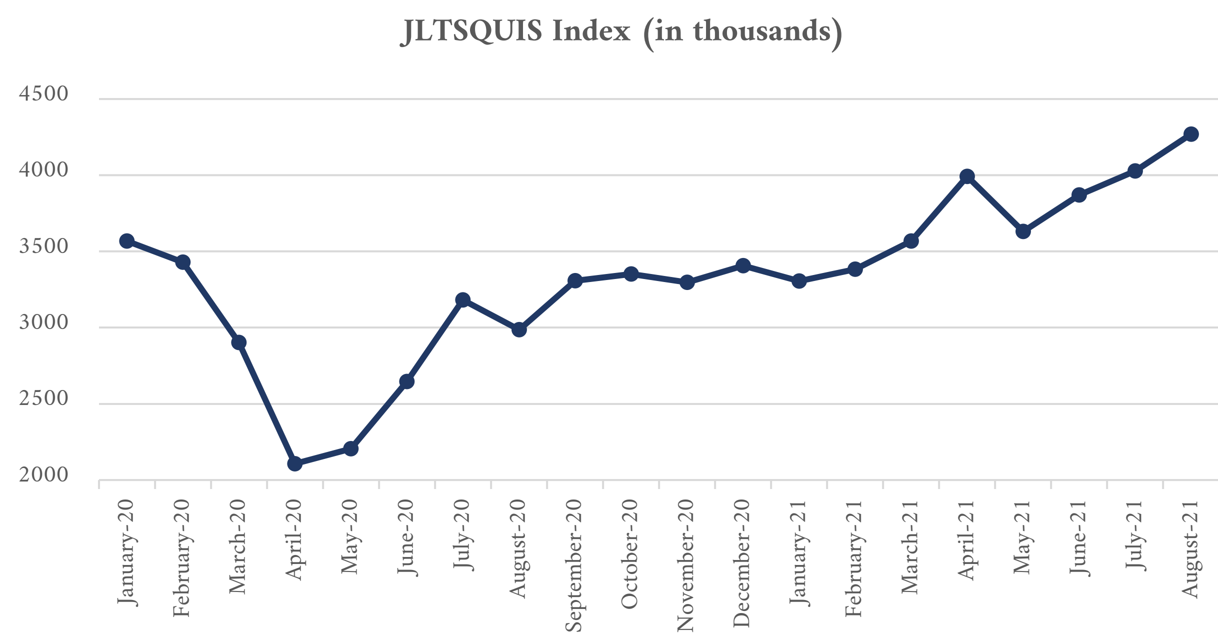
A closer look at the Labor force participation rate and the Job Opening and Labor Turnover Quits index (JLTSQUIS Index) explains the labor shortages depicted in Chart 1. The labor force participation rate highlights the percentage of the total labor force seeking out active employment while JLTSQUIS Index highlights the number of people voluntarily opting out of employment (e.g., retirement)

Table 2: US Labor force participation rate- Age & Gender

	Sep-21	Aug-21	Jul-21	Jun-21	May-21	Apr-21	Mar-21	Feb-21	Jan-21	Dec-20	Nov-20	Oct-20	Sep-20	Aug-20
Labor Force Part.%	**61.6**	**61.7**	**61.7**	**61.6**	**61.6**	**61.7**	**61.5**	**61.4**	**61.4**	**61.5**	**61.5**	**61.6**	**61.4**	**61.7**
Male/Age														
16-17	24.9	24.7	24.5	24.8	24.9	24.8	23.2	23.8	23.2	23.0	22.9	24.1	23.1	21.9
18-19	47.3	48.7	47.8	45.3	49.5	50.3	49.7	51.5	51.1	49.6	48.7	48.5	48.0	46.7
20-24	73.0	72.2	72.1	72.2	72.6	73.6	72.4	72.3	72.6	72.7	73.0	73.3	71.6	70.8
25-34	87.9	88.1	88.1	87.4	87.4	87.8	87.3	86.8	87.1	86.9	86.5	87.4	87.1	87.0
35-44	89.7	89.7	90.0	90.0	89.8	89.1	89.6	89.8	89.9	89.1	89.5	89.3	89.5	90.1
45-54	86.7	87.2	86.7	87.0	86.0	86.3	85.7	86.1	86.0	86.0	86.4	87.0	86.4	87.0
55+	44.7	44.2	44.3	44.3	44.2	44.1	43.9	44.3	44.3	44.5	44.7	44.7	44.9	45.1
Female/Age														
16-17	26.3	28.0	27.1	26.5	27.8	28.6	27.8	25.8	25.2	24.0	25.2	24.8	25.6	25.6
18-19	50.0	46.7	45.7	45.9	46.6	48.6	46.4	47.3	46.5	50.9	48.7	49.1	49.7	44.5
20-24	68.1	68.2	68.9	69.3	67.9	67.1	68.2	68.0	67.7	69.0	68.3	68.6	66.6	65.9
25-34	75.9	76.5	76.5	76.4	75.8	76.0	76.0	75.3	75.2	75.0	74.5	75.4	75.4	75.4
35-44	74.0	74.8	75.2	74.9	74.2	74.5	74.5	74.1	74.3	74.0	74.4	74.2	73.8	75.2
45-54	75.9	74.9	74.8	74.8	75.0	74.7	75.1	75.2	74.7	75.3	74.8	74.7	73.8	74.3
55+	33.3	33.6	33.3	33.2	33.3	33.4	33.4	33.1	33.1	33.5	33.7	33.6	33.7	34.6

