SHRM

LINE®

Leading Indicators of National Employment®

SHRM® SOCIETY FOR HUMAN RESOURCE MANAGEMENT

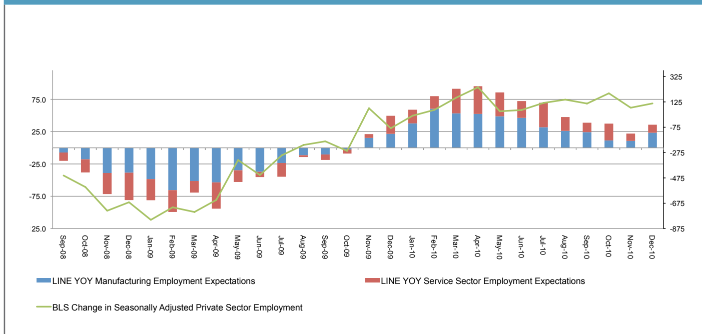
Semiannual Review: Q3 and Q4 of 2010

In 2009, the U.S. private sector lost 4.6 million jobs. In 2010, it added 1.2 million jobs. While this is a very significant improvement, the pace of employment growth in 2010, an average of 123,000 jobs per month, was not enough to bring down unemployment. The **SHRM Leading Indicators of National Employment (LINE)** report provides one of the earliest indications of any increase in the rate of job growth. **The report examines four key areas: employers' hiring expectations, new-hire compensation, difficulty in recruiting top-level talent and job vacancies.** It is based on a monthly survey of private-sector human resource professionals at more than 500 manufacturing and 500 service-sector companies. Together, these two sectors employ more than 90% of the nation's private-sector workers. The LINE employment expectations index is released one month earlier than the U.S. Bureau of Labor Statistics (BLS) employment estimates for the same period. For example, the BLS released its estimate of employment levels for December 2010 on January 7, 2011. On that same day, SHRM released the LINE employment expectations index for January 2011.

As illustrated in Figure 1, during the first half of 2010, the improvements in the LINE index preceded the improvements in the BLS employment estimates. During the second half of 2010, the companies in the SHRM sample reported slower growth than reflected in the BLS data. The multi-year LINE employment expectations series in Figure 2 shows that in December 2010, the firms in the SHRM sample were expanding at a rate similar to the growth patterns they exhibited in the pre-recession periods of December 2005, December 2006 and December 2007.

The LINE new-hire compensation and recruiting difficulty indices are above their recession lows, but suggest no wage inflation. Wages offered to new hires respond more quickly to changing economic conditions than do measures of the average wage for all employees in an organization. Wage change is one of the earliest signs of a tightening job market. As the recovery proceeds, it will be important to watch this indicator for any early signs of wage-driven inflation.

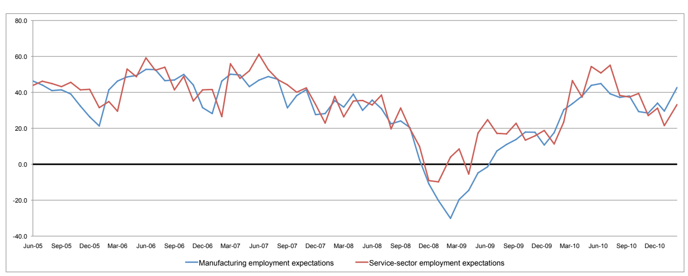
Figure 1 | Monthly Change in BLS Private-Sector Employment Compared with LINE Employment Index Released One Month Earlier



Note: The YOY indices in this figure were calculated as the LINE employment expectations index for month t minus the expectation for month t-12. For example, the YOY expectation for June 2010 is the index from the May 2010 survey minus June 2009 expectation from the May 2009 survey.

Source: Bureau of Labor Statistics, SHRM LINE historical data

Figure 2 | LINE Employment Expectations Index



Source: SHRM LINE historical data

Over the last two years, the LINE indices have proven to be a very good barometer of how the labor market has responded to the persistent effects of the recession.

