



HARVARD Kennedy School
JOHN F. KENNEDY SCHOOL OF GOVERNMENT

Presentation at the Conference “A Hot Economy: Sustainability and Trade-Offs”

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Institute for International Economics**

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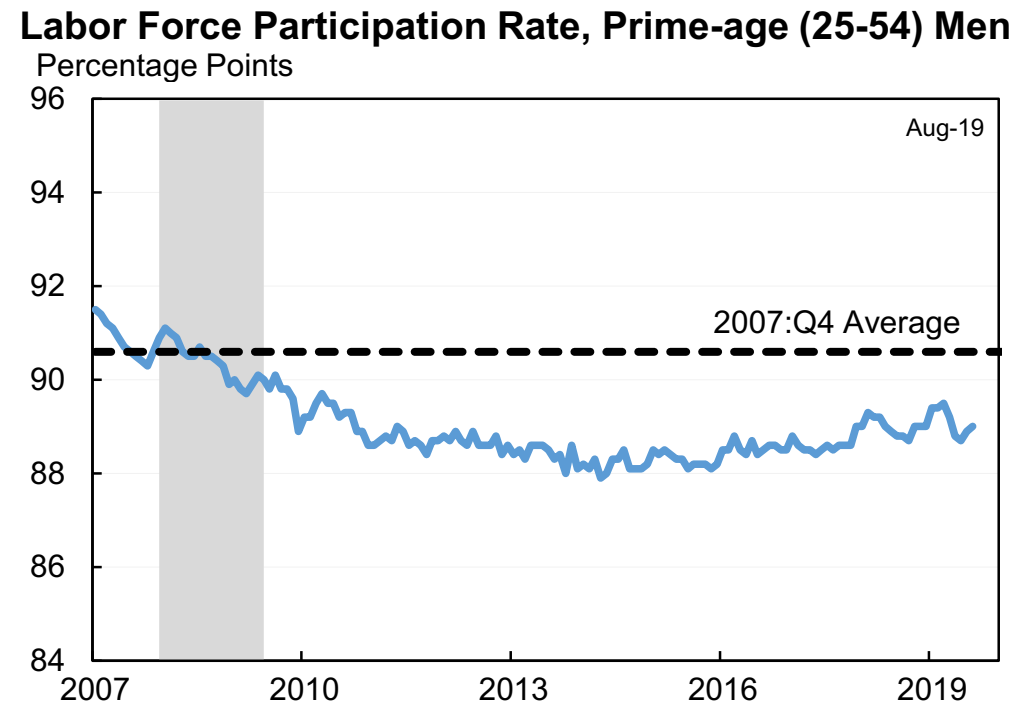
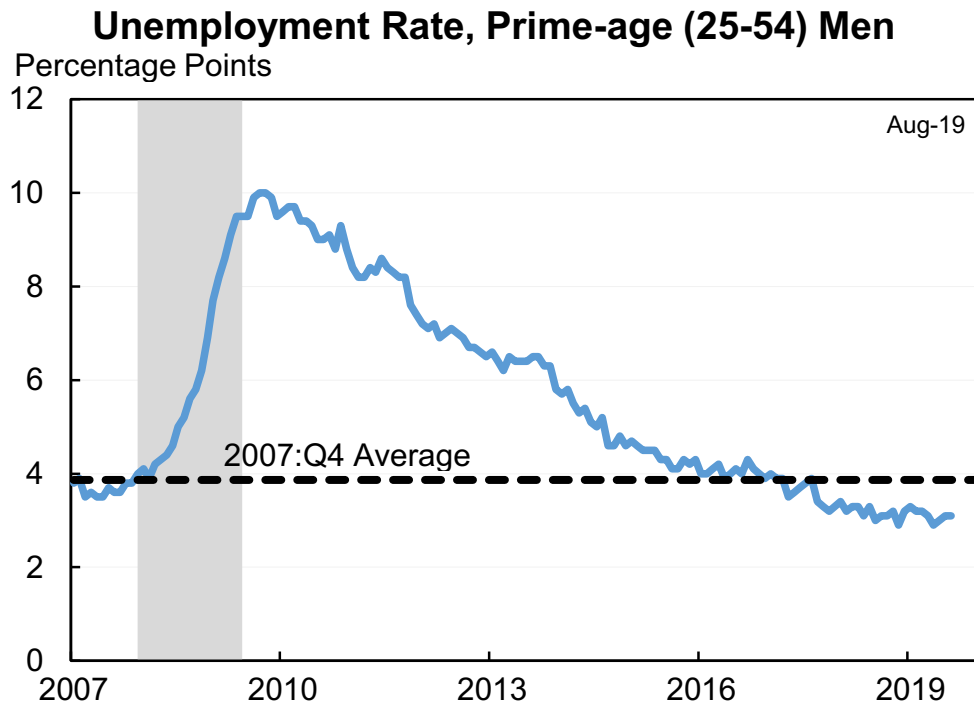
***Unemployment* rates are much lower than they were before the Great Recession**

