

Global Macro Views – Full Employment Output Gaps

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- The US is debating whether a \$1.9 tn fiscal stimulus will lead to overheating, ...
- a discussion that hinges critically on just how much slack there is in the economy.
- Output gaps are very difficult to measure, as we have argued on previous occasions.
- But employment data are easy to come by and put output gap estimates in perspective.
- We document fall-out from COVID-19 on prime-age employment across key economies.
- The decline in US prime-age employment validates the CBO output gap of -4.4 percent.
- Depressed employment in Europe even before COVID-19 points to large output gaps.

The US is debating whether a \$1.9 tn fiscal stimulus will lead to overheating, a debate that hinges critically on just how much slack there is in the economy. Output gaps are difficult to measure and there is material uncertainty around our inflation-consistent gap estimates as well. However, employment data are easy to come by and can help put output gap estimates in perspective. We examine the fall-out from COVID-19 on prime-age (25-54) employment in eight advanced economies. To control for the structural rise in female labor force participation, especially [important](#) in southern Europe, we argue that changes in prime-age male employment are the best proxy for labor market slack in a cross-country comparison. This approach validates the CBO output gap of -4.4 percent (GDP < potential) for the [US](#) last year, slightly narrower than the -5.2 percent gap in 2009. This matches the evolution of prime-age male employment in the US, which fell from 86.4 percent in 2019 to 81.8 percent in 2020, slightly above the 81.0 percent trough in the Great Recession. For Europe the picture is different, however. Depressed prime-age male employment even before COVID-19 suggests that output gaps never closed ahead of 2020, so that economic slack may be quite a bit larger than consensus estimates allow.

Exhibit 1. Prime-age male employment is down, ...

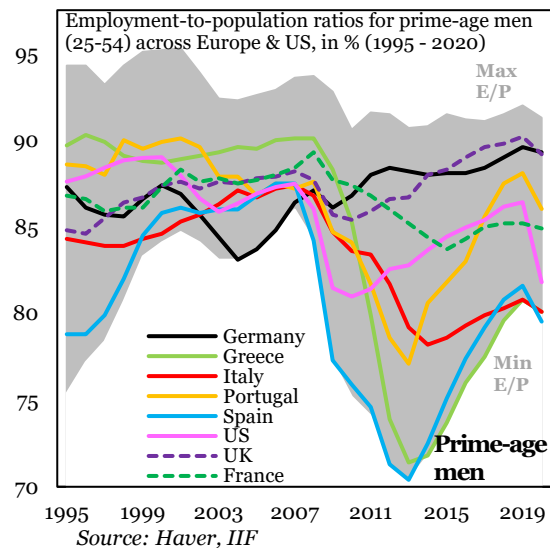
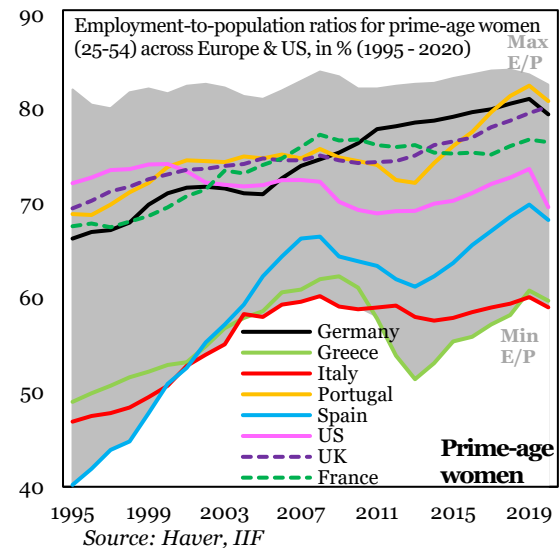


Exhibit 2. ... as is prime age employment among women.



We collect data on prime-age (25-54) employment-to-population ratios for men (Exhibit 1) and women (Exhibit 2) in eight advanced economies: France, Germany, Greece, Italy, Portugal, Spain, the UK and the US. We distinguish between men and women because heavily Catholic countries on the Euro periphery have seen a structural rise in female labor force participation, which flatters the employment picture and means that a like-for-like cross-country comparison is best done looking at prime-age male employment. We compare prime-age male employment – our proxy for the cyclical labor market picture – to consensus output gaps. For the US, this validates the CBO output gap estimate of -4.4 percent (GDP < potential) in 2020, which is narrower than the -5.2 percent output gap in 2009. That matches the message from prime-age male employment, which – despite a sharp fall – is still above where it was at its trough in the global financial crisis (Exhibit 3). The picture is different in Europe, however. For a country like France (Exhibit 4), prime-age male employment never recovered back to levels ahead of the global financial crisis, suggesting that output gaps never closed ahead of COVID-19 and pointing to ample slack.

