Global Economics Analyst

A Global Perspective on the US Unemployment Crisis (Hatzius/Struyven)

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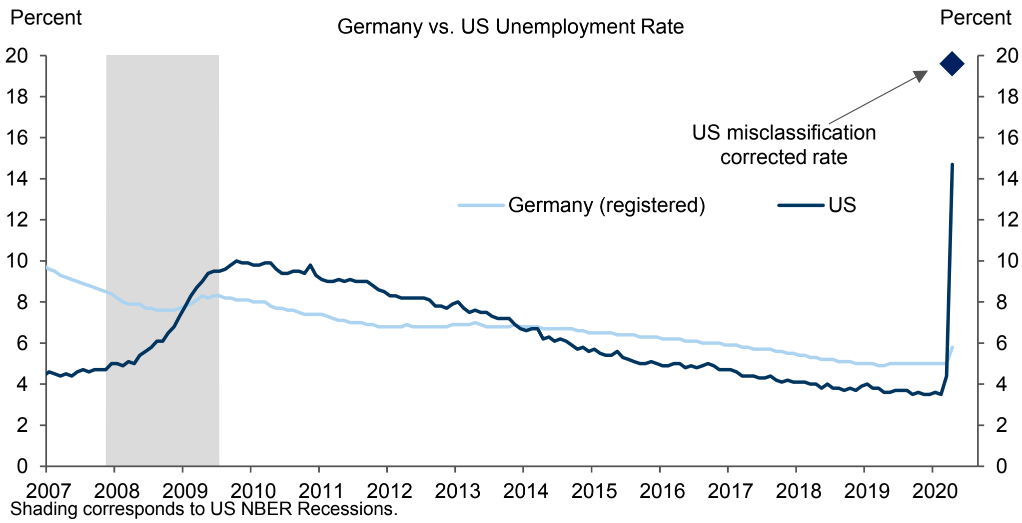
- We expect the US unemployment rate to climb further to a peak of 25% by the end of Q2, a much bigger spike than in other advanced economies including Germany, the UK, Japan, and Australia. Does this imply a greater risk of nasty "second-round effects" and a more prolonged slump in the US than elsewhere?
- Probably not, because the near-term macroeconomic differences are smaller than the unemployment statistics might suggest. Hours worked have plunged everywhere, but governments everywhere are replacing most of the lost labor income. In many countries—especially in Europe—the support comes mostly via wage subsidies. In the US, it comes mostly via enhanced unemployment benefits and tax rebates. Both approaches should keep household income fairly stable and help the global economy recover in coming months.
- Beyond the near term, however, the US unemployment crisis is likely to weigh on the recovery in two ways. First, while most job losers are on "temporary layoff" for now, not all of them will be rehired quickly. Compared with a European-style system that is more focused on job preservation, many more will thus have to find truly new jobs. This could be an advantage if the post-virus economy looks very different from the pre-virus economy and large-scale job reallocation is therefore needed. But it will be a disadvantage if structural changes are more limited.
- Second, while the $600/week benefit top-up has been instrumental in stabilizing US household income so far, it has also pushed the replacement ratio—benefits as a share of prior income—above 100% for many low-paid workers. If the measure is extended beyond its current July 31 end date, this will reduce the incentive to seek work as the economy opens up. If it expires, income will fall sharply. In the end, we think a partial extension at $300/week will limit both the incentive effects and the income hit, without fully resolving either.
- We conclude that the US unemployment crisis will not stand in the way of a near-term economic recovery but is also unlikely to go away quickly. Although the uncertainty is unusually large, we still see the US unemployment rate around 8% in late 2021, well above the levels in most other advanced economies.

A Global Perspective on the US Unemployment Crisis

The US unemployment rate has surged from a 50-year low to a nearly 80-year high in just two months and we expect it to climb further to a peak of 25% by the end of Q2.[1] By contrast, the unemployment rate has ticked up by less than a percentage point in Germany (Exhibit 1). More broadly, our country teams believe that advanced economies outside of North America including Germany, the UK, Japan and Australia are likely to see unemployment remain well within the range of the past several decades. In this *Analyst*, we ask if this implies a disproportionate risk of nasty "second-round effects" and a prolonged slump in the US, and we analyze the potential impact of labor market institutions on the recovery.

