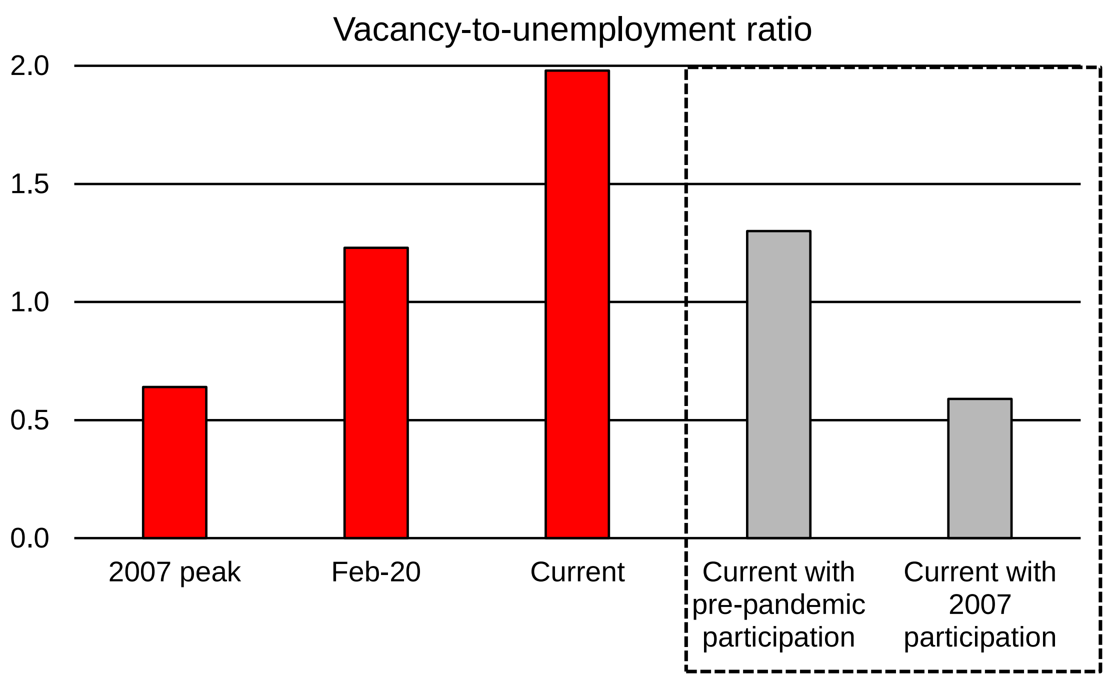
Boosting labor supply to cool down a hot US labor market



Source: BLS, UniCredit Research

- Labor market tightness in the US remains intense, with almost two job openings for every unemployed person in July (the latest available figure). This is the result of both demand and supply factors. Vacancies for jobs that could start within 30 days remain at exceptionally high levels – almost two times higher than the 2015-2019 average. On the other hand, the labor force participation rate, which has been on a structural downward trend for two decades, has not recovered its pre-pandemic levels. In August, it rose to 62.4% from 62.1%, but it remains a full percentage point below its February 2020 level. Most of the burden to contain the inflationary pressures stemming from a hot labor market lies with the Fed through tighter monetary policy aimed at taming labor demand to avoid a wage-price spiral.

- Our *Chart of the Week* shows that supply-side policies aimed at bringing Americans back into the labor force would partly shift the burden of the adjustment away from the central bank. A larger pool of workers would increase job searches, fill up vacancies and lower the wage pressures due to labor shortages, reducing the need of creating slack in the economy. The chart shows that, if the labor force participation jumped to 63.4% (the February 2020 level), the vacancy-to-unemployment ratio would return to its pre-pandemic levels – that was already high by historical standards.

- Given the high level of vacancies, many of the new joiners would likely find employment. If they all remained without a job though, which is the assumption made in the chart, the unemployment rate would jump to 5.1% from 3.5% currently. Clearly, the downward impact on wage growth from higher participation is likely to be greater if Americans move from inactivity into employment rather than unemployment because it means they possess the skills that firms are looking for. As a purely illustrative scenario, the chart also shows what would happen to the vacancy-to-unemployment ratio if participation rose of about 66% – the rate recorded in 2007.

- Admittedly, boosting labor force participation at a speed that is sufficiently fast to tame inflation in the short term is challenging. First, there are structural factors, such as the early retirement of many baby boomers, a decline in net immigration flows, and the drop in the youth participation (partly due to longer educational paths) that cannot be easily reversed. Moreover, recent research from Brookings shows that long Covid is keeping as many as four million people out of work. However, policies such as targeted training programs for detached workers (especially older and less educated ones), family-friendly policies for female workers, more widespread use of telework arrangements for less mobile workers and a relaxation in immigration policies could improve the job-matching process and alleviate labor market tightness in a reasonable amount of time, bringing some relief to the Fed.

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