It’s Quitting Time: Exploring Labor Market Dynamics

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Anu Rajakumar: Labor markets are crucial part of how we see consumption in all parts of the economy. Earlier this year, we saw the record level impact of the Great Resignation or the Big Quit, where the U.S. Bureau of Labor statistics reported that 4.3 million Americans that left the workforce for a variety of reasons, predominantly fueled by the post pandemic economy. In today's conversation, we'll discuss the key factors that led workers to leave their jobs, what is keeping them out of the workforce, and what might bring the people back. My name is Anu Rajakumar and joining me today is Robert Dishner, Senior Portfolio Manager in Multisector Fixed Income here at Neuberger Berman, who's going to shed light on a topic that has had a profound effect on our economy and society. Rob, thanks so much for coming today on the Disruptive Forces podcast.

Robert Dishner: Thanks. Great to be here. I appreciate you having me.

Anu: Now, Rob, this is an extremely important topic right now, but before we get to the meat of it, let's maybe take a step back to Economics 101. Remind us of the basics about labor supply; and help us gain a better understanding of what this Big Quit dynamic really means.

Rob: Sure. So it's, it really breaks itself down into two broad categories in the adult-age population – those that are in the labor force and those that are not in the labor force – and from there we can break it down further. So when we talk about the labor force, that's when we talk about who's employed and who is unemployed. And then there's a large portion of the, adult-age population, approximately 100 million people, that are not in the labor force. So when we do things like calculate the unemployment rate, that's only based on the labor force. So when we think about a supply-demand dynamic for labor, there are two pools to choose from. The first is the unemployed persons, as well as those folks not in the labor force. So those are the people we need to be able to attract back into the labor force, really, is these two categories, and the problem with that right now – and if you think about it in these terms.

Since February 2020, pre-pandemic, the number of unemployed people has been reduced by 4.7 million. However, the number of unemployed people has only increased by 1.7 million. So the reason why those numbers aren't the same is because 3 million people have left the workforce, so as we think about the pulling people back to work, we can draw from the 1.7 unemployed, but really we'd want to draw from this, this pool of labor which is not in the workforce.

And the issue with that, really, has been one of demographics. The over-55 group, since February 2020, has actually increased by 3 million people. The prime age working group, not in the labor force, has increased by 1 million people. So there's just a lot of people that are not in the workforce for various reasons, which, which we'll get into, but that's, that's the dynamic that we are facing, which, right now, and if –and, and just to put a finer point on the unemployment dynamic, the number of open jobs exceeds the number of unemployed people by 2.7 million. Now, this was a fairly uncommon occurrence. Pre-pandemic, that number was over a million, so we did have a little bit of a skills mismatch then, but it's only been exacerbated since then, since then.

Anu: Great. That's a very helpful primer. So I guess the question on everyone's mind is, you know, why aren't those people going back to work, and, you know, why is there this big mismatch in the numbers. You know, a lot has been said about the hesitation because of pandemic-related risks and lack of affordable childcare, etc. But, Rob, what are the main factors really at play here, and what are some of the things that aren't been talked about?

Rob: Yeah. No, absolutely. Two, two great questions. So one of the things that I think is very important that I think it gets misunderstood and this is, is that, in a typical recession, people would obviously lose their jobs, like we've had in this recession, but they would also deplete their savings. There would be other economic hardships that people would face. And in this scenario, effectively, the government underwrote aggregate demand, and what they said is, your savings are not going to change, and we are going to give you income to support, um, to support yourself during this interim period. So that's a huge dynamic, and so when, obviously when you come out of the recession, people are eager to work. They don't have savings,

they don't have incomes, whereas in this scenario, people did have savings, or they did have incomes where they, they may not be in a rush to go back to a job they may or may not like.

The other piece of it is this age issue that I spoke about before, and if we think about it in these terms, after the great financial crisis, that over-55 group it was about 31 percent of the population or 73 million people, whereas in February 2020, that number was 96 million, or 37 percent of the population. So we had a large aging of the population between now and then, and a couple things happened between the financial crisis and today. First of all, if you owned a home, you went from being flat or underwater on a mortgage to likely above, having equity in your home. If you had a 401(k) or other investments in the stock market, you've recovered your losses from the great financial crisis, plus some. And the third is really, what's the incentive to go back to work? Why go back to a job that you didn't necessarily want to have, in this environment?

So those types of things are really probably what's keeping people home at this point in time.

Anu: Yeah, I'm sure. I think it's important to distinguish, you know, that, you mentioned the government has been underwriting the demand in the most recent crisis, which is a differentiation from the global financial crisis, right? 2008 – 2009, it was a totally different situation, where folks did have to deplete their savings.

