

FOCUS · An overview of the improvement in the US labour market

The US unemployment rate has improved non-stop since it reached 10% in 2009. Specifically, in May it stood at 4.7%, close to the minimum level reached in 2005 and 2006. These data, together with relatively weak job creation figures, have led to debate regarding whether the US labour market has now achieved full employment. A debate of the utmost importance as this affects, for example, how quickly the Fed must raise interest rates.

For a more accurate assessment of the state of the US labour market, we will examine two key elements that have changed extensively in the last few years: the demographic composition of the labour force and the participation rate.¹

Demographic change is relevant insofar as the different age groups tend to have different unemployment rates. Young people normally have a higher unemployment rate than older segments of the population. Therefore, given that the relative weight of the different age groups has changed in the last few years (see the first graph), the same thing might also have occurred with the equilibrium unemployment rate.

Although this hypothesis is plausible and is often used to argue that structural unemployment is now lower, the ageing of the population over the last few years is not having much of a quantitative impact. For example, if the share of the different segments were the same as in 2005, unemployment would only be 0.1 pp higher than the current figure.

The second factor to take into account to evaluate today's unemployment rate is the large drop in the participation rate, going from 66.0% in 2006 to 62.6% in May 2016. In this case the potential impact on the unemployment rate could be considerable in quantitative terms. By way of example, if those people who have left the labour market had remained in the labour force looking for employment, the unemployment rate would be 6.5%, 1.8 pps higher than the current figure.

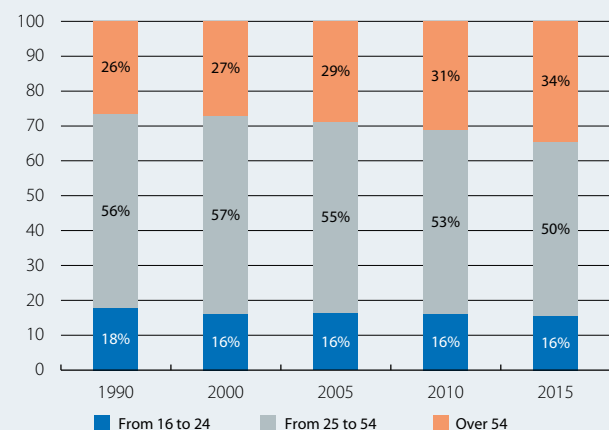
This sharp drop in the participation rate has led to intense debate regarding what proportion of those who have left the labour market will return as economic conditions improve and what proportion will remain outside the labour force structurally. Although there is no clear consensus regarding how much of the decrease in the participation rate is structural, several studies have estimated this at around 30%.² Assuming this estimate is valid, we can repeat our previous exercise, this time adding to the labour force only those people who have

become discouraged and have temporarily stopped looking for a job. In this case the unemployment rate would still be a low 5.9%.

In summary, although several factors need to be taken into account when assessing the low unemployment rate in the US, its labour market is very close to full employment. Consequently, pressure on wages is likely to increase over the next few months, an element which the Fed will have to bear in mind in deciding when is the right time to raise interest rates, in addition to the turbulent international financial conditions.

US: population by age group

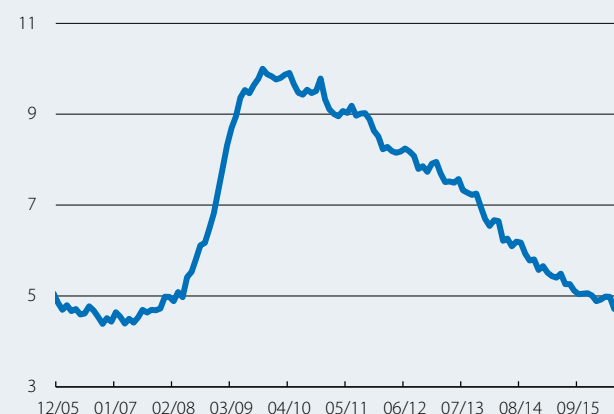
(% of the total)



Source: CaixaBank Research, based on data from the Bureau of Labor Statistics.

US: unemployment rate

(%)



Source: CaixaBank Research, based on data from the Bureau of Labor Statistics.

1. The participation rate is the ratio between the labour force and the population aged 16 and over.

2. See Aaronson, Daniel, Luojia Hu, Arian Seifoddini, and Daniel G. Sullivan, «Declining labor force participation and its implications for unemployment and employment growth», *Economic Perspectives* 38, no. 4 (2014).