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Adjusted for demographics, U.S. labor market not overly tight

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Relatively low unemployment rates generally coincide with inflation rates above the Federal Reserve's annual targets. However, in recent months, that has not been the case. Unemployment has remained near 4 percent for 12 months, while inflation has hovered around 2 percent. Because the unemployment rate fails to account for those who have voluntarily withdrawn from the labor force, U.S. policymakers have been assessing the feasibility of using complementary measures to gauge the labor market when adopting monetary policy. In "Labor market not overly tight, demographically adjusted measure shows" (*Economic Letter*, Federal Reserve Bank of Dallas, December 2018), Carlos Zarazaga and Emil Mihaylov examine whether the labor input utilization rate (LIUR) can help better gauge labor market conditions.

The LIUR is the proportion of total hours individuals devote to work. It is calculated as the total number of hours that the working-age population was actually at work relative to discretionary hours—100 hours a week on average per working-age individual—that the population could have devoted to work.

No clear tendency for the LIUR to increase or decrease existed before the Great Recession. Nearly a decade after the recession, the aggregate LIUR remained 3.4 percent below the prerecession LIUR average. The authors argue that this might be severely overestimated because of the aging labor force. To capture the impact of "baby boomers," the authors assign working-age individuals to demographic groups on the basis of age and gender, and use weighted averages and other estimation methods to develop a demographically adjusted LIUR.

Highlighted by the demographic influence applied by baby boomers retiring, the actual LIUR was 1.5 percent below the demographically adjusted LIUR by the second quarter of 2018. Also noted is the counter-baby-boom tendency for modern-day workers to spend more time working.

The authors also say structural elements contribute to the estimates, and that inferring the aggregate LIUR relies heavily on projecting into the future the prevailing trends for various gender and age groups from 1989 to 2007. After screening out these structural impacts, the demographically adjusted trends are identical (by design) through the beginning of the Great Recession in 2007. The demographically adjusted LIUR with structural breaks diverges from the LIUR with no structural breaks and moves towards the actual LIUR as it gets closer to the second quarter of 2018.

Zarazaga and Mihaylov close by noting that the two versions of the demographically adjusted LIUR suggest there may be a little more slack in the labor market than indicated by recent low unemployment rates. Accordingly, inflation rates may be in line with the Fed's target.