ECONOMICS GROUP

SPECIAL COMMENTARY

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Employment - Have We Reached a Turning Point?

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As the numbers continue to roll in, commentators wonder whether we have reached a bottom in employment. Are we at a turning point where job losses diminish from here or are greater job losses yet to come?[1] Two forces, one cyclical and one structural, will determine the answer. Economic recovery alone will not generate the level of employment that will meet previous levels of employment rates. Structural change is also needed and those changes will take time. We monitor the employment situation in at least three ways. Claims data are leading indicators of the direction of the employment cycle, nonfarm employment is largely coincident and unemployment rates lag. The weekly initial jobless claims series can provide a close-to-real time picture of the labor market, and will remain elevated in coming weeks (Figure 1). The highly anticipated nonfarm payroll numbers, available this Friday, describe the net job gains (or more accurately losses) for the month—we expect another loss greater than a half million. We look at the unemployment rate as a lagging indicator, which likely will rise for some time even after job losses slow. May's likely reading is over nine percent. For now, these data are consistent—we are in the midst of a deep recession with rampant job loss. However, April saw a better figure for nonfarm payrolls, and initial jobless claims have notched down in recent weeks. This has led some to speculate the tide has turned in the labor market. Is there a turning point?

While the early signs of a cyclical turn may be in place, we hesitate to announce that a turn has occurred due largely to our concerns of a simultaneous structural change in the trade and transportation sector, as demonstrated by the automotive sector. These adjustments will prevent the underlying cyclical trend from being evident for some time, thus a true turning point, that is, when job losses become notably smaller, is not due until some time in late summer or early fall. In terms of the labor market, the sense of springtime renewal was unjustified.

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[1] By turning point here we mean the inflection point from which losses become increasingly smaller. Others may take it to mean the point at which gains are realized, but the prospect of actual job growth is still too distant.

Figure 1

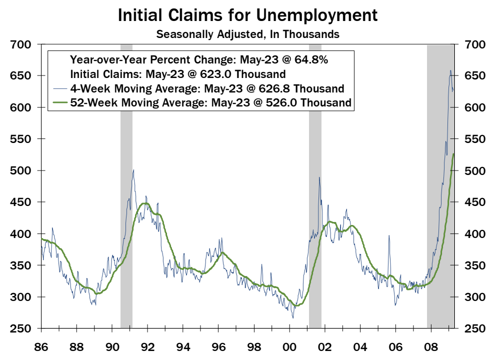
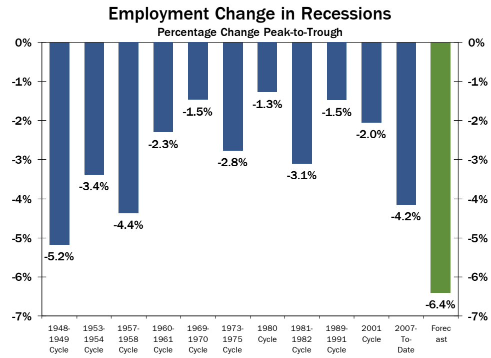


Figure 2



Source: U.S. Department of Commerce and Wachovia

Cyclical Movement in Labor Market

At times, the underlying trend in the economy can be obscured by secular issues that plague one industry. Today, the American automakers' struggle is the manifestation of that phenomenon in the U.S. labor market. Behind that noise and volatility, however, there have been some indications of hope in the job cycle. Supporting the view of a labor market that was not necessarily improving, but certainly was no longer declining at an accelerating pace by the middle of last month was the improvement in initial claims for unemployment insurance. The series reached a four-month low in the week ended May 1. The series is quite volatile over time, but the more reliable four and eight-week moving averages had both improved as well, by 34,000 and 11,000, respectively, at that point, which led credence to the belief that the cycle's largest losses may have been past. In the past few weeks, claims have once again bounced higher as the previously discussed structural problems in the automotive sector began to appear in the data.

