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Economic Watch

US

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Economic Analysis

US
Kim Fraser
kim.fraser@bbvacompass.com

Jeffrey Owen Herzog
jeff.herzog@bbvacompass.com

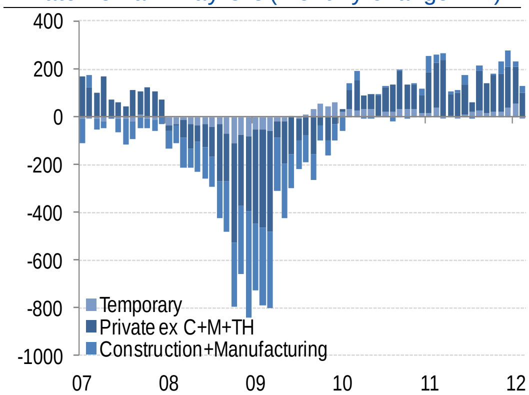
Uncertainty in the Employment Situation

Eyeing the Labor Market Through Rose-Colored Glasses

- The ratio of unemployed to job openings remains well above pre-recession levels, an indication that business' demand for labor is not yet repaired
- A return to pre-recession employment levels by 4Q14 would involve a 26% increase in job openings alongside steady declines in initial jobless claims
- Demographic changes could permanently alter employment dynamics in the coming years

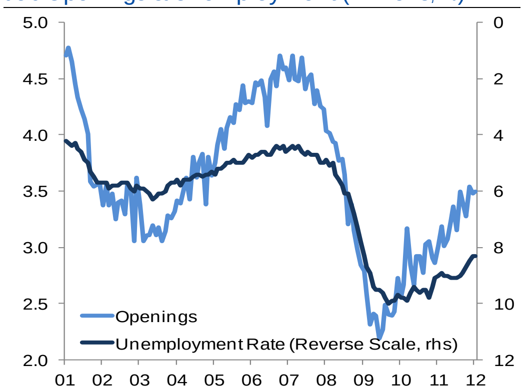
Better-than-expected employment data in late 2011 and early 1Q12 had been somewhat of a relief, offering a more optimistic view of the economic recovery moving into 2012. Fiscal uncertainties in both the U.S. and Europe intensified during the latter half of 2011, with most data suggesting that the global economy was on the brink of another recession. Since August, when markets were hit with a first estimate of flat nonfarm payroll growth, upward revisions to the data have quickly turned sentiments around. However, it may be the case that the data have made us turn a blind eye to the reality that we are still far from a full labor market recovery. On the surface, conditions appear significantly better compared to six months ago, despite the disappointing employment report for March. Nonfarm payrolls have increased 212K on average throughout the past three months, more than double the average monthly increase between May and August of 2011 and mostly led by the private sector (Chart 1). In addition, the unemployment rate declined from 9.1% to 8.2%, one of the sharpest six-month improvements in history. Despite simultaneous declines in the participation rate, falling unemployment sparked brighter activity throughout 1Q12. Still, the underlying trends are less favorable. In March, the labor force decreased 164K following two consecutive months of gains and mostly reflected flows out of unemployment. In particular, the number of long-term unemployed declined slightly, and it is likely that these individuals were forced out of the labor market after experiencing difficulty finding a job for such an extended period of time. The flows into employment were effectively unchanged in March, supporting the Federal Reserve's view that the latest improvements in the labor market appear "out of sync" with the rest of the recovery.

