SPEECHES

The U.S. Economy and the Employment Challenge

Dennis P. Lockhart
President and Chief Executive Officer
Federal Reserve Bank of Atlanta

Chattanooga Area Chamber of Commerce
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The last time I was here I delivered a speech to the Rotary Club of Chattanooga in late March of 2008. Since that time, the economic situation has changed dramatically.

A year and a half ago, as you recall, the U.S. economy was clearly slowing. But it wasn't yet apparent that we were in the midst of a deep and protracted recession. Also, a major financial crisis was not part of the outlook.

Now, evidence is mounting that the worst of the economic downturn is behind us. Today, I will talk about the economic situation and outlook at this juncture. I also want to take a deeper look into a critical economic issue for many Americans—and that is employment. The views I will express today are mine alone and do not necessarily reflect those of my colleagues on the Federal Open Market Committee (FOMC).

Current state of national economy
Let me begin with the current state of the economy. Overall, the U.S. economy is improving but still fragile. Stabilization has taken hold, and the beginning stages of recovery are under way, in my view.

Consumer spending has been dampened by housing market weakness and concerns about employment.

The attitude among the business leaders I talk to is quite cautious. Investment spending this year has declined sharply, but, according to recent data, the speed of falloff appears to be slowing. Also, inventories have been liquidated aggressively in the first half of the year.

Recent improvements in the financial sector are supporting economic stabilization. Capital flows and securities issuance reflect an unwinding of the flight to safety that occurred last fall. Despite this improved flow of capital to riskier assets, I would say that financial conditions are still vulnerable, and the flow of credit remains weak.

I'm concerned that commercial real estate weakness poses a serious potential risk to the economic recovery and to the banking system. Commercial real estate loan exposure is heavily concentrated in banks and commercial mortgage-backed securities. Commercial real estate values—that is, collateral values for loans—are being revised down materially by the potent combination of increased vacancy, rent reductions, and appropriately higher capitalization rates. Further, there is a clear link between employment trends (positive and negative) and commercial real estate trends.

As regards inflation, with continuing economic weakness and financial uncertainty, firms have very little pricing power. Headline inflation has fallen in part because of lower oil prices compared with a year ago. Core measures of inflation excluding food and energy costs also have been drifting lower. Looking ahead, I expect inflation will remain contained.

Outlook
With respect to growth, my forecast envisions a return to positive but subdued gross domestic product (GDP) growth over the medium term weighed down by significant adjustments to our economy. Some of these adjustments are transitional in the sense that they impede the usual forces of recovery. Among these are the rewiring of the financial sector and the need for households to save more to repair their balance sheets.

Some of these adjustments, however, are more "structural" in nature. By this, I mean that the economy that emerges from this recession may not fully resemble the prerecession economy. In my view, it is unlikely that we will see a return of jobs lost in certain sectors, such as manufacturing. In a similar vein, the recession has been so deep in construction that a reallocation of workers is likely to happen—even if not permanent. I'll discuss manufacturing and construction a bit more in a moment.

My forecast for a slow recovery implies a protracted period of high unemployment. And labor market weakness is a concern I hear about often as I travel around the Southeast. Given this concern, I'd like to devote the remainder of my formal remarks to the challenge of unemployment and the potential for a jobless recovery.

Underemployment
This recession has had a severe impact on employment in various ways: jobs, furloughs, and number of hours worked. For example, the average manufacturing workweek has fallen below 40 hours for the first time since 1983. And the number of workers employed part-time for economic reasons has increased more in this recession than in any since the Bureau of Labor Statistics (BLS) started tracking that information.

If one considers the people who would like a job but have stopped looking—so-called discouraged workers—and those who are working fewer hours than they want, the unemployment rate would move from the official 9.4 percent to 16 percent.

Where job losses occurred
While the unemployment pain in this recession has been broad based, certain sectors have been hit particularly hard. I've already mentioned the most prominent cases, construction and manufacturing. Both fields employ a disproportionate number of men. As a result, some have called this a "mancession."

The share of the jobs lost in construction and manufacturing is out of proportion to the share of jobs represented by these male-dominated sectors. Prior to the recession, construction and manufacturing together accounted for a little more than 15 percent of employment. Their job losses during the recession, however, account for more than 40 percent of all U.S. job losses. While men typically have borne most of the job losses during a recession, this recession ranks among the worst.

Slow recovery

Clearly, it will be some time before the number of jobs in the economy returns to prerecession levels.

The higher share of part-time employment arguably gives employers a means to increase work hours without adding to the overall number of full-time workers. Businesses seem inclined to defer hiring and focus on productivity until a sustained pick-up in top-line demand is beyond doubt.

Firms always have incentives to improve efficiency and keep a lid on costs—including labor costs. The last two recoveries have involved unusually long periods of GDP growth accomplished through productivity gains instead of employment growth. At this point, there is scant evidence that the coming recovery will break that pattern.

