



How much slack is there in the labor market, and how much do the different types of slack hold wages down?

March 2014

Peter Hooper, Torsten Slok, and Matthew Luzzetti

60 Wall Street

New York, New York 10005

Tel: 212 250 7275

Passion to Perform



There are four key elements of slack in the labor market:

- Short-term unemployed
- Long-term unemployed
- People working part-time for economic reasons
- People not in the labor force who want a job now

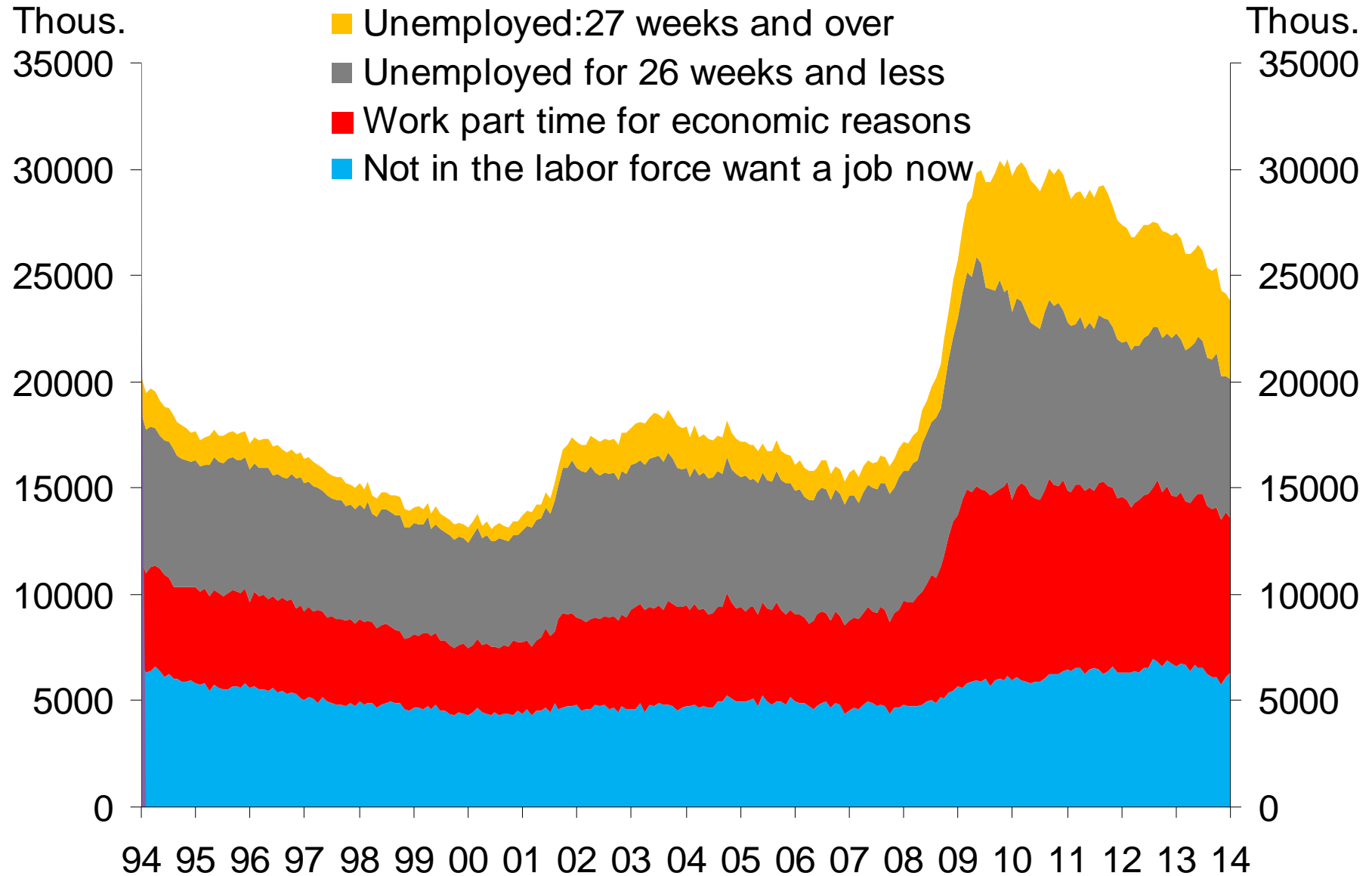
In the following we look at the size of these four types of labor market slack and estimate the impact of each of them on wages.

We find that short-term unemployment has a significant impact on wages whereas the impact on wages from long-term unemployed, people working part-time, and people outside the labor force is insignificant.

Bottom line: The only measure of slack that has a significant impact on wages is the short-term unemployment rate and the short-term unemployment rate is already back to its pre-crisis average.

This finding obviously has implications for the Fed.

Is slack in the labor market 24mn people? No, remember that:
a) slack in 2006 was 17mn and b) the population is growing

