The End is Near:
Hard Landing or Soft Landing?

by

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According to statistics published by the U.S. Department of Labor on September 1, the national unemployment rate was 3.8% in August, with a relatively large monthly increase of 0.3 percentage points from July. If the unemployment rate continues to increase by 0.1 percentage points between now and October before remaining at 4.0% until December, then a commonly accepted measure for a recession ("Sahm Rule Recession Indicator") would suggest that we have entered an economic downturn. This does not tell us if the recession will be severe or mild, but most forecasters do not predict a (very) "hard" landing for the U.S. economy.

The Inland Empire will be affected by a recession for a variety of reasons. The most obvious one is a decline in U.S. imports, which depend on consumer expenditures, and these are lower in a recession. Since 40% of all U.S. imports come through the ports of Los Angeles and Long Beach, container traffic would be heavily impacted. Currently, we already see a 2% decline in container imports compared to that of a year ago and a 17% decline in cargo shipments at Ontario International Airport over the same period – common phenomena in previous national recessions. In return, we would expect to observe declines in logistics industry output and employment. In addition, there would be fewer retail sales and shipments – again affecting the Transportation and Warehouse sector, which plays a disproportionately large role in our regions. After all, we have been labeled the warehouse capital of the world by *The Economist*.

The Inland Empire, in addition to threats from the national economy, also faces a structural dilemma. As we pointed out in a previous column, the Logistics sector is having some significant adjustment problems. While we "benefited" originally from the Coronavirus downturn, as households switched their expenditures from services to goods, the second largest employer in the Inland Empire is now being confronted with the reverse. The current unemployment rate in San Bernardino County and Riverside County stands at 4.9%, 1.5 percentage points higher than it was in May 2022 and above California's unemployment rate of 4.6%. Note that only Nevada has a higher state unemployment rate.

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While we were one of the first regions in California to regain all lost employment, we have lost 61,000 jobs since December 2022, taking us back to November 2021 employment levels. Employment in the Logistics industry peaked in November 2022 and the sector has shed over 20,000 positions since then. The problem is not unique to the Inland Empire. Across the nation, the logistics industry has lost employment shares after households have shifted their spending patterns more on services again rather than goods for the post COVID19 period. The demand for Leisure and Hospitality has outstripped the demand for goods produced by the Manufacturing and Retail Trade sectors. Pedicures, haircuts, and tattoos seem to become more important to households than purchasing food, toilet paper, refrigerators, and cell phones.

Perhaps we should pay less attention to the headline grabbing unemployment rate statistics. After all, if we look behind the numbers, then the data shows that national employment increased by almost 190,000 people in August, following two revised changes of 160,000 for July and 100,000 for June. But these increases are below the average monthly increase for the last year, which was almost 260,000 per month over the last 12 months; and it is certainly below the heydays of 2022, when the monthly increase was 400,000. Numbers such as these, coupled with other sensors of the economy, such as the shape of the yield curve, housing starts, consumer confidence, etc. certainly hint strongly at a looming recession.

A savvy reader might ask: how is it possible for the unemployment rate to increase when hiring still went up by 190,000? And something deeper, where are these people coming from when we observe unemployment rate levels at 50 year lows? Well, the change in the unemployment rate is approximately equal to the difference between the percentage change of the labor force and the percentage change of employment. When the labor force grows faster than employment, the unemployment rate increases (since more people have joined the job hunting party than those who have left) and vice versa. And the labor force growing means that people who had lost hopes of finding a job ("discouraged workers") are now saying either that they found a job or that they are back in the game.

This phenomenon is especially true currently for women, immigrants, and Americans with disabilities. The labor force participation rate (the share of the population that is in the labor force, which includes both employed and unemployed) for women has basically returned to pre-pandemic levels.This is remarkable and suggests that declines in the labor force participation rate due to school disruptions caused by the Coronavirus induced closures of schools may have finally worked themselves out - after more than three years.

Bottom line, start putting on the seat belts: you are in for the roller coaster ride turning down. While it is not going to be that scary, make sure that you are safely secured. If we are wrong, you can throw tomatoes at us at our state of the region meeting in the spring, and we actually will be happy to have cried wolf when there was not any danger in sight.