US Daily: The Lost Generation: Recession Graduates and Labor Market Slack (Hill)

- While the unemployment rate and other labor utilization measures signal an economy at full employment, wage growth has been weaker than expected recently, raising questions about the true degree of slack. To the extent that some pockets of excess slack remain, the cohort that came of age during the Great Recession would seem a natural place to find it, given the pronounced and long-lasting effects of recessions on young workers.
- In today's daily, we review the labor market experience of the cohort graduating college or beginning careers during or immediately after the recession. Unsurprisingly, unemployment rose sharply in this segment from 2007 and 2010. However, since then, jobless rates have improved dramatically on both an absolute and relative basis – particularly over the last year – and the unemployment rate in this cohort is now under the national average. Relative wages have also partially recovered, and broader measures of utilization suggest that minimal excess slack remains in this cohort.

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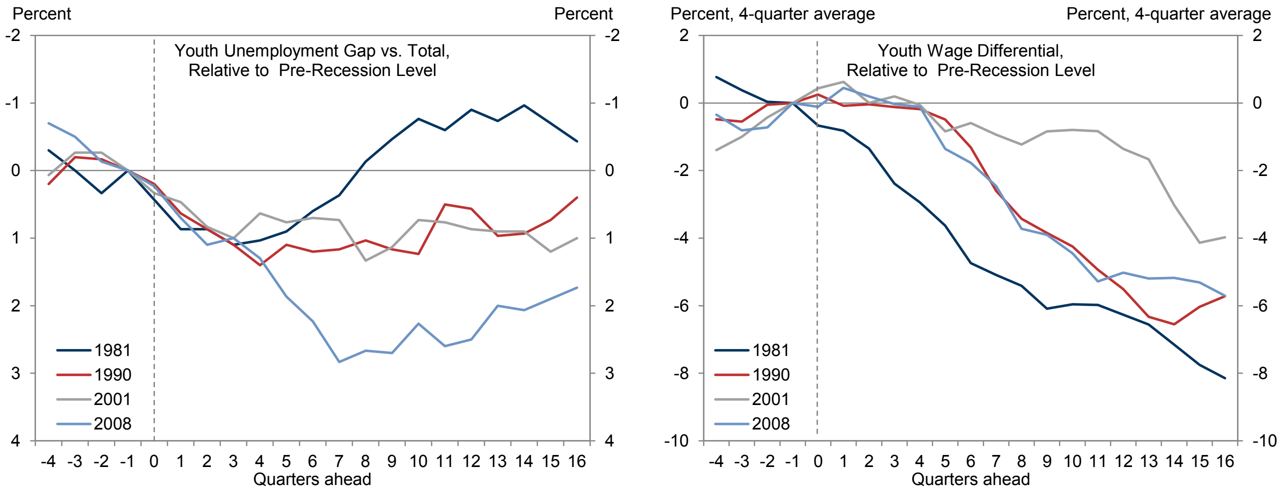
Academic research has linked graduating during recessions with adverse labor market outcomes. Studying the experience of graduates during the 1981 downturn, Yale Professor Lisa Kahn estimates a persistent drag on the level of wages worth between 1% and 13% per year – potentially lasting for multiple decades. More recently, New York Fed researchers Jaison Abel and Richard Deitz find that *under*employment rates – the share of jobs that don't typically require a college degree – climbed to nearly 50% temporarily following the Great Recession (among recent college graduates). Neither study finds permanent long-term effects on joblessness, but both datasets exhibit elevated unemployment rates among recent college graduates in the years following recession.

Looking more broadly at non-college graduates as well, data on youth unemployment rates show a sharp rise during and after the 2008-09 recession – both on an absolute and relative basis. Unemployment rates in the 16-24-year-old segment rose by 7.9pp to 19.0% between 4Q07 and 4Q09 (compared to +5.1pp to 9.9% for the population as a whole). Additionally, household survey data suggest that the average earnings discount for young workers widened by 4-6% in the years following the recession. While youth underperformance is typical of recessions, the effects of the most recent downturn appeared larger and more long-lasting than average, as shown in Exhibit 1.

