

Sevens Report Alpha Webinar – Making Sense of the Labor Market

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Why is the labor market so important?

“This may be the most important category for understanding the future evolution of core inflation. Because wages make up the largest cost in delivering these services, the labor market holds the key to understanding inflation in this category.”

“In the labor market, demand for workers far exceeds the supply of available workers, and nominal wages have been growing at a pace well above what would be consistent with 2 percent inflation over time.³ Thus, another condition we are looking for is the restoration of balance between supply and demand in the labor market.”

“Finally, the labor market, which is especially important for inflation in core services excluding housing, shows only tentative signs of rebalancing, and wage growth remains well above levels that would be consistent with 2 percent inflation over time.”

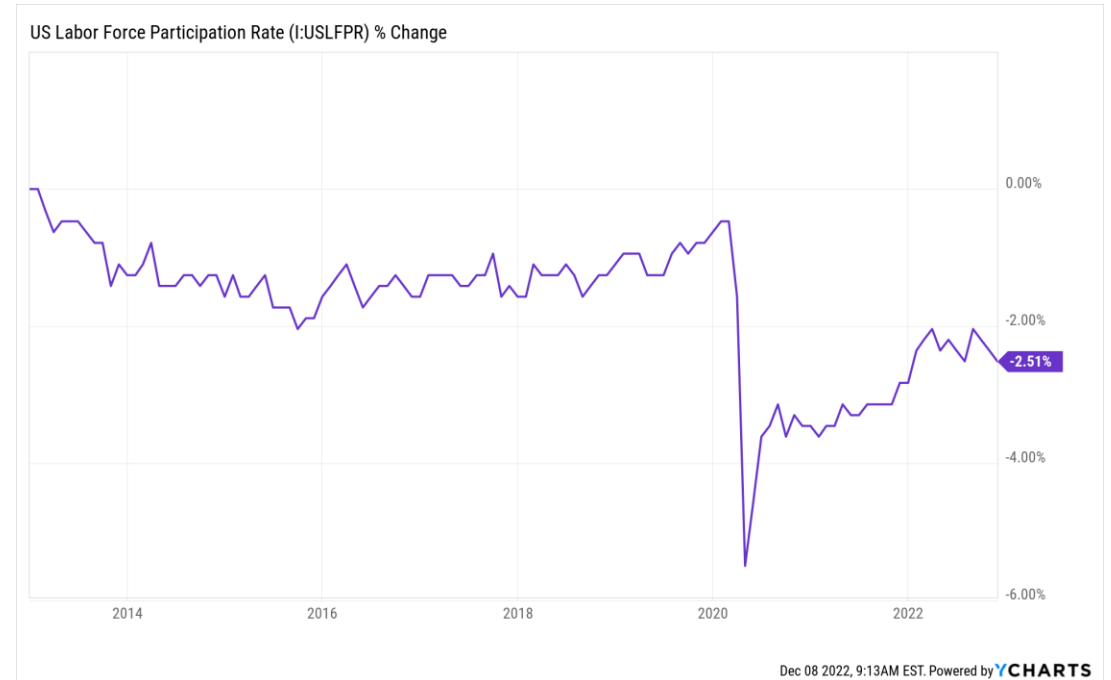
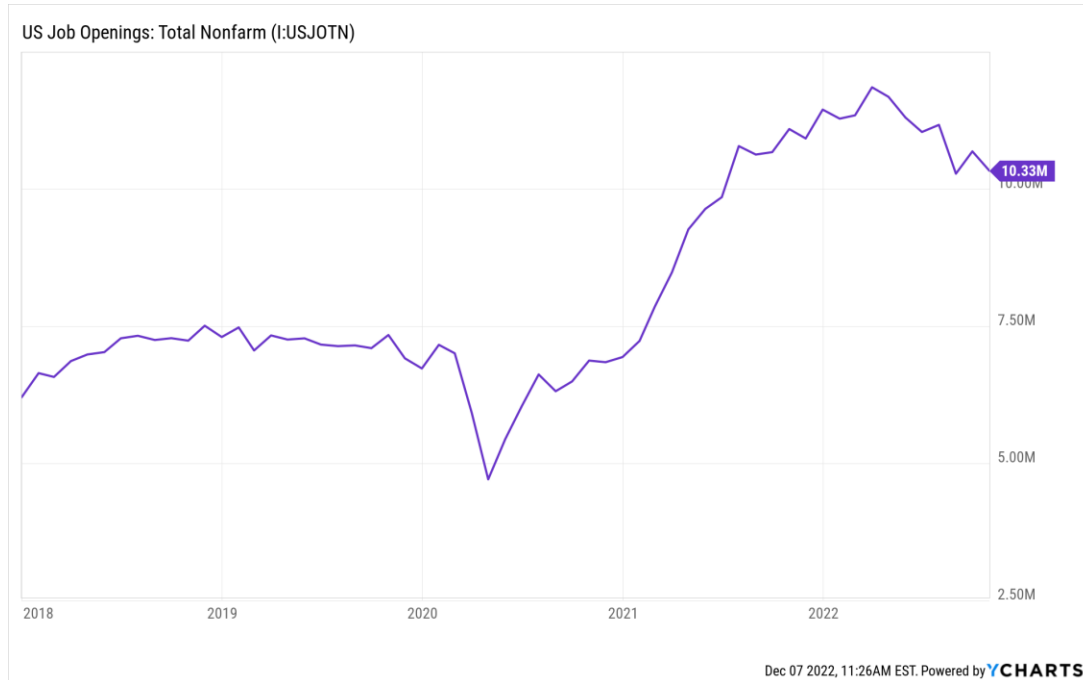
Fed Chair Powell, November 30th, 2022