	2007-Q4	2019-Q2	Change
Unemployment Rate	4.8	3.6	-1.2
U6 (broader underutilization)	8.5	7.2	-1.3
Black unemployment	8.7	6.3	-2.4
Hispanic unemployment	6.0	4.2	-1.8
Long-term unemployment	0.9	0.8	-0.1

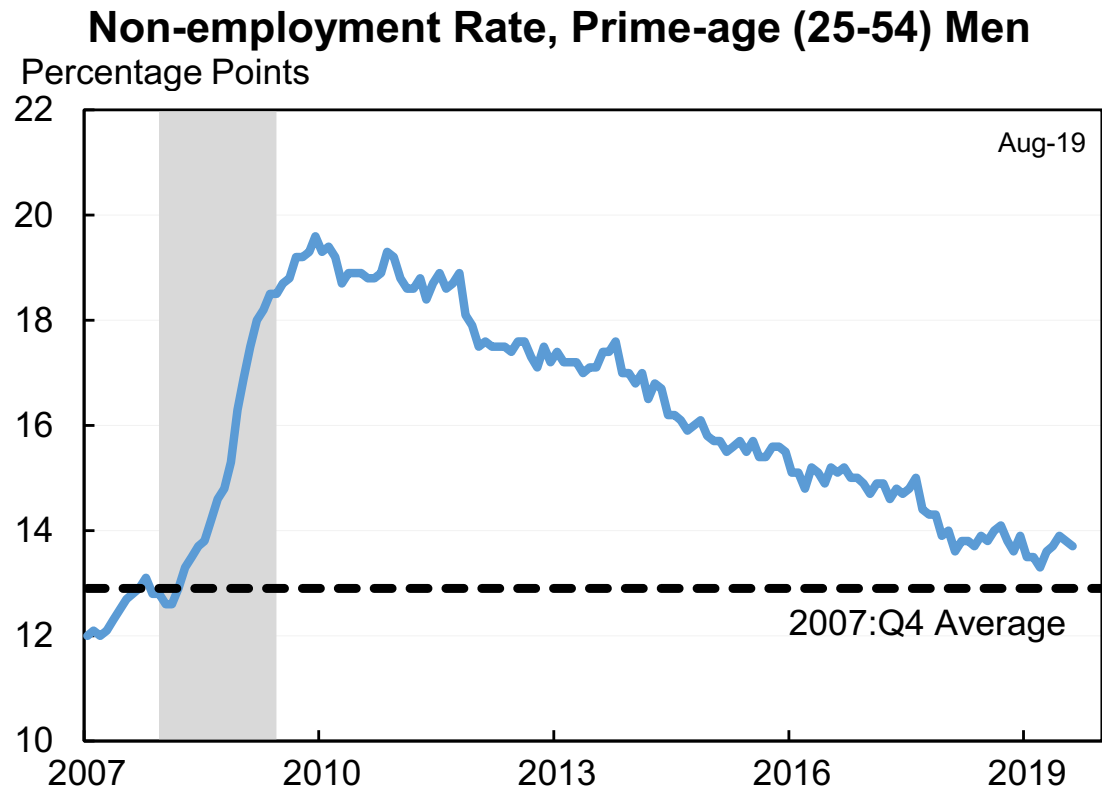
Non-employment rates (including people not looking for jobs) are more mixed

