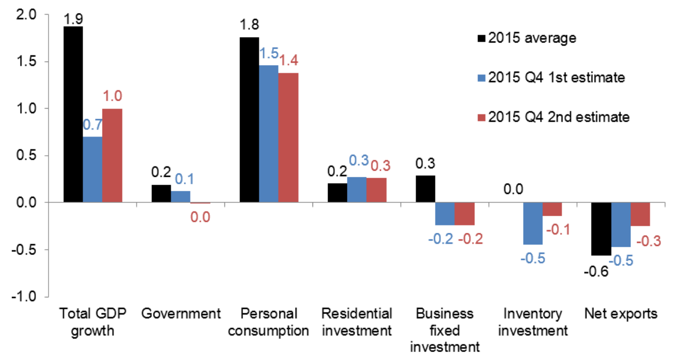
DALLASFED Economic Update
National

Job Gains Remain Strong, Inflation Improves

March 17, 2016

Economic data released in the past six weeks point to moderate U.S. economic growth in first quarter 2016. Improving job prospects, low debt burdens and low oil prices are sustaining private consumption, a major component of growth. On the other hand, a strong dollar, weak global outlook, manufacturing sector contraction and volatile financial markets remain headwinds in the near term.[1]

Chart 1
Fourth-Quarter Real GDP Growth Revised Upward



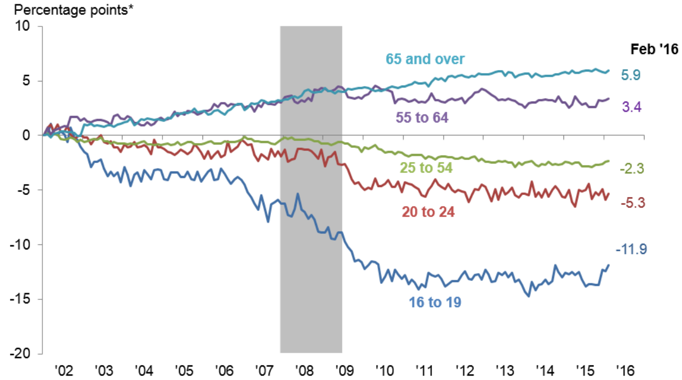
*Contribution to percent change in real gross domestic product growth; quarter/quarter, seasonally adjusted annualized rate.
SOURCE: Bureau of Economic Analysis.

Output Growth Revised Upward

U.S. real gross domestic product (GDP) expanded at a 1.0 percent pace in the fourth quarter *(Chart 1)*. The second estimate of GDP growth marked an upward revision from the original estimate of 0.7 percent. The revisions were concentrated in inventories and net exports. Fixed investment was flat with residential fixed investment being offset by a decline in business fixed investment. Albeit revised downward, personal consumption was the main source of growth, contributing 1.4 percentage points.

Recent data from the Institute for Supply Management (ISM) suggest that the service sector slipped slightly in February due to worsening conditions in mining. Nevertheless, the services index is in expansionary territory. While the manufacturing sector index remained in contractionary territory, its recent improvements signal that manufacturing may be stabilizing despite the cutbacks in energy-related production and trade influences. Weak global demand and a strong dollar constitute downside risks to manufacturing and net exports going forward.

Chart 2
Prime-Age Worker Participation Ticks Up



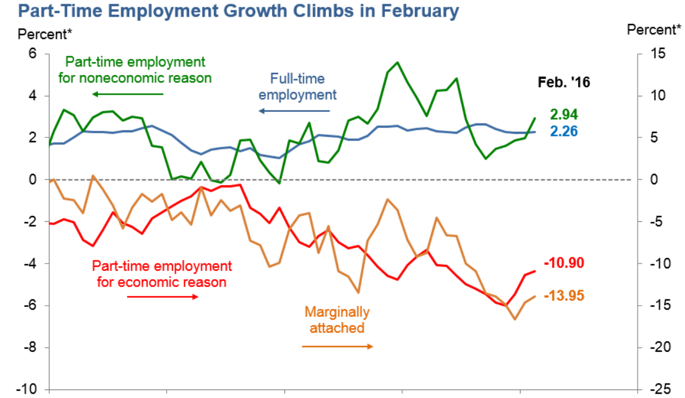
*Percentage point change in participation rate since January 2002.
NOTE: Shaded area indicates recession
SOURCES: Bureau of Labor Statistics; National Bureau of Economic Research.

