

Labor Market Recovers Unevenly

High-skilled jobs account for most employment growth in a steady recovery.

by Steven R. Cunningham, PhD, Director of Research and Education,
and Zinnia Mukherjee, PhD, Research Fellow

The economic recovery remains intact. Absent any major external shocks, the U.S. economy will continue to grow at a steady pace.

AIER experts find that 91 percent of our leading indicators (10 out of 11 for which a trend is apparent) are expanding—a sharp increase from 82 percent last month. The cyclical score of leading indicators, derived from a separate, mathematical analysis, increased from 76 last month to 84. For all AIER measures, values above 50 suggest that economic expansion is likely to continue. A higher score reflects a more positive sign for the overall economy.

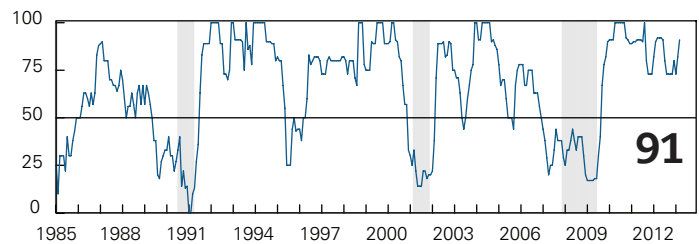
AIER's coincident and lagging indicators confirm a steady expansion of the U.S. economy, with 100 percent expanding for both series. (To see charts of all our indicators, go to the appendix.)

There are four primary engines of demand in any economy: consumer spending, investment, government spending, and net exports. According to our indicators, the first two have been carrying the load recently in supporting the expansion. Government spending, coming off stimulus packages and confronted with sequester cuts, has been a drag. Net exports have been mixed.

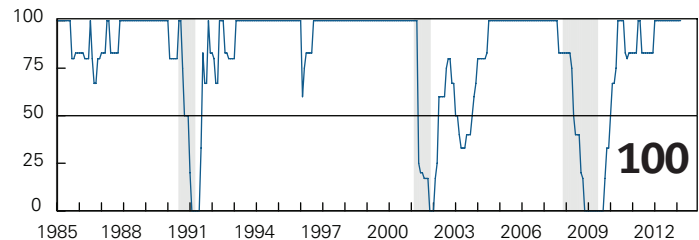
Real personal consumption expenditures grew 3.6 percent in February on a seasonally adjusted compounded annual basis. Durable goods consumption has been a powerful force in the recovery. It spiked in November and December, with real compounded annualized growth rates of 40.9

The Indicators at a Glance

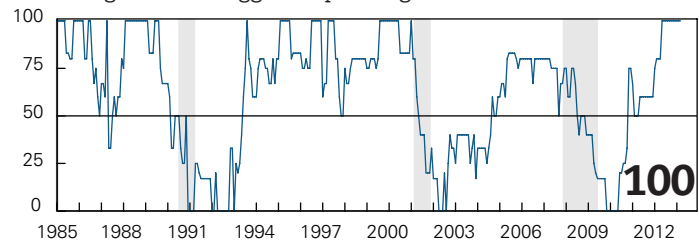
Percentage of AIER Leaders Expanding



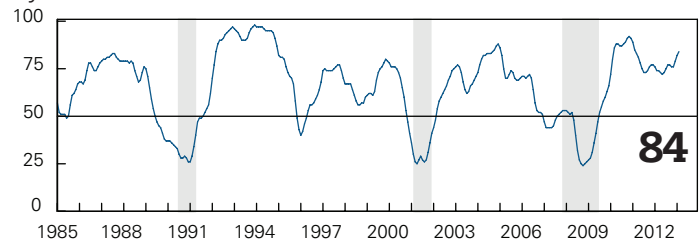
Percentage of AIER Coinciders Expanding



Percentage of AIER Lagggers Expanding



Cyclical Score of AIER Leaders



Shaded bars represent official recessions. A score above 50 indicates expansion.

and 15.1 percent, respectively. The fourth-quarter spike was probably related to the acceleration of personal income in anticipation of 2013 tax increases. (See AIER's March *Business-Cycle Conditions*, "Income Shifts; Recovery Holds.")

