

# United States Labor Market Monitor



**December 2015**

Unless otherwise noted, all figures are based in USD.

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# Thesis Overview



Continued tightening of supply in the United States labor market at the pace observed in recent years will lead to an acceleration in wage growth, and subsequently core inflation.

## Why do we care?

Labor shortages are one of the most traditional examples of labor market imbalances. Monitoring the state of the labor market is critical at this stage of the economic expansion, as its equilibrium (or lack thereof) will have implications on rates of wage growth, consumer price inflation, the stance of monetary policy, corporate profits, and ex ante equity market risk.

## Where are we today?

Today, in the United States, some of the data suggests that the supply of labor is tight, and a majority of the demand-side data suggests quantity of labor demanded is high with demand itself increasing. Thus, upside surprise in wage pressure cannot be ruled out in the near to intermediate term.

## What are the monitoring points?

To track the US labor market, we monitor indicators of labor supply and demand.

The table below summarizes select indicators, and whether they support the first premise of the thesis:

Is the United States labor market tight, or tightening?

Category	Indicator	April 2015	July 2015	November 2015
Capacity Utilization	Headline Unemployment Rate	Yes	Yes	Yes
Capacity Utilization	Broader Unemployment Rate	No	No	No
Capacity Utilization	Beveridge Curve	Yes	Yes	Yes
Labor Supply	Ratio of Employment-to-Population	No	No	No
Labor Supply	Fraction of Workers with Full-Time Job	No	No	No
Labor Supply	Years Supply of Labor Remaining	Yes	Yes	Yes
Labor Demand	Ratio of Hires-to-Openings	Yes	Yes	Yes
Labor Demand	Labor Force Turnover Rate	Yes	Yes	Yes
Labor Demand	Rate of Job Openings	Yes	Yes	Yes
Labor Demand	Ratio of Vacancy-to-Unemployed	No	No	No
Yes Count:		6 of 10	6 of 10	6 of 10

# Where could our indicators be wrong?



Two points where we could be wrong that have to be most closely followed are:

1. There is more slack in the labor market than presented here.

- Immigration may provide the United States labor market with additional capacity.
- Automation is source of alleviating demand for labor.
- Outsourcing is a method to circumvent tight and expensive domestic labor.

2. The labor market is tighter than presented here.

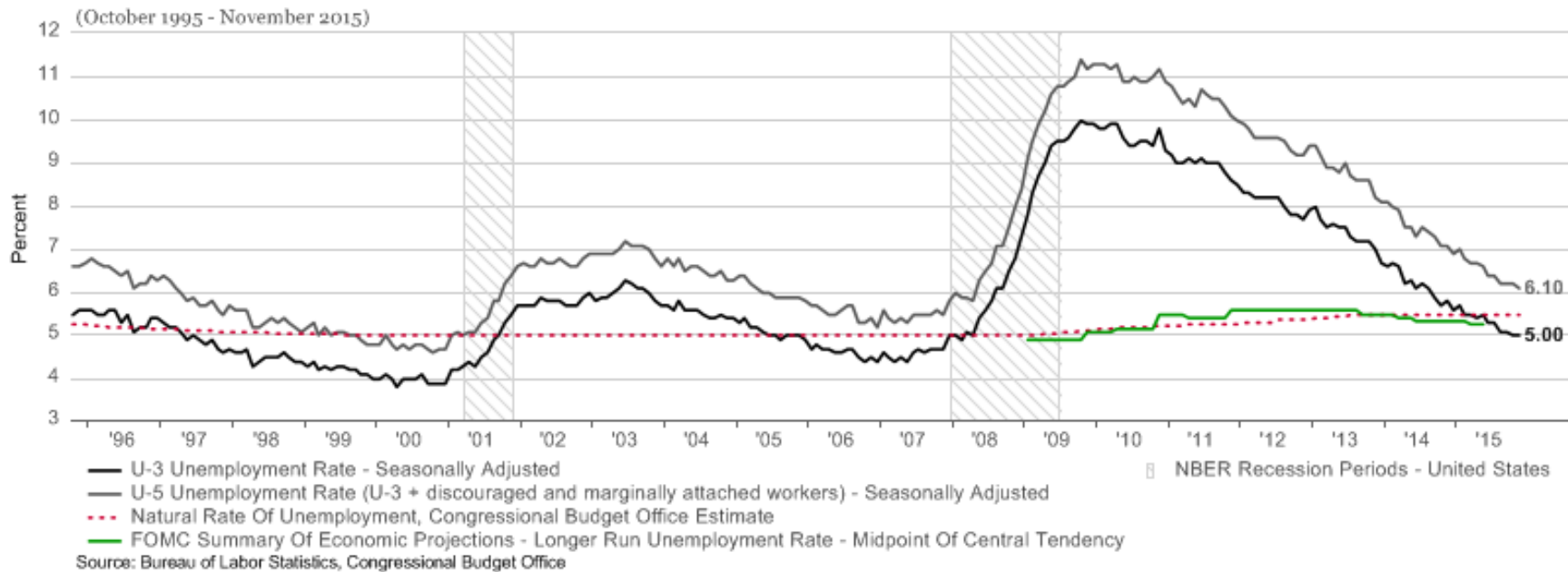
- Evidence of this might be reflected in the elevated median duration of unemployment today suggesting there are people who are unemployable due to atrophy of skills as they left the labor force in the wake of the Great Recession. These people may never return to the labor force due to lack of wanting or undesirable skills. Thus, some of the indicators listed as “no” on the prior page would be “yes.”