Exhibit 3. Employment data validate the CBO output gap, ...

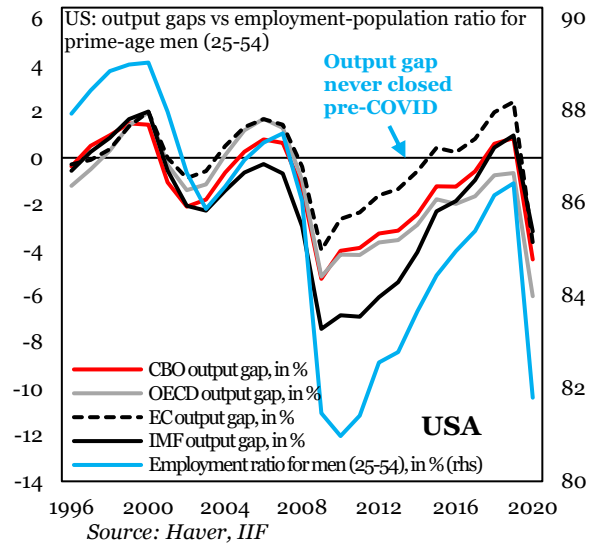
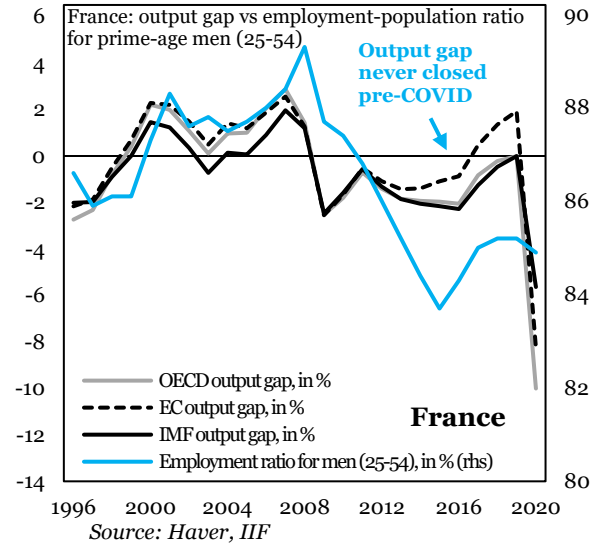


Exhibit 4. ... but point to large amounts of slack in Europe.



This picture is even more extreme on the Euro periphery, especially in Italy (Exhibit 5) and Spain (Exhibit 6), where prime-age male employment remained far below its pre-2007 level in the run-up to COVID-19, even though consensus output gaps were either near zero in the case of Italy or in overheating territory for Spain. This suggests that slack – and downward pressure on inflation – may be large on the periphery.

Exhibit 5. This is especially pronounced for Italy, ...

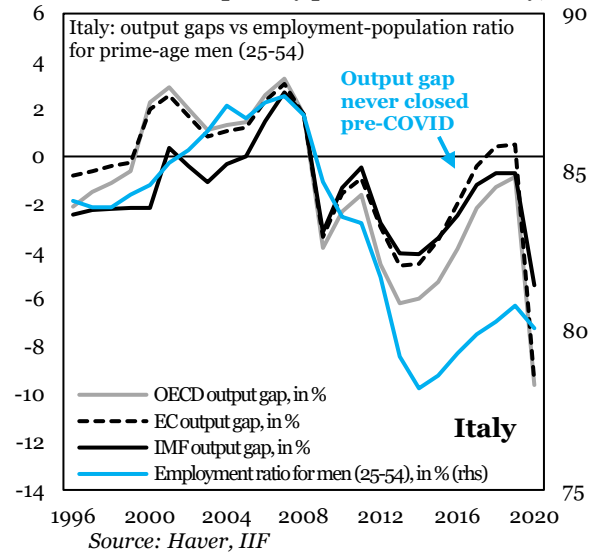


Exhibit 6. ... and for Spain given depressed employment.

