Economics from Washington

Labor Conditions Monitor

December 9, 2015

L. Douglas Lee
dlee@econfromwashington.com

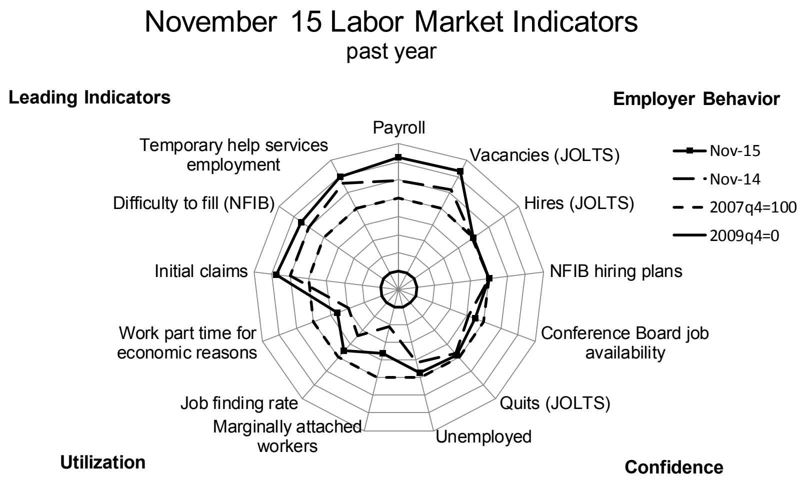
Labor market conditions have continued to improve since the September FOMC meeting, although the improvements are small. The number of long term unemployed, and consequently, the average duration of unemployment show notable improvement; other changes are marginal. A continuation of current moderate growth will cause markets to continue tightening, which is probably more important. Many Fed officials expect the unemployment rate to reach 4 ½ % sometime near mid-2016, bringing those measures that have not fully corrected from the recession close to pre-recession levels. This overshoot is quite acceptable, because inflation will remain below target levels.

A large majority of investors now expect the fed funds rate to be increased ¼ point at the December FOMC meeting, and we agree. While there is understandable uncertainty about how markets will react to this increase, our view is the positives will outweigh the negatives. First, it will signal confidence among policymakers the economy is strong enough to begin the normalization process. Second, it is very difficult for markets to react predictably when rates are near the zero bound. Any discounting model will generate infinite returns when the interest rate is zero, but no one expects to earn an infinite return. This makes it difficult for investors to know how to react to changes and reactions become erratic. Even a small move away from zero will likely be helpful. Third, cash equivalents in the economy have drifted steadily higher, reaching unprecedented rates as people recognized they forgo no interest earnings by holding these balances. Moving to positive rates will begin the normalization process, while adding a small amount of interest to income. Given the size of these balances, this will be more significant than ever before. Finally, there is legitimate concern that the extended period of exceptionally low rates has distorted investment decisions in ways that are not fully understood. Beginning the process of moving away from zero will bolster confidence that these unknown risks may have stopped growing larger.