Rob: 100 percent, and one of the things that we think might result in some return to the workforce next year is as those savings are depleted and we could see that next year, particularly, you know, as we move into the second quarter of next year, that may change. But again, given the supply-demand dynamics of demand for labor relative to supply of labor and relative to skills mismatch, we continue to believe that this will continue to put pressure on wages, particularly if there are regional differences, we need to have people relocate, as well as skills, as people get retrained for different jobs.

Anu: Absolutely. You know, Rob, you just mentioned wages, which is going to be my next question. You know, what are employers doing about this, and how do you see wages changing? You know, is there going to be continued upward pressure on wages, and if that's the case, can companies afford it?

Rob: Right. So there's a lot in there, and I think this goes back to the point you made at the outset, which is the great resignation. And it's fairly interesting because there's two dynamics at play here is, what do you do for existing employees, or what are you doing to recruit employees?

And so, for example, the latest Atlanta Fed data, and they do some interesting work on wages, says that job switchers saw a 5.1 percent increase in wages, whereas job stayers received a 3.7 percent increase in wages. So there's a big incentive to switch jobs at this point in time. And what's interesting – because one of the things we've been talking about is– what's your retention policy? And so those numbers I just gave you, the job switcher is actually down from 5.4 percent in September, and the job stare is up from 3.5 percent in September. And it was, it was interesting, because the other dynamic is, because people are short-staffed, those who are at these locations, particularly at leisure and hospitality locations, you're seeing greater pressure to retain these employees. And so, that's going to result in, price increases. For example, Chipotle raised prices over the summer, citing increased wages. how are they going to retain people? What programs are you going to put in place to retain people?

And so that's an interesting dynamic to us, which is, what employers are going to be able to pass through, if they can, wage increases, and those that are not? And one of the things that we've been talking about with our credit teams, and I'm sure people with their equity teams is– what industries are going to be able to pass price, and what industries are not going to be able to pass full price through? And whether that's supermarkets or autos or apparel or other sectors of the economy, it really forces a number of us analysts to reassess what sectors, what companies we are investing in based upon this inflationary dynamic.

Anu: Yep, sure, and maybe if I just highlight, you know, certainly in dining out and in the quick service, you know, they are facing both, like, labor shortages and the increased, input costs of food as well, right? That's another crunch for a lot of restaurants and other, you know, hospitality type of folks.

Rob: 100 percent. And the interesting dynamic there – so if we look at the latest CPI report, for example, dining out is a component of the CPI, and in particular quick service restaurants, which would be your fast-food restaurants, those prices are up 7 percent year on year, and that's a combination of food and labor costs. And what's interesting is that, you know, the Bureau of Labor Statistics divides CPI into core and non-core, and they put food and energy as non-core, and then the rest is obviously core but within food they include dining out, whereas the Fed prefers the PCE measure or the personal consumption expenditure

measure, and they again use a core and non-core, however, in their core, they include dining out. So if we are seeing further inflation pressures from dining out, how does that potentially influence Fed policy going forward? They would not include things like food at home or, or energy as well, but that is an interesting twist as some of these dining out locations get squeezed from higher wages as well as higher input costs from their raw materials.

Anu: Thanks very much for that, Rob. Now, one of the factors that maybe isn't being spoken about so broadly is the effect of cryptocurrency and meme stocks. How much is that keeping folks away from going back to the workforce?

Rob: So it's a great question and one that we believe in, although it's difficult to quantify. I mean, for example, you have the Anti-work Reddit, which is one of the fastest growing Reddit boards, which was obviously the source of a lot of the meme stocks. But whether it's crypto or meme stocks or other things that are potentially generating incomes for people it's a different lifestyle.

To a certain extent, it's a little bit like the SOES bandits of the late 1990s. For those not familiar with smaller entry, which was the rise of a lot of the NASDAQ and those type things in the, that led to the dotcom bust. But absolutely, one would be, I think foolish not to consider that as part of the equation, and I actually spent a fair amount of time on looking at some of the stuff on the anti-work, and you sort of wonder how much of it is just sort of false or, true. But a lot of it, whether we've seen the strikes, for example, that just got resolved at John Deere or otherwise, you can really see that this demand for, better working and better wages is real, and, and anyone who is staying home due to crypto trading or, or meme stock trading, you're setting the marginal rate higher for everyone else, because that's one less person the workforce. And so, as a result, probably puts pressure on wages.

