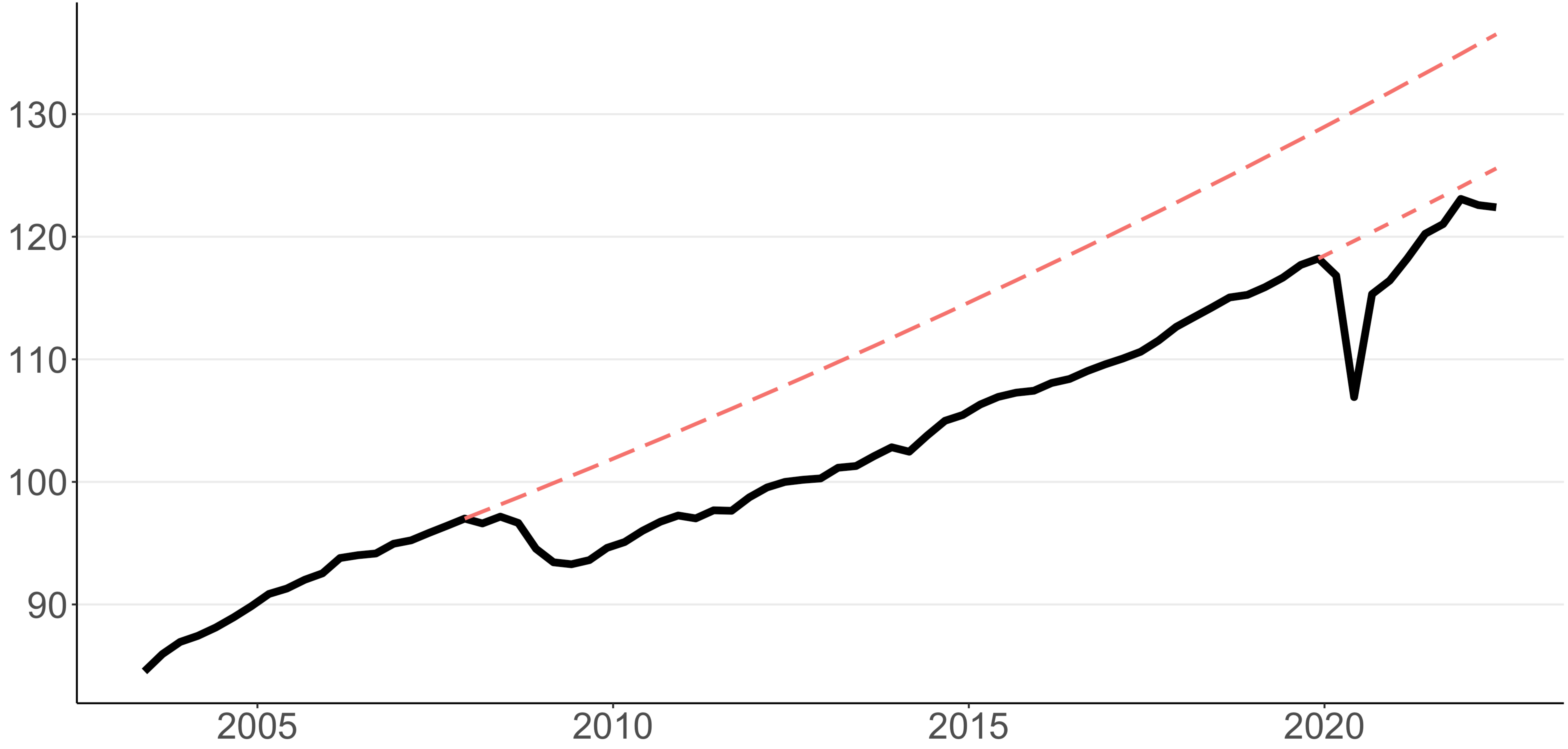
Why the Strong Recovery Matters

Assessing the US recovery from the pandemic for the labor market

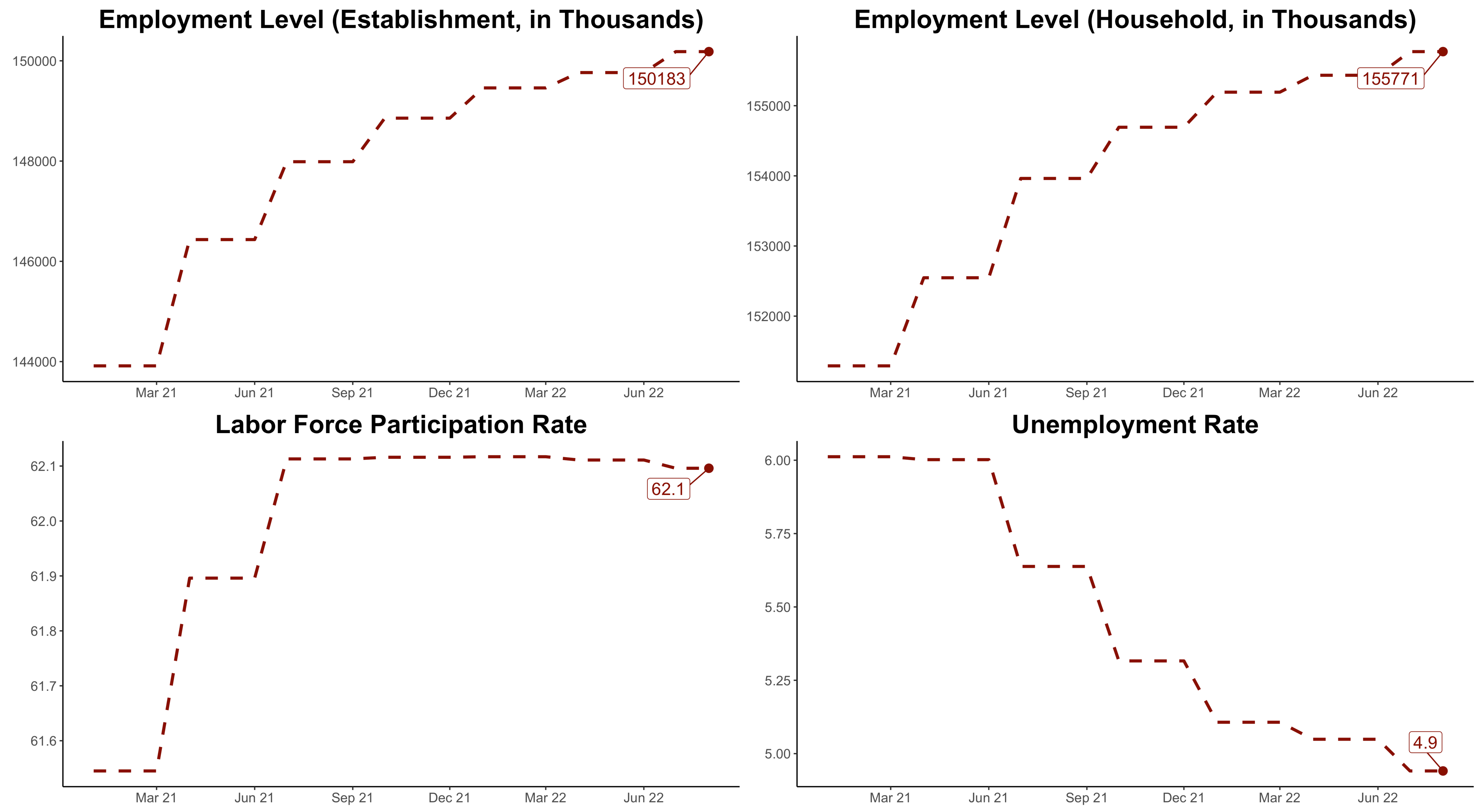
Mike Konczal, Roosevelt Institute, October 4th, 2022; Forum New Economy, New Paradigm Workshop

- The United States Recovery
- The Labor Market, in Context
- Inflation
- Wages and Inflation