	2007-Q4	2019-Q2	Change
Younger workers (16-24)	47.3	48.9	1.6
Older workers (55+)	62.3	61.2	-1.1
Prime-age (25-54)	20.3	20.3	0.0
<i>Prime-age men</i>	12.9	13.8	0.9
<i>Prime-age women</i>	27.6	26.7	-0.9

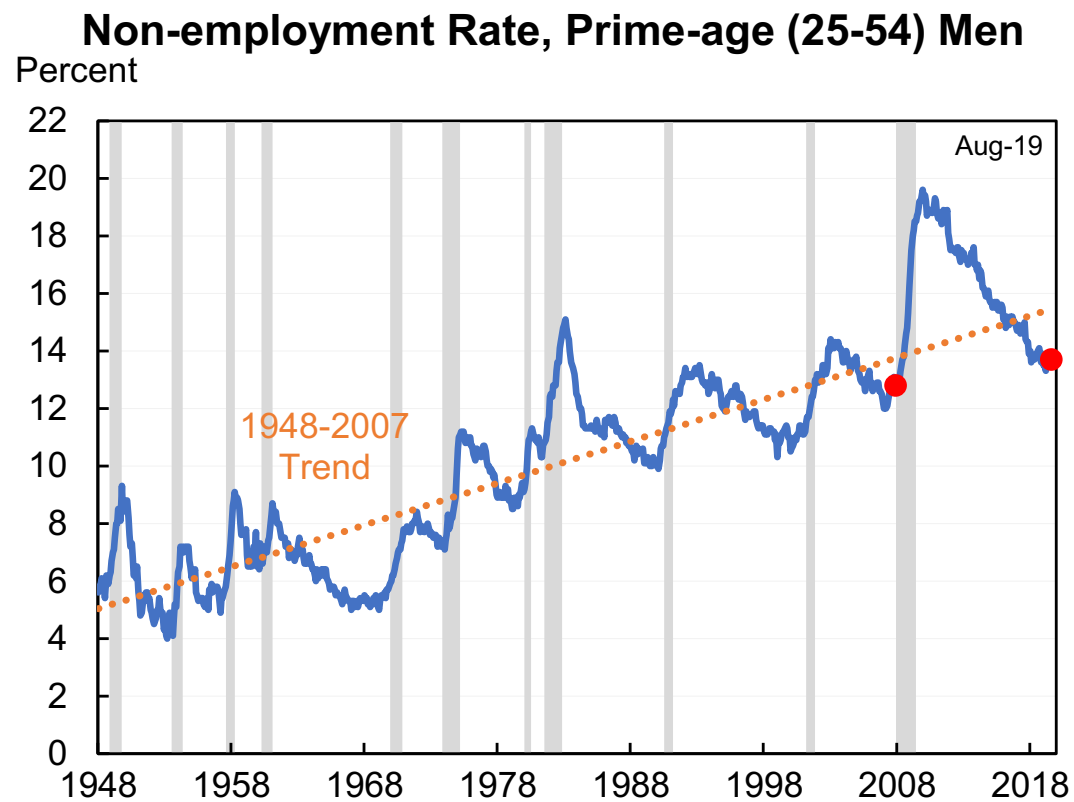
A closer look at prime-age men: unemployment rate down but also labor force participation rate down



The net effect: non-employment rates have made steady progress but not enough to make up for recessionary losses



This has almost always been the case since the 1960s



Source: Bureau of Labor Statistics; author's calculations.



