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Recruiting and labour markets

Churn, wages and employment

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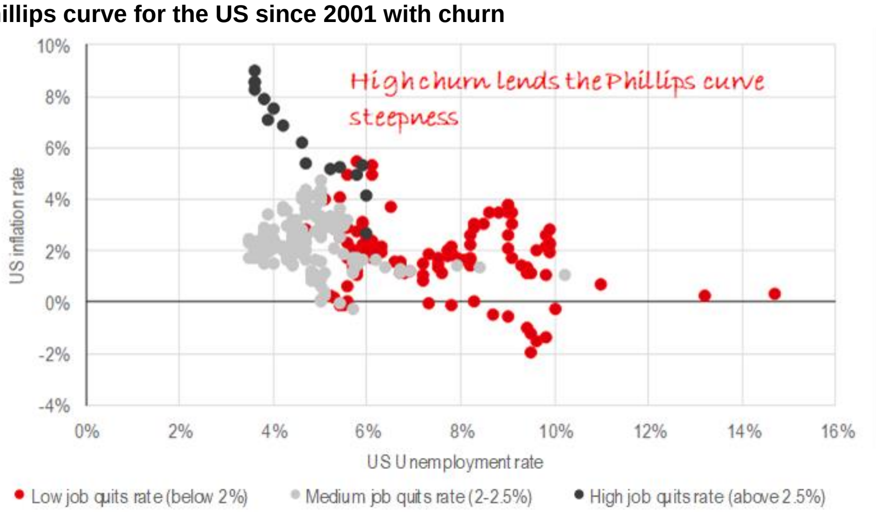
- Developed labour markets are tight: churn, where people switch jobs, employers and even type of work, is high
- Labour markets with high churn have higher wages
- Some of this is a structural change

Fear of inflation vs fear of unemployment: The relationship of inflation to unemployment is top of the agenda in financial markets. Will slaying inflation, again, require high levels of unemployment? A stronger labour market is a good sign recession isn't imminent but implies to many that interest rates will have to rise further to quell inflation, perhaps making for a worse, if later, recession.

Churn, people moving jobs, is key: The Phillips curve, the relationship between unemployment and inflation, has been much debated. The curve was assumed to have flattened, making inflation insensitive to unemployment. A steeper curve means more inflation at lower unemployment rates. Since 2020, the curve has re-steepened. **Something different to the last 20 years is happening.** A core driver appears to be churn in the labour market. More churn means more inflation as pay rises.

This seems to us a structural phenomenon: Working from home, or partial working from home, makes working further away easier. That means more job opportunities for candidates and more candidates for opportunities. Zoom and MS Teams make the hiring process easier, quicker and more private. Workers want WFH or a hybrid of it. This potentially means the labour market has become more efficient, and faster moving. It won't stop labour markets being cyclical but the structural forces seem unlikely to reverse.

Phillips curve for the US since 2001 with churn



Source: BLS, HSBC calculations

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Churn in the labour market

- Churn is a source of wage pressure (people move for higher pay) …
- …but affects gross hiring, not unemployment numbers
- For the same level of unemployment, higher churn raises wages, i.e. the Phillips curve steepens. Higher churn may be structural

Intriguingly different labour markets

The relationship between unemployment and inflation, normally described in terms of the Phillips curve, is centre stage

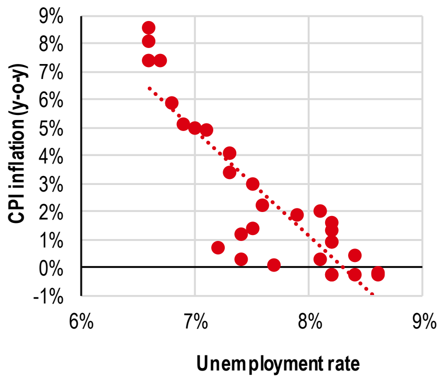
The Phillips curves return to life

The inverse relationship between unemployment and inflation, normally described in terms of the Phillips curve, is centre stage. Will the economy need to be tipped into recession, dragging the labour markets into high levels of unemployment, to 're-kill' inflation? On top of this, the robustness of labour market demand seems to be confusing many. Will that mean interest rates need to stay higher for longer to slay the beast of inflation? We have become accustomed to the "jobless recovery" in recent cycles. Can we have a slowdown that doesn't cause great unemployment?

