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Global Economics Analyst

A Temperature Check on DM Labor Markets (Briggs/Pierdomenico)

- Labor market rebalancing is well underway in DM economies, mostly because of a decline in job openings. This rebalancing has, on average, led our jobs-workers gap to retrace 58% of its overshoot during the pandemic—with notably larger reductions in Canada and the US—and wage growth to step down from its peak pace in DM economies.
- So far, the labor market cooldown has been fairly benign. Despite clear signs of softening—including an uptick in the unemployment rate, slower job growth, and softer survey data—a holistic view suggests most DM labor markets remain tighter than they were in 2019. As a result, DM central banks most likely view the current rebalancing favorably and will not be too concerned about incremental cooling.
- While a more significant labor market deterioration could raise concerns, we see three reasons why DM labor markets are likely to stabilize before slowing too much. First, growth in job openings has historically tracked GDP growth very closely, and our near-trend 2024 growth forecasts coupled with fading recession fears argue against an unnecessarily large pullback.
- Second, the labor market rebalancing thus far mostly reflects a correction of excessive job posting, as job openings overshot fundamental-consistent levels in 2021-2022 before unwinding in 2023. We suspect that labor markets will stabilize after job opening overshoots fully reverse, provided that growth and inflation dynamics normalize in line with our forecasts.
- Third, labor markets in the earlier hikers—mostly EM economies where policy and economic dynamics have led DMs by 6-12 months—continue to point toward a sustainable rebalancing process. In these economies, unemployment rates have stabilized at a low level, employment growth has stabilized at an elevated level, and the average jobs-workers gap has been roughly stable at its 2019 level since the start of the year.
- This evidence points toward a continued gradual rebalancing and subsequent stabilization in DM labor markets. We therefore continue to forecast that unemployment rates will remain near their current levels as wage growth gradually decelerates through end-2024.

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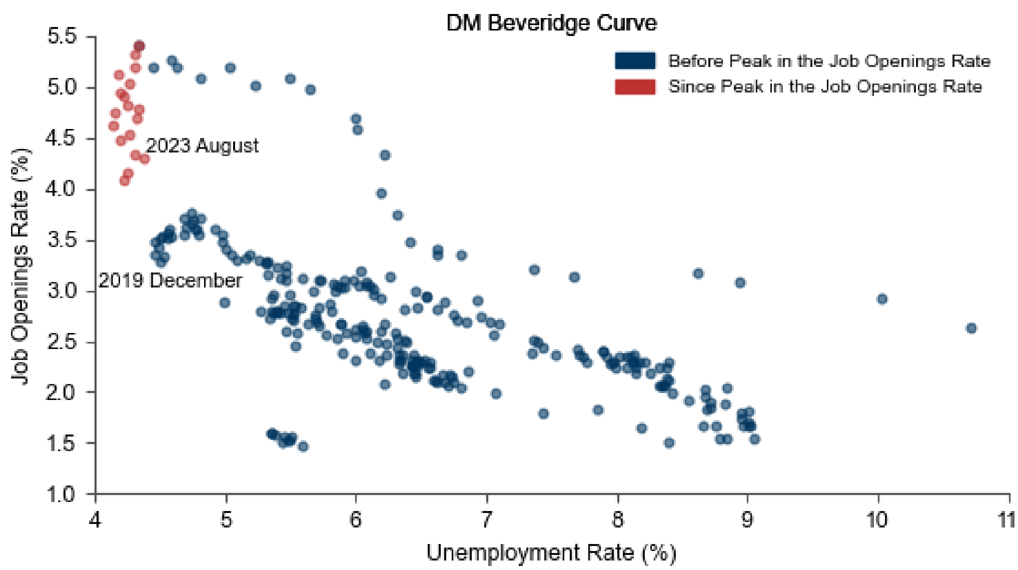
A Temperature Check on DM Labor Markets[1]

Recent progress on core inflation has been positive, but sustainably lowering inflation requires a rebalancing of DM labor markets and a slowing of wage growth to target-consistent levels. The good news is that labor market rebalancing has so far proceeded very favorably, as job openings have meaningfully declined while the unemployment rate has only modestly risen in most DM economies.

One way to visualize this progress is through the "Beveridge curve", the empirical relationship observed by plotting the job openings rate against the unemployment rate. As shown in Exhibit 1, the Beveridge curve has shifted inwards since job openings peaked in 2022, back towards its position in late 2019.

