

“Long term unemployment is coming down and is coming down steadily... The important message now is that there is still a lot of hidden unemployment... The job market is doing great, the economy is doing fine. But the part timers and the young people who dropped out, between those two, that’s a hidden population of unemployment that is simply not captured.” - Jim Glassman Senior Economist J.P. Morgan Chase

Employment. What is going on?

1Q2014 GDP was posted last week as -2.9%. However, claims are down, hours are flat, and wages are increasing above the rate of inflation as we posted the best employment numbers across the board this week. What exactly is going on here? Shouldn't there be anything but a -1 correlation between GDP and jobs? And if these job numbers are right, to what extent are they telling the whole story? There are effectively two camps. The Janet Yellen and William Dudley (Chair and Vice Chair of FOMC committee) camp which states that unemployment is largely cyclical versus the Richard Fisher and Larry Summers (Fed Reserve president of Dallas and President of Harvard University respectively) camp which tends to believe that unemployment is more structural. I agree with Fisher and Summers.

Janet Yellen and others refer to the word 'Slack' to describe cyclical unemployment. Its in their opinion that the seven million people who are part time but would like to be full time is much larger than a 6.1% unemployment rate would suggest. They likely look to the decline in unemployment not helping raise wages for workers as well as the extraordinarily large share of unemployed who have been out of the labor market which has skewed the meaningfulness of declining unemployment when compared to labor force participation rates. They state that these can be overcome with monetary policy measures and are the primary reason for a underperforming feeling of the labor market in light of such positive labor statistics posted this week.

The other camp suggests something much more dire. There is a structural mismatch between skills and jobs available. We are seeing wages rise above inflation but this is largely concentrated in high skill areas where the middle-skilled worker is finding it increasingly hard to seek work. Furthermore, Yellen and Dudley believe that those long term unemployed (who are not accounted for in most labor statistics) will come back as the short term unemployed approach more normal levels of unemployment. However, the long term unemployed face challenges such as no work experience for the last 2-5 years where employers may be less likely to higher than a new comer. I am concerned that the long term unemployed will likely be permanently unemployed or underemployed for the duration of their lives.

If employment is structural, what is the efficacy of monetary policy going forward given the zero lower bound? Employment stability has become increasingly problematic and addressing this challenge will likely require significant fiscal policy approaches. Glassman estimates that there are 2.7 million short term unemployed in excess of what would get us to full employment. Furthermore, he estimates there are another 2.7 million in long term unemployed. Note that Glassman is a believer in the cyclical story.

The employment population ratio in aggregate one observes almost no progress in the level of employment to population and demographics is not a significant factor in these numbers. You can see the employment population ratio for 25-55 year old men (historically the group with the most impact on work hours and wages) declined sharply in the financial crisis and only a very small part of which has come back.

I believe there is a huge shadow on the economies future potential to employ workers that are unskilled and as technology advances, minimum wage rises, we should see a large substitution in low cost technology for workers whose marginal value to their employer diminishes daily.

What does 6.1% unemployment mean? In my opinion, very little in the near term as there is a large amount of discouraged workers who structurally are unlikely to have the skill set necessary to satiate the appetite of employers whose alternatives are growing. I think wages are not going to grow at a satisfactory rate. My thesis may change if we see wages rise or, participation rise not at the expense of wages or the unemployment rate.

