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Were tight labour markets just a mid-life crisis?

Chief economist's comment

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- Across the major economies, companies have consistently complained about it being more difficult to hire workers since the pandemic. Job vacancy rates soared in some areas, and remain quite high.
- The conundrum is that real wages have remained weak and, until the recent normalisation of inflation, were actually falling. Labour markets cannot be considered tight if workers are lack the power to maintain their living standards.
- One reason is that during the pandemic, workers had the leisure to reconsider their life choices. This encouraged workers to change employers - especially where contact with existing employers was weak. Because job vacancies only measure externally advertised job vacancies, such churn pushes up the number.
- Individual sectors of the economy may still experience labour tightness as patterns of demand for and supply of labour adjusted after the pandemic. But that pattern only encouraged job hopping, and this distorts vacancy data.
- We expect vacancy rates to continue to fall - if you were going to have a mid-life crisis you should have had it already. As people stay in place, such vacancies as they do occur should be filled internally rather than being advertised externally. Lower churn may also boost the productivity of workers.

Something strange has happened in the labour markets of advanced economies. Since the pandemic there have been cries of anguish from the business community about the tightness of labour markets and the difficulties of hiring workers. Those complaining of tight labour markets point to a significant increase in job vacancies. This suggests that labour markets are “tight” and workers should have the upper hand in pay bargaining.

And yet hiring rates are above pre-pandemic trend. Firms clearly can hire workers, however loud the cries of anguish. Real wage growth over the past three years has been catastrophically bad. At a minimum workers want a stable standard of living, so the failure to achieve that argues against the idea of strong bargaining power.

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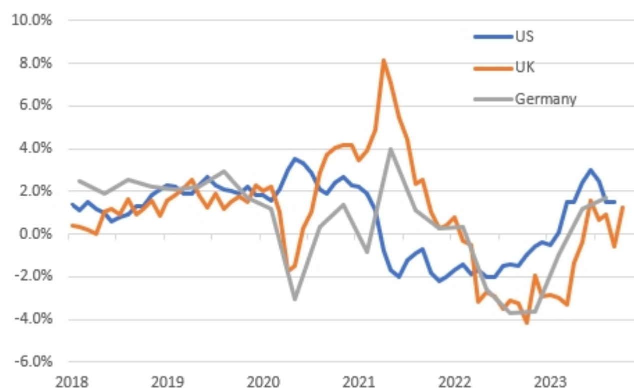
US job openings soared post pandemic, but have recently fallen fast

US job opening levels, all sectors

Source: Haver, UBS

Real wage growth has been unusually negative

Negative real wage growth has only begun to revert to normal positive levels, as inflation has moderated



Source: Haver, UBS. US real wage growth is the Atlanta wage tracker less consumer price inflation. UK real wage growth is median PAYE wages less consumer price inflation. German real wage growth is the Federal Statistical Office quarterly series. The German and UK real wage trough and spike in 2020-21 reflects the different pandemic policies to those of the US.

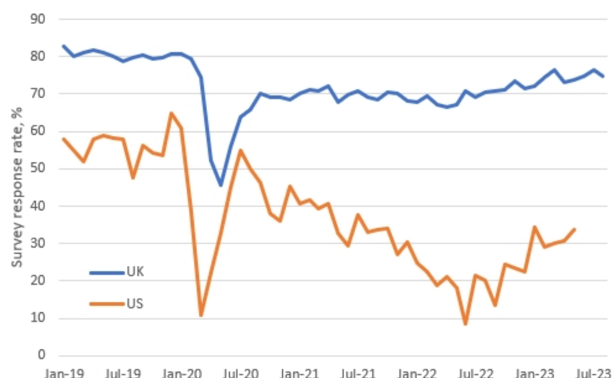
There are several possible causes of this apparent discrepancy, but a plausible explanation is the unusual shock of the pandemic. Self-reflection while spending time at home caused people to have a version of a mid-life crisis and decide to change their jobs. The savings households accumulated during the pandemic also allowed workers the time to search for alternative employment. That distorted the job vacancy data. As this distortion is now fading from jobs markets, it is important that investors understand what is happening.

