Ostrum ASSET MANAGEMENT

MyStratWeekly

Market views and strategy

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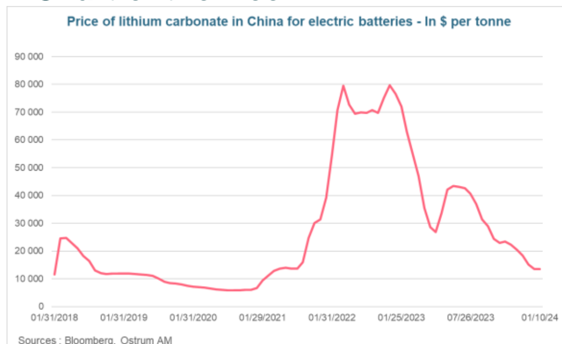
Topic of the week: On labor hoarding

- **The US labor market is tight by most measures;**
- **US businesses have been reluctant to fire workers fearing difficulties and costs to rehire, a practice known as labor hoarding;**
- **The Okun's law framework helps to identify subpar responses of unemployment to slower growth;**
- **Low readings on initial jobless claims and layoff announcements show the extent of firms' reluctance to let go workers;**
- **Besides hiring costs, reasons for labor hoarding include retaining key hard and soft skills including IT capabilities, time management and leadership.**

Market review: Summer in April?

- **The ECB fails to convince markets betting on April cuts;**
- **US growth remains strong at 3.3% in 4Q 2023;**
- **Yield curves re-steepen;**
- **Good performance from equities and credit.**

Chart of the week



In China, the price of lithium carbonate used for electric batteries fell by more than 80% year-on-year, returning to the lowest since 2020, at $13,300 per tonne in mid-January, compared to $72,000 per tonne a year ago and peaking at almost $80,000 at the end of November 2022.

This is linked to the lesser demand of the world's largest electric vehicle market: China. After increasing by 84% in 2022, sales of electric vehicles have slowed significantly to increase by 25% in 2023. This sharp drop in lithium prices has led some producers to scale back their production expansion plans.

Figure of the week

1.5

Source : European Commission

In order to achieve carbon neutrality by 2050, the European Union would have to invest nearly 1.5 trillion euros per year, between 2031 and 2050, according to a draft European Commission document seen by the Financial Times.

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● Topic of the week

On labor hoarding

The US labor market is tight by many measures. The unemployment rate at 3.7% in December remains below its long-run equilibrium level. Job openings have fallen but firms appear reluctant to fire workers, a practice known as labor hoarding. In this piece, we explore the magnitude of labor hoarding using the Okun's law and the reasons behind excess labor demand.

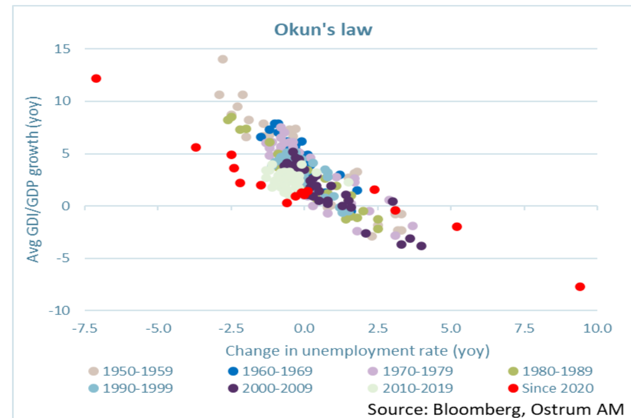
Okun's law and labor hoarding

Growth in the US has generally slowed since the strong recovery in economic activity from mid-2020 through 2021. However, labor market tightness continued to prevail. The unemployment rate was just 3.7% in December 2023 within 0.3 pp of lows.

In corporate surveys, businesses have indicated a reluctance to fire workers even in the face of slower growth, fearing difficulties if they need to rehire, a practice often called *labor hoarding*. Retaining talent is hard. For instance, in the JOLTS survey, the share of quitters (workers leaving their companies voluntarily to pursue other opportunities) remains near previous cycle highs at 2.3% of total employment and job openings. Likewise, the dismal reading on the ISM service employment component (43.2) in December pointed to hiring difficulties. Comments from survey respondents included: "Remote work is preferred for most, making it difficult to recruit skilled employees, and our skilled employees are leaving for hybrid options".

