DALLASFED Economic Update
U.S.

U.S. Economic Picture for First Half of 2017 Changes Little

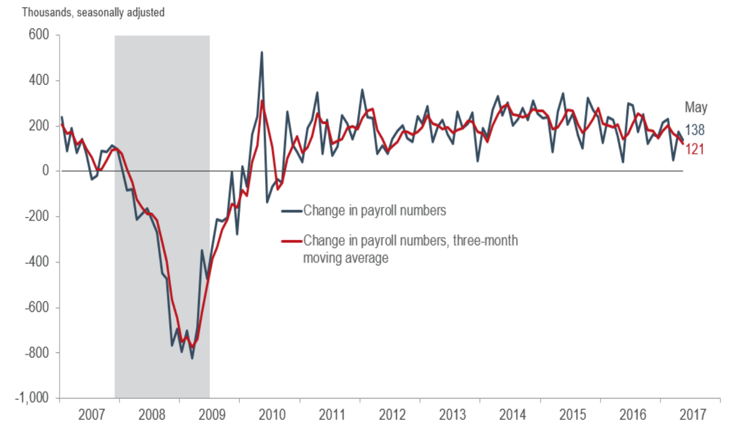
June 19, 2017

Economic indicators released in May and June point to continued moderate growth and a mostly unchanged outlook for the U.S. The economy is approaching full employment, long-term inflation expectations remain anchored despite a recent dip in inflation, and real gross domestic product (GDP) is projected to grow at a moderate rate in 2017 and 2018.

The second revision for real GDP growth in first quarter 2017 shifted upward from 0.7 percent to 1.2 percent—weak relative to 2.1 percent in fourth quarter 2016. However, forecasts point to stronger growth beginning in the current quarter. The labor market continues to strengthen, with the unemployment rate declining to 4.3 percent in May.

Headline and core inflation measures have dipped in the last two months. Nevertheless, inflation is still projected to converge toward the Federal Reserve's target rate of 2 percent over the next two years.

Chart 1
Pace of Hiring Slowing but Still Reasonably Solid



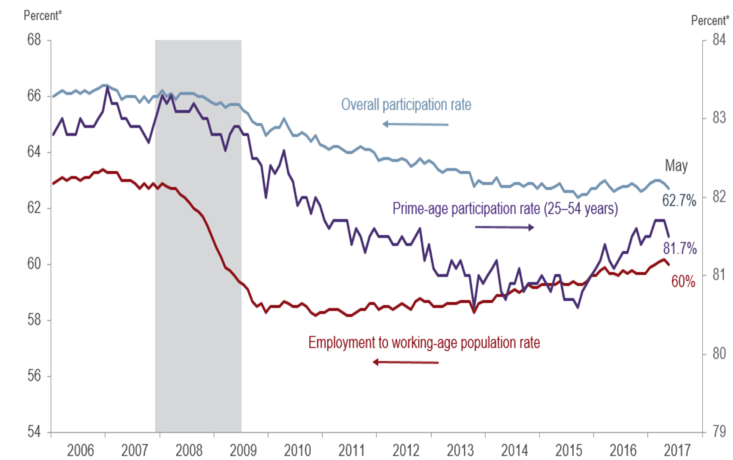
NOTE: Shaded area indicates recession.
SOURCE: Bureau of Labor Statistics.

Labor Market Growth Slowing but Still Reasonably Solid

Nonfarm payrolls grew by 174,000 in April and by 138,000 in May. Even though May's numbers were below consensus forecasts, they still suggest robust growth (*Chart 1*). The average monthly payroll change for the first five months of 2017 stands at 162,000, compared with 187,000 for all of 2016. Hiring has become more difficult as the labor market tightens.

The headline unemployment rate declined to 4.3 percent in May from 4.4 percent in April, below the Congressional Budget Office's 4.7 percent estimate of the natural rate of unemployment. The "U-6 unemployment rate," which includes discouraged workers, other marginally attached workers and those working part time for economic reasons, also declined, from 8.6 percent in April to 8.4 percent in May. This number is about 0.1 percentage points higher than the U-6 rate before the Great Recession, suggesting that there is little slack left in the labor market.

Chart 2
Employment and Prime-Age Participation Rate Rising but Overall Participation Rate Flat



*Seasonally adjusted.
NOTE: Shaded area indicates recession.
SOURCE: Bureau of Labor Statistics.

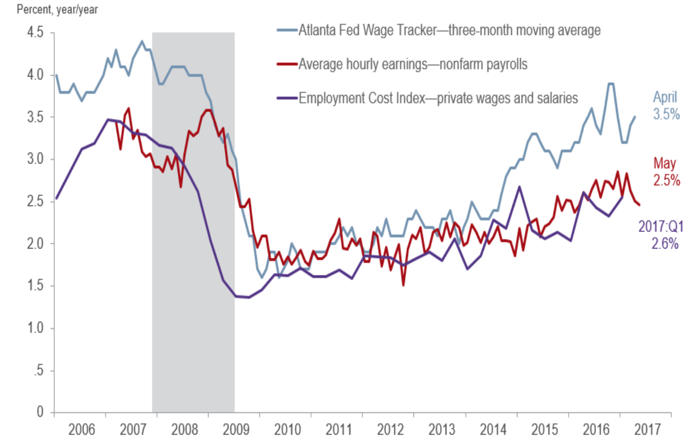
Looking at the share of the working-age population that is employed, the rate is about 2 percentage points lower than before the Great Recession (*Chart 2*), but the rate has risen slowly. By comparison, the overall labor force participation rate has stayed flat in recent years, even though an aging population suggests that the long-term demographic trend is for a lower participation rate. For prime-age workers, ages 25 to 54, the participation rate has increased but remains below pre-Great-Recession levels.

