MACRO STRATEGY

Wage Bill and Recession

October 13, 2020

Key Findings

- The current cost structure of firms is heavily tilted toward labor costs, despite massive layoffs.
- This could spell danger for the jobs recovery as firms try to manage through the pandemic.

Despite the massive job cuts, it appears that companies' costs are disproportionately "labor-heavy." That is, firms appear to be hanging onto workers in hopes of a timely recovery. A disproportionately high share of corporate expenses remain tied up in labor; this bodes ill for a continued upward trajectory in the labor market.

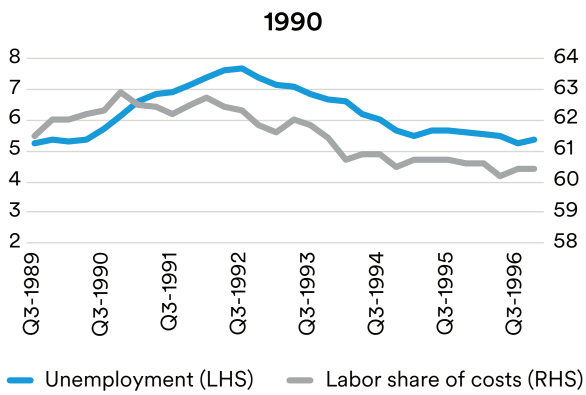
Labor Costs in Past Recessions Preceded Peak Unemployment

In past recessions, the labor share of costs and unemployment have followed a predictable pattern. Immediately before a recession, competition and compensation for workers increased while firms become more cautious with other expenses (capital expenditures, rent or utility payments). Labor share of expenses peaks. When the recession finally hits, the labor share starts to fall as companies start to lay off workers. That is, the labor share of costs tends to be a leading indicator of peak unemployment.

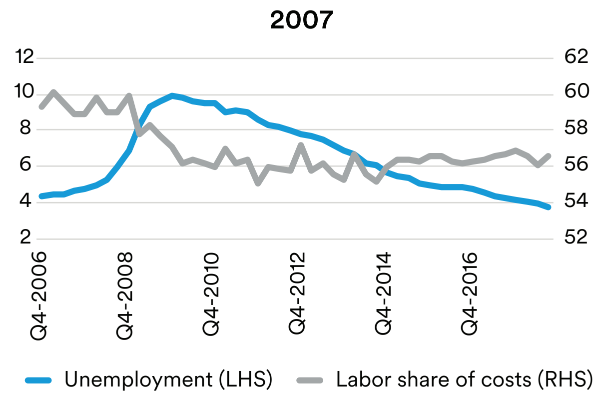
MetLife Investment Management

This pattern has been borne out in most recessions since World War II – the most recent examples are in Figure 1. The run up to the current recession is a distinct outlier to this pattern.

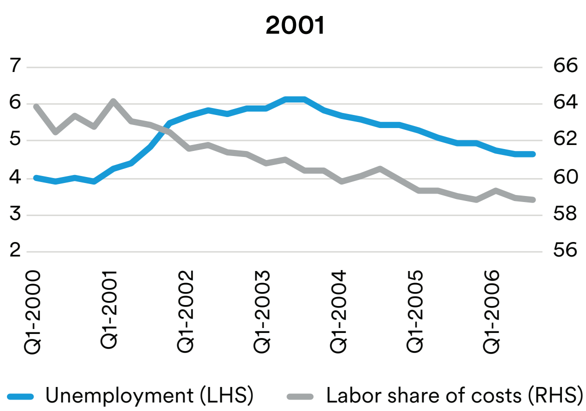
Figure 1 | The Historical Relationship Between Unemployment and Labor Costs Around Recessions



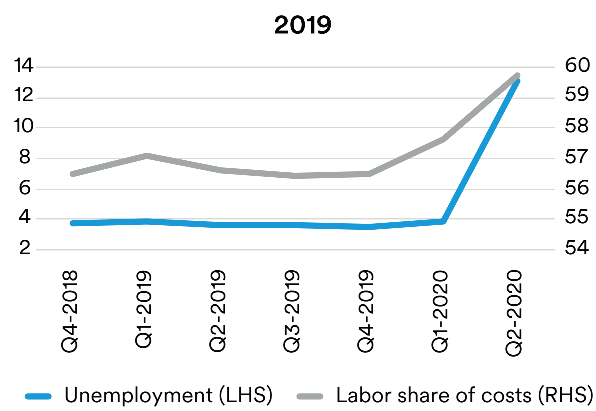
Source: BLS, NBER, MIM



Source: BLS, NBER, MIM



Source: BLS, NBER, MIM



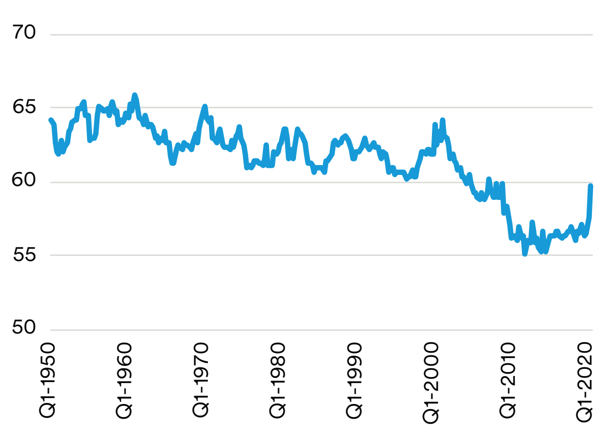
Source: BLS, NBER, MIM

This Labor Market May be Different

In a conventional recession, we would wait for the share of labor costs to start decelerating before looking for a peak in unemployment. In the current recession, the unemployment rate has very likely already hit its maximum, if only because of the spring lockdown.

