April 04, 2014

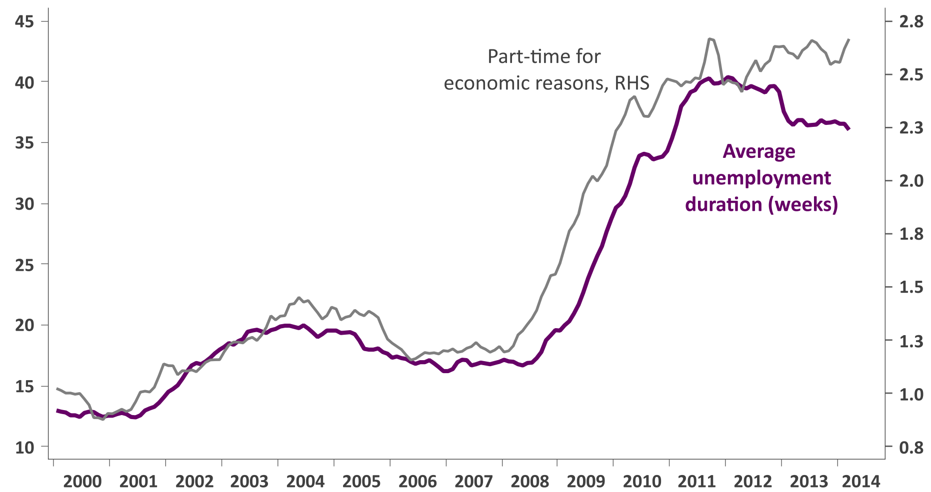
GLOBAL MACRO

Central bank's fight against underemployment

Janet Yellen's insistence on the enduringly-soft job market in the US during her speech this week in Chicago and Mario Draghi's unusual insistence on the risks associated with allowing unemployment to remain at a high rate over a sustained period in the euro area were striking for reasons others than the quick succession of the two statements. What's to be made of the messages?

US Labor Market Indicators

3mma



Sources: RichesFlores Research, Macrobond

The Fed's message is wrought with importance

That the Fed watches developments in the labor market closely is hardly breaking news: it has always had the dual remit of controlling inflation while creating the conditions for full employment. The expansion of its dashboard to the most alarming indicators - whereas it had solely focused on the unemployment rate heretofore - is somewhat of a break from the past, and is evidently not a coincidence. Using her expanded palette, Ms. Yellen painted a much more muted picture of the US landscape than the one depicted by the unemployment rate alone. In fact, the picture clashes with the notion that the

US economy is ready to be weaned off the unconventional monetary policy that the Fed has provided since the 2008 crisis. She pointed to a fall in the participation rate, the substantial percentage of workers who must accept part-time jobs, the persistently high level of the long-term unemployed, the significant amount of slack in the economy (i.e. the economy is unable to provide jobs to its pool of qualified and experience workers)...the examples Ms. Yellen chose to discuss perfectly illustrate these weaknesses, which are inconsistent with the glowing reviews of the current situation (see Dashboard on next page).

Long rates won't increase, in order "to help Main Street and not Wall Street"

What should be made of this new communication?

- Is it intended to prepare markets for a slowdown in the pace of tapering, a hypothesis we had all but written off given Ms. Yellen's resolutely upbeat message in recent weeks?
- Is it intended to justify Quantitative Easing, much maligned by the political class, whose sole aim, as underscored by the Fed Chairman, is to maintain interest rates at low levels not to help Wall Street but to help Main Street?
- Is it a warning to investors on the reality of the economic situation in an attempt to rein in excessive optimism and maintain control over long-term interest rates?

