THOUGHTS OF THE WEEK
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Businesses Hoarding Workers? Say What?

I am back from the annual NABE (National Association for Business Economics, www.nabe.com) conference in Chicago after spending three days listening to specialists in various sectors of the domestic and global economy talk about what they see today and what they expect in the future. I have been a member of NABE since 1989 and have been a board member in the past so I try to go every year and reconnect with a great number of colleagues and friends.

One of the many great benefits of being a member of NABE is that we normally have Federal Reserve (Fed) governors present at our events. At this last annual meeting in Chicago, we had two members of the Fed presenting at the conference, the president of the Chicago Federal Reserve, Charles L. Evans, who was the conference's host, and Lael Brainard, the Vice Chair of the Board of Governors of the Federal Reserve System.

Both of them mentioned the Fed's strong commitment to bring down inflation as well as the fact that it was not going to waver in its steadfast objective of bringing down inflation.

However, I was somewhat concerned with some of the things I heard during the conference or the interpretation of some of the comments. This was not the first time I have heard these issues. One of these concepts is that of 'labor hoarding.' I have been hearing this concept of 'labor hoarding' for several months and the truth is that it makes no sense in the current context. Yes, there is a 'labor hoarding' concept that has been around since the 1960s. This concept explains that companies tend to stick to workers in the short run due to the cost of hiring, training, and firing workers.

On August 4, 2022, an article in Bloomberg read "Labor hoarding holds key to how severe a US recession may get." On September 8, 2022, an article in www.thehustle.com was entitled "Layoffs are out. Labor hoarding is in." Inc.com has an article called "Why economists are talking about 'Labor Hoarding' and what you need to know about it."

I could continue to point to such articles during the last couple of months, but I think that these examples suffice. During the NABE conference, Vice Chairman Lael Brainard said, according to the New York Times article titled "Companies Hoarding Workers Could Be Good News for the Economy," that "Businesses that experienced unprecedented challenges restoring or expanding their work forces following the pandemic may be more inclined to make greater efforts to retain their employees than they normally would when facing a slowdown in economic activity."