Two lessons from the employment experience for policy

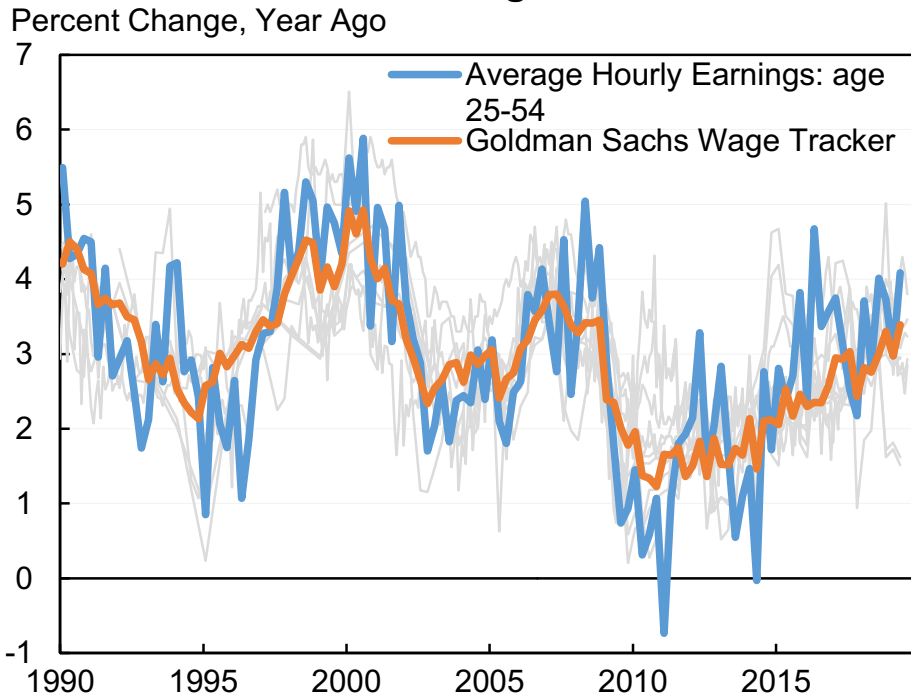
- 1. Monetary policy may have more scope than many appreciated.** A hot economy has helped bring prime-age male employment above its previous trend. And there may still be more room to grow.
- 2. Monetary policy, by itself, cannot offset decades of structural problems.** No monetary policy can erase the 10 percentage point increase in non-employment since the 1950s. Need to remedy structural issues like insufficient education, unsupportive labor markets, limits on mobility, lack of training programs, mass incarceration, the opioid epidemic, and more.

What does a hot labor market mean for wages?

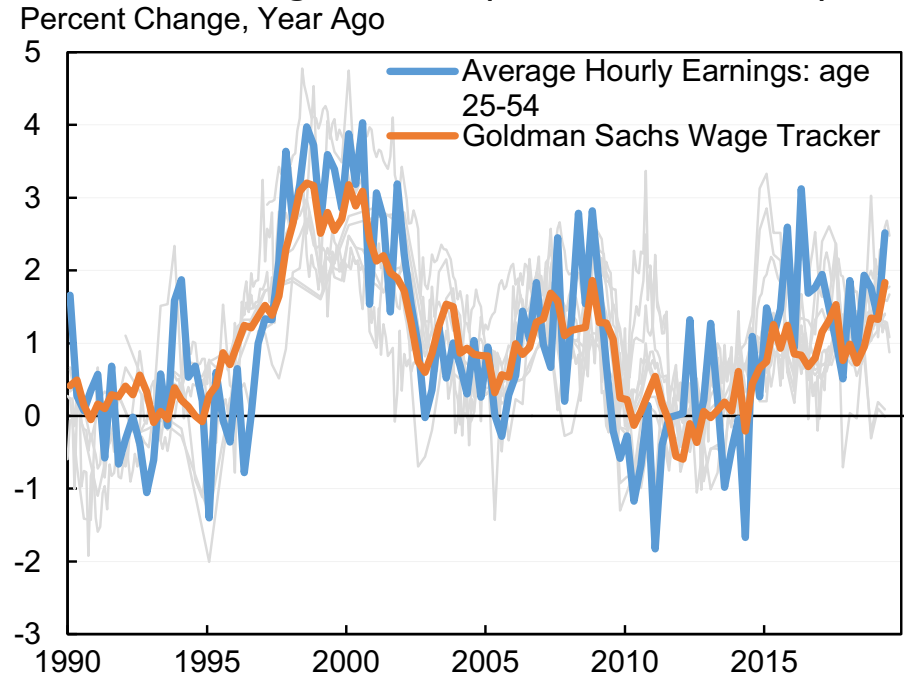
- Employment increases are a good enough reason for a hot labor market.
- Stronger real wage growth would be a bonus.
- Question: what goes up more, prices or wages?