Exhibit 1: Job Openings Have Declined Without a Significant Increase in the Unemployment Rate



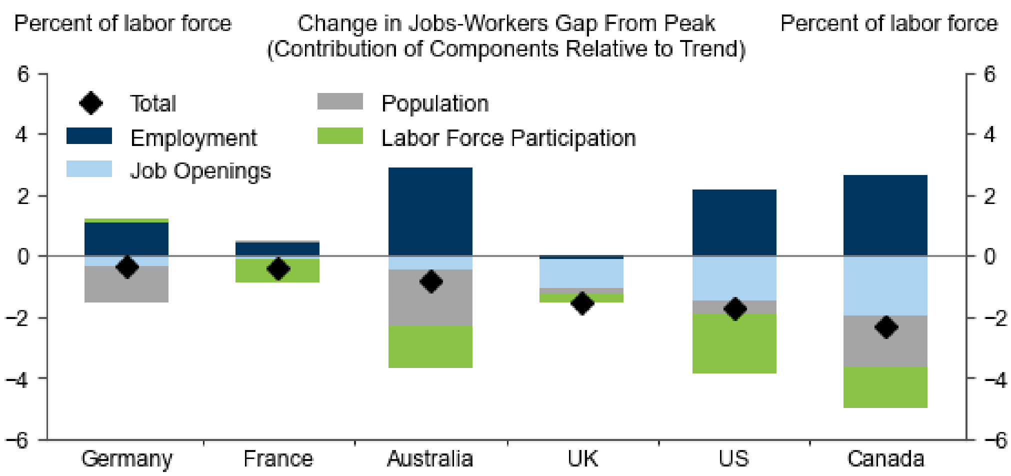
The DM Beveridge curve plots the GDP-weighted average of the job openings rate and the unemployment rate for the US, Germany, France, Italy, Spain, the Netherlands, Japan, the UK, Canada, Australia, Sweden, and Norway.

Source: Haver Analytics, Goldman Sachs Global Investment Research

Another way to visualize labor market rebalancing progress is through the decline in our jobs-workers gap—defined as the difference between the number of jobs that employers demand (i.e., job openings plus total employment) and total labor supply offered by workers (i.e., the labor force). As shown in Exhibit 2, jobs-workers gaps have declined from their peak in nearly all major economies—with notably more progress in the US, Canada, and the UK and less progress in the Euro Area—and has on average retraced 58% of its peak overshoot in DM economies.

[1] We would like to thank Chelsea Song, intern on the Global Economics team, for her contribution to this report.

Exhibit 2: Jobs-Workers Gaps Have Declined in Most DM Economies

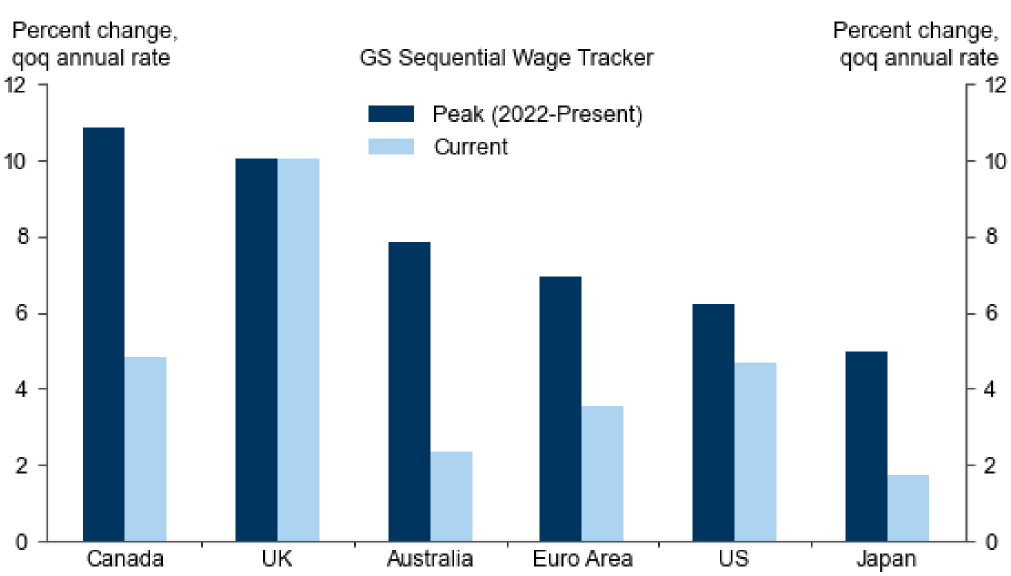


Note: The decomposition compares current values of the jobs-workers gap components to a counterfactual implied by the pre-covid population trend. Current values are GS nowcast using Indeed job openings data when official data is unavailable.

