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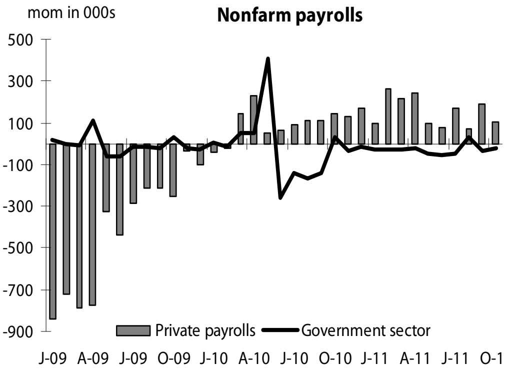
US: Decent employment growth, but not strong enough to get a sustained decline in unemployment

- Recent employment data provide further evidence that recession risks have given way to a continued moderate US expansion.
- However, even though job growth is definitely better-than-expected just a few months ago, the payroll monthly surveys continue to portray a jobless US recovery.
- Weak employment growth over the next few quarters is expected to be sufficient to push the unemployment rate down only marginally towards 8.7% by the end of 2012 from an average of 9.1% in 2011.
- The latest Fed projections include a high unemployment rate even throughout 2013 (8% year-end 2013), so the Fed keeps clear easing bias to employ its tools, should economic growth stay stubbornly slow in the quarters ahead.

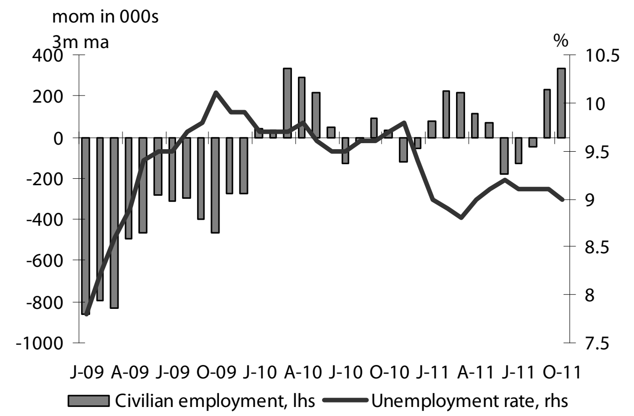
The October employment report provides further evidence of a continued moderate expansion of the US economy rather a return to a renewed recession. Total nonfarm payroll employment added 80k jobs in October, with an upward revision of 102k in the prior two months (Figure 1). The average jobs gains in the three months ended October was 114k per month, a significant improvement from an average of 67k in the three months ended July. The Household Survey for October gave an even stronger tone than the Establishment Survey. In contrast to the prior two months, when gains in civilian employment were more than offset by stronger gains in the labor force, civilian employment growth of 277k in October outweighed the labor force increase of 181k. As a result, the unemployment rate declined from 9.1% to 9.0%, reporting the lowest rate since April (Figure 2). Meanwhile, the trends in jobless claims in September and October mirror a gradual improvement in labor market conditions, with initial and continuing claims tracking about 31k and 72k, respectively, below the levels reported at the beginning of September. Furthermore, the Job Openings and Labor Turnover report reported solid gains in both job openings and hirings in September, with job openings as a percentage of total employment surging to 2.5%, the highest since August 2008.

Figure 1



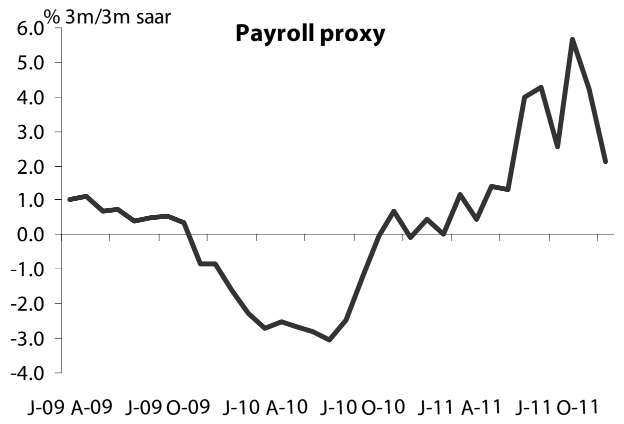
Source: U.S. Bureau of Labor Statistics

Figure 2



Source: U.S. Bureau of Labor Statistics

Figure 3



Source: U.S. Bureau of Labor Statistics, EFG estimates

However, even though employment growth is definitely better-than-expected just a few months ago, the payroll monthly survey continues to portray a disappointing labor market. Total and private payroll growth of just 114k and 122k, respectively, over the past three months is still below trend population growth and not strong enough to lead to a persistent decline in the rate of unemployment from current elevated levels. With a stable labor market participation rate[1], civilian employment has to increase about double the pace of total payroll growth (~220k) for the remaining of 2011 and through 2012 in order to see a gradual decline in the unemployment rate from the current level of 9.0% to about 8.0% towards the end of 2012.

