

# Economic Watch

US

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Economic Analysis

US

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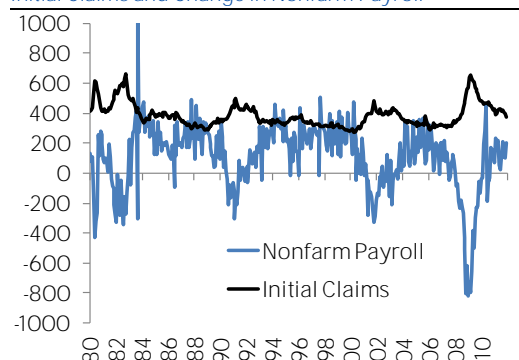
## Job Creation in 2012 will not Impress Improvements in initial claims belie longer-term issues

- Industrial reconfiguration, lack of deep reforms, a higher NAIRU, changing demography, and the participation rate will drive the labor market in 2012
- The Fed continues to sift through the implications of numerous conflicting labor market signals
- Excess labor slack will persist until a true engine of job creation arises

Over the past few weeks a number of commentators have used the sub-400k level of initial jobless claims combined with a sudden drop in the unemployment rate to argue for a more robust than anticipated labor market in 2012. Our view of the labor market is less sanguine given lack of structural reforms, demography's effect on labor force participation, political uncertainty, and a higher non-accelerating inflation rate of unemployment (NAIRU). These issues are entwined with the role of potential growth. A smaller labor force or higher levels of structural unemployment affect the size of potential growth in the US. The labor market's persistent difficulties also affect the chance of achieving political consensus necessary for deep reforms. This brief will reflect on how the short-term data may not be reflecting long-run realities.

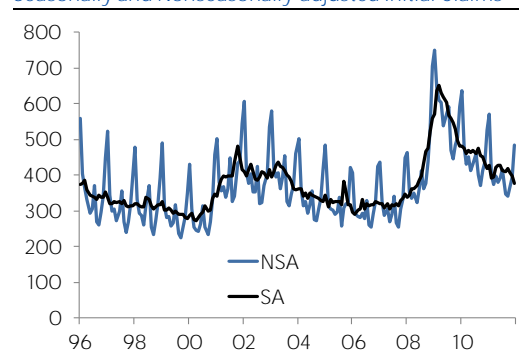
The fixation on initial claims generally revolves around a rule of thumb that sub-400k readings indicate health in the labor market. Another motivation for this rule of thumb is that since 1990, the correlation between initial claims and the change in the nonfarm payroll is around -0.74 (since 1967, the correlation is -0.55). One problem with this rule of thumb perspective is that it presumes that we are currently in a regime of strong job creation. For example, during the 1990's sub-400k initial claims coincided with strong 300k monthly increases in the nonfarm payroll. However, during that time the US benefited from an evolving technological boom, a robust housing market, and forces of globalization that were merely gaining steam rather than rearranging entire industries. While the labor market after the 2001 recession was often described as a "jobless recovery", the housing boom increased demand for low-skilled workers, temporarily shielding them from the effects of globalization. Essentially, initial claims were lower than the rule of thumb, but job creation was worse than the 1990s.

Chart 1  
Initial Claims and Change in Nonfarm Payroll



Source: BBVA Research

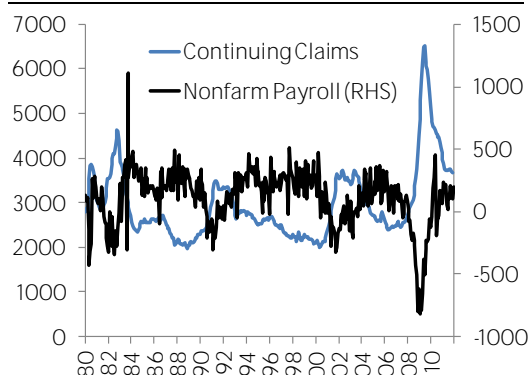
Chart 2  
Seasonally and Nonseasonally-adjusted Initial Claims



Source: BBVA Research

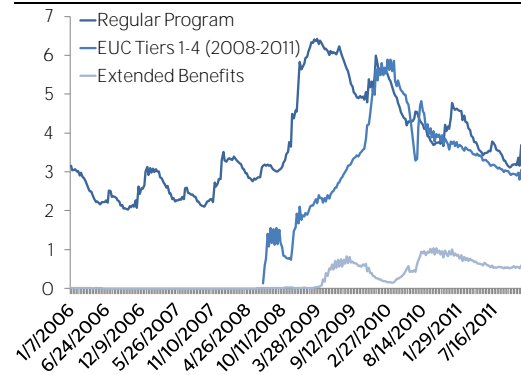
Another problem with using rules of thumb is that they can clash with other rules. For example, we are still far away from breaking through the 3000k barrier of continuing claims, which is conventionally associated with a more robust labor market. Expanded unemployment assistance programs are naturally elevating the figures, but given the amount of emergency funding in place for the unemployed, it would be hard to describe 2012 as a healthy labor market. This is not to say that initial claims are useless. In fact, they are extremely useful in judging when recessions begin and end, but they cannot divine the strength of the recovery. For example, in August and before revisions of data, completely stagnant payroll growth caused a flurry of recession fears even though initial claims were just slightly over 400k. In general, the key take-away from the initial claims data is that the US has lowered its risk of recession compared to sentiment during the summer. Seasonal effects are also a factor: it is important to note that the Department of Labor sets seasonal factors ahead of time. As such, the overall direction of claims is more important than a particular barrier.