Figure 3

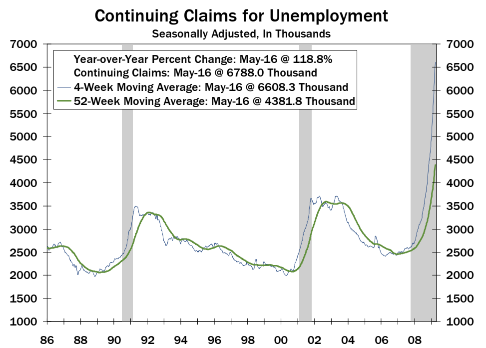
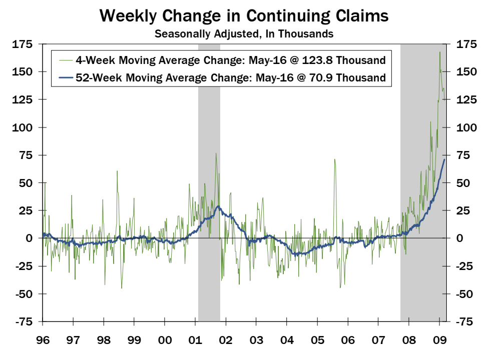


Figure 4



Source: U.S. Department of Commerce and Wachovia

Another source of concern which undermines the hope for a near-term turning point, is the state of continuing claims for unemployment (Figure 3). It is also useful to look at the change in this number, which has been increasing exponentially of late (Figure 4). This measure shows that people who have been laid off are having increasing difficulty finding new work, causing them to remain on the unemployment rolls for a significant amount of time even as new individuals are added. Once people begin to find jobs, or their permitted duration of benefits expires, the weekly change in claims will start to come down—we have seen a slight decrease in the most recent weeks.

We hope it is the former and not the latter reason that has caused the slight fall, but remain cautious on this point. When job losses begin to abate, we will begin to expect the turning of the cycle. However, as long as the economy is still destroying more jobs than it is creating, these lagging indicators will continue to rise.

Nonfarm job losses, our broad measure of employment conditions, showed some easing in recent months (Figure 5). While losses still topped a hefty half million jobs in April, this amounts to the slowest pace of declines since last October when the fallout from Lehman Brothers had yet to affect most hiring plans. Still, over this cycle we have lost more than 5.7 million jobs, or approximately 4.2 percent of our employment base. We believe we are on the way to a total loss approaching 9 million jobs and more than six percent of our employment base. While these losses are staggering and amount to the biggest downdraft since the aftermath of World War II, we do believe that the majority of the declines are behind us at this point (Figure 2). Losses continue across almost all of the major private industry groups with the exception of education and healthcare. We will need to see improvement in several more industries before we are comfortable saying the labor market is well on its way to recovery. For now however, the labor market picture is not there.

One of the key indicators that we will be watching is the diffusion index of industries adding workers (Figure 6). If the diffusion index continues to gain ground while employment losses continue at the same or an accelerated pace, we will feel comfortable that the employment problems are narrowing and the losses will likely be more contained to some key problem sectors. However, we have a long way to go from our current position of just above 23 percent of industries adding workers, but a continued move higher will still be a positive even if job losses are reaccelerating by June.

Figure 5

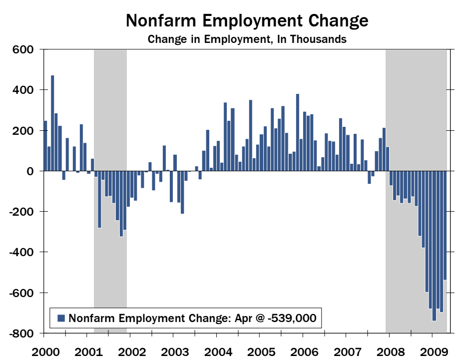
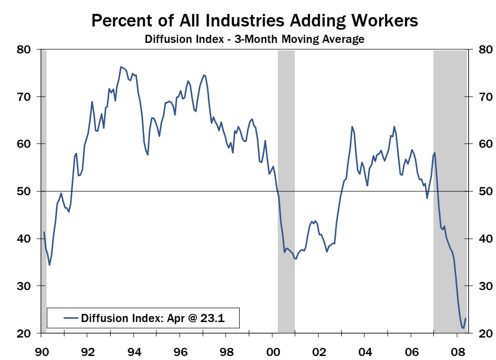