Source: Haver Analytics, Goldman Sachs Global Investment Research

This labor market rebalancing has contributed to a stepdown in wage growth. As shown in Exhibit 3, our sequential wage trackers have slowed from their peak in nearly all DM economies outside of the UK, where preliminary private-sector wage data not yet reflected in our wage tracker point to a significant slowdown in Q3. While some of this progress on wage growth reflects a cooldown in inflation itself, the labor market rebalancing thus far has likely indirectly dampened the pass-through from price inflation to wages and directly slowed wage growth through improved balance between labor demand and supply.

Exhibit 3: Wage Growth Has Slowed



Source: Goldman Sachs Global Investment Research

Some Signs of Labor Market Softening

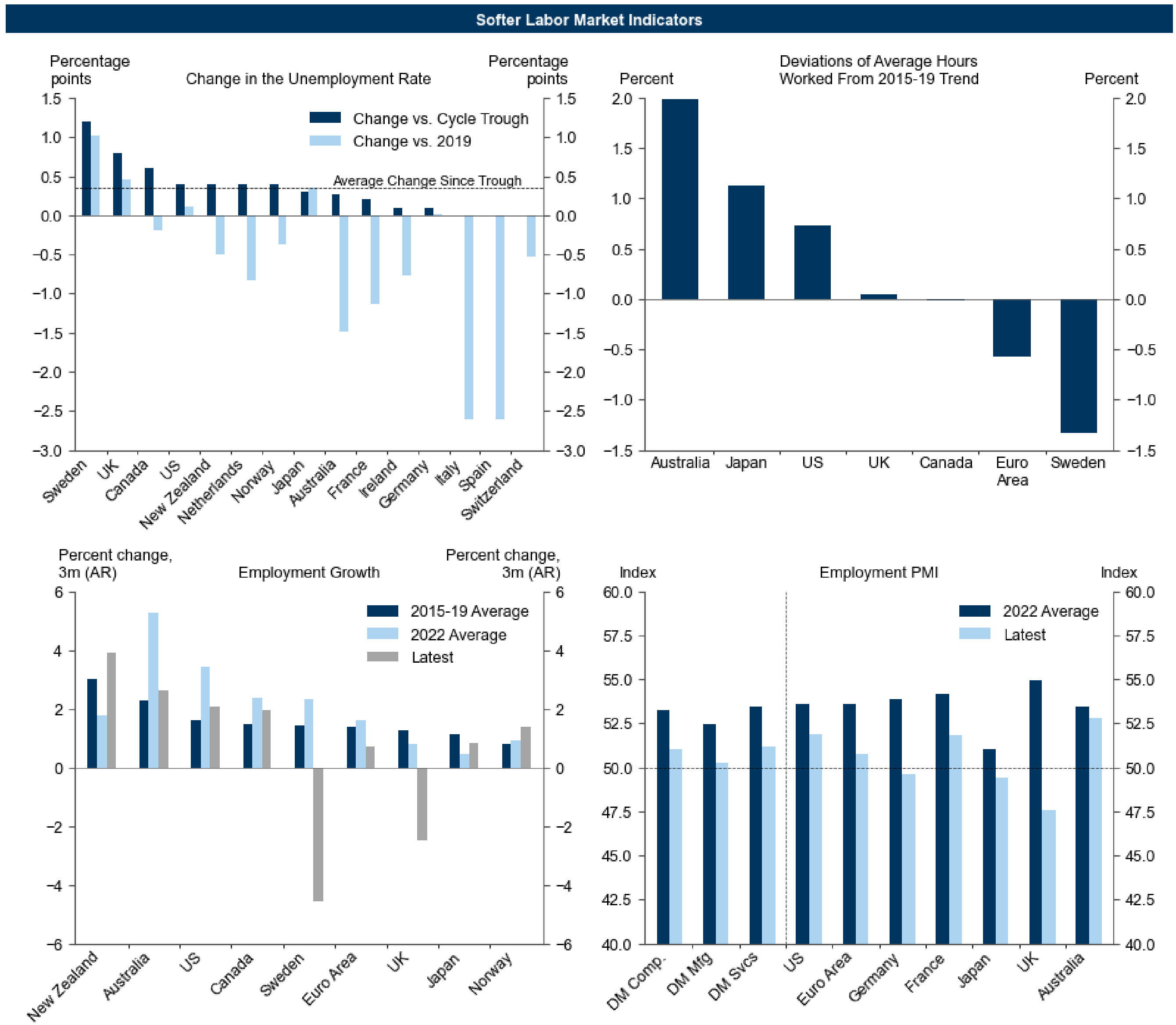
Although labor market rebalancing has gone extremely well so far, some commentators and investors remain concerned that an overcorrection could lead to a meaningful increase in the unemployment rate. This view—which is reflected in the still very elevated probability consensus forecasts assign to a US recession in the next 12 months (55% consensus vs. 15% GS forecast)—is largely based on prior empirical patterns where 1) job openings have never declined as much as they have this cycle without a corresponding rise in the unemployment rate and 2) increases in the unemployment rate tend to lag declines in job vacancies.