- **The LINE index foretold the start of the recession.** The LINE employment expectations index began a dramatic and consistent decline in December 2007. That decline corresponds exactly with the findings of the Business Cycle Dating Committee of the National Bureau of Economic Research (NBER), which concluded that the recession began in December of 2007.
- **The LINE employment expectations index revealed the jobs downturn before it was reported by the BLS.** Few long-term forecasting models were able to anticipate the precipitous loss of jobs as a result of the sudden onset of the credit crunch. However, the sudden move to payroll cuts as one of the fastest ways to reduce cash outflows was revealed in the sharp downturn of the monthly LINE employment expectations index.
- **The LINE employment expectations index reached a record low in January 2009.** In that month, HR professionals reported the lowest year-over-year hiring levels since the LINE survey began fielding five years ago. Four weeks after the release of LINE employment expectations index for January 2009, the BLS reported that January job losses in the U.S. private sector were 749,000, the largest one-month loss in more than 50 years.

GDP has recovered, employment has not

The National Bureau of Economic Research (NBER) has determined that the recession that began in December 2007 ended in June 2009. That does not mean that by June 2009 the U.S. economy had returned to pre-recession levels. On the contrary, under the technical definition the NBER uses, the end of the recession is the lowest point in the business cycle, i.e., the point when the economy stops receding. Unfortunately, it is possible to remain at or near those lows for an extended period of time.

When looked at side-by-side, Figures 3 and 4 present a clear picture of what has occurred. Figure 3 reveals that the output of the U.S. economy, as measured by Real GDP (gross domestic product adjusted for inflation), has returned to its pre-recession level. Employment, on the other hand, as shown in Figure 4, remains more than 5% below where it was at the start of the recession. Firms are very cautious about expanding employment before they can be confident that there will be a sustained demand for the goods or services they produce. In addition, the forced belt-tightening during the recession forced firms to learn how to operate more efficiently, getting more output from each worker. This increased productivity will mean that a given level of output will require fewer workers than in the pre-recession period.

It is not unusual for employment growth to lag GDP growth during periods of economic recovery. Nevertheless, the lags following the most recent recession have been exceptionally long and painful. Of the five most recent recessions (1973, 1980, 1981, 1990 and 2001), four were relatively mild. The recession that began in July of 1981 was the most severe, and a comparison to the 1981 experience may help put the most recent recession into perspective. Figure 4 reveals that three years after the start of the deep recession of 1981, employment was 3.5% above the pre-recession level. Unfortunately, three years after the start of the most recent recession, employment is still 5.2% below its pre-recession level.

Job openings are beginning to reappear

Now that product demand is returning, job openings are beginning to reappear. Figures 5 and 6 show the LINE vacancy indexes for the manufacturing and service sectors. Vacancies are defined as job openings that employers are actively trying to fill. In both the manufacturing and service sectors, vacancy growth has returned to pre-recession levels. Why then does employment remain so far below pre-recession levels? One possibility is that during most of 2009, there were very few vacancies that employers were unable to fill. The fact that most firms have more vacancies now than they did in 2009 does not mean the absolute number of vacancies is anywhere close to the pre-recession levels. A second possibility is that firms have become very cautious not only about how many people they hire but also about which people they hire.

