1-24-2016

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January 24, 2016

During the last few months of 2015, prospects looked good for the U.S. economy to continue to grow going into 2016. The U.S. labor market had just experienced three consecutive months of strong employment growth to end the year. The stock market had come back in the fourth quarter after reacting negatively to concerns about a slowdown in the China economy and the glitches in their stock market. Consumer confidence continued to climb; household debt seemed reasonable and consumers were not spending beyond their means. And then, right after everyone returned from their holiday break, everything seemed to change abruptly. China's stocks lost 11.6 percent of their value in the first week of trading, and recently installed circuit breakers seemed to exacerbate their problems more than mitigated them. The rest of the world equity markets interpreted the Chinese stock market fall as a sign of further weakening of the China economy, and the U.S. market fell nearly 6 percent the first week and continued to decline into the second week of the year.

While there is little connection in the short run between the stock market and the real economy, this worst start of the year ever for the stock market will probably weigh heavily on the confidence of consumers as the year unfolds. Furthermore, the fall in oil prices has taken a heavy toll on the profits of oil companies, which reduces investment and employment going forward. And if that isn't enough to start the year on a sour note, the strong dollar has cut into export growth, which is felt most directly in the manufacturing sector, one of the key drivers of the recovery.

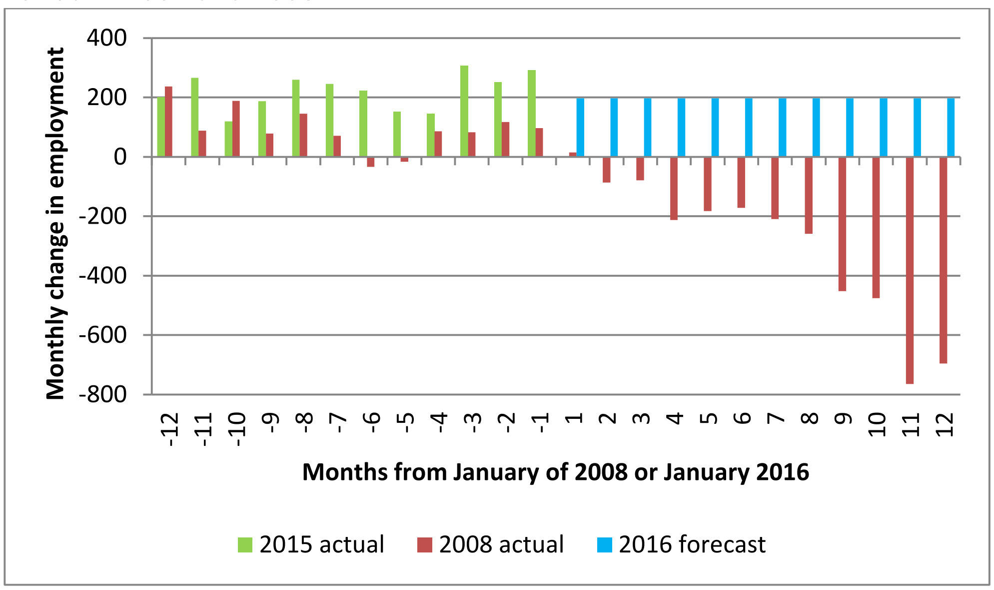
Employment Growth

Employment has now logged 63 consecutive months of growth since October 2010, when the labor market first started to turn around after the recession. Since then, the economy has added 13 million jobs at an average monthly rate of 203,000 jobs. While the rebound in the job market started a little later in this recovery than in the previous expansion, the monthly growth rate has exceeded the previous one. In the previous expansion, the string of consecutive months of employment growth extended for only 46 months, compared to the current 63 months. Employment growth in this expansion averaged 203,000 per month versus 171,000 per month in the previous recovery. Furthermore, the growth during the last three months of 2015 was significantly higher than the average for the 63-month period, which was a good sign for job growth in 2016 (figure 1).

Other indicators also pointed to a strong employment picture in 2016. The unemployment rate stood at 5.0 percent at the end of 2015 compared with 5.6 percent at the end of 2014. The number of unemployed fell by 1 million, while the number of people in the labor force actually increased by 800,000 during 2015. The relative few job seekers per job opening also points to a strong labor market going into this year. By the end of 2015, the ratio had fallen to around 1.5 job seekers per job opening, the lowest ratio since the peak of the previous expansion after reaching a high of nearly 7 job seekers per opening during the depth of the recession.