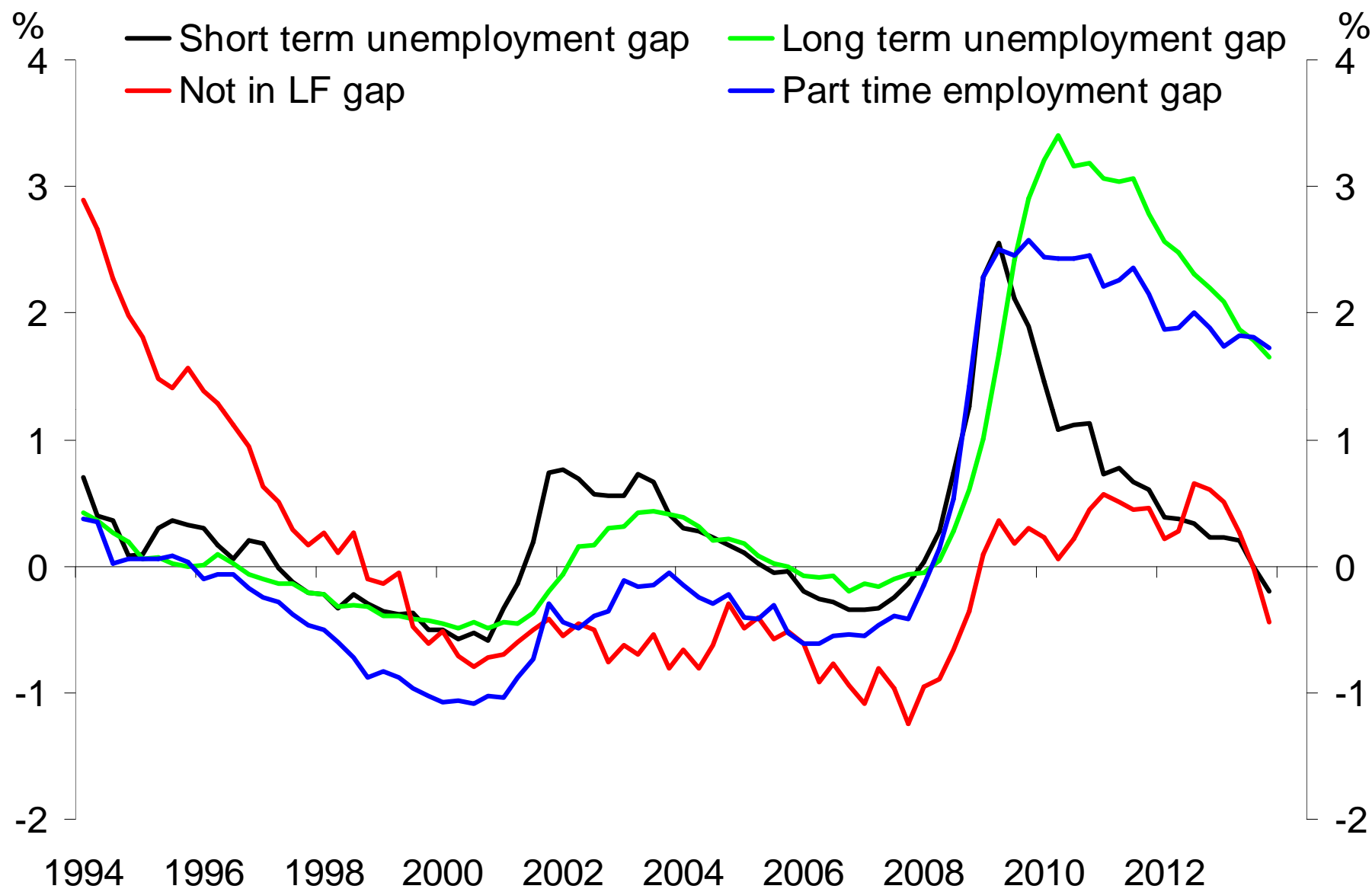


Source: BLS, Haver Analytics, DB Global Markets Research



How much slack is there in the labor market?

A more revealing way to measure slack is to consider each element of slack relative to its pre-crisis average. The long-term and part time elements remain well above their historical averages but the short-term and not in the labor force elements are back to or below their pre-crisis norms.

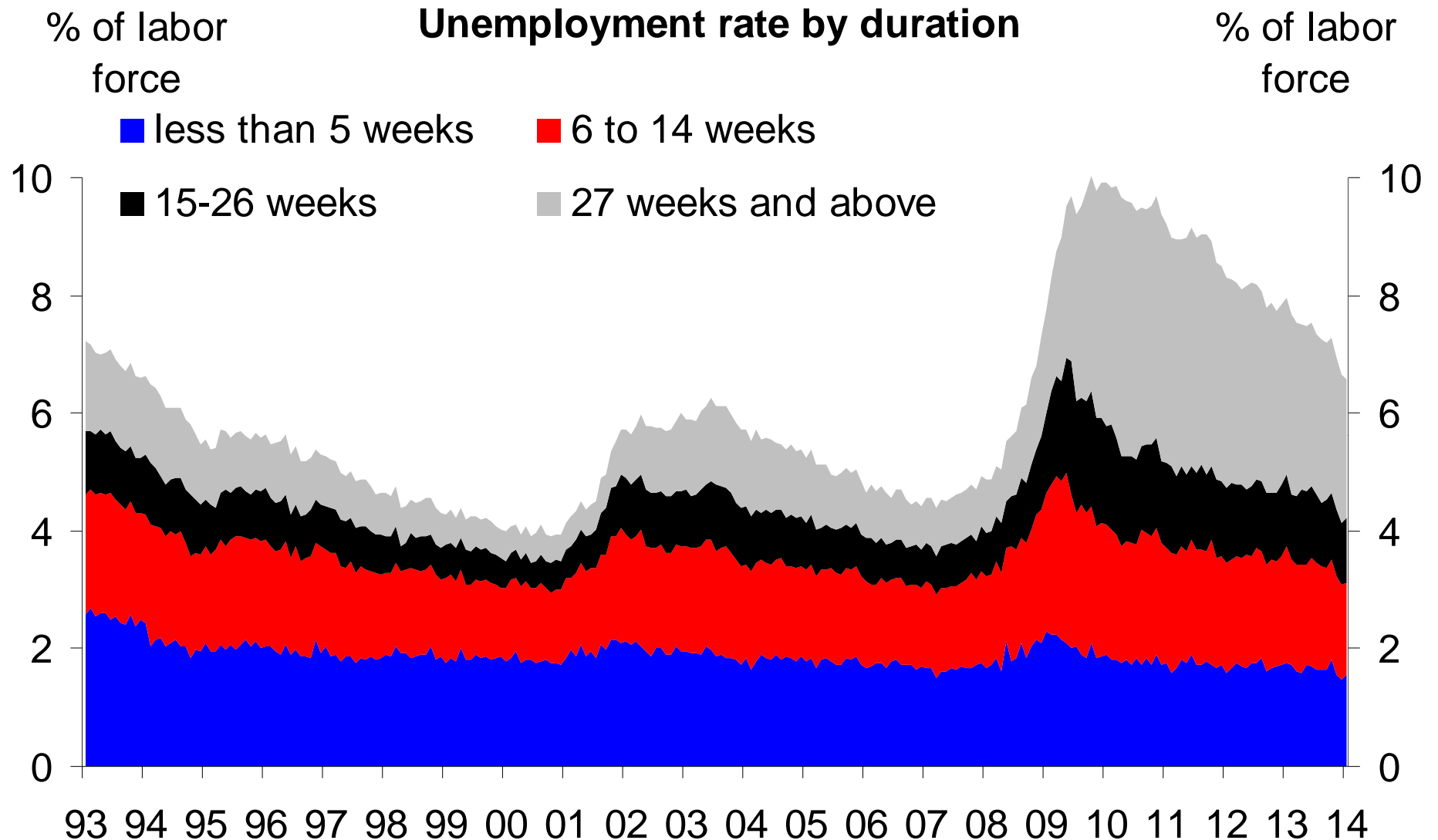


Source: BLS, Haver Analytics, DB Global Markets Research



Long-term vs short-term unemployment

Short-term unemployment rate – ie less than 27 weeks – is already back to its 2005 level



Source BLS, DB Global Markets Research

3.6mn people are long-term unemployed,
pre-crisis it was around 1.5mn...



