

INVESTMENT INSIGHTS

Analysis, Insights and a Different Perspective

May 2020

UNDERSTANDING UNEMPLOYMENT

KEY POINTS

- This issue of Investment Insights looks at how the U.S. labor force is determined.
- After some basis on the labor force, we explain the unemployment rate and its calculation.
- We use a real news headline to provide understanding on various aspects of the labor market, given the current economic situation.

Over the past few weeks, there have been many headlines about the job market. Most of the headlines on this topic have been related to the record jobless claims and the rising unemployment rate. One of the gloomiest headlines last month was that “Coronavirus job losses could total 47 million, unemployment rate may hit 32%, Fed estimates.”

This issue of Investment Insights attempts to provide insights into the unemployment rate, looks at its calculation and takes a deeper dive into this gloomy headline.

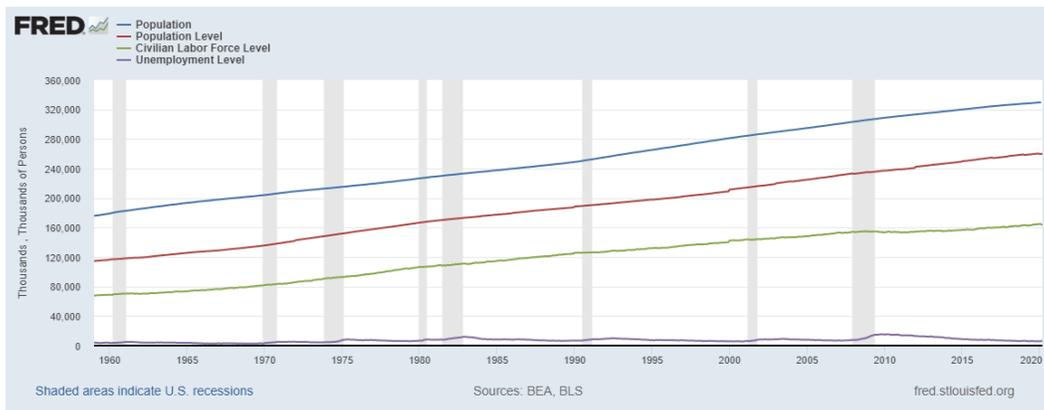


THE LABOR FORCE

Before we can talk about unemployment, it is crucial to understand the basics of the U.S. labor force. A common misconception is that the unemployment rate is the total number of people without a job divided by the number of people in the country. Instead, numerous definitions are used to define the labor force.

According to the U.S. Census Bureau, the total population of the United States was approximately 329 million in March 2020 (blue line below). This is not, however, the number used in the calculation of the unemployment rate. First, people who are under 16, inmates at institutions, and active duty in the Armed Forces are subtracted from the total population to arrive at the civilian noninstitutional population. The civilian noninstitutional population, or the population level (red line below), was approximately 260 million in March 2020.

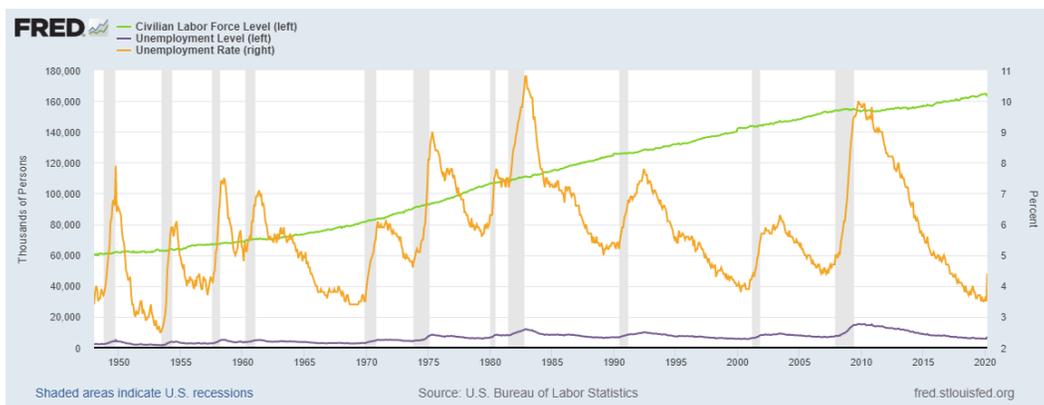
Next, individuals who are not employed and have not actively looked for work in the past four weeks are subtracted to arrive at the number of people in the labor force. The civilian labor force (green line below) was approximately 163 million in March 2020. The labor force is the total number of people that are available for work. It is made up of two components: the sum of employed and unemployed people. The number of unemployed individuals or the unemployment level (purple line below) was 7.14 million as of March 2020. With these definitions and corresponding numbers in mind, we are ready to understand the unemployment rate.



