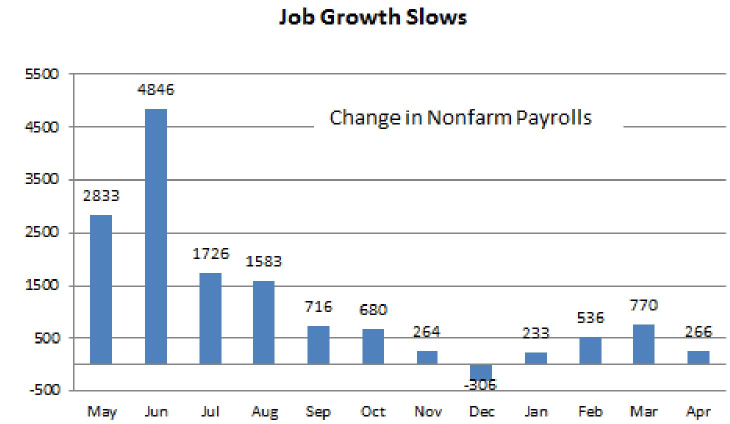
WEEKLY ECONOMIC COMMENTARY

Where are the Workers?

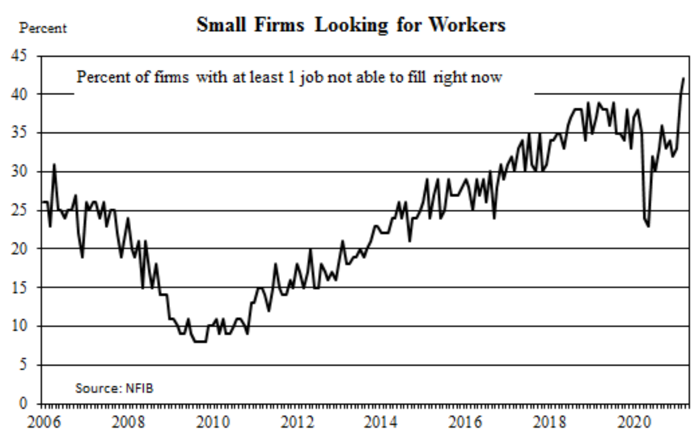
A month ago, when the Labor Department reported an outsized increase of nearly 1 million jobs in March, Fed Chair Powell was barraged with questions as to whether it was nearing the time to tap on the monetary brakes. Powell responded in the negative, noting that it would take more than "one great report" to absorb the considerable slack that still remained in the labor force. Despite growing unease in some quarters with his call for patience, the Fed chair has to feel somewhat vindicated following this Friday's jobs report for April. It turns out that "great report" was not so great after all, as the March increase was revised down from 916 thousand to 770 thousand. More to the point, the April report is now being dubbed "the great miss" as the 266 thousand increase in payrolls came in woefully below the consensus forecast of a 1 million gain. That 844 thousand shortfall is one of the largest downside misses ever.

Likewise, the Biden administration may also share in that sense of vindication. Opponents of its efforts to pump another $4 trillion of fiscal stimulus into the economy argue that such aggressive Federal spending is overkill since the economy and particularly the job market is already galloping ahead at full speed. That argument also looks less compelling in the face of Friday's jobs report. Not only did the overall increase come in well below expectations, but it was highly concentrated in the leisure and hospitality sector, which generated 331 thousand jobs thanks to the ongoing lifting of pandemic restrictions and warmer weather. The manufacturing, retail, temporary help, transportation, and warehousing sectors all suffered job losses, including the elimination of 77 thousand courier and messenger jobs. The other headline number, the unemployment rate, also ticked up to 6.1 percent from 6.0 percent.



To be sure, we caution against placing too much emphasis on one monthly jobs report that deviated from expectations, notwithstanding the enormity of the miss. This pandemic cycle underpinned by repeated shutdowns and re-openings has generated enormous shifts in broad swaths of the economy, leading to distortions in data reporting that could produce misleading results. The net change in payrolls, for example, is the product of historically massive flows into and out of the labor market that the seasonal factors may not be able to adjust properly. The 266 thousand increase in nonfarm payrolls last month represents the proverbial duck in calm waters that obscures frantic churning going on underneath. To gain a better understanding of the trend, it's prudent to wait for the churning to subside, something that will take at least several more months of monitoring.

