ECONOMIC OUTLOOK
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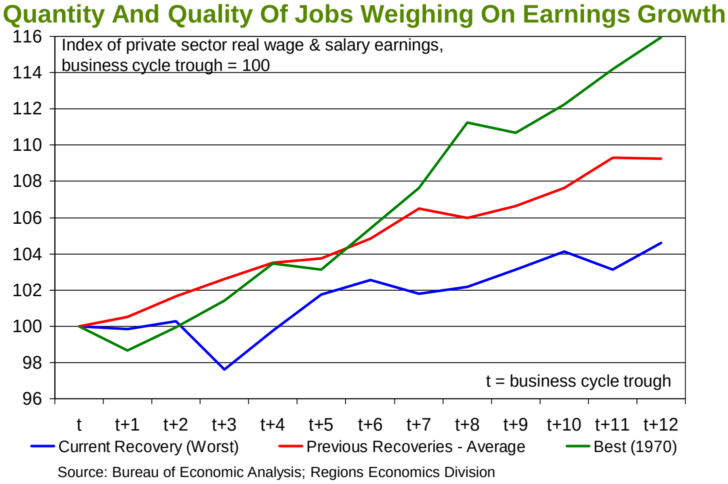
Quantity of Jobs Lacking, How About the Quality of Jobs?

As was discussed in the September *Economic Outlook*, when compared to past recoveries at the same point in the cycle, the current recovery is lagging far behind the field, with growth in corporate profits being one exception. While "outperforming" the 2001 recovery in terms of the rate of job creation (okay, "not performing as badly as" may be the proper phrasing here), job growth during the current recovery has trailed all other recoveries and remains frustratingly slow. This pace seems even slower than it is given the size of the hole the economy was left to dig out of – the Great Recession and its aftermath resulted in the loss of 8.779 million jobs. As such, even though we have seen 4.256 million jobs added since nonfarm employment bottomed in February 2010, it doesn't exactly feel like much progress has been made.

Another issue worth addressing is the quality of jobs being added during the current recovery. While a slow pace of job growth is one factor behind what remains restrained growth in personal income, the "quality" of jobs being added also plays a role in the rate of growth of personal income. It has been said that, these days, any job is a quality job, and we won't quibble over that point. More specifically, we are interested in the pay associated with the jobs being added and to what extent lower earnings jobs are also responsible for disappointingly slow growth in personal income. For some perspective, the chart below shows growth of inflation adjusted wage and salary earnings in the private sector during the current recovery versus past recoveries at the same point.

Quantity And Quality Of Jobs Weighing On Earnings Growth

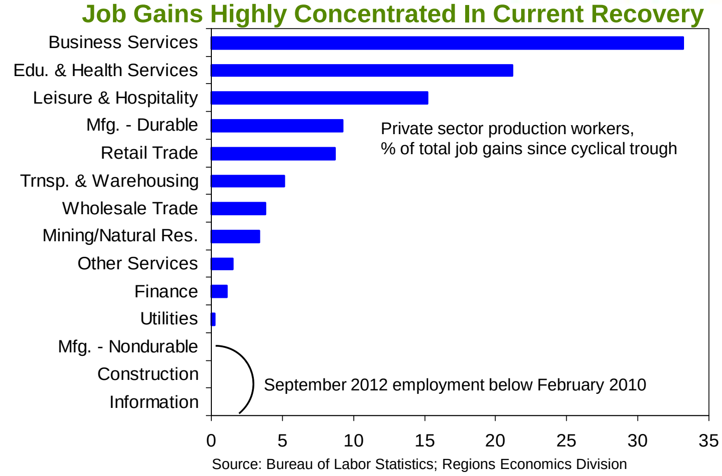


Source: Bureau of Economic Analysis; Regions Economics Division

Over the twelve quarters for which we have data on the current recovery (it is actually 13 quarters old now but we do not yet have national income data for Q3 2012), real private sector wage and salary earnings have risen by just 4.6 percent and remain 4.9 percent below the pre-recession peak. Note that for this discussion we are focusing on private sector employment and earnings, as the data on the government sector are not as detailed.

Again, to some extent this earnings gap is a function of how many jobs short of the pre-recession peak we remain, but to some extent the mix of jobs is also an issue. The chart below shows the share of all private sector jobs added during the recovery by each of the industry groups reported in the Bureau of Labor Statistics data. As can be seen, job growth has to date been highly concentrated amongst only a few industry groups.