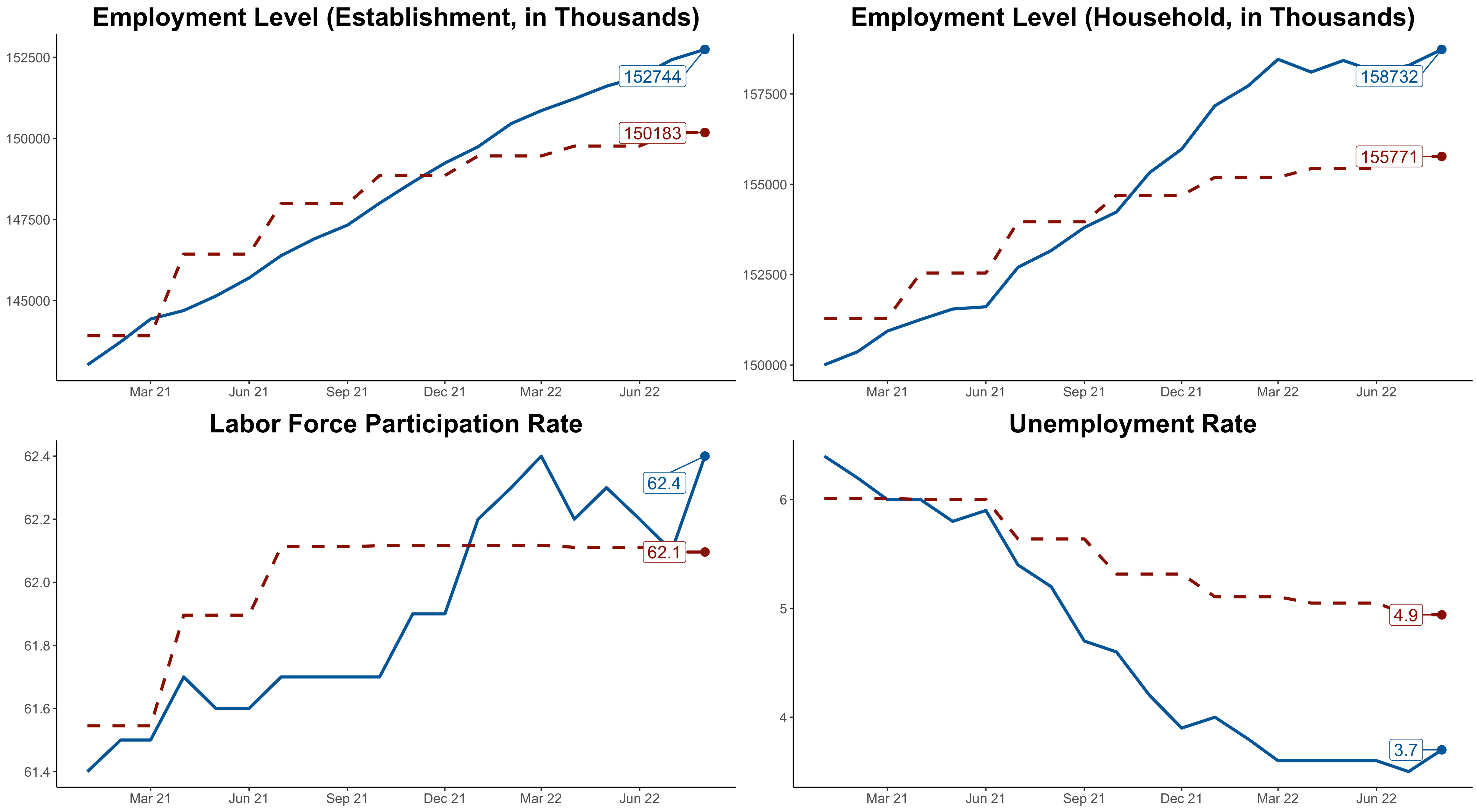
Compared to the Great Recession, real GDP hasn't fallen into a far lower trend



In Feb 2021, CBO (historically biased towards recoveries) predicted a slowing labor market in early 2022.



With the March 2020 American Rescue Plan, the actual values turned out higher and more sustained



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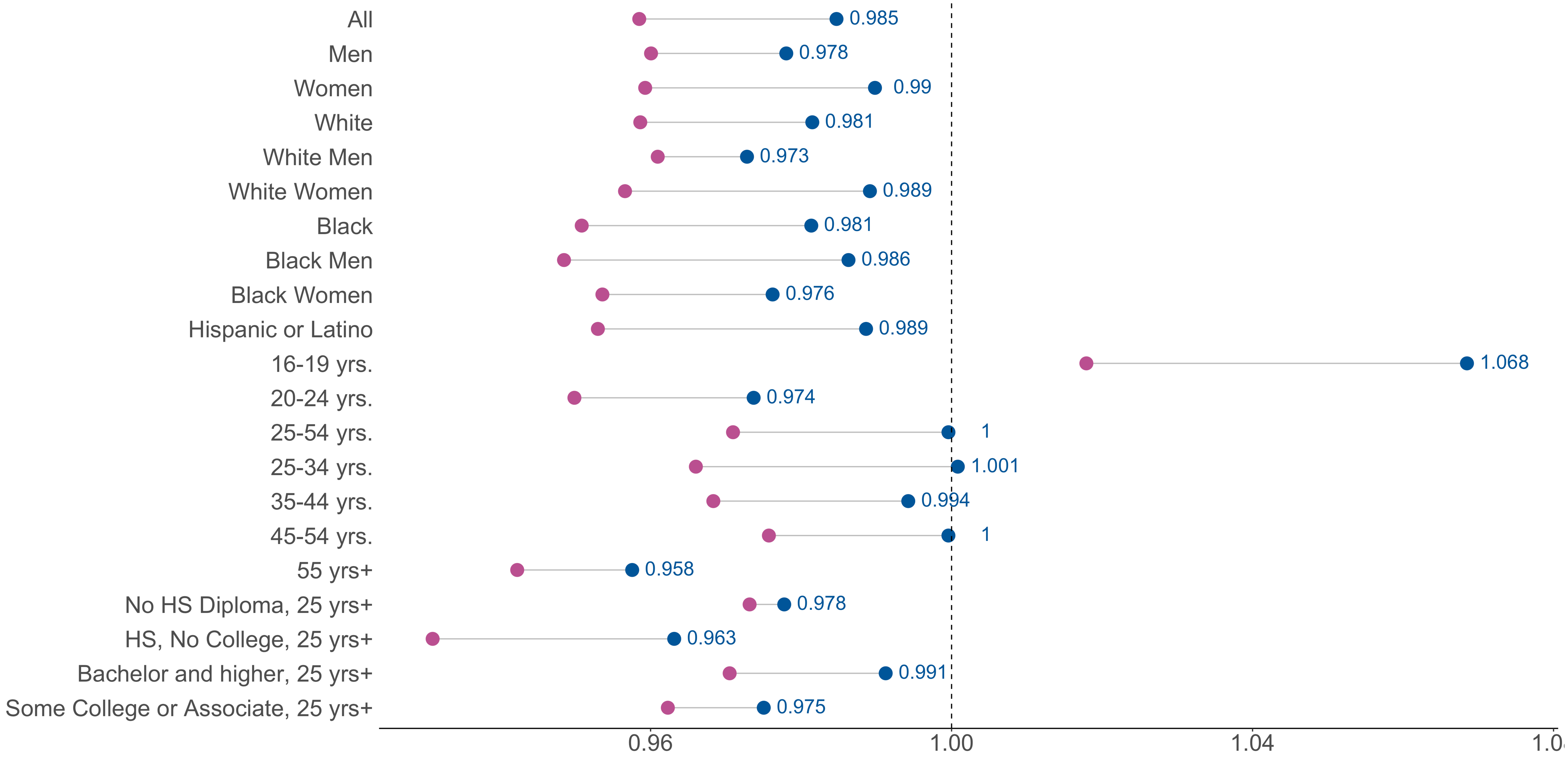
Prime age employment-to-population ratio returned after 31 months, compared to 133 months for Great Recession