West Texas Intermediate oil prices remained below $40 per barrel through the first half of March. Together with the January pickup in durable goods orders, a solid performance in consumer spending is expected to contribute to growth in the first quarter. However, the upward revision in inventory accumulation creates a downside risk to the outlook because inventory buildup will eventually wind down over the next few quarters, diminishing growth prospects.

Labor Market Robust in First Quarter

Recent reports from the Bureau of Labor Statistics indicated a pickup in job growth in first quarter 2016. In 2015, nonfarm payroll growth averaged 229,000 per month. Nonfarm payrolls rose a robust 242,000 in February, and January's figure was revised upward by 20,000 to 172,000. The headline unemployment rate remains at 4.9 percent. The February Job Opening and Labor Turnover Survey also indicates strong labor momentum with the job opening rate remaining at its highest levels at 3.8 percent, and the quits rate reaching its prerecession rate at 2.1 percent.

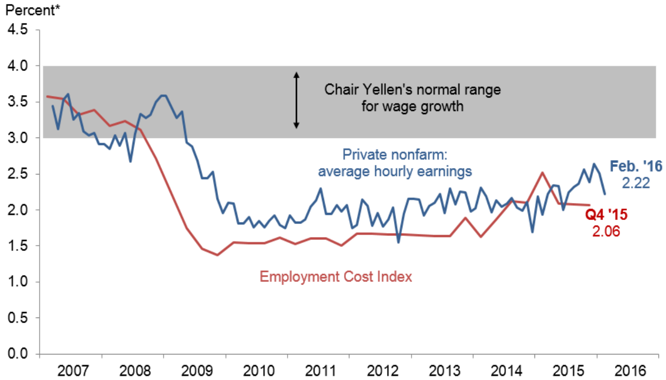
Chart 3
Part-Time Employment Growth Climbs in February



*Year/year percent change of three-month moving average, seasonally adjusted.
NOTE: Marginally attached workers is not seasonally adjusted.
SOURCE: Bureau of Labor Statistics.

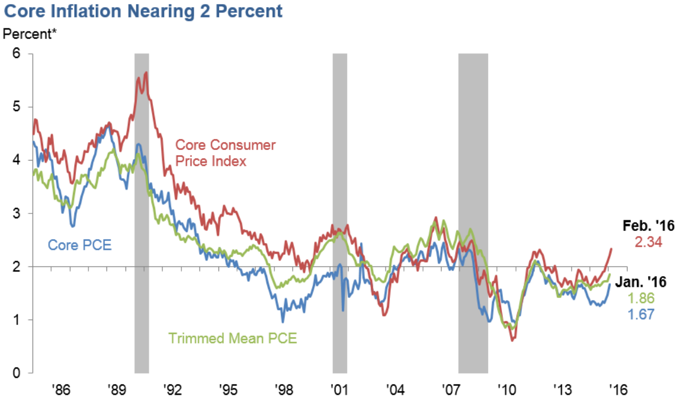
The February labor force participation rate jumped 0.2 percentage points to 62.9 percent. The participation rate has continu-