Despite clear signs of cooling, several of the often-cited concerns look relatively benign when placed in the appropriate context.

- The unemployment rate has, on average, increased by 0.3pp from its trough, but remains near or below its 2019 level (and central bank estimates of NAIRU) in all DM economies aside from Sweden and the UK (top left chart, Exhibit 4). Furthermore, in most DM economies this increase in unemployment reflects an uptick in labor supply rather than an increase in layoffs.
- Average hours worked have eased from their cycle peak in most DM economies—including by 4.3% in Sweden, 1.4% in the US, and 1.3% in Canada—but these declines mostly reflect a reversal of pandemic overshoots (themselves largely driven by changes in the composition of employment), and hours worked generally remain above their pre-pandemic trend (top right chart, Exhibit 4). A notable exception is the Euro Area, although our European economists note that some of this weakness reflects structural changes in the post-pandemic labor market that are likely to prove persistent.
- Job growth has meaningfully slowed from its rapid pace in 2022, but generally remains above its pre-pandemic pace (bottom left chart, Exhibit 4).
- The employment component of PMIs has generally eased from its 2022 level, but remains in expansionary territory in most economies outside of the UK, Japan, and Germany (bottom right chart, Exhibit 4).

These patterns clearly suggest that labor markets are rebalancing, but do not suggest they have rebalanced to a problematic point.

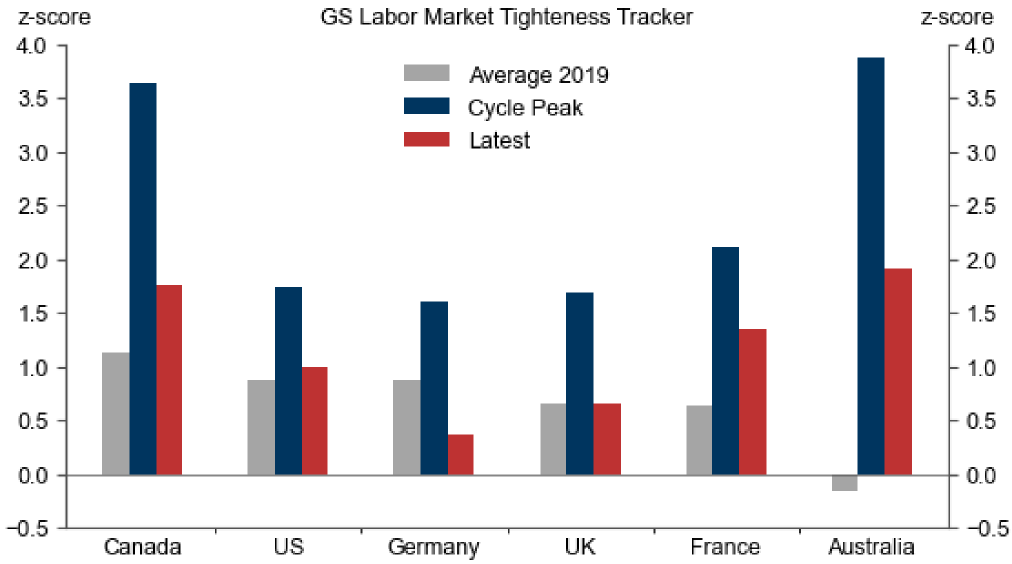
Exhibit 4: The Labor Market Has Softened Along Some Dimensions, but Not in an Alarming Manner



Source: Haver Analytics, Goldman Sachs Global Investment Research

Our relatively positive read of the labor market dashboard is confirmed by our DM labor market tightness trackers, which average the common signal from unemployment rates, 6-month percent changes in employment, PMI employment indices, and our jobs-workers gaps. As shown in Exhibit 5, these summary measures indicate that DM labor markets have softened from their peak level of tightness in 2022 and early 2023, but mostly remain tighter than in 2019, a period when labor markets were generally considered extremely strong.