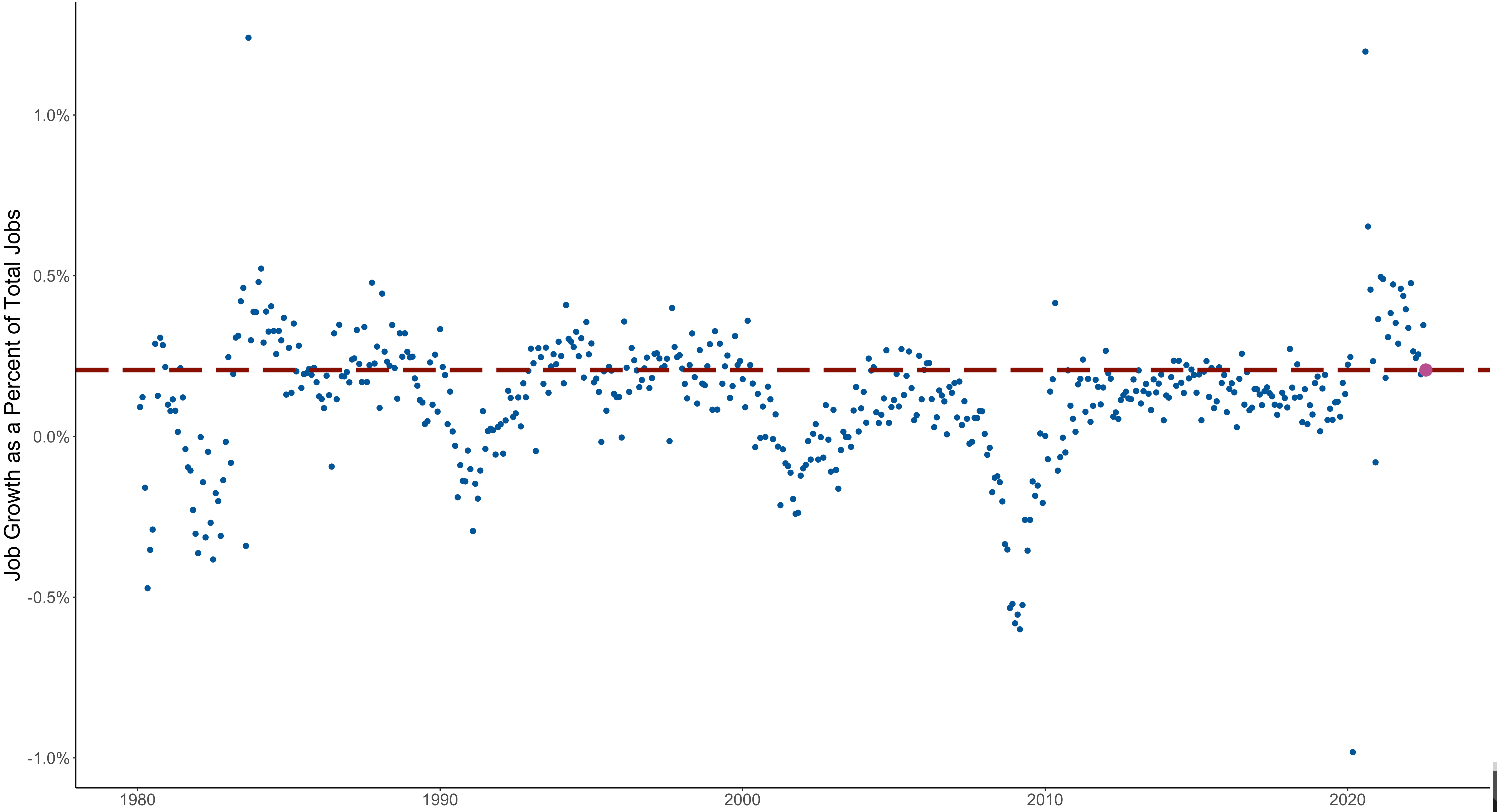
The labor market recovery is strong across the board and categories

Employment to Population Recovery, August 2021 and August 2022

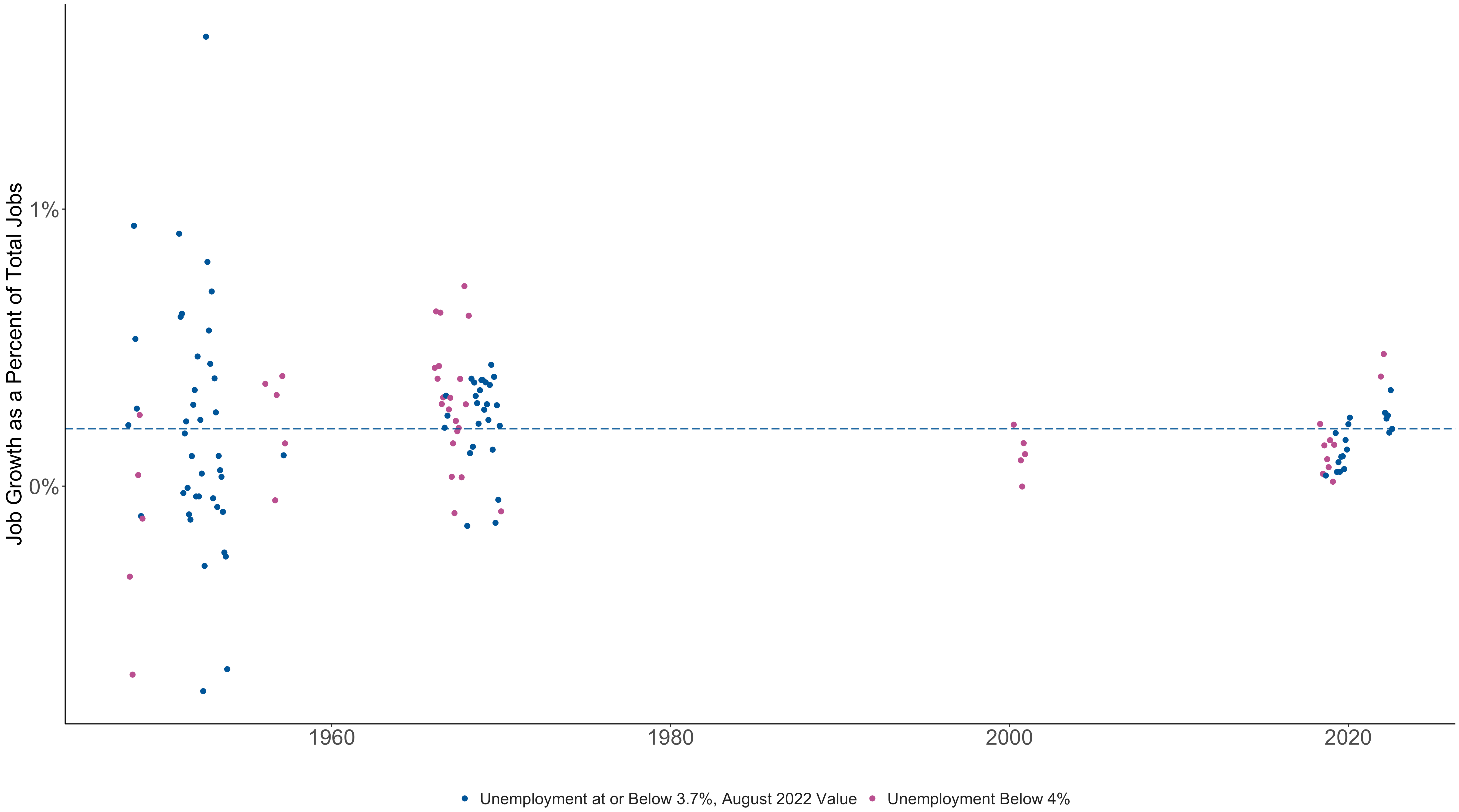


The category equals 1.0 when it returns to its pre-pandemic rate.
Pre-pandemic rate is defined as the average of the category's monthly EPOP ratio from Nov 19 to Jan 20

Job growth remains remarkably strong, especially compared to recent decades



Job growth remains remarkably strong, especially compared to periods of low unemployment



Lack of labor market dynamism was a central problem of the 21st century

The New York Times

Fewer Americans Strike Out for New Jobs, Crimping the Recovery

By Patricia Cohen
May 24, 2016

By covered wagon and jetliner, from East Coast to West, Rust Belt to Sun Belt, Americans' propensity to be on the move – to new jobs and new places – has historically provided the economy with a critical dose of oomph.

