DALLASFED Economic Update
National

Expectations of a Pickup Remain Despite Slow Start to 2015

May 1, 2015

Data released in the past six weeks have surprised to the downside, raising concerns that the nation's recovery may not have been as solid as previously thought. Temporary factors and short-term frictions—a harsh winter and a West Coast ports strike—may have contributed to slower growth in the first quarter.

The energy industry slowdown, uncertainty regarding future oil prices and a strengthening dollar also contributed. These factors, which tend to be longer lasting, reflect the transitional impact of businesses and households adjusting to a lower-oil-price environment. The U.S. economy, however, seems well-positioned to absorb the attendant costs and resume growing at least at the average annual rate of 2.3 percent observed during the recovery.

Disappointing Output Growth

In its advance estimate, first-quarter real (inflation adjusted) gross domestic product (GDP) grew at an annualized 0.2 percent rate, a sharp deceleration from the fourth quarter's 2.2 percent rate (*Chart 1*).

Real personal consumption expenditures contributed 1.3 percentage points to real GDP growth. The main negative contributors to real GDP growth were real private nonresidential fixed investment, subtracting 0.4 percentage points, and real net exports, subtracting 1.3 percentage points. Exports fell at an annualized rate of 7.2 percent in the first quarter. The decline reflected a strengthening dollar and weakening global demand. Nonresidential fixed investment fell amid uncertainty about future oil prices and tentativeness surrounding new business investments.

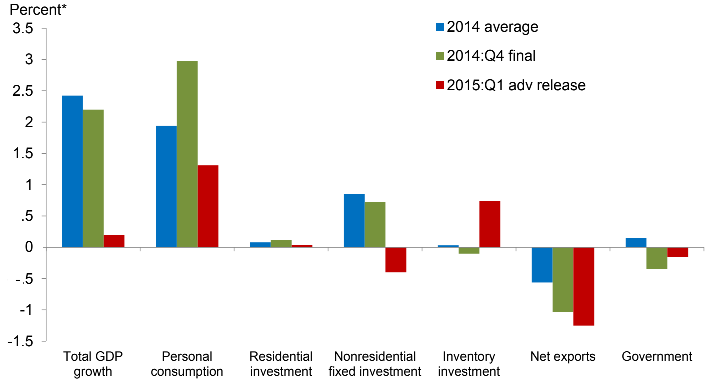
Temporary Factors, Short-Term Drag

Other recent economic indicators suggest a slowing U.S. economy. The Bureau of Labor Statistics' establishment survey for March showed a deceleration in nonfarm payroll employment gains to a seasonally adjusted 126,000 jobs—the weakest hiring in 15 months (*Chart 2*).

Net job creation averaged 197,000 per month in first quarter 2015, compared with 324,000 in fourth quarter 2014. Industrial production, which includes manufacturing as well as mining and utilities sector output, fell at a 1.2 percent annualized rate during the first quarter—the first quarterly decline since the recession ended in 2009.

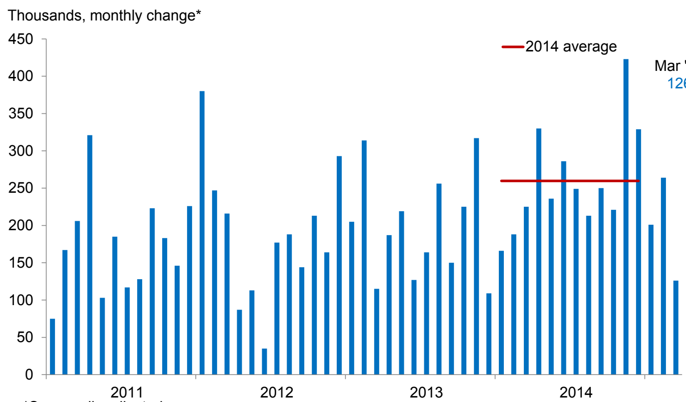
The disappointing data reflect temporary factors. The Northeast experienced an exceptionally cold winter; the number of workers reporting that they could not show

Chart 1
First-Quarter GDP Growth Decelerates from 2014 Average



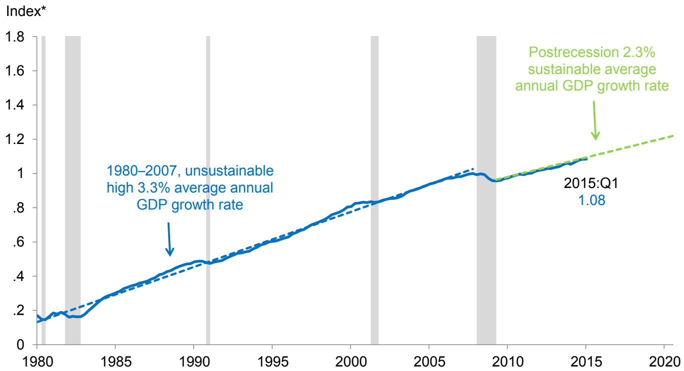
*Contribution to percent change in real gross domestic product (GDP) growth; quarter/quarter, seasonally adjusted annualized rate.
SOURCE: Bureau of Labor Statistics.

Chart 2
Nonfarm Job Growth Disappoints in March



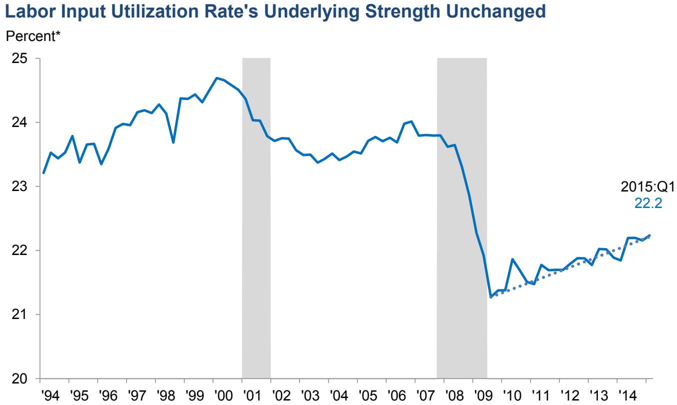
*Seasonally adjusted.
SOURCE: Bureau of Labor Statistics.