First a quick review of what has happened to nominal and (trend) real wages

Nominal Wage Growth



Real Wage Growth (Core PCE Deflator)



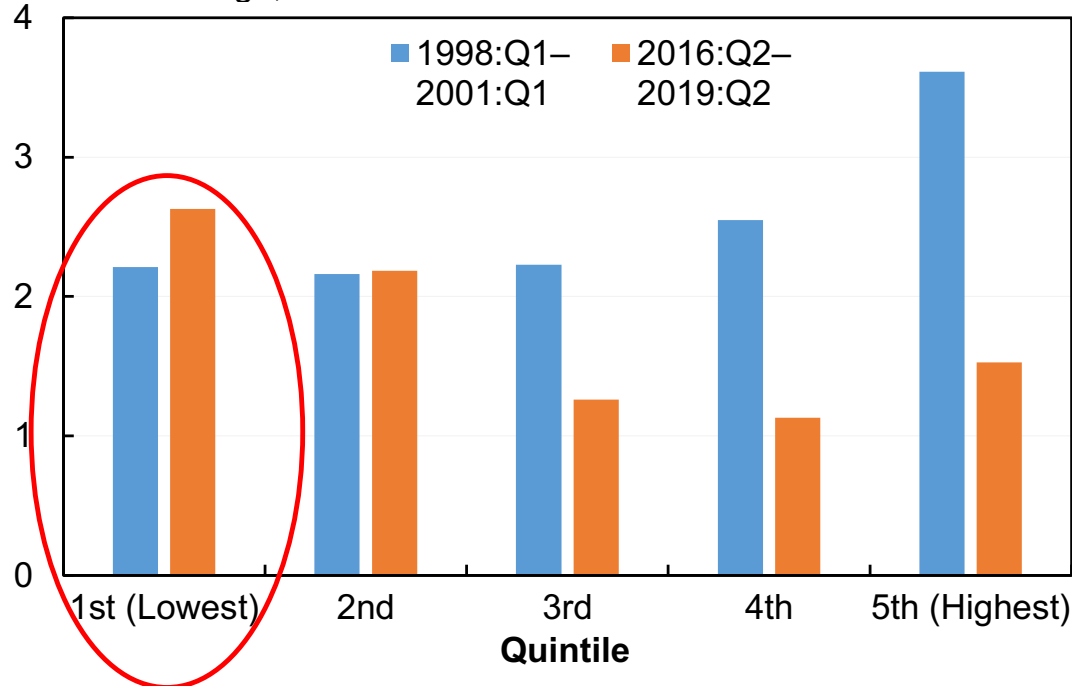
Other wage measures: Atlanta Fed wage growth tracker, ECI: wages and salaries of civilian workers, ECEC: wages and salaries of civilian workers, ECI: wages and salaries of private industry workers, ECEC: wages and salaries of private industry workers, median usual weekly earnings, average hourly earnings: total private, average hourly earnings: production and nonsupervisory workers, average weekly earnings: total private, average weekly earnings: production and nonsupervisory workers.

Source: Bureau of Labor Statistics; Current Population Survey, Merged Outgoing Rotation Groups; IPUMS CPS; Goldman Sachs; Federal Reserve Bank of Atlanta; Bureau of Economic Analysis; Haver Analytics; author's calculations.

The distribution of wages tells an even more favorable story—in fact more favorable than the last hot economy

Real Average Hourly Earnings Growth by Quintile, Prime-age (age 25-54) Wage and Salary Workers

