The Labor Market May Not be as Tight as it Appears

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Main streets across the U.S. are flooded with Help Wanted signs, companies are complaining that they can’t find workers, and economic indicators are pointing to a tight labor market. This is unusual, at a time when unemployment is so high. The current labor market dynamics represent a supply and demand mismatch, not unlike that seen elsewhere in the economy. The key question is whether it will be resolved when distortions related to the pandemic recede. Some workers may remain permanently out of the labor force, but a large fraction are expected to return and fill open jobs as constraints on labor supply ease.

At this stage of the recovery, the tightness in the labor market is real. Surveys of small business optimism show that in June nearly half of small businesses reported open jobs they couldn’t fill—near its record high set the previous month. The Conference Board Consumer Confidence Survey, which shows the difference between respondents noting that jobs are plentiful and those noting jobs are hard to find, has well-exceeded pre-crisis levels. There are plenty of openings for those who are looking for a job.

The surge in these indicators, which show a tight labor market, reveals a supply and demand imbalance. Businesses’ demand for labor has returned with a vengeance much earlier than anticipated, thanks to the quick pace of vaccine rollout and easing restrictions to activity across the U.S. Meanwhile, several factors are keeping workers on the sidelines, such as the need for family and
child care, continued health concerns, extra unemployment insurance (UI) benefits leaving lower-income workers with more money and less incentive to return immediately to work, a lack of foreign labor due to travel restrictions, as well as an increase in retirements.

Some of these frictions will likely disappear in the fall. School openings, the expiration of UI benefits, and, hopefully, the ease of health concerns should alleviate much of the pressure on labor supply.

![Graph: AMPLE LABOR MARKET SLACK REMAINS](image)

As temporary constraints ease, there are still millions of people on the sidelines who can be pulled back into the labor force; the labor force participation rate has barely budged over the last year, stuck at 61.6% in June. In fact, there are currently 5 million more people not in the labor force than prior to the crisis. Furthermore, looking at just those in their prime working years (ages 24-54), the employment-to-population ratio is down 3.2 percentage points from February 2020.

**A Differentiated Labor Tightness Across Sectors**

Some of the excess labor demand may persist. There are a handful of industries—concentrated among COVID-impacted sectors—in which activity remains more dynamic than prior to the crisis, with a higher demand for labor. In manufacturing (in both durable goods and nondurable goods business lines), wholesale trade, and retail, the ratio of unemployed people to job openings is lower now than it was prior to the pandemic.
LABOR MARKET TIGHTNESS CONCENTRATED IN COVID-IMPACTED SECTORS

Source: Haver and Barings calculations, as of July 14, 2021.

Part of this excess demand for labor is explained by the popularity of new activities during the lockdowns, which persist into the reopening. In particular, home improvement projects, hobbies, and other activities increased the demand for manufacturing-intensive goods. Moreover, as stores, gyms, and offices reopen (and consumers prepare to cash in on pandemic savings and stimulus checks), manufacturing and trade sectors are rushing to fill vacant jobs to accommodate elevated demand for their products.

The reticence of workers to return to people-facing jobs may also linger for longer. The labor market for educational services and the leisure and hospitality industries has tightened relative to its pre-crisis level. The prior has been driven by the reopening of schools and other education institutions; the latter by the spike in travel, restaurant and theater visits, and other leisure activities.

**Will People Really Return to Work?**

The data show that people have been re-entering the labor force since April 2020. This signals people are ready to return to work and actively looking for jobs. Moreover, of those not in the labor force, there are 1.9 million more people who currently want a job than prior to the crisis but are classified as not in the labor force, rather than unemployed, because they are not currently looking for a job. These individuals may be unable to re-enter because of care-taking duties and other restrictions related to the still present wave of infections.
Yet, there may be some factors that do not revert, keeping people away from the labor force permanently. In particular, more generous social benefits associated with the “blue wave” in Congress may provide an incentive for those close to retirement age to stay out. In fact, last year’s rate of retirement far exceeded the pre-crisis trend. Data from the Current Population Survey, which tallies those who self-identify as retired, show that the number of people who retired during the pandemic (as of March 2021) is 2 million above the 2019 trend—accounting for 1.2% of the June 2021 labor force. Part of this increase can be explained by the hot labor market in 2018 and 2019—in which many workers chose to delay retirement. According to a Morgan Stanley Research report, the “rise in retirement rate is entirely attributable to an increase in retirements among those ages 65 and older.”¹ These older retirees are generally less likely than early retirees to return to the labor force.

This still leaves about 5 million more people not in the labor force than prior to the pandemic. This suggests that’s there are around 3 million non-retired individuals who can still return to work. Moreover, the decline in labor force participation among older generations should be at least partially offset by the entrance of younger workers. While the labor force participation rates for older age groups remains historically low, the labor force participation rate for teens has already returned to pre-pandemic levels.

What Does This Mean for the Outlook?

While the labor market is recovering at an impressive pace, there is still a ways to go until the U.S. reaches full employment. The ample slack on the sidelines should keep broad-based wage pressures at bay in the near-term. The return to work should provide further impetus to the recovery. Workers’ re-entry in the labor force and search for work will, however, keep the unemployment rate higher, but this should be read as a welcome development. The Fed has been vocal about its objective to achieve maximum employment and will thus keep policy supportive until it sees substantive evidence that it has reached this goal, notwithstanding some inflation pressure in the data.

There remain risks to this constructive outlook. If individuals remain concerned about health risks or need to care for family for a longer period of time, it could lengthen or delay the timeline for those on the sidelines to re-enter the labor force. Similarly, if policymakers reinstate restrictive measures or lockdowns, it could dampen the demand for workers, and weigh on the pace of job gains. It will be important to watch policymakers’ responses as well as high-frequency activity data to gauge consumer behavior. So far, however, there is not much political appetite to reinstate restrictions outside of mask mandates in the U.S., and activity data remains robust as consumers unleash their pent-up demand.
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