Chart 1
Private Nonfarm Payrolls (Monthly Change in K)



Source: Bureau of Labor Statistics and BBVA Research

Chart 2
Job Openings & Unemployment (Millions, %)

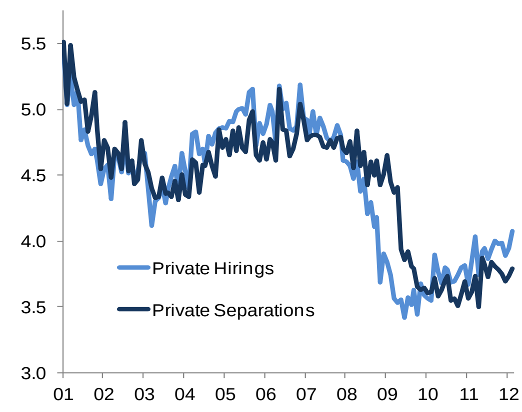


Source: Bureau of Labor Statistics and BBVA Research

In Ben Bernanke's latest speech, he referenced the fact that "despite the recent improvement, the job market remains far from normal", citing below pre-crisis employment levels and hours worked as well as increased long-term unemployment. He specifically noted weakness in employer demand as a key factor in preventing a stronger job market recovery. The job openings rate, which reflects business' demand for new employees, has rebounded 50% from the low point in the recession yet has held steady at 2.5% on average since June 2011 (Chart 2). In another speech, William Dudley discussed the seasonal impact of the warmer-than-usual winter and how this may have shifted some of the usual spring gains to the earlier winter months. In fact, the number of heating degree days in December through March have deviated significantly from the norm, suggesting that this has been one of the warmest winters in nearly six years. Back in the winter of 2006, when heating degree days also dropped far below normal, monthly nonfarm payroll growth averaged only 90K in April, May, and June. As a comparison, the average growth for these three months was near 150K throughout the prior ten years. Given the deceleration in employment growth in March 2012, we may see a similar weather impact throughout 2Q12.

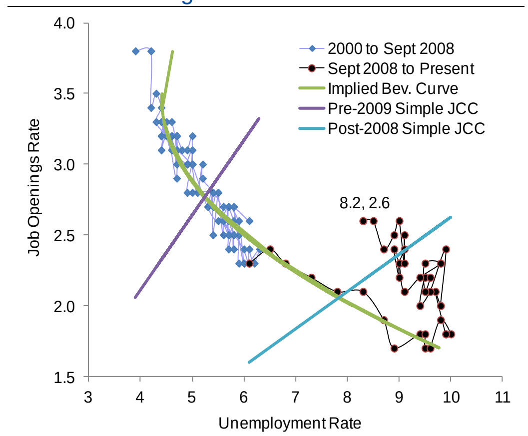
The most recent release of the Job Openings and Labor Turnover Survey (JOLTS) data for February suggest that conditions have remained relatively unchanged for the past few months. The number of job openings held steady at 3.5mn for the third consecutive month while hirings jumped up slightly near 4.4mn, with much of the strength coming from the private side (Chart 3). Separations, which remained unchanged in February, reflected both an increase in the number of quits and a decline in layoffs and discharges. Given the stronger nonfarm payroll growth in February, the corresponding JOLTS data is not surprising. However, we may expect to see a slower pace of improvements in the coming months. Despite the outward shift in the Beveridge Curve (Chart 4), Bernanke has emphasized that compared to historical experience, "these patterns do not support the view that structural factors are a major cause of the increase in unemployment during the most recent recession."

Chart 3
Private Hirings & Separations (Millions)



