Discussion of “Labor Market Dynamics and Monetary Policy”

Integral

August 22, 2014

Section 1

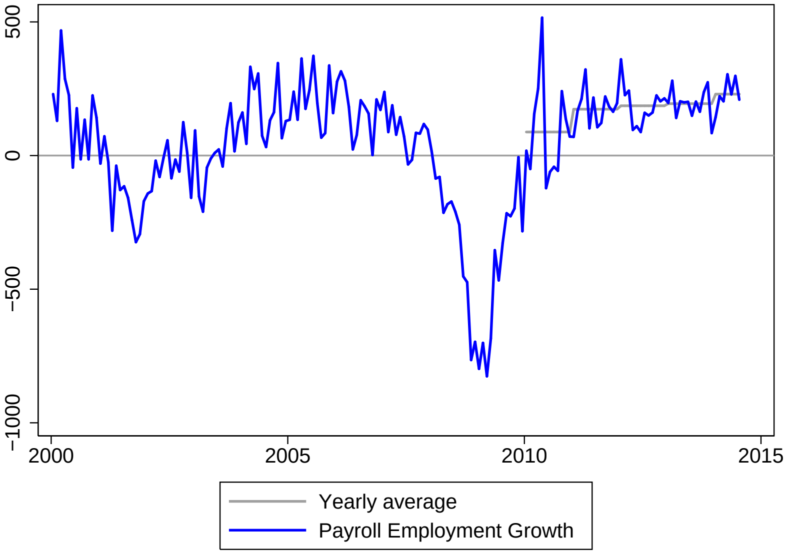
Standard Indicators

Definitions

- Population over 16: P
- Employed persons: E
- Not employed, looking for work: U
- Not employed, not looking for work: N
- Labor force: $E + U$
- Unemployment rate: $U/(E + U)$
- Employment-Population Ratio: E/P
- Labor Force Participation Ratio: $(E + U)/P$
- Employment growth: ΔE