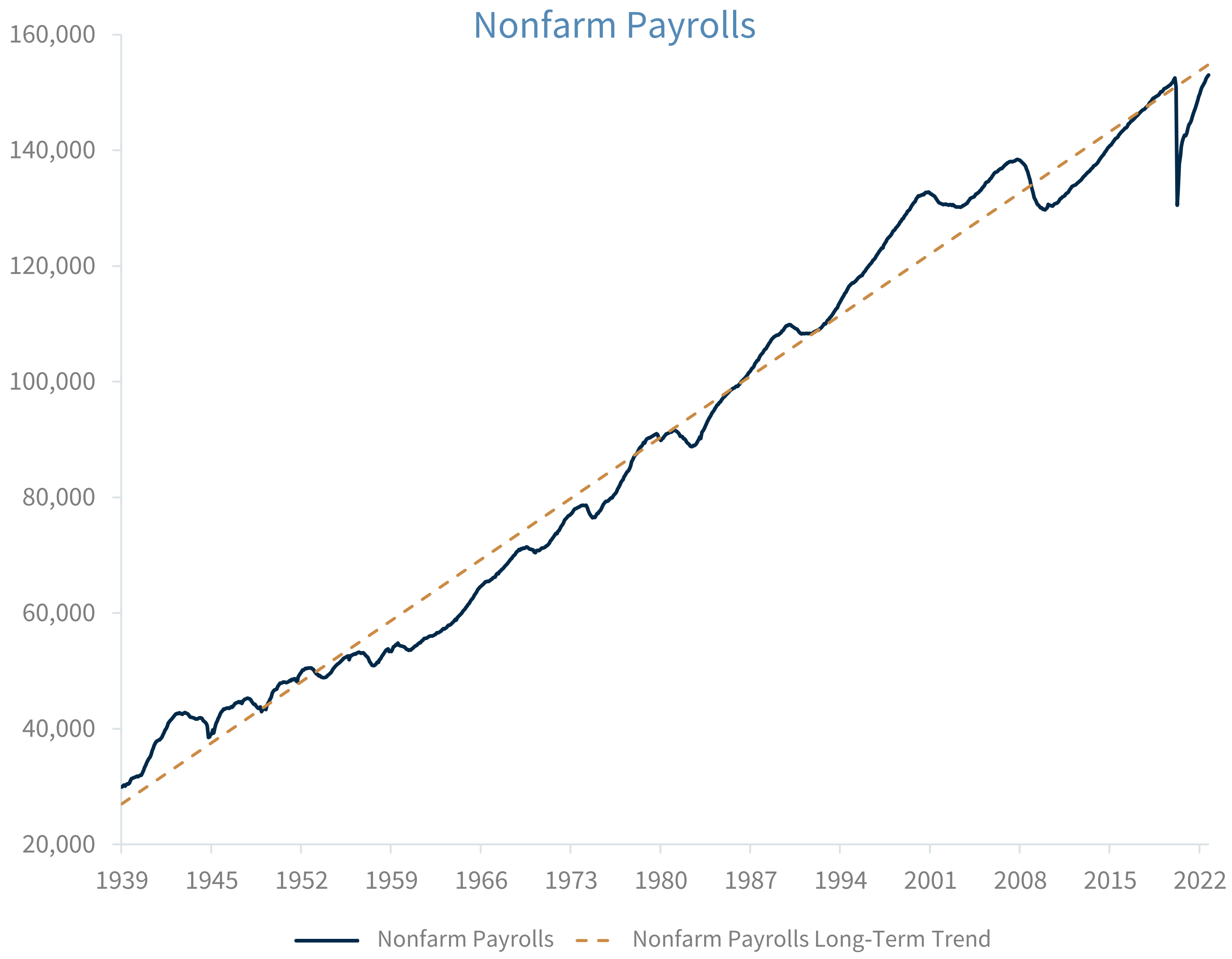
Vice Chair Brainard said that firms may think twice about letting go workers because of the "unprecedented challenges" suffered in restoring workers after the pandemic. She was not saying that companies are hoarding workers today, only that they may decide to not get rid of workers as fast as they have done in the past when faced with recessions, especially after the difficulty they have recently experienced with the recovery from the pandemic recession.

