Atlanta Fed's Hotchkiss: Don't Be Overly Alarmed by Shrinking Labor Force

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A curious thing is happening amid the ongoing labor market recovery.

The labor force is shrinking. In September, the labor force—all the people employed or looking for work—included 350,000 fewer people than in August, and 870,000 fewer than in September 2014. Average that over an entire year, and about 2,400 people are leaving the labor force every day.

If that sounds ominous, it might not be. In a recent post on *macroblog*, Atlanta Fed research economist and senior policy adviser Julie Hotchkiss examined the labor force declines. Specifically, Hotchkiss writes about twin concerns related to a shrinking labor force:

- Labor force declines might indicate that the current unemployment rate, 5.1 percent, paints a rosier picture than the reality of the job market justifies.
- Our economy needs labor—people—to make things, perform services, and generally to continue to grow. So a smaller labor force could crimp economic growth.

Hotchkiss finds good news about the first concern.

"Two pieces of evidence," she writes, "suggest that the declines in the labor force don't indicate a weak labor market: employment growth and the reasons people cite for being out of the labor force."

Concern about false optimism probably unfounded

Employment growth is healthy. We need to create on average 112,000 jobs a month to maintain the current, relatively low unemployment rate, according to the Atlanta Fed's Jobs Calculator. No sweat, for now. During 2015, the economy has churned out jobs at an average clip of 198,000 a month, Hotchkiss points out.

On the second point about why people drop out of the labor force, the news is likewise promising. It would be worrisome if most people leaving the labor market were likely to rejoin it soon and thus push the unemployment rate back up.

The good news: the number of people in those categories accounts for relatively small changes in the labor force, and their number has mostly been shrinking since April, Hotchkiss finds.

"In other words," she writes, "only a very small part of the growth in nonparticipants has come from those marginal workers who are most likely to reenter the labor force. So the first fear—that this declining labor force growth is producing a false sense of security in a relatively strong labor market—appears unfounded."

Concerning the long-term implications for economic growth, it's probably too soon to draw sweeping conclusions. The manufacturing and services sectors of the economy need a consistent pool of workers—from aerospace engineers to hair stylists to executive chefs—to fuel output. So a dwindling supply of labor could ultimately pose a challenge to economic growth, according to Hotchkiss.

On the flip side, as employers compete for fewer workers, it would figure to force wages higher. Check out the Atlanta Fed's Wage Growth Tracker to see how slowing labor force growth plays out in wages.

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