By Michael A. Tyler, CFA
Chief Investment Officer,
Eastern Bank Wealth Management

When economists and politicians talk about the labor market, they seem to be describing two completely different worlds. The economists tell us that the labor market is operating at full employment, and they have the numbers to back up that assertion: The unemployment rate is at a two-decade low; incomes are rising faster than inflation; and the labor force participation rate is rising for the first time since the mid-1990s.

The economists are correct. The chart nearby shows the number of unemployed people in comparison to the number of job openings in this country over the past decade. At the bottom of the recession, 16 million unemployed Americans were chasing only 2 million job openings, a nearly 8:1 ratio of workers to jobs. Today, that ratio is just about 1:1, with 6 million unemployed workers and the same number of job openings. Total per-capita compensation (as measured by tax filings) has been rising at about 5% per year.

On the other hand, the politicians tell us that the labor market is troubled, and they have the stories to back up their assertion: Factories have closed as companies sent jobs and entire industries offshore. Laid-off workers can’t find new jobs. Wages have been stagnant for decades.

The politicians are correct, too. Blue-collar jobs continue to disappear; only 5% of Americans are employed in manufacturing jobs today. On average, an unemployed person today needs about 10 weeks to find a new job, longer than it took at the bottom of some prior recessions. Average hourly wages are growing at only 2.5%, barely ahead of inflation.

How can it be that two diametrically opposed narratives can both be true? Is our country’s labor force doing well or doing poorly? The answer is both, for two main reasons.

The first is that America’s labor force has changed in ways that make it more difficult to match people to jobs. In bygone days, millions of single-earner families from the rural South moved to the industrial North, following the plentiful factory jobs that had opened up. Housing was available and inexpensive, so it was comparatively easy to decide to migrate across the country. Today, when one worker in a two-income family is laid off, the spouse likely still has a job and may not be willing to risk giving up the family’s remaining income to move elsewhere — especially because that family would likely be moving from a low-cost area to a more expensive urban center. It’s a much harder option, and so we are today a much less mobile society.

The second problem is what economists have called a skills gap. We have millions of high-skill jobs begging for workers, and millions of low-skill workers looking for jobs; but the low-skill workers can’t fill the high-skill jobs. Unemployment rates in areas with many high-skill industries are well below the national average, while the rates in rural and blue-collar areas are much higher.

The gap in incomes is particularly noteworthy. The 2.5% hourly wage gains include only wages and salaries, while the tax data (showing 5% annual growth) also includes bonuses and other forms of compensation. The price of labor is rising much more quickly where there are labor shortages — in the high-skill jobs that frequently use bonuses, commissions, stock options, and other financial lures. Workers with high skills are getting paid more, while workers with low skills are barely keeping up.

This two-tiered labor market poses an important political challenge: What can our state and federal governments do to help educate and train low-skill workers so that they can participate in the high-skill economy? As the midterm election campaigns begin to gear up, it’s a question we should be asking the candidates.
By Tom Bussone
Fixed Income Strategist, Eastern Bank Wealth Management

For several years now, investors have obsessed about the Federal Reserve’s path of raising the federal funds rate; this short-term interest rate still stands well below historical norms even after three hikes last year. In recent months, however, attention has been turning instead to the U.S. Treasury yield curve, which shows the relationship among interest rates of varying maturity dates.

Typically, longer maturities have higher interest rates, but the difference (or spread) has been shrinking for three years. The spread between the 2-year and 10-year Treasury notes has plunged from 231 basis points at year-end 2014 to 52 basis points at year-end 2017, and is now the narrowest since 2007; this spread may even invert, if the 2-year yield rises above the 10-year yield; an inverted yield curve has preceded the past seven recessions, most recently in 2000 and 2006.

When the yield curve is flat or inverted, investors are committing money for longer periods but getting less return, as they fear slower economic growth. It is a “risk-off” trade.

We think longer-term interest rates will remain low. Inflation is quiet, central banks are still buying long-term bonds, and investors are beginning to worry about a potential slowdown in 2019. So if the Fed raises the federal funds rate three more times this year and long-term yields are steady, the yield curve would likely invert. If so, investors need to be cautious; in such circumstances, it has historically been wise to trim equity exposure and buy long-dated Treasury maturities.

Eastern Bank Wealth Management is a division of Eastern Bank. Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

Investment Products: Not insured by FDIC or any federal government agency. Not deposits of or guaranteed by any bank. May lose value.