Forecasters are optimistic about future growth in employment going into 2016, at least as of November of 2015, which was the last time the Philadelphia Federal Reserve Bank conducted its survey. The consensus of the 53 forecasters was an average growth of 197,000 per month, slightly less than the pace during the past two years of 240,000 jobs per month but much stronger than the two years leading up to the previous recession, during which time employment grew by 134,000 per month.

Figure 1: Change in Monthly Employment for 2015 and 2016 Forecasts compared with Similar Period in 2007 and 2008.



Source: Bureau of Labor Statistics and Federal Reserve Bank of Philadelphia Survey of Forecasters, November 2015. Note: the period labeled -12 through -1 corresponds with the monthly series for 2007 and 2015 while the period labeled 1 through 12 corresponds with the period 2008 and 2016.

Employment growth during the first three quarters of 2015 was supported by GDP growth of 2.2 percent. Although the fourth quarter numbers have not yet been released, the average monthly employment growth of 283,000 for the last three months of 2015 could mean that GDP growth will be even higher. The Philadelphia Fed's survey of forecasters, taken in November of 2015, anticipated growth in the fourth quarter to be 2.6 percent and growth for the entire year of 2015 to be 2.4 percent. They also expected employment to increase by 200,000 jobs per month during the last quarter of 2015, which suggests that their GDP estimate is low since their employment missed the mark by 83,000 jobs per month. The IMF forecast, released on January 19, 2016, expects a slightly higher growth of 2.5 percent for 2015. Both the Philadelphia Fed's forecast and the IMF forecast see growth in 2016 to notch up another tenth to 2.6 percent. While growth in 2016 is expected to be marginally higher than in 2015, both the Philadelphia Fed's survey and the IMF scaled back their estimates by two tenths from earlier forecasts.

What's on the horizon that may dampen this forecast?

China and oil are the primary concerns at this point. For months, the slowing China economy has dominated the attention of businesses and investors. The official statistics, released by the Chinese government on January 19, 2016, confirmed fears of a slowdown. According to the government statistics, the Chinese economy grew 6.8 percent in the fourth quarter of 2015 and an estimated 6.9 percent for the year, the lowest growth rate in a quarter of a century. This rate was slightly below the 7.0 percent target set by the government. And there is little hope that China's growth rate will pick up anytime soon. Chinese government officials conceded that growing debt and excess capacity in housing and manufacturing weighs on future growth prospects and the usual stimuli of increased infrastructure spending, easy credit, and ramped up exports is not working. China's problems spill over into the rest of the world through downward pressure on commodity prices, particularly oil, and a devaluation of their currency, which makes exports to China more expensive and trading partners less competitive. In their forecast released January 19, 2016, the IMF expects growth in China to slow even more in 2016, from 6.8 percent to 6.3.

Other emerging market economies show similar slowdowns, as many are also plagued by increased debt, tighter credit, and fewer prospects for their exports. Russia and Brazil experienced sharp declines in their economies during 2015, and IMF forecasts still see contractions in those two economies this coming year but by not as much. The recent IMF forecast for this bloc of 23 countries calls for 4.3 percent growth for 2016, up a few tenths of a percent since 2015. Yet, in January the IMF cut its October 2015 forecast by two tenths of a percentage point.

As growth in China and other emerging markets slows, it is difficult to place much hope in the advanced economies picking up the global slack in output growth. The European countries have been burdened by sovereign debt issues and structural problems. Even the recent move by the European Central Bank to implement their own brand of quantitative easing has not stimulated the economies to any great extent, yet. During 2015, the Eurozone economies grew an estimated 1.5 percent, and the IMF expects about the same in 2016 with a forecast of 1.7 percent.

Should the slowdown be a surprise?

