Capital

The Troubled Recovery

Thomas F. Cooley and Peter Rupert 07.16.10, 6:00 AM ET

On several occasions in this column we have chronicled the path of the latest economic cycle--showing that the "Great Recession" was (or is?) certainly that. After several months of relative optimism about the economic recovery, popular sentiment has recently ebbed. There is very good reason for that.

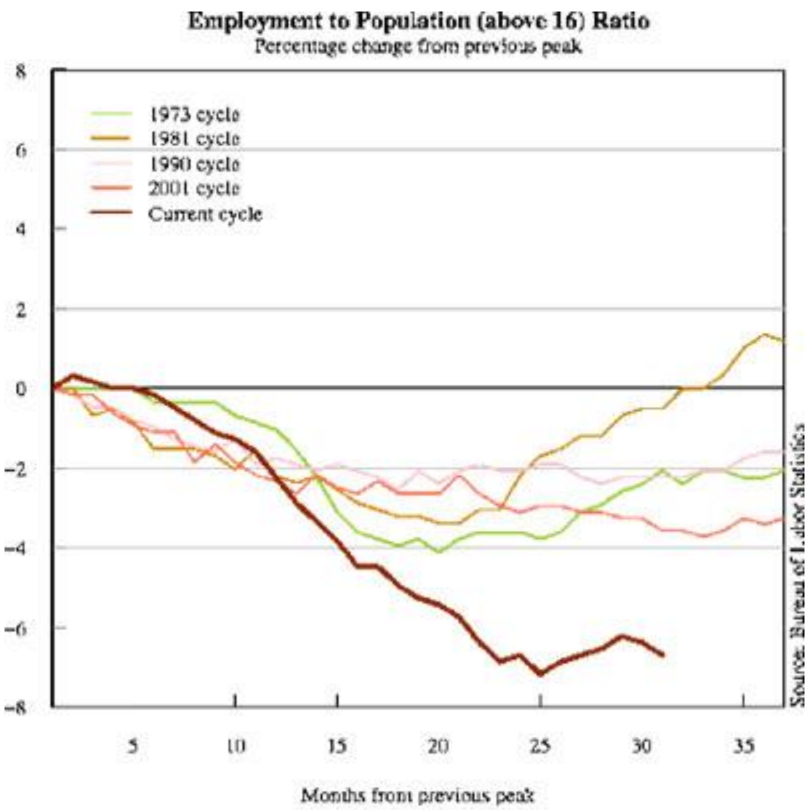
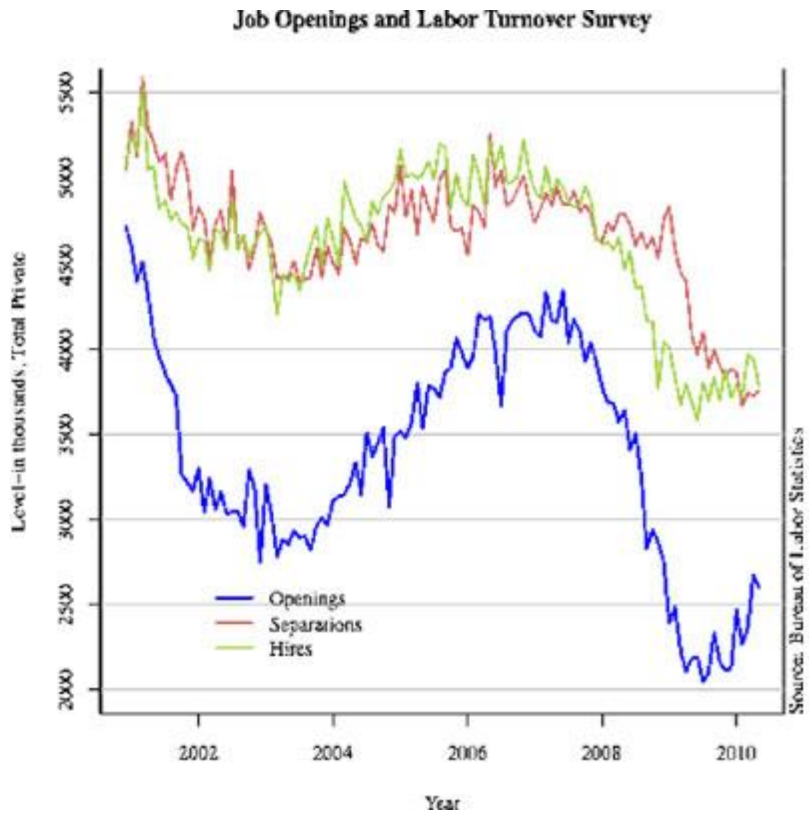
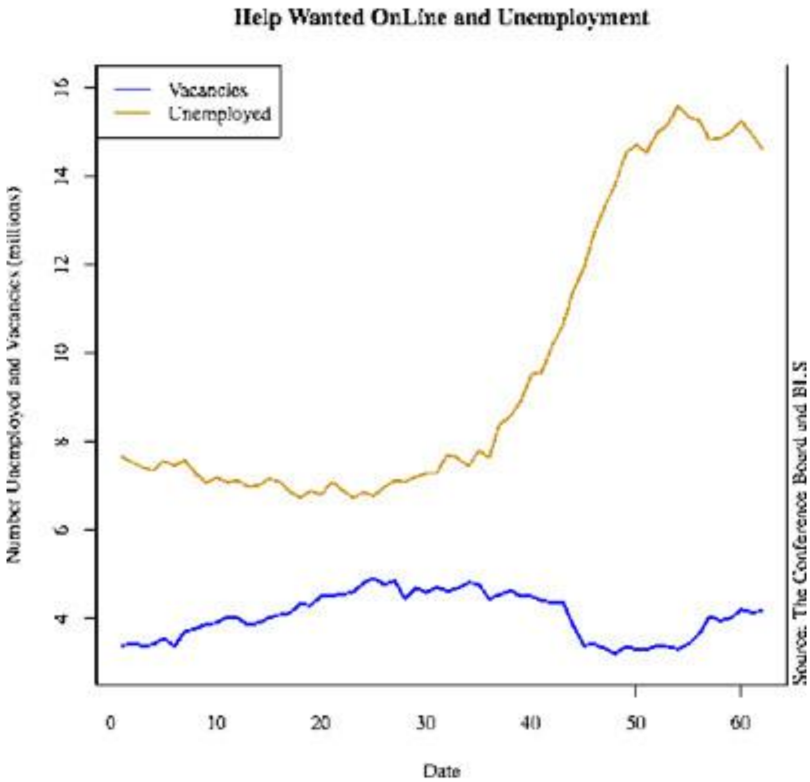


