Economic Research

Economic Insight

US labor market check-up

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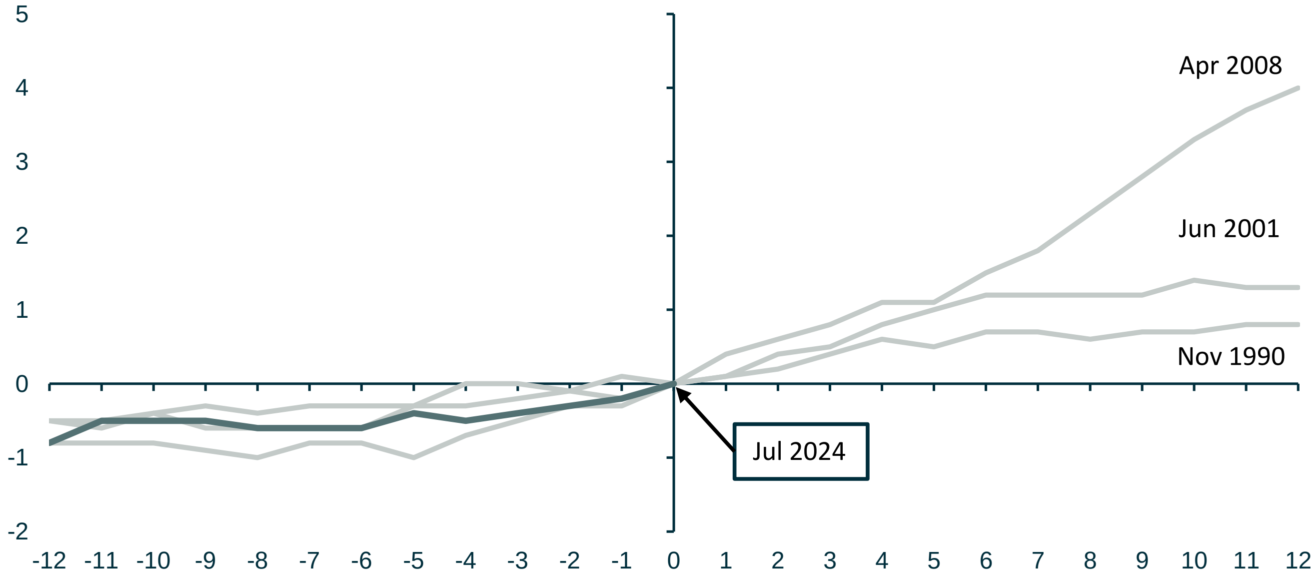
The rise in the US unemployment rate has raised concerns about a recession. However, the health of the US labor market should not be judged on the basis of one data point alone. We analyze the data across the board.

Rise in unemployment rate triggers alarm signal...

The US unemployment rate rose to 4.3% in July. This puts the three-month average 0.53 percentage points above the low of the last twelve months and triggers the critical threshold of the so-called Sahm rule; an increase in the unemployment rate of at least 0.5 points has always been associated with a recession in recent decades.

In fact, the development of the unemployment rate is similar to the path in the last recessions. In the months before the Sahm rule was triggered, a gradual and moderate rise in the rate was always observed in the last economic cycles – just as is currently the case (Chart 1). Thereafter, the rise in the rate has usually accelerated. In 2001 and 2008, for example, the unemployment rate was around 1/2 percentage point lower twelve months before the Sahm rule was triggered. Twelve months later, it was 4 percentage points higher in the 2008/09 crisis and 1.3 percentage points higher in 2001/02.

Chart 1 - In the run-up to recessions, unemployment rate tends to rise moderately
Changes of the unemployment rate in the months before and after the Sahm rule has been triggered, in percentage points. July 2024: month 0 in the current cycle



Source: BLS, St. Louis Fed, Commerzbank Research

We have described **elsewhere** that there are currently some doubts about the signal quality of the Sahm rule – which were highlighted not least by the inventor of this rule, Claudia Sahm. A large part of the rise in the unemployment rate is probably due to the fact that many new people are entering the labor market, driven not least by the enormous acceleration in immigration. Although this increases the unemployment rate, at least temporarily, it is not a sign of business-related weak demand for labor.

