
Economic Outlook For the US: What will the recovery look like and what will it mean for jobs?

Women in Government
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* The views expressed herein are my own and do not necessarily represent those of the Federal Reserve Bank of Chicago or the Federal Reserve System.

Presentation Road Map

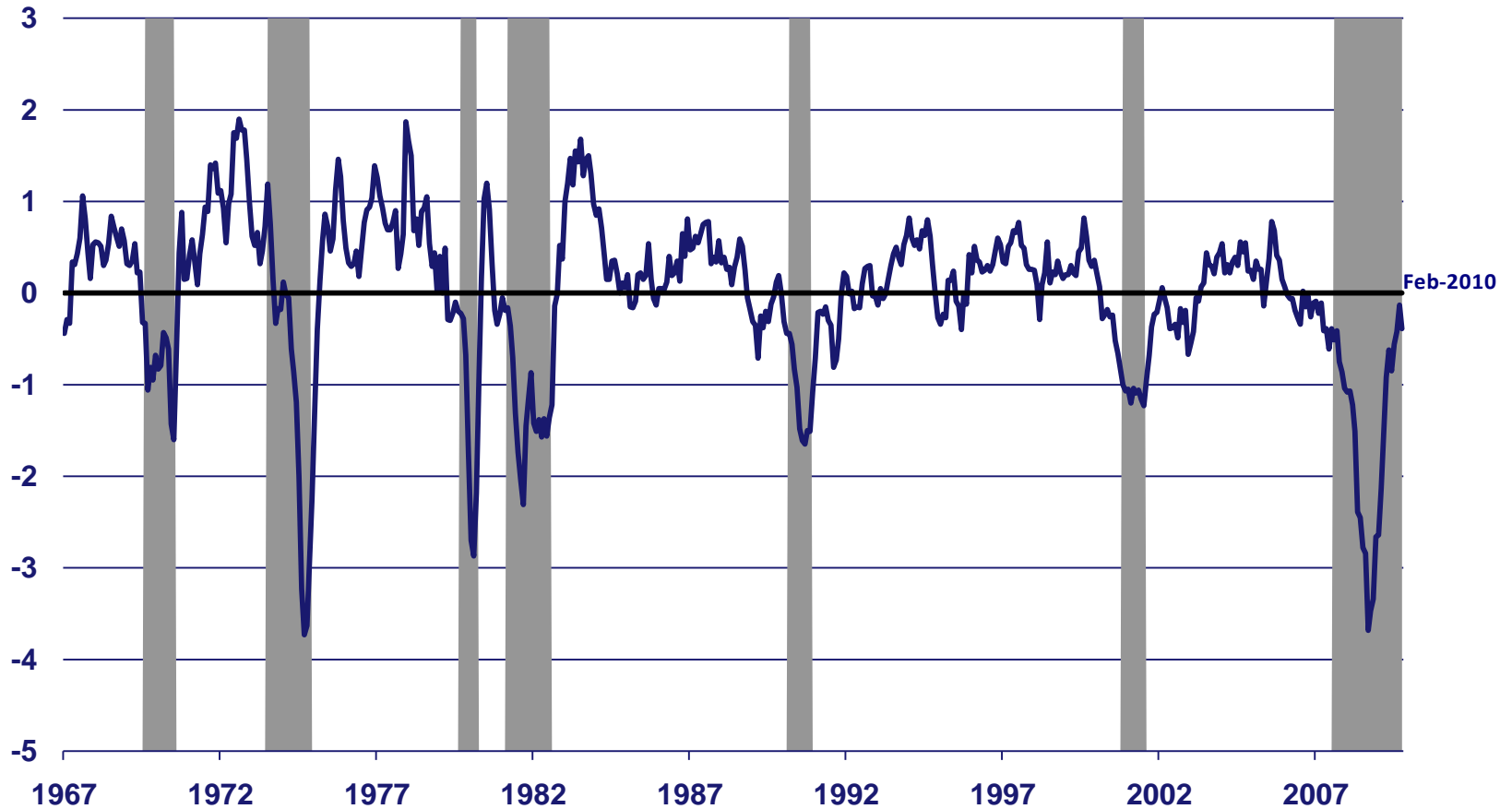
- **Understanding The Great Recession**
- **What will the recovery look like?**
- **A special look at labor market recovery**