Data quality

One of the problems with analysing the labour market is that the quality of data (in some countries), has weakened significantly. In the US the reported vacancy number is 22% above the 2019 average. However, that number is based on the responses of only one-third of companies that are asked participate in the survey that records job vacancies. The other two-thirds do not bother to reply. In 2019 over half of companies asked gave details of job vacancies. With so low a response rate today there is a real risk of distorted data. Normal businesses tend not give details of their vacancies, suggesting that the data is now a survey of outliers. Given that complaining is a strong incentive for filling in a survey, there may be a bias in favour of negative responses (meaning, complaints about difficulties in hiring).

Survey response rates

Proportion of those questioned answering surveys on job vacancies



Source: US Bureau of Labor Statistics, UK Office for National Statistics

The response rate of other countries, though lower post-pandemic, has not plunged in the way that it has done in the US. The UK's data on job vacancies is based off a survey with a 70% response rate, which is respectable enough. The number of UK vacancies is 19% above the 2019 average. So while some of the rise in vacancies might be poor quality data, the UK example would argue that there is still an increase in reported vacancies beyond data quality problems that still needs to be explained.

The jobs market and mid-life crises

So why did vacancy figures increase? Job vacancy figures across the developed world do not report total job vacancies – only those job vacancies that are externally advertised. This is an important distinction, as before the pandemic around half of job vacancies were filled internally. Those internally filled vacancies would not be published in the reported vacancies data.

This means that there are two possible reasons for a country's reported job vacancy rate to increase.

1. Employers have an overall staff shortage, and there are more unfilled jobs.

2. More people are changing their employers (known as "job hopping"), and vacancies which were previously filled internally must now be filled externally.

In the first case there would be a labour shortage and strong pay bargaining power. In the second case there is no overall labour market shortage – just labour market "churn." In both cases, companies are likely to complain that it is harder to find workers. Filling a job internally is easier to do than going through the process of advertising for external candidates, and then interviewing them. Survey-based evidence will be full of complaints about the difficulty of finding workers, because in both cases the employer has to put in some effort in order to hire an outsider.

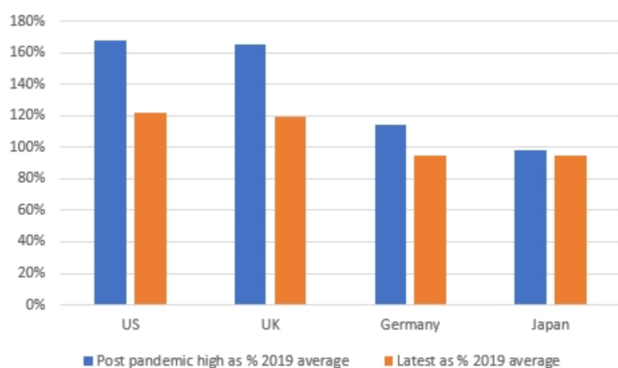
Ordinarily, replacement hiring takes less effort than new hiring, as the replacement can come from inside the organisation. Increased churn means human resource departments start having to do some work when undertaking replacement hiring, and they are unlikely to be happy about that. Unofficial data, for example online job advertisements, will also increase in both circumstances.

Both scenarios are likely to give the general population an *impression* of a labour shortages. Job vacancy adverts in the windows of shops and restaurants become more visible in both scenarios – but a labour shortage only actually exists in the first scenario. Increased visibility of vacancies can change perceptions by the general population – one consequence of which may be to encourage profit-led inflation. A narrative of "we don't want to raise prices, but it is hard to find labour" is more easily sold when every store is visibly trying to hire people.

Looking across developed economies, there was a significant jump in externally advertised job vacancies in the United States. The UK had an increase, but not as dramatic. In Germany and Japan there is no meaningful increase in vacancy rates compared to pre-pandemic times.

Some countries are more vacant

Post-pandemic high, and latest externally advertised job vacancies



Source: UBS, Haver

During the pandemic, US workers were made "temporarily unemployed," and received benefits paid by their state governments. That meant the enforced period of inactivity severed ties with the company – and although in theory they would be "recalled" to their old jobs, evidence from California suggests that fewer than half the temporarily unemployed went back to their former employers. That suggests an increase in the number of people job-hopping which would add to the reported job vacancy rate.