Exhibit 1: The Unemployment Rate Has Risen Much More in the US Than in Germany



Source: US Department of Labor, Bundesbank, Goldman Sachs Global Investment Research

Unemployment Doesn't Tell the Whole Story

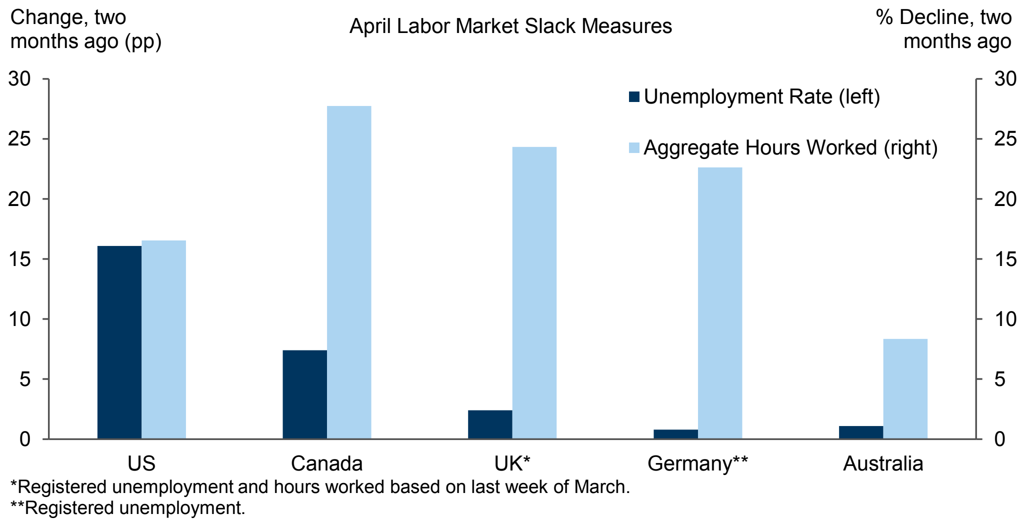
While the spike in the US unemployment rate is stunning, we see two reasons to believe that it probably does not imply a disproportionate risk of more destabilizing macroeconomic "second-round effects" and a more prolonged slump in the US.

First, labor market developments across major advanced economies are more similar than suggested by the unemployment statistics. As shown in Exhibit 2, we estimate that actual hours worked have plunged everywhere over the past couple of months, with the US actually toward the lower end of the spectrum despite the outsized increase in the unemployment rate.[2]

[1] The authors would like to thank Sid Bhushan for his contributions to this report.

[2] The US estimate of hours worked uses hours worked for private employees and employment and average hours for both public employees and self-employed from the April jobs report. The Canada and Australia hours worked data are from the April Labor Force surveys. The UK estimate comes from the ONS experimental data on the decline in hours worked until the last week of March, assuming a flat labor force since February. For the Germany hours estimate, we assume proportionality between the aggregate decline in hours worked and

Exhibit 2: Hours Worked Have Fallen Sharply Across Advanced Economies



Source: US Department of Labor, Statistics Canada, ONS, Bundesbank, Germany Federal Employment Agency, Goldman Sachs Global Investment Research

Second, governments everywhere are providing significant support to replace much of the lost labor income, as summarized in Exhibit 3. Two distinct approaches are visible. On one side of the spectrum, the United States and Canada rely primarily on an enhanced unemployment insurance program. In the US, regular unemployment benefits are now topped up by a $600/week payment that currently runs until July 31. In Canada, regular unemployment benefits have been replaced by a C$500/week payment which is also available to all individuals who have lost income due to COVID-19. These measures have temporarily turned US and Canadian unemployment insurance from some of the most restrictive into some of the most generous systems in the world.

On the other side of the spectrum, Japan, Germany, the UK, and Australia rely primarily on wage subsidies—enhanced versions of already existing programs in Japan and Germany and newly created programs in the UK and Australia. These programs differ in generosity and design, but the common feature is that they attempt to preserve existing employment relationships.

To be sure, the US and Canada have also made some effort to minimize layoffs. The US Paycheck Protection Program (PPP) provides loans to small businesses to cover payroll, rent and mortgage interest, and utilities payments for 8 weeks. The loan can be fully forgiven if at least 75% is used for payroll expenses. But while survey evidence suggests that many firms have rehired workers or maintained workforce levels specifically to maximize PPP loan forgiveness, funds have not always flowed to the most adversely affected areas and the program has not succeeded in preventing a historic surge in layoffs.[3] Similarly, Canada created the so called Emergency Wage

the cumulative excess flow of Kurzarbeit notices in March and April and that the economy-wide and industrial declines in hours worked in March are the same, in line with the Q1 average.