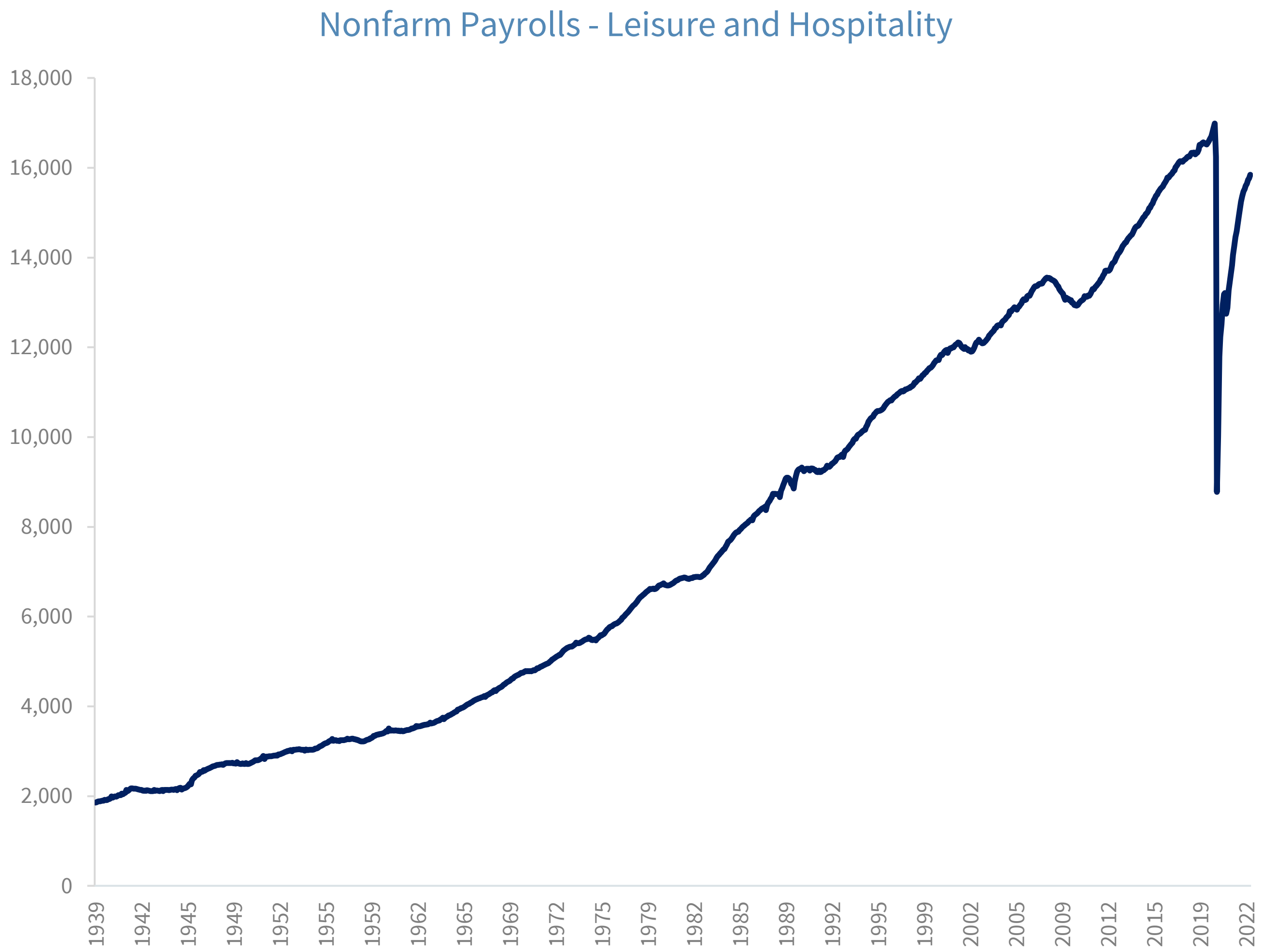
Again, the labor hoarding concept in economics has existed for many decades and is related to the concept of efficiency wages.

According to Jeff E. Biddle, labor hoarding "was presented as a profit-maximizing response by employers to costs of hiring, firing, and training workers, and thus as an explanation of procyclical labor productivity." According to an ECB Monthly Bulletin from July of 2003 "Labour hoarding can be defined as that part of labour input which is not fully utilised by a company during its production process at any given point in time. Under-utilisation of labour can manifest itself in various forms, such as reduced effort or hours worked, and the shift of labour to other uses, such as training. From the company's point of view, some labour hoarding may be optimal given the fixed costs associated with adjusting staff numbers. These costs include costs of recruitment, screening and training of new workers, as well as costs related to the termination of contracts such as severance pay."

That is, in layman terms, labor hoarding is related to how costly it is to hire, train, and fire workers. Typically, the higher the fixed costs of hiring, training, and firing workers, the longer it takes for a firm to get rid of workers when faced with a slowdown in economic activity.

However, is this what is happening today? Definitely not, companies are not hoarding labor today, they are still just trying to go back to 'normal' levels of labor input, especially in the service sector. This is particularly true in the leisure and hospitality sector, which is the sector that has seen the highest increase in wages and salaries. The leisure and hospitality sector is still 1.138 million jobs below the level of employment in February of 2020, just before the pandemic even though nonfarm payroll jobs have already recovered to pre-pandemic levels.





Recall that labor costs are about 60% to 70% of the total costs of doing business so businesses don't take employment decisions lightly, especially small businesses. Before wearing my economist hat, I managed a small business and was a small business owner during several decades, so I know how difficult these decisions are for businesses and for their survival.

While it may be true that some firms may decide to keep workers for some time when faced with a slowdown in demand, this cannot last for long. If you are a large firm and you have plenty of financing available, you may be willing to 'hoard' workers for some time before finally deciding to lay them off, but this is probably not an alternative for small businesses, which hire ~50% of all workers in the US and have smaller profit margins than large businesses.

In fact, the last two recessions, in 2008 and 2020 are good examples of how fast businesses react to bad economic news by laying off workers as soon as they realize the economy is heading into recession. Of course, neither of these recessions were typical but they show that firms make decisions relatively quickly in order to survive.