Why is the labor market so important?

The crux of Powell's speech on November 30th was this:

- He broke inflation down into three parts.
 - Good inflation
 - Housing Services inflation
 - Core Services inflation.
- He rightly pointed out that prices for goods were falling rapidly and there was clear progress on bringing goods inflation down.
- He rightly pointed out that Housing Services inflation has also likely peaked and was declining, but because of the lag in reporting the data it'll stay statistically high for a while. Regardless, progress was being made.
- Finally, on Core Services Inflation, he basically said wages are the main problem, and there has been little to no progress there. Until we see that progress, the Fed can't get confident inflation is moving lower, and that means no pivot.

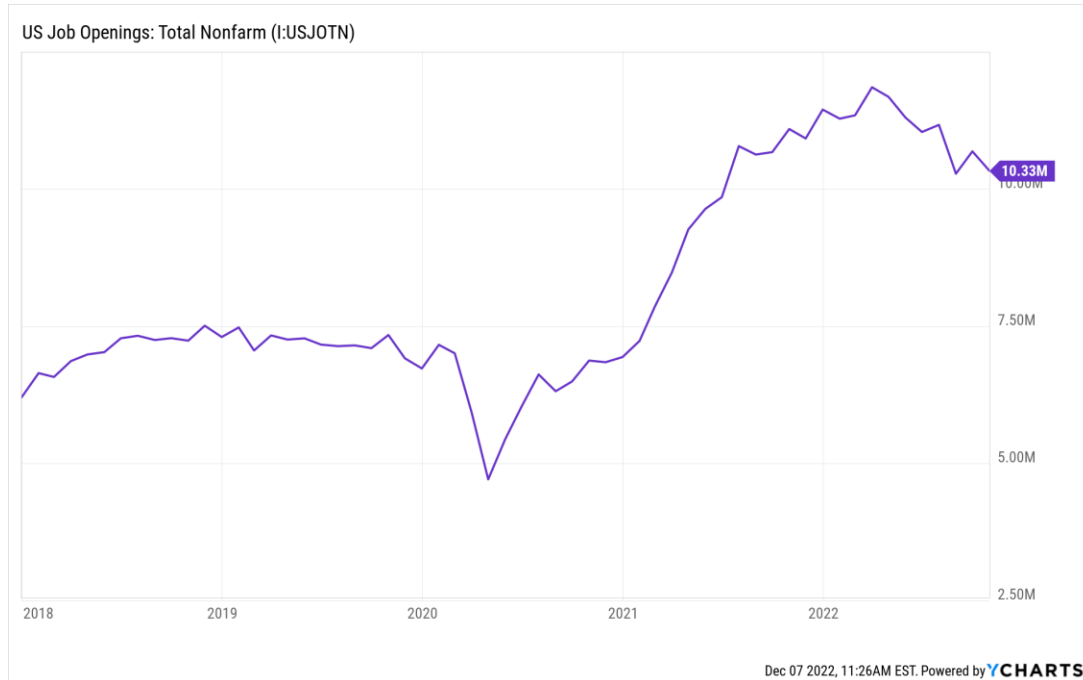
How Out of Balance Is the Labor Market? Answer: Very.