Job Gains Highly Concentrated In Current Recovery



Source: Bureau of Labor Statistics; Regions Economics Division

Another note about the data used here – we are using data on private sector production workers, which is a subset of private sector employment that excludes supervisory workers. Data on average hourly earnings for all private sector workers, i.e., inclusive of supervisory workers, date back to only March 2006 and this short history precludes comparisons to past cycles. The data on private sector production workers by industry go back several decades. Production workers account for roughly 82 percent of all private sector workers, and over the past 50 years this share has never gone below 80.5 percent or above 82.99 percent.

It is the data on average hourly earnings that helps put the above chart in perspective in the discussion of the quality of jobs being created during the current recovery. Below we show real average hourly earnings for private sector production

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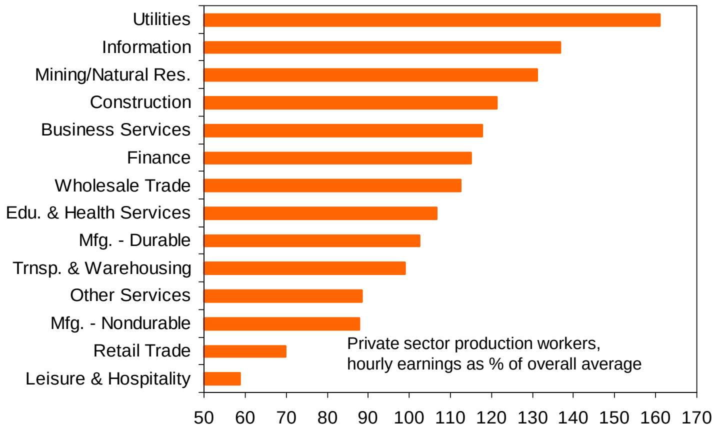
workers by industry group as a percentage of overall real average hourly earnings. Note that business services, the sector responsible for one-third of all job gains amongst private sector production workers (and 30 percent of all private sector jobs) during the current recovery, ranks only fifth highest in

Earnings Mix Helps Explain Weak Income Growth



Source: Bureau of Labor Statistics; Regions Economics Division

terms of real hourly earnings, while leisure & hospitality services, which is the source of over 15 percent of all jobs added during the recovery, ranks last in the ranking of real hourly earnings, with an average hourly wage equal to just 58.8 percent of the overall average. Also note the industry groups with the highest hourly earnings either are not contributing to job growth, such as information services, are only marginally contributing to job growth, such as utilities, or are so small a share of overall employment, as is the case with mining, that even sizeable job gains within the industry don't move the needle much when it comes to aggregate earnings.

It is also worth noting that jobs in industry groups such as retail trade and leisure & hospitality services, among other service producing industries, tend to also have shorter average workweeks in addition to below average hourly earnings. This combination is a key factor behind what remains a disappointingly slow pace of real aggregate earnings growth, which in turn is holding down growth in real personal income.

The length of the average workweek is also a relevant point to consider when discussing earnings in the manufacturing sector, particularly durable goods manufacturing. We typically hear that manufacturing jobs are desirable as they come with higher earnings, but this is where the distinction between hourly and total earnings comes into play. As seen in the chart above, the hourly earnings premium for durable goods manufacturing is now just 2.5 percent (i.e., average hourly earnings are just 2.5 percent higher than the overall average), while average hourly earnings in nondurable goods manufacturing are only 87.9 percent of the overall average. But, the length of the average manufacturing workweek tends to be significantly above average, which means on a total earnings basis manufacturing tends to outperform the overall average but on an hourly earnings basis not nearly as much or, in the case of nondurable goods, not at all. The hourly earnings premium, which in the 1980s was as much as 14 percent, has dissipated in part due to an increasingly lesser reliance on manufacturing jobs, i.e., lower demand for manufacturing workers. More recently, however, those manufacturers that have added jobs in the U.S. have tended to gravitate towards lower cost (in many cases non-union) labor, meaning that hourly wages in manufacturing are much more in line with overall average wages.

