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The Many Faces of Unemployment

by Craig D. Hafer, President

June marked the 10th anniversary of the Great Recession of 2007-2009. Yet, as Barron's magazine lamented, one would be hard pressed to find much attention given to commemorating this anniversary, or more importantly, how much stronger the U.S. economy is today. Housing prices have rebounded, consumer confidence is higher, corporate profits have grown, and the unemployment rate has fallen from its high of 10% in October 2008 to 4.3% in May 2017. The turnaround in the U.S. economy has contributed to investors' confidence in the stock market. From June 30, 2009 to June 30, 2017, the S&P 500 Index grew 164%. With an improving economy, there has been some concern regarding the prospect of higher inflation, due to increased consumer spending driving up prices on many goods and services. However, the bond market has been lowering its inflation expectations, causing long-term interest rates to fall. We believe the reason that inflation may not be a problem in the short-term has a lot to do with the unemployment rate.

Today's unemployment rate, or headline unemployment rate, as it is officially called, is calculated by the Bureau of Labor Statistics (BLS). The number is reported monthly and has long been considered a gauge of the health of the U.S. labor market and the strength of the overall U.S. economy. While the headline figure is often reported, it is seldom discussed that the headline number is just one of six calculations made each month by the BLS. The reason that there are six unemployment numbers has much to do with how the unemployment figure was first tabulated.

The first unemployment rate was calculated in the 1870's by the Massachusetts Bureau of Statistics of Labor, who, under the direction of Carroll D. Wright, set out to measure joblessness while excluding people he considered "malingerers." The survey asked town assessors to estimate the number of local people out of work. However, Wright added a crucial qualification: to count only adult men who "really want employment."

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Wright went on to become the first commissioner of what is now the BLS, and when the U.S. government finally started measuring unemployment on a monthly basis in 1940, it was with the same guideline that a person didn't count as unemployed unless they really wanted to work. Since that time, the BLS has wrestled with determining what defines "unemployed." To provide greater clarity, the BLS created 6 different measures of unemployment: the headline/ official unemployment rate (U-3) along with U-1, U-2, U-4, U-5, and U-6.

Measure	(%, Seasonally adjusted)					
	May 2016	Jan. 2017	Feb. 2017	Mar. 2017	Apr. 2017	May 2017
U-1 Persons unemployed 15 weeks or longer, as a percent of the civilian labor force	1.9	1.9	1.8	1.7	1.7	1.8
U-2 Job losers and persons who completed temporary jobs, as a percent of the civilian labor force	2.3	2.3	2.3	2.2	2.2	2.1
U-3 Total unemployed, as a percent of the civilian labor force (official unemployment rate)	4.7	4.8	4.7	4.5	4.4	4.3
U-4 Total unemployed plus discouraged workers, as a percent of the civilian labor force plus discouraged workers	5.0	5.1	5.0	4.8	4.7	4.5
U-5 Total unemployed, plus discouraged workers, plus all other persons marginally attached to the labor force, as a percent of the civilian labor force plus all persons marginally attached to the labor force	5.7	5.8	5.7	5.4	5.3	5.2
U-6 Total unemployed, plus all persons marginally attached to the labor force, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all persons marginally attached to the labor force	9.7	9.4	9.2	8.9	8.6	8.4

Source: Bureau of Labor Statistics website

When Wright's team first tabulated the unemployment rate, there was no such thing as government benefit programs for the unemployed. The purpose of the count was to figure out how many potential workers were available to help the economy grow. During WWII, the government's main goal when calculating the unemployment rate was to see if there were enough people to fill all the jobs that a wartime economy required. It is only since the latter part of the 20th century, as entitlement programs have grown, that there has been much attention given to how many people are collecting some sort of government subsidy because they are not in the work force.

During the presidential election, the Obama administration was criticized for using the headline unemployment rate to underestimate the actual number of unemployed people. Critics argued that publicizing only the headline unemployment rate overshadows the other data that the BLS generates, and that there are other statistics that more accurately reflect the state of unemployment, such as the number of people working relative to those eligible to work (the labor force participation rate.) During the Great Recession, the labor force participation rate fell from 67.3% to 62.7%. While most economic indicators have shown signs of a turnaround, this rate remains near historic lows.

Economists have pointed out that the decline in the labor force participation rate has a lot to do with the aging U.S. population. What is apparent, however, is that there are more non-working people than the headline unemployment rate would lead one to believe. What is unclear is whether the headline unemployment rate has fallen enough to cause inflation, or will the labor participation rate need to increase *first* for there to be any significant level of inflation?

For investors, low inflation means lower interest rates, which help corporate profits to grow and dividends to increase. However, as the economy continues to improve, many who are not currently working will need to join the workforce either because of economic necessity, or legislative action that would reduce long-term unemployment benefits. When this occurs, the participation rate will increase and as it does, so will the probability of inflation. But until that time, a low inflation rate together with a low headline unemployment rate may be a new reality of the post-Great Recession economy.