Chart 3  
Continuing Claims and Change in Nonfarm Payroll



Source: BBVA Research

Chart 4  
Continuing Claims by Program, in mn



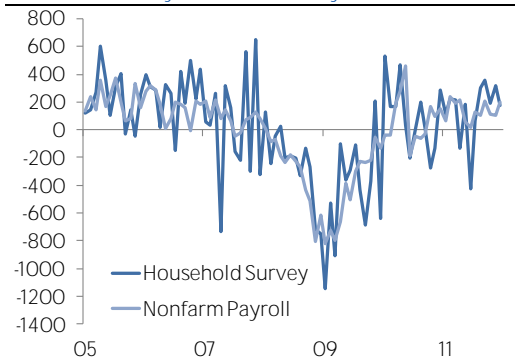
Source: Department of Labor

In general, data on the labor market at the present time is offering us a number of conflicting signals. While the unemployment rate dropped, the duration of unemployment remained high and the labor force participation rate declined. Changes in the participation rate are a combination of demographics – an aging population – but also worker discouragement. While the nonfarm payroll is demonstrating light increases in jobs, the household survey of employment is showing strong, but volatile increases in employment. The household survey is less subject to bias during economic turning points due to the model used by the BLS to estimate firms' births and deaths in the nonfarm payroll data. However, the household survey's volatility and flows out of the labor force are hard to square with one another. The unemployment rate today could embody more structural unemployment than in recent decades, but growth in measures of labor compensation suggest considerable excess resource slack. In the past few minutes of the Federal Reserve's committee meetings, these many contrasts are discussed but never resolved. Our [long-held view](#) is that the NAIRU is currently higher than the Federal Reserve's published forecasts and we expect it to nudge upwards over several quarters. So far this has been the case: November's range of 5.2 to 6.0 was slightly larger than June's range of 5.2 to 5.6. It is also [our view](#) that the growth in average hourly earnings is more reflective of inflation expectations.

Conflicting labor force dynamics are also highlighted in recent JOLTS reports. The number of job openings have hovered near 3000k for the latter half of 2011 (compared to levels near 4500k before the recession) and have declined in three of the past four months. This is likely associated with the drop in the labor force, as declines in job availability lead to an increased number of discouraged workers. Layoffs and discharges have fallen significantly in recent months, however, hiring trends remain volatile. Despite an increase in hires in November to match a high point for the year, the hiring rate has recovered less than 50% compared to pre-recession rates. While the

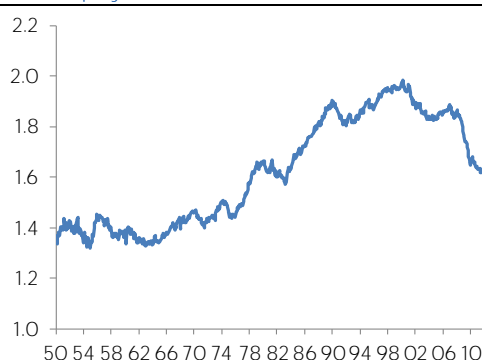
private sector continues to dominate nonfarm payroll growth, the JOLTS report indicates that private job openings and hires still have a long way to go to reach a full recovery.

Chart 5  
Household Survey and Nonfarm Payroll



Source: BBVA Research

Chart 6  
Ratio of Employed to Not in the Labor Force



Source: BBVA Research

### Bottom line: a bad-tasting mix furthers employment uncertainty

The crux of the matter is that all these issues are interrelated in a way that results in a very dour outlook for the 2012 labor market. A shrinking labor force due to demographic changes results in lower potential economic growth. A higher level of structural unemployment in the economy also negatively effects potential growth because the remaining workforce is not maximally trained to enter into the industries that are expanding in the post-recession environment. With a lower potential growth, more impetus is placed on institutional reforms that would supplement potential growth. These reforms could be enhancements to expanding industries, infrastructure improvements, tax reforms, and so on that foster the business environment. However, political consensus is difficult to build in an environment of high inequality and insufficient gains in employment. On top of these issues, businesses remain uncertain of how much consumption will occur in 2012, an uncertainty that weighs on hiring plans. The US economic recovery remains fragile as the world awaits the resolution of European sovereign debt issues and as the housing bubble collapse continues to drag on household net worth. In total, given the many conflicting signals of labor market indicators, the nontrivial structural weights on the economy, and difficulties in the political environment, excitement about the initial claims data may be misguided. Although we expect job creation to remain weak, it will improve upon 2010-11 job creation and will coincide with moderate economic growth.