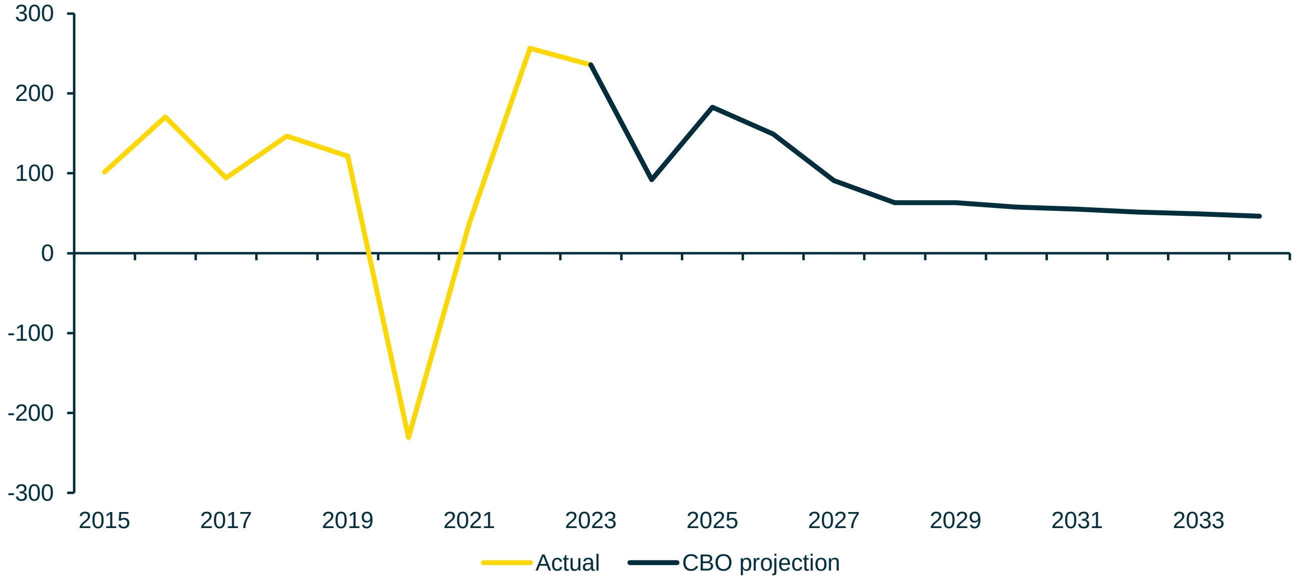
... but the decline in job growth was to be expected

In addition to the rise in the unemployment rate, the latest labor market report delivered another disappointment. Only 114 thousand new jobs were created in July. However, it was to be expected anyway that the times of extremely high monthly job growth are over. After all, employment is 6.7 million higher than at the beginning of 2020, i.e. immediately before the outbreak of the coronavirus crisis. The enormous job losses during the crisis were quickly made up for, and the pool of workers available at short notice has been exhausted. Population growth is thus setting the basic pace of the labor market. In particular, the strong immigration of recent years has led to an average monthly increase in the labor force (people already in employment or actively seeking employment) of around 250 thousand people in 2022 and 2023. This wave is gradually coming to an end. The Congressional Budget Office (CBO) assumes an average monthly increase of around 140 thousand for the years 2024 to 2026 and less than 100 thousand thereafter (Chart 2).

Against this backdrop, calculations by the San Francisco Fed suggest that monthly job growth of just over 100 thousand towards the end of 2025 will be sufficient to keep the unemployment rate stable.[1] This "speed limit" thus differs only slightly from the estimates made before the coronavirus pandemic.