Okun's law offers a rule of thumb that links output growth to changes in the unemployment rate. The rule of thumb is such that a 1 pp increase in growth should lower the unemployment rate by 0.5 pp. Labor hoarding would thus manifest itself in a subpar increase in the unemployment rate in response to slower growth.

Following a methodology developed by the San Francisco Fed[1], we have built the chart below linking economic growth to changes in the rate of unemployment. Growth is measured by the year-on-year percentage change in the average of the GDI and the GDP to iron out measurement issues. GDI and GDP are indeed the two sides of the same coin.



Source: Bloomberg, Ostrum AM

Comparisons over long periods of time risks being biased by changes in the structure of the economy and, for instance, potential progress in resource allocation making the labor market more efficient. Still, it seems fair to say that the labor market fared well since 2020 as growth moderated, arguably because firms decided to avoid layoffs and retain workers.

The series of red dots on the above chart represent Okun's relationship since 2020. The 2020s stand out as the data suggests a near one-for-one relationship between the change in unemployment rate and economic growth. Our estimates suggest that the unemployment rate has fallen by 0.4 pp on average in response to a 1 pp increase in growth using data from 1950 to 2019. Thus, economic recovery alone cannot account for the current low level of unemployment. Using 20 years of data to fit an Okun's relationship, we estimate that unemployment rate was 1.5 to 2 pp below the model's predictions in the 2021-2022 period.

Initial claims at historical lows

The weekly jobless claims number provide a real-time pulse of the US labor market. The extremely low level of initial jobless claims may be another sign of *labor hoarding*. The latest reading on claims is 187k for the week ending on January 13. To put things into perspectives, a sub-200k would be on par with cyclical

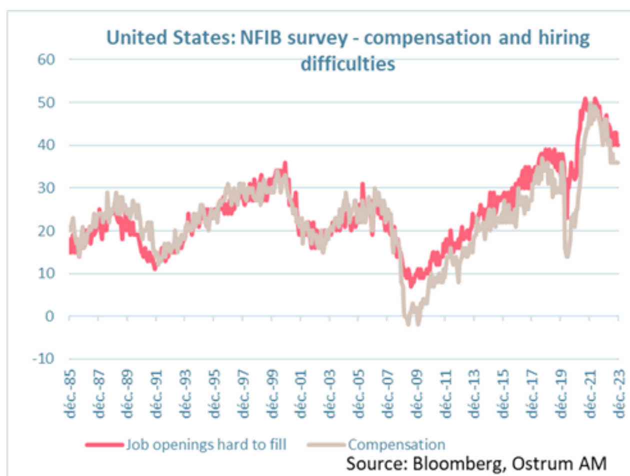
[1] https://www.frbsf.org/economic-research/publications/economic-letter/2023/december/from-hiring-difficulties-to-labor-hoarding/

lows in the early 1970s when the size of the labor force was less than half current levels.

Source: Bloomberg, Ostrum AM

Small businesses most exposed to labor market tightness

The reluctance of companies to fire workers is well documented by the NFIB survey of small business. A clear majority of small companies continue to report significant hiring difficulties despite increasing compensation plans. The apparent easing in labor market tightness still leaves the current situation about previous cyclical highs.



Source: Bloomberg, Ostrum AM

Persistent hiring difficulties and a lack of available skilled workers are unusual. The NFIB survey provides additional detail on the most pressing issues for businesses. The single most important problem for businesses over the past three years has been inflation (23% of respondents say inflation is the #1 issue, up from 2% 3 years ago), and there has been no improvement in the second half of 2023. The quality of labor (20%) and the cost of labor (9%) rank higher than regulation and red tape, interest rates or sales and competition from larger firms.

NFIB Small Business -Single Most Important Problem	Dec 2023	3-Yr chg
Inflation	23	21
Quality of Labor	**20**	**-1**
Taxes	17	-4
Cost of Labor	**9**	**3**
Government Requirements&RedTape	7	-7
Financial & Interest Rates	5	4
Poor Sales	5	-8
Competition from Large Businesses	5	-3
Cost/Availability of Insurance	5	-3
Other	4	-2

Source: Bloomberg, Ostrum AM

Furthermore, firms could have stretched worker hours or invest to gain productivity. Average weekly hours initially increased as the economy bounced back from the pandemic before declining back to their pre-covid level by early 2023. Thus, the latest decline in the unemployment rate is not traceable to shrinking hours. Productivity has increased instead, most notably in services.