A challenge for job seekers, an opportunity for hiring managers

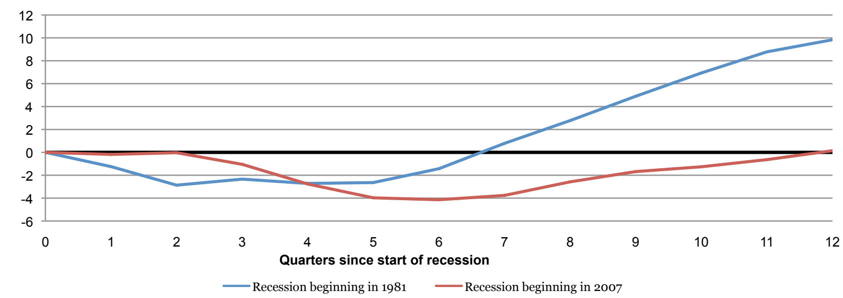
The LINE recruiting difficulty index measures how difficult it is for firms to recruit highly qualified individuals to fill positions that are of greatest strategic importance to their firms. Recruiting this kind of talent often remains difficult even when labor markets are soft and even in sectors such as manufacturing, where employment has been declining for decades. The indices in Figure 4 reflected this difficulty throughout all of 2007. It was not until the fourth quarter of 2008 and the first quarter of 2009 that these indices became consistently negative. During 2010, these indices recovered from their recession lows but remained well below pre-recession levels. The hesitancy of even healthy firms to take on these exceptionally qualified individuals demonstrates the extreme nervousness that persists among employers. Just as many financial institutions with cash are unwilling to make loans, many employers with talent needs are unwilling to make new hires. For those firms that do have the ability and willingness to mine for talent in this job market, the potential gains are large. Even firms that are continuing to reduce overall employment levels may be able to enhance their long-term competitiveness by selectively recruiting “A players” for their “A positions.”

No evidence of wage inflation

Compensation (wages plus benefits) tends to rise during periods of economic expansion and slow in recessions. These cyclical changes often appear first in the compensation offered to new hires. The hiring process forces firms to more rapidly adjust these compensation levels to the current labor market conditions. Compared with measures of the compensation level for all workers, an index of new-hire compensation should provide an earlier indication of changing economic conditions. The LINE Report provides the only published index of new-hire compensation. Figure 5 reveals how unusual the first and second quarters of 2009 were. Compensation growth often slows during recessions, but actual declines in compensation levels are much less common. During the first two quarters of 2009, the LINE compensation index recorded the first negative readings since the series was initiated. Even if firms were not cutting the wages of current employees, it appears that many were adopting either a formal or informal two-tiered wage system. Individuals who were able to find new jobs during 2009 were frequently offered lower wages than those hired into comparable positions in previous quarters. The increase in this index during 2010 is an early sign of strengthening in the job market. However, as shown in Figure 8, the percentage of firms increasing wage rates remains well below pre-recession levels. Though this is bad news for employees, whose homes and retirement savings declined in value over the last several years, rapid productivity increases combined with slow wage growth will make it less difficult for U.S. employers to compete in the global economy.

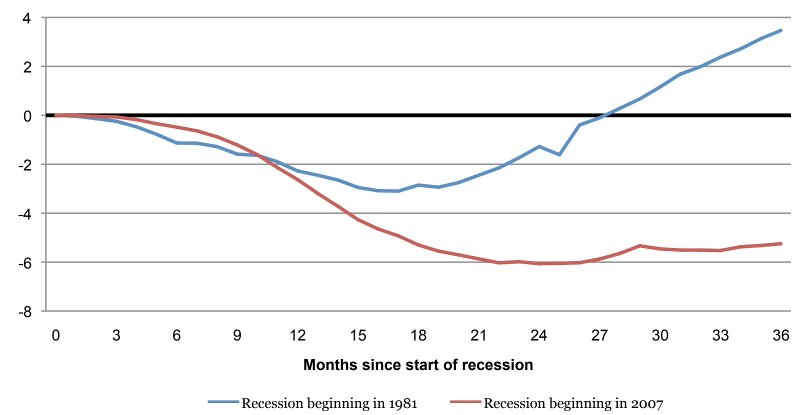
2010 was a year of good news and bad news. National economic output, as measured by real GDP, returned to its pre-recession level. Unfortunately,

Figure 3 | Change in Real GDP
(Seasonally Adjusted Data From U.S. Bureau of Economic Analysis)



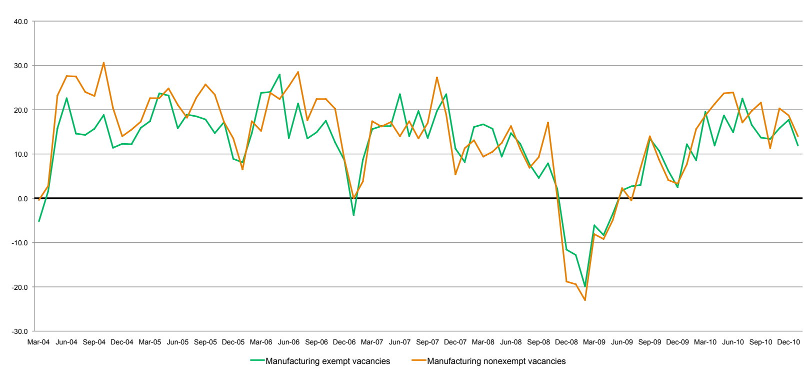
Source: Federal Reserve Bank of Minneapolis