Despite the strength of the labor market, wage growth has remained comparatively moderate (*Chart 3*). Average hourly earnings of nonfarm employees grew 2.5 percent in May on a year-over-year basis, while the employment cost index increased 2.6 percent in the first quarter, and the Atlanta Fed Wage Tracker grew 3.5 percent in April. Chart 3 also shows that the Atlanta Fed Wage Tracker, which controls for changes in the composition of workers by only tracking individuals who are continuously employed full time, paints a stronger picture of wage growth than the other two indicators.

Inflation Declines But Long-Term Expectations Still Stable

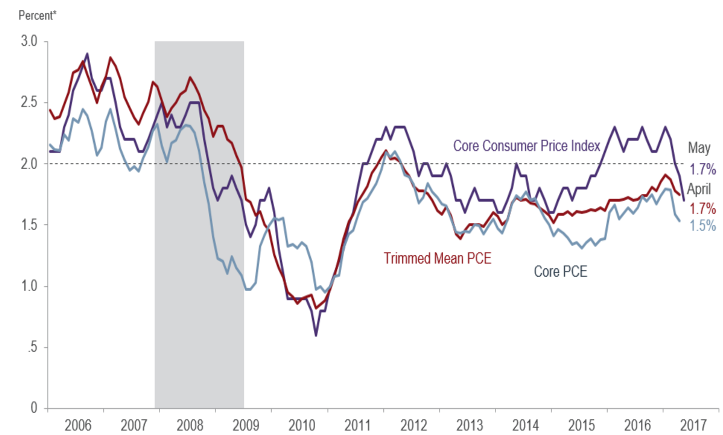
Measures of core and underlying inflation declined over the past two months (*Chart 4*). Core personal consumption ex-

Chart 3
Wage Growth Moderates



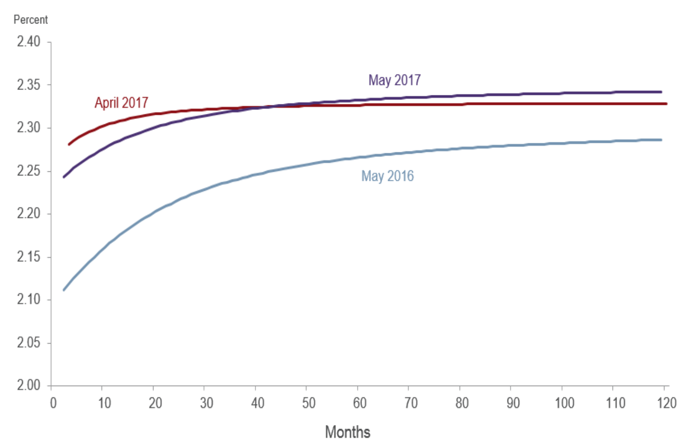
NOTE: Shaded area indicates recession.
SOURCES: Bureau of Labor Statistics; Federal Reserve Bank of Atlanta.

Chart 4
Inflation Measures Decline in Recent Months



*Year over year, seasonally adjusted.
NOTES: Shaded area indicates recession. Dashed line indicates 2 percent personal consumption expenditures inflation target.
SOURCES: Bureau of Economic Analysis; Bureau of Labor Statistics; Federal Reserve Bank of Dallas.

Chart 5
Survey-Based Inflation Expectations Remain Anchored



SOURCES: Federal Reserve Bank of Philadelphia; Aruoba (2016).

penditures (PCE) inflation—excluding food and energy—dropped to 1.5 percent in April on a year-over-year basis. Meanwhile, the Federal Reserve Bank of Dallas' Trimmed Mean PCE year-over-year inflation measure stood at 1.7 percent for the same month. One reason the Trimmed Mean PCE remains higher than core PCE is the trimmed mean's exclusion of highly volatile categories each month. For example, cellular telephone services declined at a 34 percent annualized rate during the past three months. Such sharp movements in certain product categories explain the sudden downturn in overall and core inflation. Core Consumer Price Index (CPI) inflation reached 1.7 percent in May, a decline from 2.2 percent in February.

Long-run inflation expectations remain stable. The Federal Reserve Bank of Philadelphia's Aruoba Term Structure of CPI Inflation Expectations plots the expected future path of CPI inflation over the next 120 months *(Chart 5)*. On the chart, there is little difference between the April and May 2017 inflation curves. Expected long-run CPI inflation is about 2.3 percent. Since CPI inflation typically runs about 30 basis points above PCE inflation, the forecasts are consistent with long-term PCE inflation expectations in the 1.9 percent to 2.0 percent range.

Other Indicators and Forecasts Confirm Moderate Growth

The Institute for Supply Management (ISM) manufacturing composite index stood at 54.9 in May, 0.1 percentage points higher than in April. The ISM nonmanufacturing composite index declined 0.6 percentage points to 56.9 from 57.5 in April. Since both indexes exceed 50 percent, they suggest expanding economic activity in both sectors. Retail sales unexpectedly declined 0.3 percent in May; excluding autos and gas, they were unchanged at 0 percent growth.

The Survey of Professional Forecasters report, released May 12, forecasts annual real GDP growth of 3.1 percent in second quarter 2017, a 0.8 percent rise from the previous forecast in February. On an annual basis, the report anticipates expansion at 2.1 percent in 2017 and 2.5 percent in 2018. The 2017 projection is 0.2 percent lower than the February figure, while the 2018 estimate is 0.1 percent higher. Some reasons for the relatively low GDP growth forecast include uncertainty regarding future fiscal policy, low productivity growth and an aging workforce.

—Daniel Chapman

About the Author

Chapman is a research assistant in the Research Department at the Federal Reserve Bank of Dallas.