Anu: Yep. Great. Thanks. Very interesting. Now, let's look outside of the U.S. for a moment. Are you seeing the same sluggishness when it comes to the workforce outside of the U.S., or are you seeing similar factors affecting the return of workers around the world?

Rob: So it's a little bit of a different story, and it really goes to the structure of how governments supported economies during the pandemic. And part of it was that underwriting of aggregate demand that the U.S. did, whereas Europe, for example, used more of a guarantee program. So, they never had the big spike in unemployment – or they had an increase in unemployment, but not to the same extent as the U.S., and their unemployment’s recovered.

However, they're not seeing the same type of wage growth, per se, as the US, and part of it has to go both to the structure of the economy as well as some of the demand factors. So European economies tend to be a bit more export oriented, whereas the US is much more services oriented. So from that perspective, it's a little bit of a different issue, but really goes to the point of the difference between guarantees, which kept people employed and receiving paycheck, as opposed to the US, which supported people, who unfortunately got let go, and obviously a large demand to bring them back.

Anu: Great. Thanks very much. So as we wrap up here, Rob, I just want to get your thoughts on outlook on the labor market going forward, and just a few key takeaways that our listeners should walk away with.

Rob: Sure. So I think there's a couple things here that, that we have to realize, is that demand is higher than supply of workers right now, and that, that demand could persist for a period of time. Savings are back to pre-pandemic levels, so do we see employees in this “not in the workforce, don't want a job right now” return to the workforce? Although we're a bit suspect, given that a large portion of those were in the over-55 crowd. So we need to sort of see how the 16- to 24-year-old cohort moves into the workforce. And the other piece of it, particularly on this employee retention and, and cost increases and what that means for prices going forward is, inflation is likely to be at, at persistently high levels for a longer period of time than what people think. Now, obviously, we are in very elevated levels, but there should be an expectation that inflation is at higher levels than where we were pre-pandemic.

And the other piece of it is what this means for the Fed and Fed policy into next year. We're already seeing a number of people calling for interest rate hikes next year, potential early end to tapering. So this all sort of fits together, and one thing that we need to think about is, a higher-inflation economy obviously hurts people at the, lowest end. It's a regressive tax. But one of the unique characteristics of this recovery, which we did not see post-GFC, as you highlighted, is the wage growth at the lowest levels of average hourly earnings. So it's almost a perfect correlation, with some minor exceptions, that the lower average hourly earnings are seeing at the highest rates of wage growth. And so what we’re seeing is at these lowest levels, the highest rates of wage growth are actually exceeding inflation, whereas at the highest levels, where you might have assets or other items, they are obviously below inflation.

So one of the things that we always caution people against is treating the US economy as a monolith and that there's dynamics between these things and that we are seeing support, um, with higher wages at some of these lower levels, lower average hourly earning levels. So again, I think that's going to be a dynamic that continues to support the economy as well as consumption.

Anu: Great. Thanks so much, Rob. Now, as a bonus question that you were unprepared for today, we've been talking today a lot about jobs and the workforce. So my question for you Rob is, when you were a child, what did you want to be when you grew up? And you are not allowed to say a multisector fixed income portfolio manager.

[Laughter]

Rob: Well, you're going to laugh. Well, like most kids in the 1970s, you know, I wanted to be a professional athlete, but you're going to laugh at me, but I still have the magazine, the Newsweek magazine from the 1980s about investment banking and junk bonds and all of this, and a light went on when I was 16 or 17 years old, and I said, anyone who can work hard can get – or, I shouldn't say anyone, but, you know, anyone – if you work hard, you can do well. And that to me was something that was challenging, it was something that involved numbers, and, and it was something that I saw that there was a merit – you know, somewhat of a meritocracy to, to doing that. But, yeah, so while it may not have been a multisector fixed income manager at Neuberger Berman, it was certainly being in the financial services industry.

Anu: [Laughs] That's terrific. Thank you very much. Well, this has been a terrific conversation. Really appreciate all the facts and figures that you share today on what's a very important topic, and one that certainly is the hitting home for so many around the world. So, Rob, thanks again for joining me today.

Rob: Anytime. Thank you.

Anu: And to our listeners, if you want to read more about Rob's thoughts on this topic, you can visit the NB Blog at www.NB.com/blog. He has written a number of recent thought-provoking publications. And of course, if you liked what you've heard today on Disruptive Forces, you can subscribe to the show via Apple podcasts, Google podcasts, or Spotify, or you can visit our websites, www.NB.com/DisruptiveForces for previous purposes as well as more information about our firm and offerings.

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