Economic Update
UNITED STATES
Federal Reserve Bank of Dallas

U.S. Economic Picture Unchanged in Second Quarter 2018

June 20, 2018

Economic data released since May point to continued growth in economic activity due to robust consumer spending, strong employment growth and diminishing labor market slack. Forecasted gross domestic product (GDP) growth for the rest of the year is strong. Inflation has picked up slightly, while inflation expectations have been little changed in the past three months.

Moderate Real GDP Growth in First Quarter

The second release of real (inflation-adjusted) GDP growth in first quarter 2018 stood at 2.2 percent, down from the initial release of 2.3 percent. Chart 1 shows contributions to real GDP growth across multiple years; 2018 growth so far has come mainly from fixed investment as opposed to consumption. However, real consumption spending has been strong thus far in the second quarter compared with the first, with real personal consumption expenditures (PCE) growth reaching an annualized 4.3 percent in April.

The latest Survey of Professional Forecasters (SPF) released on May 11 shows a modest upward revision to growth expectations for the remainder of the year (*Chart 2*). According to the report, forecasters expect real GDP growth to hit 3 percent for both second and third quarter 2018. This projection improves on the February forecast of 2.9 and 2.8 percent, respectively, for the second and third quarters. On an annual basis, 2018 growth is expected to continue at 2.8 percent, then gradually slow down to 2.7 percent in 2019 and 1.9 percent in 2020.

Survey-based indicators for investment and consumption have overall either stayed the same or improved. The Institute for Supply Management's nonmanufacturing composite index rose from 56.8 in April to 58.6 in May, and the manufacturing composite index rose from 57.3 to 58.7. A reading above 50 indicates expansion. These new readings remain near postrecession highs. Regional Fed manufacturing surveys, such as the Dallas Fed's Texas Manufacturing Outlook Survey and the New York Fed's Empire State Manufacturing Survey, also point to robust growth in May.

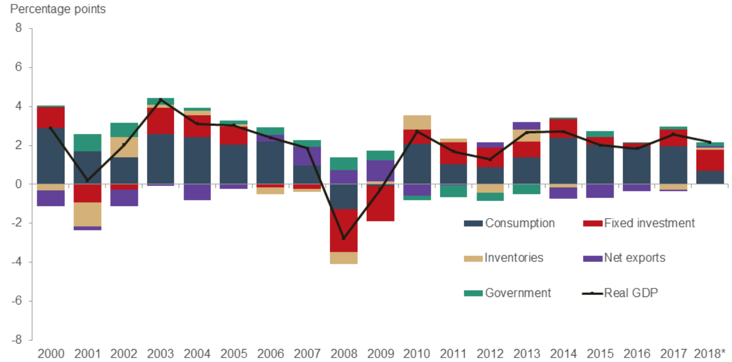
Consumer confidence remains high, as the Conference Board's Consumer Confidence Index increased from 125.6 in April to 128 in May. Similarly, the University of Michigan's Consumer Sentiment Index increased from 98.0 in May to 99.3 in June. Overall, these elevated indicators suggest sustained optimism about future growth.

Labor Market Slack Declines Further, Wage Growth Struggles to Catch Up

Nonfarm payrolls rose by 223,000 in May, making average payroll gains 207,000 per month so far this year. In comparison, average payroll gains in 2017 stood at 182,000 per month. The unemployment rate dropped further to 3.8 percent in May, the lowest point since April 2000 (*Chart 3*). The last time the unemployment rate was below

Chart 1
Consumption and Investment Drive Gross Domestic Product Growth

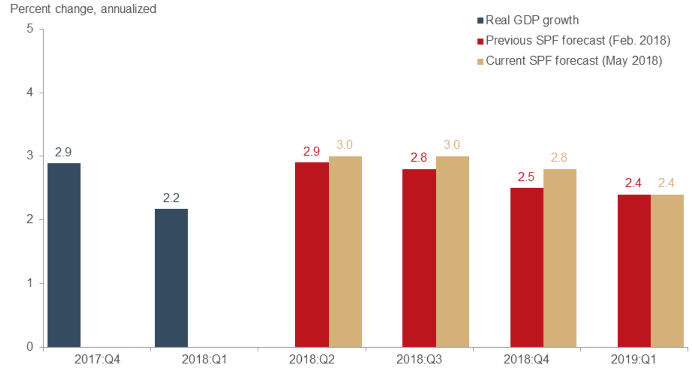
Percentage points



*Year to date.
SOURCE: Bureau of Economic Analysis.

Chart 2
Gross Domestic Product Growth Forecast Rises

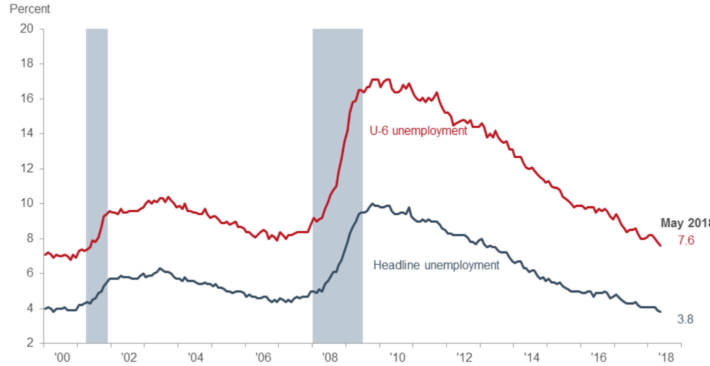
Percent change, annualized



NOTE: SPF is Survey of Professional Forecasters.
SOURCES: Bureau of Economic Analysis; Federal Reserve Bank of Philadelphia.