Economic Activity—

The Recession is Likely Over, GDP up 5.6% in 4Q, 3.2% in Q 1

Chicago Fed National Activity Index

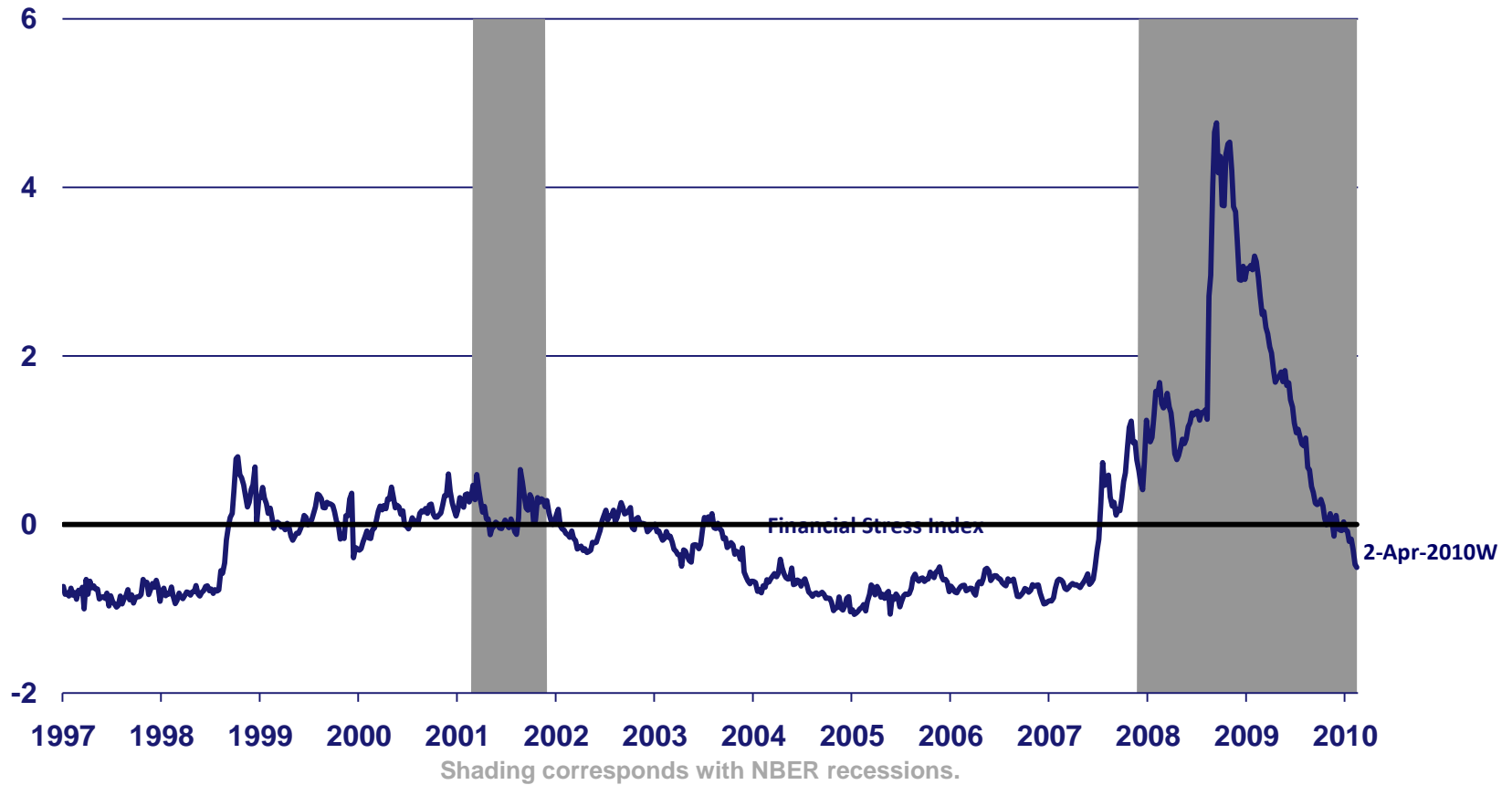
(standard deviation from trend, 3-month average)



Financial Conditions

Financial Stress Index

(deviation from trend)



* Financial Stress Index combines information from 30 variables measuring stress in Treasury, Corporate Bond, Equity, Interbank, CP and RP markets.

Possible Scenarios For Economic Recovery

V -Shaped recovery

- Deep recessions tend to be followed by steep recoveries
- Significant monetary and fiscal stimulus could reinforce this

-Shaped recovery

- Most forecasters see headwinds that make the recovery slower
- Businesses hesitant to invest given forecast uncertainty
- Consumers likely glum over job prospects and lost wealth
- Even with lower financial stress, credit still somewhat tight