Source: BLS, Haver Analytics, DB Global Markets Research

... and the long-term unemployment rate is about 2%-points above its historical average



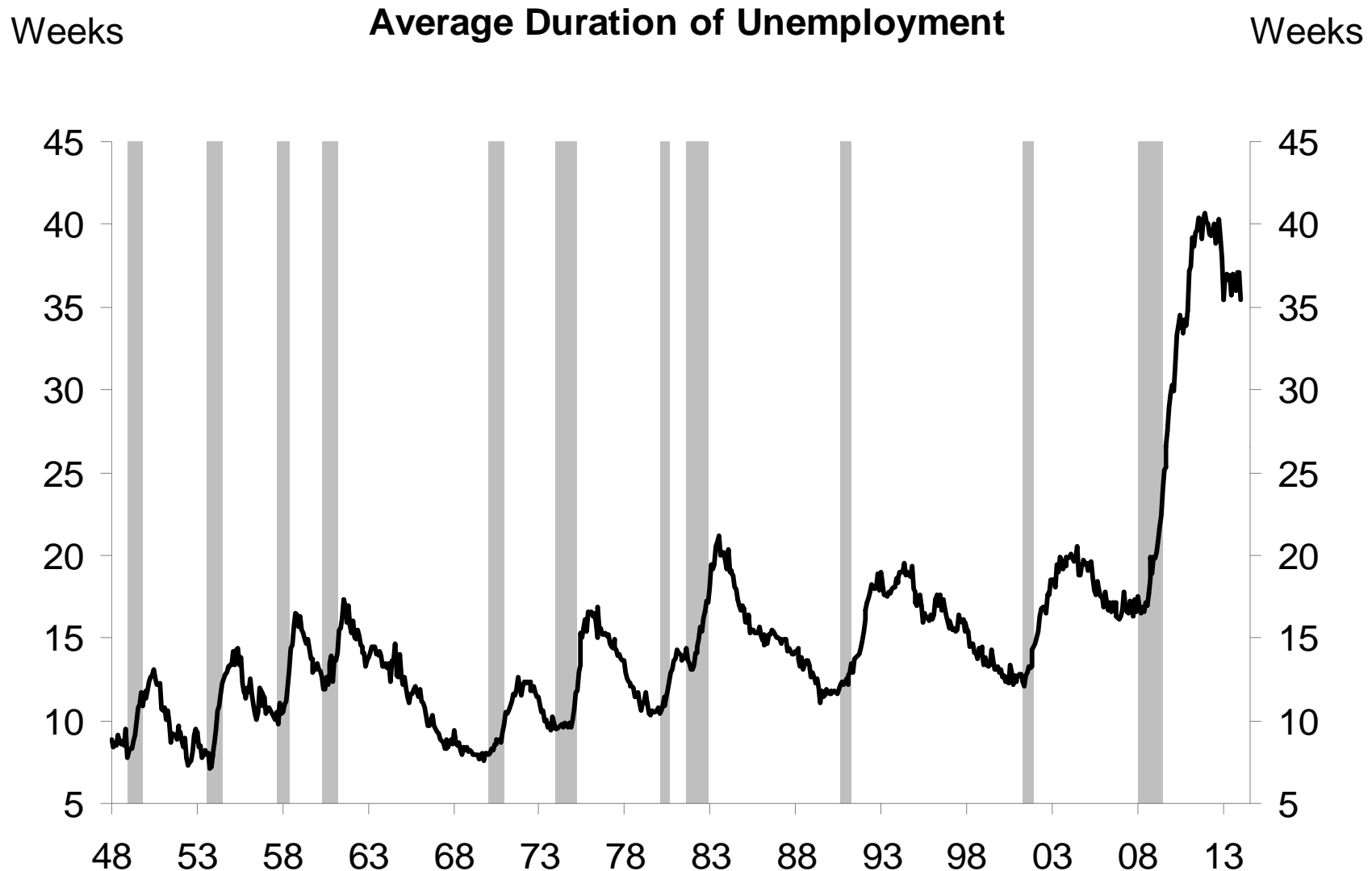
Source: BLS, Haver Analytics, DB Global Markets Research

...and the long-term unemployed make up about 35% of the total...



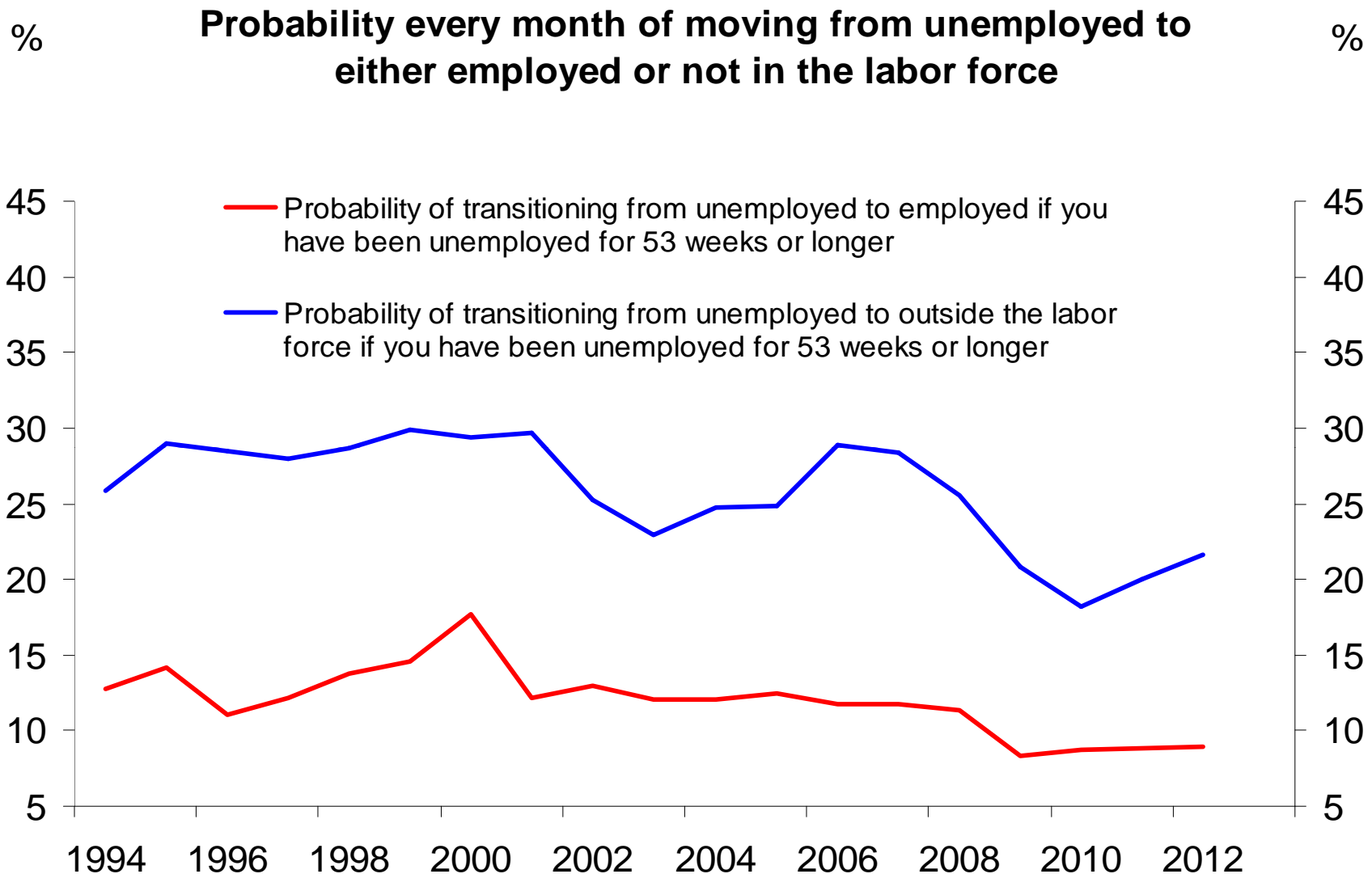
Source: BLS, Haver Analytics, DB Global Markets Research