Figure 4 | Percent Change in Employment Since Start of Recession



Source: Federal Reserve Bank of Minneapolis

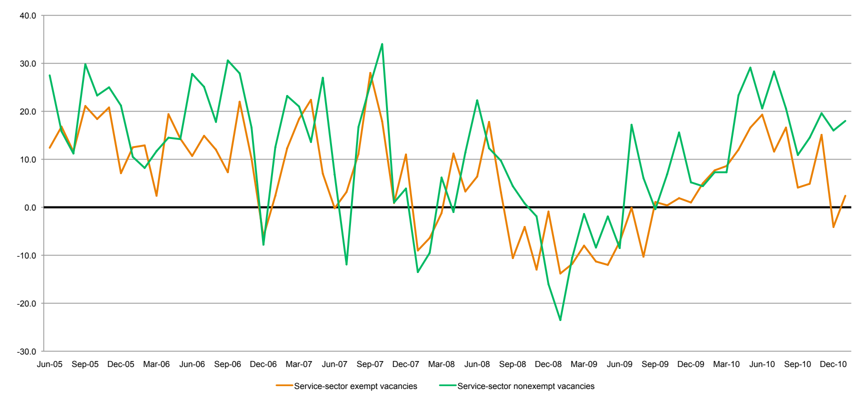
Figure 5 | LINE Vacancy Index for the Manufacturing Sector



Source: SHRM LINE historical data

the number of jobs in the economy remained more than 5% below pre-recession levels. This recession was far more severe than any other in the post-war period. And while the LINE employment expectations index suggests that things are improving, it is happening very slowly. Firms are reluctant to significantly expand their workforces but are beginning to selectively add highly qualified applicants—for example, the U.S. private sector added 113,000 jobs in December 2010. The number of jobs will continue to increase, but so will the number of individuals seeking employment. Unless the average number of jobs added per month almost doubles, the United States will face years of extremely high unemployment.

Figure 6 | LINE Vacancy Index for the Service Sector

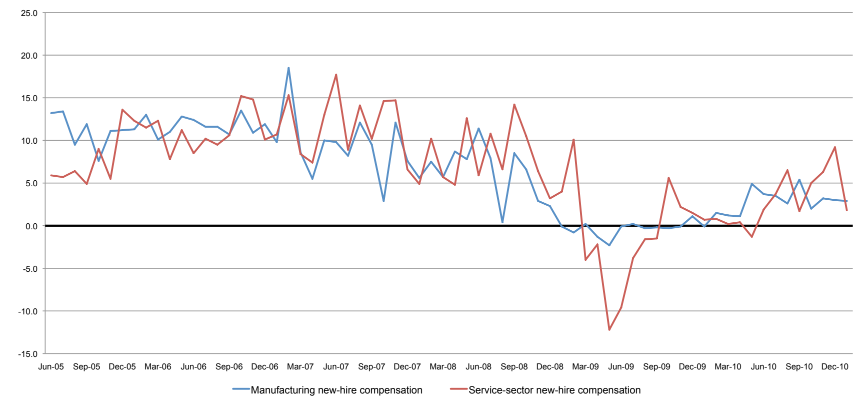


Source: SHRM LINE historical data

Figure 7 | LINE Recruiting Difficulty Index

Source: SHRM LINE historical data

Figure 8 | LINE New-Hire Compensation Index



Source: SHRM LINE historical data

The SHRM LINE report is based on a survey of over 1000 HR professionals in the manufacturing and private service sectors and is released on the first Thursday of each month. For more information, go to **www.shrm.org/line**.