Figure 6



Source: U.S. Department of Commerce and Wachovia

Auto Employment – Secular Change Meets the Cycle

Secular changes will be a primary concern over the next several months. Where we were in the cycle in late April, before the automotive concerns began polluting the data stream, may become obscured. While the small improvements in April were notable, this summer's employment data will most likely be dominated by the shutdowns and layoffs across the auto manufacturing complex (Figure 7). We have already seen the early effects. The number of initial claims for unemployment insurance jumped by 32,000 in the week ended May 9. The labor department noted that the primary driver for the jump was a group of auto-related industries as Chrysler had shutdown its major assembly sites the first week of May. Claims on the week were the highest since mid-April. Unfortunately, we expect that these numbers will remain elevated over the next few weeks and perhaps into June as GM adds assembly plant shutdowns to the list and the associated supplier shutdowns also are likely to contribute temporary, if not permanent, layoffs. Add to this the number of jobs that may be lost in coming months at dealers that are on Chrysler and GM "cut lists," and there is an almost perfect storm for continued job losses.

Initial claims will likely remain above 600,000 per week into the summer and nonfarm payroll losses will likely stay in the same range on a monthly basis. The real challenge this presents is separating what was an improving, albeit marginally, labor market picture outside of the auto sector in late April from the real secular declines facing American auto manufacturers. While the job losses and resulting income effects are certainly real in the auto sector, at this point in the cycle, they may cloud the picture of what is going on in the rest of the private economy.

Figure 7

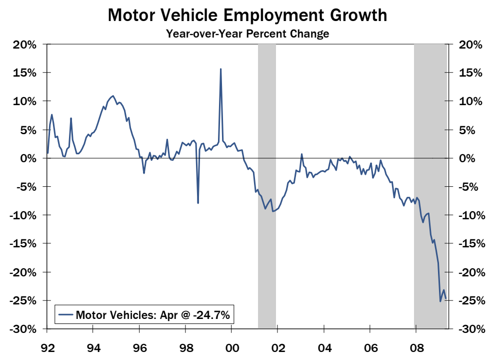
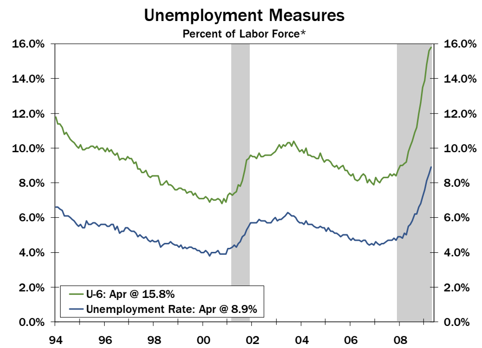


Figure 8



Source: U.S. Department of Commerce and Wachovia

Unemployment on the Rise

The unemployment rate reflects the ongoing cyclical changes in the labor market, yet will not show a turn until the economy is in recovery. Unemployment continues rising after a recession ends, and peaks, on average, eight months after the end of a recession. The previous cycle was deemed "the jobless recovery," as reflected by the 19 months of rising unemployment which followed. We expect another slow recovery in the labor market in which the unemployment rate peaks at 10.6 percent in the first half of 2010 (Figure 8). There is no turning point in sight for these measures of progress in the labor market, and unfortunately, the worst numbers of the cycle are yet to come. Though the unemployment rate will continue rising, we do not wish to overemphasize its predictive capabilities, because it significantly lags the cycle. An upside limit to the traditional measure of unemployment (U-3) may be the extent of an individual's willingness to seek work before they become discouraged, or to accept a part-time job instead of continuing to seek a full-time position. Discouraged workers leaving the labor force are reflected in U-6, a more comprehensive measure of unemployment, which now stands at 15.8 percent, almost seven full points above U-3.[2] The relevance of these series in terms of identifying moments of cyclical change is minimal. A turning point in the labor market will become clear in other indicators much before any of the unemployment series.

[2] For more detail please see this publication from the Bureau of Labor Statistics. http://www.bls.gov/opub/mlr/1995/10/art3full.pdf

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