So, How Do We Know When the Labor Market Is Moving Towards Better Balance?

- Six Labor Market Indicators to Watch (In Order of Importance):
 - JOLTS
 - ISM Manufacturing Employment Index
 - ISM Services Employment Index
 - Challenger Layoffs
 - Weekly Jobless Claims
 - Monthly Employment Report

JOLTS: Job Openings & Labor Turnover Survey



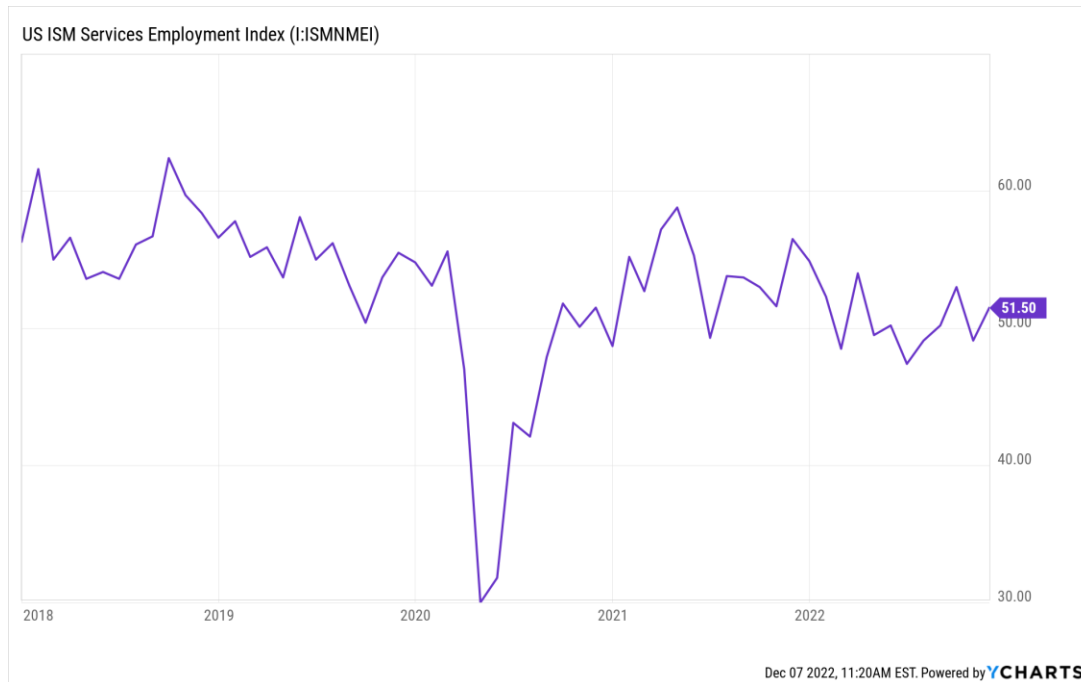
- JOLTS are a survey-based measure of job openings.
- The survey is taken by the Bureau of Labor Statistics. The sample size is 20,700 non-farm businesses from a universe of 9.4 million.
- Job openings available at the end of the month are reported.
- I have this as the “least” important labor indicator I track because concerns are rising about the validity of this data, specifically that job openings are essentially being left “perma-open” from the labor shortages of the previous year.
- **Showing balance? No!**
- **Level which implies “balance” is being restored: Between 8MM – 9MM.**