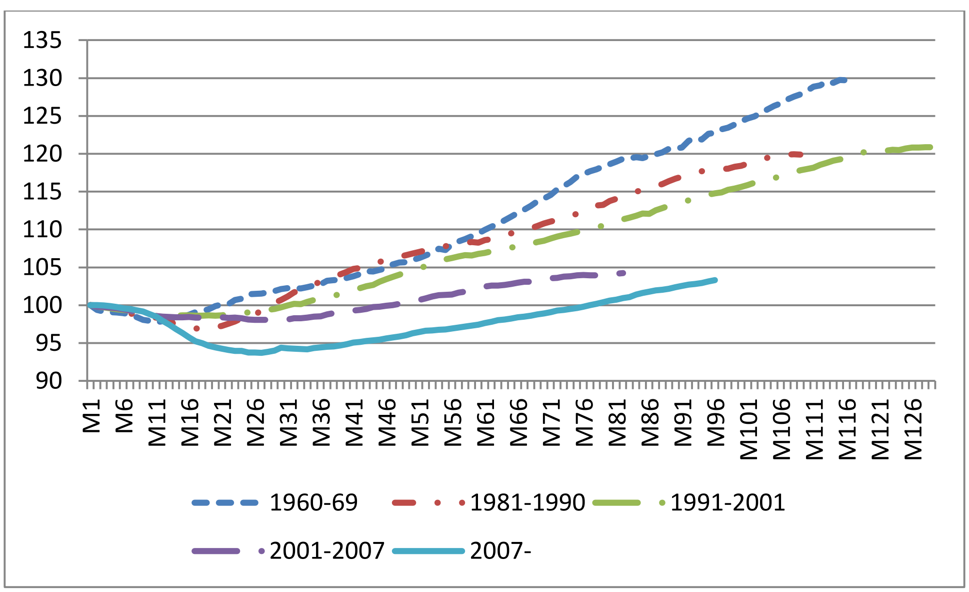
Last year at this time, concerns were surfacing about the effects of lower oil prices, a slowdown in China and other developing and emerging market countries, and possibility of a hike in the Fed Funds rate on US and global economic growth. Yet, the forecasts going into 2015 remained optimistic. In some cases, the forecasts overshot actual rates during 2015. For instance, the World Bank expected the U.S. economy to grow at an annual rate of 3.2 percent in 2015 and the IMF was looking for even higher growth at 3.6 percent. At best, U.S. growth in 2015 will come in at about 2.6 percent. However, those higher expectations were justified at the time by the Federal Reserve maintaining low interest rates, declining oil prices, and overall low inflation expectations. While most forecasters expected the Fed to raise interest rates by a quarter to a half percent sometime in 2015, they did not expect the interest rate increase to have much impact on economic growth. The same was true for oil prices and a stronger dollar. Both were seen as having only minimal effects on the economy. Many forecasters argued that lower oil prices would help energy-intensive industries lower their costs, which would be passed on to consumers. They also expected the dampening effects of a stronger dollar on exports would be offset by lower import prices, which like lower oil prices would improve the households' purchasing power. The negative aspects of these factors appeared to outweigh the positive aspects if they can be blamed for slower growth in 2015 than the forecasters expected.

And then the concern over China and other emerging market countries came into clearer focus. Global stock markets had already signalled a concern about emerging markets as stock values in those countries steadily declined throughout 2014 and 2015. The mid-summer meltdown in the China stock market led others to react negatively to the possibility that China's economy was slowing. But the US stock market rebounded quickly after a rocky few weeks and posted significant gains until the first few weeks of 2016. But it appears that while attention was on the equity markets, the actual slowdown was taking a toll on the real economy. Since growth in emerging markets and developing economies account for 70 percent of global growth in 2015, slower growth in these markets could influence U.S. growth in 2016. And if the price of oil and other commodities remains depressed in 2016, it is difficult to identify factors on the horizon that could boost U.S. growth rates higher than what the current forecasts expect.

Has the recovery run out of steam?

Although there is no expected life time for a business cycle, one cannot ignore the fact that the current cycle has outlasted most of the 11 business cycles since 1945. Only four business cycles in the history of the U.S. have run longer than the current business cycle, and three have occurred since the 1960s. So the question is how much longer will this expansion last? The question may appear a little premature in that it was only toward the middle of 2014 that employment returned to its previous peak and many people were feeling that the economy was actually recovering. Yet, even after 63 straight months of growth, employment is only 3.5 percent higher than at the previous business cycle peak in December 2007 (figure 2). By this stage of the previous three business cycles that lasted longer than this one, employment was 15 to 23 percent higher compared to their respective previous peaks. Obviously, the recession of 2008-09 was much deeper than any recession since the Great Depression of 1930 and it takes longer to return to pre-recession levels. Yet, employment has not received the same boost from the economy as it had in previous recoveries. During this expansion, US GDP growth has average 2.1 percent annually, and it slowed to 2.0 percent in the first three quarters of 2015. In the two previous recessions that lasted longer than this one, GDP growth averaged at least 3.0 percent.