> **"We need five years of unemployment above 5% to contain inflation – in other words, we need two years of 7.5% unemployment or five years of 6% unemployment or one year of 10% unemployment"**
>
> **Larry Summers, former US Treasury Secretary (June 2022)**

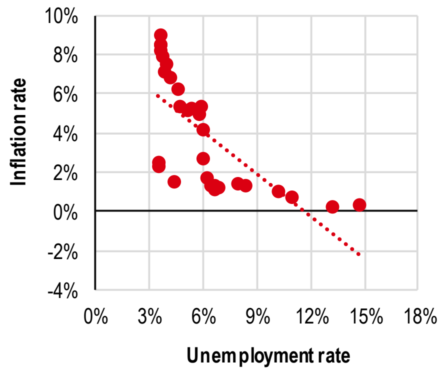
It was often regarded as dead; indeed, Jim Bullard, Chair of the St Louis Federal Reserve, claimed the Fed had killed the Phillips curve. It appears to have come back to life

Phillips curve: Europe (since 2020)



Source: Refinitiv Datastream, HSBC calculations

Phillips curve: US (since 2020)



Source: Refinitiv Datastream, HSBC calculations

Until relatively recently, the Phillips curve was often regarded as dead; indeed, Jim Bullard, Chair of the St Louis Federal Reserve, claimed the Fed had killed it. Others felt it had flattened to the point that lower unemployment made little difference to inflation. Since the pandemic, it is back, with a steepness that seems to have meaning.

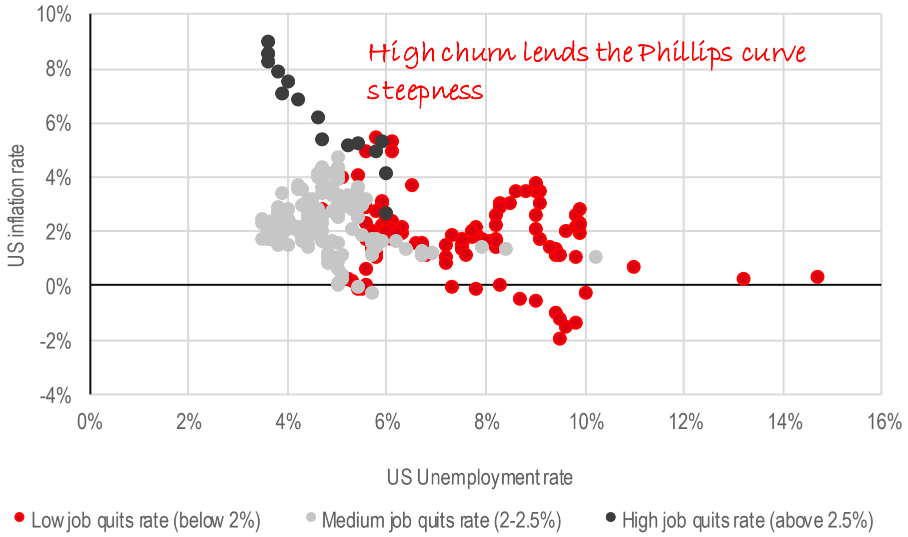
The role of churn

Phillips curve has a curve when churn is highest

The answer may lie in churn (the amount people change from job to job)

Perhaps the most striking thing about the current labour market is the rate at which people are changing job. These people often do not become unemployed and then employed again. They merely move from employer to employer and from role to role. It doesn't therefore affect unemployment or total employment numbers. Using US data for "quits", ie those voluntarily leaving their job but not retiring, as a proxy for churn, we can see that the Phillips curve has a curve when churn is highest. UK data for job "switchers" show a similar pattern. Anecdotal evidence from staffing companies suggests elevated churn and elevated pay rises for job switchers. The extent to which this is a structural change and how much a passing post-pandemic effect will be key.