THE UNEMPLOYMENT RATE

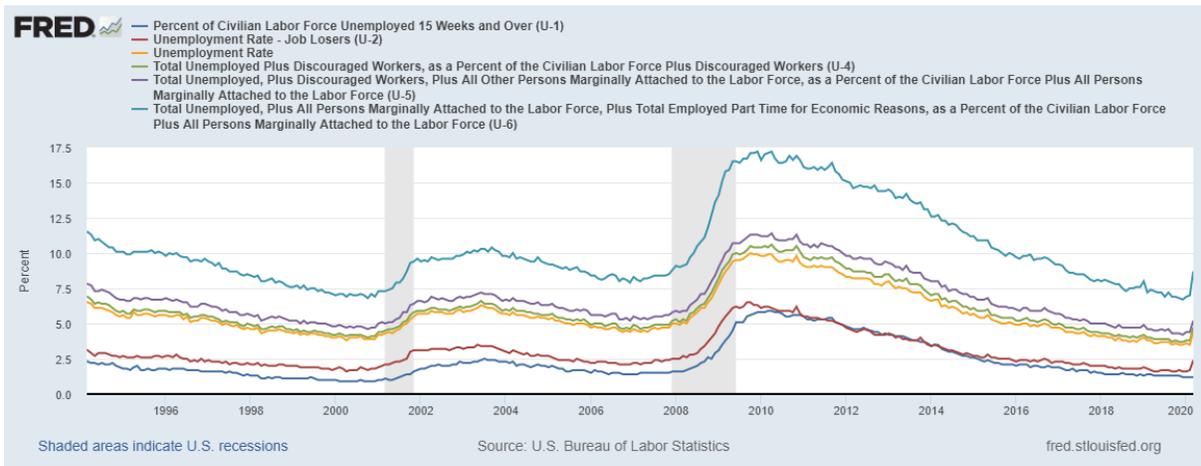
Overall, the unemployment rate measures what percentage of the labor force is unemployed. The unemployment rate (orange line below) that receives extensive media coverage is the U-3 unemployment rate. It is the official rate of unemployment that is calculated by the Bureau of Labor Statistics (BLS) by surveying 60,000 households or approximately 110,000 individuals each month.

We have already looked at the numbers used in its calculation; the unemployment rate is calculated by dividing the number of people unemployed (purple line below) with the civilian labor force (green line below). In March 2020, for example, 7.14 million people were unemployed, and 163 million people were in the civilian labor force, making the unemployment rate approximately 4.4% (7.14 million divided by 163 million).



While the U-3 unemployment rate is the official gauge for unemployment, there are other measures of unemployment that BLS reports. They vary, with U-1 applying the strictest definition of unemployment and U-6 being the loosest definition of unemployment. Let us first look at U-1 and U-2 unemployment rates that apply a narrower definition of unemployment than the official U-3 rate. As you can see in the graph below, the U-1 and U-2 rates are below the official unemployment rate. The U-1 rate is the percentage of the labor force that has been unemployed for 15 weeks or longer. The U-2 rate is the percentage of the labor force that has lost jobs or completed temporary work.

The U-4, U-5, and U-6 rates apply a broader definition of unemployment relative to the official U-3 rate. The U-4 rate adds discouraged workers to the U-3 rate. Discouraged workers are individuals who would like to work but have stopped looking because of not being able to find work. The U-5 rate adds marginally attached workers to the U-4 rate. Marginally attached workers are individuals who would like to work but have not looked for a job in the past four weeks. Finally, U-6, which is the broadest measure of unemployment, adds underemployed workers to the U-5 rate. Underemployed workers are part-time workers who would like to work full time but are unable to work full time due to various economic reasons.



FORECASTING UNEMPLOYMENT

Having examined the labor market and how the unemployment rate is calculated, we are now able to revisit the headline mentioned earlier: “Coronavirus job losses could total 47 million, the unemployment rate may hit 32%, Fed estimates.” This headline references a blog post from an economist at the Federal Reserve Bank of St. Louis and is a “Back-of-the-Envelope” forecast of the unemployment rate.