Figure 2 Employment Index for Selected Business Cycles



Source: Bureau of Labor Statistics, Total nonfarm employment, seasonally adjusted. Note: Horizontal axis is the month from the previous peak for each business cycle. Index is set to 100 at the month of previous peak.

What is also disturbing about the slower economic growth is that interest rates are still at historic lows. The Federal Reserve, even with the recent Fed Funds increase, maintains a highly accommodative monetary stance. Yet, the low interest rates do not appear to be stimulating growth as much as might be expected. As the Fed maintains low interest rates, it has little room to try to jump start the economy by lowering interest rates if the economy does indeed start to shows signs of contracting.

Several explanations have been put forth for the slower economic growth. One possibility is tighter regulations on financial institutions that were put in place after the near financial meltdown in 2008. According to proponents of this explanation, banks are reluctant to loan money to worthwhile ventures, which puts a damper on the economy, including housing construction. A significant portion of employment growth is recent years has come from small to medium size businesses, which rely more than large corporations on debt financing to grow their businesses. Another possibility is the reluctance of businesses to assume greater risk, which is a key ingredient for future growth. Recently released data show that publicly traded companies have been much more interested in buying back their stock or providing higher dividends to shareholders than in investing in plant and equipment to expand capacity and increase productivity in their own businesses. Spending on stock buybacks has increased 194 percent since 2009 while at the same time business capital investment has increased 43 percent.[1]

Productivity slowdown

Slow productivity growth has been a concern throughout much of the current expansion. Since October 2010 when employment started its string of 63 months of consecutive growth, productivity (output per hour) has remained nearly flat, growing at only a 0.5 percent average annual rate. In contrast, during a period of similar employment growth in the previous business cycle (2003Q2 to 2007Q4), productivity grew at an average annual clip of 2.3 percent. Several explanations have been posited about the productivity slowdown, which actually began two years before the country plunged into recession. These explanations include misallocation of resources, particularly to the financial sectors, slowing in business investment in high-tech equipment, and mismeasurement problems related to import prices and quality-adjusted computer prices, to name the most prevalent.

Some academics see the productivity slowdown as a consequence of the sharp decline in expenditures on business research and development and technology adoption stemming from the abrupt and deep decline in output at the onset of the recession.[2] Without continued

[1] Carlyle Group; U.S. Department of Commerce

[2] Diego Anzoategui, Diego Comin, Mark Gertler, and Joseba Martinez, "Endogenous Technology Adoption and R&D as Sources of Business Cycle Persistence" NBER Working Paper, 2015.

investment in technologies, they argue, the speed at which productivity-enhancing new technologies are incorporated into production is slowed significantly. The authors also comment that sustained drops in productivity appear to be a feature of major financial crises, such as the kind that precipitated the Great Recession. Another possible headwind in the face of productivity growth is educational attainment. Much has been written about the alleged reduction in the quality of education in the U.S., particularly at the nation's high schools. There is also concern that younger workers are no more educated than older workers, which is not the case for many advanced countries, and does not bode well for future productivity growth in the U.S.

Income Inequality growing worse

Not only does low productivity growth bode poorly for future economic growth in the US, but it may also be a major cause of wage stagnation and increased inequality. Wages of middle-to-low-income workers have barely budged throughout this expansion and even before, whereas wages of workers in the top 10 percent of wage earners have increased several fold over the same time period. This growth differential has led to greater income inequality in the U.S. for several decades now. According to OECD analysis, the upward trend in income inequality slowed during in the past few years, around the same time productivity growth slowed to a crawl. Yet in the four years between 2007 and 2011, the ratio of income of the 90th percentile of the income distribution to the 10th percentile rose from 15.1 to 16.5. Income inequality is of course a long-run issue, but according to a recent OECD working paper, the increased income inequality in the U.S. shaved 6 to 9 points off its GDP growth during the past two decades.[3] Much of this effect on growth is because of fewer educational opportunities for low-income groups, which takes its toll on future earnings and thus growth. Therefore, unless the upward trend in income inequality is reversed in the U.S., future growth will continue to fight those headwinds.

