Economic Analysis
17 December 2013

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U.S. Flash

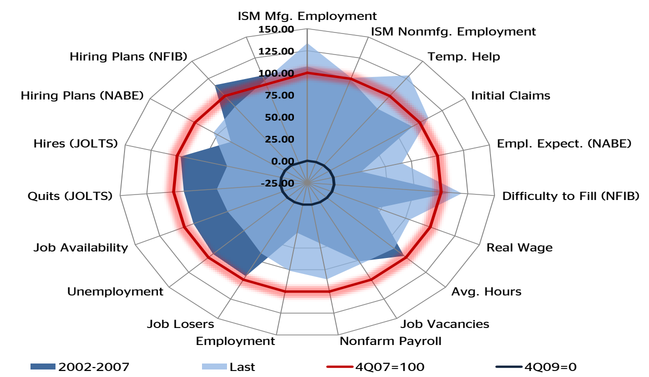
Encouraging Labor Market Utilization as the Fed Talks Taper

- **Employment outlook on the rise as hiring plans approach sustainable levels**
- **Long-term unemployment still a concern, but improvements are notable**
- **FOMC tapering decision dependent on the balance between low inflation and labor market gains**

The latest employment indicators have prompted us to revisit our outlook on the labor market, especially considering the importance related to QE3 tapering. Throughout 2013, we have seen volatile swings in job growth as the unemployment rate dropped from 7.9% in January to 7.0% in November. Still, this improvement has come on the back of steady declines in labor force participation, which does not bode well for potential growth in the coming years. While much of the underlying details in this year's employment reports have been sub-par, we must admit that there have been visible improvements as well. When it comes to the labor market outlook, many statistics are approaching, or have surpassed, the sustainable levels seen in the five-year period prior to the recession, and businesses are reporting increased hiring plans for the coming months. Furthermore, we have seen a stronger boost in manufacturing employment as the sector attempts to lead the recovery. Temporary jobs have also surpassed sustainable pre-crisis levels, yet this touches on potential structural issues as businesses struggle to find suitable candidates and remain hesitant to commit to full-time hires. As the title suggests, these jobs are only temporary and therefore not sustainable. If this trend continues, we could see a prolonged period of increasing temporary jobs that do not eventually become permanent hires.

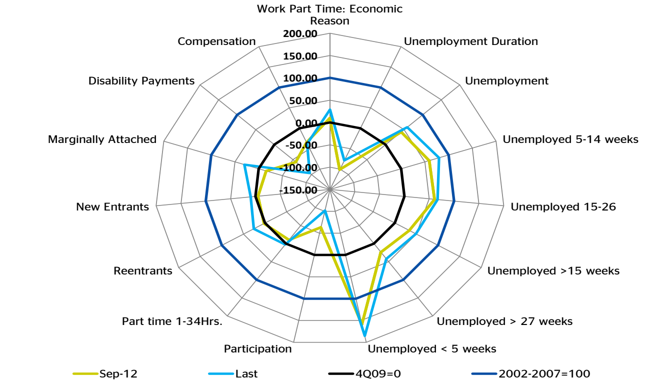
There has also been, for the first time since the crisis, visible progress in labor market utilization. We have seen significant improvement in the number of unemployed people for less than 5 weeks. In addition, the indicators for mid- and long-term unemployment have recovered about half-way toward the sustainable 2002-2007 level. Last but not least, we have seen close to a 30% recovery in those employed part-time for economic reasons, marginally attached workers, and new entrants and reentrants into the labor force, particularly over the past few months. While these marginal changes do not provide a clear answer to the cyclical vs. structural unemployment debate, it is clear that the labor market is turning a corner, albeit very gradually. Overall, it will be hard for the FOMC to overlook these improvements, but still the key challenge is to determine if these improvements are sustainable and enough to significantly mitigate downside risks in the event that they do decide to begin tapering. In addition, inflation remains well below the Fed's target and today's CPI report confirmed muted inflationary pressures which may outweigh labor market improvements when it comes to an immediate tapering decision (see inflation flash).

Chart 1
Labor Market Outlook (%)



Source: BLS, DoL, NABE, NFIB, ISM & BBVA Research

Chart 2
Labor Market Utilization (%)



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