

Initial Claims: a Reliable Indicator of Unemployment?

Every Thursday the Bureau of Labor Statistics (BLS) reports the number of people filing for the first time for state unemployment insurance benefits. These data on initial claims are examined closely by many observers of the economy for clues on the near-term change in the unemployment rate. Notwithstanding the close attention they receive, this analysis shows that initial claims do not provide much information about the direction of unemployment. However, they are a good indicator of employment.

First, consider the simple relationship between the monthly changes in initial claims and the unemployment rate. Both often change in the opposite direction. Since 1948, initial claims and the unemployment rate moved in the same direction less than 50 percent of the time. Their inconsistent behavior has been more pronounced during economic expansions. But, when the economy was in a downslide, the relationship was a little better—nearly two thirds of their monthly movements were in the same direction.

Looking at the level of claims rather than their change may be a more appropriate way to predict the direction of unemployment. This is because, given the labor force, unemployment tends to rise or fall when the number of people who have just lost their job—measured by initial claims—is relatively high or low. To determine whether the level of initial claims is high or low, the cyclical component of claims has to be separated from the trend component. This trend is related to the long-run growth of the economy and the labor

force and can be estimated by regression analysis.¹ In expansions, claims should be expected to be below trend, as fewer people become unemployed, while in recessions claims should exceed trend.

Even relative to trend, initial claims do not predict the unemployment rate satisfactorily. Only half of the time did the unemployment rate rise when initial claims exceeded their trend or fall when claims stood below it. The direction of unemployment was predicted with a little more success, at close to 60 percent, during recessions. Thus, comparing claims with trend—while for the most part better than observing their monthly change—still is not particularly helpful.

In addition to claims, many observers monitor the insured unemployment rate to predict overall unemployment. The BLS constructs the insured unemployment rate partly from initial claims data. The insured unemployment rate is not a dependable indicator of overall unemployment either. Its success rate in predicting the direction of unemployment has been only slightly above 50 percent, although somewhat better during recessions.

While initial claims do not consistently predict the direction of unemployment, they may provide a clue around cyclical troughs as to when the unemployment rate will fall. During most of the postwar recessions, claims have peaked two or three months ahead of the unemployment rate. Thus, they may serve as a leading indicator of the decline in unemployment. Around cyclical peaks, in contrast, claims frequently have begun to climb simultaneously with unemployment and by only a small, normally inconsequential amount. As a result, they may not be a useful indicator as an expansion nears its end.

To be sure, there have been occasions during recessions when initial claims turned down but then resumed their climb before the economy began to recover. In the last recession, claims declined fairly sharply but temporarily in June and July 1982, well ahead of the peak in unemployment. Thus, even during recessions, a drop

¹The trend in claims was calculated in two stages. First, the following estimated equation yielded a trend level of about 0.4 percent of the labor force. Second, the predictive performances of other, parallel trends were examined. The most successful predictions were obtained when initial claims were compared with a level 15 percent above the estimated trend at any point in time. This adjusted trend is used in this analysis. It stood at 480,000 in 1983.

$$\frac{IC}{LF} = 0.003762 + 0.0005327(U-UN) + 0.841 \text{ error}_t, \quad \bar{R}^2 = 37.8$$

(21.7) (9.2) (17.9)

where IC = initial claims, LF = labor force, U = unemployment rate, UN = natural rate of unemployment (numbers in parentheses are t-statistics). For a discussion of the natural rate of unemployment, see A. Steven Englander and Cornelis A. Los, "Recovery without Accelerating Inflation?", this *Quarterly Review* (Summer 1983).

in initial claims over two or three months may incorrectly signal a topping in the unemployment rate

Although initial claims do not tell us much about the unemployment rate, they are useful in predicting the direction of payroll employment. Admittedly, the simple relationship between the monthly changes in claims and employment is about as weak as that between claims and unemployment; in only a little more than half the time did they move in the same direction. Nevertheless, when claims are compared with trend, they serve as a good guide to the direction of employment. In more than 80 percent of the time, employment has fallen when initial claims have been greater than trend or has risen when claims have been less than trend. This rate of success has been evident in both expansions and recessions.

Claims predict employment best when the economy is not near a cyclical turning point. About half of the months in which claims relative to trend flashed incorrect signals occurred within five months of cyclical peaks or troughs. However, around cyclical troughs, claims have tended to turn around ahead of employment, although the lag has been more variable than for unemployment. Thus, claims may serve as a leading indicator at those times. Around many past cyclical peaks, though, claims and employment have often reversed direction simultaneously—with the change in claims being quite small—making claims less insightful.

In conclusion, should anyone pay attention to initial claims? The bottom line of this analysis is that for the most part the answer is no when the purpose is to predict the direction of unemployment, but yes when the purpose is to predict the direction of payroll employment. In one important case, however, it may pay to watch the pattern of initial claims to predict the direction of unemployment. This is at times when a recession seems to be ending and questions arise as to when the unemployment rate will start to fall. Although the true peak in initial claims may be difficult to determine, claims usually have peaked about two months ahead of the unemployment rate. Thus, at those times when many observers strive to pinpoint an upturn in the economy, initial claims may be of some help.

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