Exhibit 5: A Holistic View Suggests Labor Markets Mostly Remain Tighter Than in 2019



The trackers average the Z-scores of the unemployment rate (inverted), 6-month percent change in employment, PMI employment indices, and our jobs-workers gap. Z-scores are computed over 2000-2019. We use country-specific business surveys on employment expectations to extend back the PMI employment series to 2000 where needed.

Source: Haver Analytics, Goldman Sachs Global Investment Research

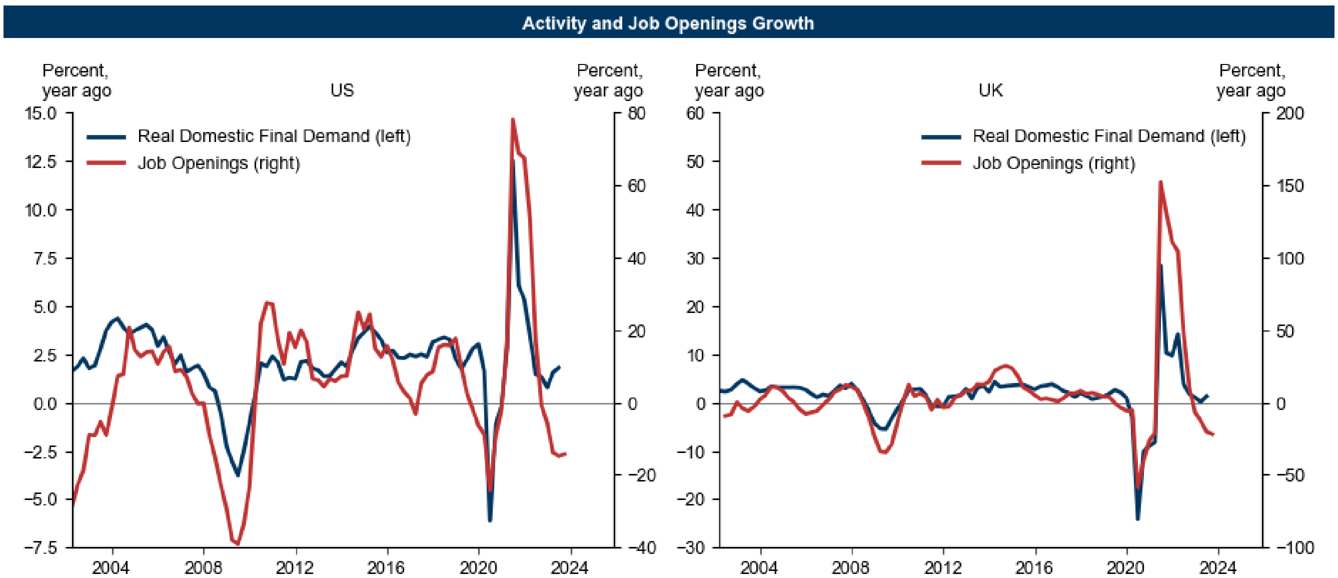
Taken together, while labor markets have eased to a greater extent in a few countries like the UK, Germany, and Sweden, a holistic view suggests that labor markets are rebalancing back to 2019 levels of tightness. As a result, central banks mostly likely view the current rebalancing favorably and will not be too concerned about further incremental cooling.

Stabilization Ahead

Of course, DM labor markets could soften too much if the current pace of labor market rebalancing continued indefinitely. However, we see three reasons why DM labor markets are likely to stabilize before rebalancing too far.

First, growth in job openings has historically tracked GDP growth very closely (Exhibit 6). In 2024, we expect that GDP growth will reaccelerate back to near trend in most DM economies. This pickup in growth—combined with fading recession fears that may have prompted some firms to reevaluate their hiring needs—argues against an unnecessarily large pullback in labor demand.