Chart 2 - Speed limit on the labor market is falling again

Labor force, average monthly change in thousands



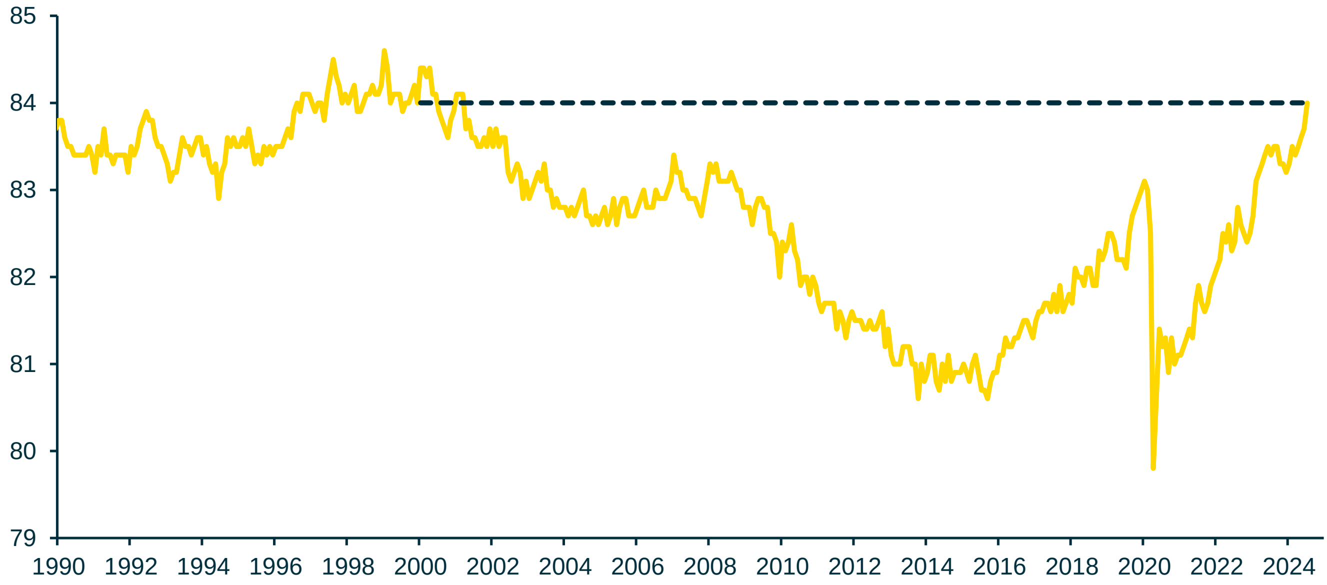
Source: CBO, S&P Global, Commerzbank Research

.. and what about the participation rate?

The speed limit in the labor market can be significantly exceeded, at least temporarily, if participation rates increase, i.e. if a higher percentage of the population than usual participates in the workforce. The participation rate currently stands at 62.7%, a good half a percentage point lower than immediately before the pandemic (one percent of the civilian population over the age of 16 currently corresponds to around 2.7 million people). However, a greater decline would have been expected due to aging. The participation rate for the 25 to 54 age group provides a clearer picture. They are in the middle of their working lives; the participation rate therefore does not need to be adjusted for aging effects (or for education, which plays a major role for the 16 to 24 age groups). The participation rate of 25-54 year olds has recently risen to 84% and is therefore not far below the record high reached at the turn of the millennium (Chart 3). On the one hand, this indicates a robust labor market – and on the other, that no further significant increase is to be expected that would significantly push up the speed limit in the labor market.

Chart 3 - "Prime group" participation has risen significantly

Labor force participation rate of 25 - 54 year old persons, in % of civilian population of this age group, monthly data