ISM Manufacturing Employment Index



- Employment is one of the sub-categories of the monthly ISM Manufacturing PMI.
- Readings below 50 imply that employment contracted (or was reduced) over the month.
- Clearly, the trend in employment in the manufacturing sector is declining, with survey 14% of survey respondents mentioning layoffs in November, while hiring freezes and attrition made up the balance of reduced employment.
- Reason this isn't as important as other labor metrics: Manufacturing is higher dependent on the U.S. dollar, so with a much stronger dollar, manufacturing has been facing headwinds all year. Additionally, it's a smaller portion of the economy.
- **Is it showing balance? Yes!**

ISM Services Employment Index



- Employment is one of the sub-categories of the monthly ISM Services PMI.
- Readings below 50 imply that employment contracted (or was reduced) over the month.
- Service sector employment has moderated but remains strong, with most survey respondents focusing on improvement in labor availability, not concerns about layoffs.
- This index is the best measure of employment in “Core Services” inflation, and it is important going forward.
- **Is it showing balance? Not yet.**
- **Level which implies “balance” is being restored: < 50 for multiple months.**

The Challenger Report



- The outplacement firm Challenger, Gray & Christmas posts a monthly tally of announced company layoffs.
- It surged in November rising to the highest level since early '21.
- However, while layoff announcements are rising, this year-to-date total is still the second lowest on record since the Report started in 1993. The only year with lower announced layoffs was 2021!
- Why this matters: It's actual job losses. Most other labor metrics are surveys of intentions – this is actual, announced layoffs.
- **Is it showing balance? Not yet.**
- **Level which implies “balance” is being restored: > 50k layoffs for multiple months.**

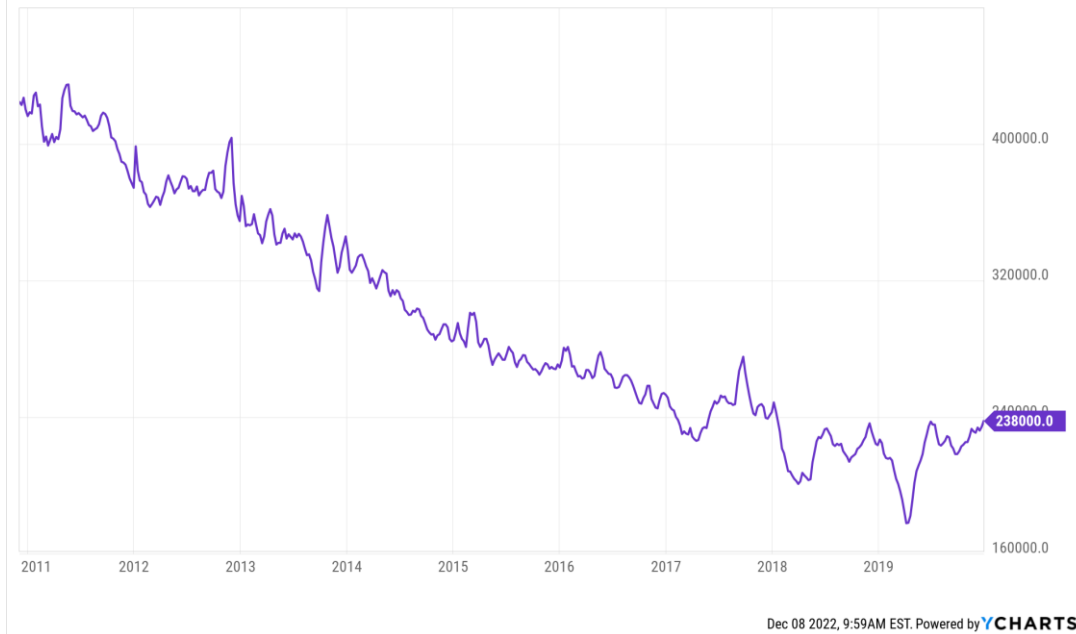
Weekly Jobless Claims

Weekly jobless claims are the most timely, real data labor market indicator out there. As such, it picks up real deterioration in the labor market first.