Many durable goods purchases can be planned, and it is likely that consumers simply moved up their spending when the income became available.

This resulted in sluggish growth of 0.8 percent in durable goods expenditure for February, despite the 8.5 percent annualized increase in real disposable personal income that month. Non-durable goods expenditures are less planned. The same month, consumers increased their nondurable goods expenditure by 5.9 percent. Although rocked by timing issues related to tax changes, the consumer sector seems intact.

The expansion of consumer demand is further

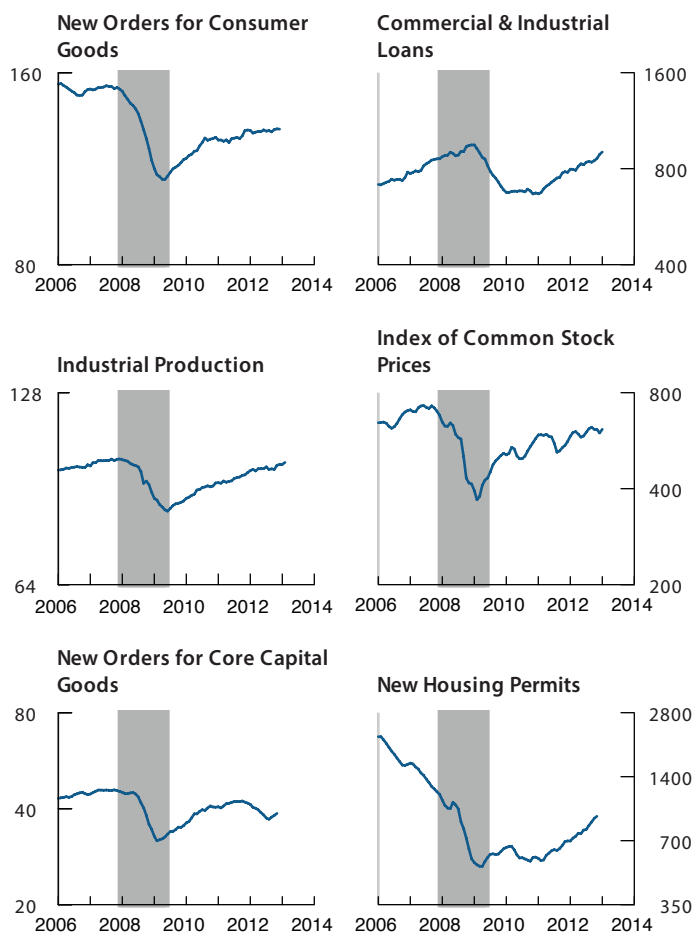
evidenced by retailers' growing flow of orders for consumer products. This is captured by our leading indicator, *new orders for consumer goods*. The series continues to show a steady upward trend, reflecting growing incomes, expanding consumer credit, and consumer optimism. The final Reuters/University of Michigan consumer sentiment index for February rose to 77.6. Rising consumer demand is also demonstrated by the upward trend in *industrial production*, which grew 9.4 percent.

The economy's investment engine refers to real investment—purchases of factories and equipment by firms, and houses by families. In some sense, such purchases are linked to consumer demand. Firms expand plant and equipment in order to be able to increase production to meet consumer and consumer-derived demand.

Business expansion is captured by our leading indicator, *new orders for core capital goods*. It has continued its upward trend since the last quarter of 2012. This is further confirmed by the upward trajectory of *commercial and industrial loans*. The steady growth of this lagging indicator suggests that businesses remain optimistic about future business prospects. In addition, record highs in major stock market indices, as shown in our *index of common stock prices*, a leading indicator, reflect optimism about future corporate profits.

Purchasing managers order the materials and set production levels in factories, and their optimism has been swelling. The Purchasing Managers Index (PMI) rose 1.1 percentage points to 54.2 percent, the highest level since June 2011. (Anything over 50 percent signals expansion.) All five of the PMI component indexes—new orders, production, employment, supplier deliveries, and inventories—were positive and signaled expansion in February.

Another form of investment is residential investment—the purchases of houses by families. The housing sector has maintained a steady recovery for some time now, as reflected by the consistent growth in *new housing permits*, another leading indicator.