...and people are currently unemployed for about 35 weeks...



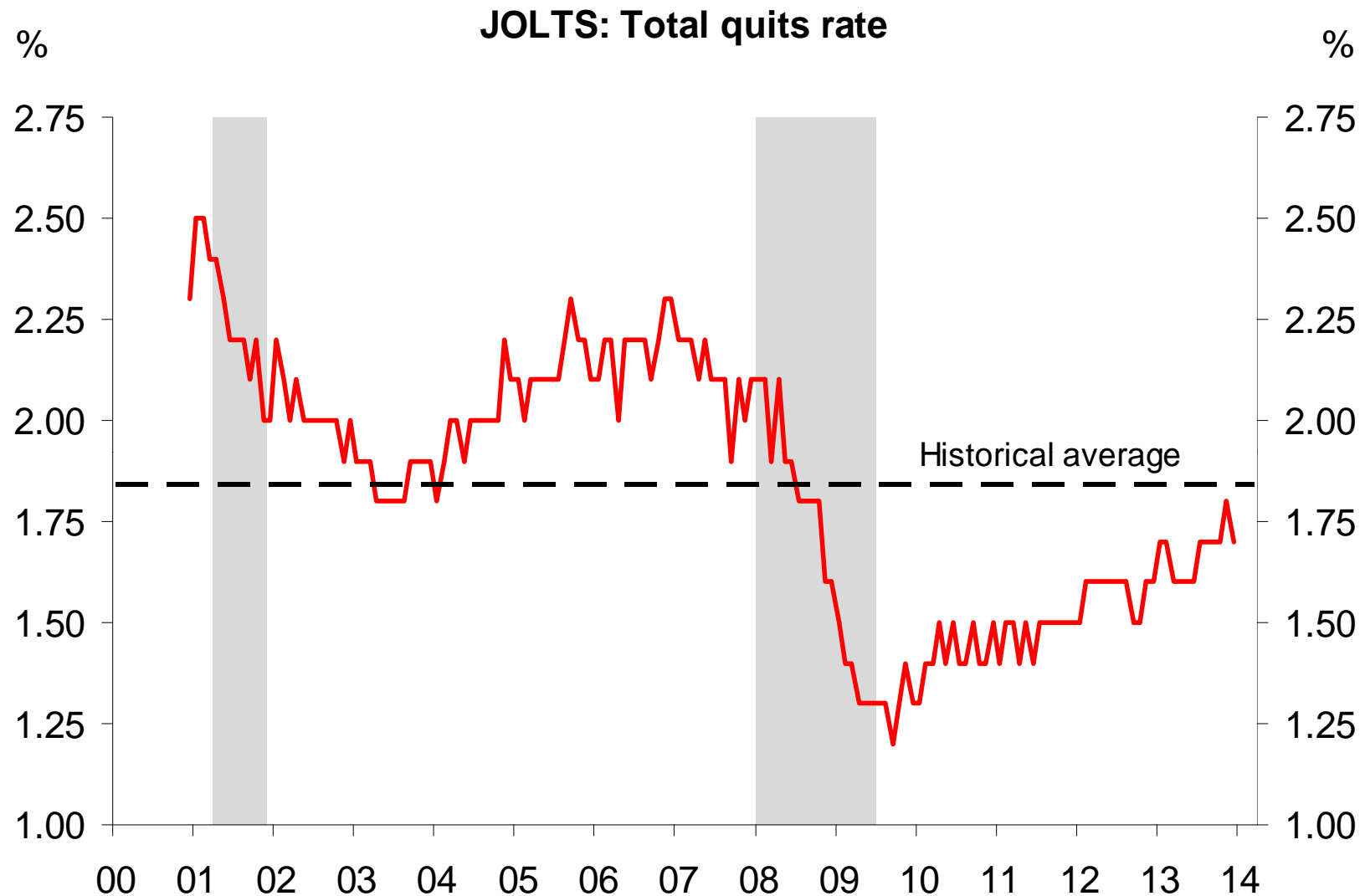
Source: BLS, Haver Analytics, DB Global Markets Research

If you are long-term unemployed the probability of leaving the labor force is more than twice the probability of finding a job



