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AEA Panel: How Economists Can Help Inform Monetary Policymaking

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Labor Markets section - Federal Reserve Board

- Part of the Division of Research and Statistics.
- Contribute to the FRB staff's economic forecast, Tealbook, etc., transmitted to the Board and FOMC prior to each of its eight meetings yearly.
- Responsible for **analysis, forecasting, and research** regarding U.S. labor markets.

Analysis, forecasting, and research of U.S. labor market

Analysis of current labor market conditions:

- e.g. maximum employment (slack/tightness); labor market strength/fragility; labor supply & demand developments; cyclical turning points
- Closely monitor and analyze broad range of indicators:
  - Key aggregates: U rate, LFPR, EPOP, job vacancies, V/U, payroll employment
  - But also: hiring rate, quits rate, L-T unemployment, PTER, wage growth; many disaggregated metrics (e.g. by industry, occupation, geography, worker characteristics); alternative data.

Forecasting labor market aggregates:

- Key aggregates: U rate, LFPR, EPOP, payroll employment, agg. hours, labor productivity
- "Star" variables: u*, lfpr*, structural productivity, y*

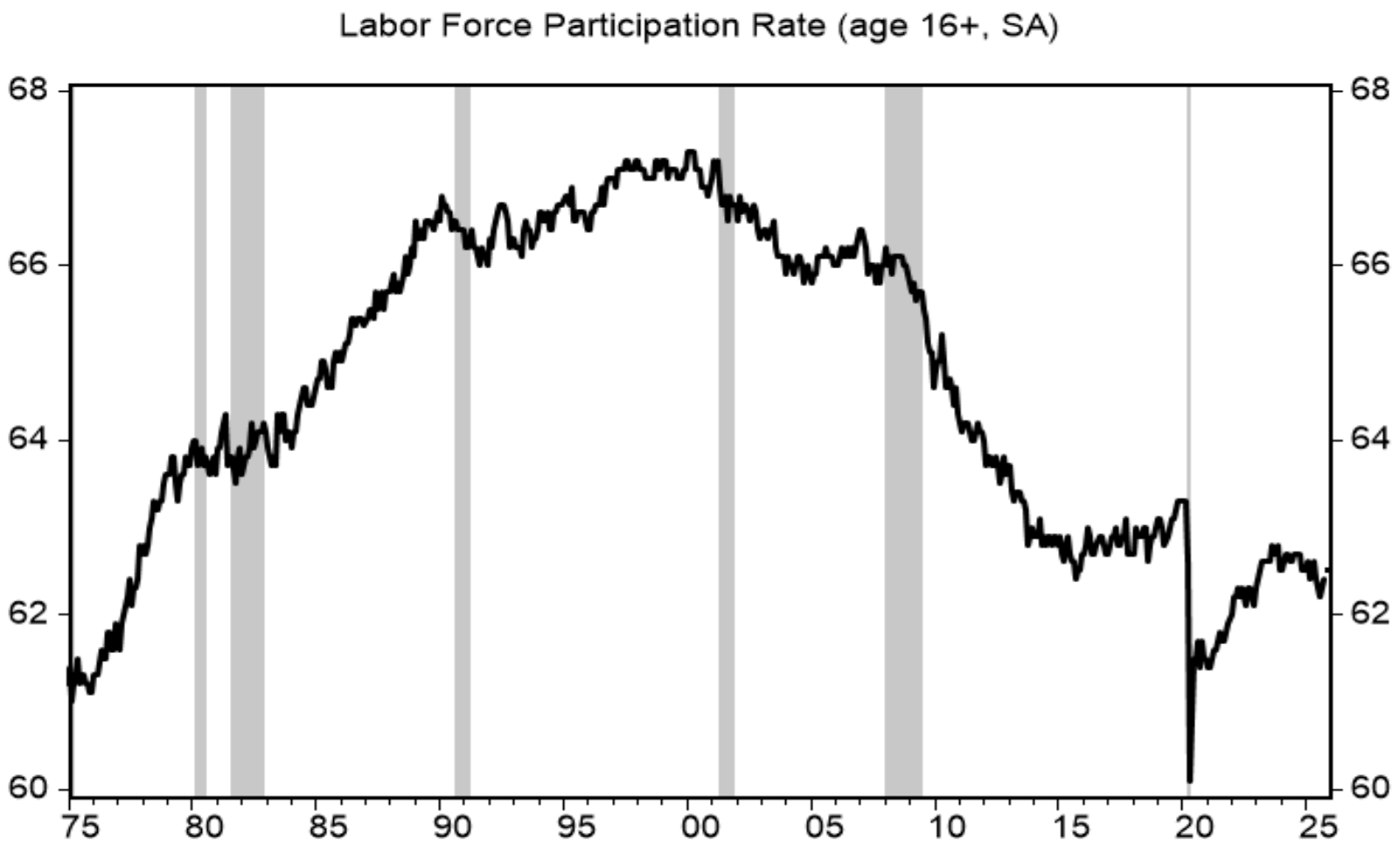
Research:

- Maintain vigorous research agenda, focused on topics relevant to our core mission.
- Engagement with research allows staff to provide research-quality analysis of current policy-relevant issues.

How does research inform policy?

- Ultimately, our aim is to help monetary policymakers make the best policy decisions possible, given all the available data and state-of-the-art knowledge of economic theory and empirics.
- We value a diverse set of research approaches:
  - e.g. traditional macro-labor and search and matching models; applied micro labor economics and empirical analysis using micro data; time series analysis and forecasting methods for labor market indicators; regional and spatial economics approaches; machine learning and AI applications in labor economics; etc.
- I will discuss two examples of how research—including staff research—has helped inform our policy work in recent years.
- Then I will highlight a few topics that are likely to be important in the coming years.

Example 1: Labor Force Participation



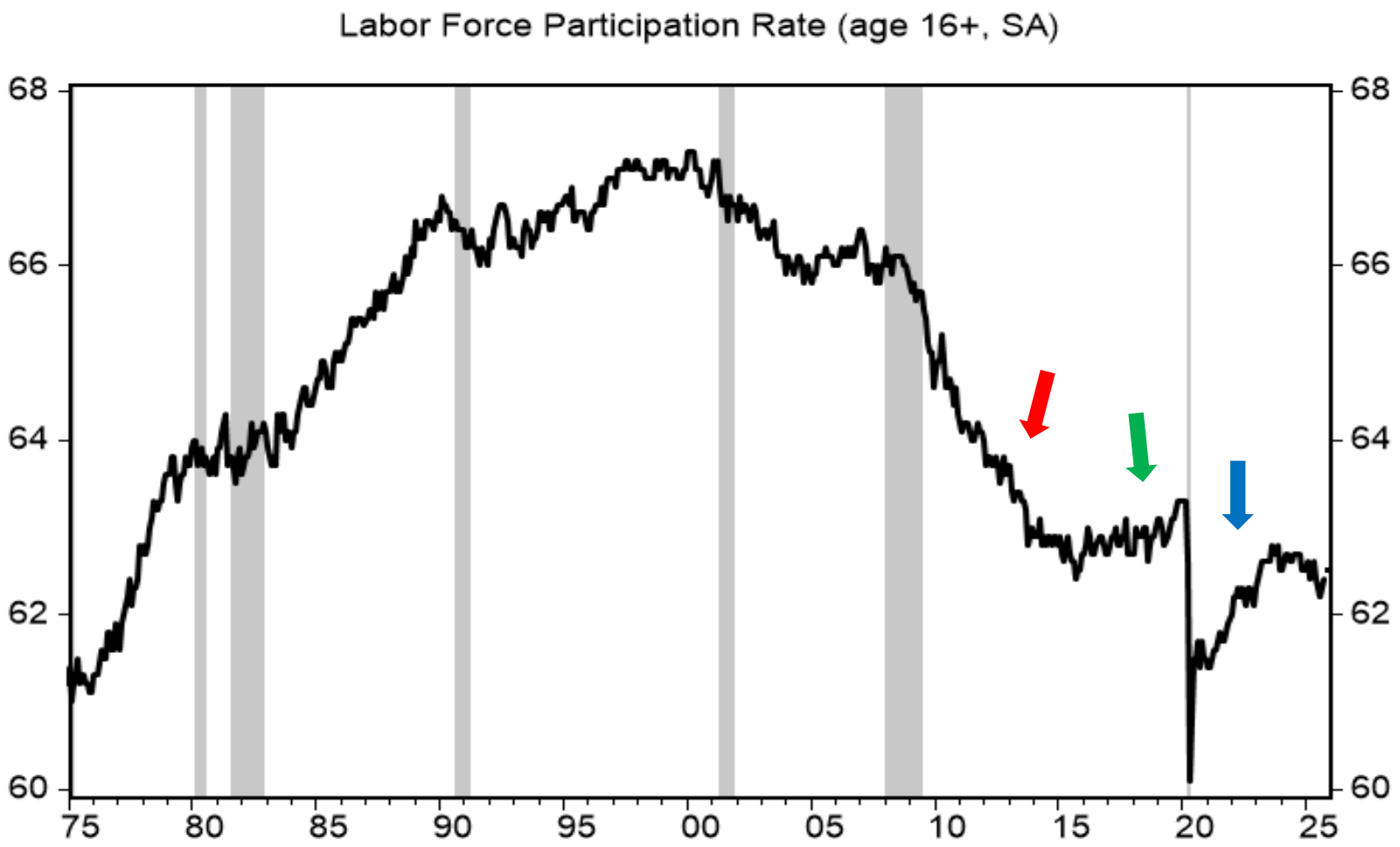
Source: Bureau of Labor Statistics/Haver Analytics

