

Fed Flash

U.S.

Bernanke Stresses Caution

- **Bernanke notes upbeat labor market conditions, but underscores that the data does not yet suggest a strong and lasting trend**
- **Even if large layoffs have been reversed by recent data, Bernanke states the economy needs more rapid growth to more significantly improve labor market conditions, which will be “supported by continued” accommodation**

Today Federal Reserve Chairman Ben Bernanke spoke at length on conditions in the labor market. More specifically, the Chairman addressed recent data's significance for Okun's Law (the statistical relationship between growth and unemployment) and the degree of structural unemployment in the labor market. For a general overview of labor market conditions, Bernanke noted that while unemployment claims, payroll employment and the unemployment rate have recently improved, hours worked is still below its pre-recession peak and the duration of unemployment remains high. Recent net job gains are more the result of unusually-low layoffs and quits rather than substantive gains in the hiring rate. Hiring rates will need to rise further in order to achieve a faster pace of recovery in the labor market. Examining the relationship between growth and unemployment, Bernanke suggests that the long-regarded statistical relationship is traditionally noisy and that recent gains are some form of reversal of large layoffs in 2008-2009. Although some may argue that workers dropping out of the labor force is driving the decline in the unemployment rate, wider measures of labor force utilization that include marginally-attached workers contrast with this assertion. Bernanke believes the decline in the unemployment rate does reflect improved conditions. On the subject of long-term structural unemployment, Bernanke suggests that only a modest part of the increase in the unemployment rate is due to a higher non-accelerating inflation rate of unemployment (NAIRU). Recent shifts in the Beveridge Curve (the relationship between the job openings rate and unemployment) cannot be considered consistent across decades and, to Bernanke, do not support high structural unemployment. Most importantly, job finding rates by workers' duration of unemployment do not imply major differences between groups of workers.

In sum, we cannot “be sure” that the labor market gains will be sustained and there will be support from “continued accommodative policies.” Today's speech will likely help to cap recent increases in Treasury yields and also remind markets that the Fed is committed to maintaining accommodative monetary policy until the data reveals a clear signal of a sustainable recovery. In April of 2011, the Federal Reserve expected 3.1% to 3.3% GDP growth for 2011. By November of 2011, the Federal Reserve expected 1.6% to 1.7% GDP growth for 2011. As such, the Federal Reserve will remain cautious. The Fed will carefully scrutinize all labor market indicators moving forward for hints that hiring is accelerating and will not be easily reversed by external or internal shocks. Today's speech will help reverse bets that quantitative easing is off the table for the Fed, since Bernanke's comments clearly reveal that the Fed is not yet convinced of the sustainability of recent labor market gains.

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