# Rate of Unemployment is at the Natural Rate



- Today, the headline unemployment rate is equal to the CBO's estimate of the natural rate of unemployment. This suggests there is little spare capacity in the U.S. labor market.
- A broader measure of unemployment (U-5) still indicates slack, but it is not far behind.
- Unemployment rates at or below the natural rate are an indication of a tight labor market.
- However, the labor market is more complex than what can be captured in this one indicator. Thus, let us review additional indicators to holistically observe how the labor market is progressing.

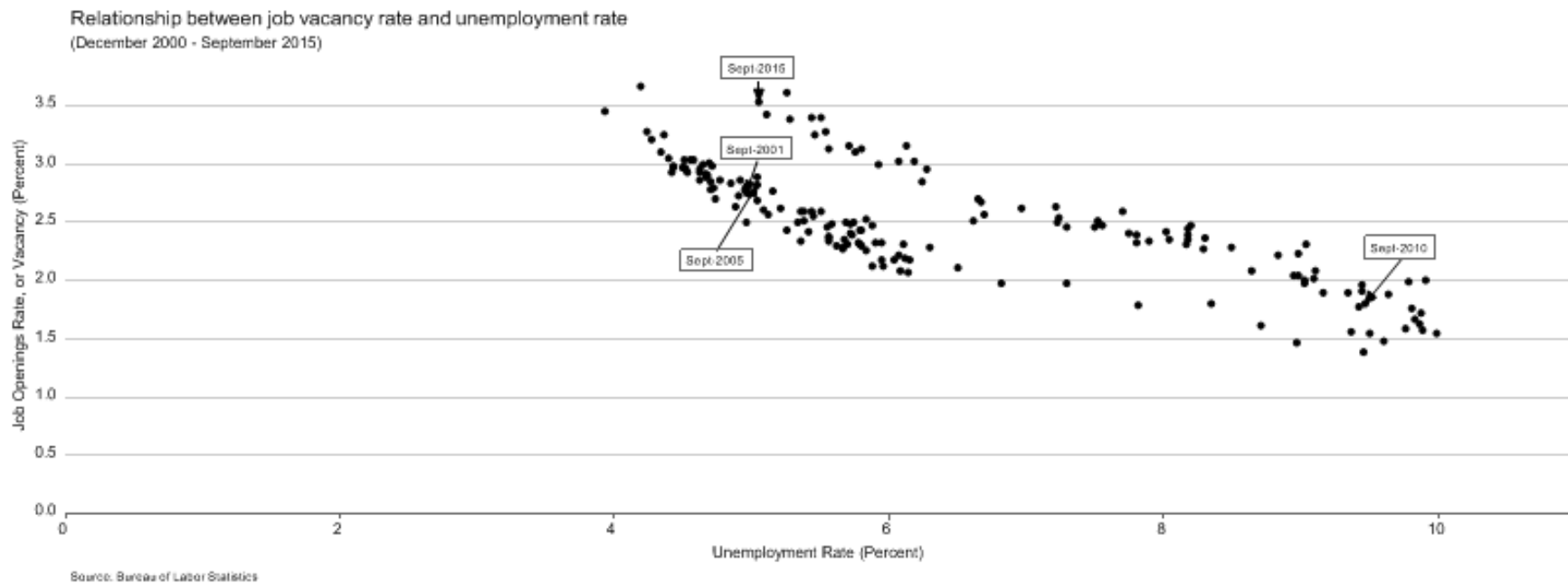
## Unemployment Rates



# Beveridge Curve

- This is a graphical representation of the relationship between the rate of unemployment and the job vacancy rate.
- If the curve moves outward over time, then it implies a lower level of efficiency in the labor market perhaps due to a structural mismatch of jobs available and labor force skill, or an immobile labor force.
- The net shift outward in this relationship in the current economic cycle is caused by a multitude of forces, some of which suggest as the labor market enters equilibrium employers ought to bid up wages for the few job candidates with the desirable skills.
- Continued lack of convergence to the pre-recession relationship is a sign of a tight labor market.

