Understanding Labor Market Trends: Challenges and a Suggested Framework

On September 13, 2012, the Federal Open Market Committee (FOMC) announced a package of strong measures to further support the economy, including a third round of bond purchases concentrated in agency mortgage-backed securities. In addition, the FOMC revised its forward guidance about the duration of very low interest rates by several months, to at least mid-2015. I see these latest measures as placing a floor of sorts under the still-vulnerable economy and providing additional assurance that economic growth remains on track to steadily, if gradually, reduce joblessness.

This latest program of bond purchases differs from earlier ones in that the purchases are contingent on the state of the economy, particularly employment. In the statement that followed its September policy meeting, the FOMC said, “If the outlook for labor markets does not improve substantially, the Committee will continue its purchases of agency mortgage-backed securities, undertake additional asset purchases, and employ its other policy tools as appropriate until such improvement is achieved in a context of price stability.”

Labor market’s complexity, dynamism are key concerns

The FOMC has clearly signaled its resolve to improve employment outcomes. However, recent actions also present the challenging task of defining in clear and measurable terms what constitutes “substantial improvement in the outlook for labor markets.” In my view, efforts to evaluate employment conditions must consider the complexity and dynamism of the U.S. labor market. What follows are several aspects that I believe give shape to the employment market reality.

First, there is a lot of movement in the labor market. Each month, about 17 million people find a job, lose a job, look for a job, or leave the labor market. In addition, being employed can take different forms. A person can work full-time or part-time, or work on a temporary or contract basis, for example. Importantly, a considerable share of part-time workers today would prefer a full-time job.

CONTINUES ON PAGE 23

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CONTINUED FROM PAGE 1

Underemployed workers in this category—also called “part-time for economic reasons”—grew during the recession. Another factor shaping labor markets is the rate of participation, which has been falling since the early 2000s. This trend is largely the result of demographics—namely, the aging population. Of course, some of the decline in participation rates also reflects recent economic conditions. Consider, for instance, the millions of “marginally attached” workers—people who indicate that they are ready and willing to work but are not actively searching. Many of these individuals will likely return to the labor market as conditions improve.

Additional aspects include the variations in employment conditions across regional labor markets, as well as the way in which new jobs are created. Research indicates that new and early-state businesses are responsible for a significant share of jobs created in this country. At the same time, young firms often do not survive past five years. Indeed, job creation in our country is in a state of continuous churn as jobs disappear due to business failure and are replaced by jobs in newer, growing industries.

Determining what improvement looks like
Hopefully, these factors provide some insight into the complexities that shape the U.S. employment market. This brings us to the challenge my FOMC colleagues and I face as we consider the labor market’s progress toward “substantial improvement.” My framework for defining this important milestone is, admittedly, a work in progress. Although the monthly unemployment rate and payroll figures are a good starting point, I will look to additional data elements to reinforce and enrich movements in these two statistics.

Examples of what I would look for include a lowering of the unemployment rate that is driven by a steady stream of job-seekers into employment. Discouraged workers leaving the labor force would also lower the unemployment rate, but I would not necessarily interpret that as a sign of improvement. I’d also look for growing public confidence in labor markets, as indicated by greater labor force participation. I would like to see employment gains that are associated with reductions in underemployment. And finally, I’d look for signs that these improvements are gaining momentum, are sustainable, and are complemented by forward-looking indicators such as falling initial claims for unemployment insurance.

Adding context to the term “substantial improvement” is important, I believe, because future monetary policy actions by the FOMC hinge on improving labor market prospects. The latest monetary policy actions announced by the FOMC, in addition to earlier measures, demonstrate its commitment to the Fed’s dual mandate of price stability and maximum sustainable employment. We will not waver on that commitment.

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