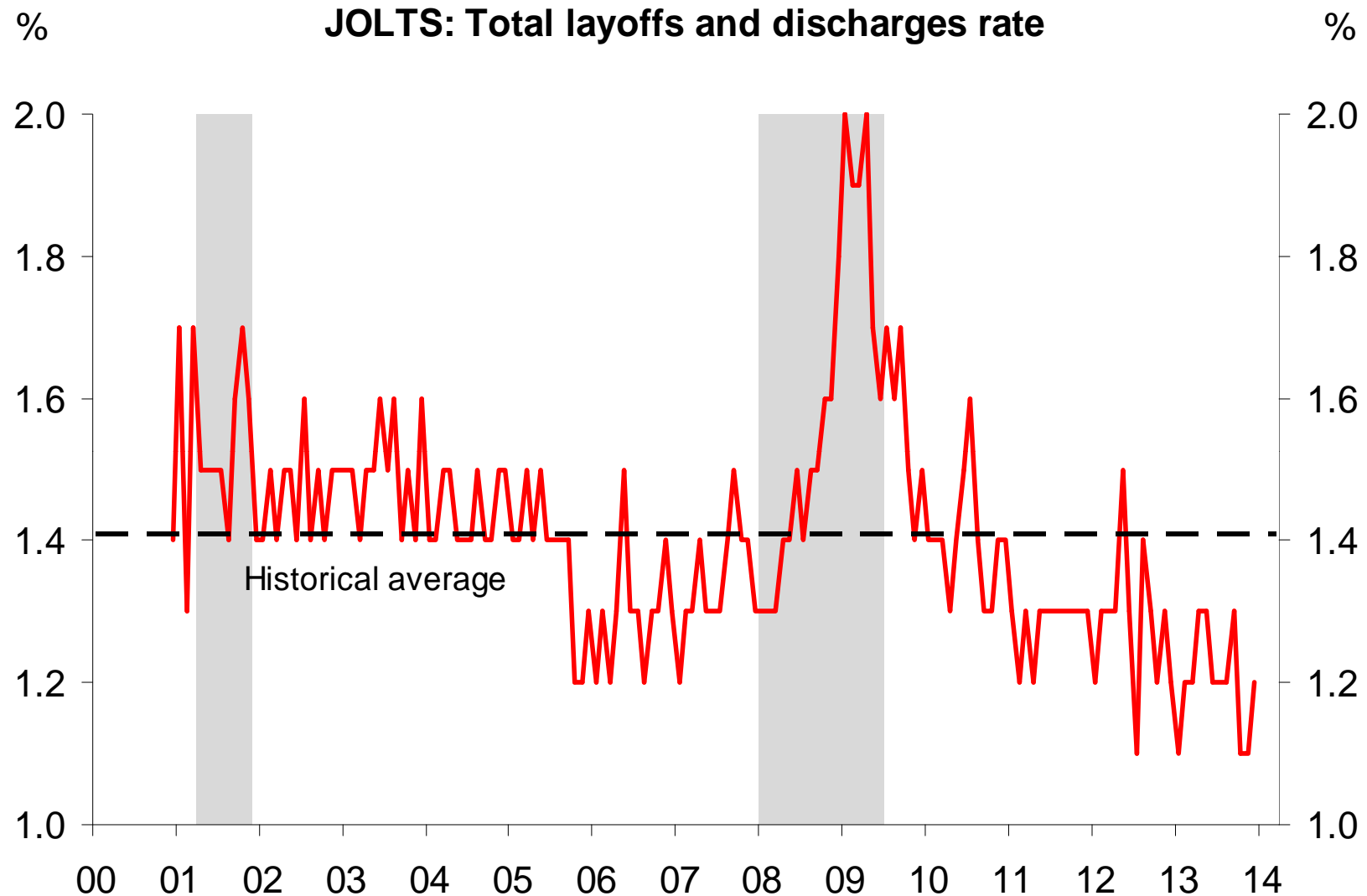
Source: BLS, Haver Analytics, DB Global Markets Research

The quits rate (ie the share of people who quit their job every month) is close to its historical norm



Source: BLS, Haver Analytics, DB Global Markets Research

The number of people who get fired each month is well below its historical average



Source: BLS, Haver Analytics, DB Global Markets Research

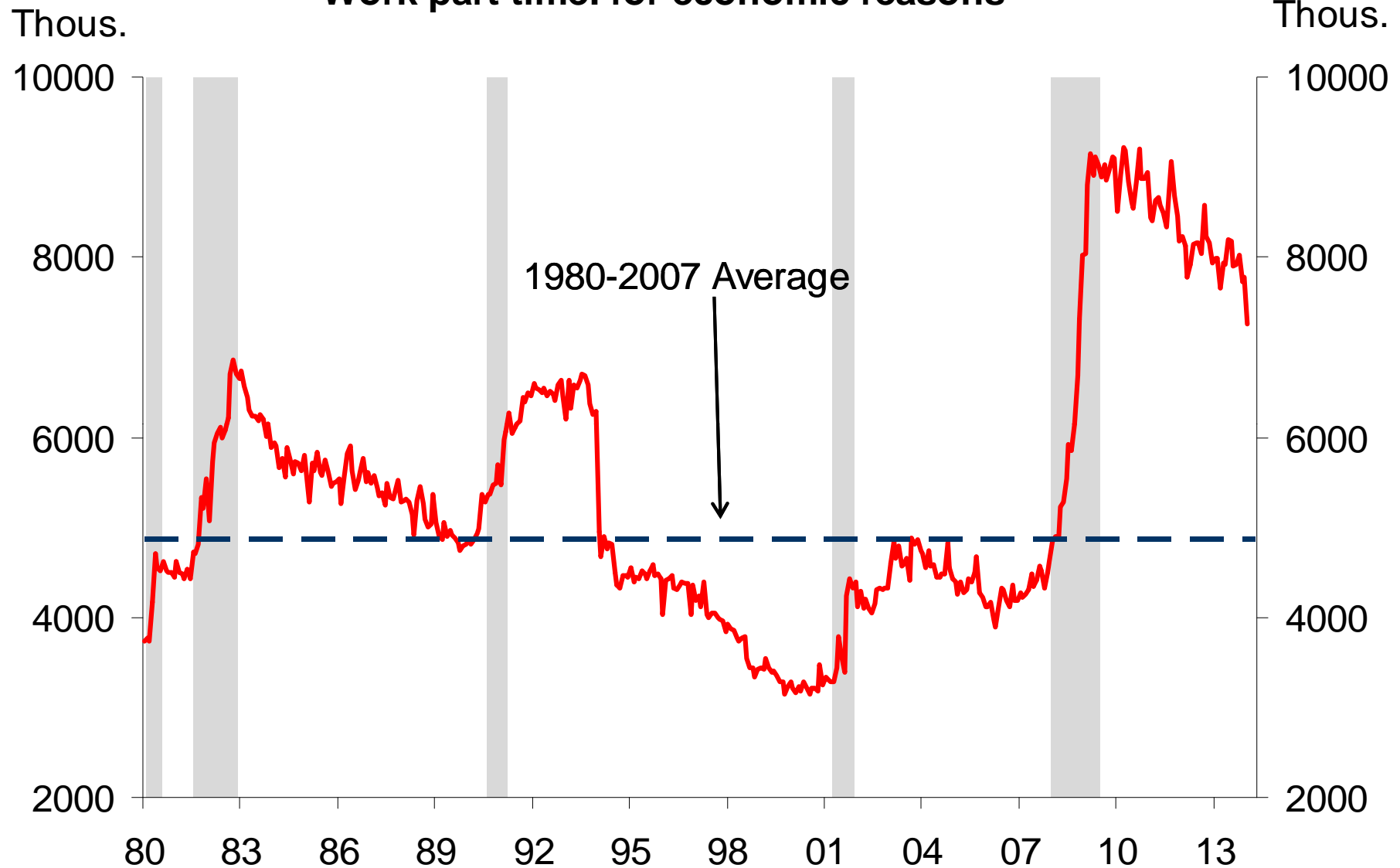


Part-time for economic reasons

7mn people work part-time for economic reasons, the historical average is 5mn...