Exhibit 6: Job Openings Growth Tracks GDP Growth Reasonably Well

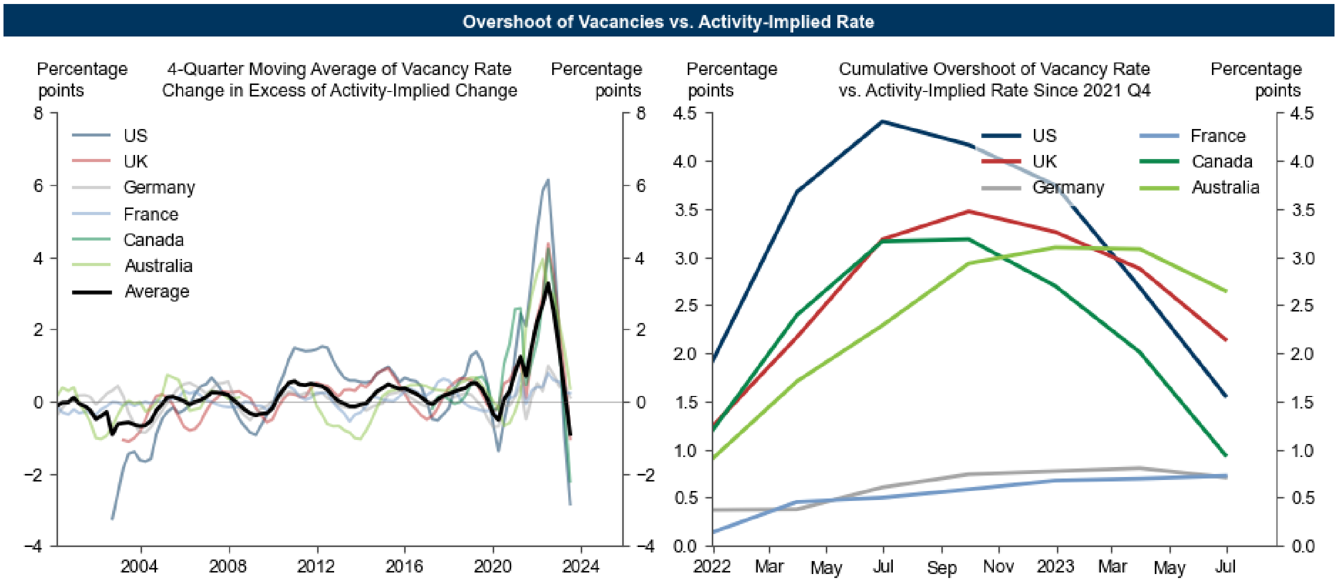


Source: Haver Analytics, Goldman Sachs Global Investment Research

Second, labor market rebalancing thus far mostly reflects a correction of excessive job posting, as job opening growth overshot fundamental-consistent levels in 2021-2022 before undershooting in 2023 (Exhibit 6). We believe that this undershoot has not yet fully run its course, and that firms will continue to close job openings rather than reduce employment on net. To demonstrate, Exhibit 7 shows that the overshoot in 2021 and 2022 was unusually large, as the job openings rate increased above the level implied by the pick-up in growth by roughly 3pp on average. While the overshoot looks less extreme today, job openings rates remain above the level implied by real demand growth in all DM economies, suggesting that some natural normalization remains in the pipeline.

Why did job openings outpace growth so meaningfully as DM economies reopened? We suspect that over-extrapolation of nominal growth during economic reopening may have contributed to the overshoot. If so, more normal economic dynamics should help labor demand stabilize going forward, provided that growth and inflation dynamics normalize in line with our forecasts.

Exhibit 7: Recent Rebalancing Mostly Reflects an Overshoot in Job Openings That is Now Reversing