Percent Change, Annual Rate



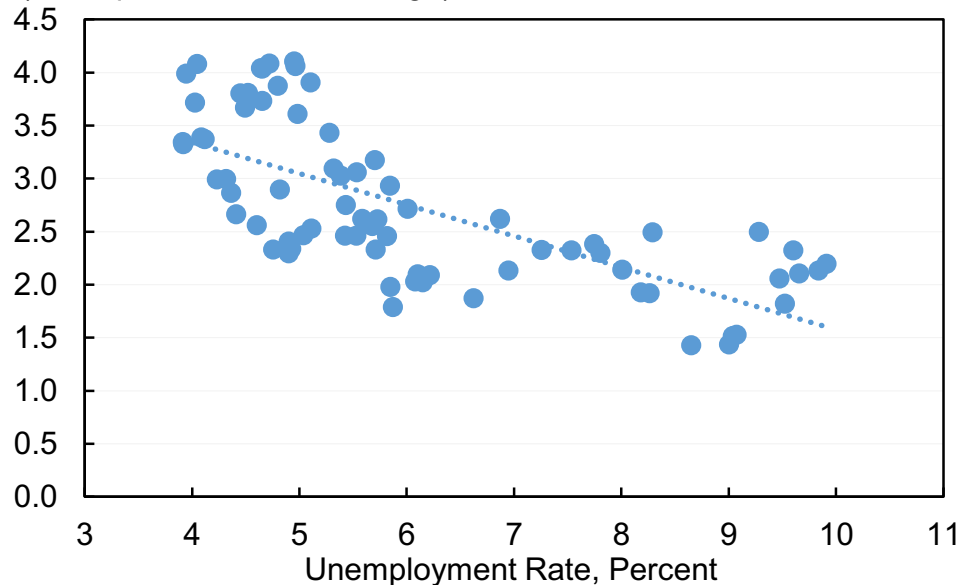
In the latest period wage growth at the bottom is higher than in the late 1990s and is higher than it has been at the top recently.

Note: Top-coded earnings are adjusted following Lemieux (2006). Excludes observations with hourly earnings below \$0.50 or above \$100 in 1989 dollars as deflated by the CPI-U-RS. Nominal wages are deflated by PCE price inflation. Source: Bureau of Labor Statistics; Haver Analytics; Current Population Survey, Merged Outgoing Rotation Groups; IPUMS CPS; Bureau of Economic Analysis; author's calculations.

It appears that wage growth has been more responsive to changes in the unemployment rate than has price growth

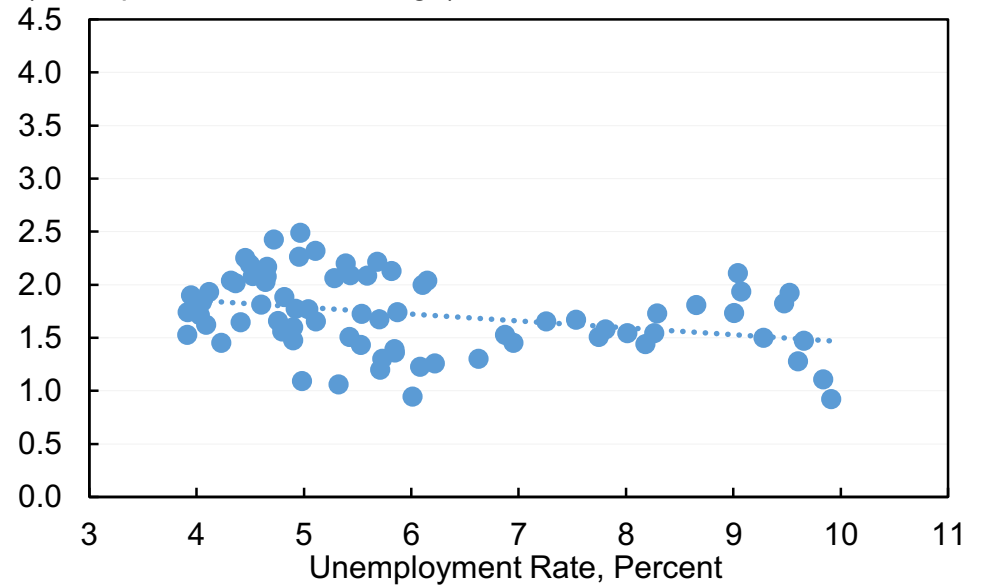
Average Hourly Earnings Growth vs. Unemployment Rate Since 2000

Average Hourly Earnings, Production and Nonsupervisory Workers (Four-quarter Percent Change)



Core PCE Price Growth vs. Unemployment Rate Since 2000

Core PCE Price Growth (Four-quarter Percent Change)



Note: Dotted line is linear trend.