3 While the PPP program's approved funding corresponds to $659bn, net lending has recently edged down to just over $511bn as some loans are returned, likely reflecting that some firms report having difficulties to

Subsidy to persuade firms to preserve employment. But take-up has been much lower than initially projected, partly because it took about six weeks from the date of announcement for the wage subsidy program to start making payments, and many layoffs had already occurred at that point.

Exhibit 3: Large Take-Up of Wage Subsidies in the UK, Germany and Australia

Country	Type: Unemployment Insurance (UI) or Wage Subsidy	Name	Subsidy Rate or Amount[1] (/week)	Take-up (% Labor Force)	Policy Expiration Date (New Rates/Amount if Applicable)	New?
US	UI	Unemployment Insurance	\$600 + 52% up to \$469[2]	26	31/07/2020 (52% up to \$469[2])	Expanded
Canada	UI	Canada Emergency Response Benefit	C\$500	40	3/10/2020 (55% up to C\$573)	Expanded
Canada	Wage Subsidy	Emergency Wage Subsidy Program	75% up to C\$847	11	29/8/2020	New
UK	UI	Jobseeker's Allowance	£117	6	NA	~ Unchanged
UK	Wage Subsidy	Job Retention Scheme	80% up to £577	28	31/10/2020	New
Germany	UI	Unemployment Benefit	67% up to €660	6	NA	Unchanged
Germany	Wage Subsidy	Kurzarbeit	~77%[3] up to €667	23	NA	Expanded
Australia	UI	Job Seeker Payment	275 + 255 = AUS\$530	12	2/09/2020 (AUS\$255)	Expanded
Australia	Wage Subsidy	Job Keeper Payment	AUS\$750	21	27/09/2020	New
Japan	UI	Shitsugyou Hoken	Y41650[4]	2	NA	Unchanged
Japan	Wage Subsidy	Employment Adjustment Subsidy	~50%[4] up to Y41650	9	30/06/2020 (~30%)	Expanded

[1] Subsidy Rate or Amount - This shows the government provided funding but employers can top this amount up.
[2] US - UI - Nevada benefit rates that lie in the middle of the national distribution from Ganong, Noel and Vavra (2020).
[3] Germany - Kurzarbeit - Rate varies between 60-87% depending on children and time on scheme. Rate would be on average ~10 pp higher on a net of social security contributions basis.
[4] Japan - Shitsugyou Hoken - Range is from Y34075 to Y41650; Employment Adjustment Subsidy - range is 45-54%.

