

# MacroMatters

## How soon can the US get back to work?

Chris Rands • 18 June 2020

### Team view

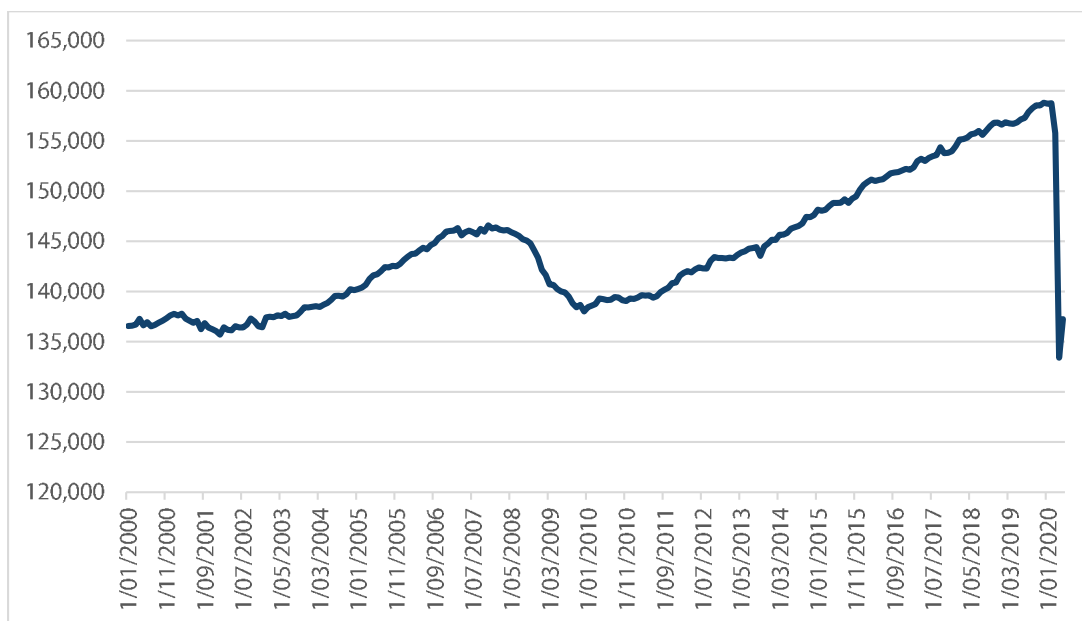
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The shock unemployment figures in the US on Friday the 5<sup>th</sup> —+2.5m jobs vs an expected -7.5m jobs—got us thinking. Just how fast could a “V” shaped recovery be? In this edition of MacroMatters, we did some digging in the weeds of the employment figures to try and get a feel for what is driving the numbers and provide a back-of-an-envelope calculation of just how fast employment could recover.

### Not all unemployment is created equal

The best place to start this note is to look at the economic damage created so far. Through the past three months, outright employment figures have seen an unprecedented amount of jobs lost, which, to date, has been about 20 million. About two times the damage of the GFC.

Chart 1 US total employment



Source: Bloomberg

However, the interesting point from Friday night is that not all unemployment is created equal. Here is one (of the many) tables produced by the US Bureau of Labor Statistics, which shows how people are categorising their unemployment.

Table 1 Reasons for unemployment, US

Reason	Not seasonally adjusted			Seasonally adjusted					
	May '19	Apr '20	May '20	May '19	Jan '20	Feb '20	Mar '20	Apr '20	May '20
Number of employed									
Job losers & persons who completed temporary jobs	2,281	20,384	17,834	2,675	2,665	2,723	3,946	20,626	18,291
On temporary layoff	594	17,878	15,03	865	742	801	1,848	18,063	15,343
Not on temporary layoff	1,687	2,506	2,801	1,810	1,923	1,922	2,099	2,563	2,948
Permanent job losers	1,229	1,951	2,206	1,300	1,289	1,279	1,456	2,000	2,295
Persons who completed temporary jobs	458	555	595	510	634	644	643	563	653
Job leavers	773	520	513	809	836	777	727	570	554
Re-entrants	1,891	1,329	1,674	1,850	1,838	1,803	1,778	1,477	1,645
New Entrants	557	271	492	602	557	505	509	389	536

Source: U.S. Bureau of Labor Statistics

Of the ~20 million people who became unemployed due to COVID-19, around 15.5 million currently believe it's temporary. This is denoted in the top row of the red box, and is completely rationale from the employee's perspective if we believe that, as the economy re-opens, they will start working again. Not an unreasonable assumption given that three million of these temporarily laid off workers just returned to work.

