

## Viewpoints

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### American Jobs Data Are Worse than We Think

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What if the U.S. unemployment rate rises above 10 percent and stays there for an extended period? This is a question that is not being asked enough, even though it entails yet another historical anomaly that will further complicate policy formulation and open it up to greater political interference.

The unemployment rate is traditionally characterized as a lagging indicator and, as such, is viewed as having limited forward-looking information. After all, unemployment is a reflection of decisions taken earlier in the cycle so the rate always lags behind the realities on the ground – or so says conventional wisdom.

This conventional wisdom is valid most, but not all of the time. There are rare occasions, such as today, when we should think of the unemployment rate as much more than a lagging indicator; it has the potential to influence future economic behaviors and outlooks.

Today's broader interpretation is warranted by two factors: the speed and extent of the recent rise in the unemployment rate; and, the likelihood that it will persist at high levels for a prolonged period of time. As a result, the unemployment rate will increasingly disrupt an economy that, hitherto, has been influenced mainly by large-scale dislocations in the financial system.

In just 16 months, the U.S. unemployment rate has doubled from 4.8 percent to 9.5 percent, a remarkable surge by virtually any modern-day metric. It is also likely that the 9.5 percent rate understates the extent to which labor market conditions are deteriorating. Just witness the increasing number of companies asking employees to take unpaid leave. Meanwhile, after several years of decline, the labor participation rate has started to edge higher as people postpone their retirements and as challenging family finances force second earners to enter the job market.

Notwithstanding its recent surge, the unemployment rate is likely to rise even further to 10 percent by the end of this year and potentially beyond that. Indeed, the rate may not peak until 2010 in the 10.5-11 percent range; and it will likely stay there for a while given the lackluster shift from inventory rebuilding to consumption, investment and exports.

Beyond the public sector hiring spree fueled by the fiscal stimulus package, the post-bubble U.S. economy faces considerable headwinds to sustainable job creation. It takes time to restructure an economy that became over-dependent on finance and

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leverage. Meanwhile, companies will use this period to shed less productive workers. This will disrupt consumption already reeling from a large negative wealth shock due to the precipitous decline in house prices. Consumption will be further undermined by uncertainties about wages.

This possibility of a very high and persistent unemployment rate is not, as yet, part of the mainstream deliberations. Instead, the persistent domination of a “mean reversion” mindset leads to excessive optimism regarding how quickly the rate will max out, and how fast it converges back to the 5 percent level for the Nairu (non-accelerating inflation rate of unemployment).

The U.S. faces a material probability of both a higher Nairu (in the 7 percent range) and, relative to recent history, a much slower convergence of the actual unemployment rate to this new level. This paradigm shift will complicate an already complex challenge facing policymakers. They will have to recalibrate fiscal and monetary stimulus to recognize the fact that “temporary and targeted” stimulus will be less potent than anticipated. But the inclination to increase the dose of stimulus will be tempered by the fact that, as the fiscal picture deteriorates rapidly, the economy is less able to rely on future growth to counter the risk of a debt trap.

Politics will add to the policy complications. The combination of stubbornly high unemployment and growing government debt will not play well. The rest of the world should also worry. Persistently high unemployment fuels protectionist tendencies. Think of this as yet another illustration of the fact that the U.S. economy is on a bumpy journey to a new normal. The longer this reality is denied, the greater will be the cost to society of restoring economic stability.

*The writer, chief executive officer and co-chief investment officer of PIMCO, is author of [“When Markets Collide: Investment Strategies for the Age of Global Economic Change”](#) (McGraw Hill). 2008 FT/Goldman Sachs business book of the year.*

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