It starts by using the February 2020 unemployment number and assumes that the individuals who were already unemployed would not be able to find a job. Next, it uses two studies that examined high-risk occupations that require direct physical contact (like hairstylists). The two studies used in this forecast came to drastically different estimates of high-risk occupations — 66.8 million and 27.3 million — so the author used an average of the two (47.05 million).

By taking a closer look at this article, we realize it makes two key assumptions. First, the author assumes all 47.05 million individuals whose jobs require direct physical contact would lose their jobs. Second, the author also assumes no fiscal support provided by the government, such as payroll support for small businesses. While these assumptions make the calculations easier, they are not reasonable.

It is possible that many businesses may ask workers to not to come to work and continue to pay them. In addition, BLS counts many workers as employed even though they are furloughed, as it assumes they will be paid again in the future.¹ Next, we know there has been fiscal support provided by the government. The Paycheck Protect Program authorized up to \$669 billion in forgivable loans to small businesses to cover payroll and other business costs.² As such, the author’s assumptions used in calculating the 32% unemployment rate do not hold, making it unlikely that the unemployment rate will be that high.

¹ “Furloughed Workers Won’t Be Counted as Unemployed on Jobs Report.” The Hill, 22 Jan. 2019.

² “Paycheck Protection Program Gets \$320 Billion Boost.” Inc.com, Inc., 21 Apr. 2020.

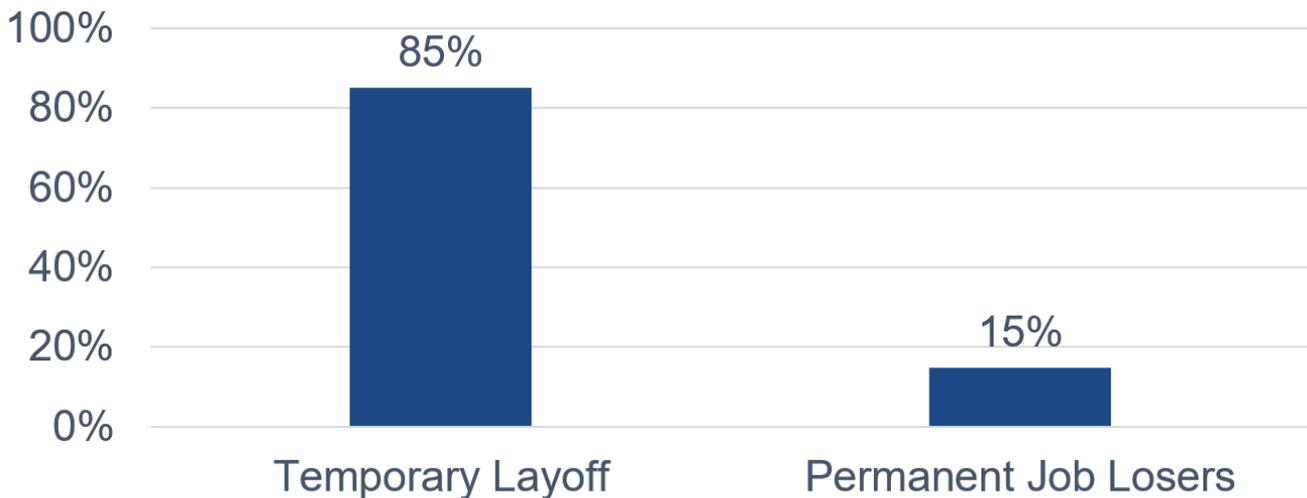
CONCLUSION

There is no doubt that the current economic conditions have brought with them many financial hardships. With record jobless claims, the most controversial headlines tend to generate a considerable amount of interest. As we have seen above, however, a forecast is only as good as the assumptions used in its calculation. Given the uncertainties with the current economic situation, it is difficult to assume what the future holds. One silver lining that we know for certain is that, last month, more than 85% of job losses were temporary layoffs, with less than 15% being permanent job losses, according to the BLS. The vast majority of temporary job losses should bode well for the labor market when economic activity picks up again.

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CONTRIBUTION TO MARCH 2020 INCREASE IN JOB LOSERS



Source: Bureau of Labor Statistics.

Important Disclosures: The information contained in this report is as of March 26, 2020 and was taken from sources believed to be reliable. It is intended only for personal use. To obtain additional information, contact Cornerstone Wealth Management. This report was prepared by Cornerstone Wealth Management. The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. Investing involves risk including the potential loss of principal. No strategy can assure success or protection against loss.

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