Evolution of the Labor Market

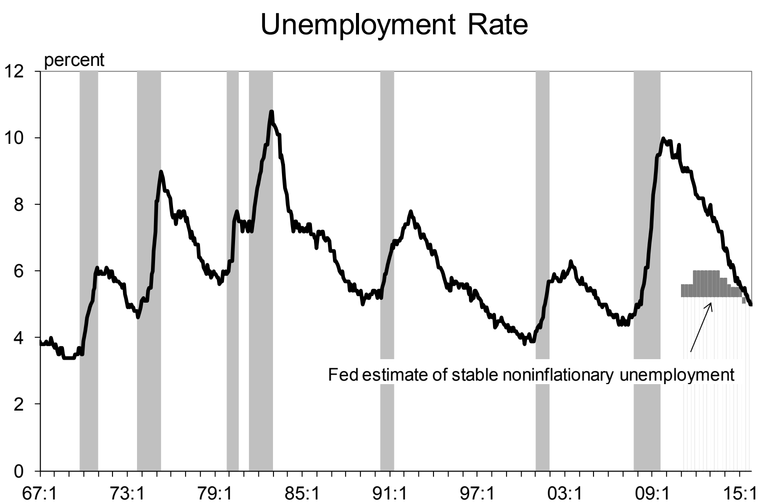
	Nov-14	Aug-15	Nov-15
Unemployment rate	5.8%	5.1%	5.0%
Employment to population ratio	59.2%	59.4%	59.3%
Broad unemployment rate (U-6)	11.4%	10.3%	9.9%
Duration of unemployment (median, weeks)	12.8	12.1	10.8
Long-term unemployed	30.7%	27.7%	25.7%
Hire rate	3.6(Oct)	3.5(Jul)	3.6(Oct)
Quit rate	1.9(Oct)	1.9(Jul)	1.9(Oct)
Payrolls: 3-month ma	139,750	142,091	142,660
Payrolls: 6-month ma	139,372	141,740	142,365
Hourly earnings (y/y % change)	2.1%	2.2%	2.3%
Initial jobless claims (4-week ma)	299,000	275,500	269,000

Economics from Washington, Inc.
T 301.365.6395 ▪ F 301.365.2686
www.econfromwashington.com



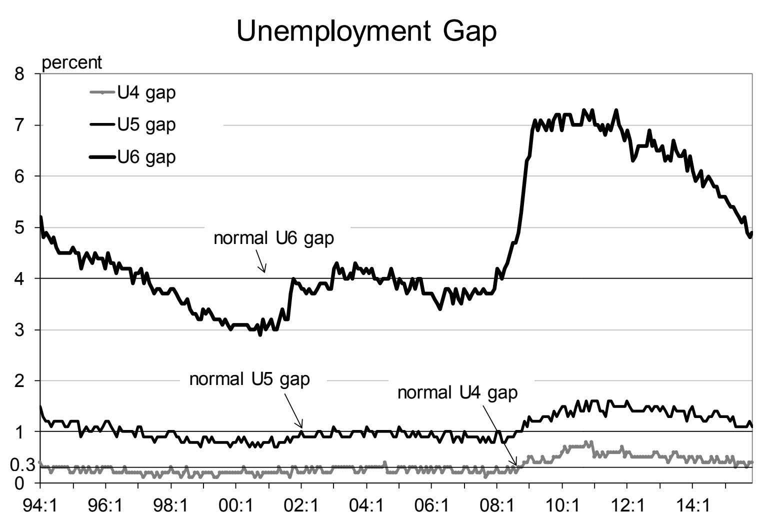
Source: US Bureau of Labor Statistics, US Department of Labor, National Federation of Independent Business, and The Conference Board

Labor market conditions have improved very little since September, but the outlook for continued improvement is good.



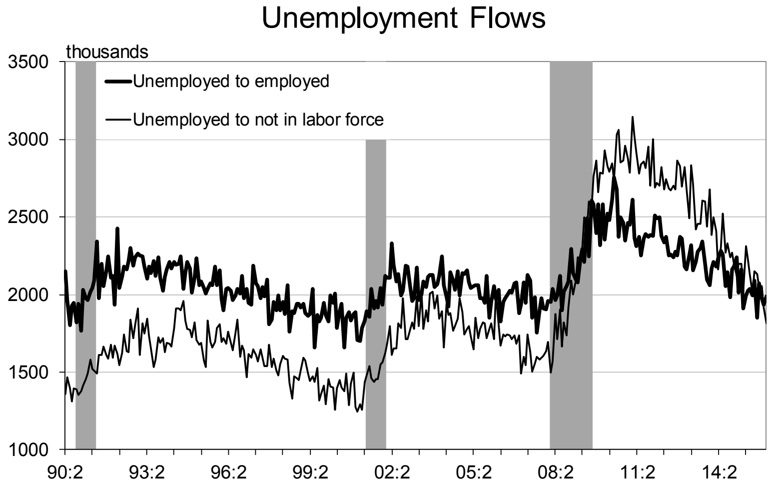
Source: Bureau of Labor Statistics

Unemployment is likely to overshoot the Fed’s full employment zone, causing various peripheral measures to tighten further.



