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Economics Group

John E. Silvia, Chief Economist
john.silvia@wellsfargo.com • (704) 410-3275
Sarah Watt House, Economist
sarah.house@wellsfargo.com • (704) 410-3282

Labor Market Dynamics: Three Peeks Behind the Curtain

Behind the curtain awaits a wealth of data that provides decision makers a more sophisticated and much-needed closer look at labor market dynamics. Here we take a peek behind the curtain.

Job Separations: When Quitting Is a Good Thing

In the case of the labor market, quitting is a good thing. Workers tend to quit when they feel confident in their job and wage prospects elsewhere, or in the case of older workers, confident in their retirement savings and income streams. Turnover in the labor market due to workers quitting one job to go to another can also improve productivity in the economy by better matching the workers' skills to the job at hand.

The rising trend in quits, alongside declining layoffs, is another signal of a gradually healing labor market (top chart). However, as also indicated in the chart, there is still a lot of healing left to do.

Labor Force Participation: Beneath the Headlines

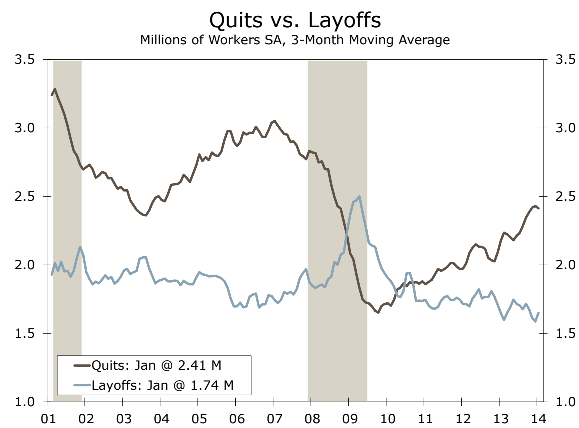
Many analysts have noted that the decline in the unemployment rate, a benchmark for the conduct of monetary policy, has been in part influenced by the drop in the labor force participation rate. This decline is often attributed to an aging population. However, beneath the headlines, the details suggest that there is more to the story.

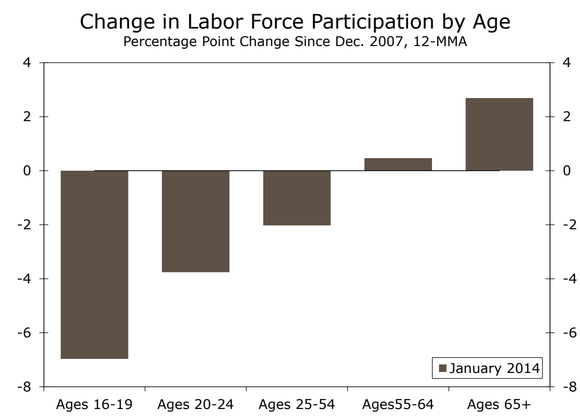
Since 2007, the drop in participation has been most pronounced in younger working groups, including prime-age workers (25-54 years old, middle chart). For the youngest cohort, ages 16-19 the pursuit of education is a large part of the story. Similarly, the 20-24 year old cohort decline reflects the combination of more students seeking higher education, but there is also a sense that many of these potential workers do not have the right skills needed for many jobs today. On the other end of the age spectrum, note that the labor force participation rate for workers age 65 and over has actually risen. This reflects a greater number of part-time job seekers, better health for the entering retirement group and some income smoothing for those who are trying to maintain a certain lifestyle.

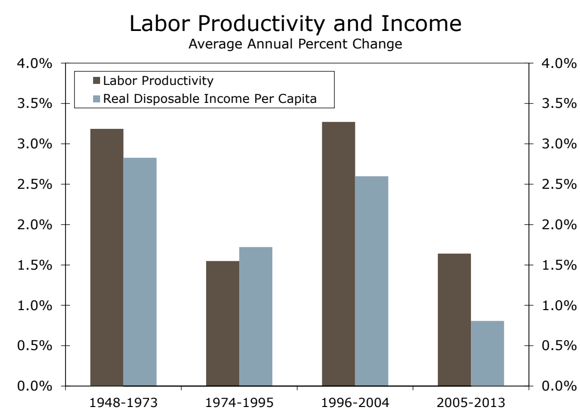
Productivity and Incomes: No Disconnect

Another urban legend that does not fully capture the labor market of today is the assertion that weak wage growth has been due to a large amount of slack in the labor market. While an excess of labor relative to demand is indeed part of the slow wage growth story, a less cited reason is lower labor productivity in recent years. Wages are reflective of the marginal product of labor. Therefore, lower labor productivity is typically accompanied by weaker income growth, as illustrated in the bottom chart during different eras of productivity growth.

During the post 2005 period, productivity gains and real income gains are fairly matched—as they have been in prior periods. What makes the current period interesting is that both productivity and income gains are low and are reminiscent of the adjustment challenges in the U.S. economy during the oil embargo era. A similar, non-oil, adjustment is going on today.







Source: U.S. Department of Labor, U.S. Department of Commerce and Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Anika R. Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Sarah Watt House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael T. Wolf	Economist	(704) 410-3286	michael.t.wolf@wellsfargo.com
Zachary Griffiths	Economic Analyst	(704) 410-3284	zachary.griffiths@wellsfargo.com
Mackenzie Miller	Economic Analyst	(704) 410-3358	mackenzie.miller@wellsfargo.com
Blaire Zachary	Economic Analyst	(704) 410-3359	blaire.a.zachary@wellsfargo.com
Peg Gavin	Executive Assistant	(704) 410-3279	peg.gavin@wellsfargo.com
Cyndi Burris	Senior Admin. Assistant	(704) 410-3272	cyndi.burris@wellsfargo.com

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