Corporate efforts to retain talent

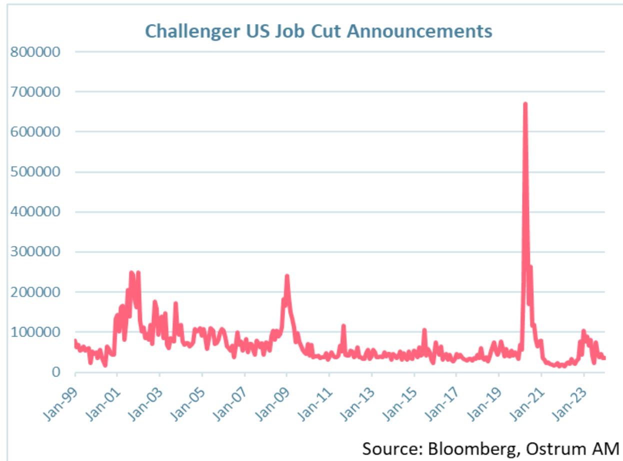
In a 2022 Skynova survey, a vast majority of 1,010 business owners (21% large, 22% medium and 57% small businesses) say they are labor hoarding. The reasons for labor hoarding given by employers were that team was strong (48%), layoffs are bad for morale (47%) and because past and current hiring effort proved difficult (43%). Avoiding training and hiring costs (about $4.5k per worker) was also mentioned by more than 40% of respondents. High turnover (15%) was not a reason for labor hoarding.

To retain talent, improving compensation (50%), transparent communication and a better work environment have helped prevent employees from quitting. Hard skills that business owners wish to retain include primarily technology skills including data literacy and analysis, IT automation and coding. Among the soft skills, time management, leadership and creativity appear most important.

Layoff plans remain low

The level of mass layoff announcements is another indicator of labor hoarding. In December, the

Challenger survey reported layoff announcements totaling just 34k jobs. Layoff plans have indeed slowed in the second half of 2023. Banks and technology companies have made headlines with cost cutting plans but staff reductions remain limited compared with previous cycles.



Source: Bloomberg, Ostrum AM

Conclusion

The tightness in US labor market conditions is well documented. Economic growth alone cannot explain the 3.7% unemployment rate. Persistent hiring difficulties have led firms to hoard labor to retain skills and avoid costs of rehiring. Labor hoarding manifests itself in sub-200k jobless claims and reduced layoffs.

Should the economy head for a hard landing, the employment adjustment could be sharper as firms squeeze more productivity from the retained workers.

Axel Botte

Market review

Summer in April?

The ECB is struggling to convince the markets so that the probability of a cut from April is increasing. US growth fuels rise in risky assets ahead of FOMC.

The financial markets refuse to integrate Ms. Lagarde's message. The guidance for a rate cut being postponed until the summer is worthless as data-dependence remains paramount in the ECB's decision-making process. The market has no tangible reason to rule out a move in April. At the same time, strong US growth is accompanied by signs of inflation stabilizing around the 2% goal. The goldilocks scenario does not seem to require any monetary relief... even though the Fed will undoubtedly confirm this week the rate cuts penciled in its December summary of economic projections. Against this backdrop, bond yields drifted lower and yield curves have steepened without prejudice to risky assets (credit, equities) which remain supported by strong growth and a few encouraging quarterly publications (including Netflix, LVMH, etc.).

The ECB's communication remains unconvincing foremost market participants. Dependance upon incoming economic data is incompatible with a calendar commitment to the next interest rate path. In addition, the continued stagnation of activity since 4Q 2022 has not made inflation disappear given the persistent imbalances in the euro area labor market. The scenario of declining inflation projected by the ECB, and even more so by the financial markets, risks being called into question by the recent disruptions in world trade. The lack of unanimity within the Council also keeps uncertainty elevated regarding the reaction function of the Central Bank. In the United States, the Fed committed to easing policy before GDP growth came in at 3.3% in the last quarter. Household consumption is growing at a steady pace of 2.8%. However, core inflation is now in line with the Fed's target of 1.85% in annualized terms in the second half. Lowering interest rates when the slowdown in prices seems traceable to goods' supply would be premature, especially as pressures on supply chains reappear. The rebound in demand for mortgage credit also indicates the magnitude of recent easing in financial conditions. New home sales recovered at the end of last year. Housing investment in the 4th quarter should thus be revised upwards.