- LFPR: Share of the (age 16+) population either working or seeking work.
- Employment: LFPR*(1-UR)*POP

Example 1: Labor Force Participation

- From Monetary Policy perspective, we are primarily interested in understanding the role of **structural (trend) vs. cyclical factors**.
- **Structural factors**—like population aging, changes in marriage, fertility, gender norms, DI policy, childcare—are very important but are not something that Monetary Policy is well-positioned to address.
- But the **cyclical component** of participation is at the heart of our maximum employment mandate.
- Also: Because policy needs to be forward-looking, assessments of where LFPR is heading also play important role.

Example 1: Labor Force Participation

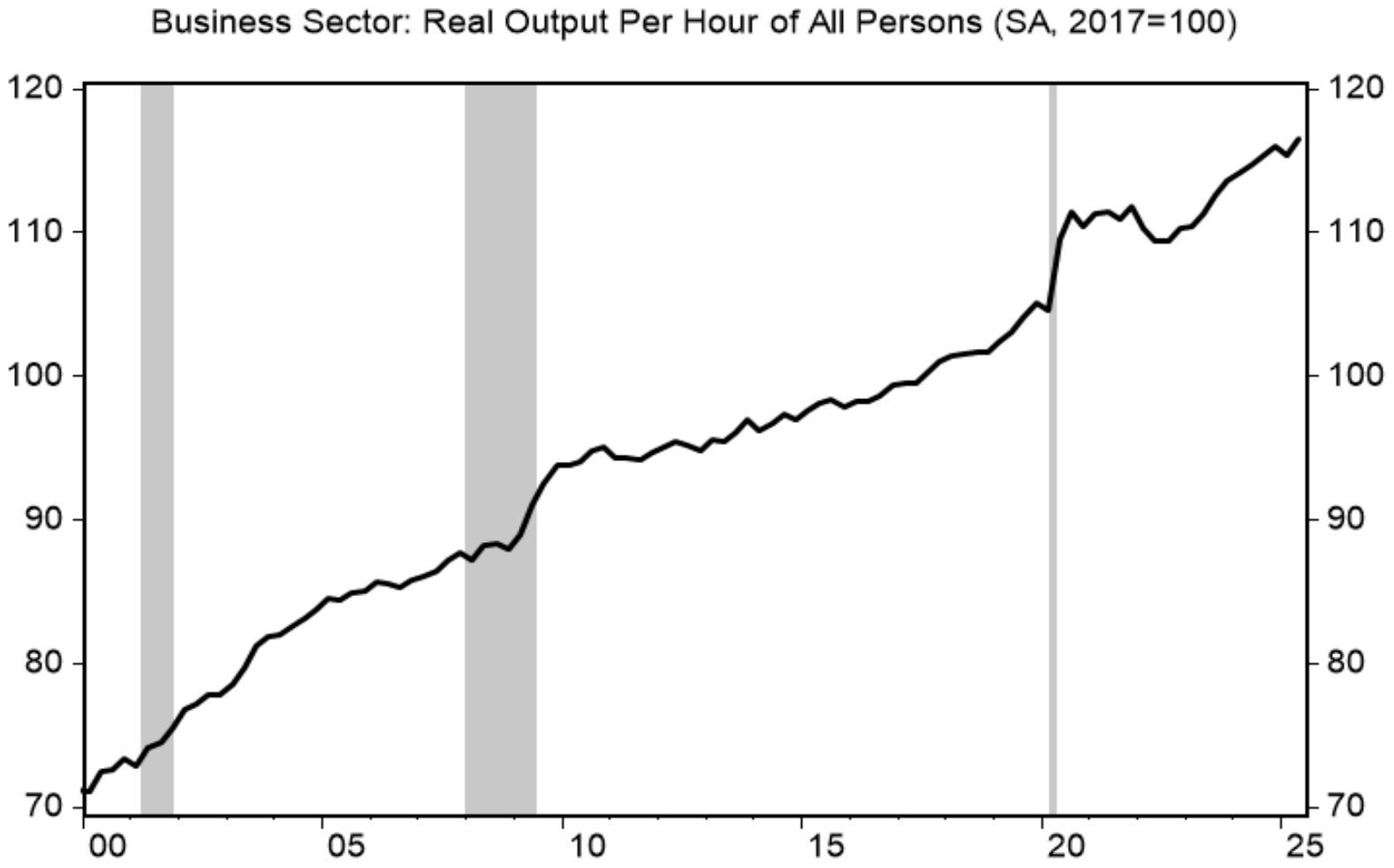


Source: Bureau of Labor Statistics/Haver Analytics

Some influential research:

- Aaronson et al. (BPEA 2006, BPEA 2014)
  - Post-GR LFPR weakness
- Cajner, Coglianese, Montes (REStat, forthcoming)
  - Late 2010s LFPR recovery
- Montes, Smith, Dajon (FEDS 2022)
  - Role of pandemic-related surge in retirements