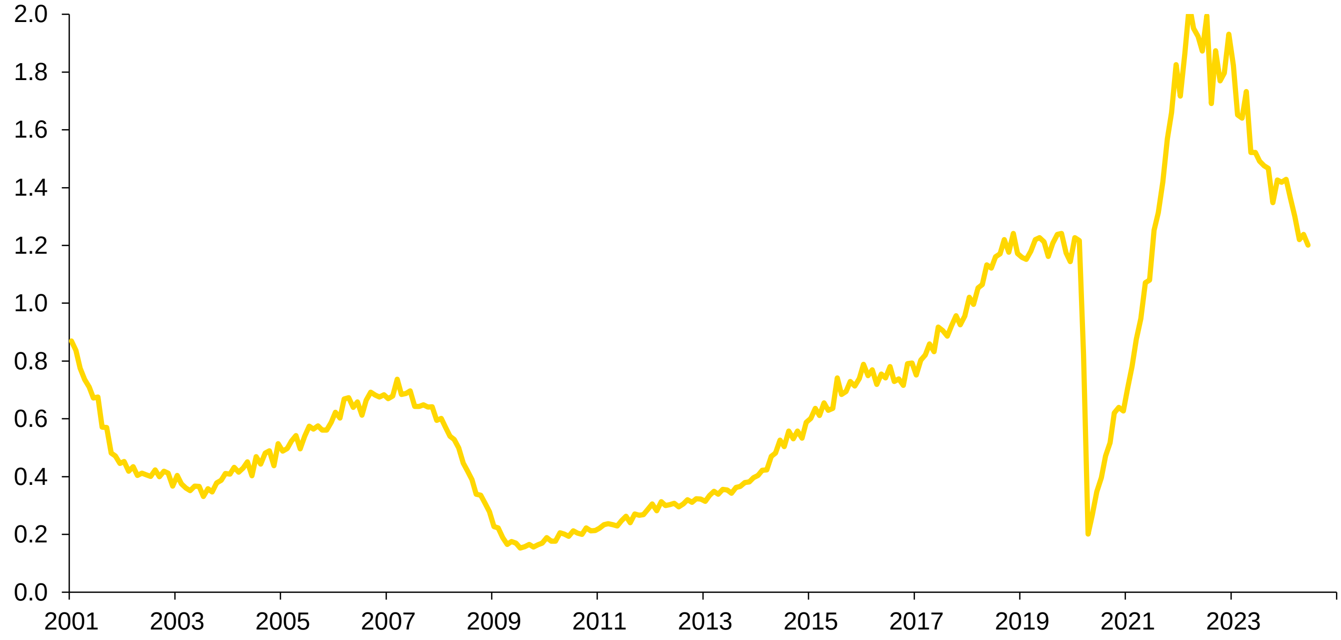
Source: BLS, S&P Global, Commerzbank Research

Job openings: back to the 2019 levels

The slowdown in the US labor market was first visible in job vacancies. While there were two vacancies for every unemployed person in 2022, this figure has now fallen to just 1.2. The situation is therefore comparable to 2019; the phase of an exceptionally tight labor market is over (Chart 4).

Chart 4 - labor market not as tight anymore

job vacancies per unemployed



Source: BLS, S&P Global, Commerzbank Research

Due to the lower demand for labor, fewer employees are now quitting their jobs voluntarily. The quit rate (= percentage of employees who have initiated a voluntary separation) is now even lower than immediately before the pandemic (Chart 4).

Wages are rising more slowly due to the lower demand for labor. As quits have a lead time of one year over wage growth, wage growth is likely to weaken further (Chart 5).

Chart 5 - fewer workers quit = wage rises slow

quits (voluntary separations initiated by the employee), in % of employment, shifted to the right by 12 months. Average hourly earnings of production and non-supervisory employees, year-on-year change in %