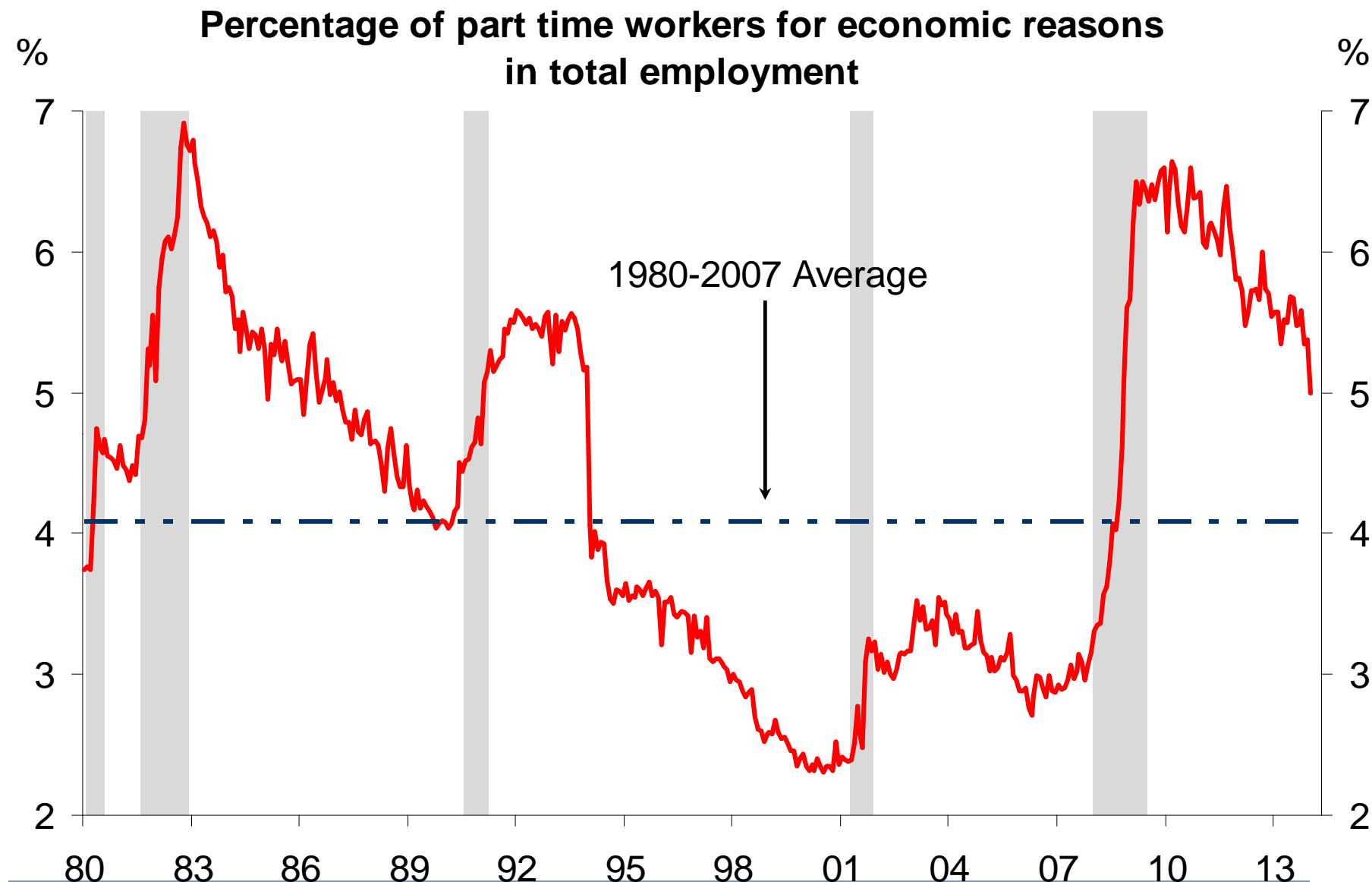


Work part time: for economic reasons



Source: BLS, Haver Analytics, DB Global Markets Research

...and in percentage terms we are still above the historical average



Source: BLS, Haver Analytics, DB Global Markets Research



Not in the labor force,
want a job now but not
searching

Persons outside the labor force who want a job is now back to its pre-crisis level



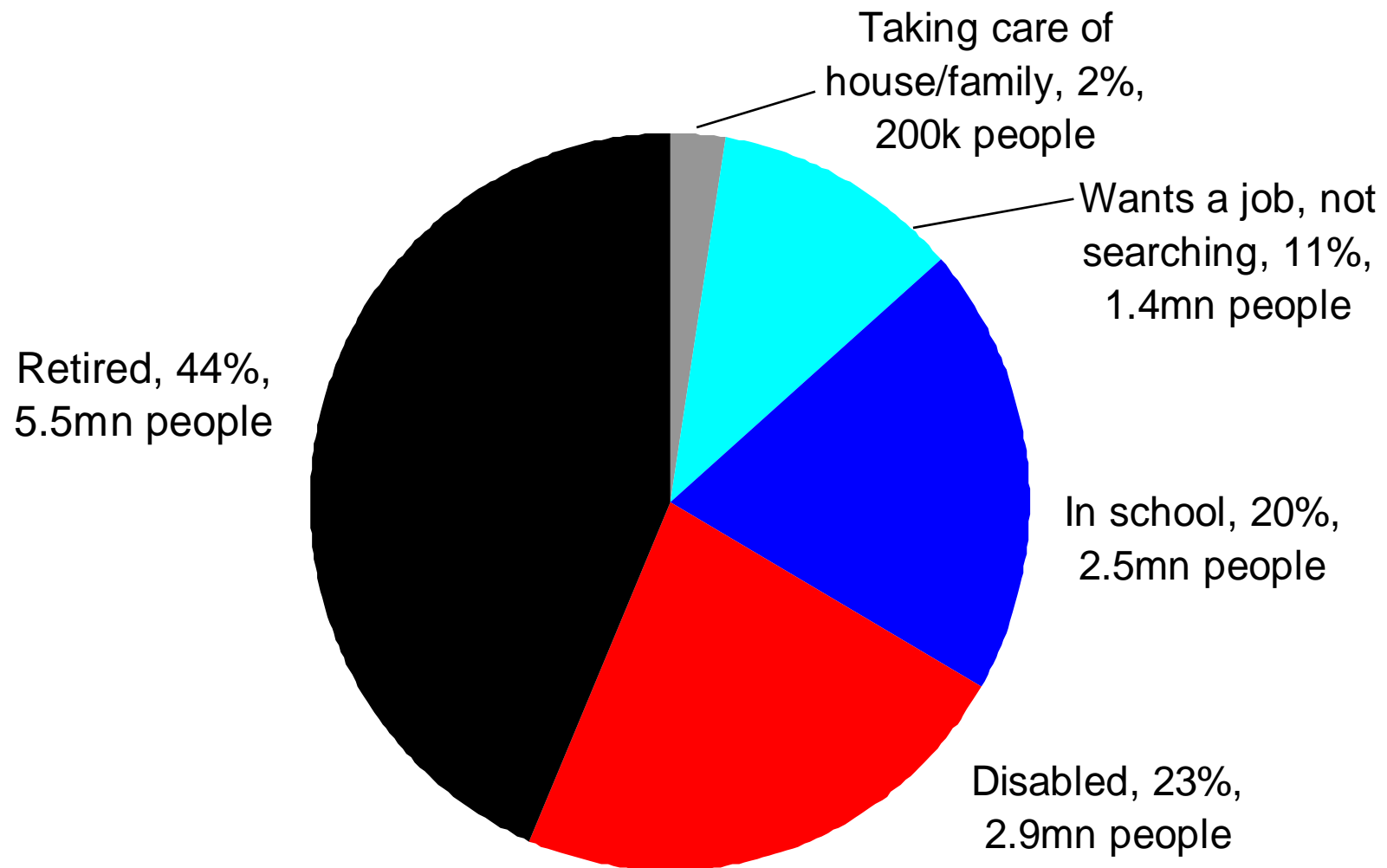
Source: BLS, Haver Analytics, DB Global Markets Research