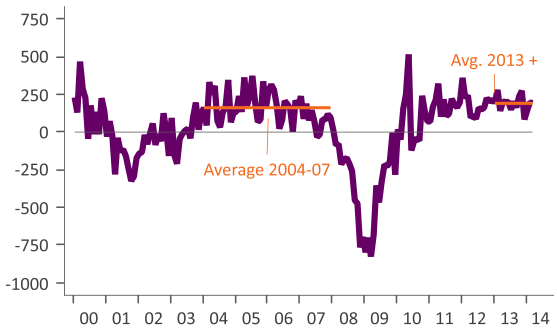
Or all three at the same time? At this point, it is difficult to say with great certainty but the shift is significant and regardless of the interpretation, it lends credence to our view that long-term interest rates stand a greater chance of decreasing than increasing - regardless of whether the Fed slows its tapering.

Mr. Draghi's rhetoric echoing Mr. Bernanke circa spring 2012...

In certain respects, the shift in tone from the ECB President is even more puzzling. Mr. Draghi rarely talks about unemployment and hardly ever about the negative consequences of persistently high joblessness on growth potential. One can only be struck by the similarity between his April 3rd statement and those issued by former Fed chief Ben Bernanke in the spring of 2012. At the time, we were disappointed that the Fed's message didn't rub off on the ECB. It was just a few weeks before QE2 was extended and less than six months before QE3 was unveiled. Obviously, the point is not to exaggerate the parallel but to measure the extent to which the ECB's tone (and probably its actual view) on the economic situation in the euro area has changed in the past few months. Although the dour signs sent by plummeting inflation rates surely have had something to do with this change of heart, it also seems that the ECB's confidence on the international situation has taken a hit recently. Both in its press release and press conference, the insistence on the risks associated with the deteriorating economic situation in emerging markets and with geopolitical unrest reflects the ECB's eroding confidence in the rest of the world. Such a view could only make the ECB that much more aware of the importance of ramping up efforts to bolster growth in the euro area. The goal is to boost growth to levels that are "higher than its potential so as to close this output gap", in the words of Mr. Draghi yesterday. To do so, the ECB President will need to move mountains and break free from the chains of the central bank's mandate. What better than alarming unemployment to justify his decision?

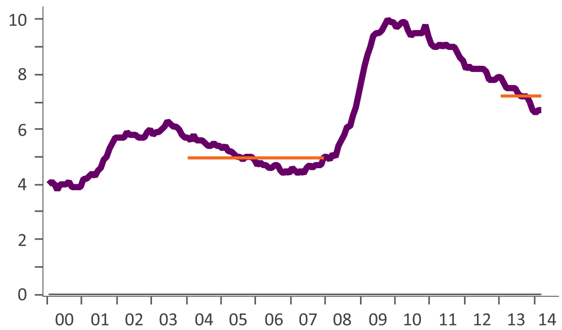
Fed Dashboard of Labor Market Conditions, as of March 2014

Monthly change in nonfarm payrolls, '000s



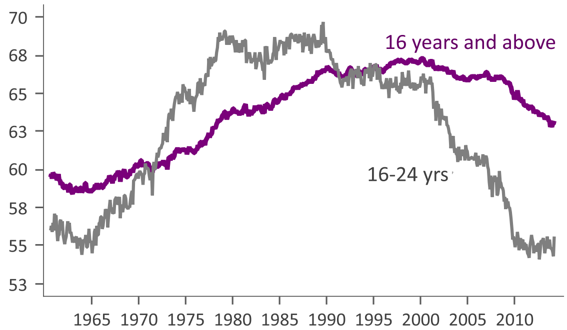
Sources: RichesFlores Research, Macrobond

Unemployment rate, %



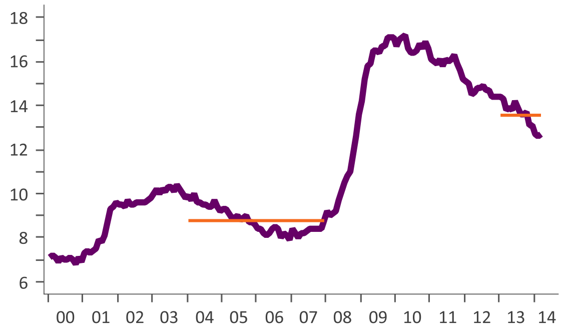
Sources: RichesFlores Research, Macrobond