That said, the April report will undoubtedly raise questions about whether the disappointing gain in jobs results from unexpected weakness in demand for workers or a shortage in the supply of labor. The latter has gained increasing attention in recent months based on anecdotal reports from various sources, most notably small businesses that appear to be struggling mightily to fill open positions. Their problem was strikingly illustrated in the latest NFIB survey of small businesses, which showed that the share of firms with unfilled positions surged to the highest level on record in March. To the scarcity advocates, this suggests that the weaker-than-expected jobs increase last month was more a supply than a demand issue.

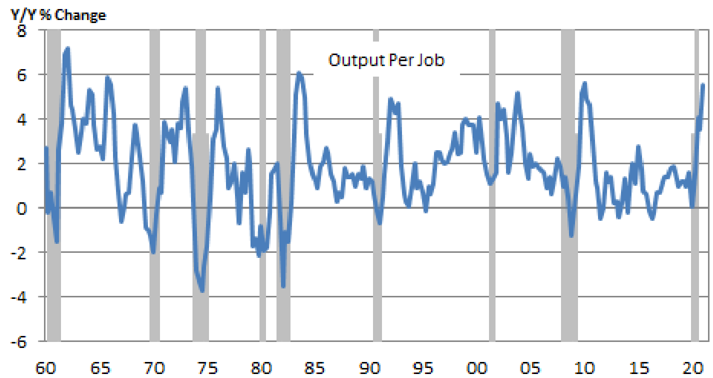


Clearly, there is an element of truth to this argument, as several factors are restraining the supply of workers. Like the patchwork reopening of the broader economy, the reopening of schools is following an uneven path. Many are moving to a hybrid system, whereas some schools are open for only a few days a week. This complicates childcare for parents, particularly those with more than one child who may have to stay home while the other goes to school. As long as many parents lack childcare assistance and are tethered to their homes, they cannot search for a job.

Health concerns are also undoubtedly holding back the number of job applicants. The lingering pandemic is understandably making people feel unsafe about taking public transit to work or spending the day in close contact with other workers. Finally, enhanced unemployment benefits that make low-paying jobs less appealing may also be reducing the incentive to look for work. The $300 weekly supplement expires in three months, and many low-paid workers, seeing a strong job market unfolding, may just decide to wait it out before returning to the workforce.

While these supply restraints may well be contributing to slower job growth than otherwise, they are not likely to persist for much longer. As the health crisis continues to improve and vaccinations become more widespread, schools will reopen more fully and free up homebound parents to return to the job market. Likewise, health-related fears that are keeping people away from the job market should subside as the pandemic becomes less threatening. And while there is much debate as to whether enhanced unemployment benefits are actually discouraging the job search, their expiration in three months will make that argument moot.

Output Outpaces Jobs



However, whether the demand for workers will increase as rapidly as generally thought when these impediments are removed is an intriguing question. Keep in mind that GDP has recovered just about all of its Covid losses, whereas there are still 8.2 million fewer jobs than there were just before the pandemic hit last February. Put another way, the economy is generating as much output as before but with fewer workers. To be sure, this is not an unusual phenomenon, as output has historically outpaced the growth in jobs early in a recovery. Indeed, the productivity uplift this time is in line with past early recovery periods.

But as can also be seen, the trend abruptly downshifted in most past recoveries, as hiring quickly catches up once businesses are confident the recovery has legs. This time, the lag might be longer. We expect that GDP will grow at a double-digit pace in the second quarter, reflecting a consumer-spending boom that has already taken flight in April and should remain elevated through the summer. Meanwhile, even if nonfarm payrolls increased by 1 million in each of the next two months, the second-quarter increase would amount to less than half the expected percentage increase in output. It may well be that during the pandemic, businesses have learned to operate with a leaner workforce. Many high-profile companies, such as Google, have acknowledged that their remote workers have been much more productive than expected.

