March 31, 2010

Employment (or lack thereof), unemployment (or surfeit thereof), and monetary policy

For what it's worth, today's advance peek at the March jobs picture via the ADP National Employment report was an unpleasant surprise. From Calculated Risk:

> "ADP reports:
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> > "Nonfarm private employment decreased 23,000 from February to March on a seasonally adjusted basis, according to the ADP National Employment Report®. The estimated change of employment from January 2010 to February 2010 was revised down slightly, from a decline of 20,000 to a decline of 24,000…
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> "This is far below the consensus forecast of an increase of 40,000 private sector jobs in March.
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> "The BLS reports on Friday, and the consensus is for an increase of 200,000 payroll jobs in March, on a seasonally adjusted (SA) basis, because of Census 2010 hiring and a bounce back from the snow storms. The underlying trend will be much lower…"

It bears noting that the ADP report is not always a very good predictor of the official job statistic as released. But even if that 200,000 figure comes to pass, and even if it does portend a trend, a full recovery in labor markets would appear to be a ways off.

Dennis Lockhart, our leader here in Atlanta, spoke to this issue at a speech delivered today in Hartford, Connecticut:

> "For perspective, let me recount the movement of the official unemployment rate reported by the BLS in my short tenure as a Fed policy maker. I became Atlanta Fed president in March, 2007, just over three years ago. When I started, the unemployment rate was 4.5 percent. Today, the rate stands at 9.7 percent, down from a high of more than 10 percent in October…
>
> "Looking forward, the consensus forecast for March is that the economy will add 200,000 new jobs. That number includes a boost from temporary government hiring for the census.
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> "But, according to an Atlanta Fed estimate, we need to add about that number to payrolls each month for the next year to bring unemployment down a full percentage point. This assumes that the growth in the labor force stays in line with the growth in the population."

That calculation makes the important assumption that the labor force participation rate—which is currently the lowest it has been in 25 years—remains unchanged. If the number of people in the labor force were to increase back to prerecession levels, the employment growth required to reduce the unemployment rate would be even higher.

What does this imply for monetary policy? President Lockhart tells us what he thinks.

> "As you know, monetary policy is highly accommodative. And I think this stance is appropriate at present. I continue to support the substance of the policy articulated by the FOMC in recent meetings. That is, economic conditions warrant a low federal funds rate target for an extended period. Markets are highly interested in the meaning of "extended period." I don't think it is appropriate to talk in terms of a specific timeframe or number of meetings. As long as inflation remains subdued and inflation expectations anchored, a key factor for me is improvement of employment markets."

What does "improvement" mean?

> "All things considered, labor markets trends appear to be headed in the right direction. But it's quite possible the recovery could be well advanced before any significant reduction of unemployment materializes. It's also quite possible circumstances justifying the start of a cycle of policy tightening will develop well before the unemployment rate has found a satisfactory level.
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> "A realistic level may not be the level I saw when I joined the Fed [in March 2007]. I do believe the structural rate of unemployment has risen. Calibrating monetary stimulus to a goal of bringing unemployment to prerecession levels would be a mistake…
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> "Going forward, I will be looking for signs that employment gains are likely to repeat, accumulate and, once achieved, are likely to be durable.
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> "What might such signs be? One indication would be the process of job creation is improving. In January, we saw a sizable increase of job openings, according to the Bureau of Labor Statistics. I'm looking for that to become a trend. A second sign would a decline in the measured rate of underemployment. And the third sign would be a string of employment gains large enough to appreciably move the unemployment rate down over time."

And if, among whatever grimness you find in today's ADP report, you would like a hint of sunshine, President Lockhart closes with this:

> "We have a long way to go, and for that reason I believe it is premature to assume an imminent reversal of the Fed's accommodative policy. But you can interpret the fact that I am here discussing the conditions under which such a reversal will be appropriate as an indication of my conviction that we are, finally, moving in the right direction."

NOTE: If you are hungering for a deeper dive into some of the underlying labor market data—on the Bureau of labor Statistics' Job Openings and Labor Turnover Survey, in particular—the latest edition of the Atlanta Fed's *EconSouth* has just the article for you.

UPDATE: It seems Calculated Risk and I are on the same wavelength. Mark Thoma is encouraged by President Lockhart's comments. The Capital Spectator offers reasons to discount the ADP report.

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