Is the Economy Now Close to Full Employment?

This morning’s employment report was certainly reassuring: Even though real household spending and core capital goods shipments decelerated notably during the autumn, the economy has still been able to produce solid gains in nonfarm payrolls. Nonetheless, the latest data also bolsters the judgment—expressed by Fed Chair Yellen in remarks earlier this week—that the labor market has not yet reached full employment.¹

Labor force participation moved upward last month, particularly among adults aged 25 to 54 years who are in their prime working years. Individuals who had previously dropped out of the labor force now comprise about one-third of the pool of people who are unemployed and actively searching for work. And many other labor force reentrants move directly into jobs without ever being classified as unemployed. Nonetheless, participation rates for youths and prime-age adults remain well below pre-2008 levels.

Wage growth remains subdued. Average hourly earnings for all employees previously showed some hints of acceleration, but the 12-month change has now fallen back to 2.3 percent, which is well within its recent range of variation. Moreover, that wage measure is sensitive to compensation trends for the highest-paid employees, namely, executives and supervisors. By contrast, as shown in the accompanying chart, the 12-month change in average hourly earnings for production and nonsupervisory workers now stands at exactly 2 percent, virtually identical to its average pace over the past five years. These developments provide further evidence that the labor market has plenty of room to expand further.

Sustained payroll gains are crucial to closing the employment gap. The Congressional Budget Office (CBO) recently concluded that the labor force is currently about 2.5 million individuals smaller than its full-employment level.² The overall employment shortfall is even larger, at around 3.2 million, mainly reflecting the incidence of people working part-time who are unable to find a full-time job. CBO analysis indicates that payroll growth of about 60,000 jobs per month would suffice to keep pace with longer-run demographic changes but would not be sufficient to make any further progress in closing the employment gap. By contrast, if nonfarm payrolls continue rising steadily by about 200,000 full-time jobs per month, as in this morning’s report, then the employment shortfall will be substantially diminished next year and the economy will finally reach full employment in 2017.

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² [https://www.cbo.gov/publication/50724](https://www.cbo.gov/publication/50724)