Government expenditure continues to slow, however, coming off peak spending during the post-recession stimulus bill. (See Chart 1 at right.) The continued reductions of government outlays, particularly at the federal level, took 1.4 percentage points from GDP in the most recent quarter. Despite those cuts, the private sector has been strong enough to carry the economy forward.

The foreign sector is likely contributing little to GDP growth at this point. In a March 7 report, the Commerce Department announced a January goods and services deficit of \$44.4 billion, up from \$38.1 billion in December. January exports were \$2.2 billion less than December exports of \$186.6 billion, and January imports were \$4.1 billion more than December imports of \$224.8 billion.

Key Industries Face Labor Shortages

If the economy's private sector is doing so well, then where are the jobs? In February, the unemployment rate fell in 22 states, and nonfarm payroll employment increased in 42 states. The employment situation is improving.

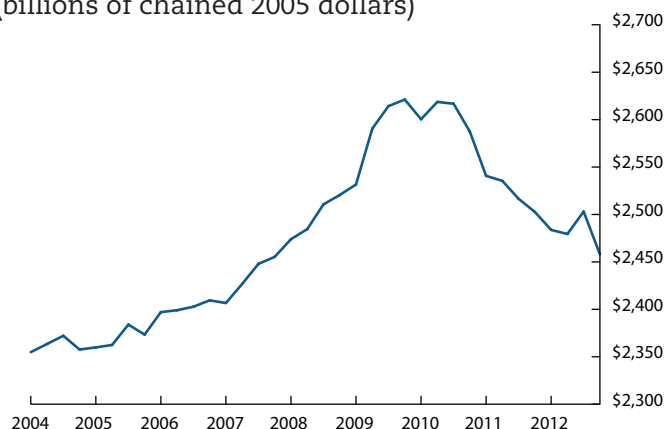
In the same month, the national unemployment rate fell to 7.7 percent. Nonfarm payroll employment increased by 268,000, a 26 percent increase from the 195,000 average of the preceding three months. This surprised most economists, especially following January's disappointing 148,000 net job increase. The number of unemployed persons, at 12 million, also edged lower in February.

Of the 268,000 jobs created, 67 percent or 180,000 could be tied to industries dominated by high-skilled workers, who are likely to have some form of education beyond high school. (The table at right shows the breakdown.)

The recovering construction industry accounts for 48,000 new jobs. Among other industries, there were some losses affecting the total number of jobs created.

About 73 percent (173,000 jobs) of the total employment gain came from four out of thirteen nonagricultural sectors listed by the Bureau of La-

Chart 1: **Government Consumption and Gross Investment**
(billions of chained 2005 dollars)



Source: Federal Reserve Bank of St Louis.

bor Statistics (BLS). They are professional and business services, health care, information, and construction.

The professional and business services sector added 73,000 jobs last month, with most of the employment gains accrued to professional, technical, administrative, and waste services. In February, this sector recorded its 20th consecutive month of employment growth. The BLS employment projection lists this sector as among those with the highest projected job growth potential over the next decade.

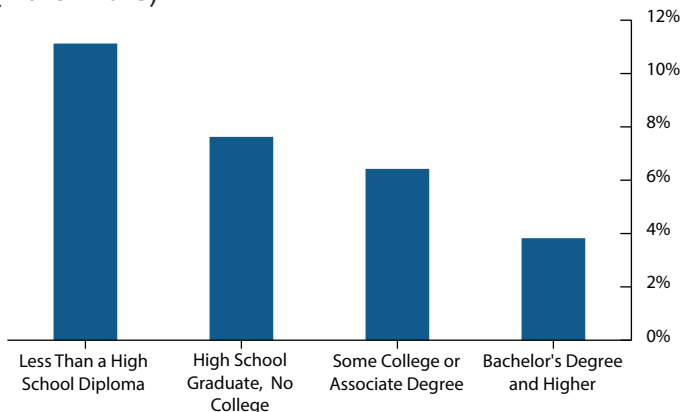
The health care industry, another sector identified by BLS as a key area of future employment growth, added 32,000 jobs over the past month. Most of the employment gains

Where the Jobs Are (February)

Industry	Net New Jobs
Professional and Business Services	73,000
Administrative and Support Services	44,000
Accounting and Bookkeeping	11,000
Health Care	32,000
Information Industry	20,000
Total	180,000
Total Nonfarm Employment	268,000

Source: U.S. Bureau of Labor Statistics.

