MUFG Asset Management

Global Fixed Income Thematic Viewpoint

HIROYUKI HIGUCHI
SENIOR PORTFOLIO MANAGER
HEAD OF FIXED INCOME AND CURRENCY

12 AUGUST 2024

Mitsubishi UFJ Asset Management (UK) Ltd.
A member of MUFG, a global financial group

Recent US employment numbers, does the Sahm Rule apply?

The July employment statistics were a little surprising. Since employment statistics are a volatile indicator, the contents of the employment statistics usually contain both strength and weakness. This time, almost all of the contents including the unemployment rate and wage data, indicate a worsening of the employment situation. It is, therefore, understandable that the market has become concerned about the risk of recession particularly when these numbers are assessed in conjunction with the current lacklustre economic indicators and easing inflation indicators.

Recent US data releases have not been overly weak, but consumers are showing price preference behaviour and many companies are becoming more conservative in their future guidance. That said, we do not see any deterioration in credit quality when analysing recent results. In other words, the economy is in a transitional period but not to the extent that the market is factoring in a recession.

Looking at US job openings and ISM non-manufacturing employment, the employment statistics appear a little too weak. There are also doubts about the Sahm Rule, which has reliably predicted recent recessions. The Sahm Rule, devised by former Federal Reserve economist, Claudia Sahm, states that a recession will occur if the average unemployment rate for the last three months exceeds the lowest unemployment rate in the past 12 months by 0.5%. In essence, the US employment market is large, so if the rate of deterioration exceeds a certain level, it is an indicator that shows that the momentum will lead to a recession. This time, it was 0.53%, triggering concerns about a recession. It is an indicator that is said to have predicted all seven previous recessions.

There are doubts about the application of the Sahm Rule in this situation. Full employment is currently estimated to be around 4% based on the relationship between the job openings rate and the unemployment rate. Since 2000, excluding the COVID-19 shock, there have been two unique employment situations: the collapse of the IT bubble and the Lehman Shock. (The reason "after 2000" is used is because the full employment line was a little higher before that, and a more rigorous discussion would be required, so we will consider the period after 2000 here.)

The lowest unemployment rates in the past 12 months used to apply the Sahm Rule during the IT bubble and the Lehman Shock are 3.9% and 4.4%, respectively. These are almost full employment levels. On the other hand, the lowest unemployment rate in the past 12 months used this time is 3.5%. 3.5% is well below the full employment level. This is due to unprecedented labour supply and demand tightening due to special factors such as renewed consumption after COVID-19, increased demand due to the wealth effect, and early retirement. The Sahm Rule is triggered when this rate calms down and reaches 4.3%, slightly above the full employment state. In other words, the question is whether the speed at which the special factor of the tight labour supply and demand after COVID-19 returns to normal is the same as the speed at which the labour market deteriorates when the economy goes from a boom to a downturn. At the micro level, the actions of corporate employers should be quite different. In our view the rule should be to count from the part beyond full employment.

If comparing the US with other countries it is difficult to see why it should enter a recession currently. The United States has a 30-year fixed mortgage, so interest rates have a lower impact on the economy than other countries. In particular, Canada, the United Kingdom, Australia, New Zealand, and Sweden use floating or relatively short-term fixed interest rates of 2-5 years, so interest rates have a quicker impact on the economy. Of course, the economies of these countries are weak, but they are not in a recession.

So it seems a little premature to be concerned about a recession in the United States. Of course, the market is a beauty contest and prices are determined separately from the real economy, so it goes without saying that it is our job as portfolio managers to gauge how long the market will continue to believe we are in a recession.

Important Information

This document is issued by Mitsubishi UFJ Asset Management (UK) Ltd. ("MUFG AM (UK)") which is authorized and regulated in the UK by the Financial Conduct Authority ("FCA") No. 121816. Information within this document may contain material that may be interpreted by the relevant authorities in your country as a financial promotion or an offer to purchase securities. Accordingly this information is only intended for persons who fall outside the scope of any law that seeks to regulate financial promotions in the country of your residence. The information provided in this document is not intended for any United States person or any person in the United States, any state thereof, or any of its territories or possessions. This report is prepared for professional investors and is not intended for retail clients as defined in the FCA rules.

The information contained in this report has been taken from sources which we deem reliable but we do not represent that such information is accurate or complete in part or in whole. Any opinions expressed here reflect our judgment at this date and are subject to change. Although we have taken all reasonable care that the information contained within this document is accurate at the time of publication, we make no representation or warranty (including liability towards third parties) express or implied, as to its accuracy, reliability or completeness. If you rely on this document, you do so at your own risk. We expressly disclaim any duty of care which we might otherwise owe to any person relying on this material. Any opinions expressed here reflect our judgment at this date and are subject to change.

Any reference to past performance should not be taken as a guide to future performance. The value of investments may go down as well as up.

Companies in the Mitsubishi UFJ Financial Group and connected persons may have positions in, or may perform or seek to perform advisory or banking services to companies whose securities are mentioned herein. Mitsubishi UFJ Asset Management (UK) Ltd. or related companies may have used researched material before publication and may have positions in or may be materially interested in any of the securities mentioned.

This brochure does not constitute an offer or a solicitation of an offer to buy a security. Neither MUFG AM (UK) nor any of its related companies accept any liability whatsoever for any direct or indirect or consequential loss arising from any use of information or material contained herein.

MUFG Asset Management is a brand of Mitsubishi UFJ Trust and Banking Corporation, along with its subsidiaries, Mitsubishi UFJ Asset Management Co., Ltd., Mitsubishi UFJ Real Estate Asset Management Co., Ltd., Mitsubishi UFJ Asset Management (UK) Ltd. and Mitsubishi UFJ Alterative Investments Co., Ltd.