## Beveridge Curve

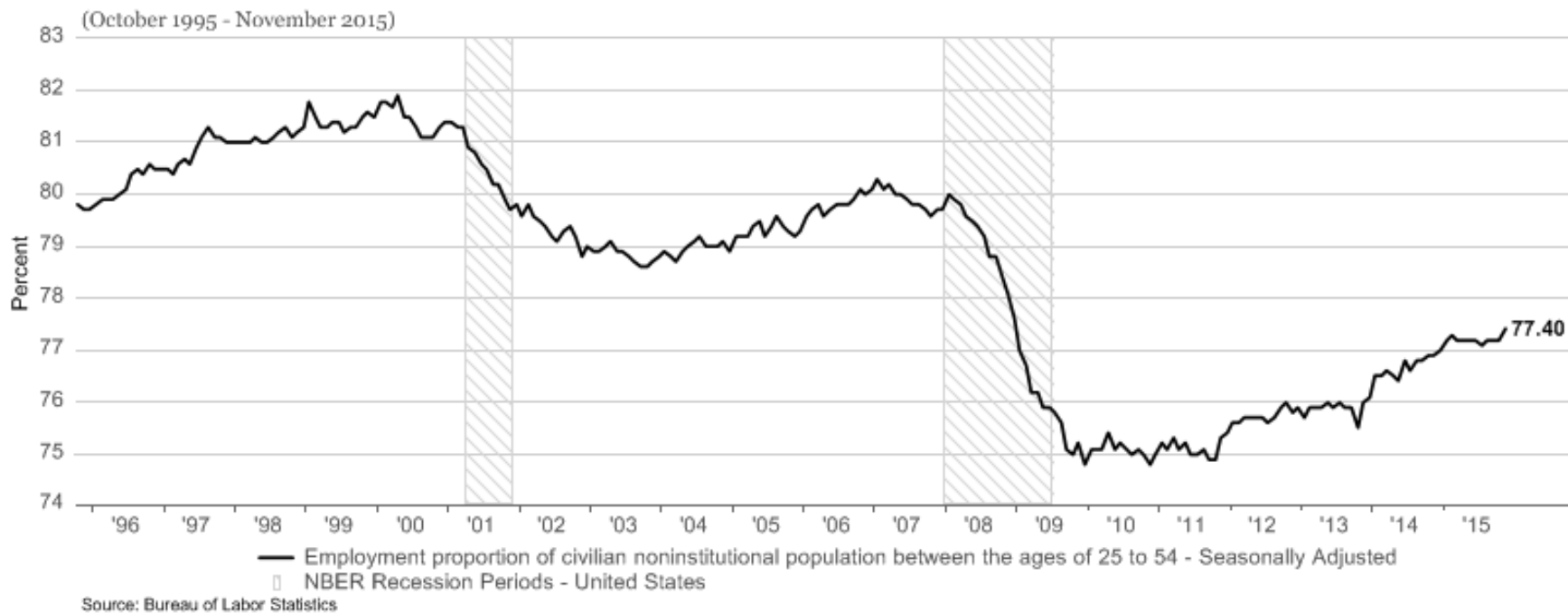


# Ratio of Employment to Population



- Here is our first ancillary indicator of labor supply. It is the proportion of the civilian non-institutional population of prime working age (25 to 54) who are employed.
- The ratio is higher than its Great Recession nadir, but it is low relative to recent cycle highs suggesting there are persons who are available for employment.
- However, this ratio is influenced by household preferences for supplying labor. Thus, continued sustained increases in this ratio is all we look for to indicate a tight labor market, as opposed to the ratio returning to its prior cycle peak.

## Employment-to-Working Age Population Ratio



# Fraction of Workers with Full-Time Positions

- This indicator attempts to reveal the shadow supply of labor available. We observe that the proportion of employed persons with full-time positions is low relative to recent economic expansions, while involuntary part-time employment is fairly high.
- This may suggest that there is an elevated level of shadow supply of labor amongst currently employed workers, as these people could work more hours should the demand for their services be required.

