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Recruiting & Labour markets

Some reasons why labour markets keep surprising

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- Labour scarcity, high churn, high vacancies and low unemployment suggest companies will be hesitant to lay staff off
- Greater economic confidence may quickly trigger hiring
- Some of this is a structural change

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The Phillips curve has steepened. The Beveridge curve has moved. There is more inflation and more job vacancies at low unemployment. There is an available labour shortage. If the unemployed and non-participants in the labour market lack desired skills and characteristics this means 'churn', hiring existing workers from other employers. This becomes a key measure of labour demand. Labour scarcity means, for many employers, letting staff go or not replacing leavers, which exposes them to the risk that future growth is severely impaired by labour shortages, even if in the near term the loss of staff might reduce costs. **Labour markets seem set to be robust in the face of all but the most severe of economic pressures.**

Reduced frictional and structural impediments to churn: Video conferencing makes hiring quicker, easier to organise and more private. Work from home (WFH) and hybrid WFH mean employees can practically be sourced from a wider geographic area, meaning more available jobs for candidates and more candidates for each job. Potentially, the labour market has become more efficient. Labour can be allocated to those who see the greatest benefit in an employee with less friction and less geographical constraint. This may be positive for the economy, especially as for most workers the labour market is a key driver of economic confidence. Labour demand will remain cyclical but the labour market may have become more resilient to negative economic factors, perhaps even a bulwark against them.

The Beveridge curve shows very strong labour demand

Source: BLS/HSBC

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A strong dam on pessimism

- Labour markets are likely to remain resilient
- Labour will remain cyclical, of course, but it will take more pressure than many imagine to break the dam
- February and March data are much more important, though, than the strong December and January data

Labour markets are a strong dam; they won't break easily

Whilst labour demand seems likely to weaken in Q1 the absolute level of demand will likely stay high

The labour markets keep surprising with strong numbers. The picture is complex. One can find snippets of evidence to support whatever opinion you started with, but the most negative arguments and forecasts have thus far proved wrong, or at least premature. Whilst labour demand seems likely to weaken in Q1, absolute demand levels will remain high, in our view. We argued in previous notes that churn or people switching from job to job was key to understanding the health of labour markets. We are sympathetic to views of a two-tier labour market but suspect that workers are 'savvy' to this as well and are adjusting. We argued that labour markets were unlikely to weaken to levels seen in previous recessions quickly or easily and, if they did, they may bounce back quickly. We stand by this view. We also argued that WFH, remote working, or hybrid remote working had changed the dynamics of the labour market structurally, and against a back-drop of scarcity of supply, these factors would drive up churn. This is especially true for white-collar work. We see little evidence to change that view.

A test is coming; but it wasn't in December '22 or Jan '23

A word of caution. Whilst we remain more optimistic than most could muster in 2022 about labour markets, December and January data pre-date the 2023 corporate budgets

Labour market data for December and January was strong, or stronger than expected, pretty much everywhere. The US non-farm payroll for January was the 'poster child' for stronger than expected labour data. It has boosted a more optimistic view of labour markets, and questions about future interest rates. A word of caution. Whilst we remain more optimistic than most could muster in 2022 about labour markets, December and January data pre-date the 2023 corporate hiring budgets that most businesses were still finalising in January and enacted in February and become most evident in March data. It is what hiring happens at this point that matters. It is such data that is likely to materially reflect the narrative of slowing economies, which has been so prevalent, upon future hiring plans.

A coda for thinking about inflation and labour markets

Much of this most negative analysis of the labour markets is rooted in a 'sotto voce' adherence to the Phillips curve (lower inflation will 'require' economic cooling and thus higher unemployment) and the Beveridge Curve (job vacancies will need to fall materially to cool the labour market). This is simply the law of supply and demand in many ways.

> **“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)**

Both curves are influenced by a myriad of dynamic factors and both have changed in nature, in our view structurally. The Phillips curve is steeper post pandemic; the Beveridge Curve is also steeper, and perhaps shifted to the upwards.

There is high demand for labour relative to the available labour pool

There is more demand for labour relative to the available labour pool. Employers, unable to find appropriate labour from the unemployed, or tempt those outside the labour market, are forced to poach staff from other employers. They also, of course, have to fend off the poaching of other employers, in a similar situation, of their staff. In such an environment each employer must balance shorter-term cost management with longer-term demand for staff, in a different way to when they imagine they will hire relatively easily to meet future demand in future. Fire too many now and crimp medium-term growth. Businesses with stronger cash flows will be able to be more hesitant to lay off production or core staff, than those with a pressing cash ‘burn.’