It should also be pointed out that, just as there are wide variances between earnings across industry groups, there are also wide variances in earnings within industry groups. For instance, business and professional services includes categories ranging from building maintenance services to engineers, lawyers, and architects. The same is true of health care, which has also been a significant source of job growth over the current recovery, with significant earnings gaps between highly skilled care providers/technicians and those who work in home health care or nursing homes – with hourly earnings in the latter two groups significantly below the overall industry average. As such, it is not only the mix of jobs across industry groups that matters when accounting for earnings and income growth, but also the mix of jobs within a given industry group.

As we did in the September *Economic Outlook* when we compared the performance of the current recovery to past recoveries in terms of overall economic growth, we were also interested in how the current recovery stacks up in terms of how dispersed job gains were across industries and how the composition of job growth leaders among industry groups has changed over time. The table below provides a quick summary of performance on both of these measures.

Recoveries Increasingly Concentrated

% of total private sector jobs added by top three industry groups

Recovery Year	Highest Concentration	Second Highest	Third Highest	Sum - Top Three Industries
1970	Durable Mfg 25.41%	Retail 16.62%	Construction 10.12%	52.15%
1975	Durable Mfg 15.71%	Retail 15.25%	Edu./Health 10.97%	41.93%
1982	Retail 16.97%	Edu./Health 13.36%	Bus. Services 12.37%	42.70%
1991	Bus. Services 24.91%	Edu./Health 18.58%	Leisure/Hosp. 12.96%	56.45%
2001	Bus. Services 25.82%	Edu./Health 20.57%	Construction 17.52%	63.91%
2009	Bus. Services 29.92%	Edu./Health 21.48%	Leisure/Hosp. 15.79%	67.19%

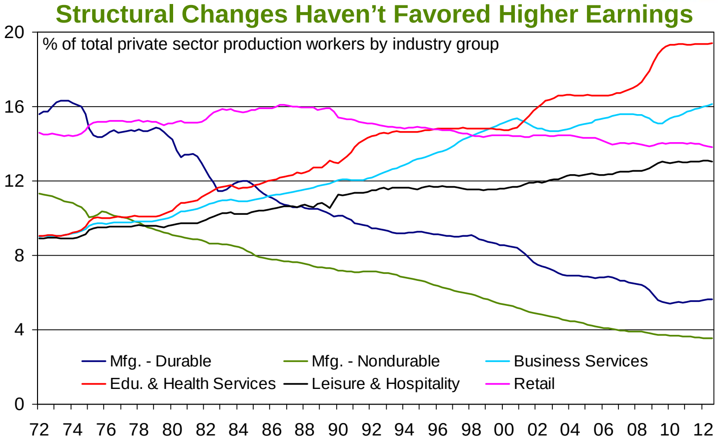
Source: Bureau of Labor Statistics; Regions Economics Division

Each recovery is compared 31 months after the cyclical bottom in total private sector employment – which is where we now stand in the current recovery. One thing that is striking is that the three private sector industry groups that have added the most jobs account for just over 67 percent of all private sector jobs added since employment bottomed in February 2010, the highest such share of any recovery for which we have the data to make this comparison.

It is interesting to note that were it not for a surge in construction employment in the wake of the 2001 recession (and we all remember how that turned out), the past three recoveries would have been led by the same three industry groups – business and professional services, education and health services, and leisure & hospitality services (which only modestly trailed construction in the 2001 recovery). The shifts apparent in the table above reflect the structural changes in the U.S. economy over the past several decades. For instance, in the 1970s the U.S. economy was still a relatively closed economy that was heavily reliant on manufacturing which, as the 1970 recovery commenced, accounted for 30 percent of all private sector employment. In that era, the sensitivity of the broader economy to swings in interest rates was far greater than is now the case, with employment, retail sales, and residential construction bouncing back more quickly during recoveries. Over time, however, the U.S. economy has become far more open, which has helped lead to considerably less reliance on manufacturing, which now accounts for roughly 11 percent of private sector employment (and now carries a significantly smaller premium on its average hourly wage relative to the overall average), while service producing industries play a far more prominent role.

The following chart helps put some of these structural changes into perspective. Note the declining share of employment for both durable goods and nondurable goods manufacturing, though the former has performed well during the current recovery. While retail's share of private sector employment has fallen slightly over time, it is still the fourth largest sector in terms of employment share, while leisure & hospitality services, education and health services, and business and professional services have all seen their employment shares rise significantly.