The Phillips curve for the US since 2001: the steepest parts have the highest churn



Source: BLS, HSBC calculations

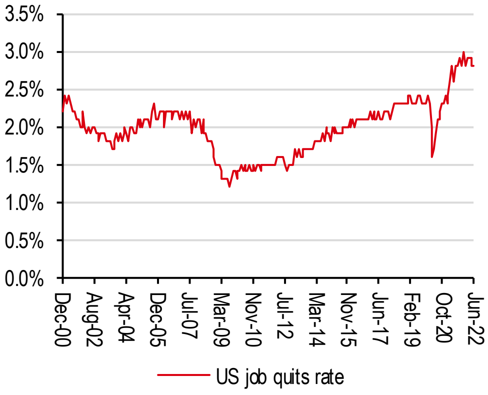
Structural changes such as WFH may be driving churn

Jobs previously inaccessible due to travel restrictions and/or cost of travel, for example, could become more accessible with hybrid WFH

If one of the reasons for fewer job changes is geographical immobility. Working from home can **break barriers to geographical immobility**. Remote working means people now look for jobs further afield than they could when tethered to a daily early morning commute.

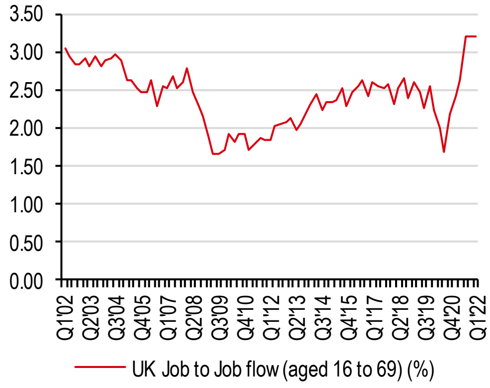
Our Economics colleagues have addressed some of the broader issues for cities in these reports: *Remote impact: The economic consequences of working from home,* 24 January 2022, and *Has the office return already peaked? What the next phase of the pandemic means for cities*, 30 March 2022.

US job quits rate



Source: Bureau of Labour Statistics; Quits include employees who left voluntarily with the exception of retirements or transfers to other locations

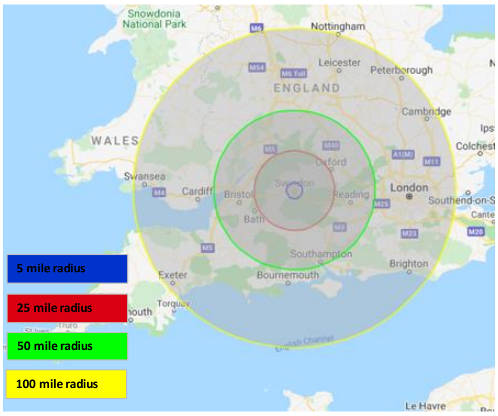
UK job to job flow rate



Source: Office for National Statistics; Job to job flows refer to those who were employed in both quarters, but who in the latter quarter reported being with their current employer for less than three months, indicating a change of job between the quarters

