Why Hasn't the U.S. Unemployment Rate Risen Further?

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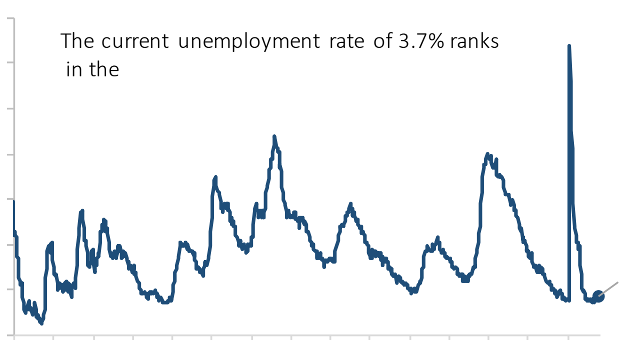
Few economic data points receive as much attention as the unemployment rate, which is calculated by dividing the number of unemployed individuals by the total labor force. It serves as a crucial gauge of labor market health and offers insight into the economy and consumer spending power. Figure 1 shows the unemployment rate is currently 3.7%, which is low compared to historical standards. This is notable considering that during the past two years the U.S. economy experienced one of the sharpest rises in interest rates on record. Traditionally, one would expect to see unemployment rise as interest rates rise, the economy slows, and businesses scale back operations and reduce their workforce in response to the changing economic environment. Why does the unemployment rate remain low today?

One contributing factor is the group classified as "Not in Labor Force", which tracks the number of retired persons, students, individuals taking care of children or other family members, and others who are not seeking work. Early in the pandemic, many individuals left the labor force due to virus concerns and childcare responsibilities. While some of those workers have come back, Figure 2 shows there are 100.3 million individuals not in the labor market, an increase of 5.1 million from January 2020.

Where are those workers? The labor force participation rate by age group offers potential insight. The participation rate for individuals aged 25-54 increased from 83.1% in January 2020 to 83.3% in January 2024. In contrast, the rate for those aged 55 and over decreased from 40.2% to 38.5% over the same period. This divergence suggests that workers nearing retirement accelerated their retirement plans. If those individuals hadn't retired early, the unemployment rate might be higher today.

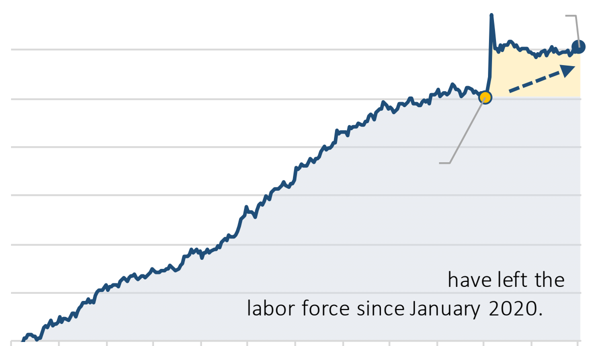
The increase in the number of individuals classified as not in the labor force significantly alters the labor market landscape. This structural change has likely provided an unexpected buffer, keeping employment levels tight and mitigating what might historically have led to a rise in unemployment. It should be noted that unemployment is a lagging indicator and could rise as higher interest rates make more of a cumulative impact. However, with the unique circumstances of this economic cycle, the ceiling on unemployment may be lower with a smaller rise than in prior cycles. The pandemic has passed, but its effects continue to linger.

Figure 1 – U.S. Unemployment Rate Since 1950



Source: U.S. Bureau of Labor Statistics. Data as of 2/15/2024.

Figure 2 – Total "Not in Labor Force" Population



Source: U.S. Bureau of Labor Statistics. Data as of 2/15/2024.

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