13mn people left the labor force since 2007, where did they go?

44% retired, 23% got disability insurance, and 20% went back to school



Change in sub-categories of "Not in the labor force," 2007Q4-2013Q4

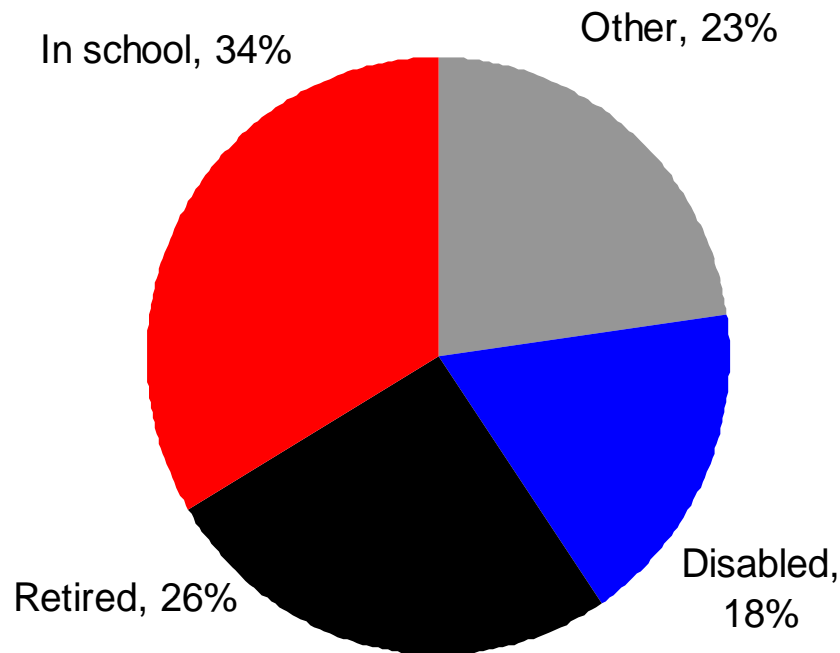


Source: BLS, Fed, DB Global Markets Research

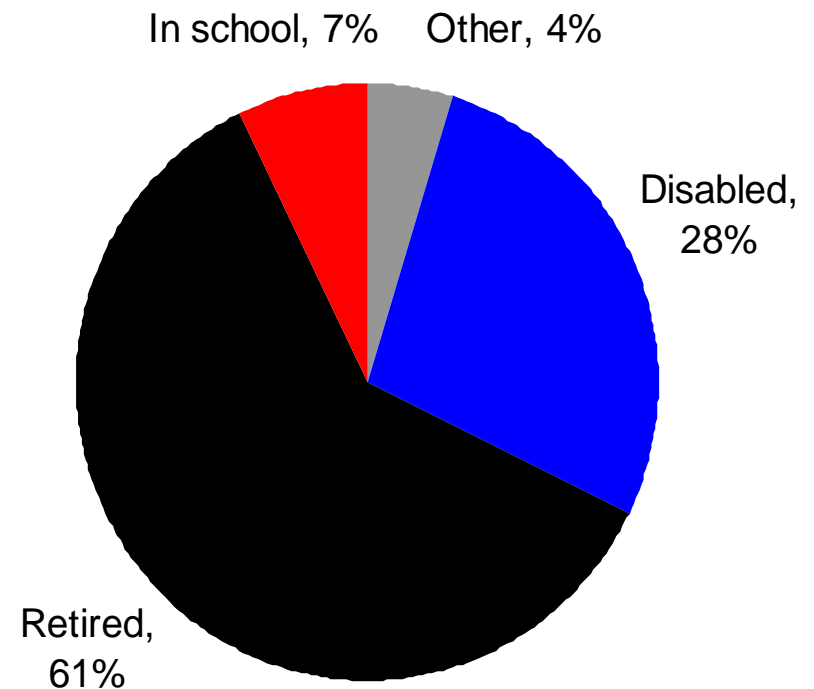
Initially people left the labor force to go back to school.
Later people left the labor force to retire, probably
because their 401(k) had increased so much