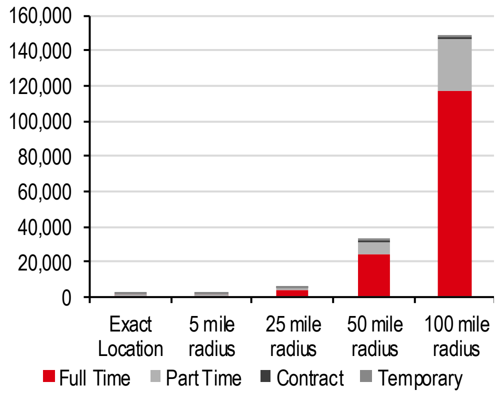
A **wider catchment area** would mean a higher number of candidates for each vacancy and a larger candidate pool for employers. WFH could also drive a higher **churn in high wage rate for the older population,** who historically are less likely to move jobs. The practical considerations of working partners, children and house moves make relocating more onerous for those in the family rearing years. WFH and 'hybrid WFH' make such moves more likely. This is important as the US Bureau of Labour Statistics (BLS) suggests that the under-24-year-old segment contracted from 13.9% of the workforce in 2009 to 12.9% in 2019. The BLS expects it to contract to 11.4% in 2029. In other words, lower churn in the pre-pandemic period may have been in part a demographic effect that now has reduced importance with changing working patterns.

Larger catchment area: Swindon (UK)



Source: Google maps, HSBC calculations

Swindon (UK): Number of jobs available increases 25x when widening the search radius by 50 miles and 117x when by 100 miles

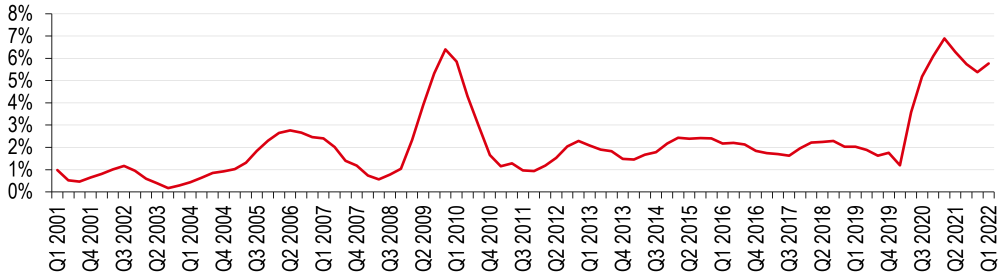


Source: Glassdoor job search – Swindon, HSBC calculations

There has been much written in the media about people leaving hospitality and other service sectors but the overall change by type of job (as opposed to sector of the employing business) is elevated

There are surely other factors than WFH in the elevated levels of job churn seen since the pandemic began. Enforced isolation can provoke introspection and reassessment. This will have played a role in current levels of churn or job switching. The advent of Zoom and Microsoft Teams, recruiters report, has made it easier to hire people. Candidates are freer to talk at home than when sitting next to the boss. They are not commuting as much, so are more available. Interviews over Zoom are easier to arrange with employers. A popular narrative of changing work patterns and colleagues changing employer or role may entrench the trend. We can also see that workers are changing roles. The composition of the type of job workers have is changing. There has been much written in the media about people leaving hospitality and other service sectors but the overall change by type of job (as opposed to sector of the employing business) is elevated. The rate is only rivalled by the period after the Global Financial Crisis (GFC) in 2009-10, when the composition of that change was very different and the labour markets were very weak.

The rate of change of composition (by type of job) of the US workforce is elevated



Source: US Commerce Department

It becomes easy to see why the labour markets remain strong

The removal of some spatial barriers, commuting onerousness, zoom interviews and workers who have thought longer and harder about what they want from life is a recipe for a "hot" labour market

The role of the labour market is, theoretically, to allocate labour supply to labour demand, using the pricing mechanism. The employer with the highest bid is likely to see the greatest utility in hiring. If barriers to changing jobs are reduced, the mechanism has become more efficient. A sudden change in the willingness of workers to consider change, the ease of changing and the volume of available roles, economic cycle aside, is likely to produce a stronger labour market. The removal of some spatial barriers, commuting onerousness, Zoom interviews and workers who have thought longer and harder about what they want from life is a recipe for a "hot" labour market.

