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Why Is Employment Growth So Low?

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Total nonfarm payroll employment declined by nearly 8.75 million jobs from December 2007 to February 2010 and has since increased by 2 million, reducing the unemployment rate from 10.1 percent in October 2009 to 9.1 percent in September 2011. A widely asked question is why employment growth is so low. We don't know all the reasons, but the data suggest that the pre-recession boom in residential and commercial real estate and the subsequent bust are very important factors.

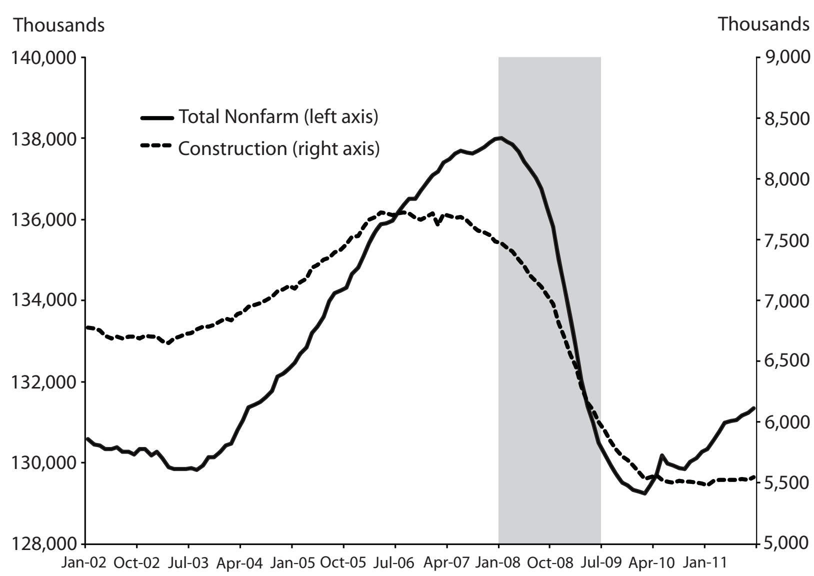
The chart shows total nonfarm employment and employment in construction for January 2002 through September 2011. Both declined significantly during the 2007-09 recession and for several months after. From the beginning of the recession (December 2007) to the trough in total employment (February 2010), total nonfarm employment declined by 8.7 million jobs, while construction employment declined by nearly 2 million jobs—22 percent of the total. Hence, construction alone accounts for much of the decline in employment since the start of the recession.

These construction numbers, even though high, likely *under*estimate the importance of construction in explaining the slow growth in employment for at least two reasons. First, as the chart shows, the peak in construction employment occurred in April 2006, well in advance of the recession and near the time house prices and residential investment peaked.[1] By the start of the recession, construction employment had already declined by nearly a quarter million jobs from its peak; this number could be added to the decline in construction employment attributed to the recession.

Second, the numbers in the figure reflect only the direct effect of the decline in construction employment and not the indirect effects that caused a slump in employment in other industries. We estimate these indirect effects using the Employment Requirements Matrix of the Bureau of Labor Statistics.[2] Assuming that about 1 million construction jobs were lost when the real estate bubble burst, we estimate that nearly 800,000 additional jobs were lost in other industries as a consequence. Hence, the decline in construction accounts for nearly 40 percent of the total decline in employment between December 2007 and February 2010.

To best evaluate employment growth, it is important to note that while real GDP is now slightly above its pre-recession peak and real consumption is about 1.5 percent above its pre-recession peak, real fixed investment is still 19 percent below its pre-recession peak, which occurred in the first quarter of 2006, and 15 percent below its pre-recession level. Essentially all of the slow growth in investment is directly attributable to low levels of real estate

Total Nonfarm Employment and Construction Employment



NOTE: The gray bar indicates the 2007-09 recession as determined by the National Bureau of Economic Research.

Anemic investment in residential and commercial real estate has been a significant factor contributing to slow growth in employment.

investment. Real residential investment is nearly 60 percent below its peak in the fourth quarter of 2005 and 38 percent below its pre-recession level. Indeed, it has declined slightly more since the end of the recession in June 2009. Real nonresidential investment in structures (investment in commercial real estate) is 28 percent below its pre-recession level. All other components of real fixed investment are very near or significantly above their pre-recession levels.

Hence, the anemic investment in residential and commercial real estate has significantly contributed to the slow growth in employment. The problem appears to be an excess supply of real residential and commercial real estate, which will continue to impede investment in residential and commercial real estate. Unfortunately, the real supply of real estate can only adjust by depreciation, population growth (two very slow processes), or by a decline in its real value, which occurs when real estate prices decline relative to the prices of other commodities. While these adjustments take place, we expect only moderate growth rates of employment. ■

[1] The Freddie Mac House Price Index peaked in July 2006; the S&P/Case-Shiller Home Price Indices peaked in the second quarter of 2006. Real residential investment peaked in the fourth quarter of 2005.

[2] This matrix can be found at www.bls.gov/emp/ep_data_emp_requirements.htm.

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