Did Virginia's Strong Labor Market in 2023 Help It to Steer Clear of a Recession?

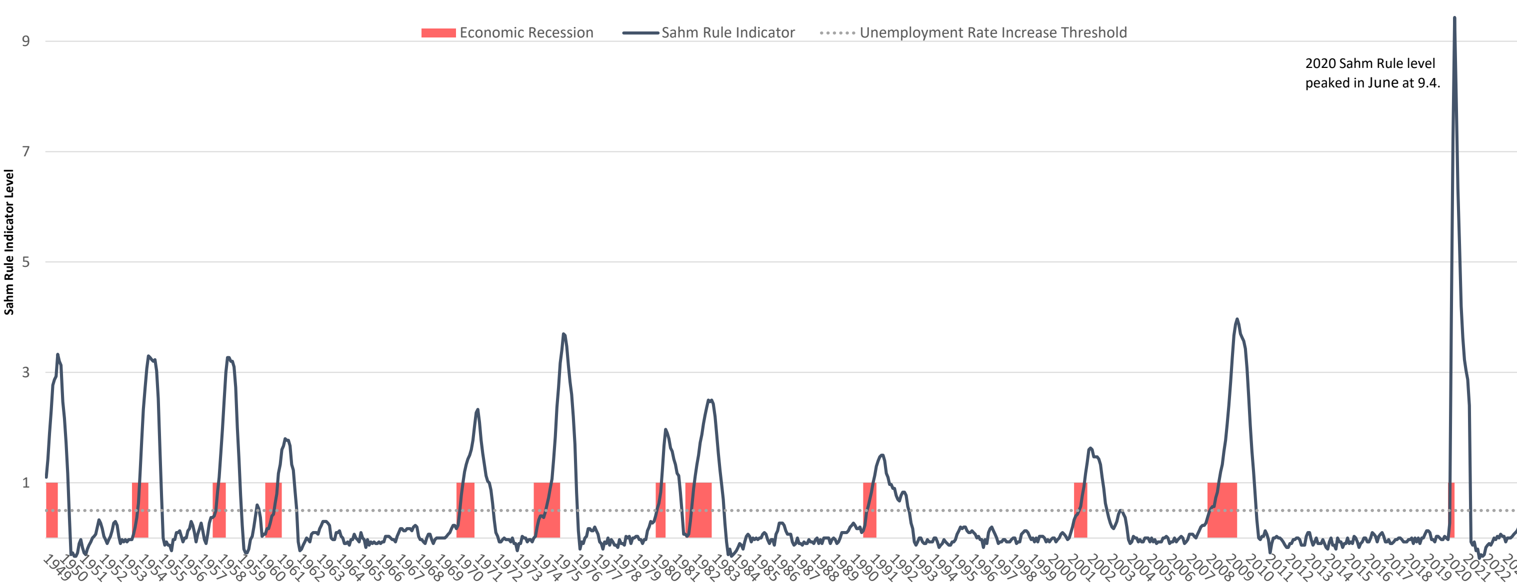
Timothy Aylor, Senior Economist

An accurate predictor of economic recessions was flashing yellow in Virginia this past winter and spring, but subsequent strong labor force and employment growth in 2023 provided a needed boost to the Commonwealth's economy.

The BLS U.S. Employment Situation jobs report[1] for October was released on November third and its marque statistic stoked debate about where the U.S. economy—and, by extension, the Virginia economy—is in the business cycle. Bloomberg reported that the U.S. unemployment rate rose to 3.9%, which indicates that a recession could be nearby, according to an accurate predictor of past recessions.[2] The Sahm Rule, developed by former Federal Reserve economist Claudia Sahm, suggests that the beginning of a recession often coincides with an increase of the three-month moving average of the unemployment rate of a half-percentage point or more relative to its low during the previous twelve months. At a value of 0.33 percentage point, October's number did not reach that threshold, but it did reach its highest point since the aftermath of the 2020 pandemic recession. This indicator has been reliable, as evidenced by its accuracy extending back to the post-WWII period of the late 1940s.[3]

Sahm Rule U.S. Indicator Levels and U.S. Recessions since 1948

The Sahm Rule indicator has been accurate at signaling the start of recessions, extending back to the 1940s.



Source: Sahm, Claudia, Sahm Rule Recession Indicator [SAHMCURRENT], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/SAHMCURRENT. November 8, 2023.
Red shaded areas represent economic recessions, or period between a business cycle peak and trough. Source: National Bureau of Economic Research (NBER), "US Business Cycle Expansions and Contractions". https://www.nber.org/research/data/us-business-cycle-expansions-and-contractions.

While this leading labor market indicator used by economists to predict economic recessions sent concerning signals this month nationwide, its performance in Virginia tells a different story. During the winter of 2022, the Virginia unemployment rate began to rise from that summer's rate of 2.5% and reached a three-month moving average of 3.2%. This elevation extended into the Spring of 2023 and exceeded the 0.5 percentage point Sahm Rule threshold. However, as this year has progressed, the Sahm Rule indicator receded as the unemployment rate trended downward. Virginia's October 2023 unemployment rate was 2.7%, which resulted in a non-recessionary Sahm indicator value of 0.1 and followed similarly low levels from over the summer.