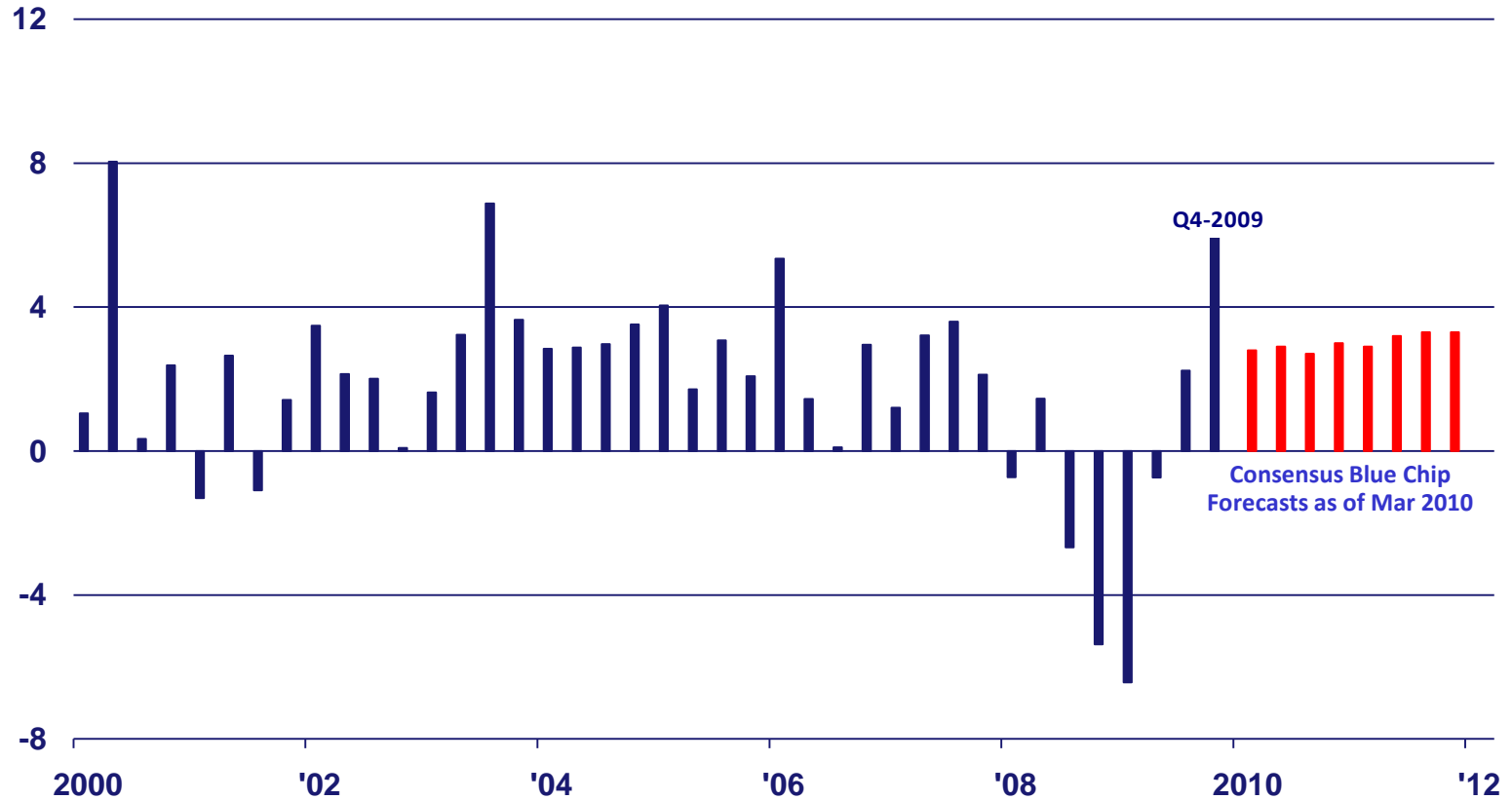
W -Shaped recovery

- Some forecasters expect a relapse once stimulus ends

Economic Growth

Real GDP Growth

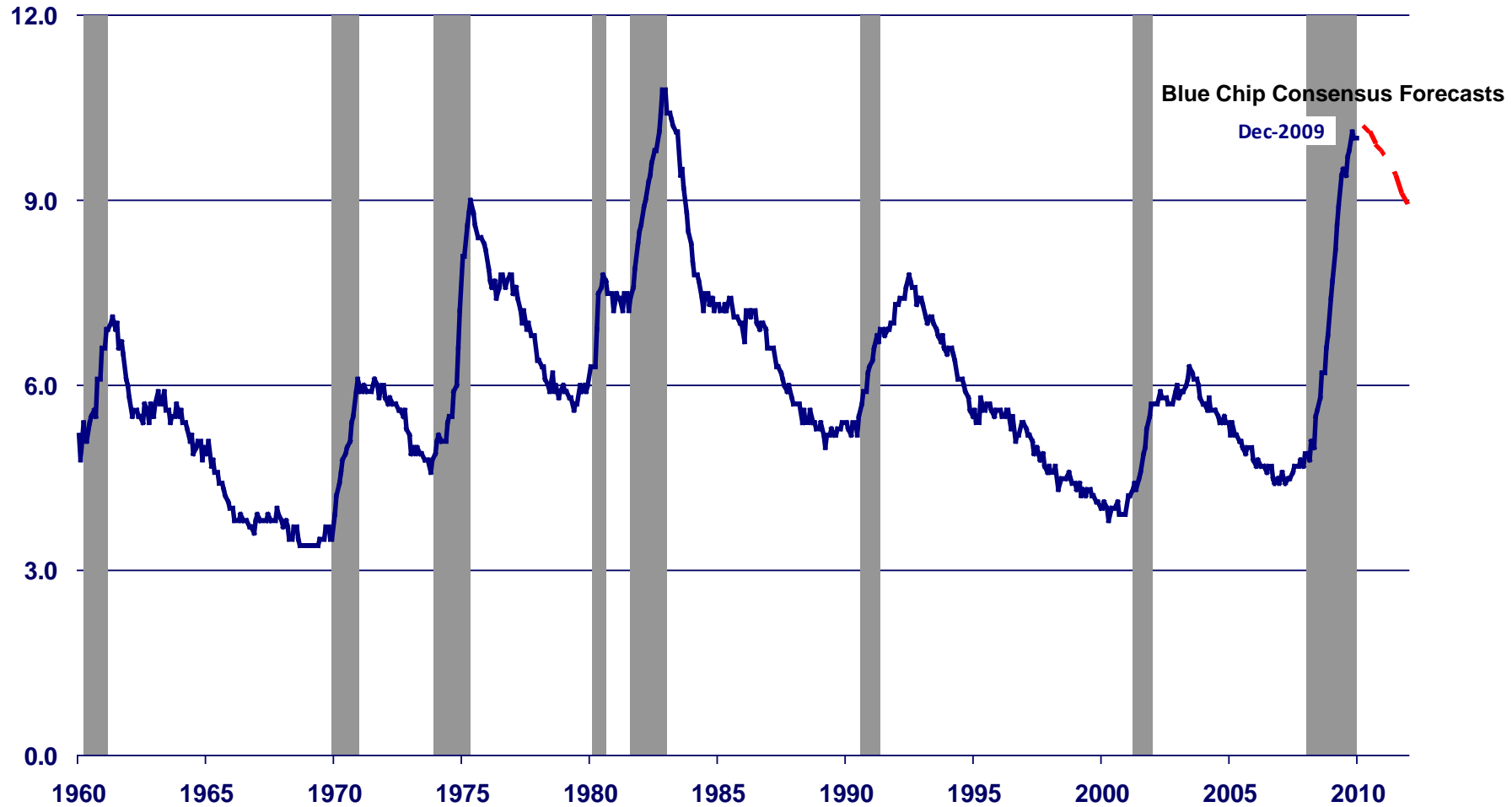
(percent change, annual rate)



Unemployment

Unemployment Rate

(percent)



Why was this recession so different?

