U.S. Expansion Stays on Steady Course

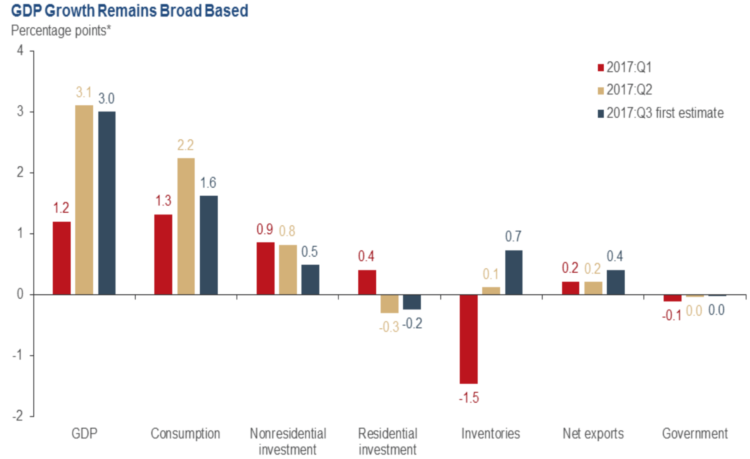
November 6, 2017

Despite recent hurricanes, economic data released since late September point to steady economic growth and underlying momentum through year-end and into 2018. Business and consumer confidence levels remain elevated, above prerecession peaks.

The first estimate for real (inflation-adjusted) gross domestic product (GDP) growth in third quarter 2017 was an annualized 3.0 percent, slightly higher than forecasters were anticipating. This is the first time since the end of 2013 that the U.S. economy has expanded at or above 3 percent for two consecutive quarters.

Headline and core inflation measures remained below the Federal Reserve's 2 percent target but have stabilized in recent months after declining in the first half of 2017. Forecasters continue to predict that inflation will rise toward the target rate.

Chart 1
GDP Growth Remains Broad Based



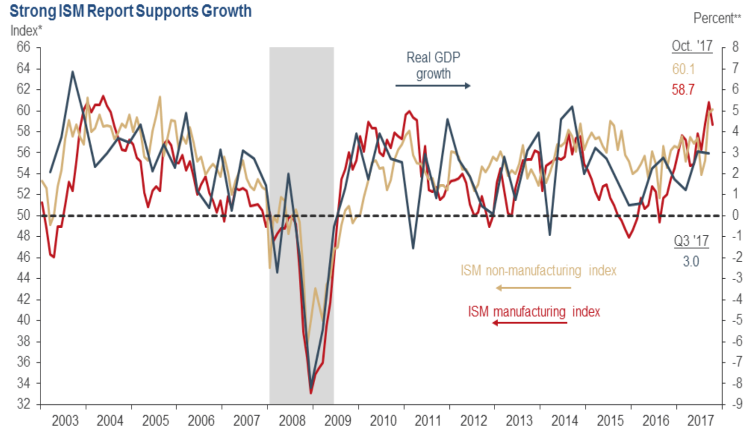
*Contribution to total gross domestic product (GDP) growth; seasonally adjusted annualized rate.
SOURCE: Bureau of Economic Analysis.

Growth Remains Strong, Despite Hurricanes

Real GDP growth of an annualized 3.0 percent in the third quarter followed 3.1 percent growth in the second quarter (*Chart 1*). A more detailed breakdown in Chart 1 shows that growth is fairly broad based, with consumer spending continuing to be the main driver. Consumption slowed in the third quarter as it contributed 1.6 percentage points to GDP growth, slightly lower than anticipated and down from 2.2 percentage points in the second quarter. Inventories contributed 0.7 percentage points in the third quarter, a noticeably large increase from the beginning of the year. Net exports also increased, contributing 0.4 percentage points as exports grew and imports fell.

The positive outlook for GDP growth is supported by the Institute for Supply Management (ISM) indexes for the manufacturing and nonmanufacturing sectors, which both remained elevated in October (*Chart 2*). The ISM nonmanufacturing index, which has been strongly correlated with real GDP growth in the past, increased to 60.1 in October from 59.8 in September, reaching a high level last seen in 2005. The ISM manufacturing index fell 2.1 points to 58.7 in October from 60.8 in September. Readings above 50 indicate expansion; those below 50 indicate contraction. The third-quarter GDP report and the ISM indexes suggest momentum is strong heading into the last quarter of 2017.

Chart 2
Strong ISM Report Supports Growth



*Values above 50 indicate expansion.
**Quarterly percent change; seasonally adjusted annualized rate.
NOTE: Shaded area indicates NBER recession.
SOURCES: Bureau of Economic Analysis; Institute for Supply Management (ISM); National Bureau of Economic Research (NBER).

Core Inflation Measures Flat, Below Fed's Target

Core personal consumption expenditures (PCE) inflation, which excludes food and energy, remained muted in September at 1.3 percent on a year-over-year basis. Meanwhile, headline PCE inflation increased 0.2 percentage points year over year in September to 1.6 percent. Chart 3 plots both of those measures and the Federal Reserve Bank of Dallas' Trimmed Mean PCE inflation, which remained flat at 1.6 percent year over year in September. As seen in Chart 3, inflation has slowed noticeably since early 2017 but appears to have stabilized the past few months. It does, however, remain below the Federal Reserve's inflation target of 2 percent.