> **Layoffs are largely the ‘non-jobs’, oversight functions that are nice to have, ‘feel good’ jobs but not directly production or revenue generating roles where one or two are important but five or six was over-staffing.**
>
> **Staffing industry executive**

The Phillips curve remains central to much analysis of labour markets and inflation

Intriguingly different labour markets: Mr Phillips & Mr Beveridge

The Phillips curves return to life

This inverse relationship between unemployment and inflation, normally described in terms of the Phillips curve, remains centre stage. If unmentioned. The robustness of labour market demand has been striking and persistent. Will that mean interest rates need to stay higher for longer to slay the beast of inflation?

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.

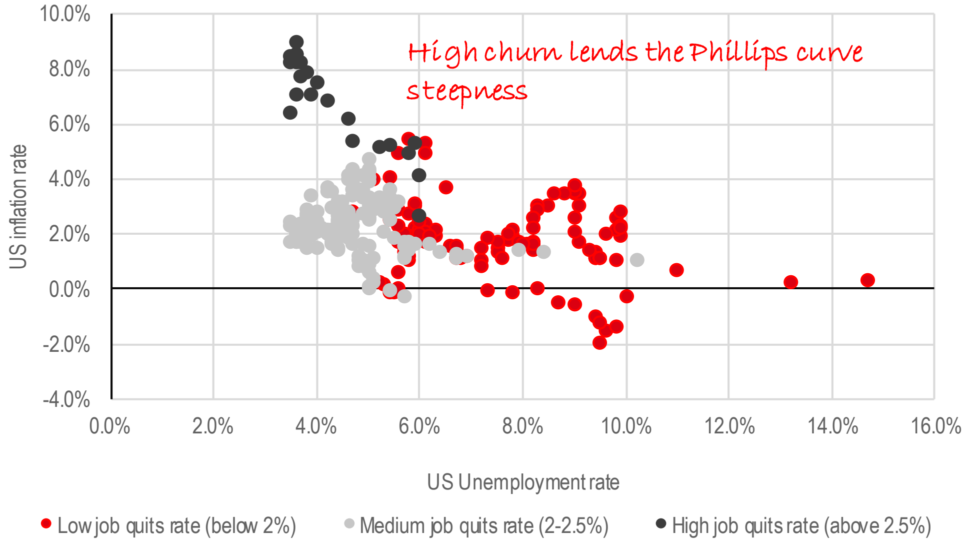
The role of churn

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”, i.e. 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. To what extent 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

that most obvious leading indicator of employment figures is job vacancies

Churn seems to have a similar effect on that most obvious leading indicator of employment figures, the job vacancies ('openings' in North America) that have to precede hires.

The UK Beveridge Curve adjusted for churn rate

Source: ONS and HSBC calculations

It strikes us that a sharp, material and fundamental shift in employers' view of required staffing levels will be required

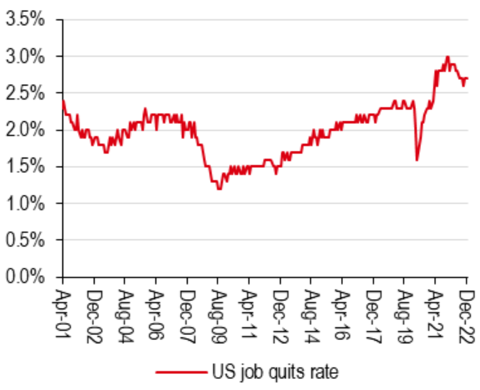
At one level, such high levels of labour demand as are evident in vacancies mean that a real 'shock' would be required to alter labour markets dynamics. As we have argued above, if this is to happen it will be evident in official vacancies and hiring data in February and March data, released in March and April, respectively. It strikes us that a material and fundamental shift in employers' view of required staffing levels will be required.

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

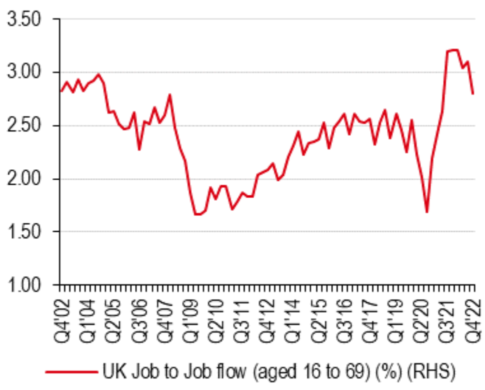
If one of the reasons for fewer job changes is geographical immobility, working from home can **break barriers to geographical immobility**. In a 2020 note, we outlined why we thought churn would increase. Remote working means people now look for jobs further afield than they could when tethered to a daily early morning commute. Our Economics colleagues have also addressed some of the broader issues for cities in their reports covering the Remote Impact and whether the office return has already peaked.