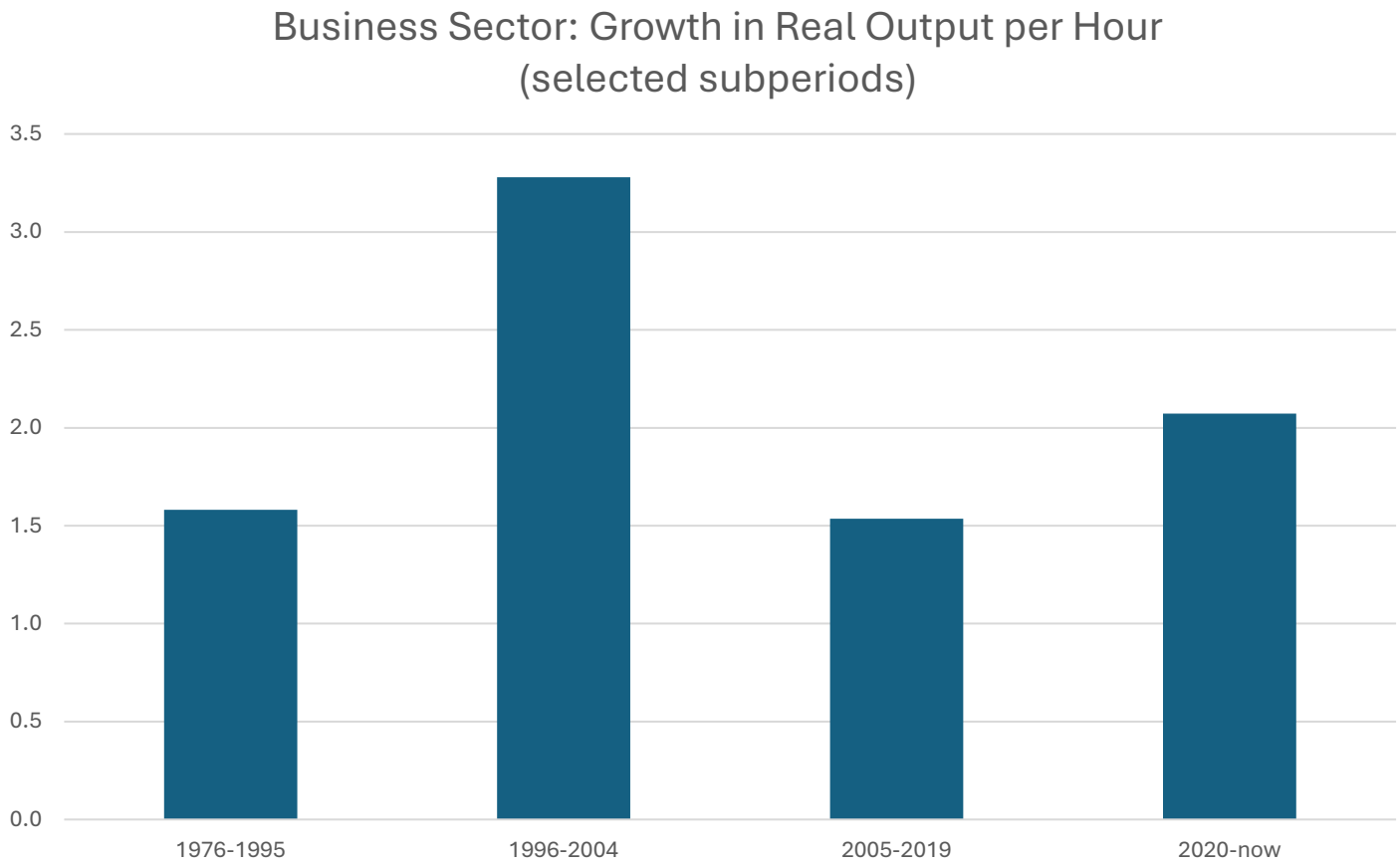
Example 2: Labor productivity



Source: Bureau of Labor Statistics/Haver Analytics

- Labor productivity = Real output (goods and services) produced per hour of labor.
- Stronger productivity growth can support stronger growth in GDP & real wages without additional inflationary pressure.
- Long-run avg. growth of labor productivity in business sector (since late 1800s): ~2 percent per year.

Example 2: Labor productivity



- Labor productivity **growth** very volatile from year to year.
- But there have been broad periods of relatively fast and of relatively slow growth.
- Relatively fast in last 5-6 years (stronger than pre-pandemic).

Example 2: Labor productivity

Why has productivity growth been stronger than pre-pandemic?

- (See Feb. 2025 **Monetary Policy Report**.)
- One key factor: New business formation surged early in the pandemic and has remained strong
  - **Alon et al. (JME, 2018)**: Newer businesses have historically been an important driver of productivity gains.
  - **Decker & Haltiwanger (BPEA 2023; other)**: Surge in business formation reflects genuine new entrepreneurial activity.
- Other likely factors include:
  - High worker reallocation (resulting in more productive matches between some workers and jobs).
  - Severe labor shortages early in pandemic led firms to expand use of labor-saving technologies and more efficiently restructure production.
- Implications:
  - Effects of new business formation ongoing and likely to persist.
  - (Other factors likely had more temporary effects on productivity *growth* rates.)

Looking ahead

- One topic where new research will be key is the effects of AI on the labor market.