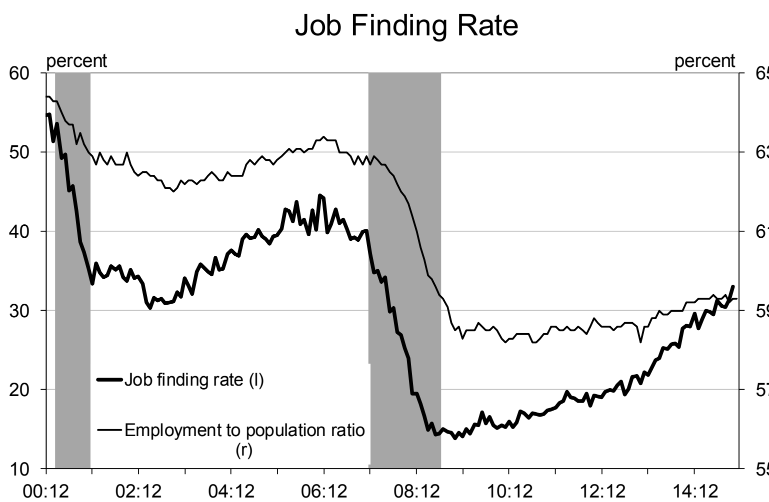
Source: Bureau of Labor Statistics

The gap between broad and narrow measures of unemployment has closed. Structural changes have increased the normal U6 gap from 4 to about 5 percentage points and it is now below that level.



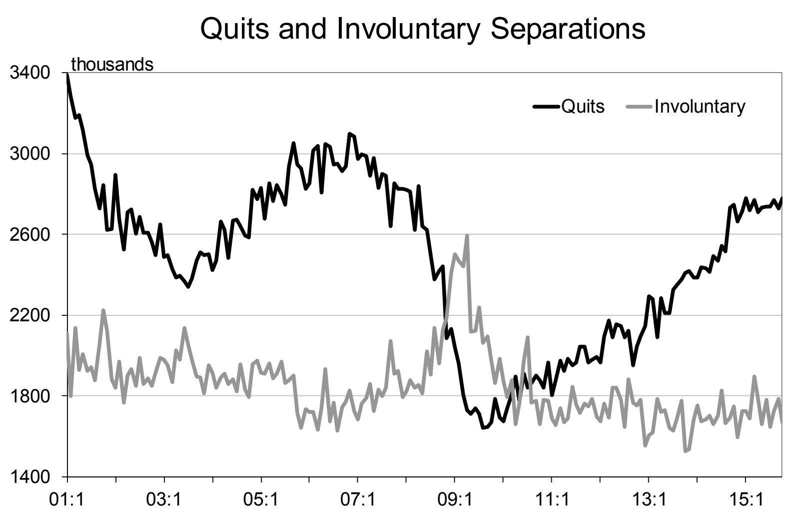
Source: Bureau of Labor Statistics

Flow data are not quite at normal levels, but they continue to make good progress in that direction.



