When Will the U.S. Job Market Recover?

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In this Global Macroeconomic Working Group newsletter, we focus on the U.S. job market. The economic recovery post-2008 is often referred to as a "jobless recovery" given the persistently high unemployment rate. In this paper we will put the current employment situation in historical context, examine the major factors behind the slow recovery, and provide a brief outlook on what we can expect.

The "Jobless Recovery" in Historical Perspective

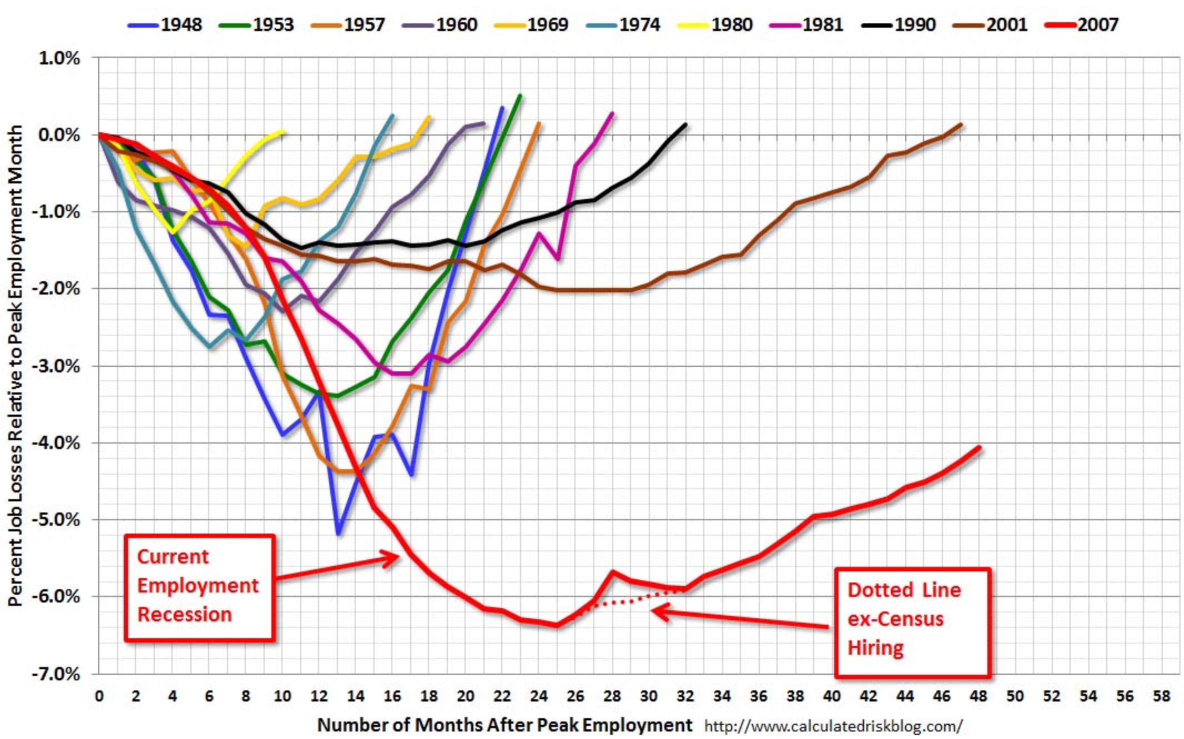
While showing signs of improvement, the post Global Financial Crisis labor market has suffered the worst decline, and slowest recovery, in modern U.S. history. Each of the past four recessions saw the job market take increasingly longer to recover, with the chart below illustrating the magnitude of the problem.

While the unemployment rate has noticeably declined, we are still at a level not seen in this country since December 1983.

The Recent Recovery May Be Worse Than It Looks

The improvement may be overstated by the way unemployment is calculated. The Labor Department's employment report for February 2012 showed a net gain of 227,000 jobs for the month and an unemployment rate of 8.3%. The better-than-expected improvement of the past few months has led to bullish sentiment that the U.S. economy is continuing to recover and "de-couple" from the issues plaguing Europe.

