

The Hiring and Firing Economy

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A key theme of interest for investors right now is the underlying shifts in the US labour market. There is a notable divergence between the daily news flow of companies cutting jobs and the release of actual economic data, which suggests that job growth continues at an impressive rate and the economy may not be heading for recession.

Part of the reason that job cut announcements have made headline news is because they have been made by large household name Technology companies, including Amazon, Google and Microsoft - all of which are large constituents in the S&P 500 index.

Goldman Sachs identified two commonalities. Firstly, that many of these companies hired aggressively during the pandemic, growing their headcount by 41% on average. Secondly, these companies have seen sharper declines in their stock prices, on average -43% from their peak. They also noted an important distinction between job cuts due to weakening demand versus investor pressure to cut costs.

Memos to the staff of Shopify and Uber last year help to highlight the reasons for workforce layoffs.

Shopify's CEO wrote: "when the Covid pandemic set in... demand... skyrocketed. To help merchants, we threw away our roadmaps and shipped everything that could possibly be helpful. We bet that... the share of dollars that travel through ecommerce... would permanently leap ahead by 5 or even 10 years. It's now clear that bet didn't pay off... (and)... now, we have to adjust."

Whereas Uber's CEO wrote: "after earnings, I spent several days meeting investors... it's clear that the market is experiencing a seismic shift and we need to react accordingly."

In many senses what we have seen is the typical rise and fall of a business cycle: companies experienced a pickup in demand, extrapolated trends too far and when demand fell and the cost of capital rose, companies reduced spending and headcount. The outcome would usually result in a recession but in a post-pandemic world this may not be the case.

The Information (Technology) sector accounts for around 2% of total employment in the US but represents a much larger share of economic activity. The Information Processing Equipment and Software sectors account for around 18% of investment and around 6% of the total economy. The composition of the S&P 500, however, is very different.

The January employment report in the US showed payrolls grew significantly by 517,000. Gains were broad based across manufacturing, retail, and professional & business services. Leisure and hospitality, which was badly impacted by the pandemic, has made a big comeback and accounted for 25% of the additions. So, although job cuts were being made in the Technology sector, much larger parts of the economy were hiring.



Layoffs in the Technology sector also mean other industries have an opportunity to hire talented employees. Given technological advances in most sectors and an increasing need for energy efficiency, this reallocation of resources is a positive for long run productivity growth.

With 11 million job openings still advertised in the US, the moving parts of the labour market are proving to be a challenge for economic forecasters and the Federal Reserve. Previous Treasury Secretary Larry Summer recently said that “it’s as difficult an economy to read as I can remember”.

While the pandemic helps to explain the shifts between sectors to some extent, there is something more fundamental going on. The pandemic has added to de-globalisation and the combination of the two has disrupted the efficiency of global labour markets, resulting in a secular change. The ability to outsource to places like China has become more difficult and policies such as the Inflation Reduction Act require increasing domestic production together with more onerous immigration rules.

The US economy has weathered the inflation and interest rate shocks of 2022 incredibly well. This has supported a strong start to the year for financial markets and helped to loosen financial conditions which in turn supports economic activity. There are two potential outcomes to the next stage of this cycle, either a recession or sticky inflation, which will require higher interest rates. With hiring continuing to offset firing, the odds of the latter have jumped higher.

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