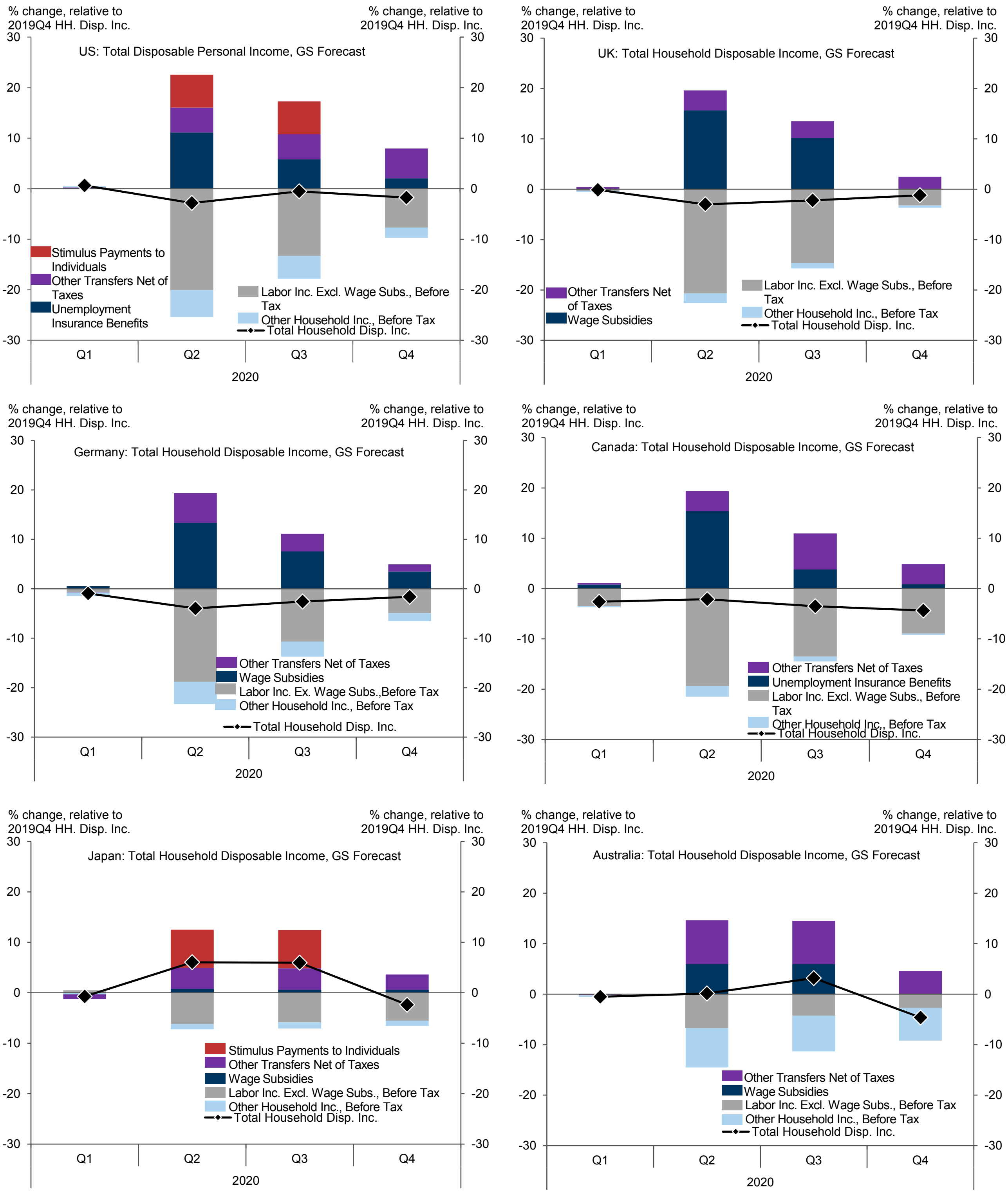
Source: Goldman Sachs Global Investment Research

Despite these very different policy approaches, Exhibits 4 and 5 show that the overall level of policy support looks fairly similar across the economies we consider. In all cases, we estimate that the policy steps taken to counteract the labor income decline will be sufficient to keep household disposable income in Q2/Q3 close to its pre-virus level.[4] In fact, Japan and Australia are projected to see *increases* in disposable income, although these are followed by sequential declines in Q4 as the Japanese tax rebates are not repeated and the Australian wage subsidies are currently slated to expire. The US, Canada, the UK, and Germany are all likely to see modest declines in disposable income in Q2/Q3, but these pale in comparison to the massive declines in hours worked and labor income. In all cases, we view the outlook for disposable income as sufficient to allow for a sequential recovery as economies gradually open back up in coming months.

meet the payroll requirements.

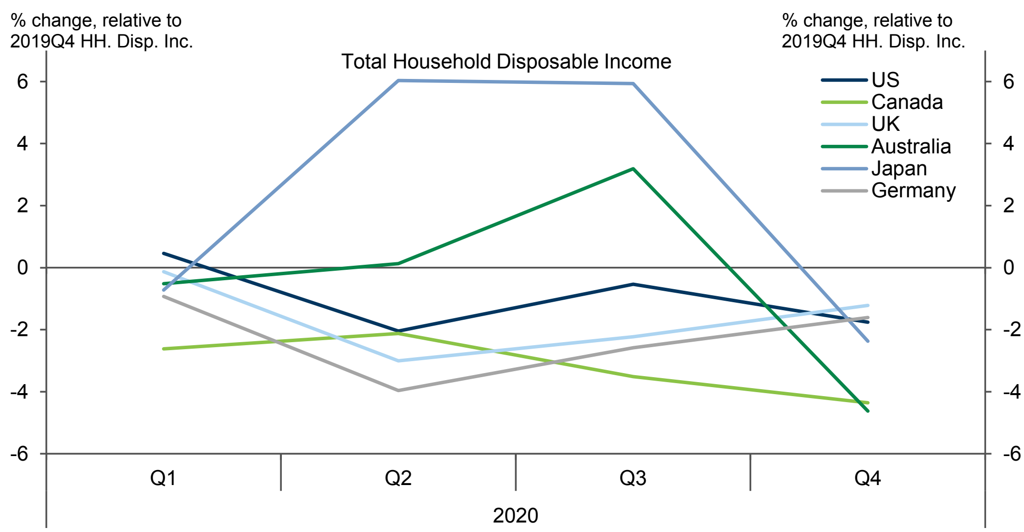
[4] The US panel in Exhibit 5 assumes that 25% of the PPP funds count as additional income for proprietors' income and corporate dividends, which are included in the other income category. We also expect the \$1,200 tax rebates for lower- and middle-income workers to be repeated in Q3 and assume that the \$600/week unemployment benefit top-up is replaced by a \$300 top-up after July 31. For more details see, Joseph Briggs, David Mericle and Ronnie Walker, "Income Losses vs. Fiscal Stimulus: Estimating Second-Round Effects from the Virus Shock", US Economics Analyst, 29 April, 2020.

