On Friday morning, Fed Chair Janet Yellen will deliver the keynote address at the Kansas City Fed’s annual monetary policy symposium in Jackson Hole, Wyoming. Those looking for clues on the timing of the first Fed rate hike are likely to be disappointed. As Yellen previously noted, “it depends.” Yellen’s speech should provide insight into how the Fed views the current labor market situation and, more importantly, how monetary policy will respond to changing job conditions as it begins to normalize monetary policy in the months ahead.

We can expect Yellen to address many of the key topics in the labor market and Fed policy debates. Specifically, how much slack remains in the job market? What drives compensation gains; is it overall unemployment, short-term unemployment, measures of under-employment? How much of an increase in wage inflation is the Fed willing to tolerate and for how long?

We already have some indication of how Yellen will characterize the job market. While the unemployment rate has fallen significantly from its recessionary peak, a lot of that is due to a decrease in labor force participation. Some of the decrease in participation is demographics, reflecting the aging of the population. However it’s also likely that the job market is a lot more flexible that most people think.
The Bureau of Labor Statistics Business Employment Dynamics (BED) data don’t get much attention from the financial markets. They arrive with a lag (we currently have information up to 4Q13). The monthly employment report is by far the most significant of the monthly economic data releases. However, the monthly payroll estimate is a net figure. Millions of jobs are gained and million are lost each quarter, partly reflecting seasonality (the school year, the holiday shopping season). The BED data are gross measures. The recovery from the Great Recession can be characterized as a period of relatively low job destruction and a gradual uptrend in job creation.

Job losses were consistently higher in the previous expansion, but so was job creation. The BED data paint a remarkable picture for the late 1990s. At the time, job losses were very high, but job creation was even higher. It was a transformative time. Cell phones, the Internet, and computer networking transformed the way businesses operate. We also learned that the job market was a lot more flexible than previously believed. While some blame the Fed for inflating the tech stock bubble, monetary policy facilitated a lot of the transformation. Workers moved up, and those on the margins came in to fill the gaps. Lured by more attractive wages, retirees and stay-at-home spouses returned to the job market.

During the next decade, we saw the downside of the new technologies as firms could do more with fewer workers. The initial rebound from the 2001 recession was a “job-loss” recovery. We didn’t begin to add jobs until nearly two years after the recession had officially ended.

The Great Recession (or if you prefer, the Lesser Depression) was not your typical economic downturn. Given the collapse in the housing sector and a massive deleveraging of the financial sector, there was never going to be a quick turnaround. The low level of job turnover has been a chief characteristic of this recovery. The housing collapse had a lot to do with that. Tied to their underwater mortgages, workers are less inclined to pull up stakes and pursue employment in other parts of the country. Quit rates are trending higher, but only gradually. There’s much less job hopping than there was in previous cycles.

The low labor turnover rate is associated with the relatively weak growth in wages. Weak wage growth in turn limits the pace of growth in consumer spending (and thus, the overall economy). While income inequality has been an important topic this year, most of the focus has been on high-end salaries rather the struggles of the middle class and below. The focus is starting to change. One can easily observe the impact of the squeeze on the middle class in retail sales and housing.

What will reverse the week trend in wage growth? A tighter job market. A recent Chicago Fed letter suggests that there is a strong correlation between real wage growth and medium-term unemployment (those out of work for 5-26 weeks), as well as with marginally attached workers, particularly those working part time involuntarily for economic reasons.

The more interesting question is how long the Fed will be willing to tolerate a pickup in wage growth, but we first have to see that pickup before we worry about tighter policy.

Yellen’s speech is likely to suggest that there is still ample slack in the job market and to imply that the Fed will be in no hurry to raise short-term interest rates.