However, digging below the headline number of 8.3% to the underlying data shows that the recovery may be less robust than it appears. The Bureau of Labor Statistics (the government body that conducts and publishes official employment surveys), defines "Unemployed Persons" as "persons aged 16 years and older who had no employment during the reference week, were available for work except for temporary illness, and **had made specific efforts to find employment sometime during the 4-week period ending with the reference week**." This last point has become particularly rele-



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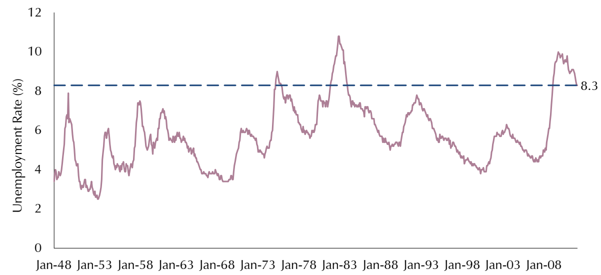
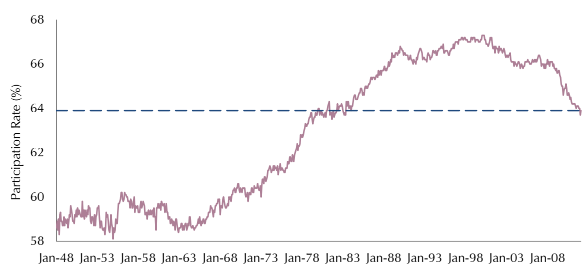
vant, as many are no longer considered "unemployed," not because they found a job, but rather because they gave up looking. The impact of this trend can be seen in the Labor Force Participation Rate. This shows the percentage of the population that is either currently employed or actively looking for a job.

U.S. UNEMPLOYMENT RATE[1]



Similar to the unemployment rate, the Labor Force Participation Rate has declined to levels not seen since the early 1980's. While labor market dynamics have materially changed over the past thirty years, this rate has declined substantially in just the past four. As of December 2007, the Labor Force Participation Rate was 66.0%, and has declined to 63.9% as of February 2012 (representing roughly 5 million people). It is safe to assume that the vast majority of the decline consists of people leaving the official labor force because they gave up looking for a job. To appreciate the impact that this has on headline unemployment, if we assume that the Labor Force Participation Rate was held constant as of December 2007, the February 2012 unemployment rate would rise from 8.3% to 11.4%. When the economy does materially improve, the unemployment rate could *increase* as people re-enter the labor force.

LABOR FORCE PARTICIPATION RATE

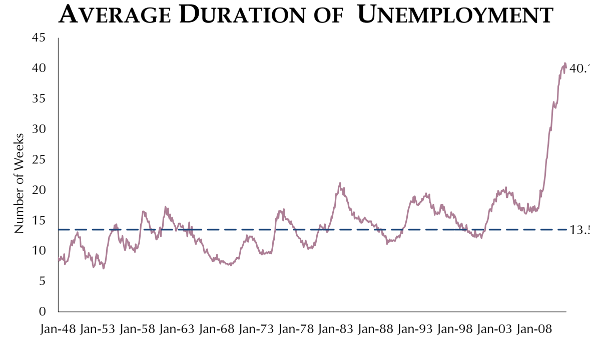


Furthermore, the Bureau of Labor Statistics (BLS) tracks workers who are employed "part-time for economic reasons," those who wish to find a full-time job, but cannot, and thus work part-time. While these people are considered employed, they are often referred to as "underemployed." As of February 2012, this group represented 5.2% of the labor force, roughly double the pre-crisis level. Thus, the percentage of the current population unemployed or underemployed is roughly 13.5% (8.3% + 5.2%), as reported in February, and 16.6% (11.4% + 5.2%) when taking into account the labor force adjustment.

Structural Unemployment

Another concerning trend is the spike in the duration of unemployment. The BLS tracks the number of weeks that the average person has been unemployed. As seen in the chart below, the duration fluctuated around a long-term average of 13.5 weeks from January 1948 through December 2007. Since 2008, however, that number has increased beyond anything seen in the past sixty-plus years. As of February 2012, the average duration stood at an astonishing 40.1 weeks, down only slightly from the all-time high of 40.9 four months earlier.

AVERAGE DURATION OF UNEMPLOYMENT



This trend raises fears of increasing "structural unemployment" (i.e., more permanent unemployment), based on the theory that the longer one is unemployed, the more obsolete his/her skills become. Further, there can be a stigma attached to people who have been unemployed for a long time. These factors can create a self-reinforcing downward spiral where the longer one is unemployed, the harder it is to obtain a new job.