## Fraction of Workers Who Are Full-Time



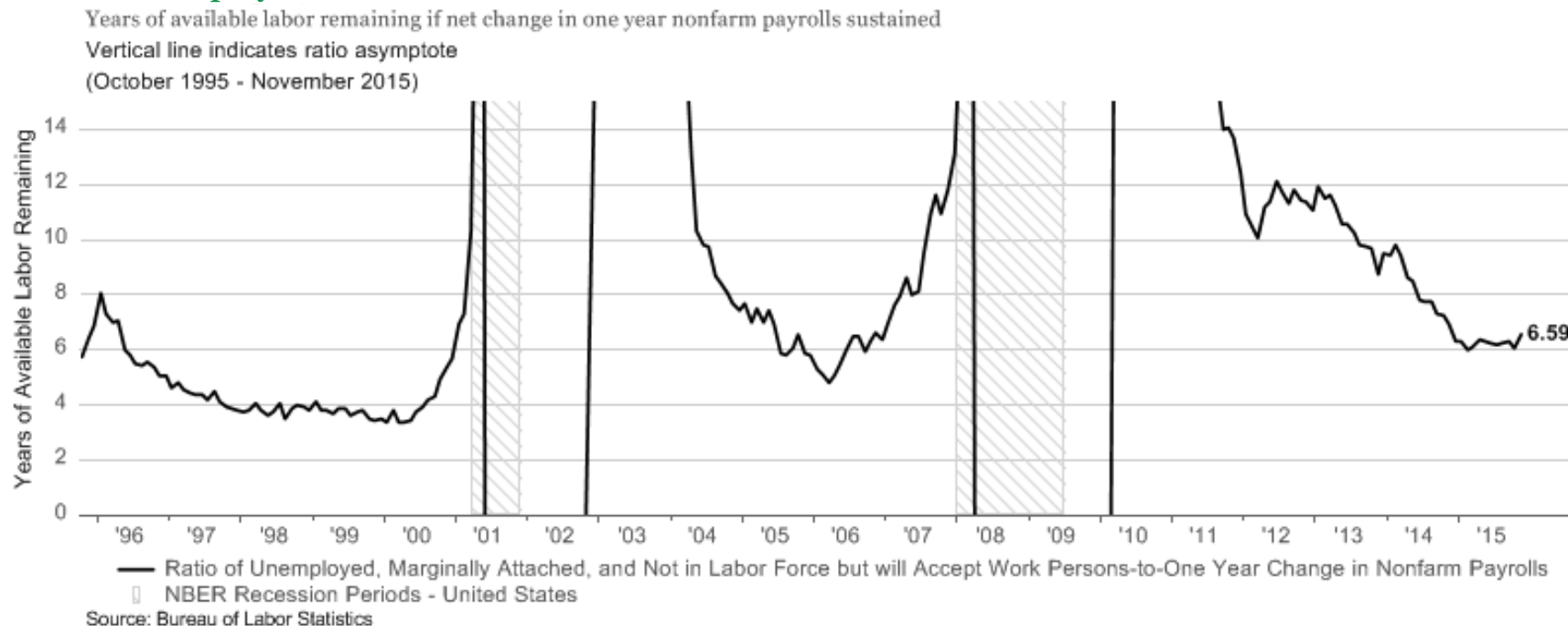


# Years of Available Labor Supply Remaining



- This indicator shows the number of years of available labor supply remaining if the magnitude of net year-over-year change in nonfarm payrolls continued ad infinitum.
- According to this indicator, today, the supply of labor is tight relative to recent economic expansions.
- Available labor supply is the sum of unemployed persons, marginally attached persons, and persons not in the labor force but willing to accept work.

