Beyond Price Stability:
The "Full Employment Mandate" at the Fed and the ECB

Antonella Trigari
Bocconi University, CEPR and IGIER

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Fed and ECB: mandates and monetary policy strategies

- Different legal mandates:
  - Fed "dual mandate": Federal Reserve Act mandates that the Fed conduct monetary policy so as to promote the goals of maximum employment and stable prices
  - ECB "hierarchical mandate": Primary objective of the ECB monetary policy is to maintain price stability. The Treaty adds that without prejudice to the objective of price stability, the ECB shall also support the general economic policies in the EU with a view to contributing to the achievement of the Union's objectives, which include balanced economic growth and full employment
- In practice, common monetary policy strategy:
  - Flexible (rather than strict) IT: also some weight on stabilizing the real economy
  - Medium-term orientation in pursuing the price stability goal provides room for monetary policy to take into account considerations such as maximum employment

Measuring 'labor market slack': relevance

Relevant to assess progress toward the goals of:

- Maximum employment:
  - Provides a measure of the cyclical position of the labor market
  - In presence of a trade-off, permits to assess its extent (e.g., whether short-run inflationary pressures are acceptable given the state of the labor market)
- Price stability: provides a signal of demand-related inflationary pressures

Measuring 'labor market slack': challenges

Two challenges:

- Which indicator?
  - Unemployment rate primary measure of labor underutilization. But unemployed $\neq$ job seekers (large flows from inactivity & employment to employment). Moreover heterogeneity in propensities to search for work A tale of two unemployment rates
  - No single indicator (U4, U5, U6, besides U3; employment rate; quit rate;...)
- Unemployment rate 'benchmarks':
  - Unemployment rate itself does not tell us if we are at full employment; need to compare it to hard-to-estimate benchmarks; true for any indicator considered
  - Two main benchmarks (Crump et al., 2020): i) a Longer-Run Unemployment rate - LRU; ii) a Stable-Price Unemployment rate - SPU

Alternative indicators of unemployment: hidden labor market slack

- A new measure of effective job seekers:

$$S_t = \sum_i \rho_t^i S_t^i$$

with S_t^i = # of job seekers of type i; ρ_t^i = search intensity of job seeker of type i

  - Challenge: measuring search intensities. One approach: proxy with job finding rates
  - Abraham et al. (2020). For US, estimate relative job finding rates for 22 groups: 13 among unemployed; 7 among inactive; 2 among employed Estimates
  - Trigari (2021). For EA, obtain relative job finding rates for 6 groups: 2 among unemployed; 3 among nonparticipants; 1 among employed Measure Volatility Cyclicality

- A critical issue: EA data availability
  - Transition rates available as annual averages of quarterly data; only from 2011; only for selected EA countries (not Germany); not for key margins given EA institutional framework (OE vs. FT contracts; workers on job retention schemes)

Revised monetary policy frameworks (Fed, 2020; ECB, 2021)

- Shared revision to approach for achieving price stability: FAIT
- Fed: also a revision of the employment mandate
  - Maximum employment is a broad-based and inclusive goal; stabilize "shortfalls" rather than "deviations" of employment from maximum level
  - Emphasis on distributional effects; "Fed Listens" to build social trust, emphasis on unequal labor outcomes and tailored communication to various communities
- ECB: no formal revision, far-reaching discussions
  - Re-affirmation of the medium-term orientation of the price stability goal
  - Emphasis on simple communication around 2% medium-term focal point; renewed emphasis on stronger inflation anchor and easier accountability to build social trust

Some evidence (US based)

- Benefits of a hot economy (Carpenter et al., 2022, among many)
  - Long expansions narrow differentials in UR, less so in LFPR
    - On average, fall in UR for high-UR groups is twice the fall for low-UR groups
  - Double blessing from long expansions:
    - During recovery and hot phases, high-UR or low-LFPR groups have larger falls in UR
    - Longer hot phases delay onset of widening of differentials, taking place in cold phases
  - Even in longest expansions, differentials do not narrow to zero
- The elusive state of full employment (Fatas, 2021)
  - Low levels of UR are short-lived
    - When an expansion is mature (low UR or high ER), probability of recession rises fast
    - Economy cannot enjoy benefits of a high-pressure labor market for long
  - Expansions end by i) building up of imbalances or ii) external shocks $\Rightarrow$ Expansions too slow to bring economy back to full employment in reasonable amount of time

Challenges from current economic conjuncture

- Revised frameworks
  - Have room/ guidance for response to adverse supply (energy and pandemic) shocks
    $\Rightarrow$ Tighten monetary policy, trade-off inflation and activity, tolerate some inflation
  - In theory, easy; in practice, hard, especially given high uncertainty: too much too soon (risk of recession) vs. too little too late (risk of losing inflation anchor)
- Specific issues:
  - Inflation anchor: policy mistake vs. bad luck; 2020 regime change
  - Inclusivity reversed in cold labor markets: policy mistake vs. bad luck
  - Data-dependent monetary policy, lacking good measurement/understanding of
    - LT inflation expectations (which ones?; salient prices; uncertainty vs. dispersion;. . .)
    - Labor market slack (divergent indicators)
- Broader message: Reliable and granular data key for both policy effectiveness and accountability/trust. Central banks can greatly contribute to this endeavor

Thank you for your attention!