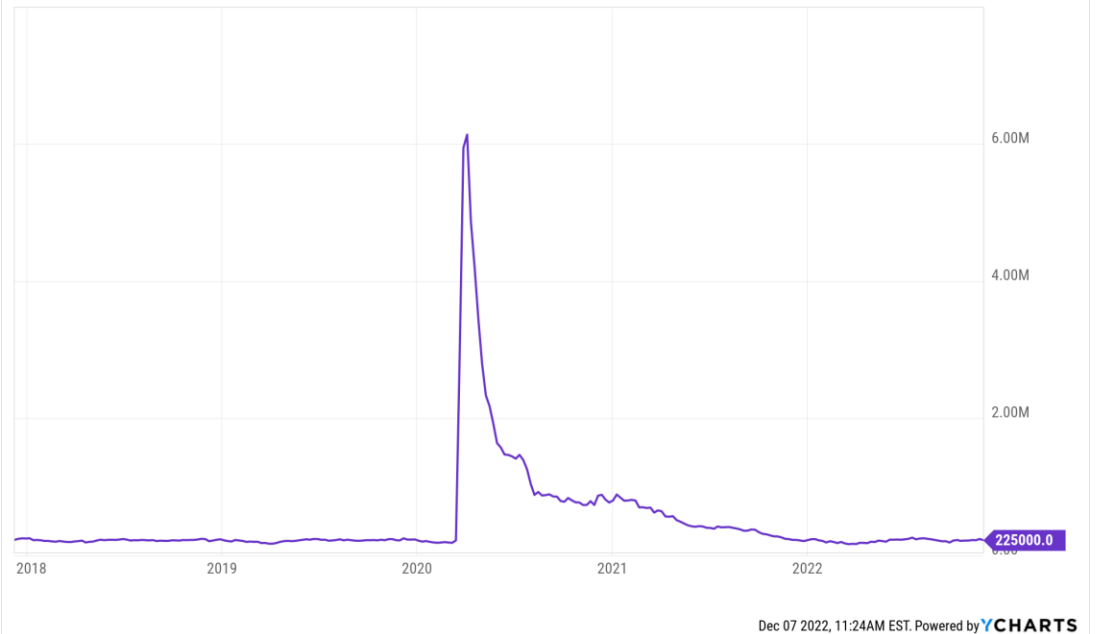
Is it showing balance? No!

Level which implies “balance” is being restored: > 300k.

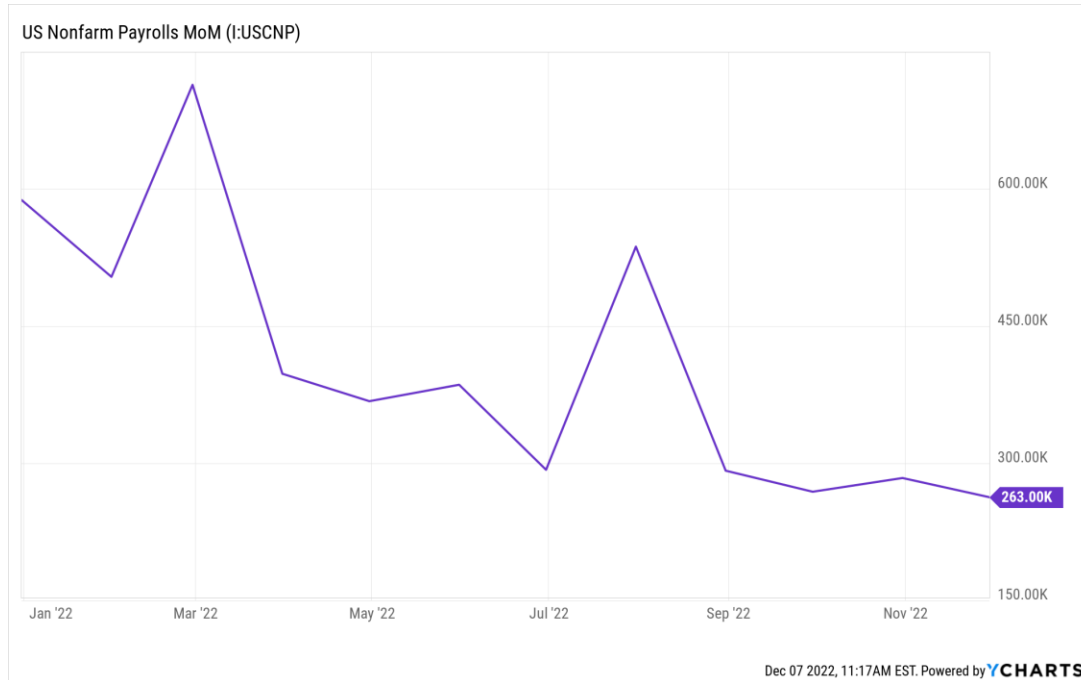
US 4-Week Moving Average of Initial Claims for Unemployment Insurance (I:US4WMAIC)