Weak payroll growth and persistent economic slack are holding back employees' wages, denting households' purchasing power. In terms of hours and earnings, average weekly hours remained unchanged at 34.3 hours in October, while average hourly earnings increased by 0.2% m-o-m, bringing the annual growth down to 1.8% from the recent peak of 2.3% in July. The trend in the payroll proxy for labor income, i.e. the product of weekly hours, hourly earnings and private payrolls, is softer relative to previous trends, decelerating to a 2.1% quarterly growth (3m/3m saar) through October, from 4.3% and 5.6% previously (Figure 3). However, given that the significant contraction in inventories in Q3 increases the probability of greater stock piling in Q4, production acceleration in Q4 could provide support to hours and earnings in the coming months.

As is evident in Table 1, the current labor market recovery is close to the weak labor market recoveries that started in 1991 and 2001. In particular, the average monthly gain in total nonfarm payrolls from mid-2009 until October 2011 is roughly in line with the average monthly increase in the 1991 and 2001 episodes. Table 1 also shows the nonfarm payrolls gain in major sectors during prior recoveries, when the economy was at this stage of the business cycle (28 months following the end of each recession). While the manufacturing sector has been in a better shape in today's recovery compared to the weak jobless recoveries of 1991 and 2001, the current recovery is being heavily hit by the construction and the government sector. Although the worst for the US housing market is probably behind us as the share of distressed properties as a percent of total sales starts to moderate, the continuing weakness of the US housing market continues to weigh on the labor market recovery. In addition, the government sector has lost about 21k jobs per month on average from mid-2009, reporting a 2.5% reduction in the 28 months' time amid large budget shortfalls. This stands in stark contrast to all previous job recoveries since 1950[2], where federal, state and local employment has increased by an average of 21k during the first 28 months of the recovery. We conclude that the US housing market needs to recover and the government sector has to start adding jobs before we can see a sustained labor market recovery. Last but not least, as the service sector has historically been a major contributor to the pace of total payroll growth, we should see larger increases in the services employment sector before the labor market generates a meaningful improvement in economic conditions.

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[1] The participation rate (=civilian labor force/civilian noninstitutional population) currently stands at 64.2%. Using the trend population growth, which is about 180k per month, the labor participation rate stays stable at 64.2% with an average labor force growth of about 128k.

[2] We exclude the 01/80-07/80 recession from our research, as it was followed by another recession in July 1981.

Past experience of the two jobless recoveries of 1991 and 2001 suggests that total nonfarm payrolls will be increasing by an average of 240k per month for the remaining of 2011 and in 2012. However, given the slowdown to a lower US growth trajectory, we expect employment monthly gains to hover around half the average of the two recent jobless recoveries through 2012 (~100-120k), with the annual average growth rate increasing from 0.5% in 2011 to 1.0% in 2012 (Figure 4). According to our estimates, weak employment growth over the next few quarters is expected to be sufficient to push the unemployment rate down only marginally towards 8.7% by the end of 2012, keeping the year average at the high level of 8.8% in 2012 from 9.1% in 2011. According to the FOMC meeting on November 1-2, unemployment is now projected as quite high even throughout 2013 (8% year-end 2013), with the Fed keeping clear easing bias in order to employ its tools and promote a stronger economic recovery, should economic growth stays stubbornly slow in the quarters ahead.

Figure 4

Source: EFG model estimates

Table 1: Nonfarm payroll growth during US recoveries

Average monthly change during first 28 months of recovery, 000s						
	Total	**Private**	**Government**	**Construction**	**Services**	**Manufacturing**
1954	+130 (+7.6%)	+107 (+7.3%)	+23 (+9.3%)	+16 (+17.2%)	+80 (+7.4%)	+32 (+6.4%)
1958	+116 (+6.6%)	+94 (+6.5%)	+22 (+7.3%)	+5 (+5.6%)	+81 (+7%)	+31 (+6.6%)
1961	+111 (5.6%)	+85 (+5.1%)	+26 (+8%)	+6 (+5.2%)	+77 (+6%)	+29 (+5.6%)
1970	+210 (+7.8%)	+177 (+8%)	+33 (+7%)	+16 (+11%)	+141 (+8%)	+53 (+6.8%)
1975	+221 (+8.3%)	+202 (+9.5%)	+19 (+3.4%)	+13 (+12%)	+156 (+8%)	+50 (+9%)
1982	+288 (+9.1%)	+273 (+10.5%)	+15 (+2.6%)	+28 (+20%)	+219 (+9.1%)	+44 (+7.5%)
1991	+87 (+2.4%)	+66 (+2.3%)	+20 (+3.1%)	-4 (-1.2%)	+108 (+3.7%)	-14 (-2.1%)
2001	-4 (+0.1%)	-13 (-0.1%)	+9 (+1.1%)	+4 (+1.5%)	+48 (+1.3%)	-55 (-9.1%)
2009	+37 (+1.0%)	+57 (+1.8%)	-21 (-2.5%)	-17 (-6.8%)	+48 (+1.3%)	+1 (+0.7%)

**In parenthesis, we estimate the percentage change in payrolls during first 28 months of each recovery.*

Source: EFG estimates

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