



INVESTMENT UPDATE

It was recently announced that the US economic recession, caused by the sudden and widespread surge in COVID-19 infections last year, is officially over. More to the point, it seems that this particular recession was over almost as soon as it started, lasting only two months—from February to April of 2020—going down in the history books as the shortest-ever US recession.

This pronouncement was made by the National Bureau of Economic Research, which is the official recordkeeper of such things. Never mind that this two-month recession didn't meet the traditional criteria of "a decline in real US GDP that extends over two consecutive quarters," the NBER says it was a recession, and that's that. At least we can all agree that this recession met the "decline in output" standard. By any measure, the decline in US GDP and massive unemployment that resulted certainly qualifies as recessionary. Our problem isn't so much a definitional one, it's that the way the NBER calculated its duration stretches the limits of credibility. Two months? In some very important ways, the recession is ongoing, nearly 18 months after its onset. Let's look at the evidence.

The chart on the top of this page shows just how severe last year's drop in US economic growth was.

We've seen severe recessions before—the double-barreled early 1980s' recession and the global financial crisis of 2007–2009 saw significant declines in US output, with GDP shrinking at an 8% to 9% annual rate. But that's a blip on the screen compared to what we witnessed last year. In one of the more remarkable events in world history, global economic growth came to a skidding halt in the first quarter of 2020. US output fell by an annual rate of more than 30%, equivalent to an annual loss of output of more than \$2 trillion—roughly equal to Italy's yearly GDP, the

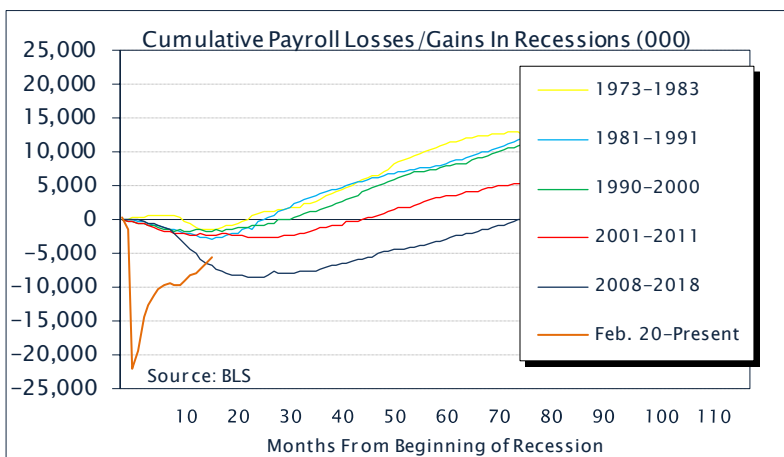
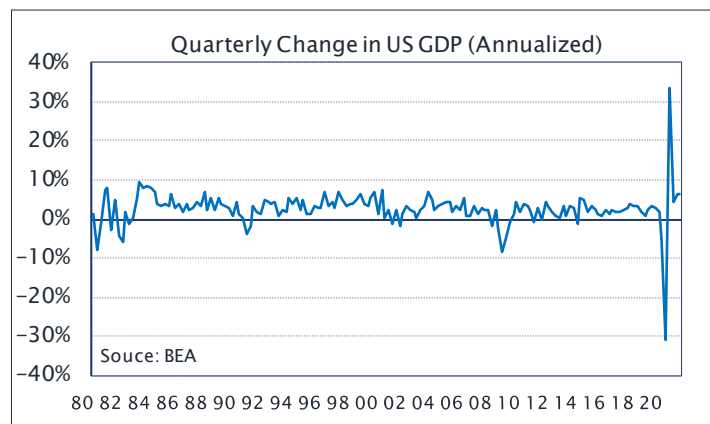
eighth largest economy in the world. And while growth rebounded quickly, it took more than five quarters for the US economy to reach the level of output reached at the previous peak in the fourth quarter of 2019.

But GDP doesn't tell the whole story, as millions of people are still out of work, one way or another, due to the effects of COVID on the labor markets. As the second chart shows, in

the immediate aftermath of the outbreak, more than 20 million workers were removed from US payrolls. Again, the magnitude of this drop was far worse than any in US history, with more than twice as large an impact on payrolls as was seen during the global financial crisis, and in a far shorter period of time. Like GDP, payrolls have made a strong comeback; unlike GDP, payrolls are nowhere near

back to pre-crisis levels. Based on pre- and post-pandemic (if that's really where we are now?) payroll numbers, it appears that five million people are out of work compared to early

2020. But, in fact, that number is quite a bit larger, as new people have entered the workforce (net of new retirees), plus there are the long-term unemployed who were already looking for work before the crisis. Unemployment benefits rolls and other data indicates that the true number of unemployed is currently closer to nine million people.