Still, the time-honored relationship between growth and jobs has not been repealed. We expect the economy to turn in the strongest growth this year since 1951 and generate a muscular pace of job creation in the process. For sure, it will not take ten years for the job market to recover all of its recession losses, as was the case following the Great Financial Crisis. We expect those losses to be recouped by the middle of next year. That's the good news. The bad news is that there is still a big hole for the labor market to climb out of before reaching the Fed's maximum and inclusive employment goal. Keep in mind that the 8.2 million shortfall in payrolls relative to the pre-pandemic level is about equal to the worst losses seen at the depth of the Great Recession.

What's more, while there were some bright spots in the April jobs report, they were more than offset by the negative ones. Of the former, the labor force participation rate did tick up to 61.7 percent from 61.5 percent in March, although it still hovers near the lowest level since the late 1970s. Another positive note is that the number of people working part-time for economic reasons plunged by 583 thousand, indicating that many of them found full-time positions. However, the negatives were more than abundant. Not only did the unemployment rate tick up 0.1 percent, at 6.1 percent, it greatly understates the slack in the labor market. When adjusted for the people that have dropped out of the labor force by choice or obligation and the lingering misclassification of workers, the unemployment rate is closer to 9 percent.

The unemployment rate for people with less than a high school diploma is 9.3 percent, and an elevated 43.1 percent of unemployed workers have been out of a job for at least six months. And if the competition for workers is as fierce as the supply shortages imply, it is not producing higher wages. Average hourly earnings are up only 0.3 percent from a year earlier, the slimmest annual increase on record.

On balance, the jobs report eased worries in the financial markets that the Fed would take away the punch bowl before the party heats up. The Dow Industrials and S&P 500 stock indexes ended the week at fresh highs, and bond yields slipped from nearby peaks, with the bellwether 10-year Treasury yield falling about six basis points on the week. At the very least, fears of a taper tantrum among bond investors were extinguished for now, as expectations the Fed would tighten sooner rather than later receded.

FINANCIAL INDICATORS				
INTEREST RATES	**May 7**	**Week Ago**	**Month Ago**	**Year Ago**
3-month Treasury bill	0.02%	0.02%	0.02%	0.12%
6-month Treasury bill	0.03	0.03	0.04	0.15
3-month LIBOR	0.16	0.18	0.19	0.56
2-year Treasury note	0.15	0.16	0.15	0.16
5-year Treasury note	0.78	0.85	0.87	0.33
10-year Treasury note	1.57	1.63	1.66	0.69
30-year Treasury bond	2.28	2.29	2.33	1.39
30-year fixed mortgage rate	2.96	2.98	3.13	3.26
15-year fixed mortgage rate	2.30	2.31	2.42	2.73
5/1-year adjustable rate	2.70	2.64	2.92	3.17
STOCK MARKET				
Dow Jones Industrial Index	34777.76	33874.85	33800.60	24331.32
S&P 500	4232.60	4181.17	4128.80	2929.8
NASDAQ	13752.34	13962.68	13900.80	9121.32
COMMODITIES				
Gold ($ per troy ounce)	1832.00	1768.80	1743.70	1704.05
Oil ($ per barrel) - Crude Futures (WTI)	64.84	63.49	59.37	23.46
ECONOMIC INDICATOR	**Latest Month/Quarter**	**Previous Month/ Quarter**	**Two-Months/ Quarters Ago**	**Average-Past Six Months/Quarters**
ISM Manufacturing Index (April)	60.7	64.7	60.8	60.5
ISM Non-Manufacturing Index (April)	62.7	63.7	55.3	59.2
Nonfarm Payrolls (April) - 000s	266	770	536	294
Unemployment Rate (April) - Percent	6.1	6.0	6.2	6.3
Participation Rate (April) - Percent	61.7	61.5	61.4	61.5
Average Hourly Earnings (April) - % chg.y/y	0.3	4.2	5.2	4.2