From these numbers, we can split those who have become unemployed into three categories.

Table 2 Unemployment categories

Category	Number of people (millions)
1. Temporarily unemployed	15.5
2. Laid off	2.9
3. Exited the labour force	1.0

The difference between category 2 and 3 is that those in category 2 lost their job but will be seeking new employment, while those in category 3 lost their job and will not be looking for new employment.

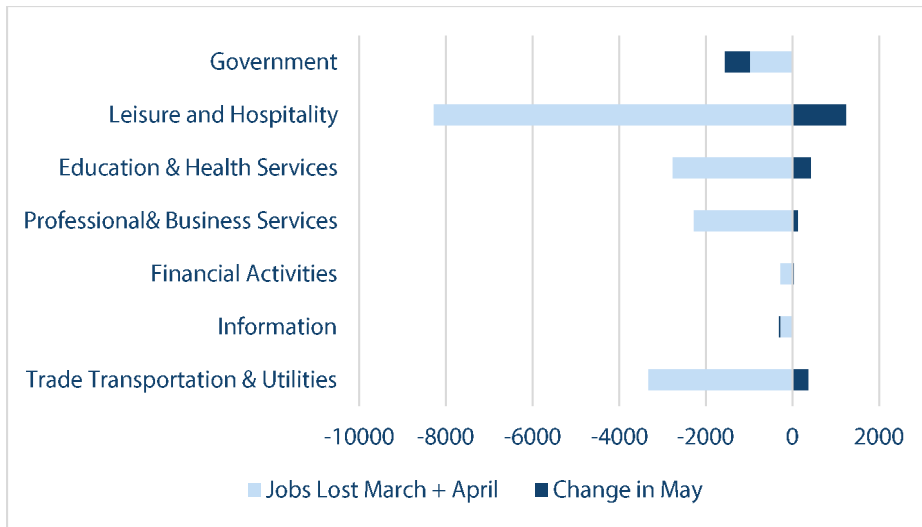
In order to answer the question of how fast unemployment could rebound, we need to make some assumptions about how long it could take for these people to return to work. For simplicity, as a starting point, I assume that those in categories 2 and 3 (i.e. not temporarily laid off) will still be unemployed in 6 – 12 months' time, as reemployment will likely come from those in category 1 first.

This means of the 20 million who became unemployed during March and April, two million people will be the baseline increase that are still unemployed in 6 to 12 months' time. Raising the more important question: what about those in category 1? How many do we expect will go back to work?

To ball park this, let's first look at what sectors the employment changes have come from.

## The story behind the numbers

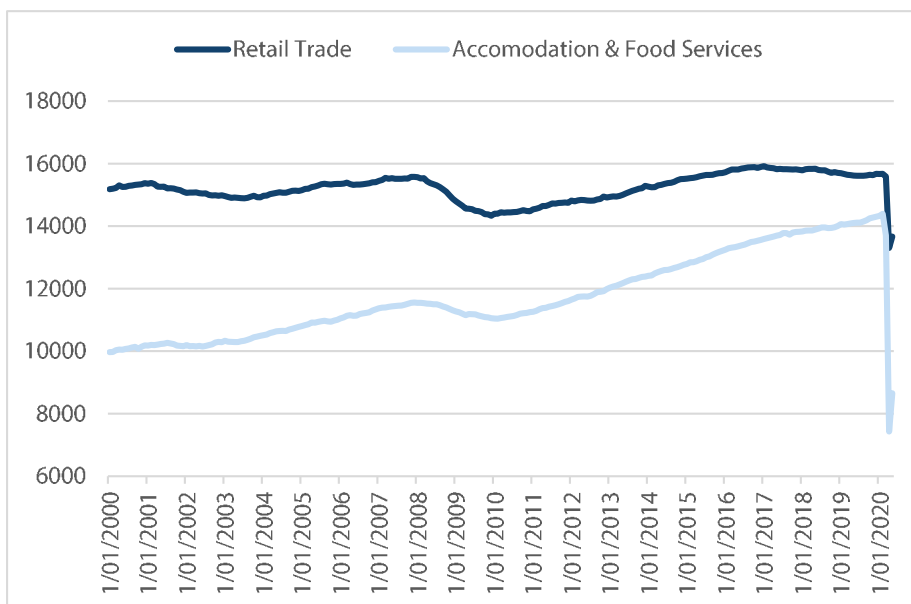
Chart 2 Job changes in the US – past 3 months



Source: Bloomberg

Most of the job losses were in leisure and hospitality, and trade, transportation & utilities, which in March and April shed about 12 million jobs combined. However, if you look at the re-hiring that came through May, most of the employment was in the hardest hit sectors, with the subcategories (not shown here) of food services & drinking places, and retail trade showing some strong employment.