Election Year Policy Priorities

The year 2016 is a presidential election year. Although the actual election is not until next November, the political campaigns have been in full gear since last summer, if not before. Republican candidates have contended with a crowded field that saw nearly 20 contenders vie for the nomination starting last summer. Today, the field has narrowed to less than a half dozen candidates that have respectable poll numbers going into the Iowa Caucus and the New Hampshire primary in February. For the Republicans, it appears that Donald Trump, Senator Ted Cruz, former Florida Governor Jeb Bush, and Senator Marco Rubio are leading in the polls,

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[3] F. Cingano, "Trends in Income Inequality and its Impact on Economic Growth", *OECD Social, Employment and Migration Working Papers*, No. 163, OECD Publishing, 2014.

but Donald Trump is far in front of the next closest contender, Ted Cruz. With President Obama in the last year of his second term in office and constitutionally forbidden to run for a third term, the democratic race is open to non-incumbents. Hillary Clinton, former U.S. Senator, former Secretary of State, and wife of former President Bill Clinton, has been the frontrunner for the Democratic ticket. However, as primary season approaches, Senator Bernie Sanders has closed the gap in the polls, and they appear to be virtually tied at this time. Consequently, it is unclear who will be on either the Republican or Democratic ticket on the November ballot, although the polls still seem to point to a Trump/Clinton race.

The candidates' policy positions with respect to labor have been cast basically along party lines. The Republican candidates focus most of their comments in debates and interviews on immigration. The primary issue involves protecting our borders from the entrance of illegal immigrants and finding a path to grant legal status for those undocumented workers and their families already in the U.S. Donald Trump flatly says there is no path to citizenship for undocumented workers, but he is open to allowing more European immigration and granting legal status to those graduating from U.S. colleges. Senator Ted Cruz says that he is committed to blocking any effort that lets undocumented immigrants remain in the U.S., while Governor Bush and Senator Rubio are open to creating some legal status, but not citizenship, to undocumented workers in the U.S. The two Democratic candidates are more open to finding a legal status for resident undocumented workers, and Senator Sanders has stated that he is in favor of granting citizenship. Both support waiving deportation for some undocumented workers.

Another issue that candidates have weighed in on is the minimum wage. The Republicans are generally against raising the minimum wage because they contend that it would reduce American competitiveness, as Donald Trump strongly states in his speeches. It appears that only Governor Bush is totally against a federal minimum wage but would allow state minimum wage laws. Donald Trump has not offered much more insight into his positions on labor, except saying that he would fight to wrestle jobs away from foreign countries. Senator Cruz adheres to a flat tax solution to creating more jobs and stimulating greater economic growth. He borrows the plan from one of the Washington think tanks that argues that a 10 percent flat income tax on households, instead of the current graduated income tax system, would substantially boost GDP, increase wages, and creation millions of additional jobs.

The two Democratic candidates call for raising the federal minimum wage as high as $15 per hour. The federal minimum wage has been at $7.25 since 2009, although some states and local jurisdictions have raised their laws to higher than this, with a few topping off at $15 an hour. Both Clinton and Sanders are strong supporters of unions, calling for stronger protections of workers' rights to organize and for restrictions on businesses from interfering in those efforts. Republican candidates typically are against protecting and strengthening unions. Senator Sanders has proposed a Plan to Rebuild America in which $1 trillion over five years will be invested in modernizing America's infrastructure and employing 13 million workers. He plans to pay for this by closing loopholes that allow profitable corporations to avoid paying taxes by off-shoring and other means.

President Obama's Agenda for U.S. workers

President Obama used his last State of the Union Address to Congress on January 12, 2016 to summarize his priorities for workers during his last year in office. The issues he chose to address included immigration, slow wage growth of middle-to-low income workers, increasing income inequality, the need for equal pay for equal work, greater access to higher education, strengthening collective bargaining, and legislation guaranteeing paid leave for workers. These issues are not new, but Congress has yet to pass legislation or additional appropriations to help address them. In the meantime, the administration has used existing appropriations to fund new programs that target many of these issues. Not surprisingly, many of the positions outlined by the President echoed those of the two Democratic candidates, but each tries to put a slightly different spin on his or her proposal.

A few days following the State of the Union Address, the White House released a description of four new proposals offered by the Administration to mitigate the problems of skill mismatch, talent shortages, and worker productivity. The new proposals provide workers with wage insurance, work sharing, stronger Unemployment Insurance protections, and support for retraining so that workers can qualify for jobs in demand.