Chart 2: **Unemployment by Education Level**
(March 2013)



Source: U.S. Bureau of Labor Statistics.

in this industry came from hiring for ambulatory health care services, nursing, residential care facilities, and hospitals.

Almost the entire employment gain in the information sector (20,000 jobs) stems from job gains in motion pictures and sound recording companies, an industry historically characterized by sharp employment fluctuations. Employment in other areas in the information sector remained unchanged.

The February growth of 48,000 jobs in construction employment was the largest one-month increase since March 2007 when 80,000 jobs were added in this sector. A large part of this increase stems from a growing housing sector.

The Case-Shiller Housing Price Index, a wide measure of housing prices, has been steadily increasing since August 2012. It recorded its steepest one-month jump between November and December 2012. This increase is consistent with the upward trend reflected by another leading indicator, *new housing permits*, which indicates a steadily improving housing sector.

A shrinking sector not reflected in the nonfarm payroll employment is the public sector. Govern-

ment employment continued to follow a downward trend in March, with the U.S. Postal Service losing 12,000 jobs.

The preliminary numbers for March 2013, released by the Bureau of Labor Statistics on April 5, indicated sharply slower job growth compared to February. Total nonfarm payroll, for example, rose by 88,000, a relatively small increase compared to the sharp rise witnessed in February. But that is not surprising, given that job growth is susceptible to monthly fluctuations. Overall, the upward trend shown by primary expanding sectors—professional and business services, health care and construction—remains unchanged.

While employment growth in recent times is a promising aspect of the recovery, there is still a long way to go to get the lost jobs back.

Higher rates of unemployment tend to occur in industries dominated by low-skilled workers, whereas lower rates occur in industries dominated by high-skilled workers. The unemployment rate for those 25 years and older who have at least a bachelor's degree is currently 3.8 percent. (See Chart 2 above.) Most economists would refer to a rate that low as essentially full employment.

This suggests a potential problem that could limit growth and shorter-term improvements to the unemployment rate. If the industries critical to growth have used up their labor pools, they are going to hit hard constraints to growth. If industries that employ low-skilled workers are not growing, unskilled workers are likely to stay unemployed.

This is almost the definition of a structural unemployment problem. It also helps to explain why U.S. firms are hiring so many high-skill foreigners while Americans go unemployed and overall unemployment rates remain high.

