

US Macroeconomics

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What Do We Need to Know About Unemployment?

The unemployment rate is a critical variable for the economic and financial outlook because: One, unemployment tends to, but not always, rises before the onset of recession. Two, Fed policymakers are fixated on the rate because they believe that current labor market tightness is the primary factor keeping inflation above target.

The February employment release showed a two-tenths increase in the unemployment rate to 3.6% because the number of unemployed rose 242k. If jobless claims continue to rise, more layoffs will be seen in the March jobs report. Since the unemployment rate almost always rises before the economy peaks, further increases will be noteworthy even though unemployment would still be historically low. Look at the table below.

The lefthand side column in the table below shows where the unemployment rate bottomed in every business cycle in the post war period. The second column shows the peak in economic activity as determined by the National Bureau of Economic Research.

The average time between the low in unemployment and the top in the economy is six months. While the median time also stands at six months, we can see there has been substantial variation in lead times among business cycles. For example, the unemployment rate bottomed at the same time the economy peaked in July 1981. Meanwhile, it was 17 months from the March 1989 low in the unemployment rate before the economy finally topped in July 1990 and went into recession the following month.

In addition, the lead time from when the unemployment rate troughs and the economy peaks has been longer on average over the last three business cycles (twelve months) compared to eight previous business cycles (four months). Consequently, the unemployment rate is likely to rise before the start of the next recession notwithstanding the July 1981 episode. What is also important, in addition to lead time, is how much the unemployment rate has risen before the economy peaks.

As shown in the righthand side column of the table, the average increase in the unemployment rate from its low to the peak in the economy is just 40 basis points. This means that **peak GDP could occur with the unemployment rate at just 3.8%** as the rate would be up from January's 3.4% cyclical low. But rest assured. Whenever the next downturn begins, many economists and investors will miss it. This is a shopworn theme in business cycle history.

Trough in Unemployment	Peak in Economic Activity	Lead Time	Rise in U3 from Trough to Recession Onset (bps)
May 1948	November 1948	6	30
June 1953	July 1953	1	10
March 1957	August 1957	5	40
February 1960	April 1960	2	40
May 1969	December 1969	7	10
October 1973	November 1973	1	20
May 1979	January 1980	8	70
July 1981	July 1981	0	0
March 1989	July 1990	17	50
April 2000	March 2001	11	50
May 2007	December 2007	7	60
Avg ->		6	40

Sources: BLS, NBER, Haver, SMBC Nikko

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