Source: BLS, S&P Global, Commerzbank Research

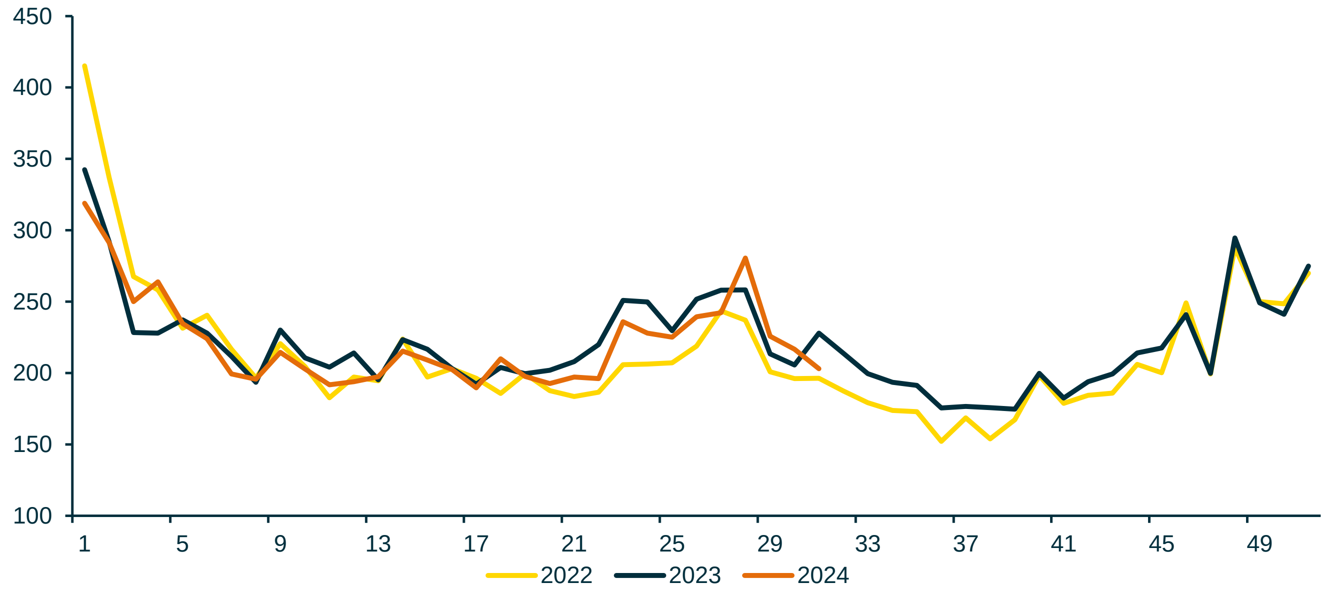
What do "real-time data" such as initial claims tell us?

The above indicators are published with a delay of one to two months. The weekly initial jobless claims, on the other hand, provide a picture of the labor market almost in real time with a delay of just one week.
Initial claims recently stood at 233 thousand, around 30 thousand higher than the low. However, they are still at a very low level; historically, they have only indicated a recession when they have risen to over 400 thousand. In addition, there are certain problems with seasonal adjustment; possibly a legacy of the upheavals surrounding the coronavirus crisis. In a non-seasonally adjusted view, initial applications are exactly at the level of the two previous years (Chart 6).

This may paint too favorable a picture. There are indications that part of the recent rise in unemployment is due to recently immigrated workers who have lost their jobs. These workers have not been paying into unemployment insurance long enough to be eligible for unemployment benefits. Initial claims for unemployment benefits therefore do not include this group of people. However, a broad downturn in the labor market would also affect domestic workers and be reflected in rising numbers of applications for unemployment benefits. This is obviously not the case.

Chart 6 - Initial claims for unemployment-related benefits: stable at a low level

Initial claims for unemployment-related benefits, not seasonally adjusted, calendar weeks 2022 - 2024, in thousands



Source: DOL, S&P Global, Commerzbank Research

Baseline scenario: no recession

The labor market indicators currently point to a normalization of the overheated labor market – a normalization that the Fed wanted to bring about with its more restrictive monetary policy – rather than a crisis. For this to remain the case, however, the figures should no longer deteriorate significantly. As Fed Chairman Powell said, he "would not like to see material further cooling in the labor market".

The slower pace of the US economy has certainly increased the risk of a recession somewhat. We currently estimate the probability of this at around a third. However, we still believe it is more likely that the US economy will avoid a recession and only expand at a below-trend rate for some time. Our main argument is that financing conditions have actually improved this year, as we recently **explained**.

[1] The employment component of the labor force is broader than non-farm employment, as it also includes the self-employed and farmers. However, when looking at monthly changes over the longer term (and the resulting "speed limit" on the labor market), these differences are not overly significant (back to text)

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