LPL RESEARCH

WEEKLY ECONOMIC COMMENTARY

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JOBS COUNT: BUT HOW DO WE COUNT THEM?

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KEY TAKEAWAYS

The job market is an important indicator of economic health, but there are many ways to look at the market and multiple ways to interpret the data.

One issue that often arises is the two different types of unemployment rates.

Another important concept for the labor market is ascertaining why people are unemployed, especially when the economy has been improving. One way to examine this is to look at the Beveridge Curve, an economic indicator.

HOW TO READ A JOBS REPORT

The U.S. Bureau of Labor Statistics (BLS) released its monthly jobs report on Friday, May 5, 2017. As usual, investors and economists (including those at the Federal Reserve [Fed]) will pour over the data for clues regarding the health of the economy, as well as for insight into interest rates and other policies. Lately, many questions arise with each data release. Different rates measure a different scope of the labor market, specifically how those who have given up looking for work, or people working part time when they would rather work full time, are counted. The difference between these rates gives rise to questions, including which rate is correct and how to interpret the data. Another measure of the health of the labor market is the Beveridge Curve. This indicator compares the number of people looking for work with the number of employers looking to hire. In theory, these should have a mostly steady relationship. Changes in the relationship may indicate a structural issue, either in the labor market or economy.

WHAT REALLY COUNTS

The BLS's monthly jobs report contains a large amount of data. But there are three numbers that matter most. One is the unemployment rate, also called the U-3 unemployment rate, which is the number of people not working but actively looking for work divided by the total labor force. However, there are other ways to measure unemployment. One of them is the U-6 rate, often called the "underemployment rate." It starts with the U-3 rate, but adds people working part time involuntarily, as well as those who have given up looking for work, often referred to as discouraged workers. The U-6 rate is therefore a broader measure of slack in the U.S. labor market. The recent history of these rates can be seen in Figure 1. The most recent reading on these figures on May 5, 2017, shows the U-3 unemployment rate is 4.4%, below its pre-Great Recession value, whereas the U-6 rate is 8.6%, still slightly elevated from its pre-Great Recession value.

The impact of the Great Recession is apparent. Not only did both rates rise, but the U-6 rate rose significantly higher (proportionally) and stayed relatively high well after the economy began to recover. U-6 unemployment did not begin declining in earnest relative to the U-3 rate until 2013 and did not fall below 12% until the middle of 2014. This difference is partially behind the notion that the recovery was leaving a large part of the population behind.

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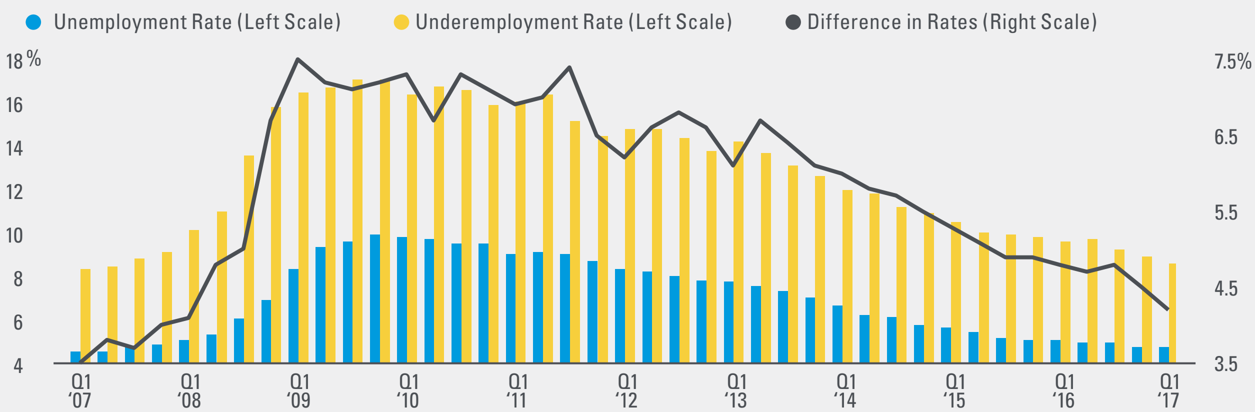
BEVERIDGES COOL DOWN THE ECONOMY

There are two other implications of the gap between these employment measures. One is the impact on the third number that gets a lot of scrutiny on jobs day, wages. Wages have been slow to rise despite the low U-3 rate. The most recent statistics on wages show that wage growth was only 2.5% during the past year, as of May 5, 2017. One reason for this is that these discouraged workers are coming back into the work force. This is a good thing for sure, but also acts as a depressant on current wages. Stagnant wages impact all workers, again supporting the notion that the economic recovery is incomplete or anemic.