Source: Bureau of Labor Statistics and BBVA Research

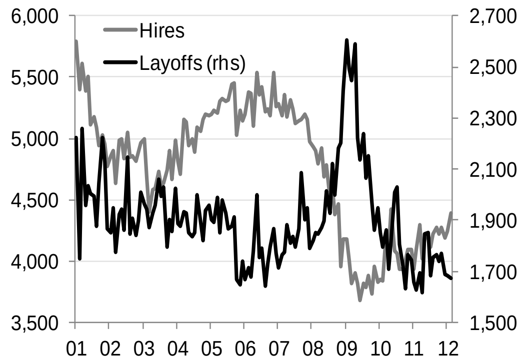
Chart 4
National Beveridge Curve



Source: Bureau of Labor Statistics and BBVA Research

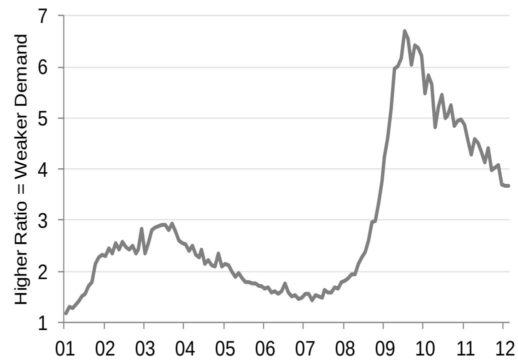
In order for the pace of employment growth to continue, the data suggest that we need to see a stronger increase in hiring relative to layoffs and quits. Nonfarm payroll growth, which essentially measures the difference in hires and separations each month, fell sharply during the recession as a result of reduced willingness to hire and a significant increase in layoffs. Throughout the past few months, as payrolls have surprised to the upside, declines in layoffs have outweighed hiring increases (Chart 5), thus contributing to the payroll gains. The ratio of unemployed to job openings (Chart 6) has dropped significantly since the formal end of the recession but remains well above pre-recession levels, an indication that business' demand for labor is not yet where it needs to be to create the necessary churn in the labor market. Job openings will rise coincidentally with hirings. Thus, if we were to expect more net employment generation, the job openings rate would have to increase strongly. The natural next question is if the implied amount of job openings in an optimistic employment growth scenario is feasible.

Chart 5
Total Hires & Layoffs (K)



Source: Bureau of Labor Statistics and BBVA Research

Chart 6
Ratio of Unemployed to Job Openings (%)



Source: Bureau of Labor Statistics and BBVA Research

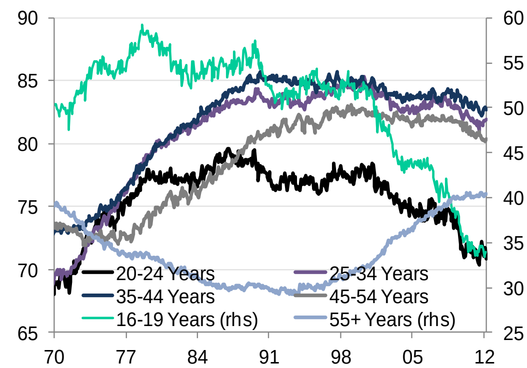
Looking at the employment data, what would constitute a stronger recovery? We developed a model to assess the relationship between employment levels, job openings, and initial jobless claims data. In order for employment to return to its pre-recession peak of 138mn by the end of 2014, we would likely need to see an openings rate near 3.1%. As a comparison, we look at the latest increase in the openings rate over an extended period, from 2.0% in February 2010 to the most recent 2.6%. Throughout that 24-month period nonfarm payrolls increased an average 137K per month. Layoffs appear to have leveled off, so in order to achieve a similar vacancy rate increase by the end of 2014 with steady nonfarm payrolls gains, job openings would need to increase 26% to reach a corresponding level of 4.404mn. We can compare this to the expansionary period after the early 1990s recession. Throughout 1994, the number of openings increased 18%, corresponding to a 0.5% increase in the vacancy rate, with nonfarm payrolls up an average of 321K per month. Given the questioned sustainability of recent employment gains, a replication of the 1994 recovery seems far-fetched. Coincidently, hirings would also increase. Assuming that layoffs remain constant near lows of 1.6mn over the next two years, this implies a near 400K jump in hirings by the end of 2014 to 4.648mn. This scenario also assumes steady declines in initial jobless claims, but at a much slower pace than recent data have suggested, falling only to 341K (monthly average) in the next few years. This supports our recent analysis that initial jobless claims are extremely useful in judging when recessions begin and end, but the data do not necessarily reflect the strength of the recovery (see brief).