Chart 3
Recovery Proceeds Along Post-Great Recession Trend



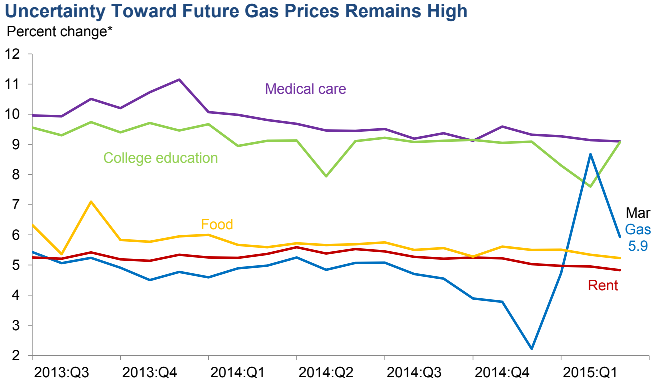
* Real gross domestic product (GDP) index, 2007 = 1, log scale.
NOTE: Shaded areas indicate recessions.
SOURCES: Bureau of Economic Analysis; National Bureau of Economic Research; author's calculations.

Chart 4
Labor Input Utilization Rate's Underlying Strength Unchanged



*Fraction of available time spent at work by population 16 years of age and older.
NOTES: Shaded bars indicate recession. The dotted line represents the trend from fourth quarter 2009 through fourth quarter 2014.
SOURCES: Bureau of Labor Statistics; National Bureau of Economic Research; author's calculations.

Chart 5
Uncertainty Toward Future Gas Prices Remains High



*One-year-ahead commodity price change expectation.
SOURCE: Federal Reserve Bank of New York.

up for work during the first quarter was the second-highest in the past four years (2014, when GDP declined in the first quarter, was the highest). Additionally, mining employment declined due to a slowdown in the oil industry, a result of low oil prices. Finally, the West Coast port strike is believed to have negatively affected output growth, creating supply bottlenecks and causing inventory shortages for many firms.

Medium-Term Outlook Unchanged

Notwithstanding the first-quarter difficulties, the U.S. economy's underlying strength remains, reflecting a growth trajectory it has followed since the end of the Great Recession (*Chart 3*). Consumer expectations continued to climb, apart from a slight dip in March; both consumer expectations and consumer confidence remain near postrecession highs.

Numerous employment indicators suggest the unexpected deceleration in March payroll gains is not representative of labor market fundamentals. The unemployment rate remained at 5.5 percent in March, and initial claims for unemployment insurance declined in April to levels last seen in 2000. The initial claims could foreshadow strong payroll growth for April. The labor input utilization rate also showed no signs of slowing (*Chart 4*).

The labor input utilization rate, unlike the other labor market indicators that count the number of workers paid regardless of the number of hours actually worked and whether workers showed up, measures the fraction of available discretionary time that the working-age population is actually on the job.

The risk of a strengthening dollar remains in the medium term. If the U.S. begins to pursue contractionary monetary policy in contrast to many of its trading partners, the value of the dollar may remain elevated. This, in conjunction with low oil prices, may subdue output growth going forward.

Oil Price Decline Benefits Still Unrealized

An economy usually benefits from an improvement in its terms of trade. Therefore, the sudden, large drop in oil prices that began in mid-2014 should have an overall positive impact on the U.S.—a net oil importer. Instead, it seems to have triggered immediate negative transitional effects without a simultaneous positive response. Diminished oil industry investment and the strengthening dollar may have depressed output growth, which is evident in the negative contribution to GDP from nonresidential fixed investment and net exports in the first quarter.

Historically, elevated uncertainty toward future oil prices has mitigated benefits of the price decline. Consumer expectations regarding gasoline prices have been highly volatile relative to other expenditures (*Chart 5*).

Volatility may cause industries that benefit from lower oil prices to remain on the sidelines until they become confident that the price change will endure long enough to justify the now-profitable investments. Uncertainty also damps anticipated household consumption increases as consumers save rather than spend extra cash (*Chart 6*).

The speed with which uncertainty subsides and the level at which energy prices settle will determine whether the balance between the detrimental and beneficial effects of decreased energy expenses will shift and at what point in time.

—Daniel Lin

About the Author

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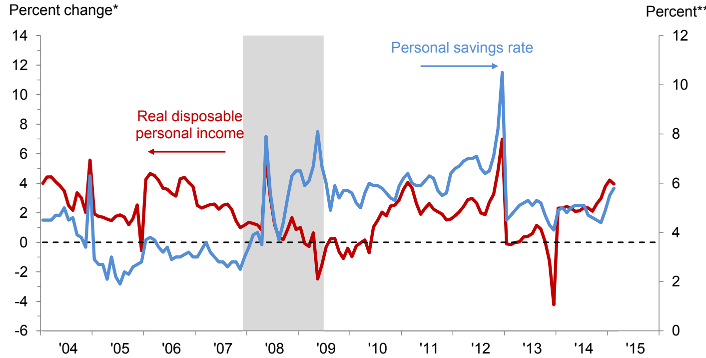
Chart 6
Lower Gas Bills Going into Savings, Not Consumption



*Year/year, seasonally adjusted annualized rate.
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NOTE: Shaded area indicates recession.
SOURCES: Bureau of Economic Analysis; National Bureau of Economic Research.