Exhibit 4: Different Policy Approaches Look Sufficient to Keep Household Disposable Income Fairly Stable



Source: Goldman Sachs Global Investment Research

Exhibit 5: Disposable Income Stable to Higher in Q2 and Q3



Source: Goldman Sachs Global Investment Research

US Labor Market Set to Underperform

Beyond the near term, however, the US unemployment crisis is likely to weigh on the recovery in two important ways.

First, while the vast majority of job losers in the US (and also in Canada) are on "temporary layoff" for now, the ties with their former employers will likely weaken over time. This means that more workers will need to find truly new jobs than in a European-style system that relies more on preserving existing employment relationships via wage subsidies.

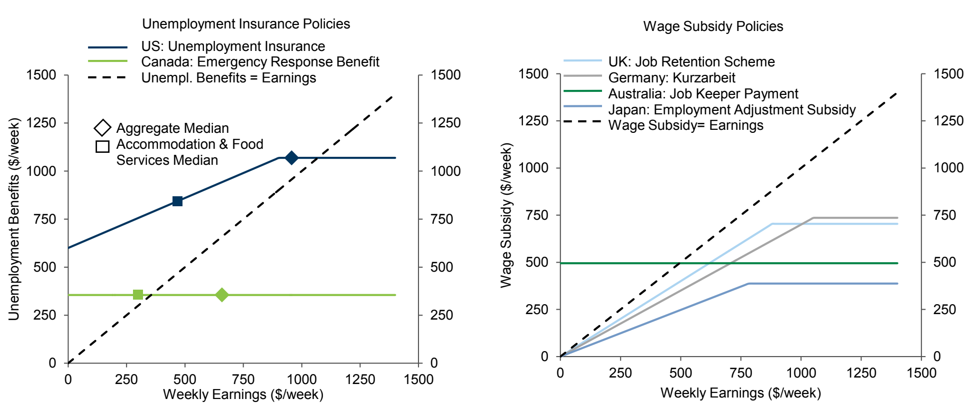
In theory, the North American model could have advantages if the post-virus economy looks dramatically different from the pre-virus economy and dramatic job reallocation is therefore needed. Suppose, for instance, that we see a dramatic structural decline in employment in accommodation and food services that is offset by a dramatic structural increase in e-commerce. The North American system is likely to facilitate this kind of reallocation better than the European system. However, we expect that structural changes will be meaningful only in some industries but much more limited in others. Moreover, only a portion of the workers that lose their jobs in shrinking sectors will be employable in growing sectors. Thus, the reallocation benefit of the North American system might be quite limited in practice, while the cost—having to re-match large numbers of workers with suitable employers—will be substantial.

Second, while the $600/week benefit top-up has been instrumental in shielding US household income so far, it has also pushed the replacement ratio—unemployment benefits as a share of prior income—above 100% for many low-paid workers. The left panel in Exhibit 6 shows that the replacement ratio is now actually slightly above 100% for the median US worker in the typical US state and around 180% for the median worker in the hard-hit food and accommodation services. If the measure is extended beyond its current July 31 end date, this could reduce the incentive to seek work as the economy opens up. If it is allowed to expire, this will deliver a hit to household disposable income. In the end, we think a partial extension at $300/week will limit both the incentive effects and the income hit without fully resolving either issue.

