Payden&Rygel

Economic Update

THOUGHTS FROM OUR ECONOMICS TEAM

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LOOK BEYOND THE OFFICIAL UNEMPLOYMENT RATE

Market focus this week was on Fed Chair Janet Yellen's inaugural Humphrey-Hawkins testimony. Despite the bright lights and novelty of it all, Yellen disappointed market participants, providing no further detail on how the Federal Open Market Committee (FOMC) thinks about its unemployment and inflation thresholds—currently a soft 6.5% unemployment threshold and a 2.5% inflation threshold.

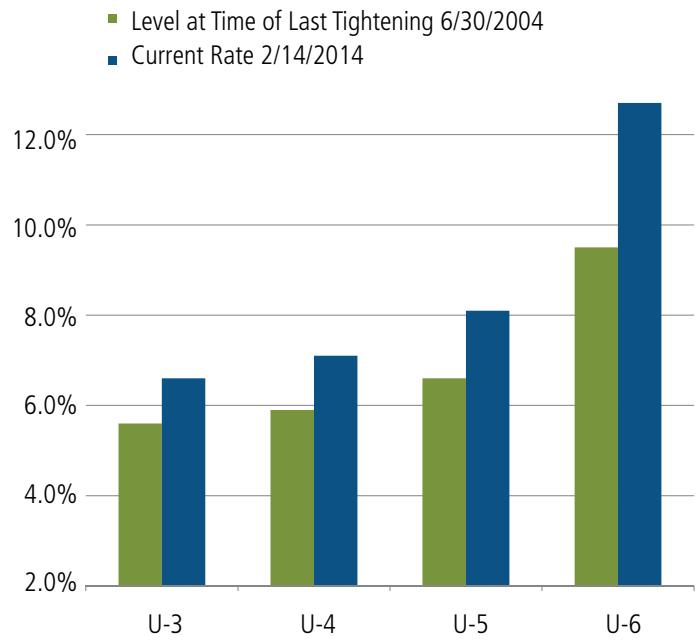
More than anything, Yellen indicated that her tenure would be a study in policy continuity, going so far as to quote verbatim her predecessor: "monetary policy is not a panacea." With little new from Yellen, we suggest investors pay attention instead to a speech given two weeks ago by Boston Fed President Eric Rosengren.

In thinking about policy, two groups of thought dominate the FOMC. The first camp believes that recent declines in the unemployment rate reflect structural changes to the labor market. More people are retiring and the fact that they are leaving the labor force (driving down the unemployment rate) is natural. Our assessment of the labor market data shows that 40% of labor market exits in the last 12 months were accounted for by workers in the 65+ age cohort.

The other camp—the Rosengren camp—thinks that the unemployment rate overstates the health of the labor market and, in Rosengren's words, thinks "that everyone following the economy should be placing weight on the broader measures of labor market utilization." Broader measures like the U-6 unemployment rate (which accounts for underemployed workers in addition to the unemployed, discouraged, and marginally attached workers) and the employment to population ratio remain severely dislocated from pre-crisis levels (See chart below).

So, which camp has it right? Although Mr. Rosengren is a non-voting member of the FOMC, we think the Committee may adopt from his script. For now, with limited wage growth, which rose just 2% year-over-year in January and remains more than 1% below long-term averages and lower overall consumer price inflation, we suspect the FOMC will conclude that the broad weakness in labor market utilization continues to weigh on wages and prices. Those more dovish members like Eric Rosengren and Janet Yellen will draw attention to metrics other than the unemployment rate when holding court on the health of the labor market and will therefore be inclined to keep interest rates low for longer than otherwise. Combine that with the current FOMC forecasts and, barring a dramatic change to the economic outlook, interest rates could remain near zero through 2015, even into 2016.

SELECTED MEASURES OF UNEMPLOYMENT, JUNE 2004 (GREEN) AND PRESENT (BLUE)



Source: BLS

U-3	Official unemployment rate. The U-3 is proportion of the civilian labor force that is **unemployed but actively seeking employment.**
U-4	Percent of the labor force of discouraged workers, or those who have stopped looking for work. These **discouraged workers are in addition to the unemployed individuals** captured by U3 unemployment.
U-5	Percentage of labor force of marginally attached workers, defined as those who "would like" and are able to work, but have not looked for work recently. **These marginally attached workers are in addition to the unemployed and discouraged workers above.**
U-6	Percentage of labor force of part-time workers who want to be full-time. These **underemployed workers are in addition to the unemployed, discouraged, and marginally attached workers above.**