Even if employment does return to its prerecession level, flows into and out of the labor force remain uncertain. The Fed has highlighted its concerns with the employment-population ratio (Chart 7), which hovers near its lowest point in nearly three decades and represents potential demographic problems facing the labor market. The falling participation rate has been very influential in the latest unemployment rate declines, adding to the fear that recent employment indicators are too good to be true. Retirement of baby boomers, smaller family size, women in the workforce, and a downward shift in teen work activity are all demographic factors impacting the participation rate. The declining share of younger workers in the labor force suggests that the participation rate may have shifted permanently lower (Chart 8). Female employment is also a factor, particularly as more have decided to leave the workforce as their spouses accept more well-paying jobs. Between 1993 and 2006, the number of college-educated women in the workforce declined 0.1%, significantly different from the 2.4% increase between 1976 and 1992. If this earlier trend had continued, the labor force in 2008 would have consisted of more than 1.6mn additional college-educated women, accounting for nearly 1% of the total labor force that year. Ultimately, it is the demographic changes that could permanently alter employment dynamics in the coming years.

Chart 7
Employment-to-Population Ratio (%)

Source: Bureau of Labor Statistics and BBVA Research

Chart 8
Participation Rates by Age Group (%)

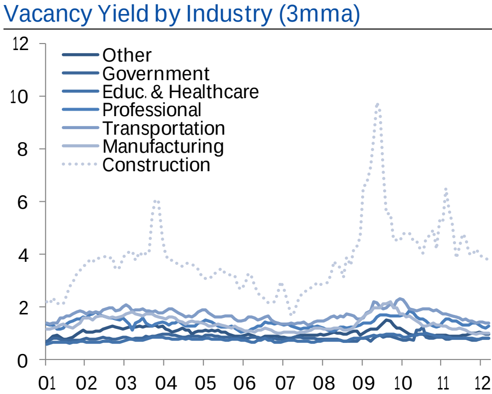


Source: Bureau of Labor Statistics and BBVA Research

Bottom line: Employment Recovery Not Yet in Full Swing

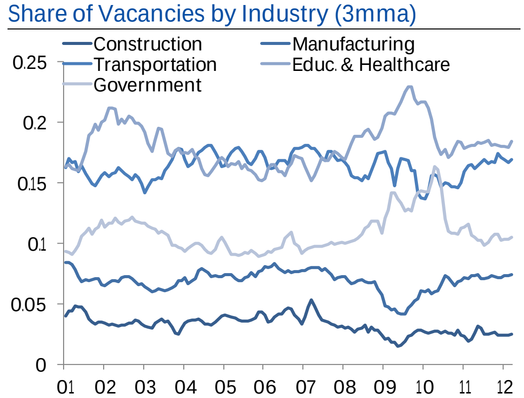
Recent employment indicators have made it easy to look at labor market conditions through rose-colored glasses. This positive news, taken at face value, has overshadowed potentially permanent damage to the standard employment cycle. Our view of the labor market has been cautious, echoing the Fed's views that the employment recovery has not yet proven itself to be sustainable. While employment is trending better than the previous year, we believe expectations of a more rapid recovery are not adequate considering the amount of openings required to reach such a level of employment growth. The gap between expectations of high employment growth and the mathematically required level of openings alludes to the long-term structural impediments facing the US labor market, such as deindustrialization tendencies from inadequate global competition. Another factor weighing on the employment situation is the extremely low participation rate, which highlights the potential for an increasing unemployment rate if more individuals enter (or re-enter) the workforce. As it stands now, businesses are not yet comfortable enough with demand conditions to expand their production levels, though we surmise that some have hired new workers simply because they have maximized their productivity with their current employee base. Payroll tax cuts may be a temporary relief for hirings data, but the underlying problems require more long-term solutions, such as more advanced job retraining programs and research into new manufacturing techniques.

Chart 9
Vacancy Yield by Industry (3mma)



Source: Bureau of Labor Statistics and BBVA Research

Chart 10
Share of Vacancies by Industry (3mma)



Source: Bureau of Labor Statistics and BBVA Research