US job quits (which excludes layoffs and retirements and as such tends to be labour market 'turnover' or 'churn')



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, 'churn'



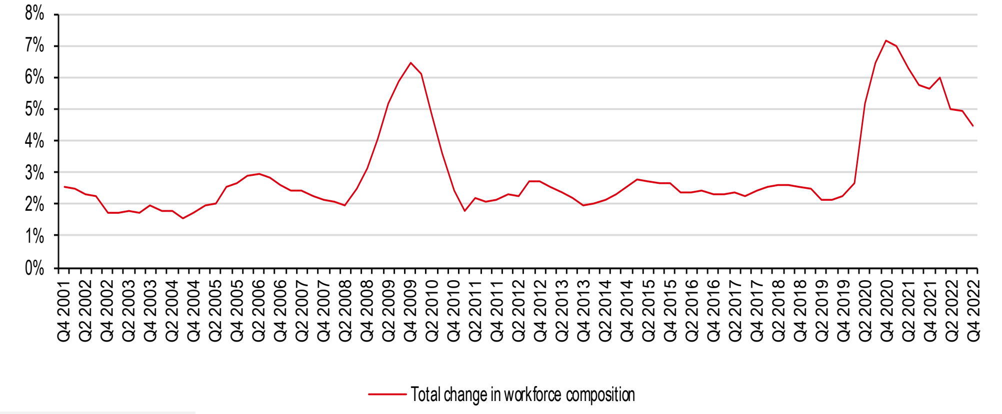
Source: Office for National Statistics; Job to job flows refer to those who were employed in both quarters, but who in the latter quarter reported being with their current employer for less than three months, indicating a change of job between the quarters

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 roles 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 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.

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 seems likely to have played a major role as lockdowns ended and may still be a factor in current levels of churn or job switching. The expansion of Video Conferencing platforms such as 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. Video conference interviews 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 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



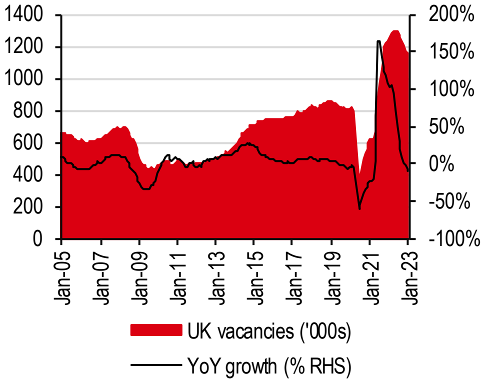
Source: US Commerce Department

Can labour markets remain strong?

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

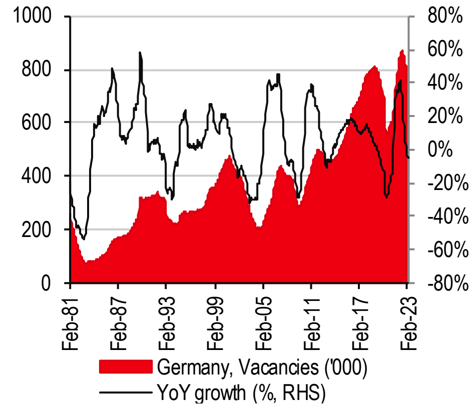
We are not able to argue that the labour market is not cyclical. Surely economic demand has always driven the labour demand and that is unlikely to change. A severe recession is defined for many by the unemployment rate it generates.

UK Job vacancies



Source: ONS

German job vacancies



Source: German Bureau of Labour statistics

YoY % growth rates look daunting but the absolute numbers of vacancies do not look recessionary

Much of the fear around labour markets has been the slowing in the rate of growth that has driven a far less threatening looking decline in the total number of job vacancies. Some of this is, of course, simply a base effect. Once the flush of backed-up demand after lock-downs ended passed through, the level of job vacancies was going to normalise. The year on year numbers were likely to come down and turn negative. Job vacancies peaked in May 2022, and as of December 2022 were still materially higher than December 2019. There is demand.

Confidence: 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 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 a recession. Moving if there is a vacancy somewhere else can make 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, which with an aging population should become a greater factor. 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.

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 redacted Free to View version of a report with the same title published on 02-Mar-23. The full note contains an in-depth look at both the Phillips and Beveridge curves and their relationship with labour markets as well as a discussion on our views around a labour market recession. Please contact your HSBC representative or email *AskResearch@hsbc.com* for more information.

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