Chart 7  
Private Hirings and Separations, In Mn

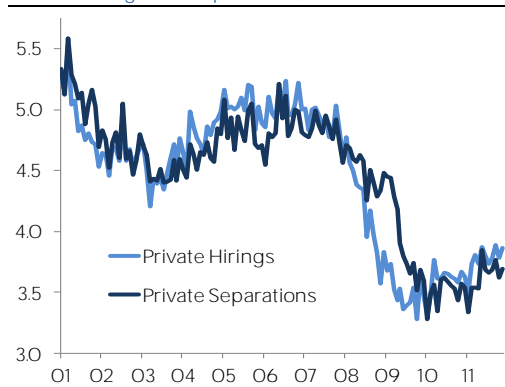


Chart 8  
National Beveridge Curve

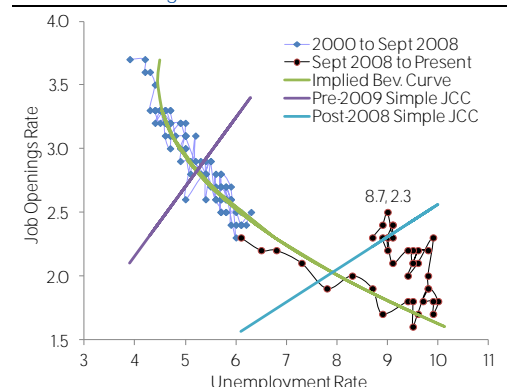


Chart 9  
Vacancy Yield by Industry, 3MMA

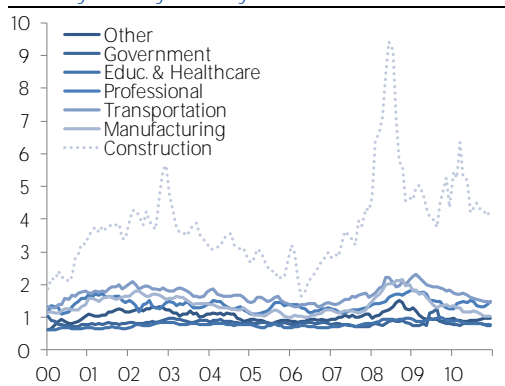


Chart 10  
Share of Vacancies by Industry, 3MMA

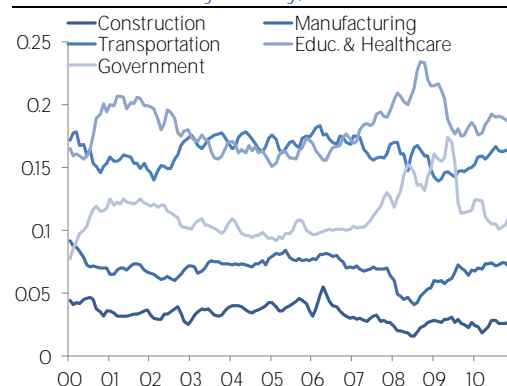


Chart 11  
Nominal Average Hourly Earnings, YoY %

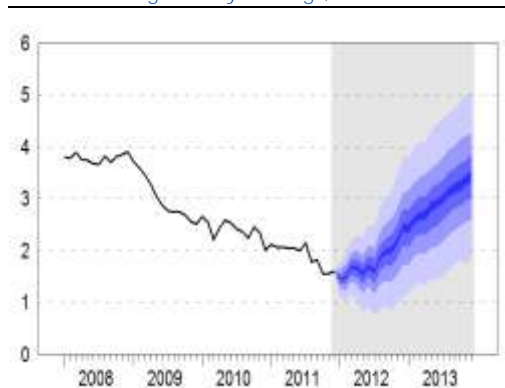
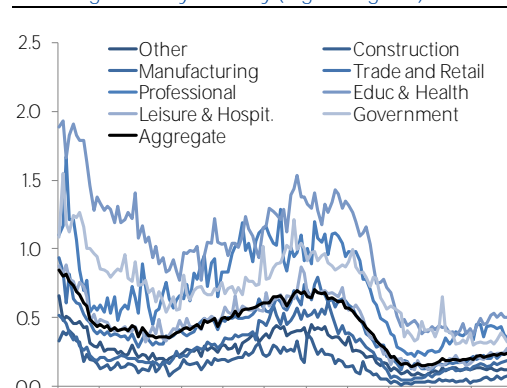


Chart 12  
Labor Tightness by Industry (higher=tighter)



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