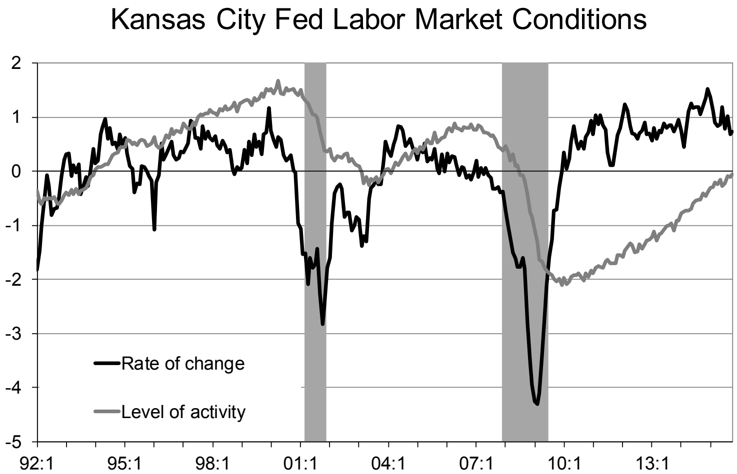
Source: Bureau of Labor Statistics

Although the employment to population ratio remains stable, the job finding rate has improved significantly.



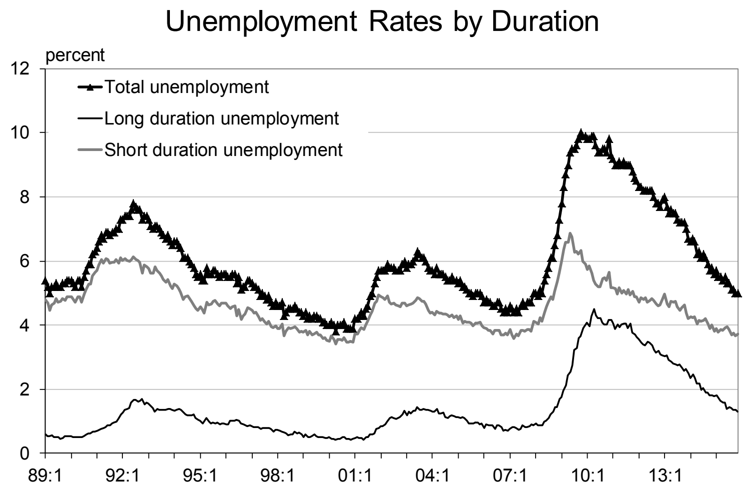
Source: Bureau of Labor Statistics

Quits have stopped rising, but are stable at a high level, and layoffs remain quite low.



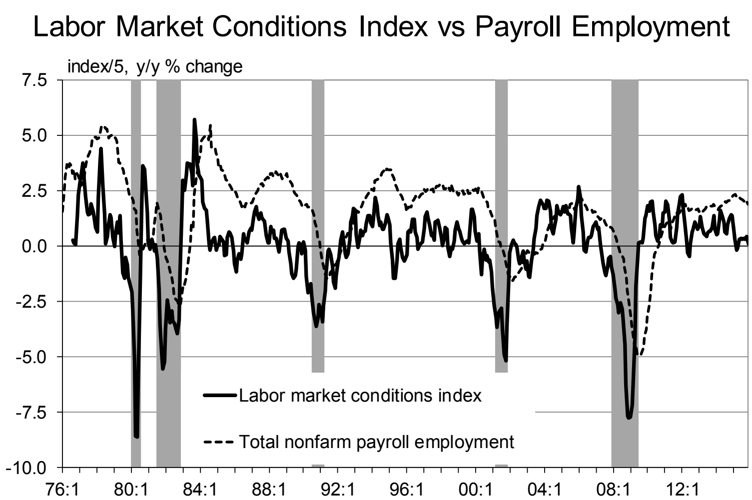
Source: Kansas City Federal Reserve Bank

The Kansas City measure clearly suggests the rate of labor market tightening is slowing. Nevertheless, the level of activity continues to show a small improvement.



Source: Bureau of Labor Statistics

Recently, falling unemployment has reduced the rate for long duration unemployment. The short duration rate has stabilized near its pre-recession level.



Source: Federal Reserve Bank of St. Louis, Bureau of Labor Statistics

The Fed's Labor Market Conditions index also points to slower, but still positive employment growth.