Chart 3
Unemployment Rate Reaches New Low

Percent



NOTE: Shaded areas indicate National Bureau of Economic Research (NBER) recession.
SOURCES: Bureau of Labor Statistics; NBER.

4 percent for a sustained period of time was 1966–69. However, long-run demographic trends—in particular changes in the age composition of the labor force—make a direct comparison to this time period inadvisable.

The broader U-6 rate, which includes discouraged workers, other marginally attached workers and those working part time for economic reasons, dropped to 7.6 percent, the lowest point since May 2001. The latest SPF release forecasts headline unemployment (U-3) to decline even further to 3.7 percent in second quarter 2019.

Different measures of wage growth have either moved sideways or gradually improved (*Chart 4*). On a year-over-year basis, growth in average hourly earnings ticked up to 2.7 percent in May from 2.6 percent in April, and the private wages and salaries component of the Employment Cost Index rose 0.1 percentage points to 2.9 percent in first quarter 2018. In contrast, wage growth measured by the Atlanta Fed Wage Growth Tracker ticked down to 3.2 percent in May, compared with 3.3 percent in April.

Inflation Measures Continue Upward Trend

Most inflation measures still remain below levels consistent with the Federal Reserve's 2 percent long-run goal, but recent releases suggest that inflation is on an upward trajectory. Core Consumer Price Index (CPI) inflation, which excludes food and energy, increased to 2.2 percent on a year-over-year basis in May (*Chart 5*). Likewise, the Cleveland Fed Median CPI measure increased to 2.7 percent in May, up from 2.6 percent in April. Year over year, core PCE inflation and the Dallas Fed's Trimmed Mean PCE held steady in April at 1.8 percent and 1.7 percent, respectively.

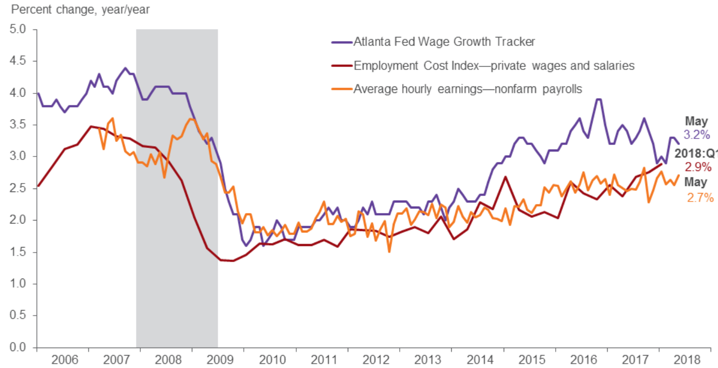
Long-run inflation expectations remain largely unchanged since the last Federal Open Market Committee meeting in May. The SPF forecasts core PCE inflation to hit 2 percent by second quarter 2018 and rise to 2.1 percent in the third, compared with the previous estimate of 1.9 percent for both quarters. The SPF implied five-year/five-year-forward (expected average inflation over the five-year period that begins five years from now) CPI inflation rate stands at 2.4 percent, up from the previous forecast of 2.3 percent in February. In contrast, the market-based five-year/five-year-forward Treasury Inflation-Protected Securities breakeven inflation rate hovered around 2.2 percent as of June 11, little changed from May.

—Daniel Chapman

About the Author

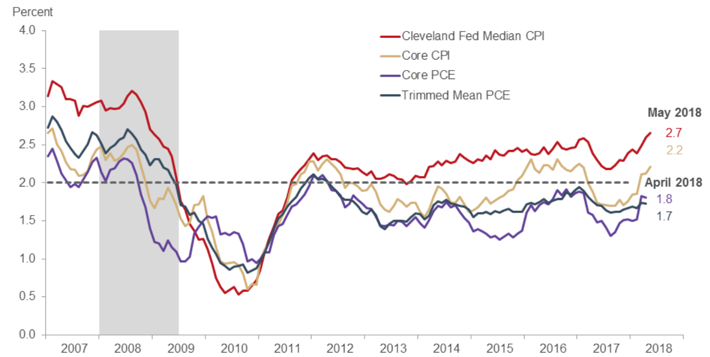
Chapman was previously a research assistant in the Research Department at the Federal Reserve Bank of Dallas.

Chart 4
Wage Growth Steady or Slightly Up



NOTE: Shaded area indicates National Bureau of Economic Research (NBER) recession.
SOURCES: Bureau of Labor Statistics; Federal Reserve Bank of Atlanta; NBER.

Chart 5
Inflation Rising Modestly



NOTES: Shaded area indicates National Bureau of Economic Research (NBER) recession. CPI is consumer price index. PCE is personal consumption expenditures.
SOURCES: Bureau of Labor Statistics; Bureau of Economic Analysis; Federal Reserve Bank of Cleveland; Federal Reserve Bank of Dallas; NBER.