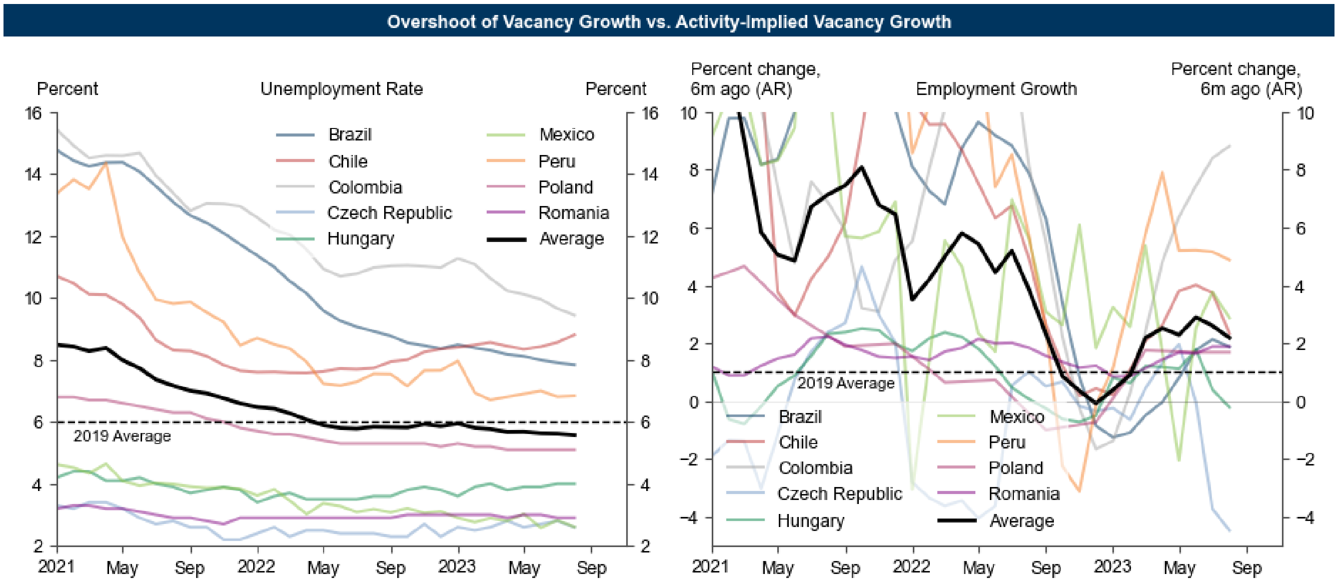


For each country, we regress year-over-year changes in the vacancy rate over year-over-year changes in real domestic final demand over a sample ending at the end of 2019 and consider fitted residuals.

Source: Haver Analytics, Goldman Sachs Global Investment Research

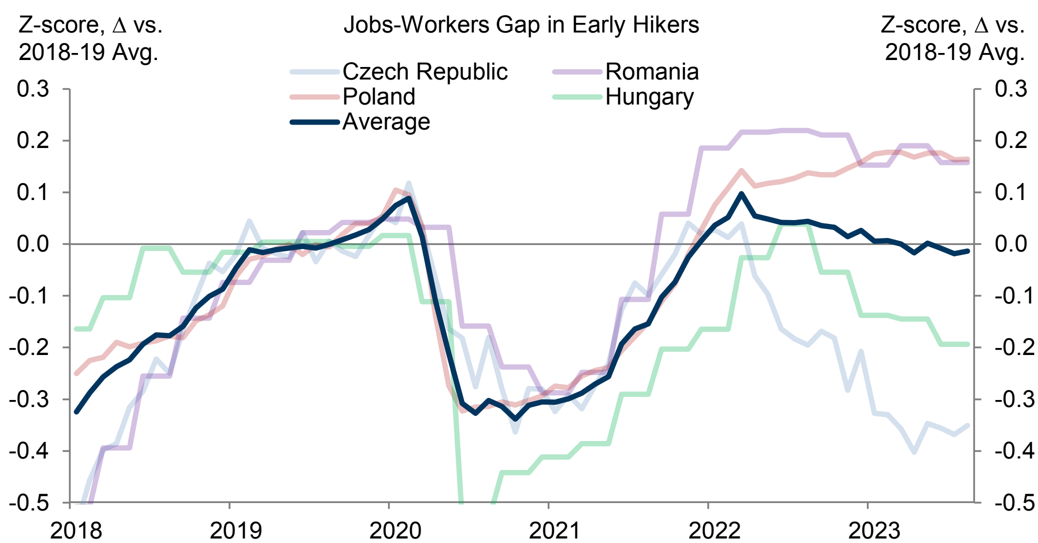
Third, labor markets in the earlier hikers—EM economies where the economic and monetary policy cycle has led DMs by 6-12 months—continue to point toward a sustainable rebalancing process. In these economies, unemployment rates have stabilized at a low level (left chart, Exhibit 8), employment growth has stabilized above pre-pandemic norms (right chart, Exhibit 8), and the average jobs-workers gap has been roughly stable at its 2019 level since the start of the year (Exhibit 9). While differences in EM and DM labor markets argue for some caution in extrapolating these results, we view the significant labor market rebalancing without any meaningful job loss as a positive signal for the DM labor market outlook.

Exhibit 8: Unemployment Rates and Employment Growth Are Stabilizing at High Levels in Early Hiker Economies



Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 9: Our Jobs-Workers Gap Is Also Stabilizing Near Its 2019 Level in the Average Early Hiker

