DALLASFED Economic Update

National

First-Quarter Growth Disappoints, but Outlook Robust

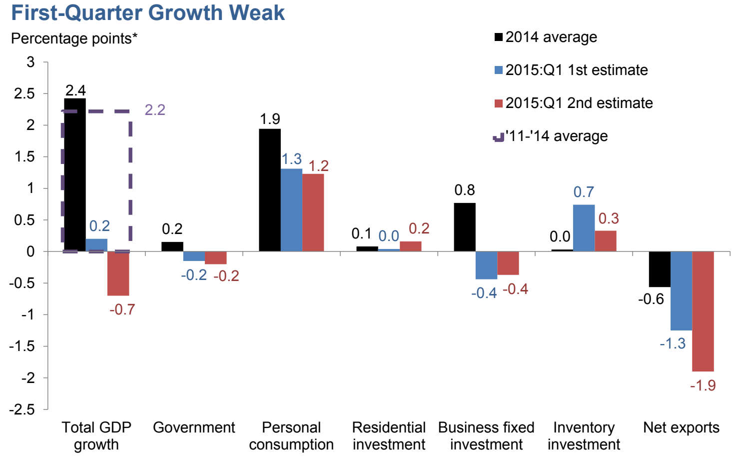
June 19, 2015

Economic indicators released since late April suggest that momentum is returning following a weak first quarter. Downside risks to growth are largely external to the U.S., including concerns over the Greek debt negotiations and softer growth in emerging markets. On balance, the U.S. economic growth path for the second half of 2015 remains robust.

Can't Shake the Seasons

U.S. output fell further than initially anticipated in first quarter 2015, according to the Bureau of Economic Analysis second estimate of gross domestic product (GDP). The seasonally adjusted, annualized growth rate was revised down from 0.2 percent to -0.7 percent. The decrease was driven primarily by downward revisions to net exports, private inventories and personal consumption (*Chart 1*).

Chart 1
First-Quarter Growth Weak

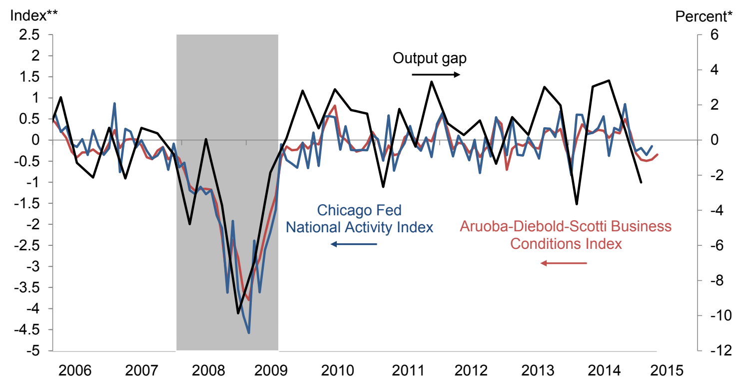


*Contribution to total gross domestic product (GDP) growth.
SOURCE: Bureau of Economic Analysis.

Transitory factors—severe winter weather and the West Coast port strike—account for some of the weakness in first-quarter GDP growth. The sharp decline in oil and gas-related investment also contributed modestly. Evidence suggests that unfiltered seasonal effects—termed residual seasonality—in the estimates may also have lowered the first-quarter growth rate.[1]

An alternative, but less timely, measure of national output is gross domestic income (GDI). GDI, which measures output from the income side rather than the expenditure side, should equal GDP. In practice, however, the two measures differ. Compared to GDP, GDI better reflects the business cycle fluctuations in output, and GDP growth generally revises toward GDI growth.[2] With 1.4 percent estimated growth in GDI for the first quarter and stronger incoming data, first-quarter GDP growth will likely be revised up in later releases.

Chart 2
Latest Data Show Return to Trend



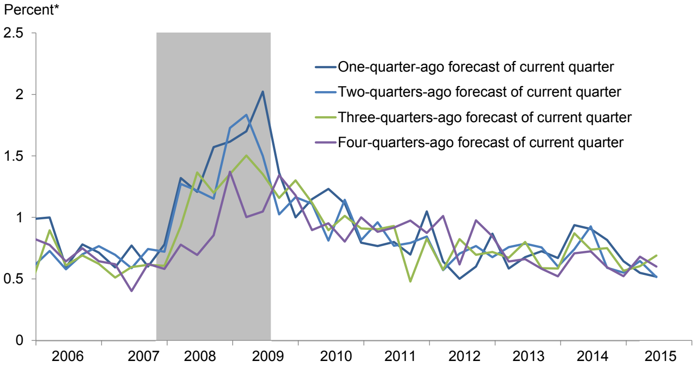
*Seasonally adjusted, annualized rate.
**Values greater than zero indicate above trend activity.
NOTE: Shaded area indicates recession.
SOURCES: Federal Reserve Bank of Philadelphia; Federal Reserve Bank of Chicago; Bureau of Economic Analysis; Congressional Budget Office.

Signs of Returning Momentum

Although first-quarter growth was slow, prompting some concerns of a loss in economic momentum, recent data releases have been more promising. Labor market indicators provided the most encouraging news. The U.S. added 280,000 nonfarm jobs in May, and cumulative employment growth for March and April was revised upward by 32,000 jobs. The headline unemployment rate ticked up slightly to 5.5 percent as more people joined the labor force, and the labor force participation rate appeared to have stabilized, rising slightly to 62.9 percent in May. In addition, the Job Openings and Labor Turnover Survey showed that job openings grew at a faster clip. Although the unemployment rate has stayed relatively flat since the beginning of the year, most labor market indicators suggest that slack is diminishing over time.

