DALLASFED Economic Update
U.S.

Outlook Points to Improved Growth in Second Half

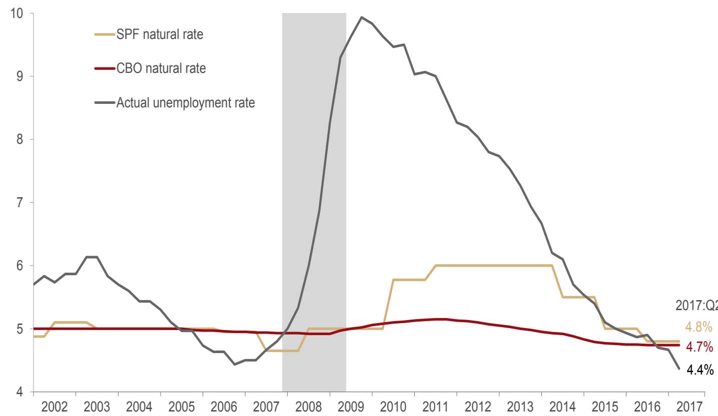
July 28, 2017

Economic indicators released the past two months point to stronger growth in second quarter 2017 and the rest of the year. The economy is close to full employment, and business and consumer confidence remains strong. Real personal consumption expenditures (PCE) growth was positive in April and May, a reversal from the negative growth rates seen earlier in the year.

The first release for real GDP growth in second quarter 2017 came in at 2.6 percent, a rebound from the revised 1.2 percent growth in the first quarter. The increase came largely from PCE and nonresidential fixed investment. Forecasters expect robust growth of at least 2 percent for the third and fourth quarters this year

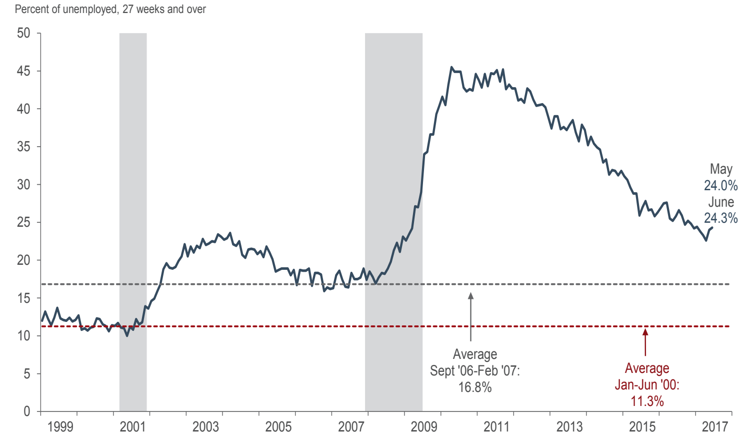
Headline and core inflation measures have dipped in recent months, but most forecasters still project both measures to reach the target rate of 2 percent by 2018.

Chart 1
Natural Rate of Unemployment Slowly Declining



NOTE: Shaded area indicates recession.
SOURCES: Bureau of Labor Statistics; Congressional Budget Office (CBO); Survey of Professional Forecasters (SPF); author's calculations.

Chart 2
Long-Term Unemployment Rate Still Elevated



NOTE: Shaded areas indicate recessions.
SOURCE: Bureau of Labor Statistics.

Job Growth Strengthens; Long-Term Unemployment Still High

Nonfarm payrolls grew by 222,000 in June, well above the consensus forecast and up from 152,000 in May. The average monthly payroll increase in the first half of 2017 stood at 180,000. That is slightly below the 2016 average of 187,000 but above the average increase of 174,000 in 2006—when unemployment was similar to the current rate. Payrolls have now grown every month since October 2010.

The headline unemployment rate rose 0.1 percentage points to 4.4 percent in June but remained below the Congressional Budget Office's (CBO's) 4.7 percent estimate of the natural rate of unemployment—the rate that would persist in the absence of business-cycle fluctuations. Both the CBO's and Survey of Professional Forecasters' natural rate estimates have gradually declined over the past five years (*Chart 1*). The headline U-3 rate—the total unemployed as a percent of the civilian labor force—and the broader U-6 unemployment rate—which includes discouraged workers, other marginally attached workers and those working part time for economic reasons—have returned to their average levels before the Great Recession, indicating tightness in the labor market.