Chart 3 US industry employment



Source: Bloomberg

Here is a more detailed sector breakdown of US employment:

<https://www.bls.gov/news.release/empsit.t17.htm>

Because of the unprecedented drop in these sectors shown in Chart 3, let's now assume that of the people in category 1 (i.e. those temporarily unemployed), 75% of them return to their jobs when the economy reopens and 25% find it challenging to return to their existing employment. That would give us the following estimates.

Table 3 Return to work estimates

Temporarily unemployed	Number of people (millions)
Return to employment quickly	11.6 (15.5m x 75%)
Delayed return to employment	3.9 (15.5m x 25%)

This would result in approximately four million people (of those 15.5m currently temporarily unemployed) remaining unemployed in 6 to 12 months' time. When we look across the different categories, we land on a total unemployment increase of eight million people – consisting of 3.9 million from the above (category 1), 2.9 million who have been laid-off (category 2) and 1.0 million who have exited the labour force (category 3).

Giving us an unemployment rate of around **7 – 8%**. Interestingly, 8.6 million jobs were lost during the GFC, from peak to trough.

If we take a step back and survey the numbers, a few questions arise.

**1. Could the economy add back 12 million jobs in 6 – 12 months?**

I think in the current circumstances, the answer seems to be yes (recognising that there are no guarantees). If half of those employed in accommodation & food services and retail trade (see Chart 3) returned to employment when the economy opens, that would equate to six million jobs. Given the scale of the decline and government policies in place, this doesn't seem unreasonable. Having said that, my 'fixed income gut' tells me that it feels a little too optimistic.

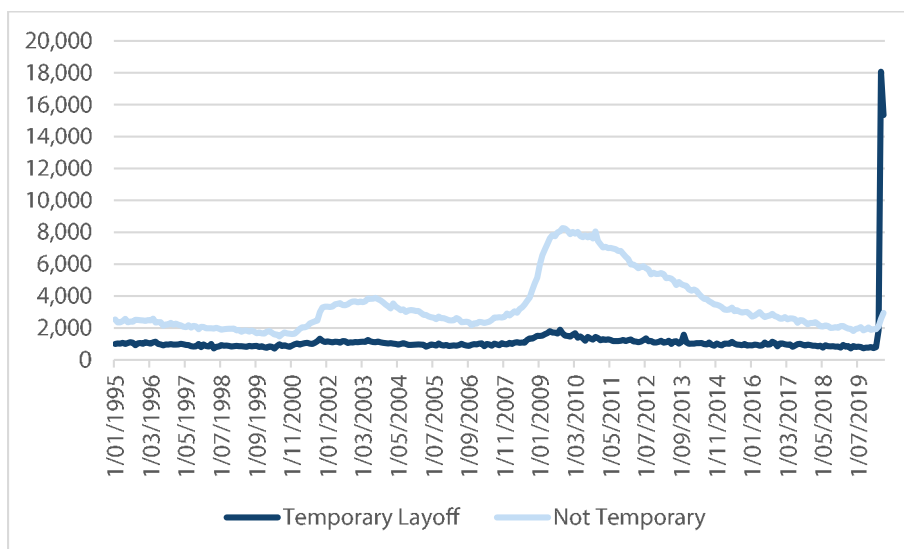
**2. Filling 12 million jobs in 6 – 12 months would require 1 – 2 million jobs per month over the short term. Has that ever happened before?**

No. History shows the US economy can put on ~500,000 jobs post a recession, but it very rarely reaches 1m+, and when it does it is not for multiple months in a row. That being said, we have never experienced these conditions before, particularly for those who believe it is all temporary – see Chart 4.

**3. Is 75% a good estimate of the temporary change?**

This is the most challenging question to answer. Getting more granular with the estimate by sector would offer some insight, but it's only an estimate at best.

Chart 4 US reason for unemployment



Source: Bloomberg

Once these 'temporary' workers are re-employed, I would expect the pace of re-employment will slow considerably, leaving a percentage of workers who thought they were only 'temporarily unemployed' now out of work for a longer period of time.

To put this into context for rates, the US Federal Reserve (Fed) didn't hike rates until 2015 (seven years after hitting 0% in 2008), when the unemployment rate fell to about 5%. If the above estimate is correct, that unemployment in 6 – 12 months' time is at 7 – 8%, then we can add another 3 – 5 years to the time it could take for the unemployment rate to fall from 8% to 5%.

