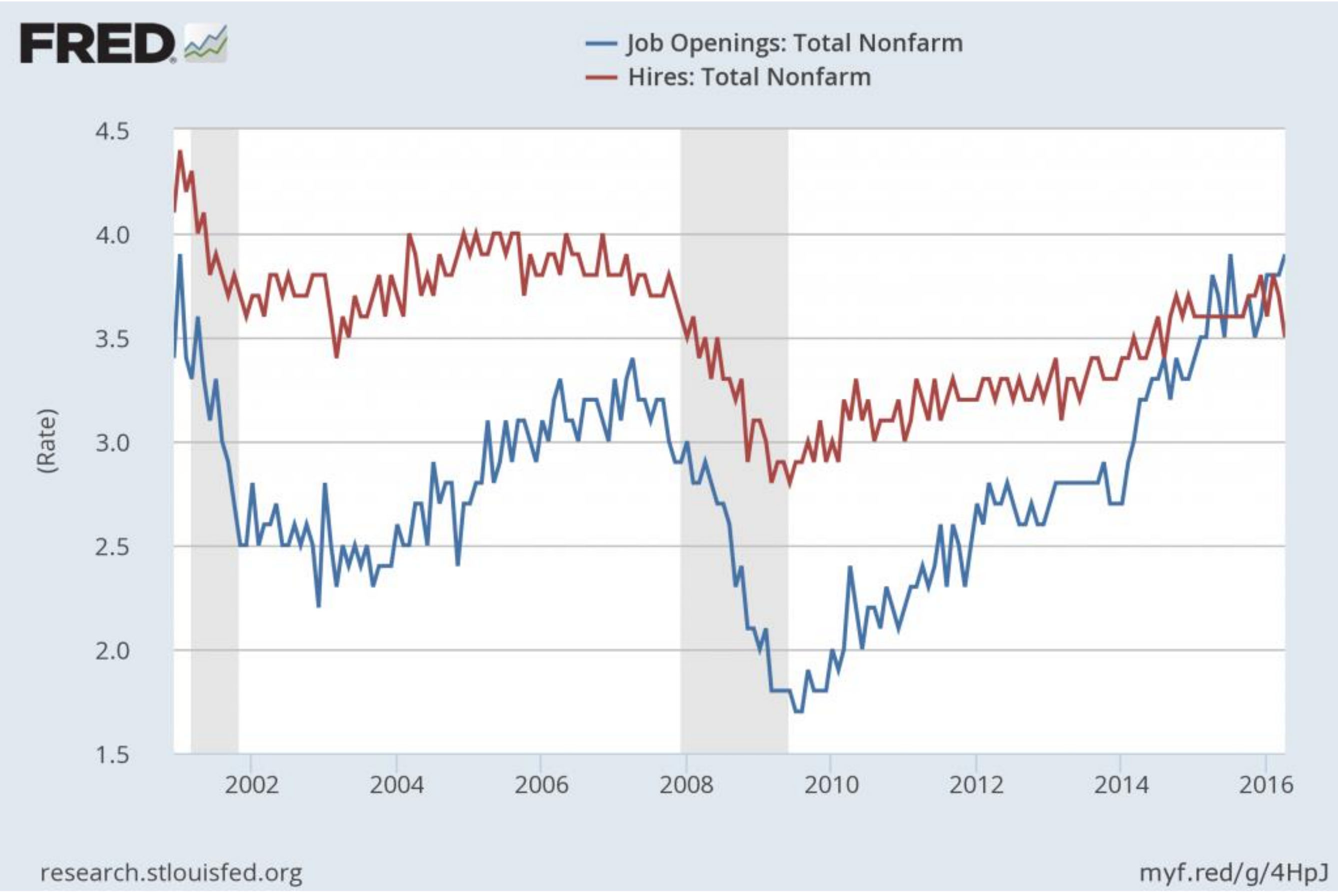
[Market Insights: Is America running out of workers?]

Courtesy of BetaShares

The much weaker than expected 38,000 gain in United States payrolls for May led many to fear a weakening in the US economy and immediately caused the market probability of a near-term Federal Reserve interest rate increase to drop notably. But rather than weak demand, the soft payrolls report might also reflect emerging capacity constraints. If so, it would pose upside risks to inflation and interest rates and downside risks to economic growth and profits.