- **One word—“leverage”**
- **Why will the recovery be so different?**
 - One hyphenated word—de-leverage
- **Big issue—repricing risk**
- **The New Normal**

CDOs of subprime mortgage backed securities

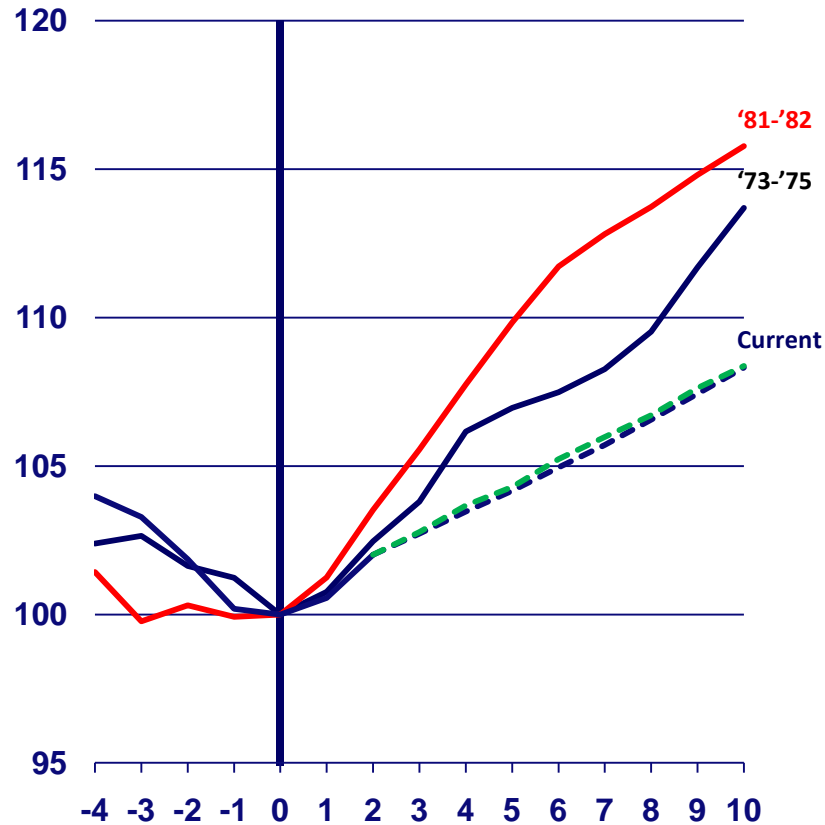
(issued 2006-07, McKenzie)

	Estimated 3-year Default Rate	Actual Default Rate
AAA	0.001	0.10
AA+	0.01	1.68
AA	0.04	8.16
AA-	0.05	12.03
A+	0.06	20.96
A	0.09	29.21
A-	0.12	36.65
BBB+	0.34	48.73
BBB	0.49	56.10
BBB-	0.88	66.67

Recession Comparisons

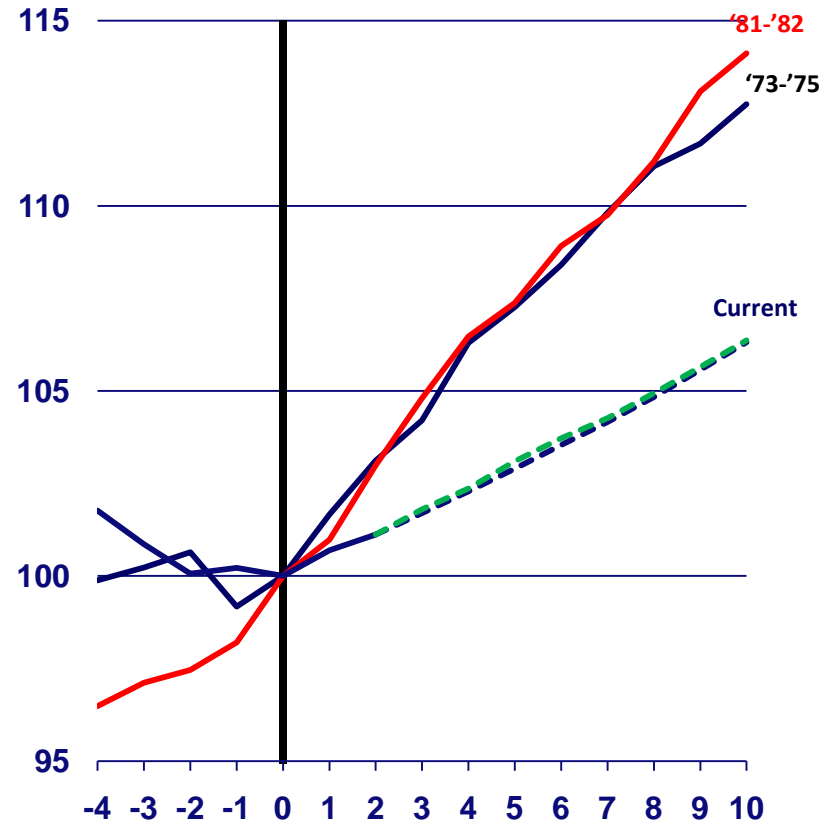
Real GDP

(Quarterly, 100 = Recession Trough)