Structural Changes Haven't Favored Higher Earnings

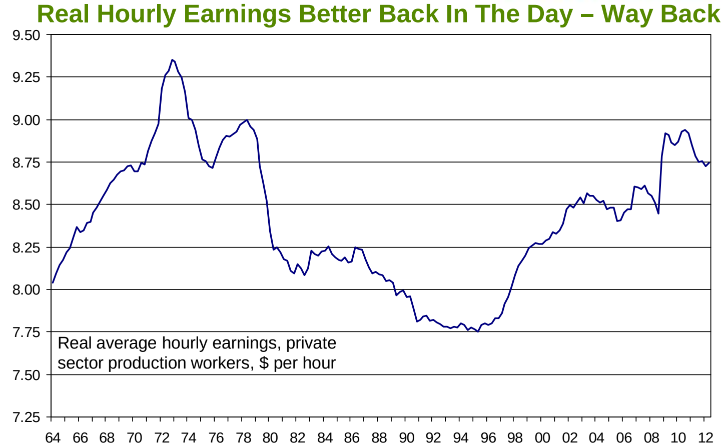


Source: Bureau of Labor Statistics; Regions Economics Division

This is also where the point made above as to wide variances in earnings within industry groups is relevant. For instance, of all jobs added in the business and professional services group during the current recovery, 39.7 percent have been jobs in temporary help agencies, where average hourly earnings are but 55.7 percent of the overall average for the business and professional services group. In the same manner, over one-third of all jobs in health care have come in either home health care or nursing home facilities, both of which have average hourly earnings considerably than the overall average for health care, which itself is modestly above the overall average hourly wage for all private sector workers.

The mix of jobs added during the current recovery, particularly the concentration in relatively low hourly earnings industries, is reflected in the path of real average hourly earnings shown in the chart below. At first glance, the spike in real average hourly earnings (which is an employment share weighted average across all private sector industry groups) seen in Q4 2008 may seem more impressive than it actually is – inflation, as measured by the CPI, declined by 2.3 percent during that quarter mainly due to plunging retail gasoline prices. It is this decline, rather than faster growth in nominal earnings, that is responsible for the spike in real average hourly wages.

Real Hourly Earnings Better Back In The Day – Way Back



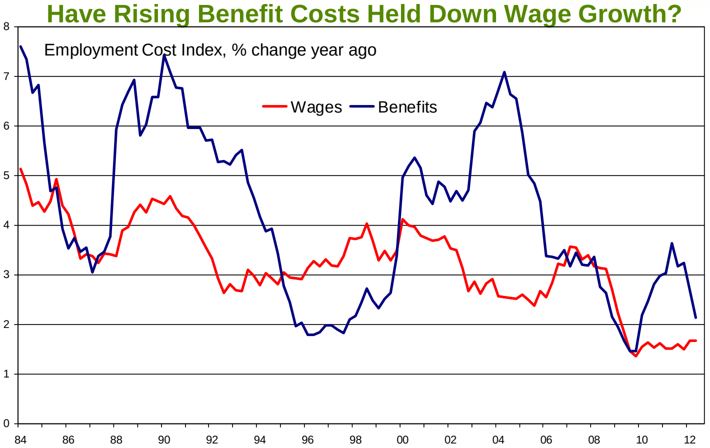
Source: Bureau of Labor Statistics

More tellingly, real average hourly earnings have fallen on an over-the-year basis for 20 consecutive months with declines across most industry groups and, 31 months away from the cyclical trough of employment, real average hourly earnings now stand 1.4 percent below their February 2010 level. Though disappointing, this is nothing new when we look back over previous recoveries – one has to go back to the recovery that began in March 1975 to find a recovery in which real average hourly earnings were higher at the 31-month point than at the cyclical trough of employment. Since then, however, higher inflation, a fading share of jobs in durable goods manufacturing, and stagnant worker productivity all combined to drive real hourly earnings lower between the late 1970s and the mid-1990s. Over the latter half of the 1990s, broad-based economic growth and revived worker productivity growth lifted real hourly earnings in all major industry groups.

At present, a high degree of labor market slack is the primary factor weighing down real hourly earnings. What little growth we have seen in nominal hourly earnings simply has not been able to keep pace with the rate at which prices are rising, thus pushing real average hourly earnings lower. Absent significant and sustained improvement in labor market conditions, there is likely to be little upward pressure on nominal earnings in most industry groups for some time to come.

