LPL FINANCIAL RESEARCH

Weekly Economic Commentary

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What Is "Normal" in the Labor Market?

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Highlights

A look back at key labor market indicators suggests that mid-to-late 2007, just prior to the Great Recession onset, was not "normal" for the labor market.

It's hard to make the case that unemployment of 4.4% or below is normal, particularly when analyzing prior economic cycles.

The composition of the labor market—particularly a review of construction employment—also suggests that the period just prior to the onset of the Great Recession was not normal.

In our *Weekly Economic Commentaries* over the last two weeks (*Jobs: Far From "Back to Normal,"* November 4, 2013, and *Labor Market: On the Mend, but Not "Back to Normal,"* November 11, 2013), we discussed the state of the U.S. labor market in late 2013, and whether or not it has returned to "normal." In those reports, we defined "normal" as mid-to-late 2007, just prior to the onset of the 2007–09 Great Recession. But was mid-to-late 2007 really normal for the labor market?

4.4% Unemployment Isn't "Normal" in the Historical Context

Since 1948, the unemployment rate (the number of unemployed as a percentage of the civilian labor force) has averaged 5.8%, and the median (the level at which half of the readings are higher and half are lower) is 5.6%. In October 2006, as the housing-driven economic recovery that began in November 2001 entered its sixth year, the unemployment rate hit 4.4% and stayed between 4.4% and 4.6% until June 2007. Between 1948 and mid-2006, the unemployment rate had been 4.4% or lower only about 25% of the time, concentrated in five different periods: the late 1940s, the early 1950s, the late 1950s, the late 1960s, and the late 1990s. Thus, it's hard to make the case than an unemployment rate at 4.4% or below is normal. A 4.4% unemployment rate was not unprecedented, but it wasn't normal either.

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Prior to 2006, the last time the unemployment rate spent significant time below 4.4% was between mid-1998 and mid-2001. That period marked the end of the long, technology-driven economic expansion that began in 1991 and ended in February 2001. Prior to the late 1990s and early 2000s, the last time the unemployment rate was below 4.4% was in the late 1960s. The unemployment rate hit 4.4% in August 1965, and stayed there until April 1970—for almost five years. This period encompassed the latter half of the long, robust economic recovery that began in 1961, and ended in late 1969, as well as the early months of the 1969–70 recession.

An oft-cited metric used to gauge whether or not the labor market has returned to normal is the labor force participation rate. The participation rate is defined as the percentage of the working age population that is either employed or looking for work. Today, the participation rate stands at 62.8%—the lowest reading in 35 years—and well below where it stood in mid-to-late 2007 (around 66%). However, we believe the participation rate is not the best gauge of labor market normalcy. There are several drivers of this decline—some related to demographics and others related to the

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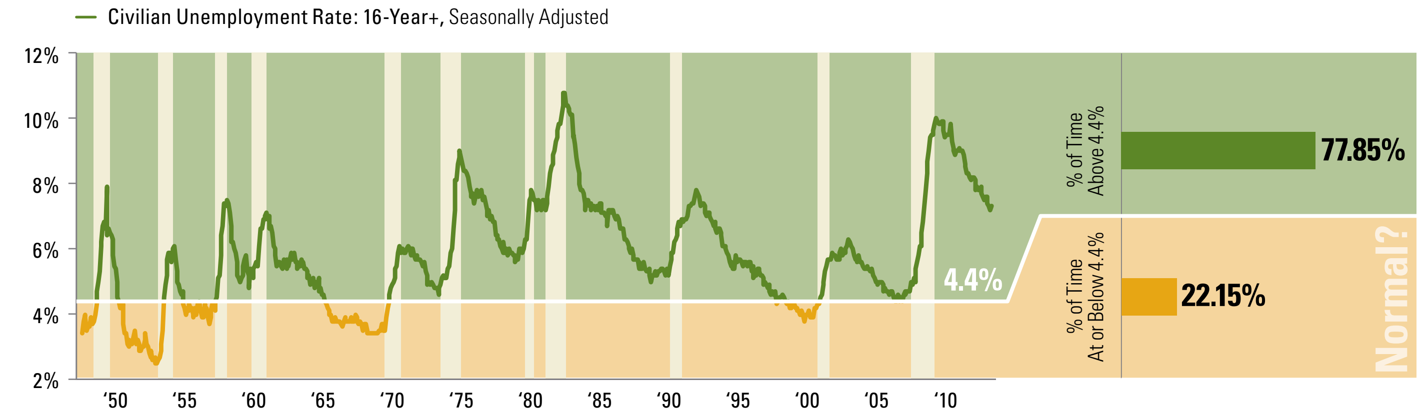
1 Over the Past 65 Years, the Unemployment Rate Has Been at or Below 4.4% Less Than 25% of the Time



Source: Bureau of Labor Statistics, Haver Analytics 11/18/13

Shaded areas indicate recessions.

nature of this expansion. In any case, those waiting for the participation rate to return to its mid-to-late 2007 level before declaring a return to normalcy for the labor market are likely in for a long wait.