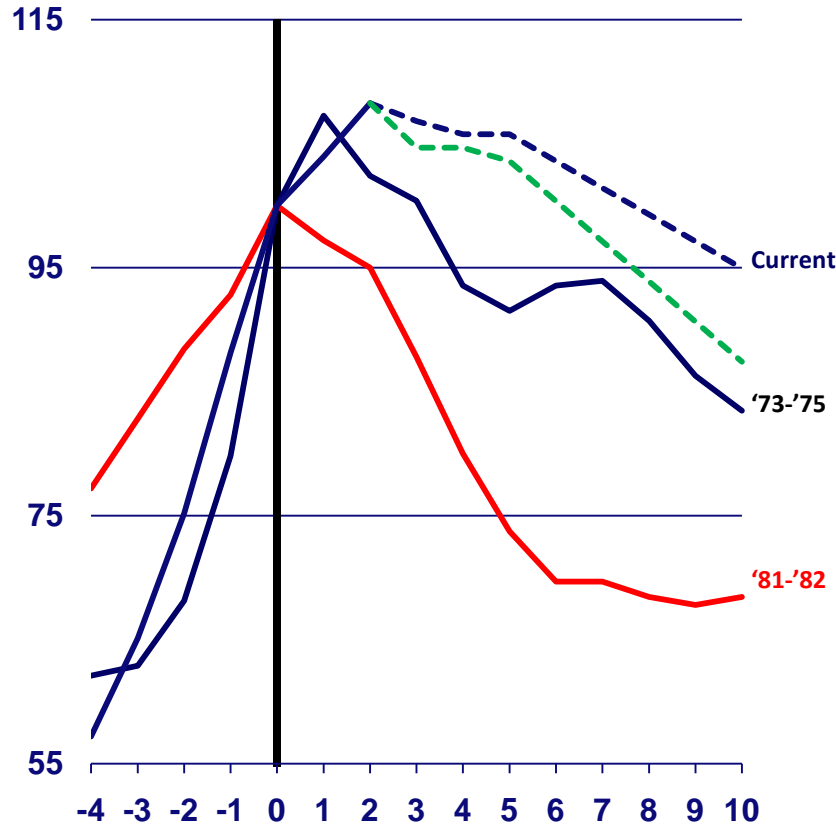
Real PCE

(Quarterly, 100 = Recession Trough)

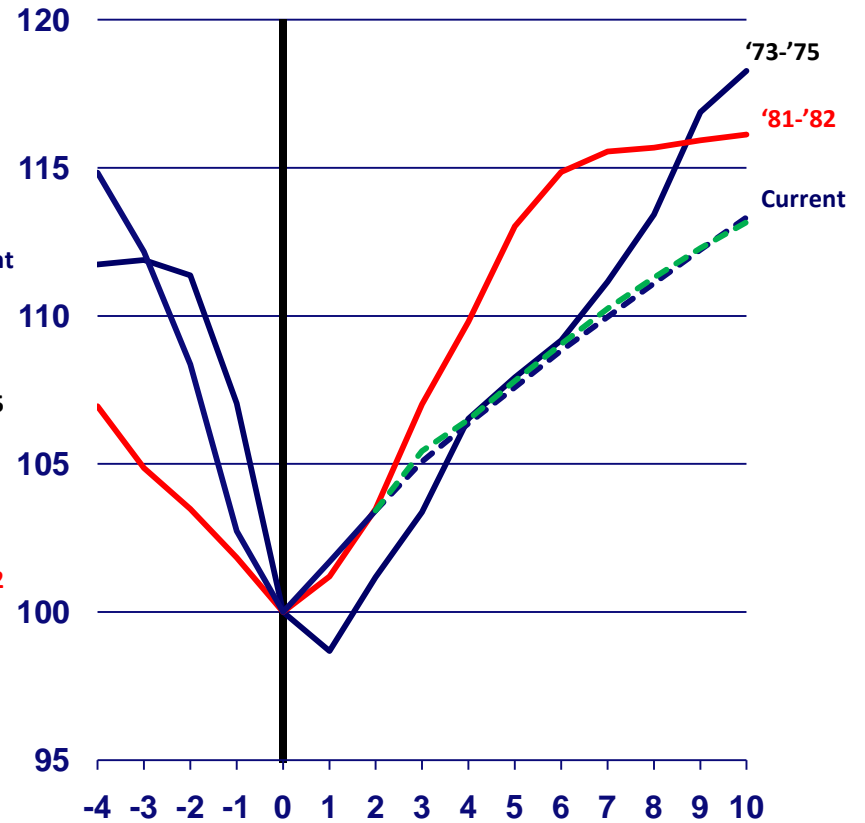


Recession Comparisons

Unemployment Rate
(Quarterly, 100 = Recession Trough)



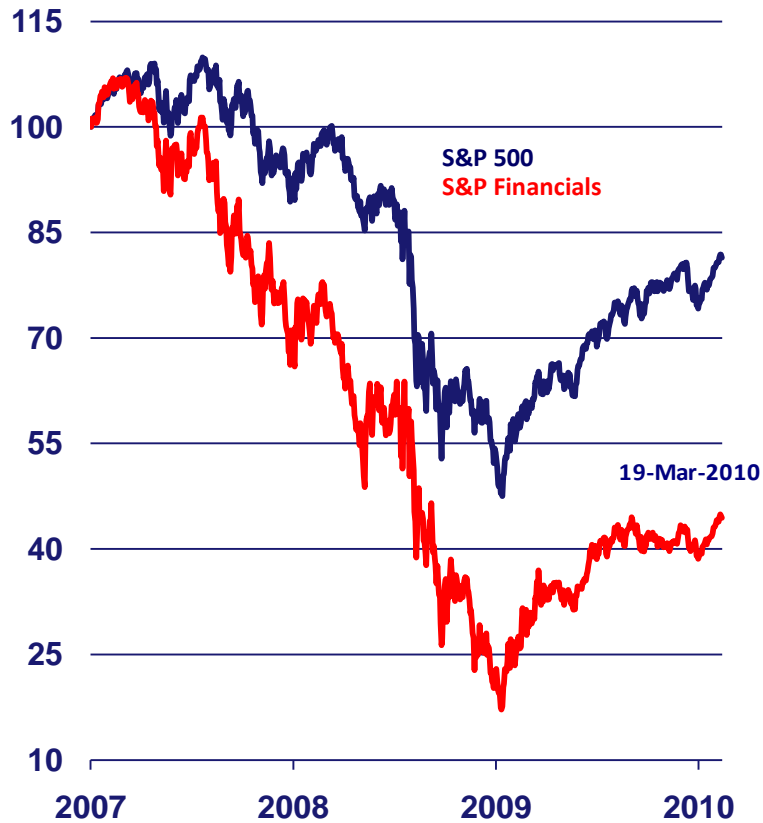
Industrial Production
(Quarterly, 100 = Recession Trough)