Source: Bureau of Labor Statistics, Bloomberg, Lighthouse Canton dt. 24th Oct 2021

Chart 2: US Job Opening and Labor Turnover Quits Level (in thousands Seasonally adjusted)

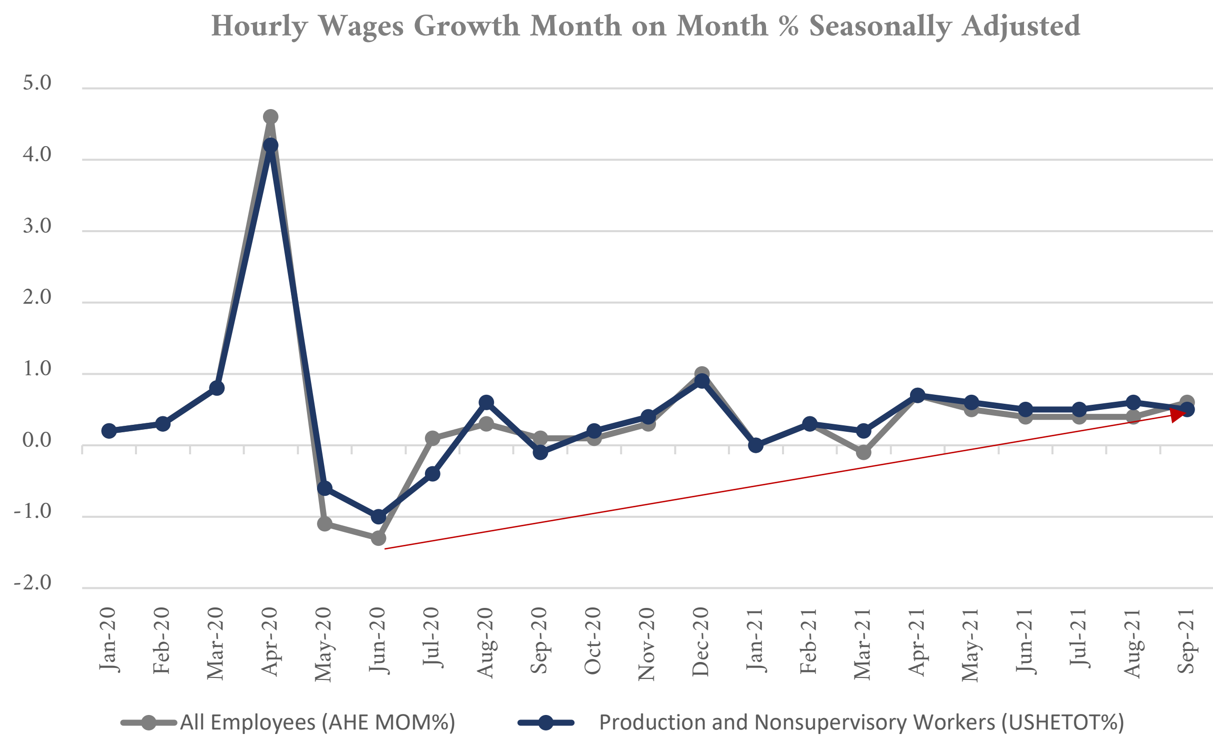


Source: Bureau of Labor Statistics, Bloomberg, Lighthouse Canton dt. 24th Oct 2021

As highlighted in Table 2, there is a lower participation rate in Age group 55+ across both genders. Additionally, a higher voluntary quits level (4.3MM in Aug 2021, Chart 2) signifies the confidence of the employees in their ability to obtain a new employment. This is almost 3% of the work force and the phenomenon is being driven in part by workers who are less willing to endure inconvenient hours and poor compensation and are quitting to find better opportunities or retire.