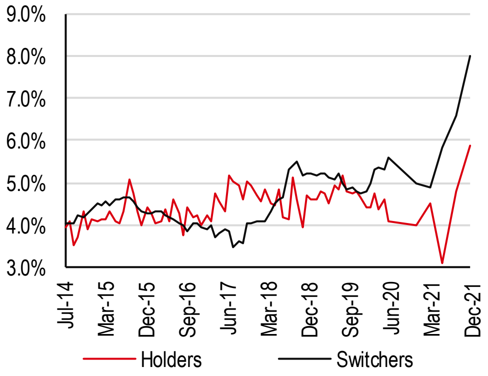
Can labour markets remain strong?

We are not about to argue that the labour market is not cyclical

We are not about to argue that the labour market is not cyclical. Surely economic demand has always driven the labour demand and that is unlikely to change. A severe recession is almost defined by the unemployment rate it generates. A recession without rising unemployment is a rare thing, and normally gets called a 'technical' recession because GDP does contract a little for two consecutive quarters.

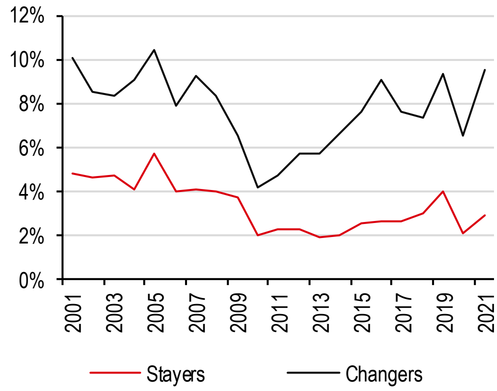
Staffing companies and HR departments have long talked about 'candidate confidence' as a key driver of the labour market. One factor now is whether changing job for a pay rise is attractive enough because of inflation, for more money to offset the higher cost of living and thus maintain a standard of living, set against the fear of changing jobs. The uncertainty about taking a new job rises in recession. Moving if there is a vacancy somewhere else makes that person "the last in so first out" and so is more uncertain. For those who have been in situ for a longer period, the protection of a more substantial severance payment is also likely lost. There will of course be fewer vacancies to switch to. Along with all this, the supply of labour from outside the labour market rises, reducing the likely uplift in wages.

Switchers have been experiencing higher wage growth than holders (US)



Source: ADP Workforce Vitality Report, HSBC calculations

Job changers experience higher pay growth compared with job stayers (UK)



Note: ONS April 2021 report of 'Job changers and stayers, understanding earnings'
Source: ONS, HSBC calculations

We have limited accurate measures of labour market churn before the last 20 years so we do not know if high churn can lift a labour market into a "soft landing." We expect, though, that the best measure of a labour market's health is the churn within it. Job vacancies, gross hires, churn and metrics other than unemployment or total payrolls seem the best measures. While churn remains strong, it seems likely the labour market is telling us there is sufficient demand at hiring businesses to warrant recruiting at prevailing pay rates, at least in the view of those businesses. There is little sign of slowing to date.

It seems likely that structural changes like WFH may mean a faster bounce-back in the health of labour markets in the wake of any economic slowdown than we saw after the GFC

It also seems likely that structural changes such as WFH may mean a faster bounce-back in the health of labour markets in the wake of any economic slowdown than we saw after the GFC. Candidates will still be able to look in a geographically wider circle for jobs, so be able to consider more roles, and they will be able to interview more easily. Corporates will be aware of the shortages of supply they have experienced, and perhaps quicker to jump back into recruiting to avoid the same issues again.

This is a Free to View version of a report with the same title published on 3-Aug-22.

The full note contains an in-depth look at the Phillips curve, from why many thought it dead to why churn seems to have brought it back to life, a discussion of why central banks are discussing driving up unemployment to depress inflation, the relationship between WFH and Inflation, why churn in the labour market has structurally changed despite an ageing workforce demographic. We also look at signs of impending labour market contraction and ponder the arguments for recession but highlight why not all labour market recessions are equal.

For any questions, please contact your HSBC representative or email *AskResearch@hsbc.com*. The full note is available at www.research.hsbc.com

Disclosure appendix

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