Exhibit 1: Youth Employment and Earnings Among the Hardest Hit During Recessions

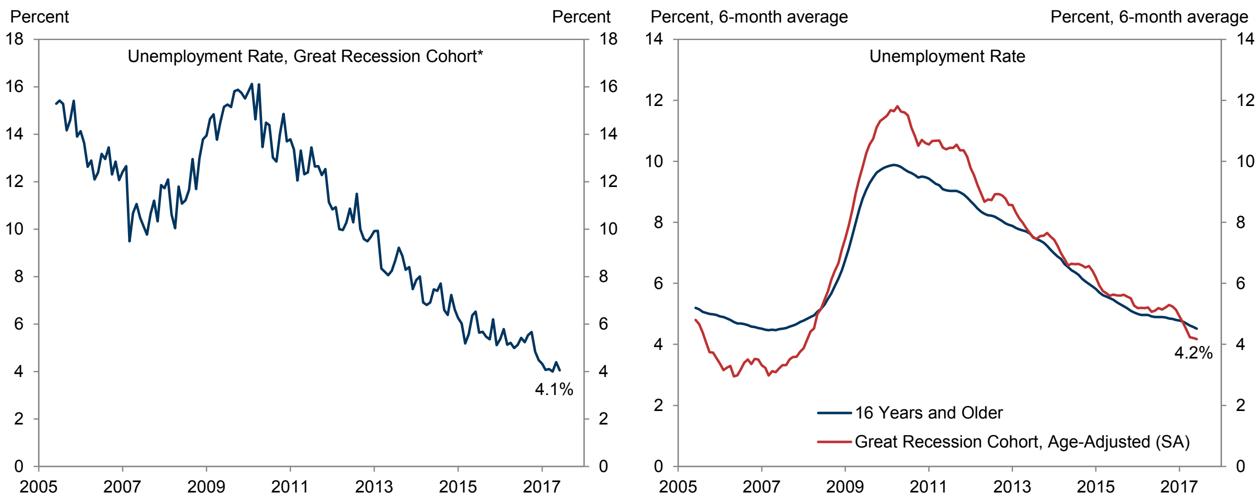


Source: Department of Labor, Goldman Sachs Global Investment Research

While youth jobless rates and relative wages have both recovered since 2011, much of this may simply reflect the aging of the Great Recession cohort into the 25-34-year-old segment. To more closely track this cohort's labor market experience, we analyze household survey data organized by single-year age group (16-year olds, 17-year olds, etc.). We define the "Great Recession" cohort as the segment of the population that turned 22 years old in 2008, 2009, or 2010 (i.e. individuals graduating college or beginning careers during or immediately after the recession).[1] As shown in the left panel of Exhibit 2, unemployment rates have improved dramatically in this segment since mid-2010, with a particularly sharp drop over the last 12 months.

[1] Specifically, we focus on the segment of the population born between September 1985 and August 1988, broadly consistent with the graduating classes of 2008, 2009, and 2010 (four-year colleges). While the recession ended in July 2009, the unemployment rate peaked in October 2009 and remained above 9% until October 2011, and we include the class of 2010 accordingly. In order to classify each age group into a cohort in a given month, we assume survey respondents were born in the middle of the year on average.

Exhibit 2: Unemployment Rates in the Great Recession Cohort Have Improved on Both an Absolute and Relative Basis



Source: Department of Labor, Goldman Sachs Global Investment Research

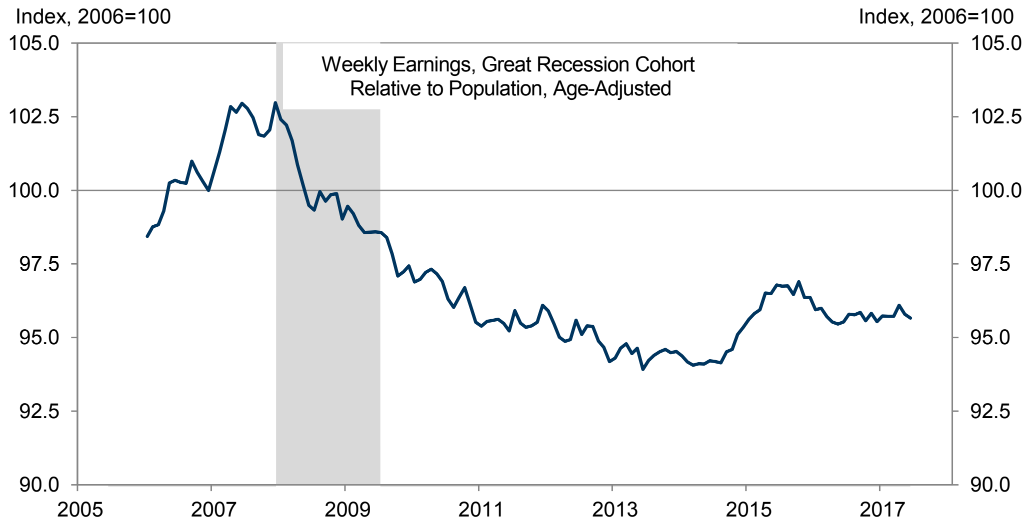
While encouraging, the extent of the improvement shown in the left panel is misleading, because cohort jobless rates generally fall over time, reflecting the accumulation of skills and experience as well as fewer employment constraints from schooling. To account for this, the right panel of the same exhibit shows age-adjusted unemployment rates.[2.] Following several years of underperforming the national average, jobless rates in this cohort fell below 5% at the end of last year (on an age-adjusted basis). By mid-2017, jobless rates had dipped to 4.2% – below the economy-wide measure.