But as fewer and fewer Americans are loading up the moving van in search of opportunity, that advantage may be slipping away. In recent years, economists have become increasingly worried that a slide in job turnover and relocation rates is undermining the

THE WALL STREET JOURNAL.

Risk-Averse Culture Infects U.S. Workers, Entrepreneurs

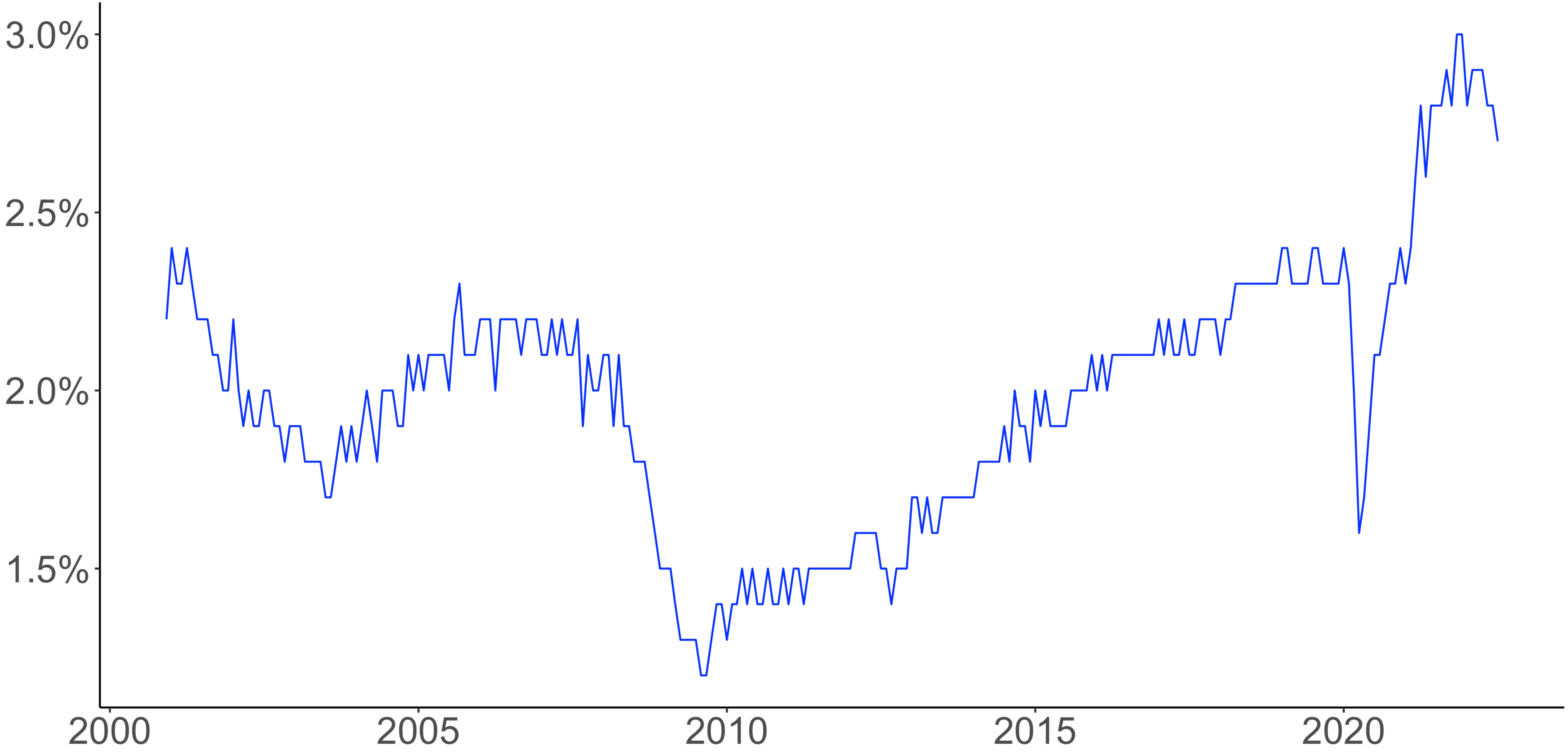
By Ben Casselman
June 2, 2013 11:02 pm ET

Americans have long taken pride in their willingness to bet it all on a dream. But that risk-taking spirit appears to be fading.

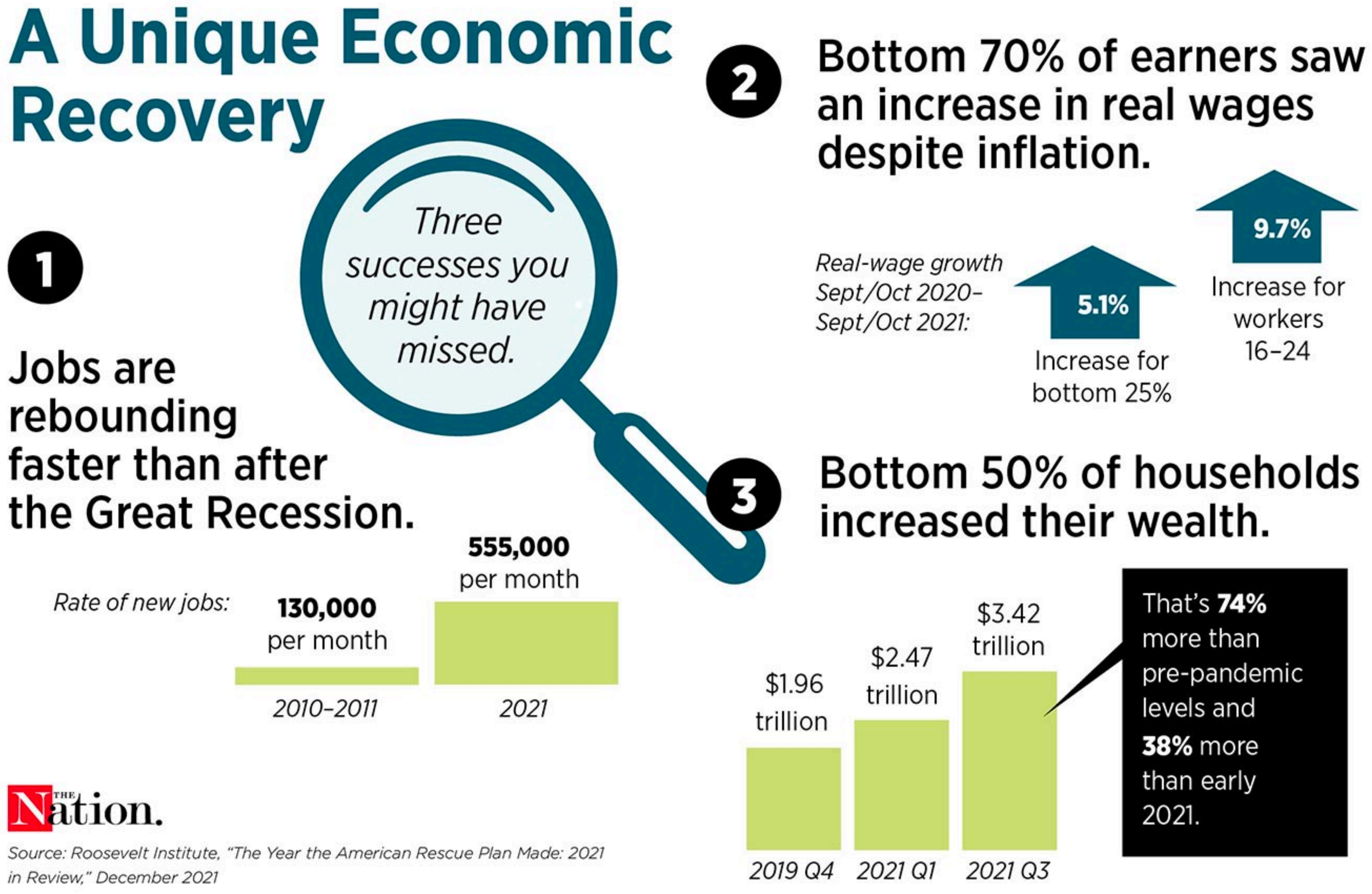
Three long-running trends suggest the U.S. economy has turned soft on risk: Companies add jobs more slowly, even in good times. Investors put less money into new ventures. And, more broadly, Americans start fewer businesses and are less inclined to change jobs or move for new opportunities.