Such is the tightness in the US labor market, that employers are unable to fill in open positions despite increasing the hourly wages. The US hourly wages growth rate read 0.6% month-on-month for September, 2021 as evidenced in Chart 3 below.

Chart 3: Hourly Wages Growth Rate



Source: Bureau of Labor Statistics, Bloomberg, Lighthouse Canton dt. 24th Oct 2021

Why is the US Labor market tight?

The tightness of the labor market can be attributed to the following

- **Generous unemployment benefits**: Despite the recent cuts in pandemic related benefits, many have benefited from the months of generous unemployment benefits and multiple rounds of stimulus. So much so that the workers can do better or nearly as well by not working compared to if they were working now. This will be true particularly in low entry level jobs in industries like leisure & hospitality, mining & oil exploration **(refer Table 1).** While the generosity can be justified during the pandemic, continuing it for such a long time has led to withdrawal from the labor force **(participation rate down to 61.6% vs pre pandemic levels of 63.7% refer Table 2)** as well as made the labor supply relatively inelastic (i.e. supply does not increase by much despite increase in wages)

- **Closure of schools:** As most secondary earners are women; the closure of schools has seen many quit their jobs to look after their families. Although it has been reported that schools and childcare services have been opening in September to coincide with the school term, this has not been the case across the country. This may well turn to be a long term negative if care services are not improved and/or schools continue to operate online. It is making the labor supply inelastic as well.
- **Early retirement:** Pandemic led layoffs have forced people to retire early, particularly employees closer to their retirement age. Under normal circumstances, they would have continued to work if they had a job. This phenomenon is clear in the **Table 2**, that depicts lower participation rate in 55+ categories across male and female. **Chart 2** also corroborates the same.
- **Flexible working options:** The pandemic had a psychological effect on employees. Focus on health and work-life balance increased. This led to employees opting for the flexibility to work from home rather than onsite. This flexibility also reduces the risk of contracting COVID from the commute and allows women to take care of their children at home. Industries like Financial Services, that offer this flexibility has seen lower unemployment rates (**refer Table 1**). On the contrary, industries like Hospitality and Leisure, Mining and Oil exploration have seen higher unemployment rates largely owing to the inability to provide the option to work from home.

What is the way forward?

With the abatement of COVID cases and the rapid pace of vaccination in the US, we think that the labor market will most likely restore normalcy. However, the time taken to reach normalcy could potentially be longer than a year.

Industries that cannot operate on work from home models, like mining, oil exploration could eventually experience an easing of the tight labor conditions, mostly owing to decline in COVID cases, rapid pace of vaccination and buoyancy in global demand.

Complete reopening of schools and improved care giving infrastructure could potentially motivate women to get back to the work force. In addition, relaxation of global travel restrictions will potentially add more workers to the leisure and hospitality industry. This could contribute to the elasticity of labor supply.

Finally, higher cost of living, fueled by higher inflation, might force people to be actively seek out employment opportunities thereby making the labor supply relatively elastic.

Conclusion - How should portfolios be positioned?

Continuing tightness in labor markets will mean employers will continue offering higher wages to attract talent and this will keep the pressure on inflation readings upwards. US Treasury yields are likely to move higher on the longer end and with no rate hikes anticipated until 2023, treasury curve steepening could be the natural consequence. This is assuming no negative data prints come in.

Investors should look to actively reduce the duration and convexity of their bond portfolios. The addition of long short strategies on credit will potentially help to minimize downside risk. An ability to go short on credit will enable the portfolio manager to generate alpha that could potentially negate the adverse mark-to-market owing to steepening of the curve. A long only manager will not have the mandate to do so thereby exposing the complete portfolio to higher drawdowns.