Household Wealth and Income

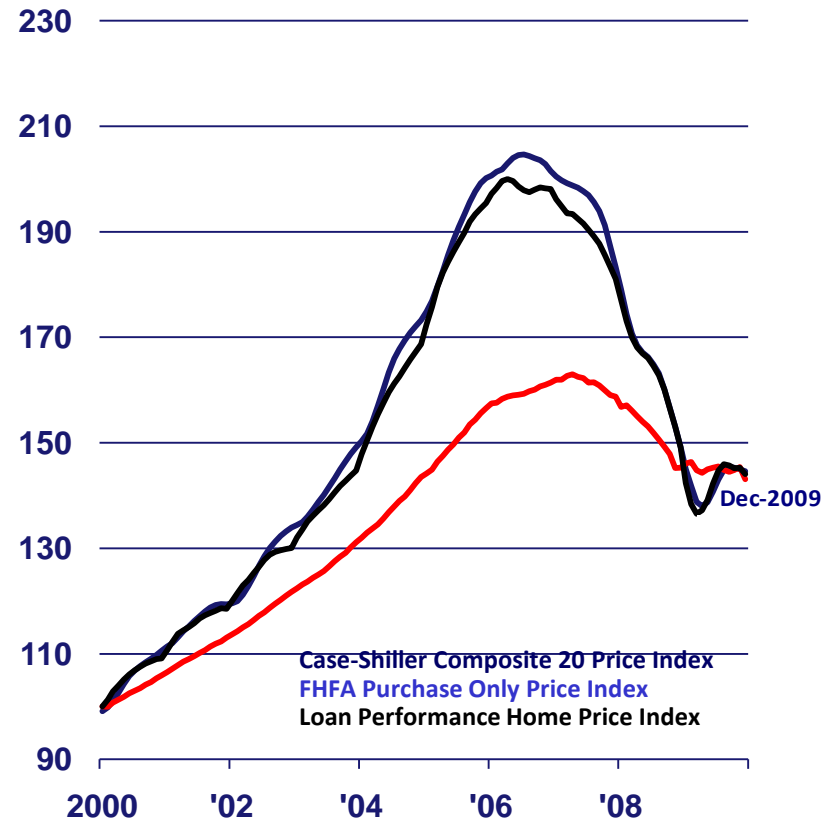
S&P 500 and S&P Financials

(Index: 100=4/2/2007)



Home Price Indexes

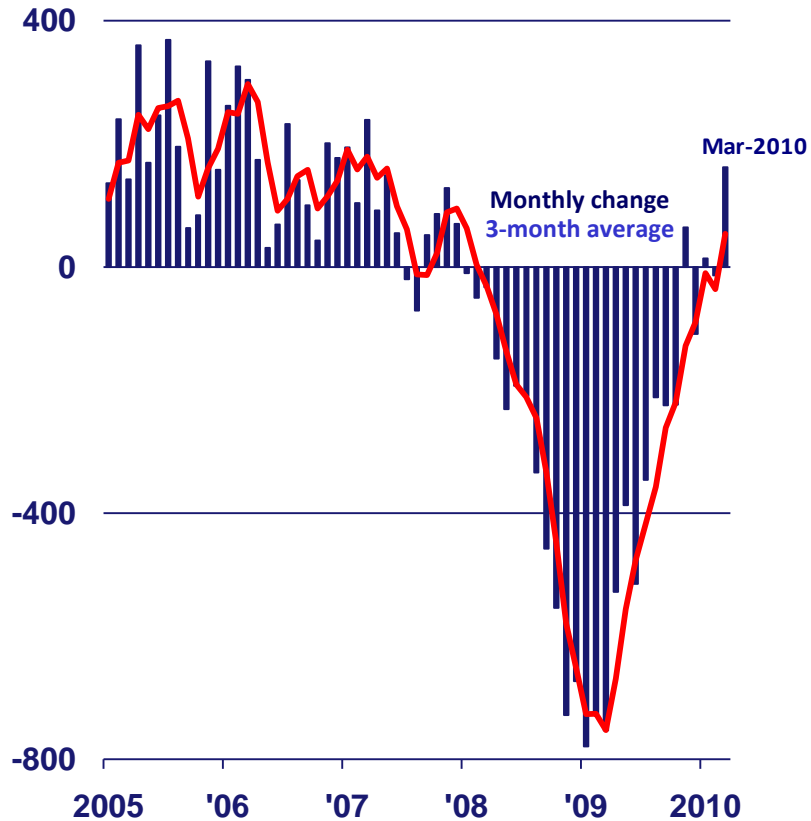
(Q1-2000=100)



Labor market improvement?—Feb +32 K, March +230K, April +290K

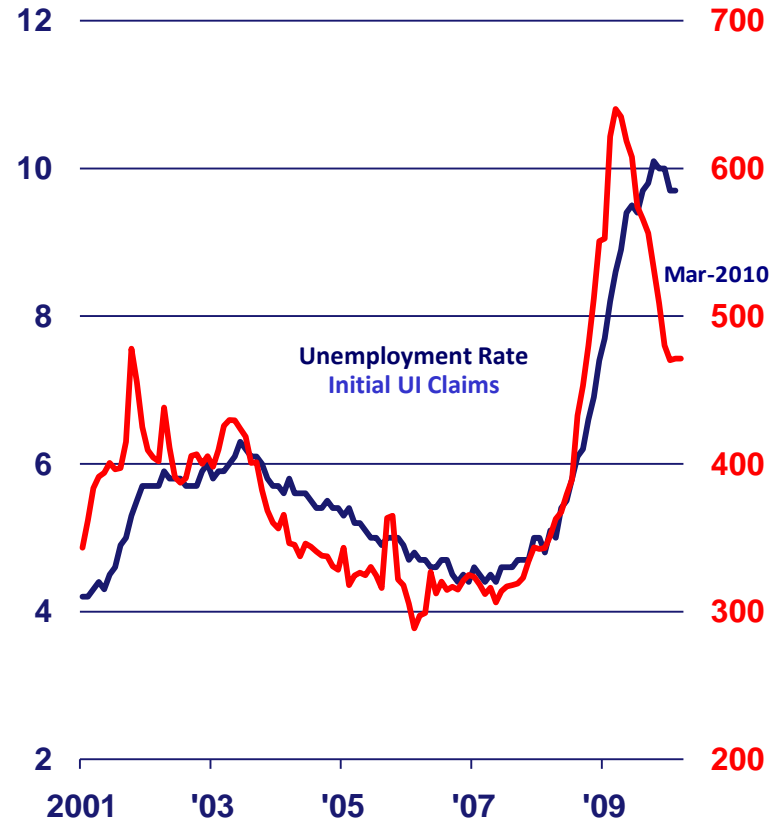
Nonfarm Payroll Employment

(change, thousands)