Lack of labor market dynamism was a central problem of the 21st century - SOLVED

Quits rate:



This has broader rewards beyond simple economic metrics



However, not everyone agrees about the success of this labor market!

"While higher interest rates, slower growth, and softer labor market conditions will bring down inflation, they will also bring some pain to households and businesses […] The labor market is particularly strong, but it is clearly out of balance, with demand for workers substantially exceeding the supply of available workers."

- Federal Reserve Chair Jerome H. Powell, August 26, 2022

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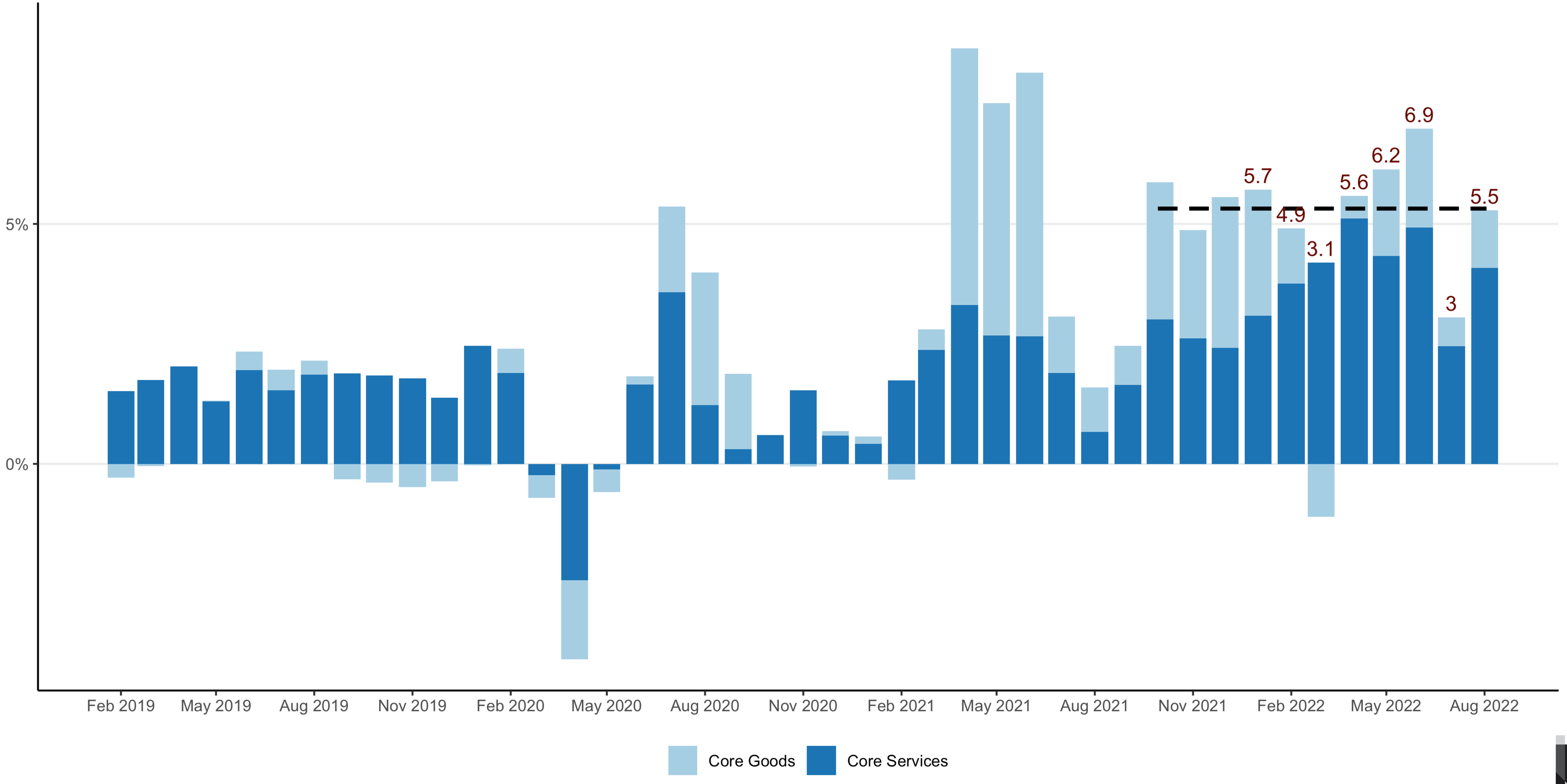
Inflation is higher, broader, and more consistent than expected, and it is a political problem



What was transitory inflation? It was the idea that inflation would be:

- confined to sectors impacted by the pandemic and reopening
- limited to categories that became more volatile from reopening, reflected in metrics that ignored outliers (e.g. trimmed mean PCE, median CPI)
- driven by the shift into goods from services; with time, inflation in goods would come down while inflation in services would be contained
- still in line with the Great Moderation, driven by a handful of categories rather than broader increases, reflected in metrics of pre-pandemic price movements (e.g. Stock-Watson's cyclically sensitive inflation)

What was transitory inflation?

(Year over year values)	2019	August 2021
Trimmed mean PCE	2	2.3
Core CPI services	3.1	2.7
Cyclically sensitive inflation	2.0	3.1

What was transitory inflation?

(Year over year increases)	2019	August 2021	August 2022
Trimmed mean PCE	2	2.3	4.7
Core CPI services	3.1	2.7	6.1
Cyclically sensitive inflation	2.0	3.1	6.5

However, that transitory inflation wasn't the correct story doesn't mean:

- That any other specific story of inflation is correct
- That the Fed needs to overreact now (or even under reacted in 2021)
- That there's evidence to believe nominal wage growth, while at a high level, is the driver of inflation

Consider:

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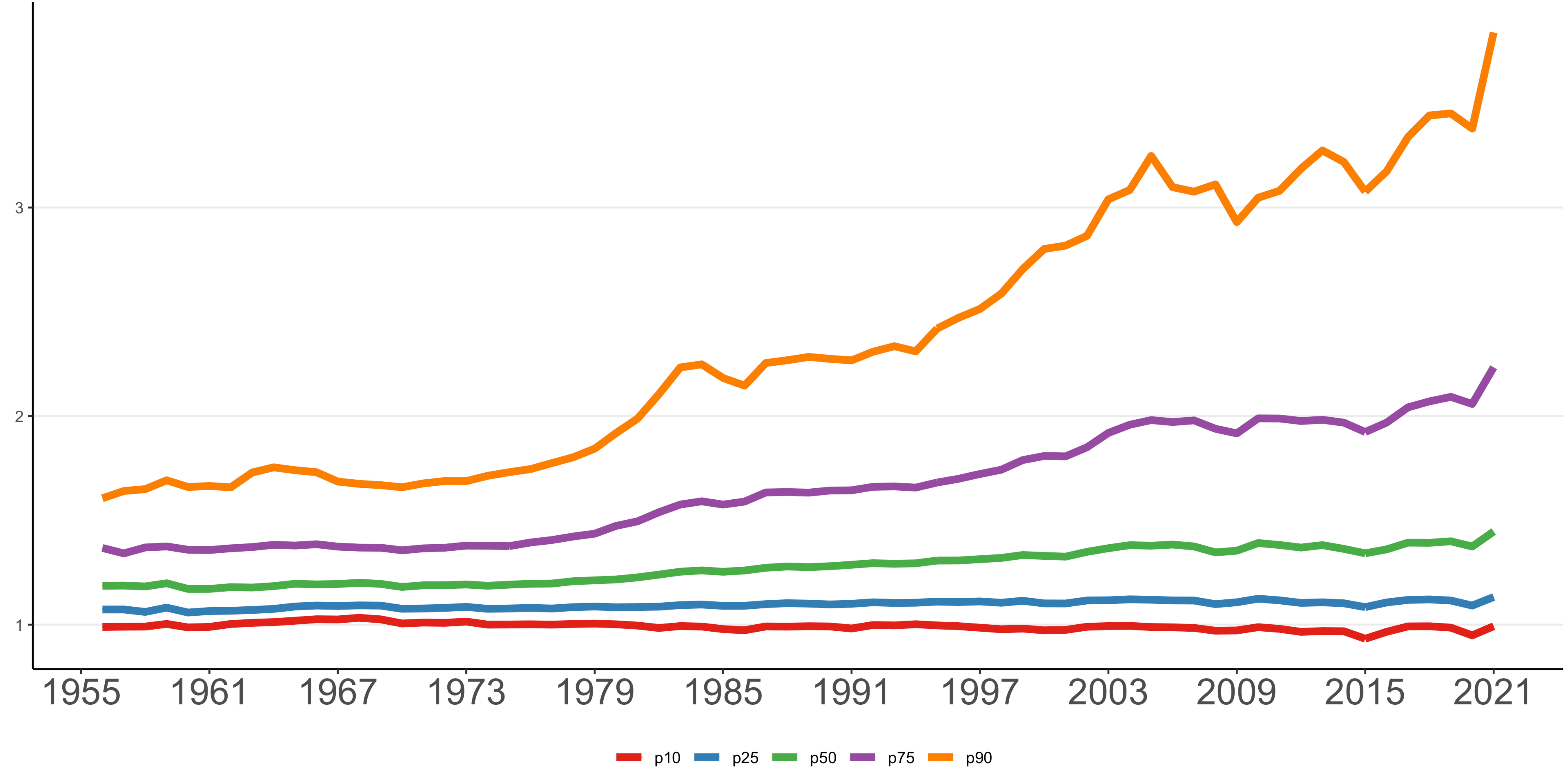
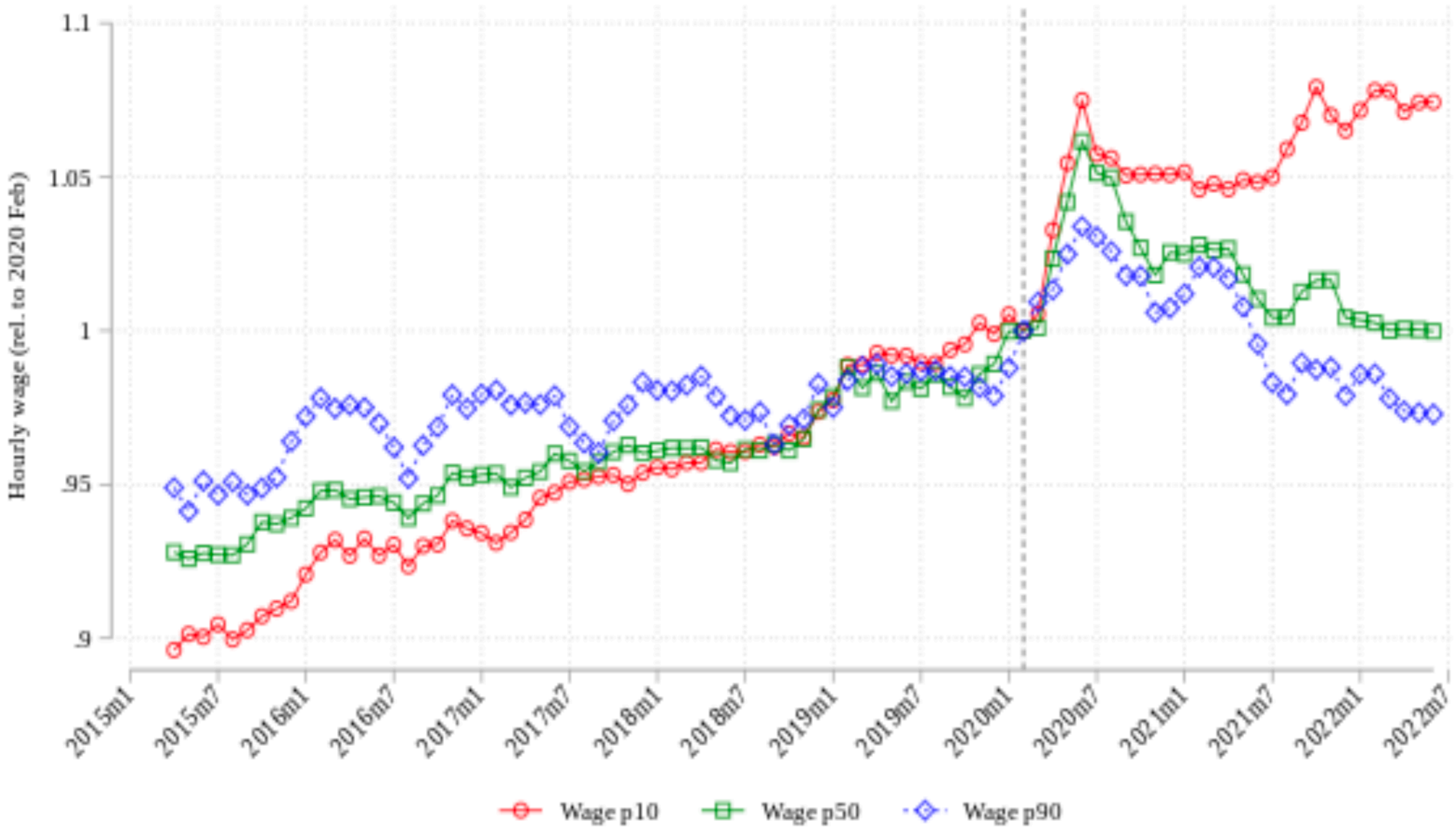
Profits have reflected corporate price increases more than labor

The sudden pandemic rise in corporate markups, especially at the top, is still a major part of the price increase for corporations