This positive, downward trend in the Virginia Sahm Rule indicator implies that the Commonwealth may have dodged recession during this period. There are additional considerations that point toward a Sahm Rule 'false positive' and that its past success as an indicator does not guarantee accuracy in the current environment. The largest, looming one is the pandemic and its dramatics effects on labor markets in Virginia and nationwide.

> **"The reason the story of the Sahm Rule breaking without a recession has any credibility is the fact that we've had such a disrupted economy since the pandemic and the disruptions are not gone.[4]"**
> **-Claudia Sahm**

During the first quarter of 2020, Virginia's labor markets experienced the calm before the storm as the quarter began benignly but ended reeling from the COVID-19 pandemic and efforts to contain it. During January and February, Virginia's unemployment rate and the number of initial claims for unemployment insurance remained at near record lows. The spread of COVID-19 and efforts to mitigate it abruptly ballooned these in March. By the end of that month, initial claims for unemployment insurance soared to 112,497, compared to only 3,267 initial claims during the last filing week in February. Virginia's unemployment rate settled at 2.8 percent that winter but shot up to twelve percent in April 2020. These indicators receded from those historically elevated levels in subsequent months and have returned to pre-pandemic levels in 2023. However, disruptions caused by this event persist and may make Sahm Rule comparisons of current conditions with previous recessions difficult.

Sahm Rule Virginia Indicator Levels and U.S. Recessions since 1977

The Sahm Rule indicator passed the 0.5 point threshold last winter. However, a similar 'bump' occurred in 1985 with no resulting recession.

Source: Sahm, Claudia, Sahm Rule Recession Indicator [SAHMCURRENT], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/SAHMCURRENT. November 8, 2023.
Red shaded areas represent economic recessions, or period between a business cycle peak and trough. Source: National Bureau of Economic Research (NBER), "US Business Cycle Expansions and Contractions". https://www.nber.org/research/data/us-business-cycle-expansions-and-contractions.

The Relationship between Rebounding Labor Force Participation and Unemployment

The pandemic worsened long-term declining trends in the labor force participation rate[5], which suppressed unemployment figures, before rebounding rapidly in 2023. In addition to Baby Boomer retirements, many left the labor force to care for family members, because of concerns about the virus, or other reasons. This differs from other recessions in recent decades, which had higher labor participation rates and resulting unemployment.

Having so many workers on the sidelines during the pandemic may have contributed to the rapid unemployment rate rise early in 2023. This is because, as more people decided to return to the labor force, some would be designated as unemployed until they found work. According to Census Household Pulse survey data, the number of Virginians not working declined from September 2022 to September 2023 as the effects of the coronavirus pandemic subsided. Those not working dropped by 173,000, or 7.5 percent, year-over-year. Those remaining on the sidelines cited shifting reasons for not working than earlier in the pandemic recovery. Retirees numbered one million in Virginia, little-changed from a year earlier. However, a smaller share did not want to be employed and many fewer reported Coronavirus and its disruptions as a reason for not wanting to work (though more cited non-Corona related illness for not working).[6] As of October, the Commonwealth's labor force participation rate remained unchanged at 66.8 Percent, or 2.4 percentage points higher than in January 2022[7] and was the highest labor force participation rate experienced in Virginia since April 2012. The rate was ninth highest among states and its year-to-date growth was among the fastest among states.

Historically Tight Labor Markets Send Countervailing Signals to Rising Unemployment Rate Trends

The labor market disruptions during the pandemic era contributed to a shortage of workers that is ongoing and has resulted in a greater availability of jobs for those who want one than the unemployment rate trend alone might show. In September and over the last year, analysis of BLS Job Opening and Labor Turnover Survey (JOLTS) data for Virginia indicates that the Commonwealth's labor market was tighter and more active than in much of the country. The number of Virginia job openings remained at the elevated level of 263,000 in September, which was unchanged from August but over twenty percent higher than five years earlier. In fact, December 2022 job openings reached a record high of 352,000 during the period of the unemployment rate increase that triggered the Sahm Rule last winter and spring. This was not the only sign of strong—not weak—labor demand in Virginia.

During periods of recession, people often hold onto their job amid rising layoffs. Of the 145,000 total job separations in September, seventy percent were quits, which indicates continued confidence among job switchers. Similarly, the pace of movement from job to job (the 'churn rate') slowed slightly in September to 7.4, indicating still-elevated velocity of rotation into and out of jobs. In 2023, the velocity of movement from job to job as represented by the churn rate has steadily slowed nationwide while holding steady in Virginia. [8]

Virginia's strong employment growth over the summer provides additional evidence that the recent Sahm Rule recession trigger was likely a false positive—at least for now.