More broadly, Exhibit 6 shows that countries which rely predominantly on enhanced unemployment benefits—i.e., the US and Canada—have created significant incentives against maintaining existing employment relationships. In the US, a majority of workers now see higher incomes from unemployment than from employment, especially in low-wage sectors such as accommodation and food services where the layoffs have been concentrated. In Canada, the system is less generous and the incentive issues are therefore less severe (although the C$500/week Emergency Response Benefit is slightly above median earnings in accommodation and food services).[5]

What about economies that rely primarily on wage subsidies? Since Germany and Japan calculate the subsidy as a percentage of prior earnings and allow part-time work, they have the smallest effects on work incentives. The UK does not allow part-time work, which creates a different but also inefficient disincentive to work (although this is slated to change in August). By contrast, Australia pays a flat amount for each employed worker, which ensures that low-paid workers are protected but somewhat tilts the incentives in favor of part-time work. Most importantly, however, all of these countries have created powerful incentives to keep workers on the payroll until the pandemic has subsided.

Exhibit 6: Benefits Exceed Wages for Low-Income US Workers

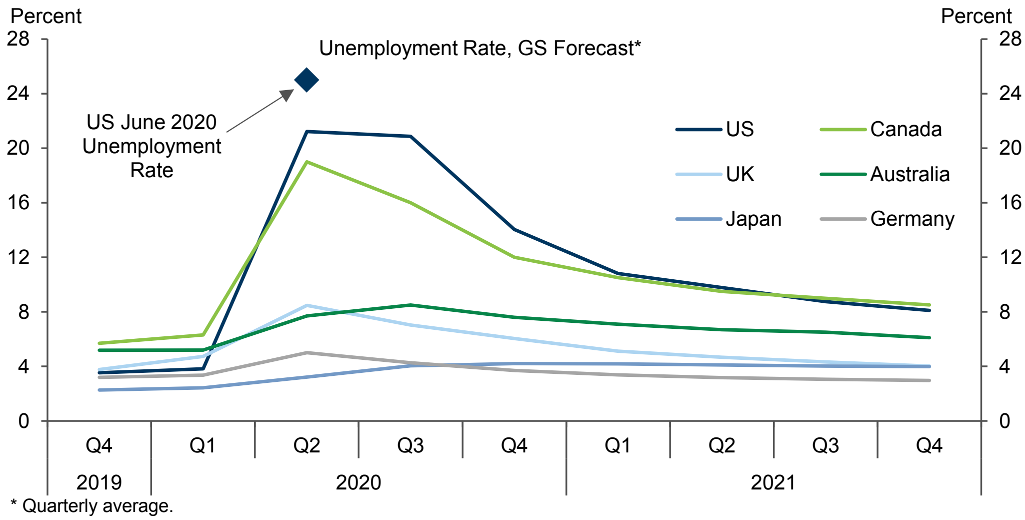


Source: Goldman Sachs Global Investment Research

[5] By replacing the regular Employment Insurance program tied to income, Canada's flat C$500/week Emergency Response Benefit actually made some higher-income job losers somewhat worse off than they would have been under the regular unemployment insurance system.

How will all of this play out as far as labor market outcomes are concerned? While it is still much too early for a definitive view, we think a reasonable baseline is that US employment grows dramatically in the second half of 2020 as many workers on "temporary layoff" are recalled to their previous positions, but that the overall unemployment rate is still around 12% by the end of the year. And even by the end of 2021, Exhibit 7 shows that we still expect an 8% rate in the US and Canada, well above our forecasts of 4% in Japan and the UK and just 3% in Germany.[6]

Exhibit 7: Much Larger Increases in Unemployment in the US and Canada



Source: Department of Labor, Statistics Canada, ONS, Australian Bureau of Statistics, Bundesbank, Japan Ministry of Affairs and Internal Communication, Goldman Sachs Global Investment Research

We draw two main conclusions from our analysis. First, despite sharp differences in the headline unemployment rate, fiscal support looks sufficient to keep household disposable income fairly stable and help the economy recover in coming months across the major advanced economies. Second, however, the US (and Canadian) unemployment rate is likely to remain at levels well above those seen in economies that have put greater emphasis on preserving existing employment relationships during the coronacrisis.

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Daan Struyven

6 Admittedly, focusing only on headline unemployment rates might overstate the cross-country differences in overall labor market underutilization, which also includes labor force withdrawal and involuntary part-time work. This is obviously true in the near term, as shown in Exhibit 2, but it might also be true to some degree in the longer term.

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