What is happening today is not that firms are hoarding labor. What they are doing is just trying to get back to pre-pandemic levels and they are struggling to find workers. And this may, in fact, be good news going forward because if firms are still struggling to find workers to cover their employment needs (that is, they are not hoarding labor) then the probability is that they will have to layoff a reduced number of workers if faced with a recession or a slowing of demand for their products, which is very different than what many are saying businesses are doing, which is 'labor hoarding.'

Summary of the week:

Producer Price Index: The Producer Price Index (PPI) declined slightly on a year-over-year basis, but inflation continued to be sticky as shown by PPI ex. food & energy, which nudged upwards after five months of continued declines. Today's PPI report showed that despite the progress made over the last two months, the Fed still has a tough road ahead. As investors and the Fed await tomorrow's Consumer Price Index report, today's PPI release further supports our view that the Fed will hike by 75 basis points at their upcoming November meeting. After two months of negative readings, PPI increased 0.4% in September, much more than the 0.1% consensus forecast. On a year-over-year basis, the number increased 8.5%, which is slightly lower than August's number of 8.7%. While most of the decline over the last two months was due to falling energy prices, two-thirds of the increase in the index in September was due to a 0.4% increase in final demand services. The largest increase for the month can be traced to a 6.4% increase in traveler accommodation services. Additionally, after declining for two consecutive months, final demand goods increased by 0.4% as well, where the majority of the increase can be attributed to an increase in final demand for foods. PPI ex. food, energy & trade was also higher by 0.4% in September, which is the highest reading since May. On a year-over-year basis, PPI ex. food, energy & trade was unchanged at 5.6%. The PPI report for September was a negative report for future inflation as both goods and services prices increased for the month. Today's data point just confirms that the Fed has still a long way ahead to bring inflation under control.

Consumer Price Index: This was an overall bad inflation report, as inflation was 0.4% during September compared to market expectations of a 0.2% reading. Although the year-over-year rate was slightly lower, at 8.2% in September versus 8.3% in August, the strength in core prices is not a good omen for inflation going forward and assures that the Federal Reserve (Fed) will increase the federal funds rate by 75 basis points during its November FOMC meeting. The consumer price index (CPI) increased a more than expected 0.4% in September on a seasonally adjusted basis, according to the Bureau of Labor Statistics. Year-over-year, and not seasonally adjusted, the CPI increased 8.2%. Although energy prices declined by 2.1% during September, food prices increased by 0.8% with food at home inching up 0.7% and food away from home increasing 0.9%. Gasoline prices declined 4.7% during the month while the price of fuel oil declined 2.7%. Energy services prices increased 1.1% due to an increase of 0.4% in electricity prices and a 2.9% increase in natural gas prices. The all items less food and energy index increased a more than expected 0.6%, repeating the August increase and is up 6.6% compared to September of last year on a non-seasonally adjusted basis. The largest increase in the core services was allocated to shelter costs, up 0.7%, transportation services, up 1.9% and medical services, up 1.0%. Overall services prices less energy services increased 0.8%. Commodities less food and energy commodities were flat in September due to a 0.7% increase in new vehicles prices and a 1.1% decline in used cars and trucks. The consumer price index (CPI) increased a more than expected 0.4% in September on a seasonally adjusted basis, according to the Bureau of Labor Statistics. Year-over-year, and not seasonally adjusted, the CPI increased 8.2%. Although energy prices declined by 2.1% during September, food prices increased by 0.8% with food at home inching up 0.7% and food away from home increasing 0.9%. Gasoline prices declined 4.7% during the month while the price of fuel oil declined 2.7%. Energy services prices increased 1.1% due to an increase of 0.4% in electricity prices and a 2.9% increase in natural gas prices. The all items less food and energy index increased a more than expected 0.6%, repeating the August increase and is up 6.6% compared to September of last year on a non-seasonally adjusted basis. The largest increase in the core services was allocated to shelter costs, up 0.7%, transportation services, up 1.9% and medical services, up 1.0%. Overall services prices less energy services increased 0.8%. Commodities less food and energy commodities were flat in September due to a 0.7% increase in new vehicles prices and a 1.1% decline in used cars and trucks.