Employment Growth

Thousands of jobs per month

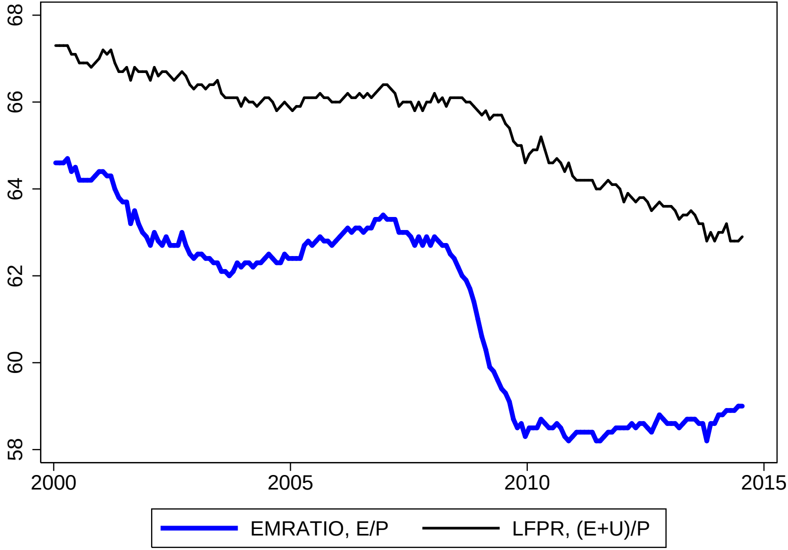


Unemployment Rates

Percentage of labor force

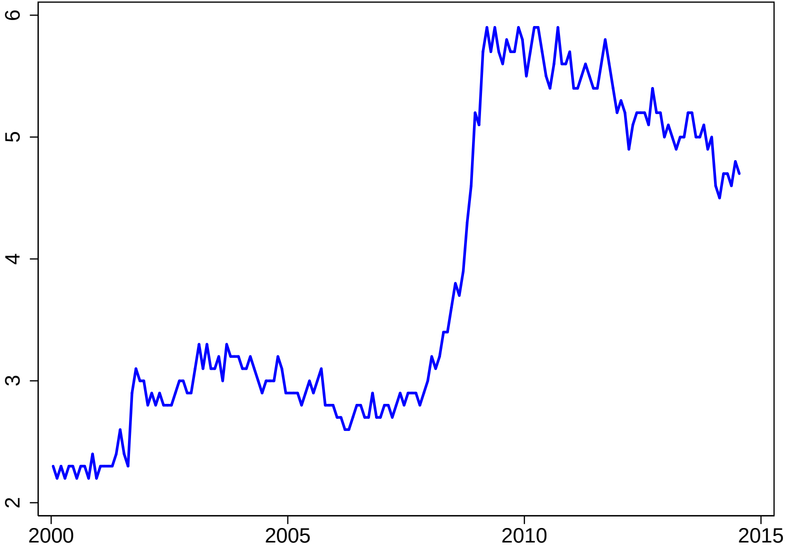
Labor Force Participation and Employment Rate