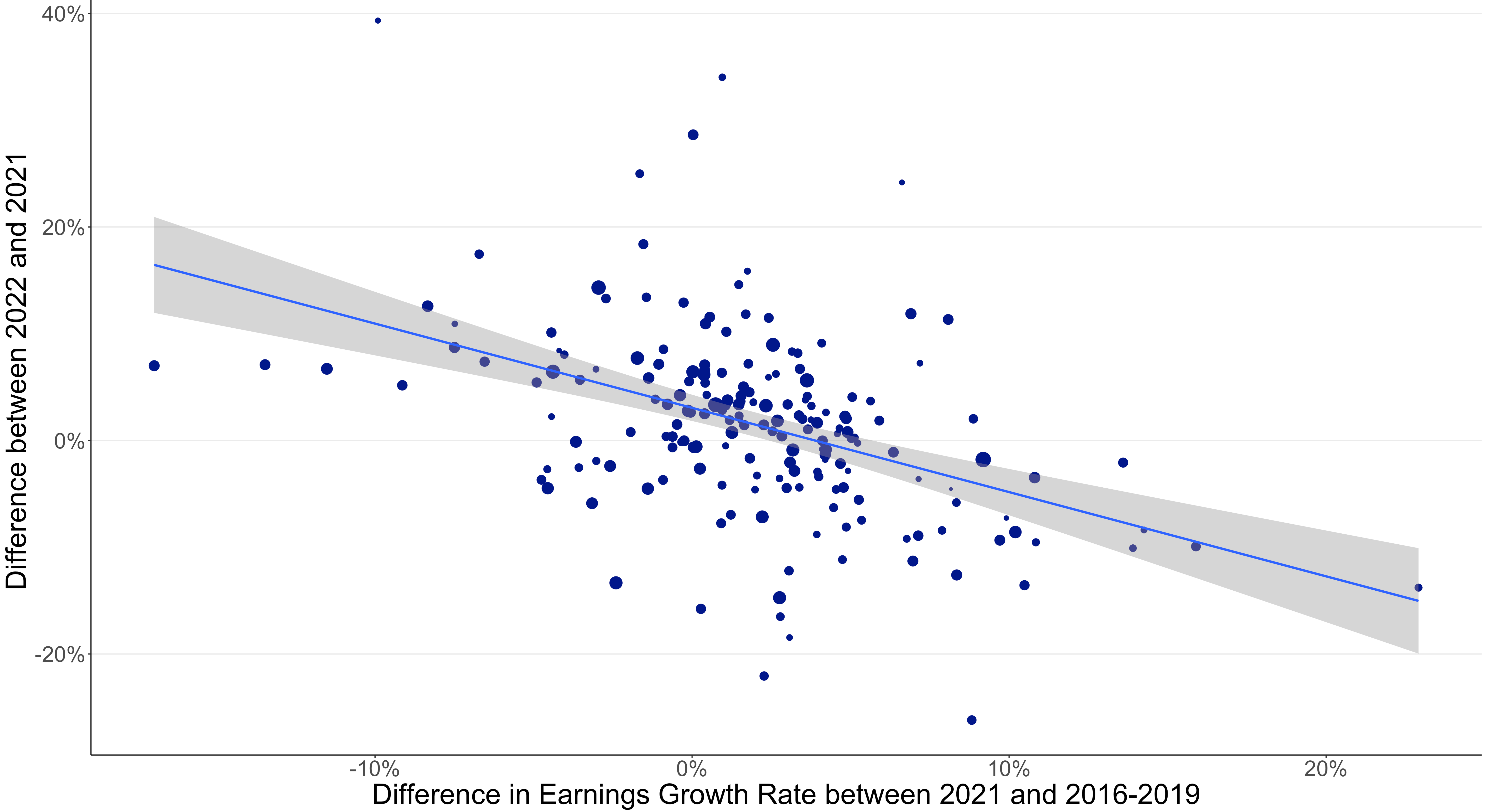


Wages may be about catch-up and a new labor floor: significant wage compression between 10th and 90th percent, real wage growth at the bottom. From Autor/Dube/McGrew

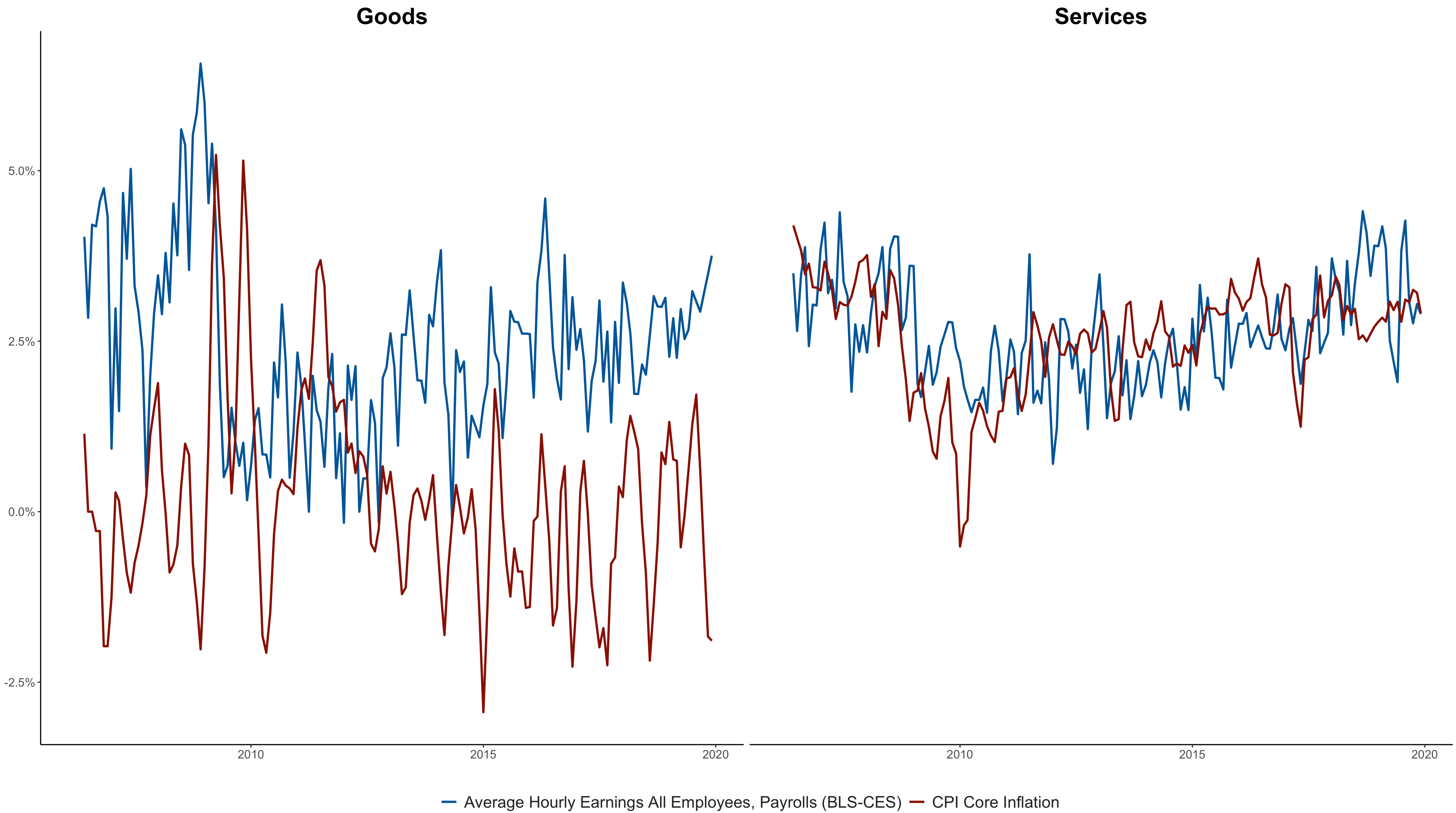
Real wage trends by quantiles (2015-2022)