- A few examples of papers we've found useful so far:
  - **Brynjolfsson, Chandar, Chen (2025)** use ADP data and find a relative decline in early-career employment among workers in occupations highly exposed to AI relative to early-career workers in non-AI exposed occupations (and older workers in AI-exposed occupations).
  - **Hosseini & Lichtinger (2025)** use data from Revelio Labs and reach similar conclusions – AI might be starting to affect hiring for certain entry-level positions.
  - **Hampole et al. (2025)** find small effects of AI on aggregate employment, as task reallocation and firm productivity increases offset lower demand for certain skills substituted by AI. (Sample ends in 2023.)
- Aggregate employment effects small so far (as negative effects limited to a narrow subset of the workforce); but are only starting to appear.
- Effects of AI on aggregate productivity also probably small so far, but as AI becomes more widely adopted and more efficiently used, understanding productivity effects will also be key.

Looking ahead

A few other topics likely to be important:

- **Natural rate of unemployment (u*)**: Has the long-run u* changed since before the pandemic?
- **LFPR and employment**: Effects of demographics—including from changes in immigration flows. Effects of various policies (e.g. tax and other fiscal policy).
- **Labor productivity**: Other factors (beyond AI & business formation) affecting productivity growth.
- **Cyclical dynamics** of the labor market.
- **Alternative data**: Are there other ways we could be measuring employment and unemployment beyond the official statistics?

Thank you!