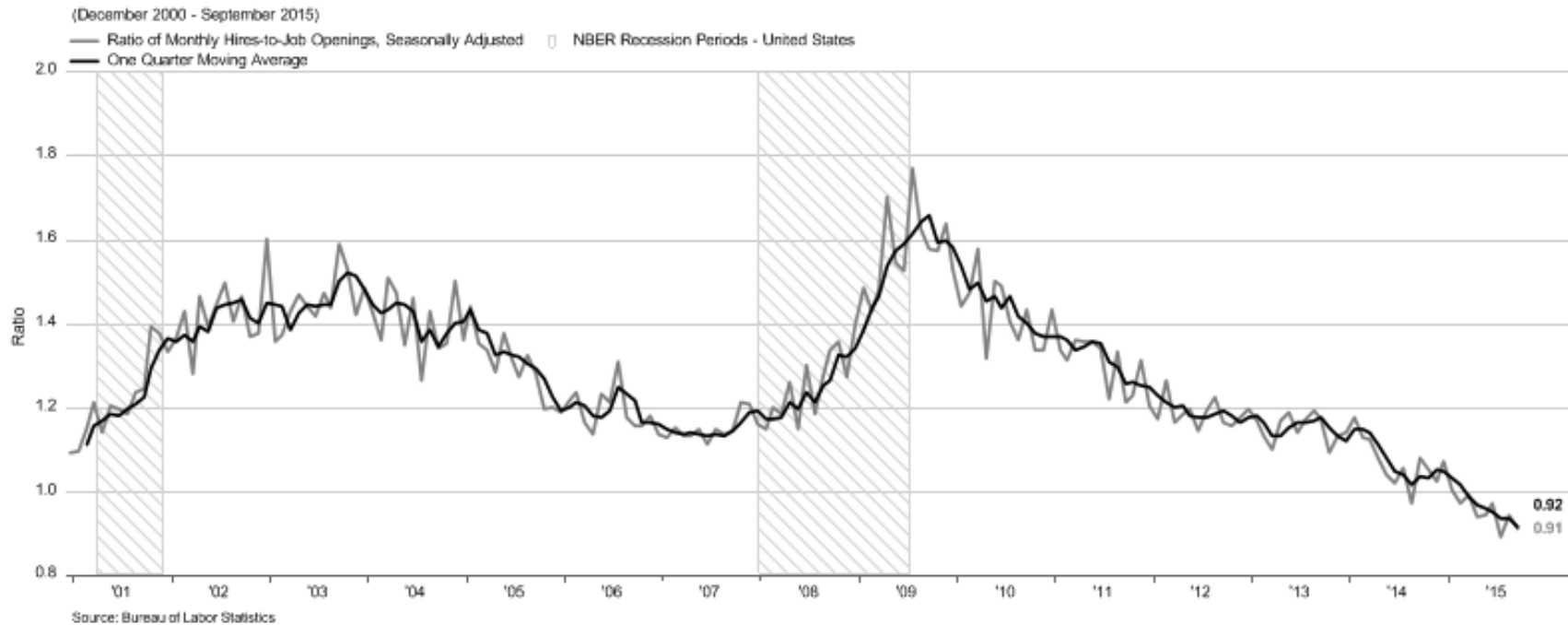
## Pace of Employment Growth



# Labor Demand

- The ratio of monthly hires-to-job openings is near 1.0 – a critical ratio. A ratio below 1.0 indicates there are a greater number of job openings than the number of people hired last month. A ratio persistently near or below 1.0 is an indication of a tight labor market.

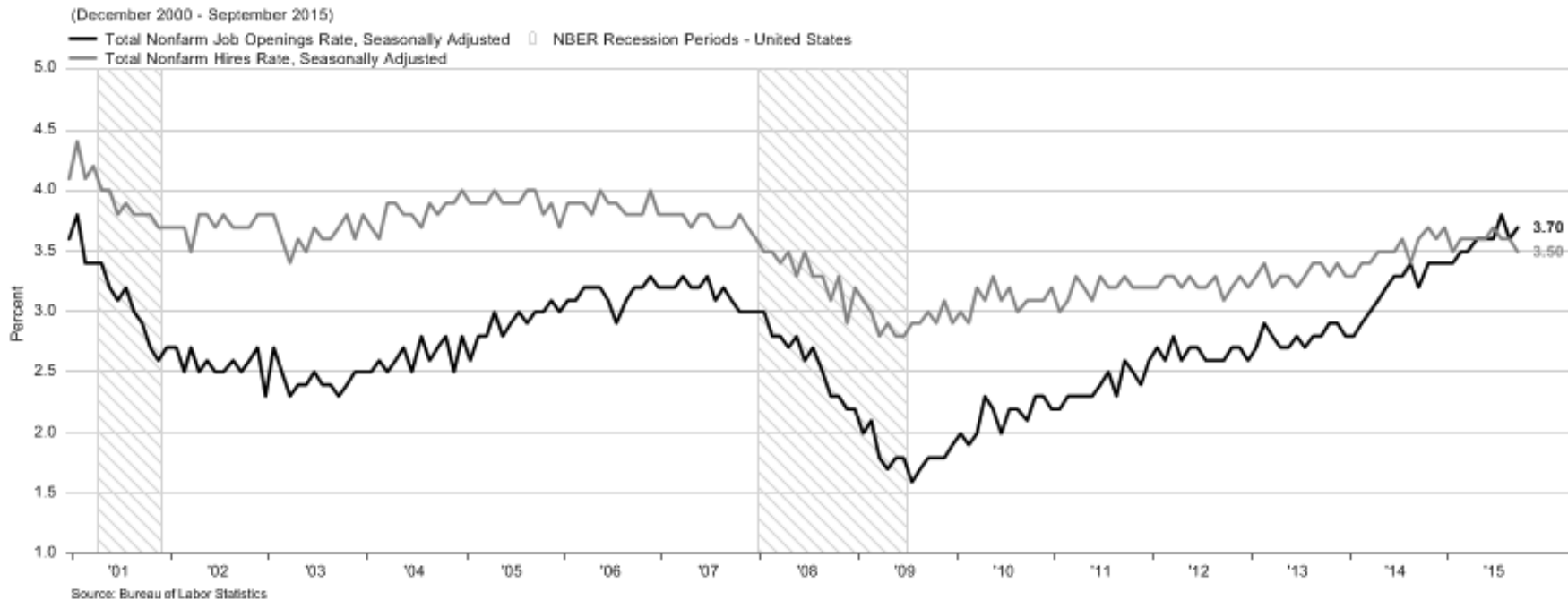
## Labor Demand



# Labor Demand

- We observe that the rate of vacancies (job openings) exceeded the past cycle high. This suggests that the quantity of labor demanded is high today, or at least at a level consistent with later-stage economic expansion.
- The rate of hires is also recovering, though at a slower pace, possibly held back by a mismatch of skills. If that is the case, then employers may need to compete for employees who have the skills they demand.