Wage Insurance

For several decades, academics and policy influencers have floated the idea of offering a wage supplement to workers who have taken a job after becoming displaced from their previous job at a wage that is below what they received before.[4] Research shows that on average experienced workers starting over with a new job receive 10 percent less than what they earned on the job their lost. For workers with 20 or more years of experience, the wage gap between the old job and new job is upwards of 25 percent. Some argue that the wage gap may extend the length of time that workers search for a job and may even discourage some workers from accepting work since the new earnings make it difficult to support themselves and their families. Although the wage subsidy is temporary, it provides time for a worker to transition into a higher paying job while receiving compensation that brings the worker closer to what he or she earned previously. The President's specific proposal is to ensure workers

[4] Stephen Wandner, "Wage Insurance as a Policy Option in the United States," W.E. Upjohn Institute for Employment Research Working Paper 16-250, January 2016.

have access to wage insurance that would replace half of lost wages, up to $10,000 over two years. Displaced workers who lost their job through no fault of their own, making less than $50,000, and who were with their prior employer for at least three years are eligible.

This proposal, as stated in the press release, is different from wage supplements (funds given directly to workers) or wage subsidies (funds given directly to employers), since it attaches the supplement to an insurance program. While no specifics were given in the press release, it is likely that the wage supplement would be added to the existing Unemployment Insurance System. Research has shown that wage supplements, such as the Earned Income Tax Credit program, which pays out about $70 billion to 26 million taxpayers, has been highly successful in encouraging people, primarily single mothers, to find work.

Work-sharing

To complement wage insurance, President Obama proposes to encourage businesses to use work sharing, also known as short-time compensation, to avoid laying off workers during times of slack demand. Work-sharing has been part of the Unemployment Insurance System for some time, and additional funds and incentives were made available to states during the recession under the American Reinvestment and Recovery Act to promote its use. Germany is well-known for its use of work sharing and during the last recession they were able to avoid significant layoffs by reducing hours instead and compensating workers for the resulting reduction in pay. The President's proposal would provide states with implementation grants and additional incentives to encourage businesses to use work sharing instead of laying off workers. By reducing hours instead of laying off workers when a business's sales are down, workers remain attached to their employer, which eliminates the disruption for the employee of losing a job and needing to find a different one. For the employer, eliminating a layoff maintains the talent and skills they need to continue their business without disruption when demand for their products picks up again.

One of the hurdles in using work sharing has been employer awareness. Businesses in the U.S. are not accustom to this approach of adjusting their workforce in times of slack demand. There is also some pushback because firms sometimes use a downturn to let go of workers who are falling short of the firm's performance expectations. Nonetheless, having both a viable work sharing program and the traditional Unemployment Insurance system provides workers and businesses with more options for mitigating disruptions and improving transitions when the economy slows.

Worker Training and Career Navigation

Another component of the President's proposals is to allow and encourage states to create temporary work-based training programs to help workers get back on the job while still collecting UI benefits. Currently, a UI beneficiary can attend training that improves his or her employment opportunity but it must be approved by the UI administrator and it must be closely related to their previous job. In certain cases, a worker's prior job may have become obsolete or the industry has left the area and that worker needs to retool in order to find employment. The President's proposal allows more flexibility so that workers can participate in apprenticeship programs and on-the-job training while receiving UI benefits.

The President also proposes to provide resources to states for Career Navigators, who will proactively reach out to workers who are most at risk of being able to continue on a successful career path after becoming unemployed. The Career Navigators will work with the long-term unemployed, discouraged workers, older workers, and others who are having difficulty getting back on their feet after a job loss. These individuals will be identified through the existing Worker Profiling system, which uses statistical means to identify those UI claimants who are least likely to find meaningful reemployment. Career Navigators will help them find a job, match with an appropriate training program, and reconnect to federal support services.

Summary

At the end of 2015, the U.S. economy seemed poised to continue with employment and overall economic growth into 2016 at a pace that would at least equal the growth rate during 2015. However, the first few weeks of the new year have refocused some lingering concerns in the economy—slower growth in China and other emerging market economies, the strong dollar, collapsing oil prices, and the stance of the Fed to continue with its current low interest rate position. Longer-term issues could also be in play going into 2016, such as a secular slowdown in productivity, slow wage growth, and upward trending income inequality. For now, any political solutions to these issues are most likely on hold as the presidential campaigns continue to heat up and the candidates jockey for position while the U.S. Congress watches to see who will sit in the White House in 2017.