However, one segment of the labor force—the long-term unemployed, defined as those who have been looking for work for 27 weeks or more—has not returned to pre-Great-Recession levels (*Chart 2*). In June, the share of long-term unemployed was 24.3 percent, about 7.5 percentage points higher than the pre-Great-Recession average of 16.8 percent.

Labor Force Participation Declines Sharply

From 2006 to 2016, the U.S. labor force participation rate fell from 66.2 percent to 62.8 percent, a decline of over 3 percentage points, the highest percentage-point decline among advanced economies (*Table 1*). The participation rate either dipped less or increased in other countries,

Table 1: Trends in Labor Force Participation Rates Differ in the U.S.

A. Overall (15+ years) Labor Force Participation Rate (percent)

	2006	2011	2016	Change: 2006-16	Change: 2011-16
Canada	67.0	66.7	65.7	-1.3	-1.0
France	56.2	56.3	55.9	-0.2	-0.4
Germany	59.0	60.1	61.0	2.1	0.9
Japan	60.5	59.4	60.1	-0.4	0.8
Sweden	63.4	63.7	65.0	1.6	1.3
U.K.	62.7	62.3	62.9	0.3	0.6
U.S.*	66.2	64.1	62.8	-3.4	-1.3
OECD ex U.S.	58.2	58.5	59.0	0.8	0.6

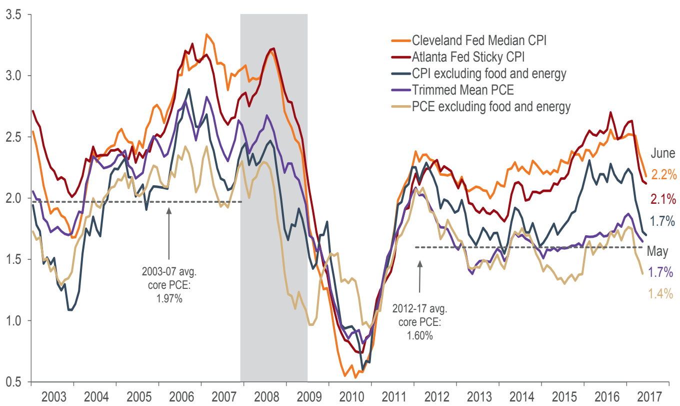
B. Prime-Age (25-54 years) Labor Force Participation Rate (percent)

	2006	2011	2016	Change: 2006-16	Change: 2011-16
Canada	86.2	86.4	86.5	0.4	0.1
France	87.6	88.3	87.5	-0.1	-0.8
Germany	87.1	87.7	87.4	0.3	-0.3
Japan	83.0	84.3	86.1	3.1	1.8
Sweden	89.5	90.3	91.0	1.5	0.7
U.K.	84.5	85.3	86.1	1.6	0.8
U.S.	82.9	81.6	81.3	-1.6	-0.3
OECD ex U.S.	80.1	81.2	82.1	2.0	0.9

*16+ years.
SOURCES: Organization for Economic Cooperation and Development (OECD); author's calculations.

including those in the Organization for Economic Cooperation and Development (OECD) aggregate, which excludes the U.S. A major contributor to this decline is the prime-age (25–54) participation rate. Unlike other advanced countries, which reported increases in the prime-age participation rate from 2006 onward, the comparable U.S. rate declined from 82.9 percent in 2006 to 81.3 percent in 2016. As a result, the U.S. now has the lowest prime-age participation rate among these advanced economies. Potential explanations for this outsized decline include relatively poorer health outcomes in the U.S., demographic changes, and lower spending on job-search-assistance programs.

