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FOR DECODING LABOR MARKET, UNEMPLOYMENT RATE MAY NOT DO THE JOB

Wage growth has been muted and inflation weak, leading economists to come up with new measures of joblessness

By David Harrison
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The U.S. unemployment rate last month hit 3.7 percent – one of the lowest levels in half a century.

In theory, that should mean we're living in a very tight labor market, where workers are scarce and employers are boosting pay and benefits to attract new hires. That should push up inflation, as firms raise prices to afford higher salaries.

Instead, wage growth has been muted and inflation weak, leading economists to re-evaluate how they measure the labor market.

They've concluded the official unemployment rate is increasingly inadequate to gauge the health of the job market.

Recent research has come up with new measures that suggest the job market still has room to improve without spurring inflation. These measures imply there are more people on the sidelines who might be induced to get a job or to work more than they do now.

The Federal Reserve is paying attention. "We don't have any basis or any evidence for calling this a hot labor market," Fed Chairman Jerome Powell said Wednesday on Capitol Hill. He pointed to slow wage growth and said, "to call something hot, you need to see some heat."

For Fed officials, more slack means plenty of room to hold interest rates low or even cut them without worrying about inflation taking off.

The Labor Department's official unemployment rate only counts people who aren't working, who are available to work and who have made an effort over the past four weeks to find a job. The department publishes variants of the unemployment rate that include temporary workers who want permanent jobs, people who haven't looked for work recently but say they want jobs and part-timers who say they'd prefer full-time jobs.

But the department's estimates aren't set up to count people who have full-time jobs but who would like to work more hours or who would like to switch jobs.

Changing population trends also make it hard to compare the unemployment rate across decades. For instance, the labor force is aging, and older people are less likely to be unemployed than younger people, which pushes down the unemployment rate. Likewise, more young people go to college now rather than directly into the workforce. That means they are less likely to be looking for work now than a generation ago.

"We've treated the unemployment rate as though it were a sufficient statistic for the state of the labor market and I don't think that's right," said Katharine Abraham, a University of Maryland economist and former commissioner of the Bureau of Labor Statistics.

Ms. Abraham and her co-author, John Haltiwanger, also of the University of Maryland, have created a labor-market assessment that takes into account people who aren't in the labor force but want to work and those with jobs who are looking for new opportunities. They also attempt to measure how intensely employers are looking for workers.

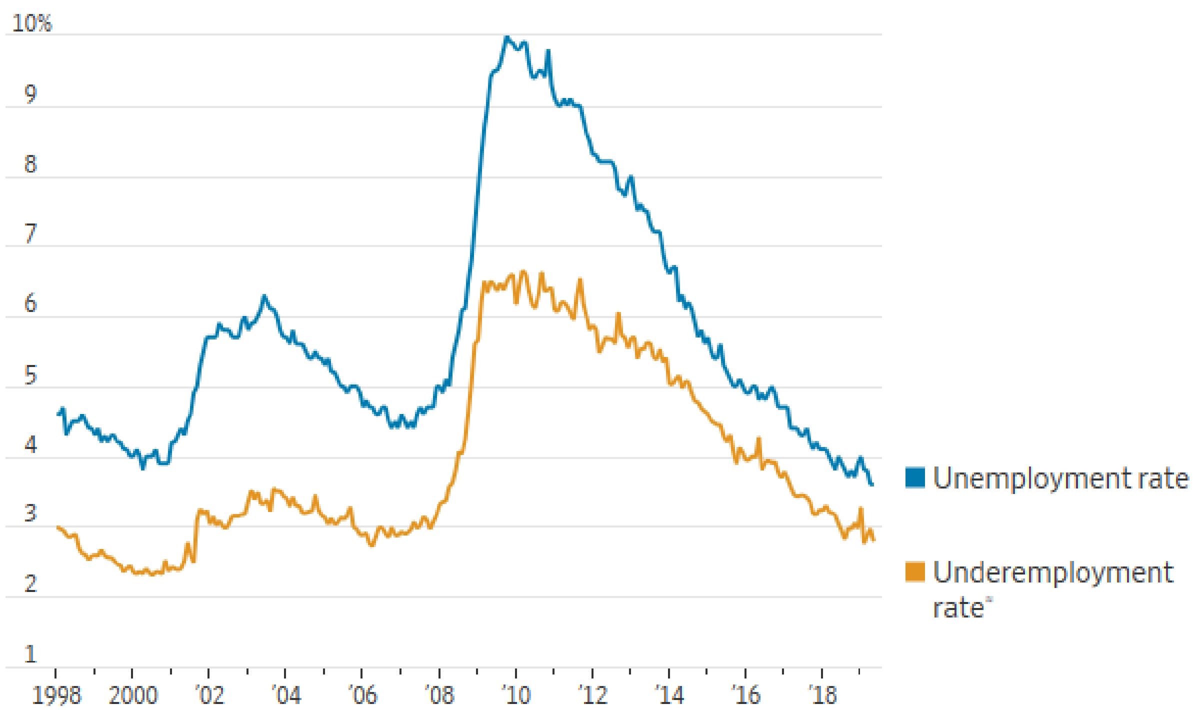
Compared with the official rate, their measure suggests a less volatile labor market, one that didn't contract quite as much during the recession and one that hasn't improved quite as much since.

Other economists take a different approach. Economists David Blanchflower, of Dartmouth College, and David Bell, of the University of Stirling, examine part-time workers who would prefer a full-time job as a share of overall employment.

Their measure of underemployment suggests the U.S. labor market hasn't fully recovered from the recession, as the part-timers who want full-time work still make up a bigger segment of the overall workforce than they have historically. That explains why wage growth has been relatively tepid, they write.

Tight Market?

The underemployment rate has not yet hit its most recent low point even though the unemployment rate has.



*The Bell-Blanchflower underemployment rate shows part-time workers who want full-time jobs as a share of all employed workers.

Sources: Labor Department (unemployment); Bell and Blanchflower (underemployment)

“What you need to explain is why weak wage growth exists and a variable like unemployment is not going to explain [that],” Mr. Blanchflower said in an interview.

Fed economists have also come up with new gauges of the labor market.

Regis Barnichon, of the Federal Reserve Bank of San Francisco, and Geert Mesters, of the Barcelona Graduate School of Economics, recently developed a version of the unemployment rate that takes the aging of the population into account which, as of early 2017, indicated there was still room for the labor market to improve.

Carlos Zarazaga and Emil Mihaylov, of the Dallas Fed, developed another way of accounting for an older population by looking at how much time people spend at work based on their age. They found that after adjusting for demographic changes, Americans in aggregate are devoting fewer hours to work than before the recession, leading them to conclude the labor market was not “overly tight.”

These new measures could become more influential with policy makers if the current environment of weak wage and inflation growth combined with a low unemployment rate persists.

That would represent a validation for officials such as Minneapolis Fed President Neel Kashkari, who has long argued that the standard unemployment rate can’t explain current conditions.

“The unemployment rate lately has falsely signaled that maximum employment was near, even though millions more jobless people still wanted to work,” he wrote in a Wall Street Journal op-ed piece in May. “Labor-market watchers must retool their methods.”