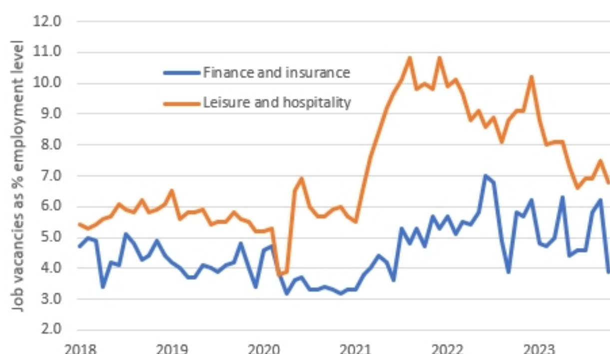
The UK pandemic experience was different. People were paid a proportion of their wage or salary by their employer, not by the government. The government paid the employer. Ties to the company were not severed, and people were not classified as being unemployed. Some people undoubtedly did rethink their life choices while sitting at home, and that led to some churn in the labour market - but on a smaller scale that in the US. The reported vacancy rate rose, but not as much as the US. This is interesting because the UK almost certainly had a higher proportion of migrant workers who quit their jobs and returned home during the pandemic than was the case in the US – and that is a process that will raise reported vacancy numbers.

Meanwhile, in Germany and Japan, companies paid furlough payments to workers, and a tradition of additional benefits and social norms kept prevented workers from job hopping in the way that their Anglo-Saxon counterparts had done. As a result, the reported job vacancy rate did not rise to the same degree.

This pattern also helps to explain why externally advertised job vacancy rates were more likely to increase for lower skilled work. Lower-skilled employees, especially those in the service sector, were more likely to sever their ties to their employers. Higher-skilled employees were more likely to be able to work from home, implying no severing of ties and also less time in which to indulge in a mid-life crisis and decide to change careers. Higher-skilled employees are also likely to have other ties reducing the desire to hop jobs – what economists would call the sunk capital of having established a professional network, and things like pension and healthcare benefits.

Sectors vulnerable to job hopping have higher vacancy rates

US job vacancy rates were higher in sectors that have more low-skilled workers



Source: Haver, UBS

Why do we care?

The more that the increase in vacancies is due to labour market churn, the less troubling it is for financial markets. Vacancy rates that represent churn are less of a threat to profit margins, and generally should be less inflationary (as they are unlikely to produce a wage price spiral). While some policy makers, including US Federal Reserve Chair Powell, have referenced vacancy rates in support of tighter monetary policy, the case is not proven. Overdependence on vacancy rates, without accounting for the structural breaks of declining data quality and an increase in job hopping, increases the risk of central bank policy error.

Labour market churn is not expected to last indefinitely. The collective mid-life crisis induced by pandemic lockdowns is not likely to turn most people into serial job hoppers; if you wanted to change job you should have done it already. As fewer job hoppers distort the numbers, vacancy rates are already coming down. Just as it was important to recognise that the rise in vacancies is not a proportionate tightening of the labour market, the reduction in labour churn does not mean that labour markets are easing.

Generally speaking, if there is more churn in a labour market productivity is likely to be negatively affected. The time spent learning new technology systems and building new personal networks is something that is likely to subtract from an individual employee’s efficiency. If employees get over their mid-life crises and stay in place for longer, their productivity is likely to improve. (After thirty years at UBS, I should acknowledge that I may have a personal incentive to stress this point.) This means that as labour churn starts to slow, labour cost growth is also likely to slow – and indeed to slow more aggressively.

Was it all a mid-life crisis?

Clearly, the pandemic shook up labour markets in multiple ways. Demand patterns have shifted, probably permanently. Online shopping means consumers demand delivery drivers to deliver their purchases, and are no longer content to collect their shopping themselves. These structural changes lead to a lasting shift in labour demand. Flexible working has meant that geographic patterns of spending have changed, so that workers may be in the wrong place for the jobs that are available. In some countries (e.g. the US) female participation in the workforce fell as childcare demands rose.

While there have been more “frictions” in the workforce, as labour markets struggle to adjust to the abrupt changes of the wider economy, we need to be cautious about assuming labour markets are universally tight, even as businesses complain. The pandemic pushed people to reconsider their life choices and challenge the status quo. In some cases that meant changing jobs. As job hopping declines and people stay in place, talk of labour tightness should decline (and worker productivity increase). Job vacancy numbers do not tell the story the headline numbers suggest.

Appendix

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