Average earnings trends in the household survey show a similar pattern of underperformance and subsequent recovery. As shown in Exhibit 3, usual weekly earnings in this cohort declined by 6% relative to the population during and after the recession (on an age-adjusted basis). However, despite a partial recovery, the earnings gap remains: relative wages on this basis have only retraced a third of the post-recession decline (qualitatively consistent with the predictions of the academic literature).[3.]

2. Before calculating the cohort-level unemployment rate, we adjust each age-group's jobless rate by adding back its 30-year-average gap versus the overall unemployment rate.

3. To account for differences across age groups, we adjust average earnings in each age group by the 30-year-average proportional discount (or premium) versus national average earnings. While relative wages may have partially recovered, note that real incomes remain well below the level implied by their pre-crisis trend. Additionally, some of the recovery in wages reflects additional schooling that bore associated educational costs.

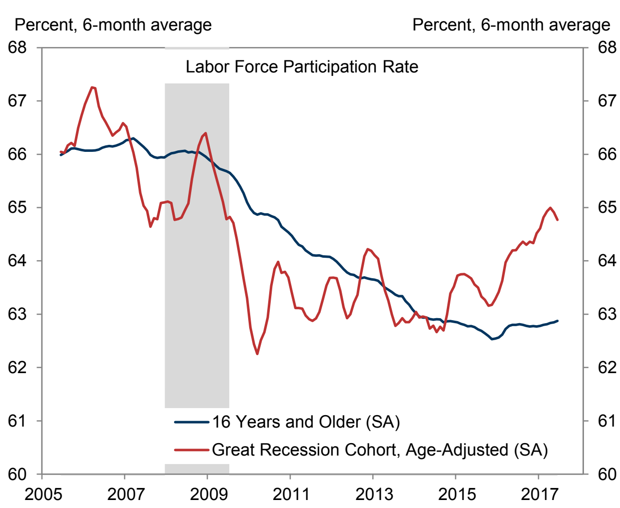
Exhibit 3: Average Weekly Earnings Underperformed in This Cohort but Have Started to Recover

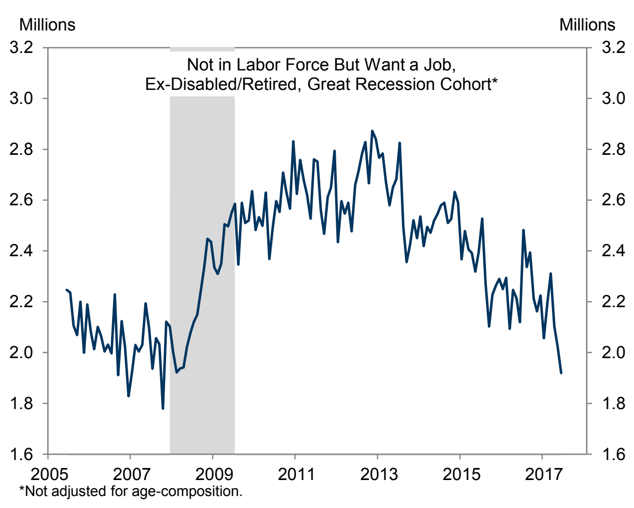


Source: Department of Labor, Goldman Sachs Global Investment Research

We conclude by analyzing two broader measures of labor market underutilization for this cohort. As shown in the left panel of Exhibit 4, the post-recession improvement in jobless rates was not driven by discouraged-worker effects: Labor force participation rates (on an age-adjusted basis) were range-bound during most of this period and actually increased during 2015-16, returning to their 2007 average level (of around 65%). Household survey data for this cohort also show that the number of non-participants who want a job has fallen back to its pre-crisis level (right panel of Exhibit 4).

Exhibit 4: Participation Rates among this Cohort Have Recovered to Pre-Recession Levels, and the Number of Non-Participants Who Want a Job Is No Longer Elevated





Source: Department of Labor, Goldman Sachs Global Investment Research

While we cannot rule out a return of cohort participation rates to 2005-06 levels, we see little evidence of excess slack in this segment of the labor force, despite its particularly difficult experience during and after the recession. Additionally, we believe the sharp reductions in labor market underutilization in this cohort contributed to the brisk pace of aggregate payroll growth in recent years. With most of this excess slack now exhausted, the burden of continued labor demand growth will increasingly fall on other segments of the labor force, where slack is even harder to find.

Spencer Hill

Disclosure Appendix

Reg AC

We, Jan Hatzius, Alec Phillips, David Mericle, Spencer Hill, Daan Struyven, Karen Reichgott and Avisha Thakkar, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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