Economic Update
UNITED STATES
Federal Reserve Bank of Dallas

U.S. Economy Appears Well-Positioned for Second Half

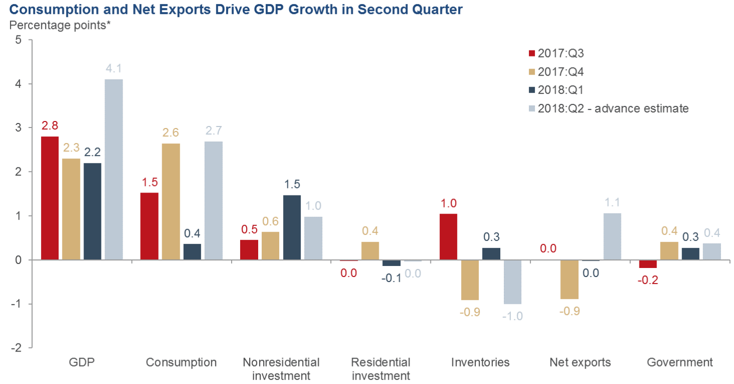
August 7, 2018

The U.S. economy entered its 10th year of economic expansion last month, and recent data point to continued economic growth for the second half of the year. Robust consumer spending, above-trend labor force growth, and elevated business and consumer sentiment support above-potential growth through the rest of 2018. Inflation measures remain at or just below the Federal Reserve's 2 percent target, and long-run inflation expectations are little changed.

Second Quarter Registers Strong GDP Growth

The advance estimate of real (inflation-adjusted) gross domestic product (GDP) for second quarter 2018 indicated the economy grew at a strong pace. GDP growth came in at a seasonally adjusted annual rate of 4.1 percent, in line with many forecasts (*Chart 1*).

Chart 1
Consumption and Net Exports Drive GDP Growth in Second Quarter

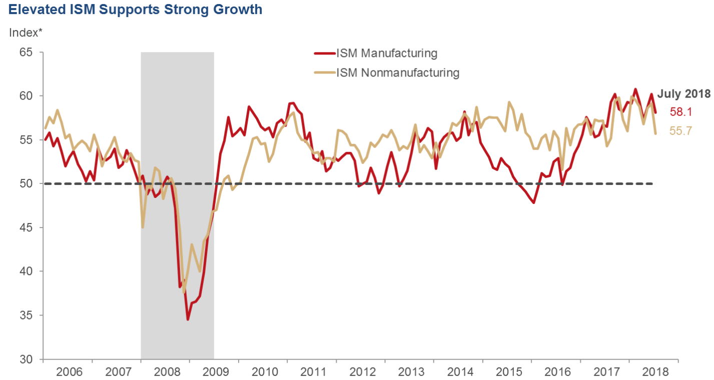


*Contribution to total real gross domestic product (GDP) growth, quarter over quarter; annualized and seasonally adjusted.
SOURCE: Bureau of Economic Analysis.

The strong quarter is due to a rebound in consumer spending, which contributed 2.7 percentage points, up from the first-quarter contribution of 0.4 percentage points. Net exports and nonresidential investments were also drivers of growth in the second quarter, contributing 1.1 and 1.0 percentage points, respectively. On the downside, inventories subtracted 1.0 percentage points from GDP growth.

Although running lower than a month ago, survey-based indicators for real economic activity remain in expansionary territory. The Institute for Supply Management (ISM) manufacturing index dipped from 60.2 in June to 58.1 in July. Similarly, the nonmanufacturing composite index dropped from 59.1 in June to 55.7 in July (*Chart 2*). Values above 50 indicate expansion.

Chart 2
Elevated ISM Supports Strong Growth



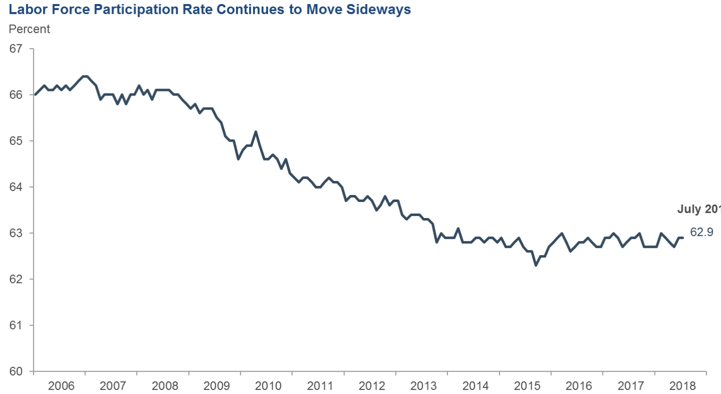
* Value above 50 indicates expansion.
NOTE: Shaded area indicates National Bureau of Economic Research (NBER) recession.
SOURCES: Institute for Supply Management (ISM); NBER.