Labor force participation ratio, %



Sources: RichesFlores Research, Macrobond

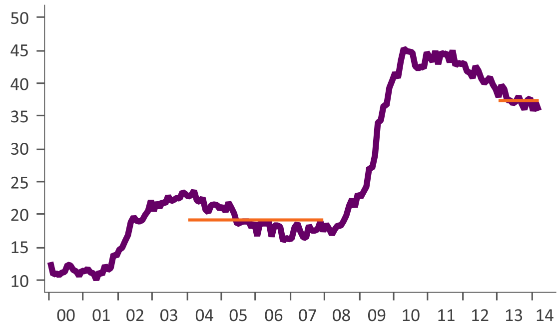
U-6 underemployment rate, %



Sources: RichesFlores Research, Macrobond

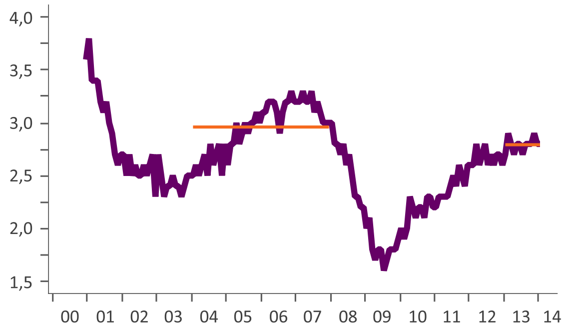
Fed Dashboard of Labor Market Conditions, as of March 2014 (cont.)

Long-term unemployed share (>27 w), %



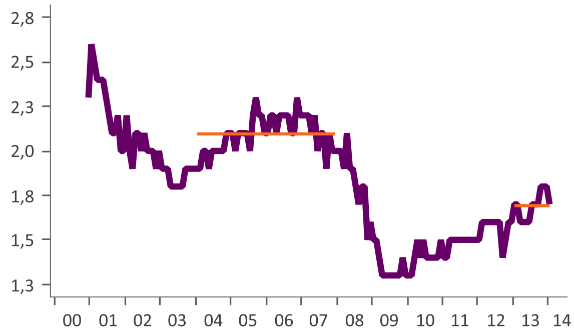
Sources: RichesFlores Research, Macrobond

Job openings rate, % of paid employment



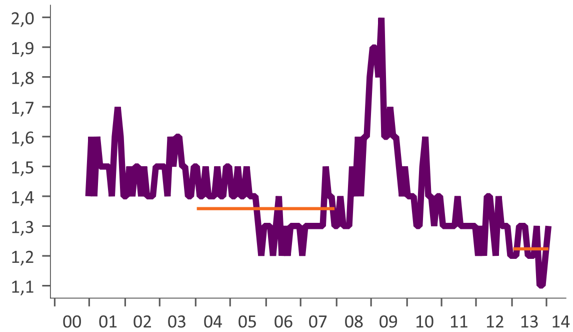
Sources: RichesFlores Research, Macrobond

Quits rate, % of paid employees



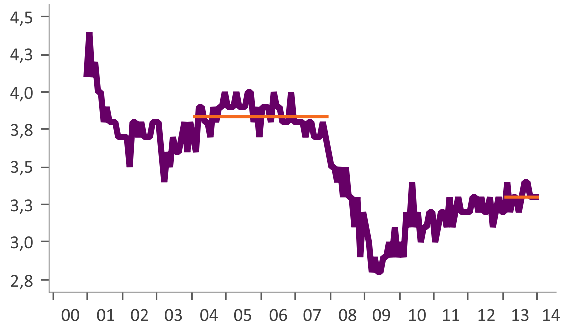
Sources: RichesFlores Research, Macrobond

Layoffs rate, % of employees



Sources: RichesFlores Research, Macrobond

Hires rate, % of paid employment



Sources: RichesFlores Research, Macrobond

Véronique Riches-Flores
contact@richesflores.com

Véronique Riches-Flores, contact*@richesflores.com*