Labor Market Healthy, Retail Sector Struggling

Nonfarm payrolls bounced back in October with the addition of 261,000 jobs, and September's report was upwardly revised from a loss of 33,000 jobs to a gain of 18,000. September's report was largely affected by Hurricanes Harvey and Irma. With September's upward revision and

October’s gain, the economy has now added jobs for 85 consecutive months.

The headline U-3 unemployment rate dropped from 4.2 percent in September to 4.1 percent in October, a postrecession low. The unemployment rate remains below the Congressional Budget Office’s estimate of its natural rate, roughly 4.7 percent. The labor force participation rate declined in October to 62.7 from 63.1 in September, largely contributing to the drop in the unemployment rate.

To illustrate and better explain sources of job growth, Chart 4 plots the average number of jobs added per month for major sectors in the third quarter (blue bars), in the first half of the year (red bars) and in 2016 (gold line). Most sectors added a similar number of jobs per month in the third quarter as they did in the first half of the year. There are some differences; for example, the leisure sector saw a dramatic decrease in job growth in the third quarter, but this was primarily due to the effects of the hurricanes. The retail sector has seen a large decline in 2017—roughly 107,000 jobs since February of this year—while it added about 200,000 jobs in 2016 and in prior years.

Consumer Confidence at Prerecession Highs

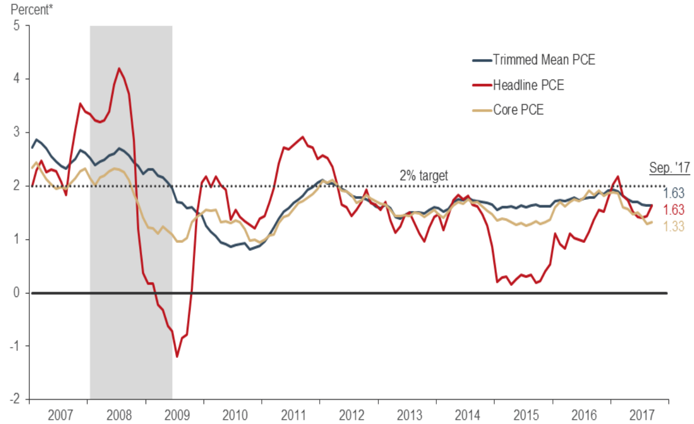
The University of Michigan’s Index of Consumer Sentiment increased to 100.7 in October, up from 95.1 in September. The Conference Board’s Consumer Confidence Index rose in October to 125.9 from 120.6 in September (*Chart 5*). Both indexes show no perceptible reaction to the hurricanes and are at postrecession highs, pointing toward optimism for robust economic growth in coming quarters.

—Laton Russell

About the Author

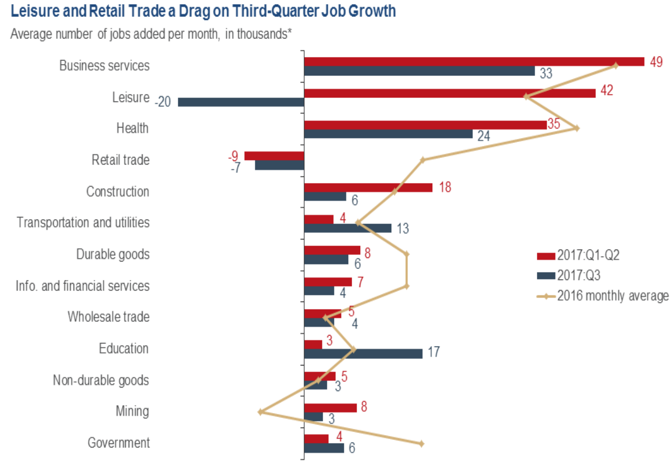
Russell is a research assistant in the Research Department at the Federal Reserve Bank of Dallas.

Chart 3
12-Month PCE Inflation Remains Low



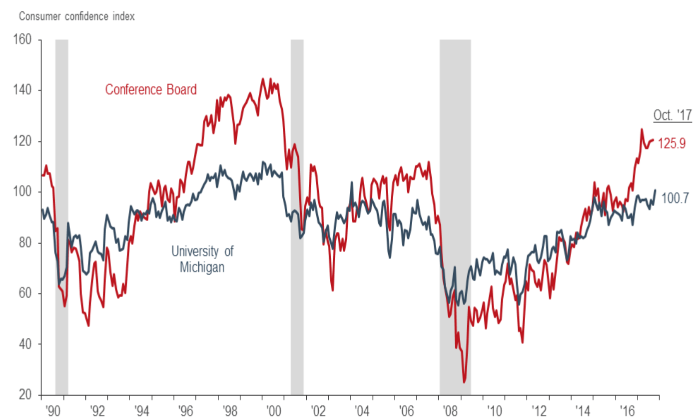
*12-month percent change in personal consumption expenditures (PCE) measures.
NOTE: The shaded area indicates NBER recession.
SOURCES: Bureau of Economic Analysis; National Bureau of Economic Research (NBER); Federal Reserve Bank of Dallas.

Chart 4
Leisure and Retail Trade a Drag on Third-Quarter Job Growth



*Seasonally adjusted.
SOURCE: Bureau of Labor Statistics.

Chart 5
Consumer Confidence at High Levels



NOTE: Shaded areas indicate NBER recessions.
SOURCES: Conference Board; University of Michigan; National Bureau of Economic Research (NBER).