Consumer confidence also remains elevated. The Conference Board's Consumer Expectations Index decreased slightly in June to 101.7 from 104.0 in June. Likewise, the University of Michigan's Consumer Sentiment Index was little changed in July at 97.9, compared with 98.2 in June.

Labor Force Growth Above Average for 2018

The July employment report shows that the labor market remains tight. Total nonfarm payrolls increased by 157,000 in July, compared with 248,000 in June, bringing 2018 average monthly job gains to 215,000. The 2018 gains exceed the 2016 and 2017 average of 182,000 and 195,000, respectively.

Chart 3
Labor Force Participation Rate Continues to Move Sideways



SOURCE: Bureau of Labor Statistics.

The labor force is also experiencing above-average growth this year and added 105,000 people on net in July, bringing the 2018 monthly average to 235,000. For comparison, the monthly gains in 2017 and 2016 averaged 72,000 and 141,000, respectively. The labor force participation rate was unchanged at 62.9 percent in July (*Chart 3*). Despite the aging population, the participation rate has moved sideways since 2014 and has remained within a similar range (62.3 to 63.7 percent) over the past five years.

The labor market remains tight as the headline unemployment rate (U-3) ticked down to 3.9 percent in July from 4.0 percent in June. The broader U-6 rate, which includes discouraged workers, other marginally attached workers and those working part time for economic reasons, dropped 0.3 percentage points to 7.5 percent in July.

Wage Growth Remains Subdued

Despite the strong labor market, recent data suggest there is little upward pressure on wage growth (*Chart 4*). The 12-month rise in average hourly earnings for all employees was 2.7 percent in July, unchanged from June. Likewise, the employment cost index of wages and salaries for civilian workers increased 2.7 percent year over year in the second quarter, unchanged from the first. The three-month moving average of the Atlanta Fed weighted median wage growth tracker pulled back slightly in June to 3.5 percent from 3.8 percent in May.

June Inflation Measures Change Little

Recent data for June show core inflation measures changed little from May, remaining near the Federal Reserve's 2 percent target (*Chart 5*). On a year-over-year basis, core personal consumer expenditures (PCE), which excludes energy and food, increased 1.9 percent in June, just as it did in May. Similarly, the core Consumer Price Index (CPI) growth rate was unchanged at 2.2 percent in June. The Federal Reserve Bank of Dallas' Trimmed Mean PCE inflation remained at 1.9 percent on a year-over-year basis.

The Federal Reserve Bank of Cleveland's median CPI suggests inflation is rising gradually. The 12-month inflation rate ticked up in June to 2.8 percent from 2.7 percent in May. This particular measure has seen a fairly pronounced acceleration since the end of 2017, as seen in Chart 5.

Both survey- and market-based inflation expectations have changed little, according to recent data. Market-based inflation expectations, measured by Treasury Inflation-Protected Securities-implied five-year/five-year-forward CPI inflation expectations (expected average inflation over the five-year period that begins five years from now) was 2.2 percent in July, unchanged from the month before.

—Laton Russell

About the Author

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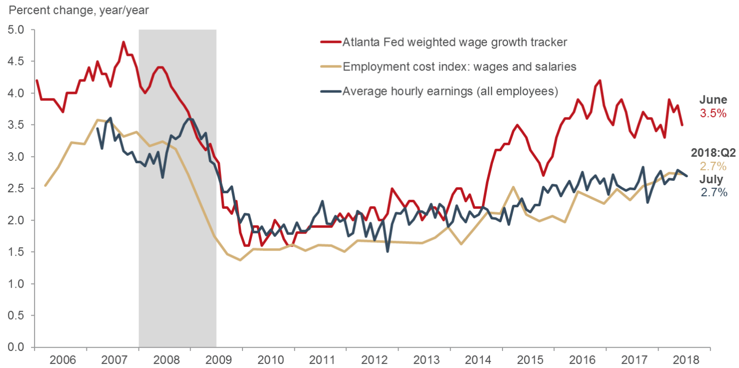
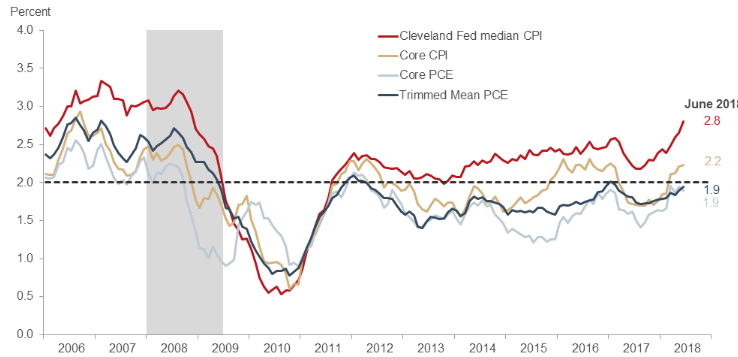
Chart 4
Recent Wage Growth Appears Flat



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 Remains Just Below or at Fed's Target



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.