In October, the number of employed residents in Virginia decreased by 1,938 to 4,492,524. However, most of 2023 has been a year of strength in Virginia's labor markets as the Commonwealth has been a state leader in employment growth. From January 2022, household employment rose by 5.4 percent, which was the third fastest growth rate among states and twice as rapid as nationwide. Because of this, the many Virginians rejoining the labor force were outpaced by those growing the rolls of the employed. As a result, the October unemployment rate remained at the low rate of 2.7 percent, which ranked eighth lowest among states.

What makes this even more impressive is that recent years' unemployment rate in Virginia has been at or near full employment, unlike during most economic recessions over the last 70 years. This means that 2023's employment increase came off an already low level of unemployment. According to DWDA household survey data, Virginia's seasonally adjusted unemployment rate increased in October to 2.7 percent. With that result, the Commonwealth's unemployment rate remained in a narrow range of 2.5 percent and 3.0 percent for much of 2023. Many consider such low levels an indication of a labor market at, or close to, full employment.

Other Measures of Virginia Unemployment have also Been Quite Low

Another important measure of unemployment is claims for unemployment insurance. For the filing week ending November 18, the figure for seasonally unadjusted initial claims for unemployment insurance in Virginia was 1,770, which was an increase of 59 claimants from the previous week. Continued weeks claimed totaled 12,083, which was little changed from the previous week but an increase of 61 percent from the 7,490 continued claims from the comparable week last year. However, claims remained far lower than during the pandemic year of 2020 and comparable to pre-pandemics volumes in 2019.[9] Three years ago, during the May 16, 2020 filing week—and at the height of pandemic shutdowns—continued claims peaked at just over 400,000. But from the third quarter of 2020 onward, Virginia continued claims totals steadily trended downward as filers found jobs, left the labor force, or exhausted benefits.

Virginia JOLTS data on layoffs and discharges also indicated little unemployment. The number of layoffs and discharges in Virginia was unchanged at 40,000 in September and remained at its lowest level in 2023. This was an increase of 21 percent over the year, but still at low, pre-Pandemic levels. Layoffs and discharges are countercyclical, which means that layoffs typically increase during economic contractions and decrease during economic expansions.

Conclusion

During the winter of 2022/2023, Virginia's seasonally adjusted unemployment rate began to rise from the summer's low rate of 2.5 percent and reached a three-month moving average of 3.2 percent. The difference during this period exceeded the Sahm Rule threshold, indicating possible recessionary conditions. However, in the Spring, labor market performance began to improve as the unemployment rate receded back down to 2022's 2.5 percent unemployment rate. A similar condition occurred in 1985 when the Sahm Rule briefly indicated a recession, followed by improving conditions and economic expansion for several years afterward. Few are certain about what exactly lies ahead for the Virginia economy. But the extraordinary aftereffects of the pandemic, full employment conditions with a very tight labor market, and Virginia's nation-leading growth in employment all seem to point toward—if not rapid expansion—the Commonwealth having avoided recession in 2023.

Endnotes

[1] Bureau of Labor Statistics. "*The Employment Situation—October 2023*." November 3, 2023. https://www.bls.gov/news.release/pdf/empsit.pdf.

[2] Rich Miller. Bloomberg. "*US Unemployment Rise is on Verge of Triggering Recession Rule*." November 3, 2023. https://www.bloomberg.com/news/articles/2023-11-03/us-unemployment-rise-on-verge-of-triggering-sahm-recession-rule#xj4y7vzkg.

[3] Sahm, Claudia, Sahm Rule Recession Indicator [SAHMCURRENT], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/SAHMCURRENT. November 8, 2023.

[4] Colby Smith. Financial Times of London. (November 7, 2023). "*Claudia Sahm: 'We do not need a recession, but we may get one.' The former Federal Reserve economist on talk of a recession, the battle to tame inflation and the difficulties of forecasting*." https://www.ft.com/content/3213f700-26a7-4d84-aca0-d7c-c5bf11484

[5] The labor force participation rate measures the proportion of the civilian population age 16 and older that is employed or actively looking for work.

[6] U.S. Census Bureau. Household Pulse Survey, Week 62. https://www.census.gov/data/tables/2023/demo/hhp/hhp62.html.

[7] The Virginia Department of Workforce Development and Advancement." *Virginia's October's Unemployment Rate increased by 0.2 percentage points to 2.7%; Labor Force Participation Rate remained unchanged at 66.8% and Employment decreased by 1,938 to 4,492,524*." November 17, 2023, https://www.vec.virginia.gov/latest-release.

[8] The Virginia Department of Workforce Development and Advancement, "*Virginia Hires Grew by 9,000 in September. Latest BLS Jobs Openings and Labor Turnover Survey Shows Quits Lower at 100,000.*" November 21, 2023. https://www.vec.virginia.gov/node/17888.

[9] The Virginia Department of Workforce Development and Advancement. "*Virginia's Unemployment Insurance Weekly Claims for Week Ending November 18, 2023*." https://www.vec.virginia.gov/UI-press-release.