Unemployment Rate Could Take Decade to Return to 6%

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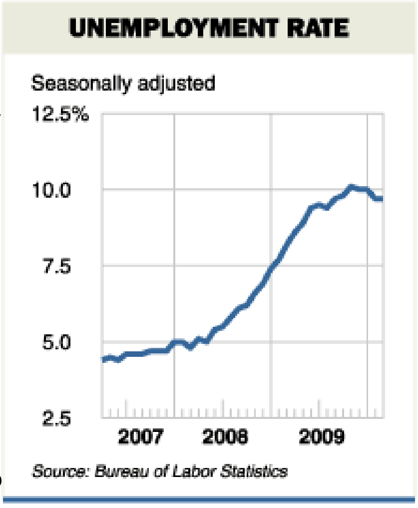
By Michael S. Derby

An end to the recession is unlikely to bring any improvement in hiring in the U.S., a new paper from the **Federal Reserve Bank of Kansas City** argues.

The research, made available on the bank's Web site, affirms the widely held view that hiring is unlikely to spike much even if the recession ends, as most believe is imminent, and warns things could be worse than now thought. Persistent levels of high unemployment could also change how the Fed assesses inflation pressures, with important and as yet unsettled implications for monetary policy.



Written by **Edward Knotek** and **Stephen Terry**, the paper asserts two main forces explain why something akin to a jobless recovery is likely to follow the end of the recession. First, there have been changes in the structure of the economy that make employers more reluctant to take on new hires. And second, recessions begat by banking crises tend to cast longer shadows on recoveries, depressing the pace of job growth.

The paper's authors project what they believe will be the course of joblessness, adjusted for structural changes in the economy and the impact of the banking crisis. That path sees unemployment breaching 10% and staying there through 2011, after which it "slowly drifts" down to 8% by 2014 and 7% by 2016. Even a decade down the road, unemployment could be above 6%, the paper warns.

This outlook is considerably worse than what would be expected based on a normal post-war recession, or even the aftermath of a recession like those of recent experience.

The paper was published after last Friday's release of July hiring data. That report showed a moderation in the pace of job losses and an unexpected move down in the unemployment rate. While economists and investors took comfort in the report, there was a sense that the unemployment rate decline was a quirk of falling labor force participation, and that it's pretty likely that measure will again begin to rise.

Economists have for some time been anticipating job losses, even as they see modest growth returning to the economy. What is now a 9.4% unemployment rate is seen as peaking at 9.9% in December, according to The Wall Street Journal's most recent survey of forecasters.

The paper's authors allow their worst-case scenario may not play out. Their estimates rely in part on data from other countries that may not fit the American experience closely enough. The somewhat unique U.S. system for credit allocation, which relies more heavily on markets over banks, could also skew the data in unexpected ways.

The forceful response of government — extraordinary Fed policy actions coupled with huge government stimulus efforts — could also work to create a less ugly outcome.

The study warns changed labor market dynamics could also skew the so-called natural rate of unemployment toward a higher level, which in turn means the lower levels of unemployment could create the sort of inflationary forces the Fed would be forced to deal with.

But there's uncertainty on this point. "Estimates of the natural rate are likely to be an important topic for policy makers for the foreseeable future."

http://blogs.wsj.com/economics/2009/08/13/unemployment-rate-could-take-decade-to-return-to-6/