**6mn people left the labor force from
2007-2010, where did they go?**



**6.6mn people left the labor force from
2010-2013, where did they go?**

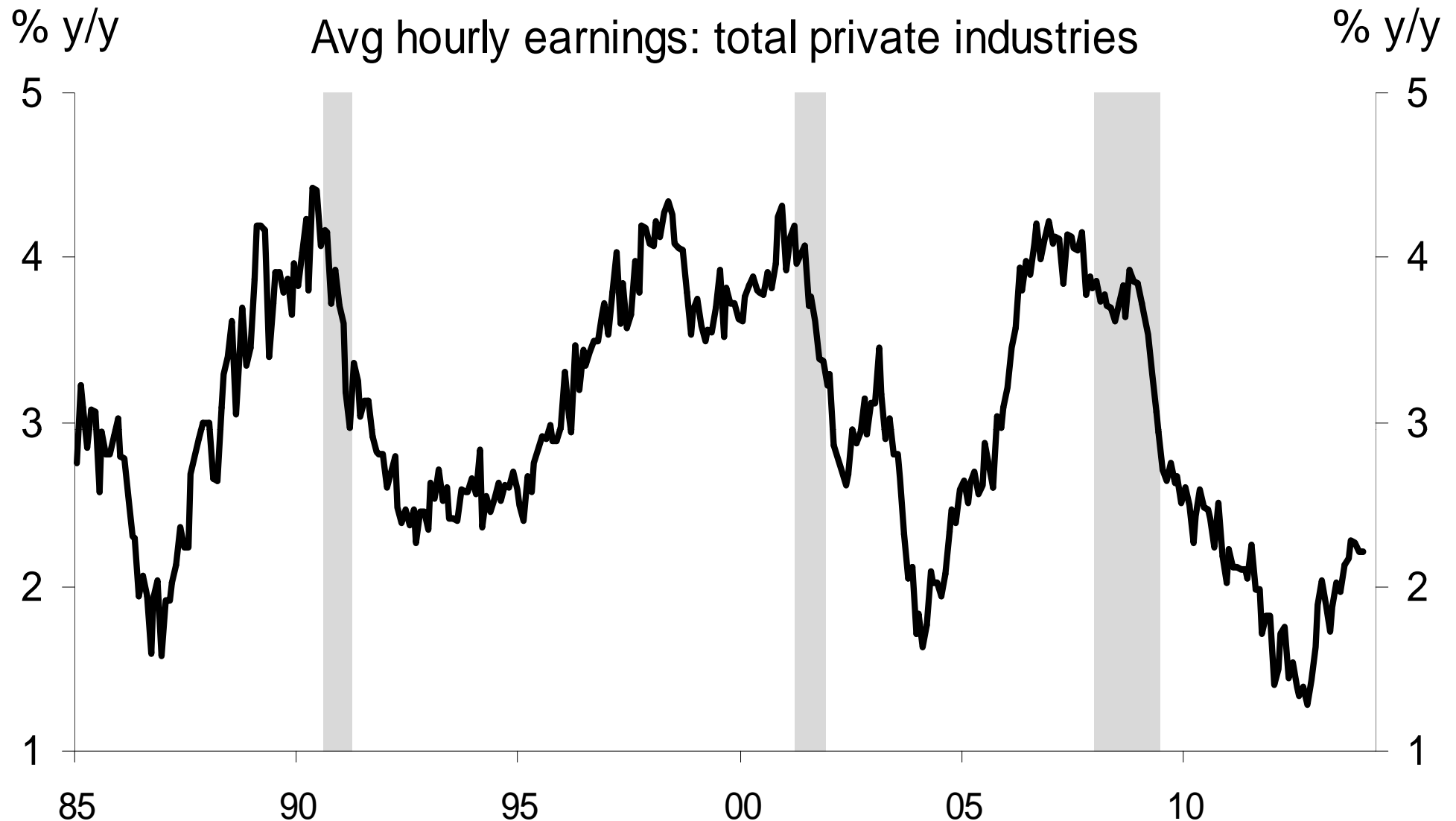


Source: BLS, Fed, DB Global Markets Research



What is the impact on
wages of different
types of slack in the
labor market?

Wages have been trending up recently



Source: BLS, DB Global Markets Research

Different measures of slack, different impact on wages



Type of slack		Estimated impact on wages/inflation
Short-term unemployed	—————→	Significant
Long-term unemployed	—————→	Less significant
People working part-time for economic reasons	—————→	Not significant
People not in the labor force, want a job now, not looking	—————→	Not significant

Bottom line:
**Different types of slack are expected to have
different impacts on wages and inflation**



To quantify the effect of different types of slack on wages we ran the following regression (variables in bold are significant, p-value=0.05):

Wage inflation =

0.9*Wage inflation(-1) +

-0.2*Short-term unemployment gap +

-0.1*Long-term unemployment gap +

0.1*People working part time gap +

0.0*Not in the labor force, want a job now gap + **0.4**

Sample: 1994-2013

The results show that the short term unemployment rate is significant but the other slack variables are not. In other words, there is only one measure of slack that is having an impact on wages, and as seen above, the short-term unemployment rate is already back to its pre-crisis level, which means that any further declines in the short term unemployment rate will put upward pressure on wages.



Peter Hooper

Managing Director, Chief Economist

Deutsche Bank Securities, Inc.

+1 (212) 250-7352

peter.hooper@db.com

Peter Hooper is currently Managing Director and Chief Economist for Deutsche Bank Securities. He joined Deutsche Bank Securities in the fall of 1999, first as Chief International Economist and shortly thereafter as Chief US Economist. He became Chief Economist and co-head of global economics in 2006. Prior to joining Deutsche Bank, Hooper enjoyed a distinguished 26-year career at the Federal Reserve Board in Washington, D.C. While rising to senior levels of the Fed staff, he held numerous positions, including as an economist on the FOMC and as Deputy Director of the Division of International Finance.

Hooper produces weekly and quarterly publications for Deutsche Bank with a focus on US and global economic developments and Fed policy; he also comments on US and global economic and financial developments in the news media. His US Economics team has been ranked No. 1 in fixed income research by Institutional Investor in 2010 and 2011. Hooper currently serves as a member of the Economic Advisory Panel of the Federal Reserve Bank of New York, a member and former chairman of the Economic Advisory Committee of the American Bankers Association, a founding member of the US Monetary Policy Forum, a member of the Economic Leadership Council for the University of Michigan, and a member of the Forecasters' Club of New York.

Hooper earned a BA in Economics (cum laude) from Princeton University and an MA and Ph.D. in Economics from University of Michigan. He has published numerous books, journal articles, and reviews on economics and policy analysis.



Torsten Slok, Ph.D.

Chief International Economist, Managing Director

Deutsche Bank Securities, Inc.

- Torsten Slok joined Deutsche Bank Securities in the fall of 2005.
- Mr. Slok's Economics team has been top-ranked by Institutional Investor for the past four years. Slok currently serves as a member of the Economic Club of New York
- Prior to joining the firm, Mr. Slok worked at the OECD in Paris in the Money and Finance Division and the Structural Policy Analysis Division. Before joining the OECD he worked for four years at the IMF in the Division responsible for writing the World Economic Outlook and the Division responsible for China, Hong Kong, and Mongolia.
- Mr. Slok studied at University of Copenhagen and Princeton University. He has published numerous journal articles and reviews on economics and policy analysis, including in Journal of International Economics, Journal of International Money and Finance, and The Econometric Journal.



Matthew Luzzetti

212-250-6161

Matthew.luzzetti@db.com

Matthew Luzzetti received a Ph.D. in Economics from the University of California, Los Angeles, focusing on macroeconomics. Prior to that he worked as a research analyst at the Federal Reserve Bank of Philadelphia. Matt joined Deutsche Bank in September 2012 and is part of DB's top II ranked economics team.



Appendix 1

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