Figure 1 shows the path of the current employment-to-population ratio compared with the previous four recessions. The decline in this ratio has been much deeper than any recession in the past 40 years and still shows little signs of improvement. In fact, after increasing five months in a row, the employment-to-population ratio dipped again in May and June, indicating the labor market is still on shaky ground. Though some optimists, such as Robert Gordon and Mark Zandi have declared the recession over, it sure won't feel like it's over until more people are back at work.

Our "official" business cycle dating committee, housed at the National Bureau of Economic Research and of which Robert Gordon is a member, will, at some point, back-date the end of the recession. However, the committee mentioned that the 1.2 million drop in payroll employment was the biggest factor in determining the start of the contraction. So one might conclude that they would also put some amount of weight on the employment numbers to determine when we have exited the recession. From the looks of the recent performance of the employment to population ratio, that won't be soon.



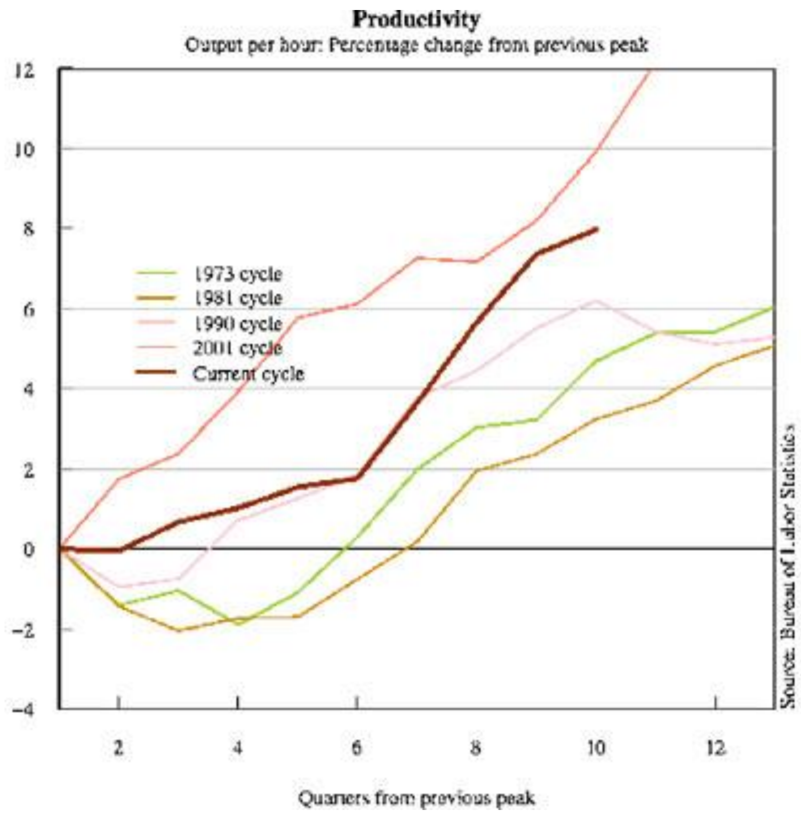
In addition, the most recent data from the Bureau of Labor Statistics' Job Openings and Labor Turnover Survey, plotted in Figure 2, shows that there were small declines in the number of hires and job openings in May.



Further, the Conference Board's Help Wanted OnLine release on June 30 showed that online advertised vacancies were little changed in June after declining slightly in May. The release shows that for the U.S. as a whole, there were 3.62 persons unemployed for each advertised vacancy (see Figure 3). "While all states have experienced some positive upturn in labor demand," the release says, "states that were heavily impacted by the housing market downturn, in general, are rebounding more slowly. Also, occupations that are most closely associated with real estate--construction, architecture and engineering, and legal--have been slower to advertise for additional workers while the labor demand in other occupations such as sales, entertainment, food preparation, and health care and personal care have already risen to pre-ecession levels."

In other words, the report links the woes in the labor market to those in the housing market. If indeed there is any credence to this relationship, it does not bode well for the labor market recovering soon, especially for places like California that have about five unemployed individuals for each advertised vacancy.

As many have pointed out, due to the massive "shadow inventory" of houses, the housing sector may still be a long way from recovery because the shadow inventory will take some time (up to three years by some estimates) to unwind.



So, why aren't firms hiring? Output per hour is high; the productivity of those still in the labor force actually never fell during this recession as seen in Figure 4. Of course this just means that hours have fallen substantially more than output. Nevertheless, as mentioned in an earlier column, businesses are sitting on large amounts of cash; so, with productivity high and cash on hand, it seems like a ripe opportunity to begin to hire labor and expand. The point of that earlier column was that economic policy uncertainty might be holding back firm investment until there is some resolution as to just how much such policies will cost both small and large businesses. Many businesses claim they are not investing because there is not sufficient demand to warrant it. Retail sales confirm this having fallen in both May and June. According to the Bureau of Economic Analysis of the Department of Commerce household personal saving as measured by the Flow of Funds Account has also increased sharply over the last two quarters suggesting that households are also sitting on the sidelines.

Neither businesses nor consumers seem to have a lot of confidence in this recovery. It seems highly unlikely in the current political climate that the government is going step in and fill the void. That suggests to us that it is worth thinking more deeply about the source of the pessimism.

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