Standard Life Investments

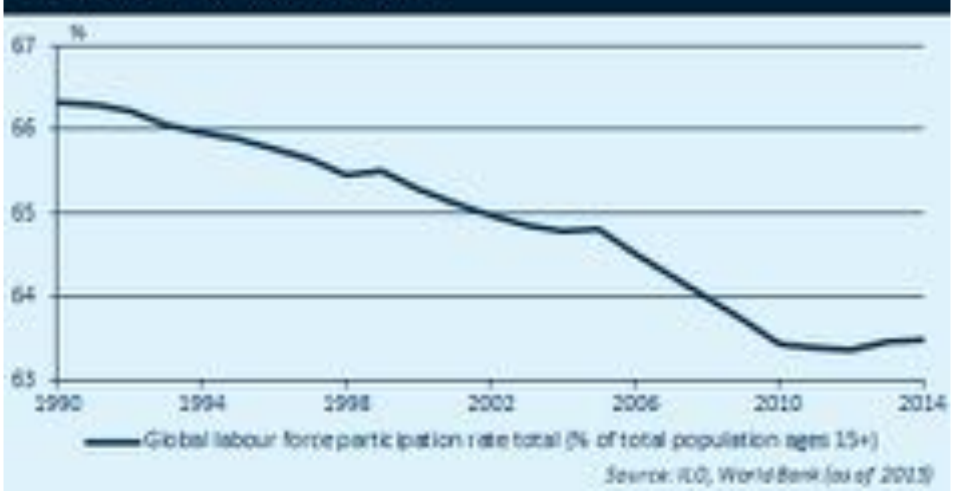
Weekly Economic Briefing
Global Overview

It's the taking part that counts
12 July 2016

The trend in global labour force participation makes for alarming viewing. The proportion of the working age population employed, or looking for a job, has fallen over the past 25 years from 66.3% to 63.5%. Declining participation rates in developed economies like the US have been well-publicised. However, we have seen broader reductions, with participation among middle-income economies falling 4.4 percentage points over this period. The trend in lower-income economies has been more encouraging, with participation rising as might be expected at this stage of their development cycle. However, this has not offset the broader trend. In part, lower participation reflects shifting demographics. The share of older workers (55 or older) in the global labour force expanded from 10.5% in 1990 to 14.3% in 2014. This cohort, which is more prone to leave the workforce permanently, is set to continue expanding. By 2030 this share is expected to reach a full 18%. The International Labour Organisation estimates that global labour force growth will be a full percentage point lower in 2030 on account of this aging. There has been another driver of the weakness in participation – the Global Financial Crisis. Participation fell by almost 1 percentage point between 2008 and 2010. The severity and persistence of that shock has meant many workers who became unemployed found it difficult to get back into work, became discouraged and left the labour force.

The decline in labour force participation poses worrying questions over the long-term growth prospects for the global economy. Indeed, two billion people of working age are not currently participating in the labour market and this share looks set to increase. Policymakers are not entirely powerless to resist this. The first step is to repair the damage done by the financial crisis. Falling unemployment rates should help bring discouraged workers back into the labour market. In some cases, extra training and job matching support will be required. The next step is structural reform to encourage high labour force participation. The nature of this will differ across countries, although in many cases the greatest reward will come from greater incentives/fewer barriers for older workers and women.

Chart 1: An inexorable decline?



Contributors

Authors:
Jeremy Lawson
James McCann
Stephanie Kelly
Govinda Finn

Editors:
Govinda Finn
Stephanie Kelly

Chart Editors:
Craig Hoyda
Alessandro Amaro

Contact:
Jeremy Lawson,
Chief Economist
jeremy_lawson@standardlife.com

Relief

The dramatic slowdown in employment growth in April and May sparked widespread fears that the labour market was losing momentum and that outright job losses might lie ahead. Our interpretation had been that the deterioration in labour market conditions mostly represented a lagged response to the moderation in economic growth through 2015 and the first quarter of 2016 amid declining profits and credit availability among energy and industrial firms, and a natural consequence of an economy edging closer to full employment. The June employment report went a long way towards confirming our thesis, as the economy added 287k jobs, lifting the 3-month moving average back to a respectable 147k (see Chart 2). Importantly, the index of hours worked also increased in the month, and by enough to suggest that the upward trend has resumed, albeit at a more subdued pace than in 2015. In the household survey, the unemployment rate increased to 4.9%, almost completely reversing the May drop, mostly due to an increase in the erratic labour force participation rate. Looking through the noise, the participation rate likely bottomed for the current cycle in late 2015, though it remains only a little above its multi-decade lows. Looking forward, **we remain of the view that further improvement in the labour market is likely in H2, with more modest progress than in previous years** as labour productivity growth becomes a larger contributor to overall growth.

The labour force participation rate remains 3.3 percentage points (ppts) below its level on the eve of the last recession and 4.6ppts below its peak in April 2000. **As the participation rate has plunged, the composition of the labour force has also changed dramatically (see Chart 3)**. For example, the labour force participation rate of those aged 16-19 has fallen by 17.8ppts since June 2000, driven mostly by declining participation among young white Americans, although the youth participation rate has fallen more widely. In the current cycle, the participation rate of those aged 16-19 bottomed in mid-2011 and has since risen by 1.3ppts, thanks almost entirely to large increases among black and Hispanic workers. At the other end of the age spectrum, the participation rate of those aged 55 and over was on a strong upward trend from the mid-1990s until the financial crisis. Since then, this has levelled off, mostly due to early retirement among those aged 55-64, thanks to reduced job opportunities, but also the recovery of high average levels of net worth since the crisis.