Weak employment despite strong hiring intentions

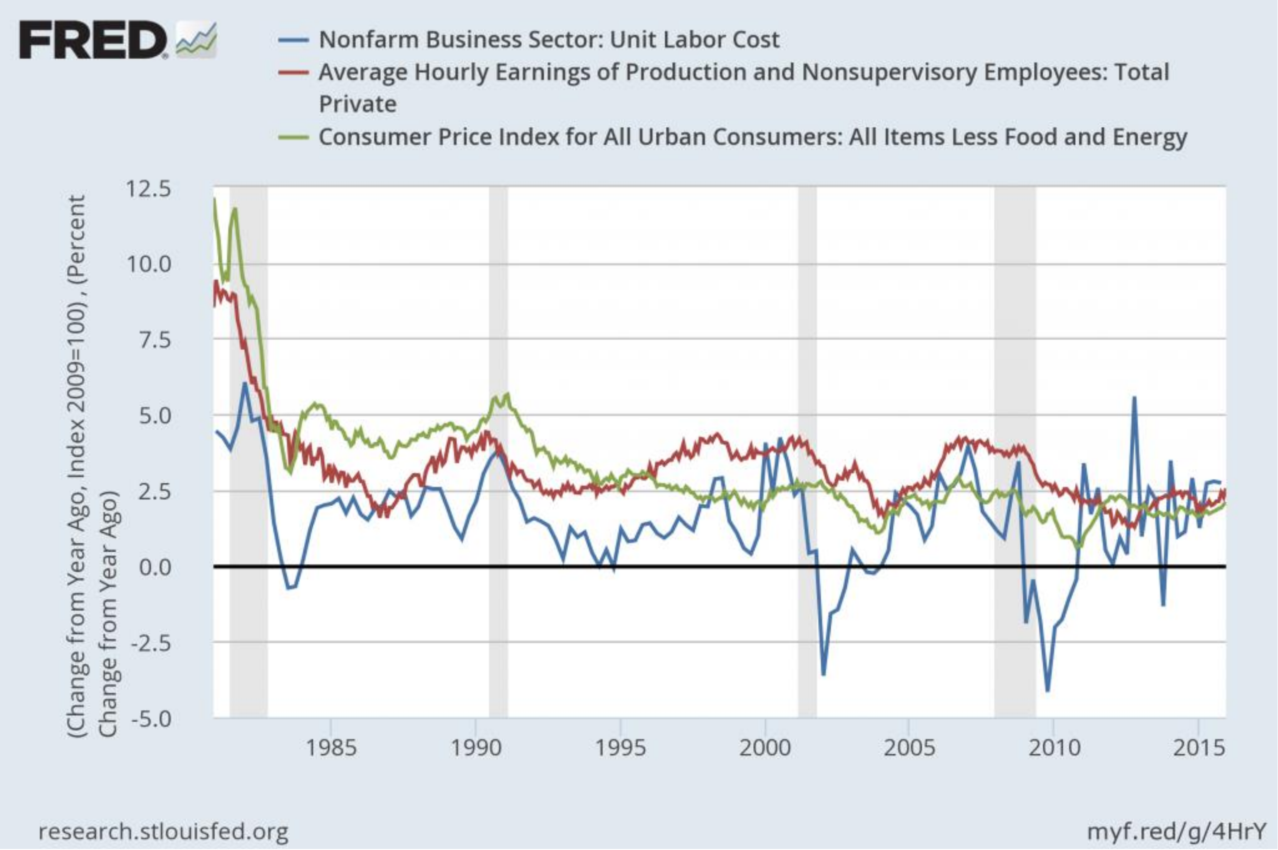
The knee-jerk market reaction to weak US payrolls report was to suggest it reflected a weakening in labour demand. Yet such a result is inconsistent with still strong US hiring intentions. As seen in the chart below, the official US job opening rate (total surveyed job openings as a % of employment plus job openings) has continued to march upward in recent months, and is now at a higher level than prior to the financial crisis. That suggests the employment result could simply be a “rogue number”, which is either revised away or followed by a large rebound in coming months.



That said, the soft result is also consistent with the possible emergence of capacity constraints. The above chart also shows that the rate of labour hires appears to have flattened off somewhat, which against the backdrop of still high openings suggests employers may be finding it more difficult to attract suitable workers. And less noted in the May payrolls report was the sharp decline in the unemployment rate to only 4.7%, which is now the lowest level since just before the financial crisis.

Labour costs and core inflation edging up

Labour market tightness is also evident from an upturn in average hourly earnings in recent months to around a 2.5% annual rate. While this is still relatively low by historic standards, the direction now appears clearly upward. What's more, due to much weaker than typical labour productivity growth during the current expansion, unit labour costs – quite unusually – are now running at a *faster* annual pace than hourly earnings, at around 3% over the past year. That's also consistent with an (albeit gentle) uptrend in core consumer price inflation since mid-2015.



US profits looking ever more vulnerable

The final chart shows trends in the unemployment rate and America's corporate profit share. As evident, a peaking in the profit share has usually taken place mid-way during past economic expansions, and begins to decline notably as the unemployment rate reaches relatively low levels – indicative of labour market tightening pushing up wages and squeezing profits. Although the US profit share has clearly peaked and appears to be turning down, it has yet to fall precipitously and remains at a relatively high level. But if the unemployment rate continues to edge lower, the risk is that wages growth will start to accelerate and the profit margin will contract much further – which in turn could cause corporate America to cut back on employment and investment, potentially precipitating the next recession.