Percentage of population



Part-Time for Economic Reasons

Percentage of labor force

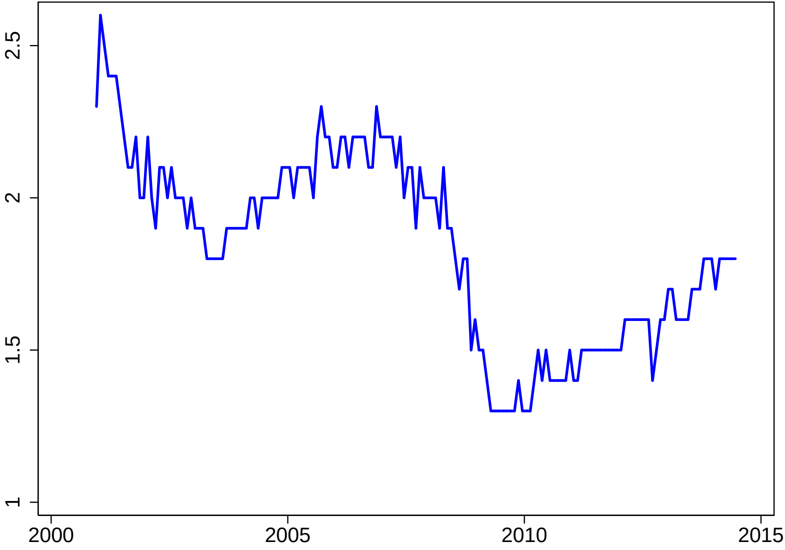


Section 2

Indicators from the Job Openings and Labor Turnover Survey

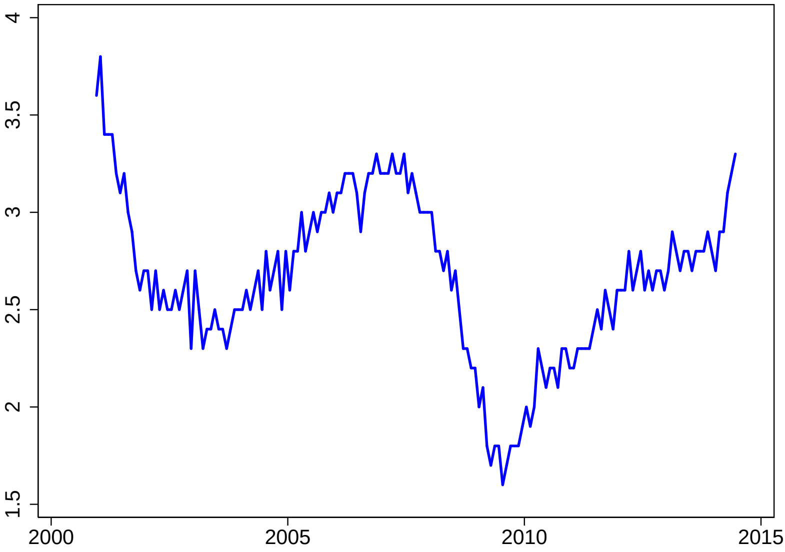
Quits

Percentage of Labor Force



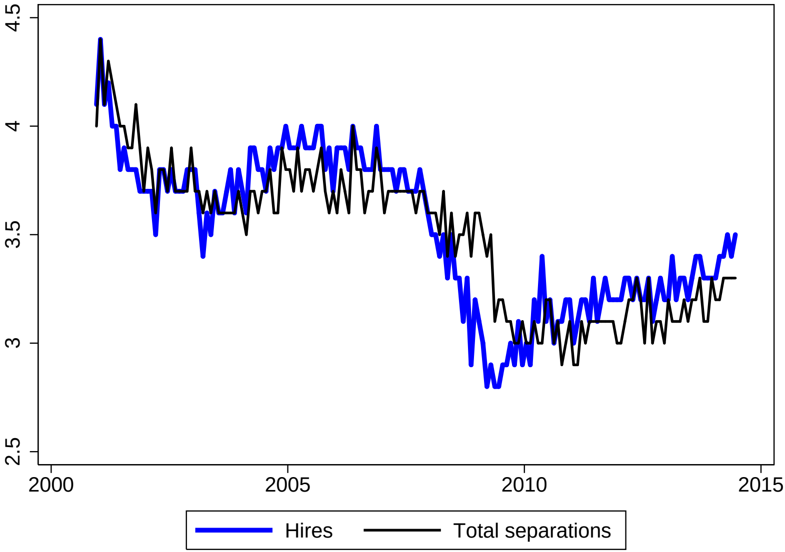
Openings

Postings as Percentage of labor Force



Hires and Separations

Percentage of Labor Force

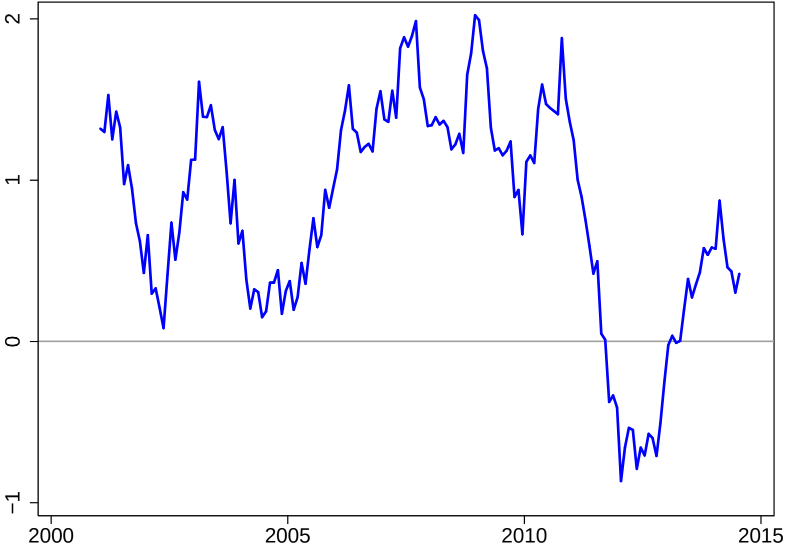


Section 3

Labor Compensation

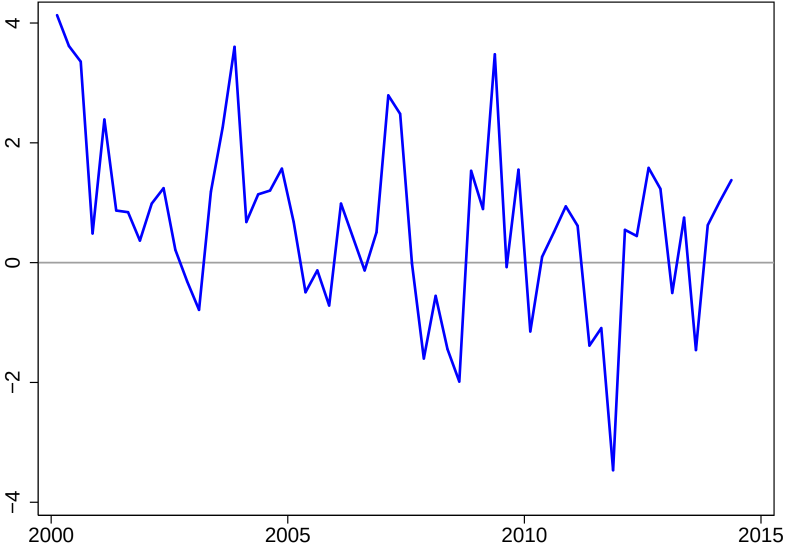
Real Wage Growth

Percentage change over previous year



Real Compensation Growth

Percentage change over previous year

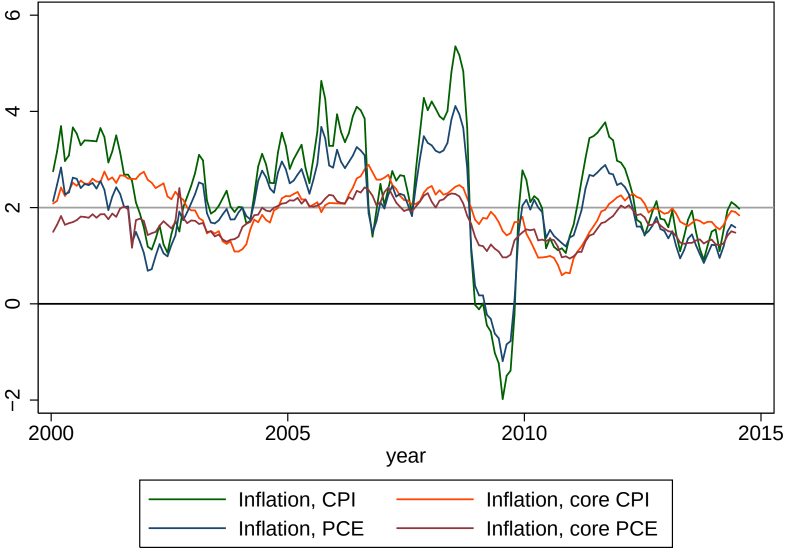


Section 4

Implications for Monetary Policy

Remember the other half of the dual mandate

Inflation, year-over-year, four measures



Economic Indicators and The Stance of Monetary Policy

- Inflation is returning to target
- labor markets are healing quickly, but not back to potential
- Should we tighten monetary policy as soon as inflation reaches target?

Elements of theory

- Let labor market slack be denoted $(h_t - h^*)$
- Remember the Phillips Curve:

$$\pi_t = \beta E_t \pi_{t+1} + \kappa(h_t - h^*)$$

- Implication: focusing on inflation will also heal labor market
- But inflation is already very close to target, and labor market weakness persists
- Caveat: inflation is driven by other factors as well, so inflation could return to target in the presence of considerable labor market slack
- Caveat: Could be prudent to not tighten just as soon as inflation hits target, if we also believe labor market slack is significant

Moving Forward

- Labor markets are healing faster than the Committee had anticipated
- However, "The Committee judge[s] that underutilization of labor resources still remains significant."
- Discretion is the order of the day: "There is no simple recipe for appropriate policy in this context, and the FOMC is particularly attentive to the need to clearly describe the policy framework we are using to meet these challenges."

Section 5

Integral's Comments

Inflation

- Inflation is not yet reliably back on target
- On inflation grounds alone, there is reason to keep an accomodative stance of monetary policy
- Other nominal indicators also show considerable slack

Labor Markets

- Yellen excellently summarizes the labor market's current state
- She also excellently describes the considerable uncertainty the FOMC faces in judging labor market conditions
- Clearly the U3-rate is not sufficient for measuring labor market outcomes
- A catholic approach to indicators is prudent, but market expectations will be anchored more firmly with a single indicator
- No obvious candidate; labor markets are complex and driven by a host of factors outside the monetary authority's control. . .

"The need to clearly describe the policy framework"