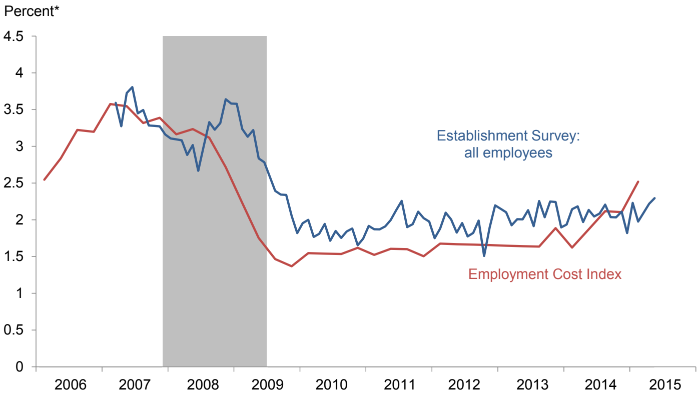
Consumer activity picked up as well. Auto sales grew strongly in May, reaching a 10-year high, according to Census Bureau estimates. Core retail sales growth, which excludes building supplies, gas station sales and auto parts, rose 0.7 percent in nominal terms in May and averaged 6.9 percent annualized growth from March through May. Indexes of consumer expectations remain at high levels, accord-

Chart 3
Uncertainty About Real GDP Growth Declines



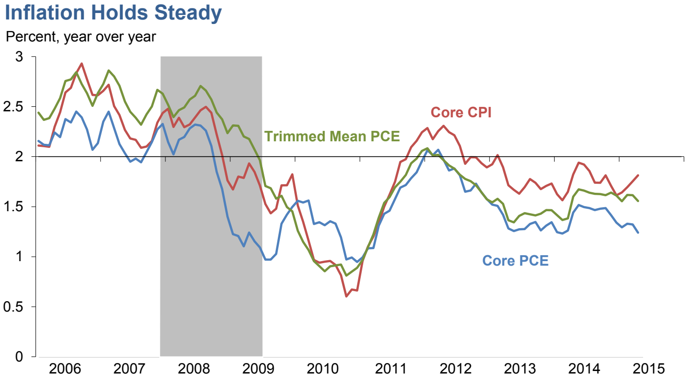
*Quarter-over-quarter seasonally adjusted, annualized growth.
NOTES: Shaded area indicates recession. Cross-sectional dispersions are computed as the 75th percentile estimate minus the 25th percentile estimate.
SOURCE: Federal Reserve Bank of Philadelphia.

Chart 4
Signs of Wage Growth Accelerate



*Year-over-year growth.
NOTES: Shaded area indicates recession. The Employment Cost Index controls for compositional shifts.
SOURCE: Bureau of Labor Statistics.

Chart 5
Inflation Holds Steady



NOTES: Shaded area indicates recession. PCE refers to Personal Consumption Expenditures and CPI to the Consumer Price Index.
SOURCES: Bureau of Economic Analysis; Bureau of Labor Statistics; Federal Reserve Bank of Dallas.

ing to surveys from the University of Michigan and the Conference Board.

On the business side, the picture remains murky. While the latest Institute for Supply Management Manufacturing Purchasing Managers Index for May is consistent with ongoing expansion in manufacturing activity, other manufacturing indicators show continued softness. New orders of business equipment continued to weaken in April, and industrial production and capacity utilization both ticked down in April and May. As other economic factors strengthen, however, manufacturing will follow suit. More comprehensive measures of current economic conditions, including the Federal Reserve Bank of Philadelphia's Aruoba-Diebold-Scotti Index and the Federal Reserve Bank of Chicago's National Activity Index, suggest that activity continued to normalize from the first-quarter slump (*Chart 2*).

Steady as She Goes

This positive momentum is expected to carry forward into the rest of the year, according to the Philadelphia Fed's second-quarter Survey of Professional Forecasters (SPF), which shows real GDP growing by approximately 3 percent in the second half of 2015. Uncertainty around the SPF forecasts, as measured by the dispersion of the point estimates from all contributing forecasters, remained stable (*Chart 3*). This evidence is consistent with forecasts from the June Livingston Survey and June Blue Chip Economic Indicators and supports the view that the U.S. economy will continue to regain momentum going forward.

Higher Wages and Steady (but Low) Inflation

The improvement in the labor market has generated higher wage growth. According to the first-quarter Employment Cost Index, wages and salaries rose 2.6 percent year over year (*Chart 4*), up from 1.6 percent growth in first quarter 2014. The year-over-year rise in average hourly earnings from the May Establishment Survey—a volatile measure of earnings—was 2.3 percent, at the upper end of the range that has prevailed since the Great Recession.

Core and trimmed mean measures of Personal Consumption Expenditure (PCE) inflation remained below the Federal Reserve's mandate of 2 percent year over year (*Chart 5*). Headline measures of PCE inflation were near zero, influenced by low oil prices and the appreciation of the dollar.

These effects are likely to be transitory, and PCE inflation is forecast to rise gradually over the next couple of years toward 2 percent. The SPF and the Thomson-Reuters/University of Michigan Surveys of Consumers show that long-run expectations of PCE inflation are also well-anchored around a 2 percent rate.

—Camden Cornwell

Notes

1. "BEA Works to Mitigate Potential Sources of Residual Seasonality in GDP," Bureau of Economic Analysis blog, May 22, 2015.
2. "The Income- and Expenditure-Side Estimates of U.S. Output Growth: An Update to 2011Q2," by Jeremy Nalewaik, Brookings Papers on Economic Activity, Spring 2011, pp. 71–121.

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About the Author

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