Summary of the week:

Import and Export Prices: Both US import and export prices declined for the third consecutive month in September, but once again the decline can be mostly attributed to lower fuel prices. These declines in prices, along with slower global growth, should continue to provide some relief to supply chains. While today's import and export prices report should be good news for the Federal Reserve (Fed), it is unlikely to have a significant impact as we head toward the next meeting in November, during which the Fed is likely to hike the fed funds rate by another 75 basis points. US import prices fell again in September by 1.2% after declining in August and July by 1.1%, and 1.4% respectively. Just like in the last two months, the September decrease in fuel (-7.5%) and nonfuel prices (-0.4%) were the largest drivers of the decline. Even when removing fuel imports, import prices declined by 0.4% in September. On the other hand, prices for foods, feeds, and beverages increased by 0.2% in September, after declining steadily since April 2022. However, the small increase can be attributed to a large 12.2% increase in vegetable prices for the month. Overall, prices for imports declined 4.3% in 3Q22, but are still 6.0% higher than a year ago. US export prices declined for the third consecutive month in September by 0.8%, after falling 3.3% in July. Lower prices for soybeans, fruit, meat, and nuts were the biggest contributors to the September decline. Agricultural products aside, export prices declined 0.9%, with industrial supplies and materials leading the charge with a decline of 1.8%. Overall, prices for exports declined 6.2% in 3Q22, which is the largest quarterly drop since 4Q08. Both import and export prices were lower for the third consecutive month in September. Excluding energy and food, import and export prices declined by 0.5% and 0.6%, respectively. Both declines are good news for the Fed's goal of bringing inflation lower, but they are unlikely to make a dent in its upcoming November decision.

Retail Sales: The September retail and foods services report was weak on the goods side but still strong on the services side of the economy. Furthermore, control group sales were up 0.35% in September and 0.22% in August. Thus, although goods consumption is suffering, the service side of the US economy continues to expand. Retail and food services sales remained flat in September, according to the US Census Bureau. Retail and food services sales were upwardly revised to an increase of 0.4% in August. Meanwhile, retail sales were down 0.1% in September after increasing 0.2% in August. However, the retail sales control group, which it is used to calculate growth in personal consumption expenditures, increased a more than expected 0.35% during the month. Retail and foods services sales excluding motor vehicle and parts sales increased 0.1% while total retail and food services sales excluding gasoline sales also increased 0.1%. If we exclude motor vehicle and parts as well as gasoline station sales, retail and food services sales increased 0.3%. Motor vehicle and parts dealers' sales declined 0.4% while furniture and home furniture sales declined 0.7%. Electronics and appliance stores sales declined by 0.8% while building material and garden equipment and supplies dealers sales declined 0.4% during the month. However, food and beverage stores sales increased 0.4% while sales at health and personal care stores increased 0.5%, the same rate of increase as sales at clothing and clothing accessories stores. Gasoline station sales, on the other hand, declined 1.4% while sales at miscellaneous store retailers dropped by 2.5%. Sales at sporting goods, hobby, musical instruments, and bookstores declined 0.7% but sales at general merchandise stores increased 0.7%. Non-store retailers' sales increased 0.5% while sales at food services and drinking places also increased 0.5%. Although the retail sales report was lower than expected, control group retail sales were still strong, up 0.35%. However, the report is a reminder that consumer demand has continued to slow, especially in the goods side of the economy while the service side of the economy remains relatively strong, as shown by the 0.5% increase in food services and drinking places sales.