Appendix

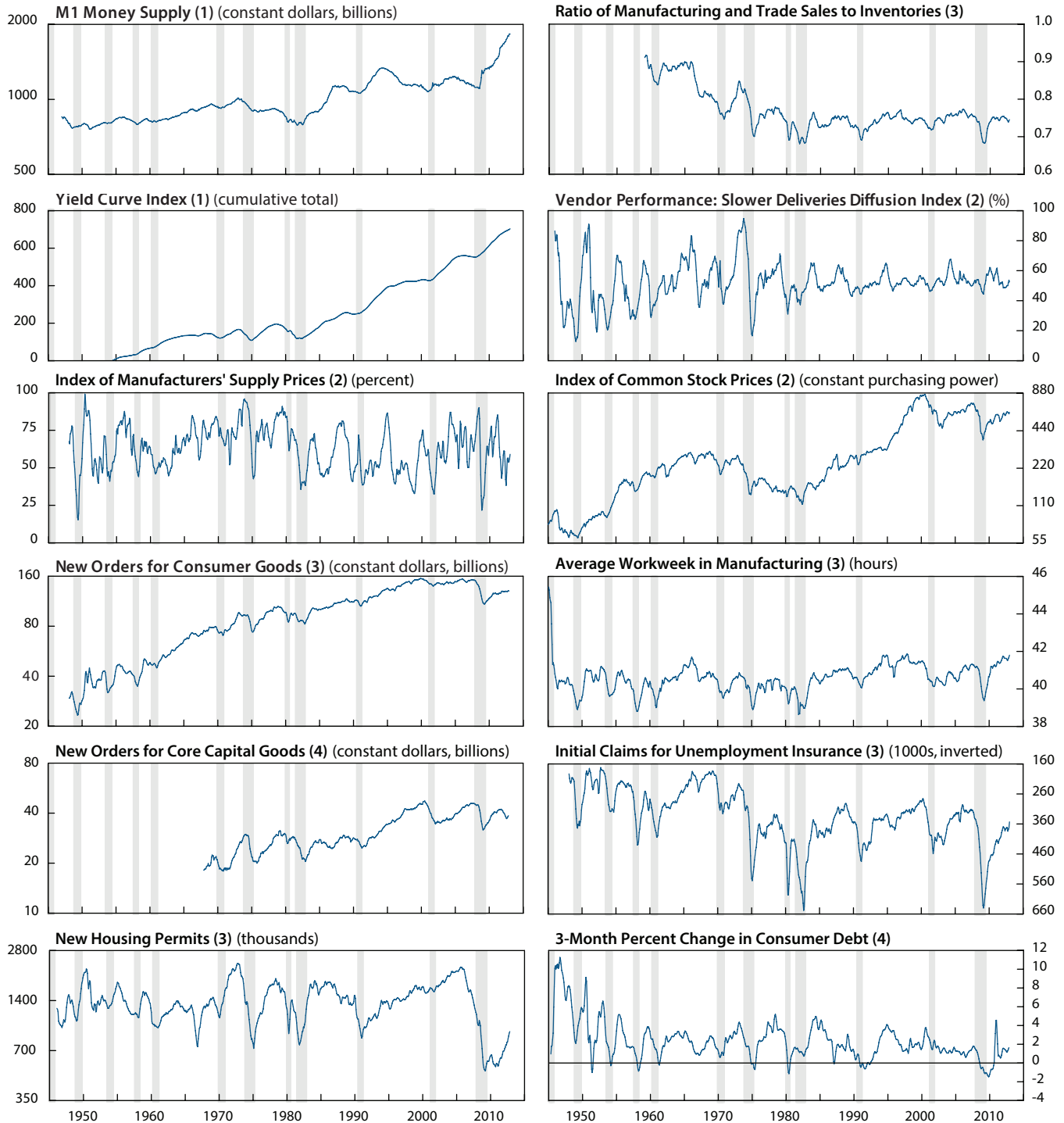
Statistical Indicators of Business-Cycle Changes

<i>Change in Base Data</i>					<i>Cyclical Status</i>		
Nov	Dec	Jan	Feb		Jan	Feb	Mar
Primary Leading Indicators.							
-	+	+	-	M1 money supply	+	+	+
+	+	+	+	Yield curve index	+	+	+
-	+	+	+	Manufacturers' supply prices	-	-	-?
+	-	-		New orders, consumer goods	+	+	+
+	-	+		New orders, core capital goods	-	?	+?
+	+			New housing permits	+	+	+
+	+			Ratio of sales to inventories	-?	-?	?
+	+	-	-	Vendor performance	?	+?	+?
-	+	-	+	Index of common stock prices	+	+	+
+	+	-	+	Average workweek, mfg.	+?	+?	+
-	+	+	+	Initial claims, unemplmt. insurance*	+?	+?	+
-	+	+		Change in consumer debt	+	+	+
				Percentage expanding cyclically	73	82	91
Primary Roughly Coincident Indicators							
+	+	+	+	Nonag. employment	+	+	+
-	+	+ ^r	+	Index of industrial production	+	+	+
+	+	-		Pers. income less transfer payments	+	+	+
+	+			Manufacturing and trade sales	+	+	+
-	-	-	+	Civilian emplmt. to population ratio	+?	+?	+?
+ ^r	+ ^r			Gross domestic product	+	+	+
				Percentage expanding cyclically	100	100	100
Primary Lagging Indicators							
+	+	+	-	Avg. duration of unemployment*	+	+	+
+	+			Manufacturing & trade inventories	+	+	+
+	+	+		Commercial & industrial loans	+	+	+
-	-	+		Ratio of cons. debt to income	+	+?	+
-	+			Chg. in labor cost/output, mfg.	+	+	+
nc	-	nc	+	Short-term interest rates	?	?	?
				Percentage expanding cyclically	100	100	100