A tale of two unemployment rates: US vs. EA during Covid

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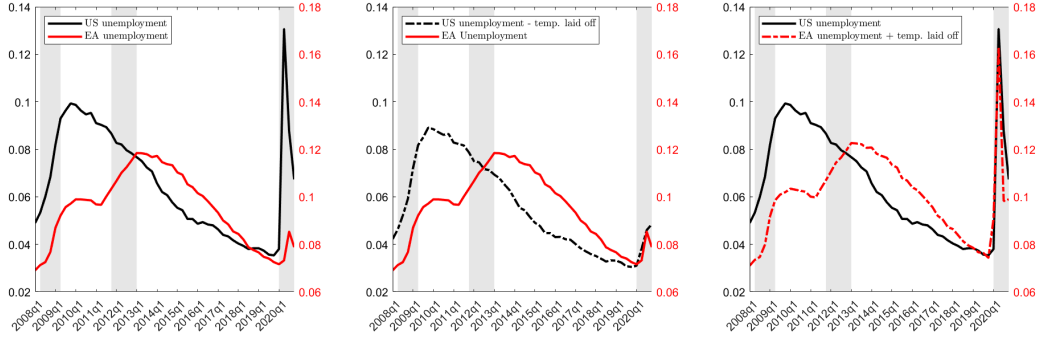

- Unemployment measured differently in US and EA, e.g. temporary laid off workers
- Temporarily laid off workers do not search as intensively as the (permanently) unemployed

  2 limit scenarios:

  1. They do not search at all (middle panel)
  2. They search as intensively as the unemployed (right panel)
- Rigorous assessment: weight temporarily laid off by their actual search intensity

Estimated relative job finding rates

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	Share (%)	JFR	Rel. JFR
Unemployed: Recently left job	0.09	27.81	0.48
Unemployed: Recently permanently laid off	0.29	23.12	0.38
Unemployed: Recently temporarily laid off	0.28	51.8	1.00
Unemployed: Temporary job recently ended	0.13	32.88	0.56
Unemployed: Recently newly entered	0.12	12.65	0.22
Unemployed: Recently reentered	0.27	21.3	0.37
Unemployed: Left job months ago	0.16	19.29	0.32
Unemployed: Permanently laid off months ago	0.90	14.41	0.24
Unemployed: Temporarily laid off months ago	0.26	36.15	0.60
Unemployed: Temporary job ended months ago	0.24	20.06	0.33
Unemployed: Newly entered months ago	0.24	9.41	0.16
Unemployed: Reentered months ago	0.57	16.45	0.28
Unemployed: Long-term unemployed	2.14	10.92	0.18
Want Job: Discouraged	0.47	11.33	0.19
Want Job: Looked last 12 months	0.52	9.76	0.17
Want Job: Other	1.27	12.3	0.21
Not in Labor Force: In school	5.07	6.28	0.11
Not in Labor Force: Retired	15.56	1.41	0.02
Not in Labor Force: Disabled	5.17	1.42	0.02
Not in Labor Force: Other	7.26	6.76	0.12
Employed: Involuntary part-time	3.73	3.63	0.06
Employed: Not involuntary part-time	55.27	1.77	0.03

A (very rough) measure of effective job seekers in the Euro Area

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- Eurostat (LFS-based) data, 2006Q1-2021Q1: unemployment by duration, supplementary indicators, transition rates
- Effective job seekers (with 6 labor market states):

$$S_t = \underbrace{\rho^{ST} U_t^{ST} + \rho^{LT} U_t^{LT}}_{\text{Unemployed}} + \underbrace{\rho^{SNA} N_t^{SNA} + \rho^{ANS} N_t^{ANS} + \rho^{O} N_t^{O}}_{\text{Nonparticipants}} + \underbrace{\rho^{E} E_t}_{\text{Employed}}$$

- Weights given by relative average raw transition rates to employment:

$$\rho^{ST} = 1,\ \rho^{LT} = 0.41,\ \rho^{SNA} = 0.38,\ \rho^{ANS} = 0.27,\ \rho^{O} = 0.11,\ \rho^{E} = 0.11$$

- Rate of effective job seekers:

$$s_t = \frac{S_t}{U_t + N_t + E_t}$$

- Some EA caveats: job retention schemes; fixed-term vs. open-ended contracts

Effective job seekers rate (s) less volatile than the unemployment rate (u)

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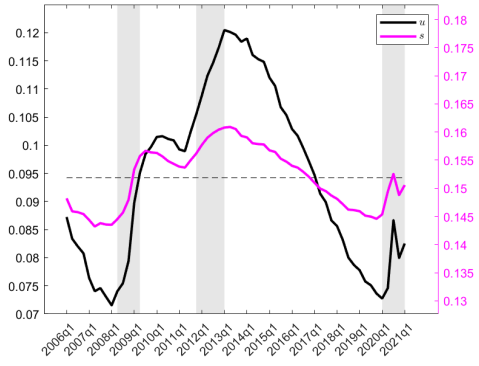
- Both measures are countercyclical, but s is less volatile than u
- How much less volatile?
  - $\sigma_s/\sigma_u = 0.35$
  - % increases during GFC + sovereign debt and Covid recessions:
    - 68% and 19% for u
    - 12% and 6% for s
- Why is the volatility dampened?
  - Offsetting changes in the cyclical composition of searchers: during recessions more unemployed, but less employed job seekers
  - Downweighting of the long-term unemployed reduces the volatility from this component



Unemployment rate (u) imperfect signal of effective job seekers rate (s)

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- Standardize both u and s for comparison
- u imperfect signal of s:
  - u underestimates slack during recessions (and immediate aftermath in GFC case), relative to expansions
  - Downweighting of the long-term unemployed (more sluggish) implies s raises more promptly
  - Different story during Covid: i) raise in inactivity; ii) drop in long-term unemployment
- s-based wage Phillips curve possibly flatter during recessions, compared to u-based one:
  - for given $\Delta\pi^w$, $\Delta s > \Delta u$, hence $\frac{\Delta\pi^w}{\Delta s} < \frac{\Delta\pi^w}{\Delta u}$
- Caveat: need estimates of benchmark rates s^* and u^*