Chart 3
Inflation Falling Below Recent Averages
Percent change, year/year*



*Seasonally adjusted.
NOTES: Shaded area indicates recession. PCE stands for personal consumption expenditures; CPI stands for consumer price index.
SOURCES: Bureau of Economic Analysis; Bureau of Labor Statistics; Atlanta Fed; Cleveland Fed; Dallas Fed; author's calculations.

Inflation Declines, but Expectations Remain Anchored

Core PCE inflation, which excludes food and energy, dropped to 1.4 percent in May on a year-over-year basis. Meanwhile, the Dallas Fed's Trimmed Mean PCE year-over-year inflation measure came in at 1.7 percent. Chart 3 plots these two measures of inflation, along with the Atlanta Fed's Sticky Consumer Price Index (CPI) measure, the Cleveland Fed's Median CPI, and core CPI inflation. All five measures began trending down in March. Even after replacing March's monthly growth rate with the average growth rate over the past year (excluding March), inflation still declined, indicating that the current trend is not just the result of the sharp fall that occurred in March.

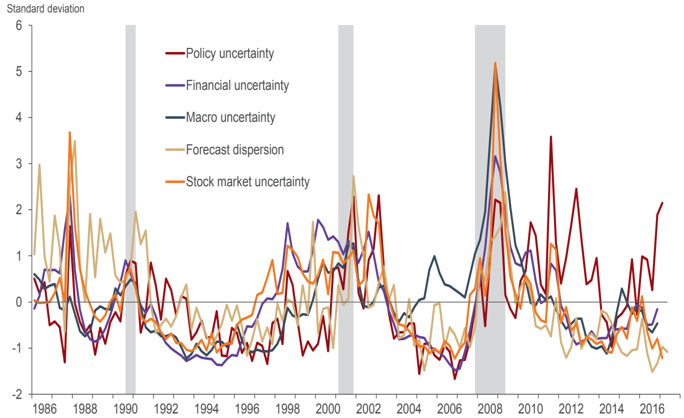
Business and Consumer Confidence Is Strong

The Institute for Supply Management (ISM) manufacturing composite index stood at 57.8 in June—2.9 percentage points higher than in May and the highest reading since August 2014. The ISM non-manufacturing composite index also rose, from 56.9 in May to 57.4 in June. The Conference Board's Consumer Confidence Index climbed 1.3 points from May's reading to 118.9 in June, one of the highest values since June 2001. All of these releases indicate growing optimism about the U.S. economy.

Policy Uncertainty Continues

Recently, economists and business leaders have identified policy and other forms of uncertainty as possible sources of concern for the U.S. economy. Chart 4 plots five different types of uncertainty and their corresponding indexes (normalized for comparison purposes) from first quarter 1986 to second quarter 2017.[1] As seen in the chart, all types of uncertainty are low right now, except for policy uncertainty.

Chart 4
Policy Uncertainty Heightened



NOTE: Shaded areas indicate recessions.
SOURCES: Survey of Professional Forecasters; Jurado et al. (2015); Ludvigson et al. (2017); Baker et al. (2015); Chicago Board Options Exchange; author's calculations.

—Daniel Chapman

Note

1. The five different uncertainty indexes are: The inner quartile range of individual Survey of Professional Forecasters GDP forecasts; the Chicago Board Options Exchange's VXO, which measures stock market volatility; the Macro Uncertainty Index from Jurado et al. (2015); the Financial Uncertainty Index from Ludvigson et al. (2017); and the Policy Uncertainty Index from Baker et al. (2015). For more information, see: "Measuring Uncertainty," by Kyle Jurado, Sydney C. Ludvigson and Serena Ng, *American Economic Review*, vol. 105, no. 3, 2015, pp. 1,177–216; "Uncertainty and Business Cycles: Exogenous Impulse or Endogenous Response?" by Sydney Ludvigson, Sai Ma and Serena Ng, National Bureau of Economic Research, NBER Working Paper no. 21803, 2017; "Measuring Economic Policy Uncertainty," by Scott Baker, Nicholas Bloom and Steven J. Davis, *Quarterly Journal of Economics*, vol. 131, no. 4, 2015, pp. 1,593–636.

About the Author

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