U.S. Labor Market – How Low Can Unemployment Go?

July 2019

OVERVIEW

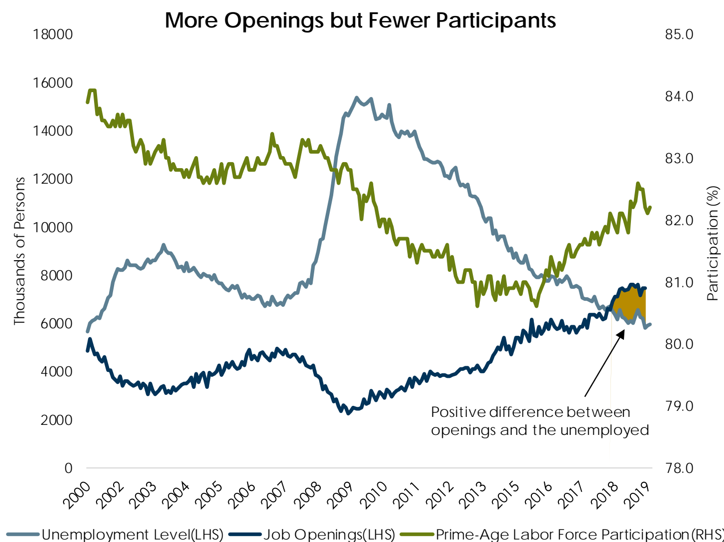
- **Millions of new jobs have been created since 2010, with unemployment close to its lowest level since the late 60s**
- **Though the U.S. has experienced one of the longest economic expansions ever, wage growth has been modest**
- **Technological innovation and the impact of the Great Recession has altered labor market dynamics**

Background

As of June 30, 2019, the official U.S. unemployment rate resides at 3.7%, very near the lowest in 50 years, as 21.5 million new jobs have been added in the last decade. This rate is well below the Federal Reserve's longer run projected rate of 4.2%, a number which has been repeatedly revised downward over the last four years, from approximately 5.2%. This longer run rate is supposed to represent "full employment" in the economy. Yet there continue to be discouraged workers, as well as businesses struggling to fill open positions. The hallmarks of full employment are typically inflation and wage growth, neither of which has occurred in great quantity thus far. So why has full employment been difficult to reach, and what data is the unemployment rate missing?

Hidden Slack in the Labor Market

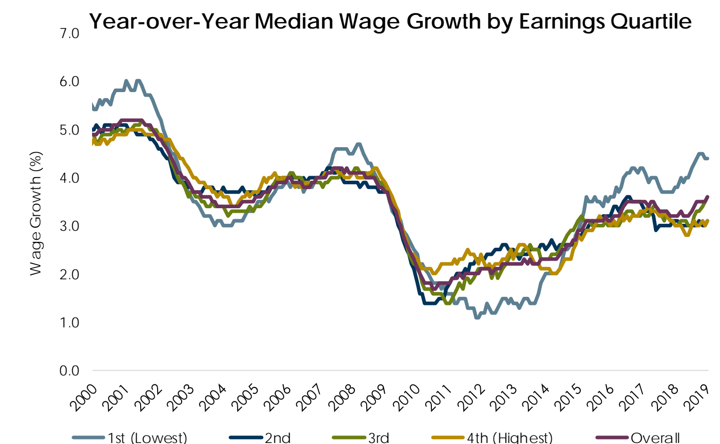
As jobs have been added, the unemployment rate has also seen downward pressure from a decreasing supply of labor. There are key demographic trends contributing to this, such as retiring baby-boomers. A factor that is more difficult to explain is the change in labor force participation. The unemployment rate counts only people actively looking for work, and in the wake of the trauma of the Great Recession that number has diminished significantly. This could be for a number of reasons, such as early retirees, people going back to school, participants choosing the "gig economy," or people simply too discouraged to bother anymore. The labor force participation rate of 82.2% for prime-age workers (25-54 Years) is an improvement from post-recession lows but still trails the 83.3% from 2007 and the 84.4% in 2000. The modest change in percentage terms from 2000 to today represents 2.3 million people who would have been participating in the labor market. This exceeds the current positive gap of 1.6 million between job openings and people counted as unemployed.



Source: St. Louis Federal Reserve (FRED database), ACG Research

An Incomplete Recovery

There have been headlines speculating the U.S. economy was at full employment since 2015, and reports of labor shortages for at least that long. For example, an industry survey indicated 74% of construction firms reported difficulty filling positions as far back as 2013, a number that still stands at 78% as of 2019. Nonetheless, median yearly wage growth for early post-recession years of 2010-2015 averaged a meager 2.2%, with low-wage occupations such as retail and hospitality faring the worst. Whatever labor shortages may have existed, they were not numerous or severe enough for businesses to increase wages at rates consistent with the overall expansion. The widely reported "skills gap" suggests workers lack the talents required to perform available positions, regardless of wages being offered. There are indications this environment, along with a perceived decline in value of a college degree has begun to shift behaviors. An Obama era Department of Labor focus on apprenticeships has seen participation in those programs increase 56% since 2013. Trade school revenues have increased 22% in that time, and recent industry surveys indicate an uptick in on-the-job training. With the benefit of minimum wage reforms, wage growth has finally started to trend up for the nation's lowest earners. This is key for economic growth, as it's this constituency that spends the greatest share of incremental income, and ultimately drives consumer spending (the most critical component of domestic GDP at nearly 70%).



Source: Atlanta Federal Reserve, ACG Research

ACG's Position

While recently improved, both labor-force participation and wage growth remain below pre-recession levels. It will be necessary for the Fed to continue to re-evaluate what constitutes "full employment" in this environment. With a host of ongoing uncertainties acting as a headwind to hiring, year-to-date job creation has slowed from the pace observed in 2018. Stubbornly low inflation, and the steady supply of discouraged workers also lend support to the idea of renewed Fed rate cuts in the near future, regardless of historically low unemployment.

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