However, a still-unanswered question is whether there could be a second wave of unemployment as part of a second, more modest, downturn. The peak would likely be lower than in April, but it is possible for unemployment to worsen before it gets better. As a base case we find that scenario unlikely; the recovery appears to have some

Figure 2 | Labor Share of Costs



Source: BLS, MIM

momentum, consumers in aggregate are in a strong financial position, and there will likely be additional stimulus after the election if not earlier. However, risks remain and job gains have continued to slow.

There are several reasons, grounded in the outsized labor cost share, that the unemployment rate could stall out or worsen going forward.

First, most firms have in mind optimal labor-capital proportions. For example, a fast food restaurant may know that to sell 100 burgers it needs X employees and Y amount of working capital. All of those levels are out of whack right now, and until these firms have certainty about how much they will be able to sell, they will struggle to get back to their optimal cost structure. They may not want to commit to righting any imbalances until they have more clarity.

Second, firms may need to rethink those labor-capital proportions for the long run. From the above example, the proportion of X employees to Y working capital may no longer hold in the "new normal." Restaurants may need more outside seating and a lower density of workers in the kitchen. Office workers may need more space per employee, and/or more technology per employee. We may expect more capital per employee, but the quality (and therefore cost) of employees may need to be higher as well. What the ultimate optimal labor-capital proportions should be is currently unclear.

Finally, with labor cost shares so high, firms aren't likely to hire too many people right now. If anything, they may start by adding capital if the recovery goes well. More pessimistically, they may start laying off people if the economy starts to head south again. In either case, a big jump in employment doesn't appear very likely in the near term.

The (Uncertain) Way Forward

Substantial and rapid improvements in the job market cannot be ruled out. They could come from unexpectedly good news on the COVID-19 virus front. A well-structured stimulus plan could provide some assurance to firms. But more likely scenarios involve the extreme uncertainty and structural headwinds noted above. The path forward is likely to be long and gradual.

Author

TANI FUKUI
Global Economic & Market Strategy

Tani Fukui is an Economist and Associate Director for the Market Strategy and Research Group. Her responsibilities include assessing and communicating economic conditions and overseeing coordination of the global economic view. Prior to joining MetLife in 2015, Tani was an economist at the U.S. International Trade Commission, an independent Federal agency. Tani holds a B.S. in Finance from the Wharton School at the University of Pennsylvania, an M.A. in International Affairs from Columbia University and a Ph.D. in International and Macroeconomics from UCLA.

About MetLife Investment Management

MetLife Investment Management (MIM),[1] MetLife, Inc.'s (MetLife's) institutional investment management business, serves institutional investors by combining a client-centric approach with deep and long-established asset class expertise. Focused on managing Public Fixed Income, Private Capital and Real Estate assets, we aim to deliver strong, risk-adjusted returns by building tailored portfolio solutions. We listen first, strategize second, and collaborate constantly as we strive to meet clients' long-term investment objectives. Leveraging the broader resources and 150-year history of the MetLife enterprise helps provide us with deep expertise in navigating ever changing markets. We are institutional, but far from typical.

For more information, visit: **investments.metlife**

Disclosure

For Institutional Investor, Qualified Investor and Professional Investor use only. Not for use with Retail public.

This document has been prepared by MetLife Investment Management ("MIM") solely for informational purposes and does not constitute a recommendation regarding any investments or the provision of any investment advice, or constitute or form part of any advertisement of, offer for sale or subscription of, solicitation or invitation of any offer or recommendation to purchase or subscribe for any securities or investment advisory services. The views expressed herein are solely those of MIM and do not necessarily reflect, nor are they necessarily consistent with, the views held by, or the forecasts utilized by, the entities within the MetLife enterprise that provide insurance products, annuities and employee benefit programs. The information and opinions presented or contained in this document are provided as the date it was written. It should be understood that subsequent developments may materially affect the information contained in this document, which none of MIM, its affiliates, advisors or representatives are under an obligation to update, revise or affirm. It is not MIM's intention to provide, and you may not rely on this document as providing, a recommendation with respect to any particular investment strategy or investment. Affiliates of MIM may perform services for, solicit business from, hold long or short positions in, or otherwise be interested in the investments (including derivatives) of any company mentioned herein. This document may contain forward-looking statements, as well as predictions, projections and forecasts of the economy or economic trends of the markets, which are not necessarily indicative of the future. Any or all forward-looking statements, as well as those included in any other material discussed at the presentation, may turn out to be wrong.

[1] MetLife Investment Management ("MIM") is MetLife, Inc.'s institutional management business and the marketing name for the following affiliates that provide investment management services to MetLife's general account, separate accounts and/or unaffiliated/third party investors: Metropolitan Life Insurance Company, MetLife Investment Management, LLC, MetLife Investment Management Limited, MetLife Investments Limited, MetLife Investments Asia Limited, MetLife Latin America Asesorias e Inversiones Limitada, MetLife Asset Management Corp. (Japan), and MIM I LLC.

L1020008594[exp1022][All States], L1020008587[exp1022][All States], L1020008569[exp1022][All States], L1020008599[exp1022][All States]

MetLife Investment Management