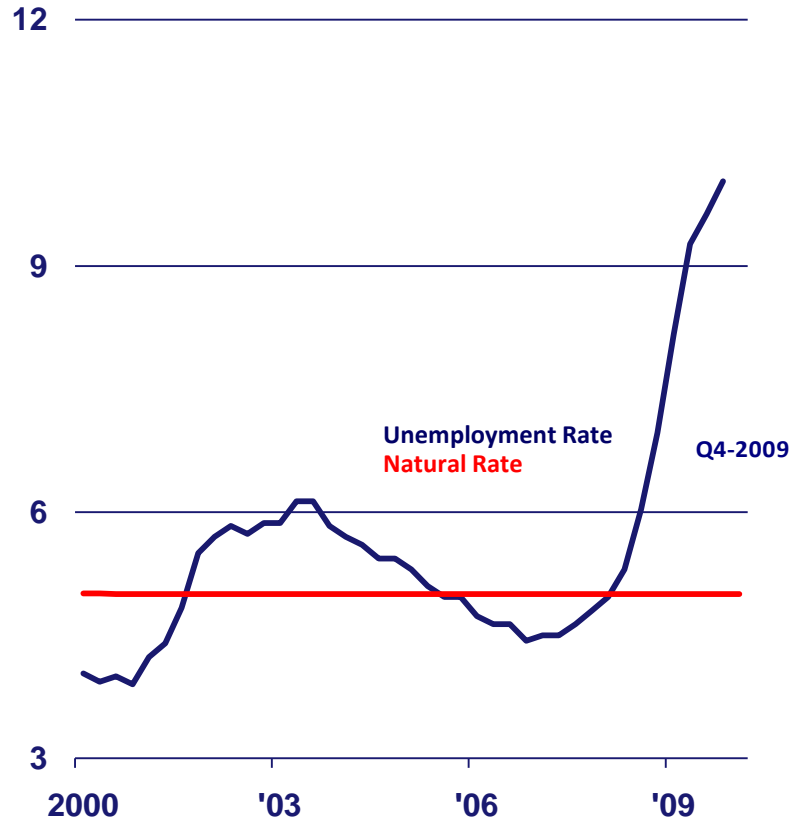
UI Claims and the Unemployment Rate

(4-week MA; percent of labor force 16 and over)

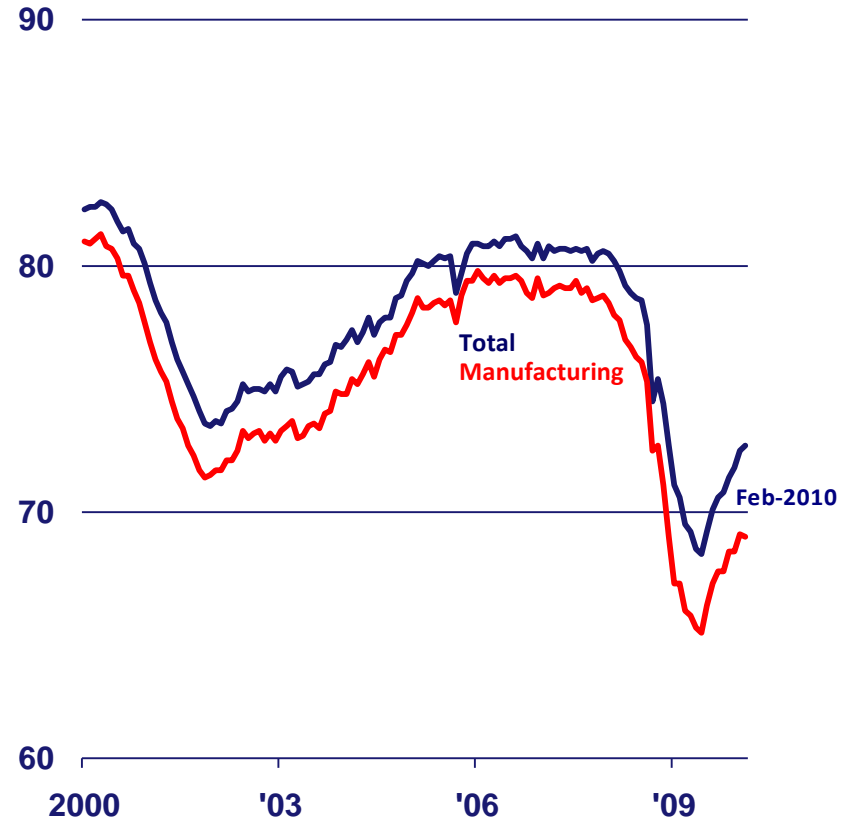


Economic Slack

Unemployment and Natural Rates (percent)