Employment is arguably the single most important consideration when judging the health of an economy. When people have jobs, especially good-paying jobs, they're confident enough not just to pay their bills, but to make other important decisions regarding family, savings, and leisure activities. When jobs are plentiful economic sentiment strengthens further, as employees have the confidence to ask for promotions and increases in wages and benefits, as their services may be

in demand from competing employers. Alternatively, when job opportunities are limited and millions of unemployed workers are struggling to find work, confidence falls, consumer spending weakens, and economic growth sputters.

Right now, we're getting mixed signals from the labor markets. On the one hand, as we saw above, while the employment picture is improving, there are still millions of people out of work. And yet, when we look at the Bureau of Labor Statistics' JOLTS (Job Openings and Labor Turnover Survey) reports, there are a record number of jobs available—currently in excess of 10 million, more than at any time since this series began 20+ years ago. By any measure, there are more job openings than there are unemployed people.

One of the big reasons for this disconnect is extended unemployment benefits, which are still being sent to millions of households. The two biggest programs, Pandemic Emergency Unemployment Compensation (PEUC) and Pandemic Unemployment Assistance (PUA), were extended earlier this year, and will be expiring on September 9th, although roughly half of US states ended some or all of these payments over the past two months. In July, 9.5 million Americans were receiving payments from these programs, and that number has declined since then by a couple of million (since the programs are implemented at the state level, getting precise data is difficult). As these benefits roll off, payrolls should continue to rise, but in the meantime it appears that these programs are keeping a lot of potential workers on the sidelines.

Extended benefits aren't the only factor as to why employers are finding it difficult to find workers. Many people continue to be concerned about the dangers of returning to work, which have likely increased over recent weeks with the spread of the Delta variant. Working families with children at home have been particularly impacted, as childcare is difficult to source for many, while remote education puts a bigger burden on parents to stay home and help with school. To the extent that vaccinations and immunity from a previous COVID infection ultimately gets us to something close to herd immunity, these obstacles are expected to fade over the next year or so.

What isn't likely to fade over the near-term are certain structural challenges, some of which were already present before COVID, and others made worse by the virus. Another look at the chart on this page shows that, even prior to 2020, there was a growing gap between job openings and new hires; despite a healthy economy and growing demand for labor, hiring remained essentially unchanged for years before COVID. Many

economists believe this has been due to a mismatch between the type of skills that employers need and the skills that unemployed workers offer. The financial crisis upended the US labor market, and while millions were able to adapt, new skills—particularly in the tech sector—remain in short supply.

The events of the past year have, as the chart shows, only widened that gap. Many of the job openings over the past few months are in industries that were the hardest hit last year, including restaurant, transportation, and hotel/lodging industries. These jobs generally don't pay well, and higher-skilled folks don't want those jobs. In some cases, former restaurant and hotel workers have found different jobs and won't be coming back. There are anecdotal reports that in places like New York and San Francisco, workers have moved away from urban areas, and further from where these jobs are clustered.

In what *Barron's* is calling "The Great Resignation," millions of people in the US labor force have been emboldened by stimulus checks and disruptions in their work lives to take a hard look at their employment situation, and an increasing number are switching jobs. Once again, you can see it in the data in the rising number of "quits" in the US labor market, a sign of confidence among workers that

there's a better job out there for them. It's no surprise that surveys indicate that the events of the past year have led to increased alienation among workers. With potential employees increasingly selective in taking on a new job, employers will have to adjust to the demands of the labor force. It's not just higher pay; surveys show that workers are willing to

defer salary increases if it means more flexibility in scheduling, including remote working options.

The big question, as it relates to bond investors, is whether workers' new-found leverage will translate into higher wages and salaries over the medium and longer term. In a service-oriented economy like ours, personnel expenses that rise period after period are one of the biggest risks to long-term inflation. One-off signing bonuses don't lead to higher inflation; that's just a cost increase. But a working population with bargaining power, in a world where employers are in a constant struggle to find the right people for job openings—that is a credible scenario for higher wages over the next few quarters.

There's no reason to push the panic button just yet; certain imbalances in the US labor market should subside in the coming months. And higher wages, if they persist, won't be passed through dollar-for-dollar into consumer prices. Nevertheless, this is an important topic worth keeping close tabs on.