One additional factor that may have helped hold down growth in wages over the past several years has been the cost of employer provided benefits, which have risen at a significantly faster pace than wages, as seen in the chart below.

Have Rising Benefit Costs Held Down Wage Growth?



Source: Bureau of Labor Statistics

Though wages continue to make up the overwhelming share of total compensation, that share has fallen slightly over time. Despite their relatively small share of overall compensation, benefit costs have risen at such an accelerated rate that many employers likely responded by holding back wage growth as a means of getting a firmer handle on total compensation costs. Still, this does not account for falling real hourly earnings in sectors such as retail trade, leisure & hospitality services, and certain segments of health care which simply command lower earnings and come with few, if any, benefits.

What Does It All Mean?

Perhaps the most obvious implication of the trends discussed above is what falling real hourly earnings mean for personal income growth and, in turn, growth in consumer spending. Earnings account for the majority of total personal income, and with earnings failing to keep pace with inflation, growth in real disposable personal income – which accounts for income from all sources and personal tax payments – remains exceptionally weak. A theme that we have been pressing for quite some time is that in what remains a somewhat credit constrained environment earnings growth will have to be the main driver of growth in consumer spending.

Household deleveraging continues to weigh on growth in consumer spending, which we expect to continue to be the case into 2014 – recent growth in automobile related credit and student loans notwithstanding. In addition, while we are seeing increased mortgage refinancing activity, this is not having nearly the same impact on growth in consumer spending as was the case in the years leading up to the Great Recession. During that period, homeowners were actively pulling equity from their homes and using the proceeds to finance consumption spending. Now, much of that housing equity has evaporated and those with equity remaining are largely unwilling or unable to extract it. Thus, while mortgage refinancing at lower interest rates is helping free up cash in the form of lower monthly principal and interest payments, the impact on consumption spending is considerably less.

Over the Q3 2003 though Q3 2007 period, real consumer spending grew at an average annualized rate of 3.1 percent per quarter, with this growth supported by growth in household debt. Since the beginning of the current recovery, growth in real consumer spending has averaged 2.1 percent (annualized) per quarter, and we do not expect it to stray far from this average over coming quarters in the absence of firmer growth in wage and salary earnings. This firmer growth, however, will not come until job growth becomes more broad based and we see a meaningful reduction in the degree of labor market slack – think in terms of the over 8 million people now working part-time for economic reasons and the discouraged job seekers who simply give up looking for work and leave the labor force.

Another much discussed topic of late – and one we also touched on in the September edition – is the extent to which we are seeing structural versus cyclical unemployment. One could argue that job gains being so heavily concentrated amongst a small number of industry groups is a sign that weak growth in aggregate demand is the primary source of the slack labor market conditions we are experiencing, i.e., cyclical unemployment. We do not disagree with that contention, but simply point out that there is also some degree of structural unemployment. This has, however, been the case for some time now – refer back to the chart showing the long running decline in manufacturing's share of private sector employment.

And, while this may not be an officially designated category, we would argue that we are also seeing some degree of "structural underemployment." In other words, the recession and subsequent weak recovery left an exceptionally large number of long-term unemployed. It could be that many of these long-term unemployed are now taking jobs that they would otherwise not consider, particularly as more and more people see the expiration of their extended Unemployment Insurance benefits. This could help account for increased employment in sectors such as retail, leisure & hospitality services, temporary help, and lesser skilled segments of health care. These industry groups have posted steady gains in employment without any meaningful upward pressure on wages. And, with shorter average workweeks in these industry groups, it could be that many workers are working more than one part-time job – note that this would be reflected in the nonfarm employment survey data but would do nothing to increase the labor force participation rate. The question remains whether we will ultimately see economic growth become strong and broad based enough that these structurally underemployed workers migrate back into higher skill, higher earnings jobs. One could argue that the longer they remain underemployed, the lesser the odds of such a transition.

At present, the economy is simply not growing fast enough to generate broad based job growth and reduce what remains a considerable degree of labor market slack which, given the impact on personal income growth and consumer spending, becomes a vicious circle of underperformance. This is one reason why Chairman Bernanke remains so focused on fostering a meaningful recovery in the labor market.

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