This would leave rates at zero for the next four (at the lower end of the estimate) to seven years (at the higher end), before the Fed was in a position to contemplate higher rates. Well beyond the Fed's recent commentary that rates will be low until at least 2022.

On Monday 8 June, the Fed released these central estimates for unemployment (see Table 4). The short-term impact looks similar to what I described above—unemployment will sit within the 7% - 9 % range in 12 months' time. However, the Fed assumes the rate will drop back to 5% in 2022, which seems like a relatively optimistic forecast in my view.

Table 4 Estimated unemployment rates, US

Variable	Median <sup>1</sup>				Central Tendency <sup>2</sup>				Range <sup>3</sup>											
	2020	2021	2022	Longer run	2020	2021	2022	Longer run	2020	2021	2022	Longer run								
Change in real GDP	-6.5	5.0	3.5	1.8	-7.6	-5.5	4.5	6.0	3.0	4.5	1.7	2.0	-10.0	-4.2	-1.0	7.0	2.0	6.0	1.6	2.2
December projection	2.0	1.9	1.8	1.9	2.0	2.2	1.8	2.0	1.8	2.0	1.8	2.0	1.8	2.3	1.7	2.2	1.5	2.2	1.7	2.2
Unemployment rate	9.3	6.5	5.5	4.1	9.0	10.0	5.9	7.5	4.8	6.1	4.0	4.3	7.0	14.0	4.5	12.0	4.0	8.0	3.5	4.7
December projection	3.5	3.6	3.7	4.1	3.5	3.7	3.5	3.9	3.5	4.0	3.9	4.3	3.3	3.8	3.3	4.0	3.3	4.1	3.5	4.5
PCE inflation	0.8	1.6	1.7	2.0	0.6	1.0	1.4	1.7	1.6	1.8	2.0	2.0	0.5	1.2	1.1	2.0	1.4	2.2	2.0	2.0
December projection	1.9	2.0	2.0	2.0	1.8	1.9	2.0	2.1	2.0	2.2	2.0	2.0	1.7	2.1	1.8	2.3	1.8	2.2	2.0	2.0
Core PCE inflation <sup>4</sup>	1.0	1.5	1.7	2.0	0.9	1.1	1.4	1.7	1.6	1.8	2.0	2.0	0.7	1.3	1.2	2.0	1.2	2.2	2.0	2.0
December projection	1.9	2.0	2.0	2.0	1.9	2.0	2.0	2.1	2.0	2.2	2.0	2.0	1.7	2.1	1.8	2.3	1.8	2.2	2.0	2.0
Memo: Projected appropriate policy path																				
Federal funds rate	0.1	0.1	0.1	2.5	0.1	0.1	0.1	2.3	2.5	2.5	2.5	2.5	0.1	0.1	0.1	1.1	1.1	1.1	2.0	3.0
December projection	1.6	1.9	2.1	2.5	1.6	1.9	1.6	2.1	1.9	2.6	2.4	2.8	1.6	1.9	1.6	2.4	1.6	2.9	2.0	3.3

Source: US Federal Reserve

Finally, we also need to be aware of the risk that could be lurking for the employment figures, as there is still a decent chance that those who are 'temporarily unemployed' morph into something else. As an example, at the recent LA protests, more than 50,000 people crammed into Hollywood Boulevard to protect during a pandemic. Does this set the scene for the second wave of infections, which have already been rising in a number of US states?

## CONCLUSION

Looking at the number of people who believe they are temporarily employed and the speed with which they could return to the economy, suggests that the first phase of the recovery could see the unemployment rate drop to 7 – 8% before it begins to slow down. From an historical perspective, this is still relatively high unemployment, but drastically better than the 15% seen in April.

Once the economy reopens, and these temporarily unemployed people find work, the gains will be harder to come by. Hence, a recovery in unemployment will look impressive compared to where we are now, but will still only be at levels associated with a recession. As such, while the Fed says that rates will remain low until at least 2022, I would think this is actually going to be far longer.

## **Chris Rands**

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Chris joined Nikko Asset Management in 2011 and is responsible for portfolio management, including portfolio construction and trading for the Australian multi-sector portfolios. Chris is also responsible for macroeconomic research, assisting the fixed income team with strategic direction and in formulating the macroeconomic viewpoints for portfolio positioning. Prior to becoming a portfolio manager, Chris was a credit analyst. He holds a BCommerce (Economics & Finance) and M.App Fin.



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