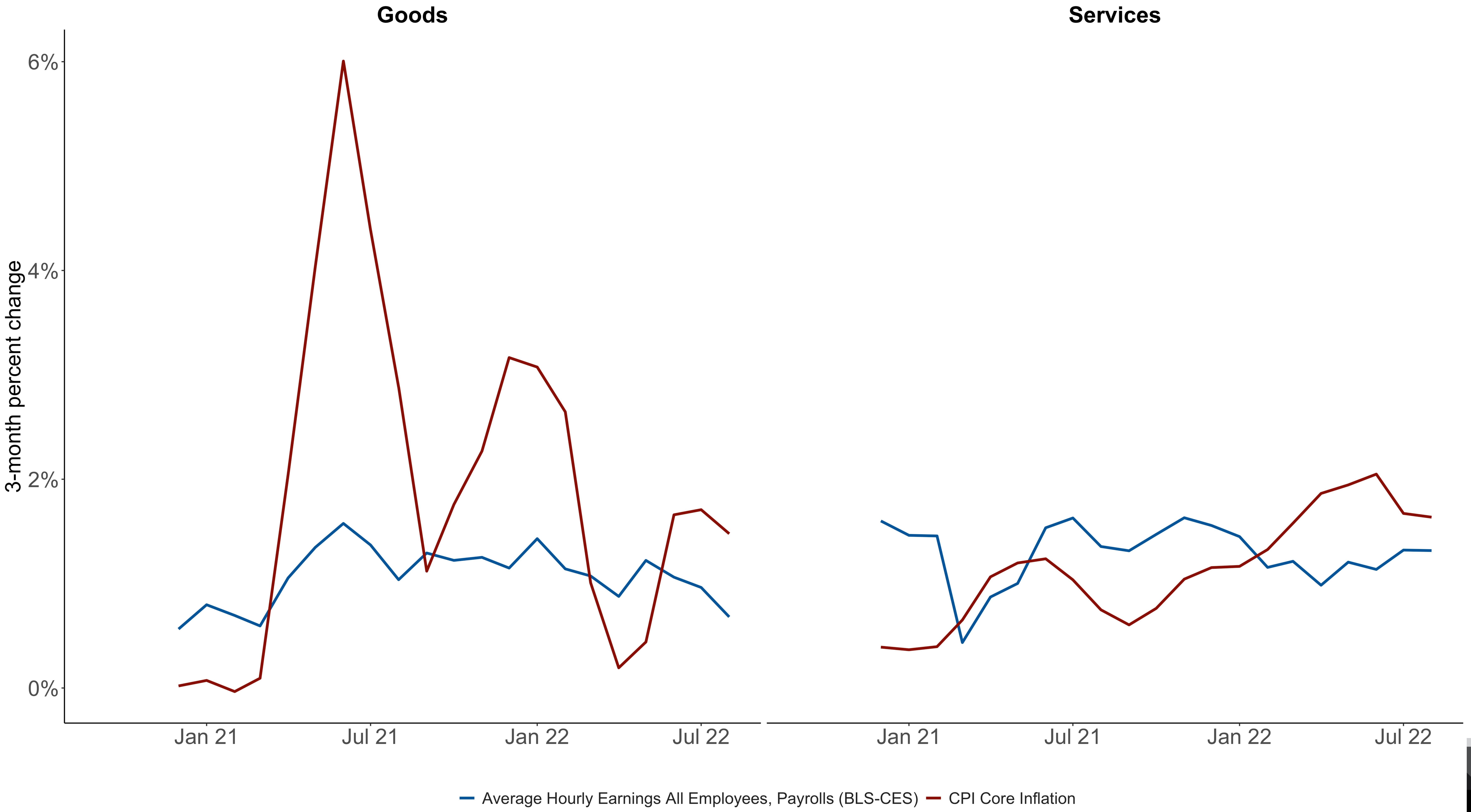
Wages may be about catch-up and a new labor floor: sub-industries with faster 2021 average hourly earnings growth saw larger decelerations in 2022



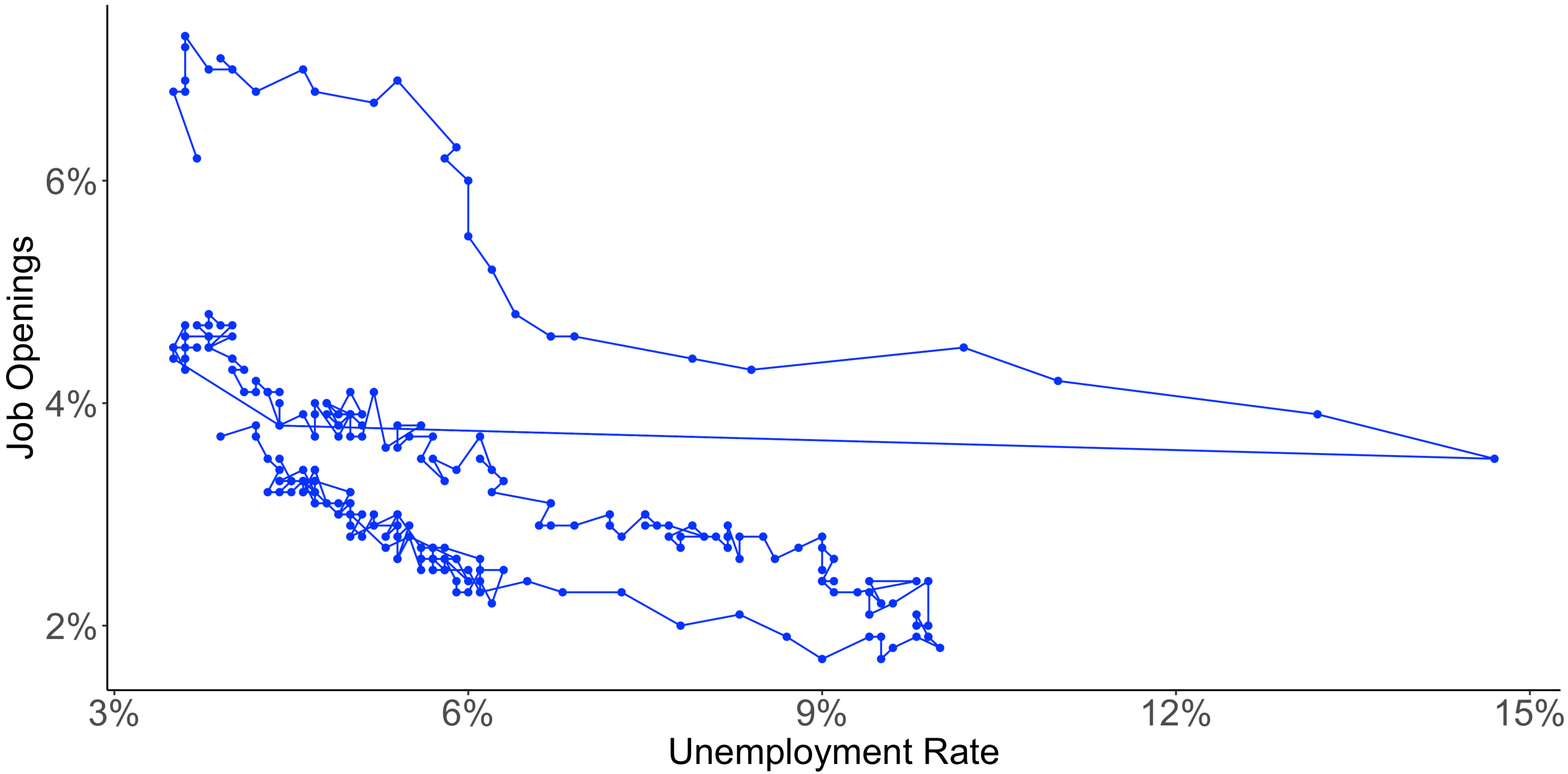
Research finds that wages matter less for goods inflation than services in recent decades



However that story isn't as clear since 2021, timing and location is off



There remains concerns about the Beveridge Curve, that there's too many job openings given unemployment:



However, consider:

- This is not a structural relationship, and instead is very influenced by Federal Reserve policy
- Job-to-job transitions are a major story in this recovery - it's why hires and quits are so high - yet they play no role in the popular analysis here
- Worse, high hire rates can increase unemployment in these Beveridge Curve analysis, and lower hire rates reflect not weaker demand but worse matching efficiency
- This matters as there's already been a weakening of demand as seen in quits and hire rates, and now job openings