United States
A new tool for the Fed to measure the job market

Among the Federal Reserve’s (Fed) multiples mandates, attention has particularly shifted to the goal of full employment. The Fed has sought a target for the job market for some time, adopting between December 2012 and March 2014 a 6.5% threshold for the jobless rate, above which it held its key rate at floor level. Reaching this threshold has forced Fed leaders, the majority of whom were clearly not yet ready to deviate from the accommodative policy in place, to look at other job market indicators.

In her speeches, Fed Chair Janet Yellen repeatedly mentioned several elements that can be used to judge the strength of the job market and the degree of underutilization of labour resources. In addition to net monthly hires and the unemployment rate, there are also the degree of participation in the labour force, the number of involuntary part-time workers, the number of long-term unemployed workers and the duration of such unemployment, job openings and voluntary resignations. Since the spring, Fed researchers have gathered many of these elements into an index that will provide an overview of the job market’s strength. The Labor Market Condition Index (LMCI) is an amalgamation of 19 job market indicators. These indicators are grouped into nine categories: 1) unemployment and underemployment, 2) employment, 3) workweeks, 4) wages, 5) vacancies, 6) hiring, 7) layoffs, 8) quits and 9) consumer and business surveys. Starting today, the Fed will update the LMCI data each Monday following the release of the monthly employment surveys.

The data used are generally related; vacancies should translate into hires and employment and therefore lower unemployment. In practice, indicators may temporarily diverge and evolve differently based on where the U.S. economy is in the growth cycle. For example, at the start of a recovery, the LMCI is pushed up by lower layoffs (reflected in the reduction of new jobless claims) rather than net hires. The index can also be used to consider the fact that current improvement in the job market still has little effect on wage growth.

Implications: The new LMCI index cannot be used to predict or provide new information on employment growth. It is especially useful for providing a more general portrait of the job market than what is provided by just monthly hires or the jobless rate. This provides the Fed with a more objective view of the pressures the economy bears. For investors, the LMCI is a supplementary indicator that can provide insight on Fed leaders’ frame of mind when they attend their monetary policy meeting. A falling LMCI that is approaching zero or slips into negative territory could encourage the Fed to be more dovish. Conversely, a fast and sustainably rising LMCI could cause the Fed to tighten monetary policy more quickly. For the moment, the index, which rose from 2.0 to 2.5 between August and September, backs the current position of patience adopted by Ms. Yellen and her colleagues.

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Note to readers: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.

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