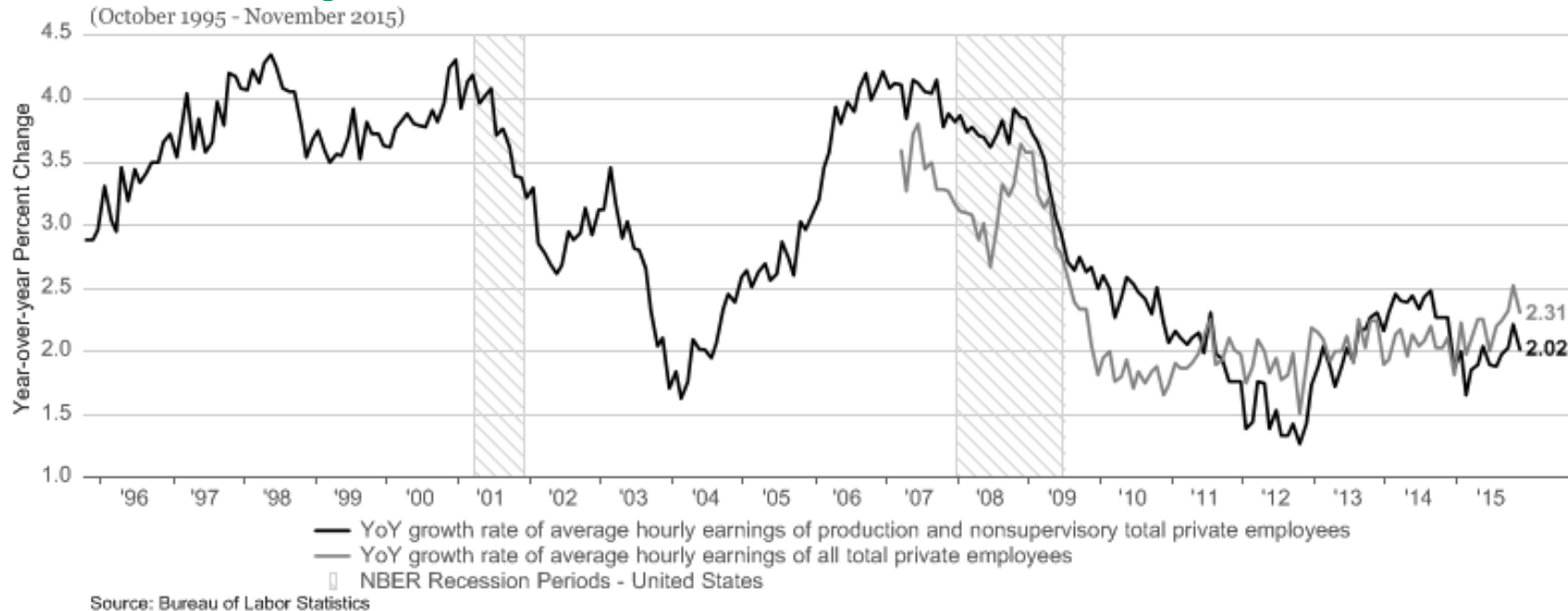
## Labor Demand



# Wages: The Price of Labor

- Since wages are the price of labor, we ought to monitor the growth rate of wages in order to determine how tight the labor market is.
- For production and nonsupervisory workers, the pace of wage growth has increased in recent months, though this is starting from a muted pace.
- For all private employees, wages have continued to accelerate through most of 2015.
- The risk with this indicator is that it is backward looking, and tells us little about the current state of labor supply and demand.