Construction Employment Tells Another Story About "Normalcy"

The composition of the labor market (where the jobs came from/who was being hired, etc.) in 2006 and 2007 is another area to consider when determining whether or not the period was normal. In 1992, construction employment as a percent of total private sector employment stood at 5.0%, after averaging 6.0% between 1948 and 1992. The year 1992 was the start of the 15-year housing boom that ended in the mid-2000s. Between 1992 and 2007, construction employment as a percent of total employment moved from 5.0% to as high as 6.7% in mid-to-late 2006, around the same time the unemployment rate first hit 4.4%. The latest data point (October 2013) reveals that construction employment as a percent of total employment is now just 5.0%, or just about the prior long-term average.

Put another way, between mid-2003—when the economy routinely began adding jobs after the mild 2001 recession and uncertainty surrounding the start of the U.S. invasion of Iraq in early 2003—and mid-2006, when the unemployment rate hit 4.4%, the private economy added 6.2 million jobs. One million of those 6 million jobs, or 17%, were construction jobs. To put that number in perspective, just 5% of the 81 million net new jobs created between the end of World War II and 2013 were construction jobs. In other words, during the mid-2000s housing boom, construction jobs accounted for a disproportionately large amount of job creation. When the housing boom ended, these jobs disappeared, and many of them may never come back.

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Of course, construction jobs alone do not tell the whole story of the housing-driven economy of the mid-2000s. Although there is not an official metric of "housing-related" employment, we added employment at commercial banks and employment in real estate, rental, and leasing, to construction employment to approximate employment related to the housing boom. In early 2003, employment in these three areas totaled 10 million. As the unemployment rate hit 4.4% in late 2006, employment in these three areas hit 11.2 million, an increase of 1.2 million jobs. This rise accounted for 18% of the 6.2 million jobs created in the entire economy in this period. Again, housing-related jobs accounted for a disproportionately large percentage of jobs created during that period, and our definition of "housing-related" employment is relatively conservative. A case can be made that the housing boom also boosted employment in advertising, auto manufacturing, and manufacturing of construction materials, furniture, and home appliances—just to name a few areas.

The Beige Books of the 2003–06 era do not describe a "normal" labor market.

Other labor market metrics from that era, such as wages, hours worked, job openings, etc., tell the same story, as does the contemporaneous qualitative assessment of the labor market. For example, the Beige Books of the 2003–06 era often describe construction activity as "brisk" or "robust," and note that economic activity related to construction materials and equipment was also booming. (See the *Weekly Economic Commentary: The Lowdown on the Shutdown* from October 21, 2013, for details on the most recent Beige Book.) The Beige Books of the era also often cite "shortages of skilled workers," "tightening of conditions," and increases in wage pressures in the construction area of the labor market, even among unskilled workers. Generally speaking, these words do not describe a "normal" labor market. Notably, a similar set of words were used in the Beige Book to describe the economic and labor market conditions in the technology sector in the late 1990s/early 2000s, when the tech boom drove the unemployment rate down below 4.0% for several months.

Worker Gaps and Wage Pressures

On balance, we continue to note that while the labor market is on the mend, it is still not back to "normal." However, if the public, market participants, pundits, policymakers, and politicians use mid-to-late 2007 as "normal," the labor market may never return to normal, given the unique conditions present in the labor market during that era. Over the past three-and-a-half years, the economy has added nearly 7 million new jobs. Hiring has generally been evenly distributed across all industries and occupations. However, recent Beige Books have noted that employers are having some difficulty in finding workers in certain areas of the economy, and that wage pressures are building in many of these areas. These areas include:

- Technicians;
- Truck drivers;
- Software developers;
- Engineers;

- Legal and compliance professionals;
- Accountants;
- Financial analysts;
- Machine operators;
- Biotech;
- Advanced manufacturing;
- And yes, construction too.

At the current pace of job growth (around 200,000 net new jobs per month have been created over the past 12 months), total employment will surpass its December 2007 peak of 138 million workers at some point in 2014. When that occurs, we may have to rethink what a normal labor market actually is. ■

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