The sectors in which job losses have been most pronounced are unlikely to see a rapid return to prerecession levels of business activity, let alone prerecession levels of employment. Construction, which represents about 6 percent of employment, has seen a recent activity uptick in the residential category from very low levels. But the inventory of unsold homes on the market is elevated. Much of this inventory will have to be absorbed before construction employment returns to any levels we might consider "normal." Industry capacity before the recession approached 2 million housing starts on an annual basis. Starts are now hovering around 580,000.

Unfortunately, time may not return manufacturing employment to prerecession levels. Between 1965 and 2000, manufacturing employment generally fluctuated between 16.5 and 19.5 million jobs. The number of manufacturing jobs fell to just over 14 million in the first years of this decade and has continued to drift downward. The harsh financial constraints of this recession appear to have accelerated this secular decline.

Solutions to the unemployment problem

The country's employment problems are not completely intractable. Fortunately, most who are directly affected by job loss are eligible for the short-term income support of unemployment insurance. Benefits through that program have been extended three times since July 2008 and may be extended again.

For many workers, unemployment benefits provide much-needed income support to see them through a difficult job market. Some workers will have to look for a job in a new field. There are some powerful forces in place that can assist those workers who need to make career changes—labor market flexibility and an educational infrastructure well suited to retraining workers.

First, with respect to labor market flexibility, the easier it is for workers to change employers, the faster structural adjustment can occur. U.S. workers have become accustomed to changing jobs. The BLS estimates that the youngest baby boomers had almost nine different jobs by the time they reached the age of 42.

Along with worker flexibility, worker retraining programs can also facilitate necessary adjustments. Community colleges serve an important role in preparing "nontraditional," often older, students for new careers and in providing targeted training on a contract basis with private companies.

In the fall of 2007, more than a third of all postsecondary students were enrolled in community colleges, according to the National Center for Education Statistics. Since the early 1960s, enrollment in community colleges increased by about 750 percent—roughly four times the growth rate of enrollment in public and private four-year institutions.

The role that community colleges play in retooling the workforce can be seen by the bumps in enrollment during recessions. Also, enrollment in for-profit educational institutions has increased from only about 1.5 percent of postsecondary students in 1990 to about 7 percent more recently.

In recognition that many of the nation's unemployed will need to retool to re-enter the labor market, approximately $24 billion of federal stimulus money was allocated for training and education, according to the Workforce Alliance.

How Chattanooga is poised for recovery

With respect to our national employment challenge, Chattanooga offers a useful example—and perhaps a preview—of how labor markets will adjust as recovery takes hold. Since 1990, Chattanooga's employment situation has typically beaten that of the United States. But in this recession Chattanooga has been sharing the national pain. Like the nation as a whole, Chattanooga has seen a disproportionate share of job losses in construction and manufacturing.

Fortunately for this area, top employers also include health and long-term care insurance companies, health care providers, and health care educators. Officials project one of the fastest-growing employment sectors through 2016 will be health care. Chattanooga should benefit from this growth coming out of the recession, and the local health care insurance industry is also poised for more demand with the aging of the U.S. population.

But Chattanooga can boast of something unusual in today's economy: new manufacturing jobs. As you know, the new Volkswagen plant is expected to add some 2,000 manufacturing jobs to the local economy by 2011. This development runs counter to national trends, as I've already explained.

Policy issues

If my prognosis for the broad economy is correct, the pace of job restoration and growth through the medium term will be frustratingly slow. So, what can be done to address the prospect of high unemployment and underemployment?

Further fiscal stimulus has been mentioned, but the full effects of the first stimulus package are not yet clear, and the concern over adding to the federal deficit and the resulting national debt is warranted.

The FOMC has stated its intention to keep the policy interest rate low for an extended period. I agree that this approach is needed. This policy stance should encourage more business activity and facilitate more hiring.

No policy is certain to improve outcomes, and no policy is without risks. The challenge my colleagues and I face is navigating between the risk that early removal of monetary stimulus snuffs out the recovery and the risk that protracted monetary accommodation stokes inflation expectations that could ultimately fuel unwelcome inflationary pressures.

The Fed must deal with this tension, particularly in coming quarters, as we pursue our dual mandate of price stability and maximum employment. I believe the overriding concern should be the quality of recovery as opposed to the speed of recovery. The best answer to unemployment is restoration of a healthy, balanced, and growing economy capable of producing sustainable employment. This objective will require structural adjustment in the economy and personal adjustment for many workers.

I believe the economic outlook—including the employment picture—calls for continuing efforts to remove obstacles to the rebuilding of economic strength on solid foundations. Chief among such obstacles is the still-constricted bank and securitization credit system, especially those segments that finance small business and households.

I also believe progressive local community leaders can play a role in addressing the unemployment challenge. Beyond recruiting inbound investment that brings immediate jobs, you as local leaders can continue to pursue a human capital agenda for your region. By this, I mean initiatives to advance early childhood pre-K education for three- and four-year-olds, improvement of the public K–12 system, and backing of the community and technical college infrastructure that is so vital to worker skill development and retooling.

I do not expect quick fixes for the unemployment challenge ahead, but I am convinced the right policy objective is sustainable employment growing out of a recovery that is grounded in durable and resilient fundamentals.

Contact: Jean Tate 404-498-8035

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