Summary of the week:

Consumer Sentiment: Although the increase in consumer sentiment is good news for the US economy, the increase in inflation expectations for both, the year ahead and the five year ahead, is not good news for interest rates and the Federal Reserve (Fed). Any upward movement in inflation expectations is going to put the Fed on edge and in a defensive position, which guarantees that it will keep the pressure on economic activity by continuing to increase the federal funds rate. The Michigan preliminary index of consumer sentiment increased slightly in October, 59.8 compared to 58.6 in September. The index for current economic conditions improved, from 59.7 in September to 65.3 in October while the index of consumer expectations declined to 56.2 in October from 58.0 in September. However, the bad news in this report was that the median expected year-ahead inflation rate increased to 5.1% in October from 4.7% in September while the five-year-ahead inflation expectation increased from 2.7% to 2.9%. Both inflation expectations came in higher than in September. However, while the 0.4 percentage point increase in the one-year ahead measure is concerning, the increase in the longer-term inflation expectation number, from 2.7% to 2.9% may be more important for the Fed.

Economic Forecasts:

	Quarterly Historical						Quarterly Forecast						Annual	Annual Forecast	
	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	2021	2022	2023
GDP (annual rate)	**6.3**	**6.7**	**2.3**	**6.9**	**-1.6**	**-0.6**	**2.0**	**-0.7**	**-0.9**	**-1.8**	**-0.9**	**0.9**	**5.7**	**1.7**	**-0.5**
Year-over-year	0.5	12.2	4.9	5.5	3.5	1.7	1.6	-0.2	0.0	-0.4	-1.1	-0.7			
Private Domestic Final Purchases	**11.8**	**10.1**	**1.4**	**2.6**	**3.0**	**0.2**	**0.6**	**-1.4**	**-1.4**	**-2.6**	**-1.5**	**0.4**	**7.9**	**2.2**	**-1.2**
Year-over-year	2.5	16.0	7.3	6.4	4.4	1.9	1.7	0.8	-0.5	-1.2	-1.7	-1.3			
CPI (y/y)	**1.9**	**4.8**	**5.3**	**6.7**	**8.0**	**8.6**	**8.3**	**7.6**	**6.2**	**4.5**	**4.0**	**3.5**	**4.7**	**8.1**	**4.5**
Ex-food & energy	1.4	3.7	4.1	5.0	6.3	6.0	6.3	6.2	5.5	4.7	3.6	2.9	3.6	6.2	4.2
PCE Price Index (y/y)	**1.8**	**3.9**	**4.3**	**5.5**	**6.3**	**6.5**	**6.2**	**5.7**	**4.9**	**4.0**	**3.8**	**3.2**	**3.9**	**6.2**	**4.0**
Ex-food & energy	1.7	3.4	3.6	4.6	5.2	4.8	4.8	4.7	4.3	4.0	3.5	2.9	3.3	4.9	3.7
Unemployment Rate	**6.2**	**5.9**	**5.1**	**4.2**	**3.8**	**3.6**	**3.7**	**3.9**	**4.2**	**4.5**	**4.9**	**5.2**	**5.4**	**3.8**	**4.7**

Fed Funds Target Rate:

	Fed Meeting	Fed Funds Target Rate
2022	September 20-21	3.00-3.25
	November 1-2	3.50-3.75
	December 13-14	4.25-4.50
2023	January 31-February 1	4.25-4.50
	March 21-22	4.25-4.50
	May 2-3	4.25-4.50
	June 13-14	4.25-4.50
	July 25-26	4.25-4.50
	September 19-20	4.25-4.50
	October 31-November	4.25-4.50
	December 12-13	4.25-4.50

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Consumer Price Index is a measure of inflation compiled by the US Bureau of Labor Studies. Currencies investing are generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Consumer Sentiment is a consumer confidence index published monthly by the University of Michigan. The index is normalized to have a value of 100 in the first quarter of 1966. Each month at least 500 telephone interviews are conducted of a contiguous United States sample.

Personal Consumption Expenditures Price Index (PCE): The PCE is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The change in the PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

Consumer confidence index is an economic indicator published by various organizations in several countries. In simple terms, increased consumer confidence indicates economic growth in which consumers are spending money, indicating higher consumption.

The Consumer Confidence Index (CCI) is a survey, administered by The Conference Board, that measures how optimistic or pessimistic consumers are regarding their expected financial situation.

Leading Economic Indicators: The Conference Board Leading Economic Index is an American economic leading indicator intended to forecast future economic activity. It is calculated by The Conference Board, a non-governmental organization, which determines the value of the index from the values of ten key variables

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Source: FactSet, data as of 10/14/2022

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