Chart 4
Wage Growth Slips in February



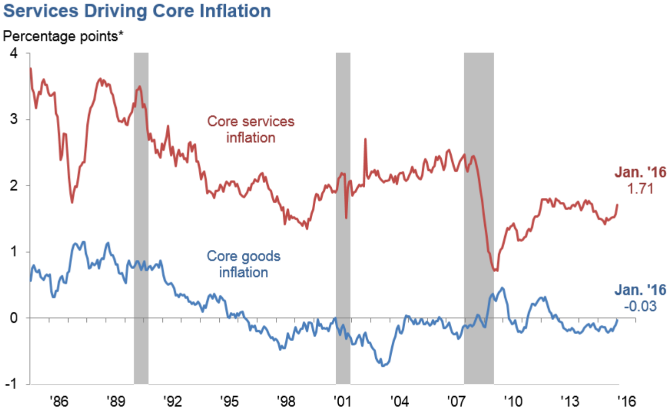
*Year/year percent change, seasonally adjusted.
NOTE: The Employment Cost Index controls for compositional shifts.
SOURCE: Bureau of Labor Statistics.

Chart 5
Core Inflation Nearing 2 Percent



*Year/year percent change, seasonally adjusted.
NOTES: The line at 2 percent represents the Federal Open Market Committee's target for Personal Expenditures Consumption (PCE) inflation. Shaded areas indicate recession.
SOURCES: Bureau of Economic Analysis; Bureau of Labor Statistics.

Chart 6
Services Driving Core Inflation



*Year/year, seasonally adjusted percentage point contribution to core PCE inflation.
NOTE: Shaded areas indicate recession.
SOURCES: Bureau of Economic Analysis; Federal Reserve Bank of Dallas; author's calculation.

ously ticked upward since September 2015. The participation rate for prime-age (25 to 54 years) workers edged up in February *(Chart 2)*. Full-time employment growth has been flat since late 2014 while part-time job growth has picked up in recent months *(Chart 3)*. Even after discounting the recent pickup in part-time workers as reflecting a stronger-than-usual pickup in temporary holiday hiring, the number of involuntary part-time workers is still high.

Wage Growth Flat

The average hourly pay for private-sector workers and the Employment Cost Index are both well below the 3–4 percent rate consistent with the Federal Open Market Committee's (FOMC's) long-term inflation target, as indicated by Federal Reserve Chair Janet Yellen *(Chart 4)*.[2] Average hourly earnings fell 0.1 percent in February after January's 0.5 percent increase.[3] The average work week shrunk by 0.2 hours in February to 34.4 hours, reflecting the recent rise in part-time workers. While hourly earnings growth has picked up across industry sectors, average weekly earnings growth looked less impressive with the shrinkage of the work week and rise in part-time workers. The slow wage growth may not exert upward pressure on inflation in the near term.

Core Measures of Inflation Firming

In addition to the strong employment data, inflation readings have made good progress toward the FOMC's 2 percent objective. Core measures of inflation, which strip out the volatile effects of fuel and food costs, accelerated sharply in the past few months. In January, core and trimmed mean measures of the Personal Consumption Expenditures (PCE) price index over 12 months grew 1.7 percent and 1.9 percent, respectively, while in February, the core Consumer Price Index (CPI) grew 2.3 percent *(Chart 5)*.

Chart 6 shows the contribution to core PCE inflation from core services and core goods inflation. Tighter rental markets and rising health care costs prompted the recent acceleration in core services inflation. A decline in Chinese producer prices, low energy prices, weak global demand and a strong dollar all pose downward pressure on core goods inflation. Though short-term inflation expectations have been weighed down by the plunging oil prices in recent months, long-term inflation expectations remain stable.

—Daniel Lin

Notes

1. However, the trade-weighted exchange value of the U.S. dollar has been decreasing since late February against both broad and major currency indexes.

2. Given an inflation target of 2 percent and a typical productivity growth of 1 to 2 percent, this suggests that the economy is out of slack only when wage growth hits 3 to 4 percent.

3. The pickup in wage growth in January may have been partly due to the implementation of minimum wage increases in 14 states and some municipalities across the United States on Jan. 1, 2016.

About the Author

Lin is a research analyst in the Research Department at the Federal Reserve Bank of Dallas.