1 All source data and statistics throughout this issue are from the Bureau of Labor Statistics (BLS).

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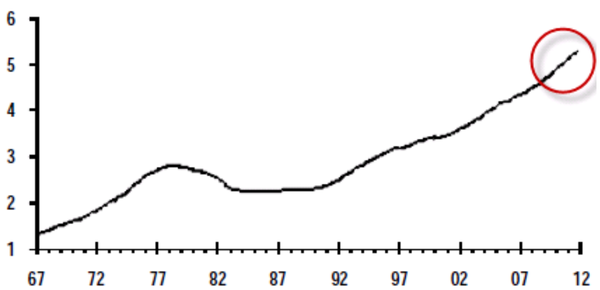
Further contributing to concerns of rising structural unemployment has been the recent increase in disability claims. According to recent research by J.P. Morgan, as of January 2012, over 8.5 million individuals were receiving federal disability payments. Since 2008, this figure has grown faster than the overall potential labor force. Currently 5.3% of the population aged 25-64 is on federal disability, up from 4.5% when the recession began.

Persons Receiving Federal Disability Benefits
% of Population ages 25-64



J. P. Morgan estimates that increases in the number of disability benefits recipients account for about a quarter of the recent decline in employment participation. As unemployment benefits run out, some may be switching to disability benefits, dropping out of the labor force. Disability status essentially reclassifies workers from "unemployed" to "unemployable," making it less likely that they will ever return to the workforce.

Supply and Demand

Despite the recent improvement, the U.S. labor market remains extremely weak, particularly considering that the U.S. is almost three years into an economic recovery. Understanding why is critical to forming an outlook on how long this is likely to last. Analyzing the current factors affecting the supply (i.e., workers) and demand (i.e., employers) for labor reveals many of the root causes of the persistently high unemployment rate.

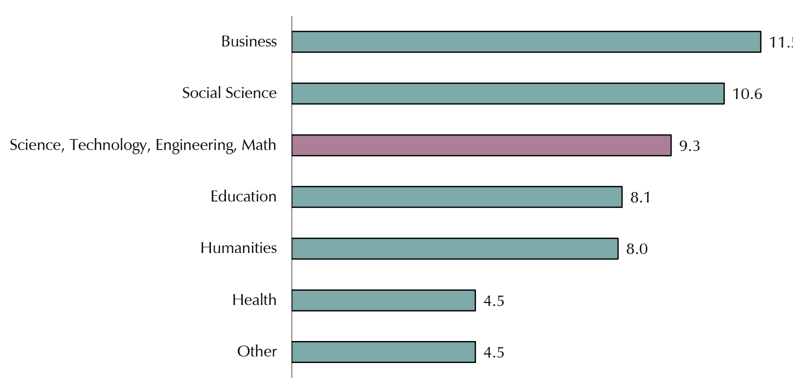
Labor Supply

One important labor supply issue is the "skills gap," the mismatch between the skills workers have and the skills employers need. The evolution of the U.S. economy from a manufacturing-driven economy to a services-driven economy has shifted the skills that companies require. Unfortunately, worker skills have not evolved as quickly as the skills required by companies. This dynamic only worsens with the longer duration of unemployment. In part, this is an issue of education. As shown below, the current unemployment rate is inversely related to education.

	February 2012 Unemployment (%)
Less than High School	13.1
High School Graduates	8.4
College Degrees	4.2

As well, evidence exists that even those who pursue higher education are focusing on the wrong areas. In a paper published by the Bureau of Labor Statistics entitled "Help Wanted: Projections of Jobs and Education Requirements Through 2018," they projected that the United States will produce more than twice as many graduates in social sciences and business than in the STEM (science, technology, engineering and mathematics) fields that are in higher demand from employers.

Bachelor's Degree or Higher, by Specialization
(2018 Projections, Millions)



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Another issue contributing to the current environment is "labor force mobility," which is affected by the collapse in housing prices. Labor force mobility refers to the ease with which job seekers move from one geographic location to another. However, underwater mortgages left many workers unwilling or unable to sell their homes, and as a result, they remain tied to their current locations.

Aging demographics also play a role, because workers are less likely to move or to re-train later in their working life. Older workers who have lost their jobs may be less likely to return to the workforce.

Lastly, economic policies may affect unemployment. Increasing the maximum term of unemployment benefits to 99 weeks may stabilize the economy over the near-term, but also contribute to a lack of urgency by the unemployed to find a new job.

Labor Demand

As described last month, we do not believe the U.S. economy is recovering from a typical recession. The deleveraging environment triggered by the Global Financial Crisis should result in lower GDP growth than the typical economic recovery, and by extension, lead to a lower level of job creation. Demand for labor will always be lower in a deleveraging, as the past few years have shown.