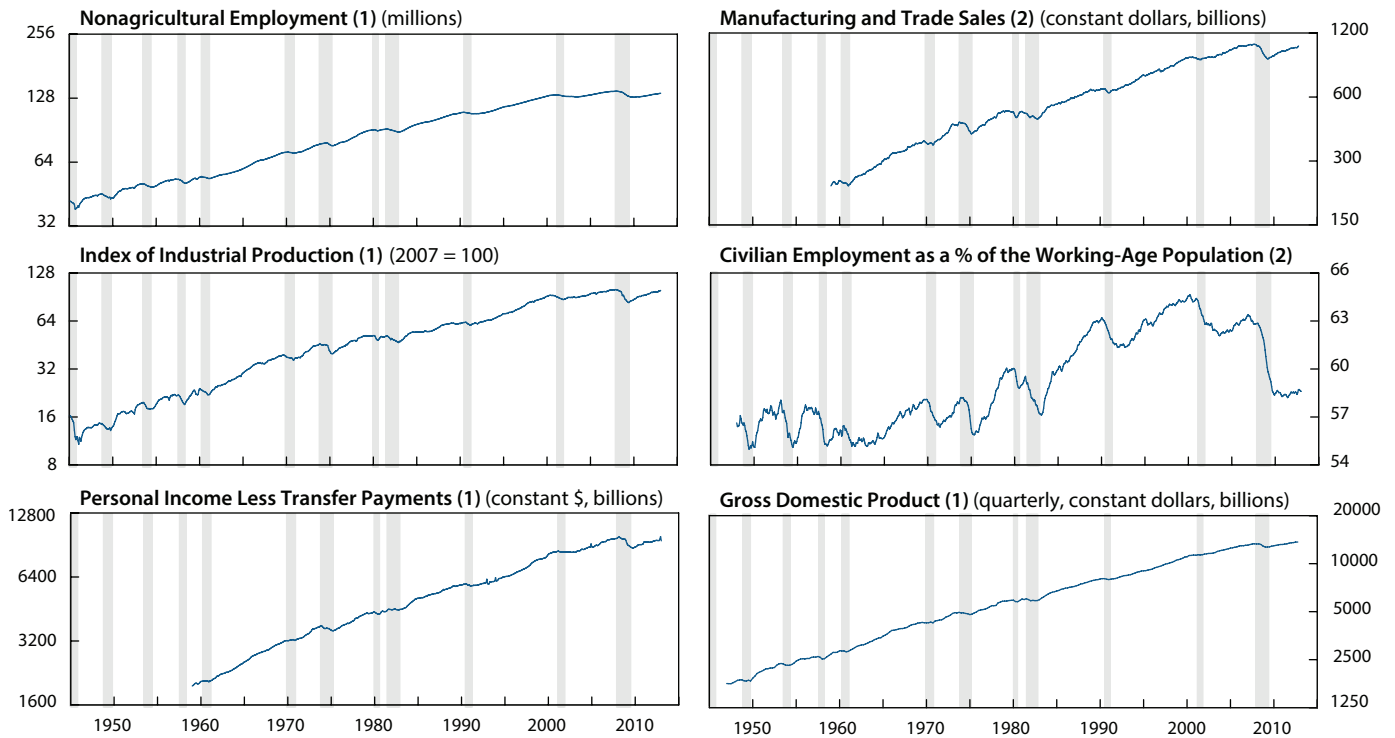
nc No change. r Revised. * Inverted. Under "Change in Base Data," plus and minus signs indicate increases and decreases from the previous month or quarter; blank spaces indicate data not yet available. Under "Cyclical Status," plus and minus signs indicate expansions or contractions as currently appraised; question marks indicate doubtful or indeterminate status.

Appendix

Primary Leading Indicators



Primary Roughly Coincident Indicators



Primary Lagging Indicators