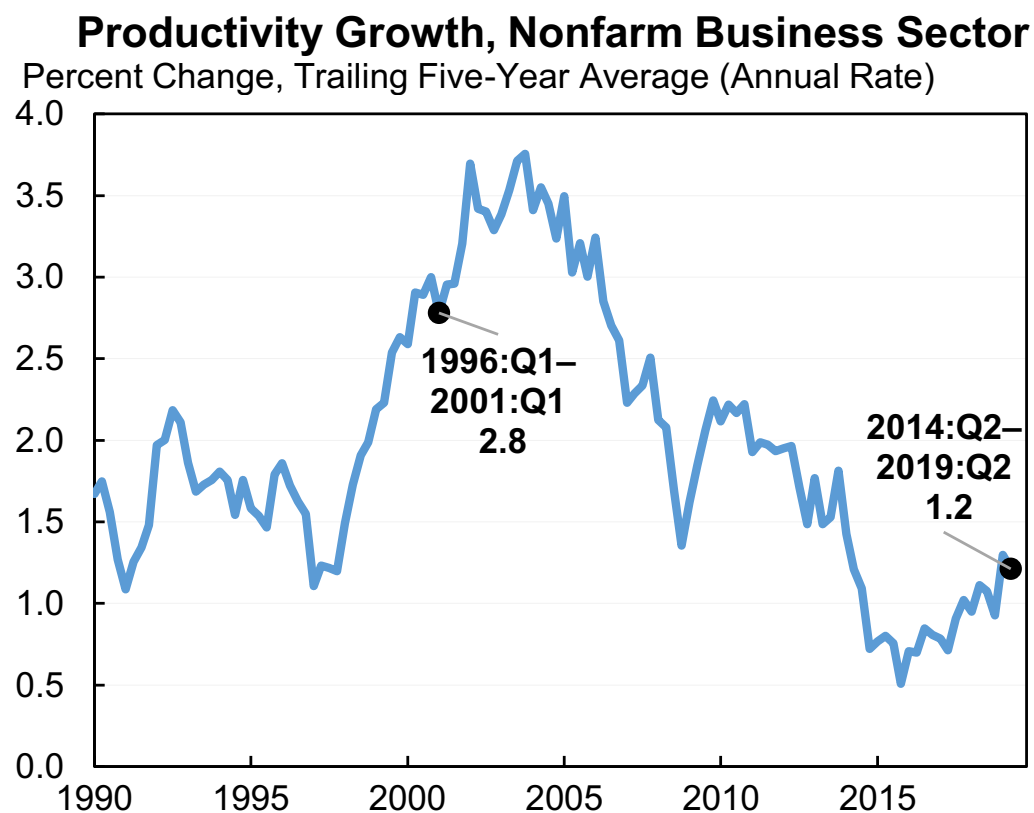
Source: Bureau of Labor Statistics; Bureau of Economic Analysis; Haver Analytics; author's calculations.

This is generally true for different models of the Phillips curve and measures of slack (plus prices/wages, not shown)

Effect of a 1 percentage point improvement in labor markets (2000 to present)						
Slack Measure	Traditional Phillips curve		Accelerationist Phillips Curve		Autoregressive Phillips Curve	
	Average Hourly Earnings	Core PCE Prices	Average Hourly Earnings	Core PCE Prices	Average Hourly Earnings	Core PCE Prices
UR	0.29**	0.06**	0.09	-0.03	0.21**	0.06**
Short-term UR	0.50**	0.14**	0.32**	-0.06	0.40**	0.12
Prime-age employment	0.30**	0.06	0.01	-0.03	0.25**	0.06**

Note: ** indicates estimate is significant at the 5 percent level. Estimated with Newey-West standard errors using an 8 quarter lag.
Source: Bureau of Labor Statistics; Bureau of Economic Analysis; Haver Analytics; author's calculations.

The hot labor market is helping to make up for the fact that productivity growth is slower than it was in the late 1990s



With lower productivity growth, we would expect wage growth to be lower—by as much as 1.6 percentage points.

Focusing on wages has an analogous policy lesson as focusing on employment

- 1. Monetary policy appears to be able to raise real wage growth.** More research needed—especially on relative effects on wages and prices.
- 2. Monetary policy, by itself, cannot offset decades of structural problems.** Slower productivity growth and higher inequality are major impediments to wage growth. Monetary policy can help with these but cannot fully undo the deeper forces like the nature of technological change, slowdown in educational advancement, weaker labor unions, lower minimum wage, and more.



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Costs and Benefits of a Hot Economy

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