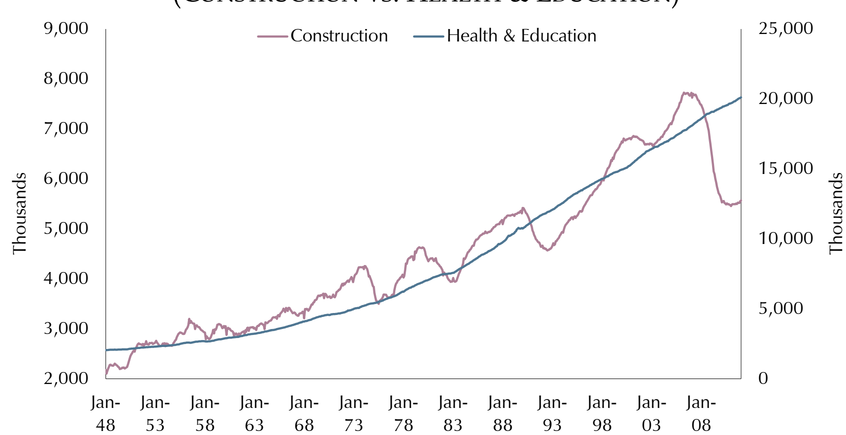
The industries that benefited most from the debt-fueled economic boom have suffered the most in the aftermath, and are unlikely to recover to pre-crisis levels. Industries such as homebuilding and retail are likely to remain well below peak levels of employment, even as the economy recovers. This dynamic contributes to the skills gap discussed earlier, as many of these "boom"-related job skills are not demanded in new fields of work.

The chart below shows the significant downturn in the construction industry contrasted with a continued rise in the demand for health and education workers. The skills of the former are a mismatch with the skills required by the latter.

The deleveraging economy led companies to cut costs in response to declining revenues. At the consumer level, the increased desire to save and to pay down debt in a deleveraging environment results in what economists call the "Paradox of Thrift." It may be beneficial for any one individual to increase savings and cut expenditures. However, if everyone attempts to save, it creates a self-reinforcing cycle whereby higher savings leads to less spending, which leads to less economic activity, which leads to lower growth, which leads to lower incomes, which leads back to even more saving, and so on.

This same phenomenon applies to companies in what can be thought of as the "Paradox of Profitability." It may be beneficial for any individual company to cut expenses and maximize profitability by laying off workers. However, when all companies do this, it results in higher unemployment, lower economic activity, lower revenue for companies, and ultimately more layoffs.

NUMBER OF NATION-WIDE EMPLOYESS
(CONSTRUCTION VS. HEALTH & EDUCATION)



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A 2008 study by the Organization for Economic Co-operation and Development (OECD) highlighted how the U.S. may be particularly susceptible to the Paradox of Profitability. The OECD developed a system that scored 40 different countries from zero to six (zero being the least restrictive) on a variety of employment protection factors. As shown below, the United States ranked as the country with the lowest degree of employment protection or, in other words, the easiest country in the world in which to fire workers. While this can provide companies with cost flexibility under "normal" market conditions, it may exacerbate the unemployment issues we are experiencing.

	Protection of Permanent Workers Against (individual) Dismissal	Regulation on Temporary Forms of Employment	Specific Requirements for Collective Dismissal	OECD Employment Protection Index
United States	0.56	0.33	2.88	**0.85**
Canada	1.17	0.22	2.63	**1.02**
United Kingdom	1.17	0.29	2.88	**1.09**
New Zealand	1.54	1.08	0.38	**1.16**
South Africa	1.91	0.58	1.88	**1.35**
Australia	1.37	0.79	2.88	**1.38**
Ireland	1.67	0.71	2.38	**1.39**
Japan	2.05	1.50	1.50	**1.73**

Lastly, while globalization and technological advances have had a number of positive impacts on the U.S. economy, it is worth pointing out some of the drawbacks related to employment. Increasing globalization of the world economy has changed the competitive dynamics of the labor force whereby many low-skilled U.S. jobs have been exported to countries with lower labor costs. Many argue that this is a necessary and ultimately beneficial transition for the economy, but the U.S. labor supply has not yet filled the "skills gap" created by this globalization. Similarly, technological advances such as factory automation have eliminated many manual labor jobs.

Conclusion

The extent to which supply or demand factors drive the current employment situation is important, in that supply factors tend to be more structural and have the potential to become long-term problems. Demand factors are largely cyclical and can be expected to improve with the overall economy. Given the deleveraging that still must take place, we expect this recovery to remain slower than most. Thus, while it is difficult to clearly disaggregate the impact of labor supply and demand factors on our current situation, we expect an elevated level of unemployment to persist.