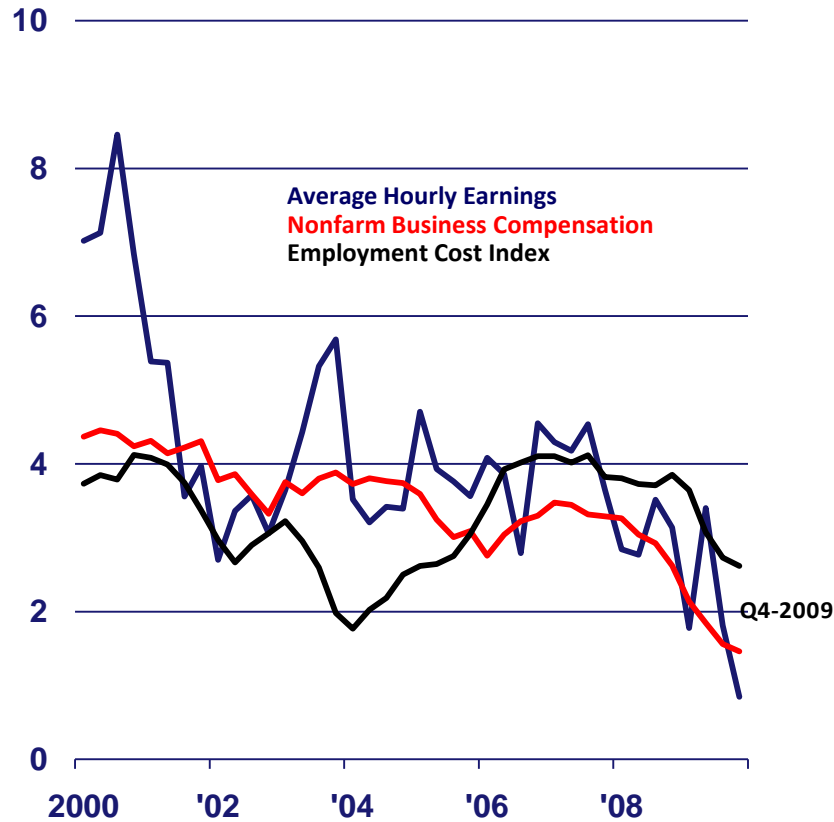
Capacity Utilization (percent)



Wage Growth

Wages

(4-quarter percent change)



Unit Labor Costs

(4-quarter percent change)



A Special Word About Labor Adjustment

- **The path out of the 2001 recession was muted for labor. Private sector job growth in the 2001-2007 expansion averaged 1 million per year. In the two prior expansions job growth averaged 2.4 million and 2.2 million. (This wasn't because of slower labor force growth)**
- **This has translated into an absolute loss in private sector jobs for the first time since the Great Depression. By August of 2009 there were 1.3 million fewer jobs than had existed in 1999.**
- **More pressure on the way. BLS estimates that the US labor force will grow by 1.3 million per year between 2006 and 2016. We need to add 1.3 million jobs per year just to keep up with the labor force growth**

Is the jobless recovery the new model?

- **First noticed in the 1990-91 recession. After the recovery began it took a full 11 months before job losses reversed**
- **Even worse in 2001 recession. A very mild recession—lasted 8 months. During the recession 1.9 million jobs were lost, HOWEVER, during the first 19 months of the recovery another 1.3 million jobs were lost**
- **Why? Business is managing its labor cost more aggressively and in some industries out-sourcing**
- **Structural vs cyclical unemployment—losses in construction and manufacturing may be hard to reverse—permanent decline in earnings?**
- **Housing bust makes it harder for people to move—less mobility**
- **Extended Unemployment Insurance as a two edged sword**

Changing composition of losses (US BLS)

Recession	Total	Goods Producing #	Goods Producing %	Private Service #	Private Service %
July 1981- Nov. 1982	-2.626(m)	-2.566 (m)	97.7	-60 (thousand)	2.3
July 1990- March 1991	-1.168	-.955	82.6	-.203	17.4
March 2001- August 2003	-3.289	-2.704	82.2	-.585	17.8
Dec. 2007- August 2009	-7.047	-3.474	49.2	-3.573	50.7

And now for something really depressing...

- **“America’s New Post-Recession Employment Arithmetic”, James Hughes and Joseph Seneca, Rutgers University**
- **Authors calculate that the Job “deficit” by December of 2009 will be 9.39 million (Job losses plus lack of new job creation)**
- **If the recovery takes hold and private sector job growth hits the average for the 1991-2001 recession (2.15 million per year) when combined with natural labor force growth we will erase these employment losses in....**

The Rutgers scenerio

■ **AUGUST 2017!**

What else will be different this time?

- **Small business hiring will be muted. This sector of the economy is still finding it hard to access capital. Adding staff will be hard if they can't borrow to grow their business**
- **Large business appears to be snapping back (at least in terms of profits) but are reluctant to hire. They have grown use to managing labor costs more actively and seeking increased profits through productivity. Also move to service economy encourages this as labor becomes a larger and larger share of production costs**
- **Government sector faces structural imbalance. Revenues aren't keeping up with program demands. Hard time simply replacing existing staff let alone adding new staff.**

What can be done?

- **In the long-run its all about education and training. The higher the skill level, the less likely to be unemployed. Up-skilling is found across all professions.**
- **In the short-run, managing the transition for the unemployed. If the cause is structural unemployment, can existing skills be adapted to growing or emerging industries (Midwest effort to take auto and manufacturing workers into green industries or turning construction workers into home and office energy efficiency rehabilitation specialists)**
- **Bigger issue is better Labor Market Information. Much of the information is supply side driven. It measures who the existing workers are and what the existing training programs produce. Need more demand side analysis. What are firms looking for? What skills do they need? Skills certification**
- **Tax credits—mixed evidence—hard not to simply reward firms that would have hired anyway.**

Summary

- **A relatively slow recovery is likely underway**
 - Monetary and fiscal stimulus are supporting this
 - Tight credit conditions, lingering uncertainty, and need for balance sheet repair are significant headwinds

- **Labor is looking for a new normal**
 - Unemployment will come down slowly
 - A new “natural rate” of unemployment
 - Most effective strategies for reducing unemployment may not be very sexy—reducing friction in the labor market and improving labor market matching. Need to understand skill and job demand as much as who is unemployed and why.