Looking forward, workers aged 55 and over will continue to rise as a share of the population and unless their participation rates rise dramatically, this will pull the overall participation rate down over the longer-term. Indeed, according to the latest Bureau of Labor Statistics (BLS) projections, the overall participation rate is likely to decline to below 58% by the middle of the century. The other cleavage in participation rates is between people with different levels of education. In early 1992, **there was a 40ppts gap between the participation rate of those with undergraduate degrees (or higher) and those without a high school diploma, partly reflecting the lower education attainment rate of Blacks. Since then, that gap has shrunk to 29.2ppts**, as the participation rate among those without high school diplomas has increased and the participation rate among degree holders has fallen. Since the financial crisis, degree holder and high school diploma holder participation has continued to decline while those without high school diplomas has held broadly steady.

Chart 2: Back to normal

Source: BLS, Haver (as of June 2016)

Chart 3: Changing composition

Labour force participation %	June 92	June 00	June 07	June 16
Aggregate	66.7	67.1	66	62.7
16-19	50.4	52.4	40.9	34.5
20-24	77	77.9	74.5	70.6
25-54	83.9	84.1	82.9	81.2
55 and over	29.8	32.2	38.7	40
Male	76.2	74.8	73.3	69.2
Female	57.9	60	59.3	56.6
White	66.9	67.3	66.4	62.9
Black	64.5	65.7	63.5	61.3
Hispanic	66.2	69.8	68.5	65.8
No high school	41.6	43.9	44.8	45.2
High school	66.2	64.3	62.9	57.2
BAs degree and higher	81.6	79.7	78	74.4

Source: BLS, Haver(as of June 2016)

Europe

Forever young

Last week, we highlighted the latest unemployment figures out of the Eurozone, which posted at 10.2% in May, noting that the UK referendum will likely weigh on UK and European investment and hiring going forward. **While substantial uncertainty remains in the short to medium-term, the Eurozone also faces longer-term demographic headwinds to the pool of labour it can draw on**. Long-term sustainable growth requires a skilled and expanding workforce, as well as an economy that can generate sufficient demand for labour. The employment-to-population ratio can give us an insight into both shorter-term drivers of employment on one side and the longer-term demographic pressures in the economy. The employment-to-population ratio for the Eurozone, having accelerated through the late 1990s and early 2000s, contracted almost 3% to 50% in 2014. Drilling down, substantial differences emerge at the country level (see Chart 6). The German employment-to-population ratio continued to rise through the post-crisis environment, sitting at a high of 57% most recently. Meanwhile, the boom and bust in southern Europe through the 2000s is reflected in the ratios of Greece, Spain and especially Ireland; these countries saw significant improvements in this ratio through the early 2000s and experienced the greatest declines during the financial crisis, reflecting the damage felt in these countries relative to their German counterparts.

While cyclical factors evidentially weigh on the employment-to-population ratio, it also reflects the demographic foundation of the economy. **The population structure in developed markets is notoriously poor in terms of labour supply potential; Europe is no exception**. Better nutrition, hygiene and medical advancements increased overall life expectancy through the 20th and in to the 21st century. This health dividend continues to drive up the median age in the Eurozone, which rose from 33.7 in 1982 to 43.3 in 2015. This trend is reflected in a rise in the dependency ratio, the measure of people not in the labour force relative to those who are, from 20% to 31% over the same period (see Chart 7). While the population ages on one side of the spectrum, the fertility rate in the Eurozone is 1.56, below the basic replacement rate of 2. This is not a new issue in the Eurozone, but its persistence is bad news for longer-term labour supply and potential growth.

So, what can policymakers do to address these challenges? Effective monetary and fiscal policy can smooth through cyclical challenges to reduce the downside impact on employment but longer-term initiatives to maximise the pool of skilled labour will be key to counteracting demographic issues. Pensions are a significant proportion of expenditure in a number of European countries, accounting for an average of approx. 13% of GDP in the euro area – with Greece topping the scales at 17.5% of GDP. So, initiatives to extend the retirement age or otherwise reduce this burden, while taking advantage of the longer, healthier lives of experienced workers, make sense but can be politically problematic. **The migrant crisis in Europe, although logistically and politically challenging, presents governments with another opportunity: an influx of young potential labour to rebalance the population structure**. Training and integrating these new migrants will be essential to maximise this opportunity.

Chart 6: A tale of two crises

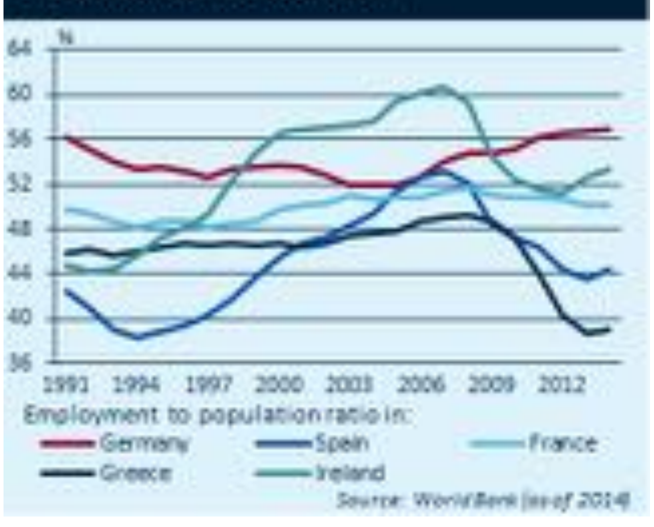


Chart 7: Rise of the pensioners