US Initial Claims for Unemployment Insurance (I:USICUI)

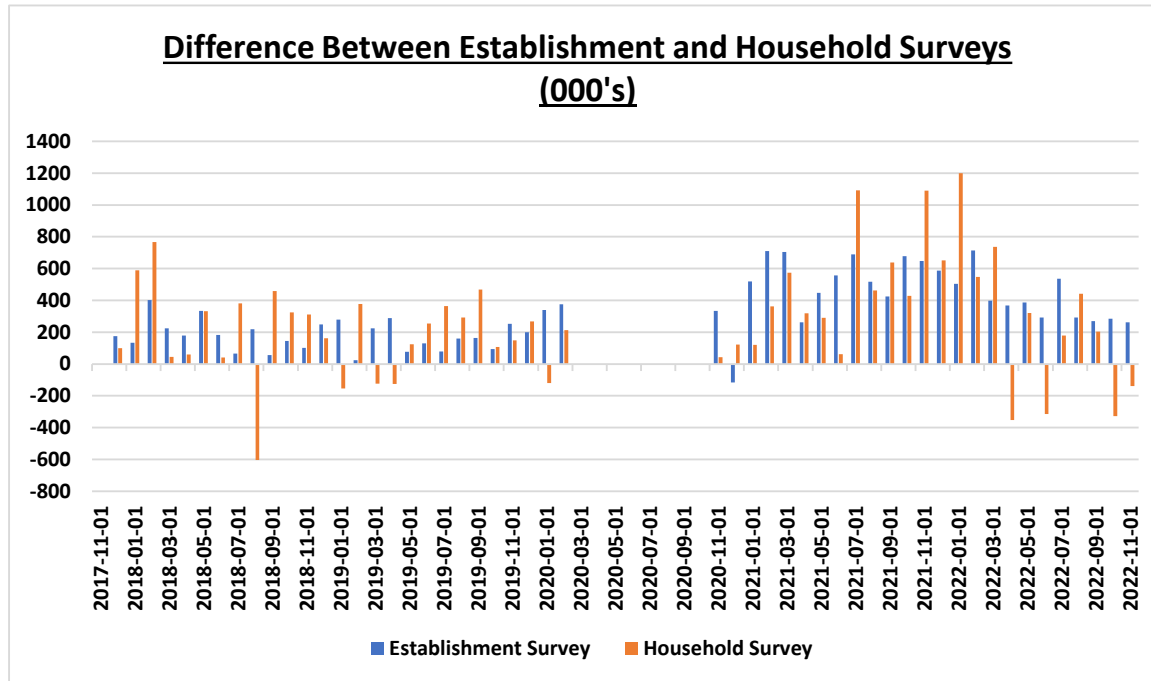


Employment Situation Report



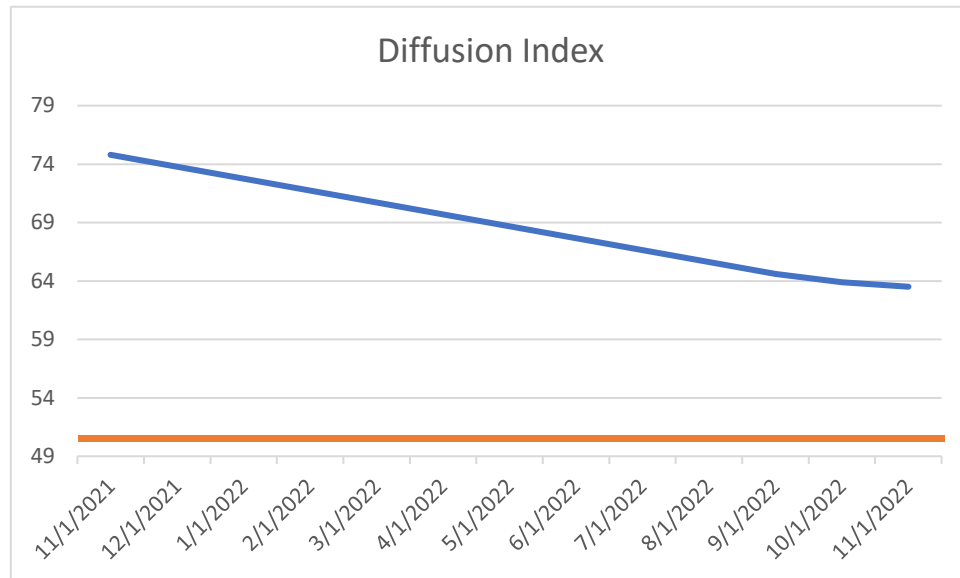
- The monthly jobs report is the most comprehensive employment report we have, and it's been strong.
- Job adds have averaged 391k for 2022, an extremely high number.
- The Unemployment Rate remains at 3.70%, historically very low.
- **Is it showing balance? No.**
- **Level which implies “balance” is being restored: < 150k job adds for multiple months.**

Employment Situation Report



- The employment survey is made up of two separate surveys:
 - The Establishment Survey (this survey's businesses to see if they added workers over the past month).
 - The Household Survey (this survey calls people to see if they are unemployed).
- Recently the surveys have diverged, with the Establishment Survey showing monthly job gains and the Household Survey showing job losses.
 - Why?
 - First, disagreement isn't irregular (chart).
 - Second, sample size:
 - Establishment Survey: 131,000 businesses (670k individual worksites)
 - Household Survey: 60,000 households.
 - Third, questions.
 - The Establishment Survey asks how many workers are added to payrolls (or removed).
 - The Household Survey asks if people in the house are unemployed. It doesn't ask *why* they are unemployed, however. Additionally, this includes ag workers, self-employed, and workers that quit or are on unpaid leave.
- Bottom line, disagreement between the two surveys is normal. But, the fact that the Household Survey has turned more negative may signal some initial broader weakness in the labor market.

Employment Leading Indicator – Diffusion Index



- The Diffusion Index is found at the bottom of the Establishment Survey, on pg. six of the Employment Situation Report.
- The Diffusion Index produces a percentage. It's calculated by taking the number of employers who say they plan to add workers over the next month and adding it to half the number of employers who are making no changes to payrolls.
- Any reading > 50 means on balance firms are still adding workers.
- Any reading < 50 means on balance firms are cutting workers.
- Current reading: 63.5.

Labor Market Overview

Indicator	Showing Balance?	Level that Implies Balance
JOLTS	No	7M – 8M
ISM Manufacturing Employment Index	Yes	
ISM Services Employment Index	No	< 50 for multiple months
Challenger Layoffs	No	> 50k layoffs for multiple months
Weekly Jobless Claims	No	> 300k
Monthly Employment Report	No	< 150k job adds
Diffusion Index	No	< 50