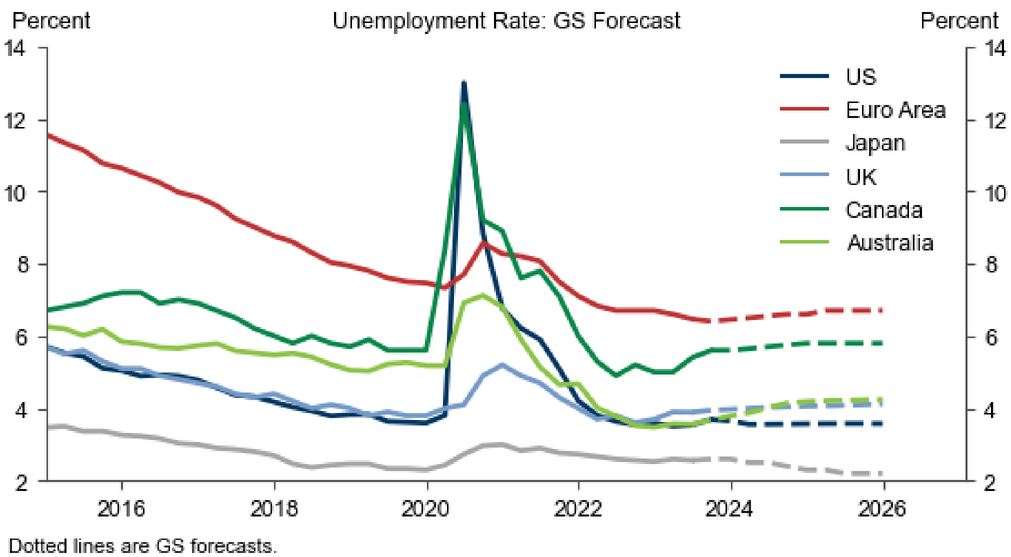


Source: Haver Analytics, Goldman Sachs Global Investment Research

Reiterating Our Positive Labor Market Outlook

Taken together, this evidence points toward a continued gradual rebalancing and subsequent stabilization in DM labor markets, with further rebalancing mostly occurring through a reduction in job openings with only a moderate increase in the unemployment rate (Exhibit 10).

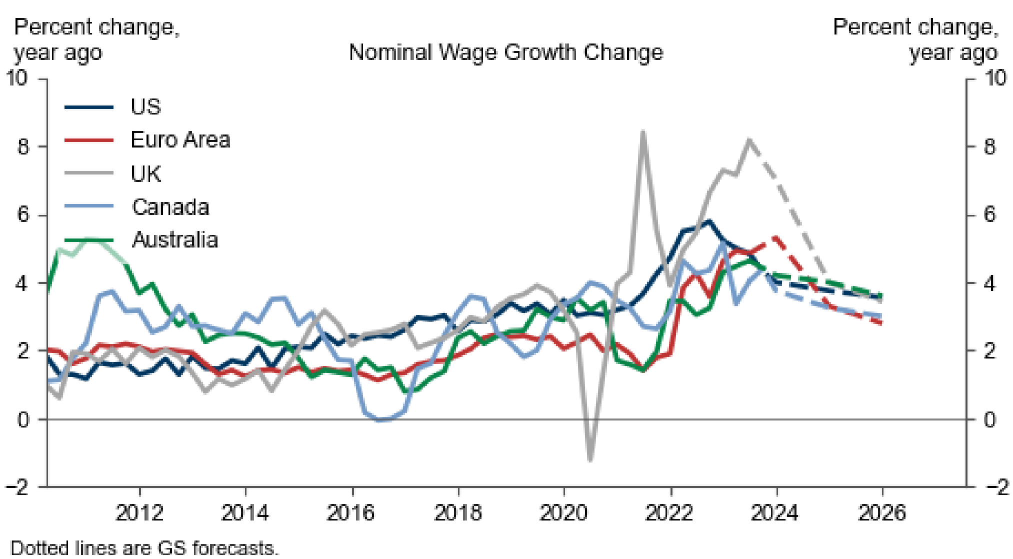
Exhibit 10: We Expect Unemployment to Remain Near Its Current Level



Source: Haver Analytics, Goldman Sachs Global Investment Research

Given our forecast that labor market rebalancing continues to unfold in a relatively controlled manner, we expect wage growth to gradually decelerate through end-2024, before stabilizing at levels roughly consistent with 2% target inflation (Exhibit 11).

Exhibit 11: We Expect Wage Growth to Moderate Gradually



We plot realized values and forecasts for the GS wage trackers in all countries except the UK, where we show average weekly earnings growth (regular pay for the private sector), our preferred wage growth measure.

Source: Haver Analytics, Goldman Sachs Global Investment Research

This slow deceleration in nominal wage growth—combined with a sharper deceleration in headline inflation—should lead real wage growth to swing comfortably into positive territory, thereby providing a strong tailwind for real income, consumer spending, and overall GDP growth in 2024.

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Giovanni Pierdomenico

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Reg AC

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