## Growth Rate of Wages

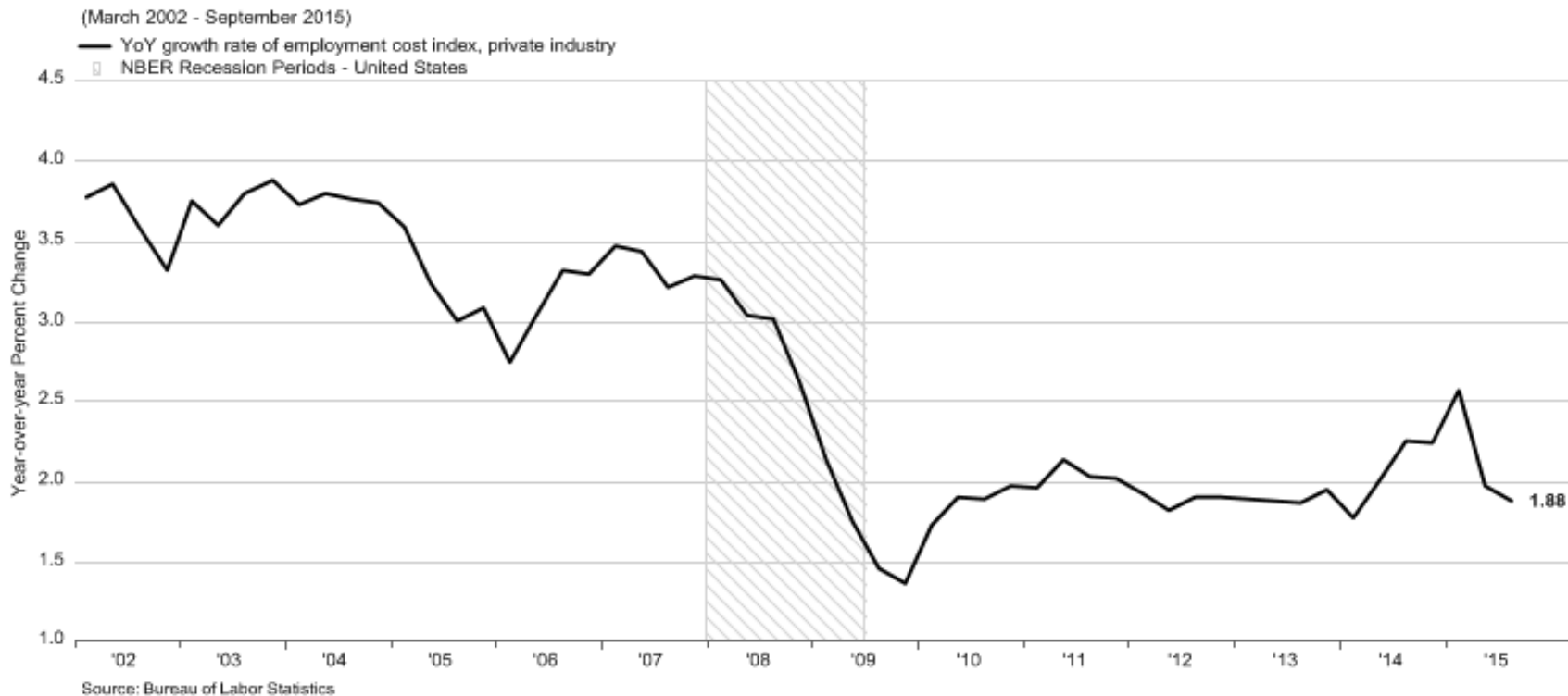


# A More Comprehensive Measure of Labor Cost



- While this data does not resolve the problem of backward looking data, it does provide a more holistic portrait of the rate of change in the cost of labor.
- Here we see that the year-over-year percent change in the employment cost index for all private industry employees fell notably in the second quarter of 2015 and remained subdued in the third quarter. This measure of labor costs includes wages, salary accruals, and benefits.

## Employment Cost Index



# Rate of Core Inflation

- This is a monitoring point of a second order effect of a tight labor market. Namely, should we observe acceleration in the rate of wage growth, it is likely to lead to inflationary pressures in the broader economy.
- Monitoring core inflation is salient. Depicted here is the Dallas Fed's trimmed mean PCE inflation rate. At present this indicator shows little hint of inflationary pressures today.

## Trimmed Mean PCE Inflation Rate



Source: Federal Reserve Bank of Dallas

## IMPORTANT INFORMATION

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