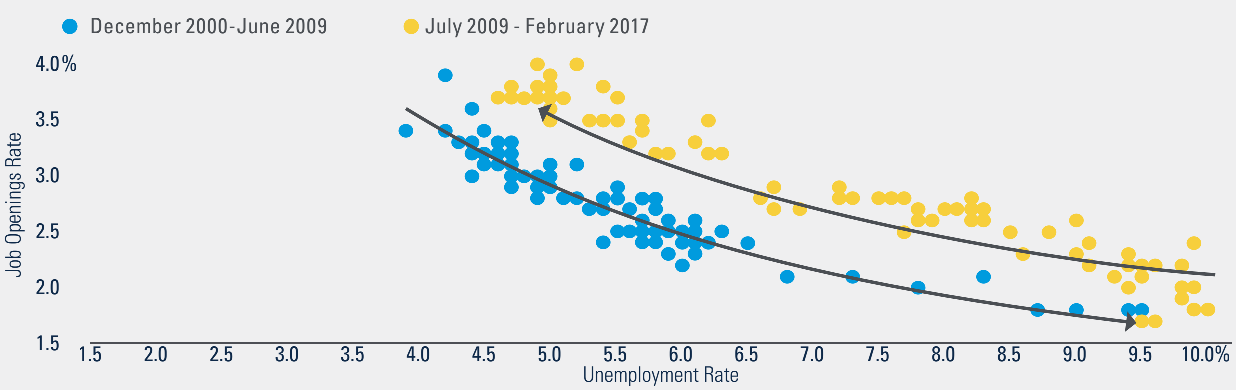
These concepts are generally referred to as cyclical, that is they relate to the business cycle. There is actually an implied "yet" in many statements about the job market, implying a belief that the cycle will continue to get better. "Discouraged workers haven't found full time jobs, *yet*." "Wages haven't increased despite lower unemployment, *yet*." However, all the issues in the job market may not

1 UNEMPLOYMENT VS. UNDEREMPLOYMENT – BOTH DOWN FROM HIGH, BUT UNDEREMPLOYMENT ONLY NOW BECOMING NORMAL



Source: LPL Research, Bloomberg 05/05/17

2 BEVERIDGE CURVE – GAP BETWEEN JOB SEEKERS AND JOB CREATORS



Source: LPL Research, Bureau of Labor Statistics, Ned Davis Research 05/05/17
Data as of 02/28/17

be cyclical. They may not be solved simply by giving the economy more time, or even by rising wages, bringing even more people into the labor market.

Why might people continue to be underemployed even though the unemployment rate is low? Maybe companies are not hiring. However, the BLS also tracks job openings, new jobs created by companies. We can track the unemployment rate against the job openings rate, resulting in something called the Beveridge Curve [Figure 2]. This shows two sets of data. The blue dots show the relationship between job openings and unemployment rate before the Great Recession, while the yellow dots display that relationship since the Great Recession. You can see there is a greater mismatch recently. There are proportionally more people looking for work at the same time there are more companies looking for workers.

How can this be? Why can't job seekers and employers get together? There are many possible answers, but we suggest two. The first is cyclical. They simply haven't gotten together *yet*. Some companies have increased wages, luring more people back into labor pool, but maybe wages haven't increased enough for everyone to get a job. Maybe, as the economy continues to improve, employers will be forced to increase wages. Or maybe workers who have been holding out for more will decide that the current market is as good as it gets and accept wages as offered.

Or maybe the issue is structural. There has been some concern that many of the people looking for jobs don't have the skills the job creators need, referred to as a "skills gap." Many jobs, even those considered only semi-skilled, require a degree of computer literacy unneeded even a few years ago. There is anecdotal evidence, mostly from companies themselves, that technologically sophisticated workers are in short supply. This isn't a "yet" problem. Training workers will take time, money, and a clear vision of what is needed in the workplace.

This issue is a real quandary for the Fed, which at times suggested running the economy "hot," keeping interest rates lower than they might otherwise be to help boost wages. Remember, Fed Chair Janet Yellen was a labor economist who is very sensitive to issues of wages, not merely jobs. If one believes the primary problem in the labor market is cyclical, this approach may be effective, even if there are some adverse side effects. However, if the primary problem with the labor market is structural, such as a skills gap, waiting to tighten monetary policy further is unlikely to make the situation better and may even make it worse.

CONCLUSION

The most recent jobs report was largely good news, but looking under the surface we see some of the issues that have bedeviled economists, policymakers, and business owners since the economic recovery began. Though the Fed has begun to normalize interest rates, the gap between U-6 and U-3 unemployment rates and issues like the skills gap remain a problem. Spring and summer are popular times to visit Washington, D.C., but it's very warm. If you see Yellen, you might want to offer her a cool Beveridge. ■

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results.

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The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

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DEFINITIONS

A Beveridge Curve, or UV-curve, is a graphical representation of the relationship between unemployment and the job vacancy rate (the number of unfilled jobs expressed as a proportion of the labor force). It typically has vacancies on the vertical axis and unemployment on the horizontal.

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