Euro fixed income markets are not giving up on the possibility of a rate cut in April. This probability even increased after the ECB press conference. The slope of the German yield curve steepened by 7 bp last week on the 2-10 year segment. The Bund dipped back temporarily below 2.30% pending the finalization of the German budget due in early February. The primary market is now lighter, which has favored the stabilization of the 10-year swap spread at around 45 bp. At the same time, the OAT is trading under 50 bp. Italy plans to borrow €15 billion from households with a new BTP Valore, the launch of which is scheduled for the end of February. This source of financing, which had added up to €44 billion in 2023, eases the pressure on the 10-year BTP spread (152 bp). Breakeven inflation rates (-3 bp) did not react to the rebound of $3.5 per barrel of crude oil over the past week. Tensions in the Red Sea constitute another source of inflation, so far ignored by the financial markets. In the United States, the T-note stood at 4.15% at the end of the week. The steepening trend continues. The 2-10 year spread has recovered by 34 bp since mid-December.

The credit market backdrop continues to improve. The average spread on IG credit slips below the threshold of 90 bp against swap. Financials' debt and utilities outperform. Long credit risk positioning is strengthening on the iTraxx main. Primary market issuance is down compared to 2023 and will slow down further as the earnings season approaches. High yield is in line with the performance of IG without significant compression in the speculative-grade cash bond markets.

Corporate earnings releases relating to the 4th quarter have started. The earnings outcomes are mixed on the S&P 500 although mostly above consensus with the continued decline in profits over one year in sectors linked to energy. Financial profits fell by 5.8%. The markets are nevertheless upbeat. Technology stocks continue to drive market indices upward in the United States and in Europe. The Nikkei benefits from the weakness of the yen gaining 6.8% since the start of the year. In contrast China stocks are down in 2024.

Axel Botte

Main market indicators

G4 Government Bonds	29-Jan-24	1wk (bp)	1m (bp)	2024 (bp)
EUR Bunds 2y	2.57%	-12	+17	+17
EUR Bunds 10y	2.24%	-5	+22	+22
EUR Bunds 2s10s	-33.4bp	+7	+5	+5
USD Treasuries 2y	4.33%	-6	+8	+8
USD Treasuries 10y	4.1%	0	+22	+22
USD Treasuries 2s10s	-23.4bp	+5	+14	+14
GBP Gilt 10y	3.91%	+1	+37	+37
JPY JGB 10y	0.72%	+7	-7	-7
€ Sovereign Spreads (10y)	**29-Jan-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
France	48bp	-1	-5	-5
Italy	151bp	-4	-16	-16
Spain	90bp	-2	-6	-6
Inflation Break-evens (10y)	**29-Jan-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
EUR 10y Inflation Swap	2.12%	-1	-1	-1
USD 10y Inflation Swap	2.49%	+0	+8	+8
GBP 10y Inflation Swap	3.55%	+5	+2	+2
EUR Credit Indices	**29-Jan-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
EUR Corporate Credit OAS	130bp	-6	-8	-8
EUR Agencies OAS	67bp	-1	-2	-3
EUR Securitized - Covered OAS	74bp	-1	-5	-5
EUR Pan-European High Yield OAS	360bp	-17	-42	-39
EUR/USD CDS Indices 5y	**29-Jan-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
iTraxx IG	58bp	-1	0	0
iTraxx Crossover	319bp	-5	+6	+6
CDX IG	55bp	0	-2	-2
CDX High Yield	352bp	-3	-5	-5
Emerging Markets	**29-Jan-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
JPM EMBI Global Div. Spread	400bp	+0	+15	+16
Currencies	**29-Jan-24**	**1wk (%)**	**1m (%)**	**2024 (%)**
EUR/USD	$1.082	-0.570	-1.975	-2.0
GBP/USD	$1.269	-0.126	-0.299	-0.3
USD/JPY	JPY 148	0.122	-4.651	-4.7
Commodity Futures	**29-Jan-24**	**-1wk ($)**	**-1m ($)**	**2024 (%)**
Crude Brent	$82.9	$2.9	$5.9	7.6
Gold	$2 036.2	$14.5	-$26.8	-1.3
Equity Market Indices	**29-Jan-24**	**-1wk (%)**	**-1m (%)**	**2024 (%)**
S&P 500	4 891	1.06	2.54	2.5
EuroStoxx 50	4 626	3.25	2.32	2.3
CAC 40	7 631	2.94	1.17	1.2
Nikkei 225	36 027	-1.42	7.66	7.7
Shanghai Composite	2 883	4.61	-3.08	-3.1
VIX - Implied Volatility Index	13.92	5.53	11.81	11.8

Source: Bloomberg, Ostrum AM

Additional notes

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