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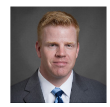
U.S. Labor Market Strength May Be Tenuous

May 2023

Asset Allocation Insights



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KEY INSIGHTS

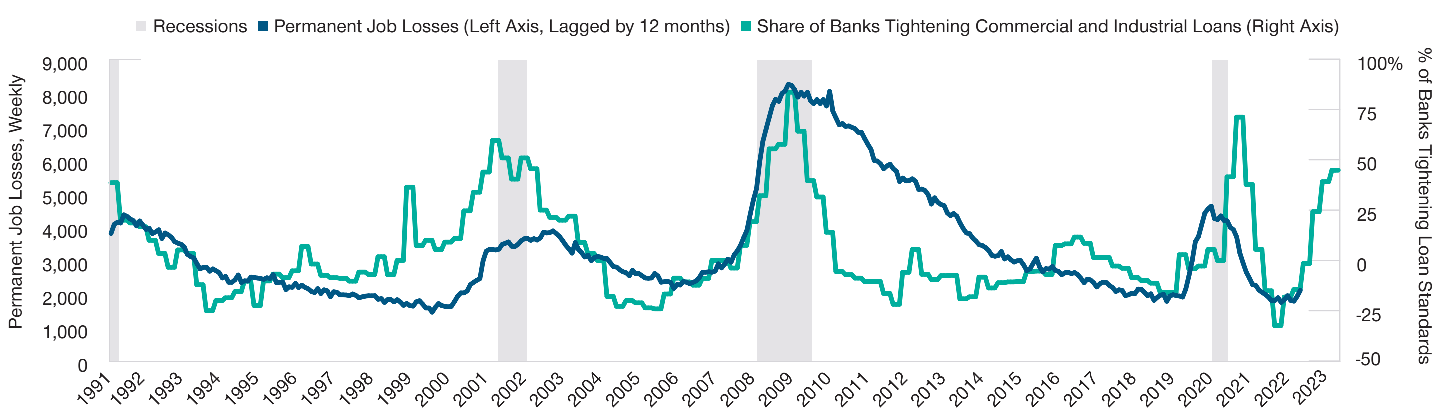
- The U.S. labor market faces headwinds amid tighter credit conditions for small businesses and declining corporate profit margins.
- We are closely monitoring forward-looking employment indicators, as historical data show that a persistent uptick in unemployment can be difficult to reverse.

The current strength in the U.S. labor market could deteriorate over the next 12 months. Tighter bank lending standards typically hurt small businesses—which account for a very large share of the U.S. employment market—and falling profit margins usually mean bad news for jobs.

In the first half of 2022, strong employment data helped to fend off a U.S. recession despite negative gross domestic product growth in the first and second quarters. While the economy has further softened over the past year, the labor market remains at a historically strong level, with unemployment at a remarkably low rate of 3.5% as of March 2023. However, emerging signs of weakness could mean that job losses are on the horizon.

Tight Credit Conditions Often Weaken Labor Market

(Fig. 1) Job losses versus tighter bank lending standards



January 1, 1991, through March 31, 2023.
Past results are not a reliable indicator of future results.
Source: Bloomberg Finance L.P.

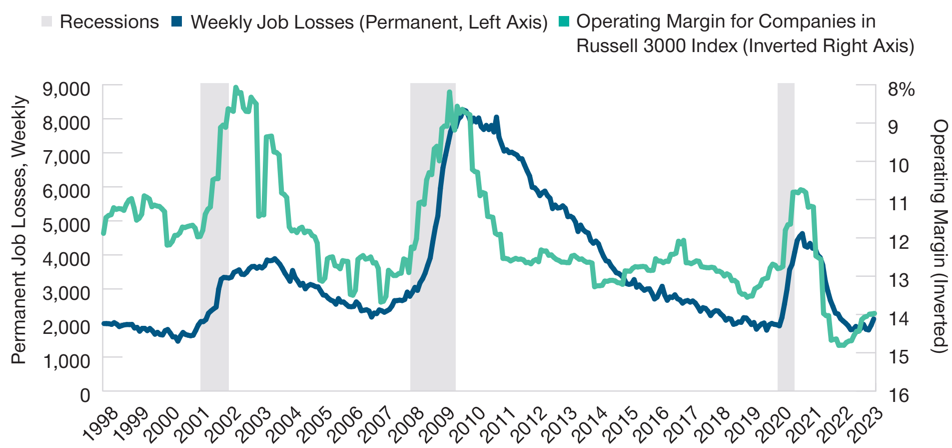
Following the recent banking woes, risk-conscious banks have been tightening lending standards to help preserve liquidity. Since small businesses often rely heavily on banks for their ongoing credit needs, tighter credit conditions could limit their operations, which would not augur well for the labor market (Figure 1). In fact, current survey data show that small businesses have moderated their hiring intentions.

Falling corporate profit margins are another concern for the labor market. With dwindling savings, consumers have become less willing to pay the higher prices that corporations charged post-pandemic to help offset surging input costs. As corporate profits decline, employers may inevitably be forced to cut costs by laying off employees (Figure 2).

Modest weakness in the labor market could help to push wage inflation back to sustainable levels, which would be positive for the economy. However, historical data show that once employment momentum turns negative, the trend is very difficult to reverse. Therefore, we are closely monitoring forward-looking employment indicators, and we remain cautious about the medium-term path for the U.S. economy.

Falling Profit Margins Typically Lead to Job Losses

(Fig. 2) Profit margins versus weekly job losses



January 1, 1998, through March 31, 2023.

Past performance is not a reliable indicator of future performance.

Sources: U.S. Bureau of Labor Statistics and the Federal Reserve Bank of Atlanta/Haver Analytics.

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