First Trust
Monday Morning OUTLOOK
630-517-7756 • www.ftportfolios.com
April 4, 2016

Don't Short the Participation Rate!

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – Dep. Chief *Economist*
Strider Elass – *Economist*

Last Friday was an interesting day. For years now, the US has consistently added jobs and the unemployment rate has steadily fallen. But, the Pouting Pundits of Pessimism keep arguing that a falling unemployment rate is only because of weak growth in the labor force.

So, on Friday, when the employment data for March were released, showing growth in the labor force and a rising unemployment rate (from 4.9% to 5.0%) guess what the pundits focused on? You got it, now it's the unemployment rate that matters.

In spite of these Nattering Nabobs, the job market keeps getting better. The March payroll increase of 215,000 makes it 66 consecutive months of positive job growth. And now, both measures of job growth – the payroll report and the household data, which captures small-business start-ups – are up 234,000 per month in the past year. Not super strong, but certainly not weak.

But what's changed the most lately is a pick-up in the growth of the labor force. The total number of people in the labor force is up 2.2 million in the past year, the largest increase since 2007-08. The labor force is now growing faster than population and the labor force participation rate bottomed at 62.4% back in September – the lowest level since the late 1970s – and in March made it back to 63.0%.

That's still low by historical standards. Nonetheless, it shows that economic growth is finally overcoming the loss of workers due to baby boomers retiring and more generous government handouts to those who don't work.

Faster wage growth is part of the reason. Average hourly earnings – workers' cash earnings excluding tips and irregular bonuses/commissions – are up 2.3% in the past year. In the first three months of 2016, those earnings rose 2.7% at an annual rate. And with gas prices holding overall inflation down, those earnings go further.

Even more important, the acceleration in wages is happening while there's a lull in the expansion of the welfare state. The welfare state has grown substantially in the past several years. The Affordable Care Act, also known as Obamacare, expanded Medicaid and created large subsidies to buy health insurance. As a result, people have less incentive to work. The same goes for letting disability benefits become, in effect, a "waiting station" for middle-age workers before they can get Social Security retirement benefits.

Even without retiring Boomers, a bigger welfare state should mean slower growth in the labor force and lower labor force participation, exactly what's happened. But, for the next few years, as wages grow faster, the bargain available to those who work will likely get better faster than welfare benefits.

And that means a rebound in labor force growth.

It also means stabilization for the unemployment rate. The jobless rate ticked up to 5.0% in March and is now barely lower than the 5.1% back in September, six months ago. We would suggest that the US is now at "full employment," or is even above full employment.

Earlier in the economic recovery, some analysts were complaining that slow growth in the labor force was causing the unemployment rate to drop quickly even though job growth was not that fast. Now we have the opposite: faster growth in the labor force, paired with faster job growth, meaning the jobless rate barely moves.

At present, we think the unemployment rate will likely stay right around 5.0% or slightly lower this year, with continued robust gains in both jobs and the labor force. However, we could eventually see further declines in the jobless rate in 2017 due to the delayed effects of loose monetary policy this year. But that would come with a negative – higher inflation.

What we'd really like to see is a shift in policy next year, one that both trims the welfare state and cuts tax rates. In that situation, jobs and the labor force would grow even faster and the Federal Reserve would have more room to raise rates back toward normal, even if the unemployment rate went up a little.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-4 / 9:00 am	Factory Orders – Feb	-1.7%	**-1.7%**	-1.7%	+1.2%
4-5 / 7:30 am	Int'l Trade Balance – Feb	-$46.2 Bil	**-$46.2 Bil**		-$45.7 Bil
9:00 am	ISM Non Mfg Index – Mar	54.2	**54.3**		53.4
4-7 / 7:30 am	Initial Claims – Apr 2	270K	**267K**		276K
2:00 pm	Consumer Credit– Feb	$15.0 Bil	**$16.9 Bil**		$10.5 Bil