The Daily Dish

The Labor Market and the Fed

DOUGLAS HOLTZ-EAKIN | OCTOBER 4, 2022

This Friday the Labor Department will release the employment report for September, and all eyes will be trained on it for evidence that the Federal Reserve's campaign to tighten financial conditions and rein in inflation is slowing demand in the economy. In this regard, there are two separate questions. First, does the Fed *have* to raise unemployment to fight inflation? Second, is there any evidence that the Fed is having an impact?

With regard to the first, the basic logic is simple. Faced with excessively rapid growth in the demand for goods and services, firms will add labor to raise production, even if it means paying overtime, hiring at increased salaries, or otherwise raising their unit labor costs. Having done so, firms must raise consumer prices to cover the additional costs. The Fed is trying to run this process in reverse, with higher interest rates and tighter financial conditions deterring purchases and lessening pressure in the labor market.

There are two notable exceptions to the scenario of higher interest rates leading to increased unemployment. The first is the hope that instead of actually laying people off, firms will instead simply eliminate unfilled positions. As has been widely documented, there are roughly two jobs for every person looking for work. One line of reasoning is that there will be a sharp decline in job openings that is evidence of the Fed slowing demand. (Note: Today at 10:00 a.m. the Labor Department releases the latest data on Job Openings and Labor Turnover (JOLTS).)

The other exception is when inflation is not driven by excess supply. Suppose instead that there is a sharp increase in transportation costs due to COVID-19-induced bottlenecks. This has nothing to do with the labor market, but a cost increase is still a cost increase that shows up in inflation. In the same fashion, as these supply chain issues resolve themselves, the process works in reverse. Recall that this was the logic behind "inflation is transitory." Unfortunately, it was only a part of the story and the resolution of supply chain difficulties has yet to occur.

So, some deterioration in the labor market is doubtless in our future. Or is it here? *The New York Times* ran an article entitled "Less Turnover, Smaller Raises: Hot Job Market May Be Losing Its Sizzle," which is representative of a slew of commentary seeking to identify the first cracks in the labor market. On the whole, excess demandstill seems to be the basic situation in the labor market. And the Times article acknowledges: "The unemployment rate, which stood at 3.7 percent in August, remains near a five-decade low. There are twice as many job openings as unemployed workers available to fill them. Layoffs, despite some high-profile announcements in recent weeks, are close to a record low."

But there are a few indicators of cooling. In the past two employment reports, the number of people working part-time for economic reasonshas risen by about half a million, while the number of people holding multiple jobs has risen as well. Similarly, there has been a modest decline in the number of quits in the labor market in recent months.

Those are modest indications of weakness at the margins of the labor market. Perhaps the next month's data will change the overall picture, but for now the labor market has by and large refused to crack.