How High is the Unemployment Rate Really?

Misclassification of idled workers may be understating the unemployment rate at present. The unemployment rate could move higher in coming months if the Bureau of Labor Statistics corrects this misclassification.

Regardless of Definition, Unemployment is Elevated

The number of jobless workers has clearly spiked in the last few months. In February, there were 5.8 million individuals who were classified as unemployed (top chart). These individuals were jobless, but they were actively searching for a job. The number of unemployed workers spiked to more than 23 million in April, when much of the economy was locked down, before receding to nearly 21 million in May. Consequently, the U-3 measure of the unemployment rate skyrocketed from only 3.5% in February to 14.7% in April, the highest jobless rate since the 1930s. At “only” 13.3% in May, the U-3 unemployment rate still remains elevated.

However, there are strong reasons to believe that the actual unemployment rate is even higher than the reported rates highlighted above. To calculate the unemployment rate, the Bureau of Labor Statistics (BLS) asks a sample of roughly 60,000 households each month about their employment situation. In “normal” times, there were roughly 1.5 million individuals per month who said they were employed but that they were not at work due to “other reasons” (middle chart). This category spiked to nearly 9 million individuals in April. The BLS suspects that many of these individuals have been furloughed due to the pandemic. Therefore, they should really be classified as “unemployed on temporary layoff.”

But it is the practice of the BLS not to make ad hoc decisions to reclassify survey responses. Therefore, those individuals were counted as employed for purposes of calculating the unemployment rate. If instead those individuals were counted among the ranks of the jobless, then the unemployment rate would have been close to 20% in April and in excess of 16% in May. If the BLS changes its survey methodology or reclassifies workers in the June employment report, which will be published on July 2, or in future releases, then the unemployment rate could jump higher due to statistical reasons.

There is still the issue of workers who may not be counted as unemployed because they have become discouraged and have stopped searching for a job. Recall that an individual must be actively searching for employment to be considered as unemployed in the U-3 definition of the measure. There are also individuals who are “underemployed.” That is, they are working only part-time due to economic reasons (e.g., the economy is in recession and their employer can no longer afford to keep them on the payroll on a full-time basis). These individuals, along with marginally attached workers, are included in the so-called U-6 measure of unemployment, which soared to nearly 23% in April (bottom chart).

Anyway it is measured, the U.S. unemployment rate is very elevated at present and we expect it to remain so for the foreseeable future. As we outline in our most recent forecast, we look for the U-3 unemployment rate to recede to only 6% by the end of next year.

Source: U.S. Department of Labor and Wells Fargo Securities