Economic Update

UNITED STATES

Federal Reserve Bank of Dallas

U.S. Economy Expected to Remain Strong Through Year-End

October 3, 2018

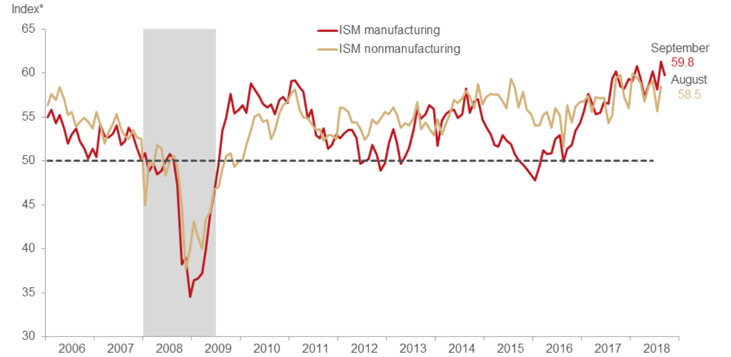
The U.S. economy continued to expand at a brisk pace in the third quarter, based on recent data releases. Robust consumer spending, positive consumer and producer sentiment and a tightening labor market suggest that this expansionary phase might continue through at least the end of 2018. Strong growth has led most inflation measures to approach or exceed the Federal Reserve's 2 percent target, and long-run expectations remain unchanged.

Estimates Suggest Healthy Third-Quarter GDP Growth

Estimates of real (inflation-adjusted) gross domestic product (GDP) for third quarter 2018 suggest growth will remain close to its second-quarter rate of 4.2 percent (third estimate). At the low end is the Survey of Professional Forecasters' estimate, which suggests the economy will expand 3 percent in the third quarter, faster than the growth recorded in recent years but 1.1 percentage points lower than second-quarter GDP growth. At the high end is the Atlanta Fed forecast of 4.4 percent growth, buoyed by a rise in inventory accumulation, which is estimated to contribute 2 percentage points to third-quarter growth. In addition, estimates of annualized real consumption expenditure growth in July of 2.8 percent are consistent with strong consumption in the third quarter.

Survey-based indicators of real economic activity support the case for strong third-quarter growth. The Institute for Supply Management (ISM) manufacturing index remained high at 59.8 in September. Likewise, the nonmanufacturing composite index rose to 58.5 in August from 55.7 in July (*Chart 1*).

Chart 1
Elevated ISM Supports Continued Strong Growth



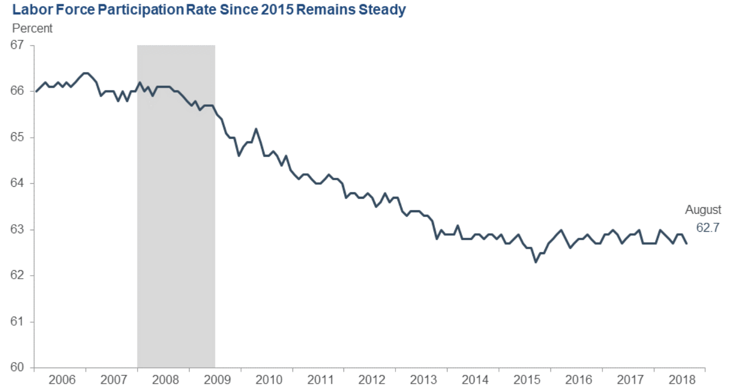
*Value above 50 indicates expansion.
NOTE: Shaded area indicates National Bureau of Economic Research (NBER) recession.
SOURCES: Institute for Supply Management (ISM); NBER.

Payroll Growth Continues, Participation Rate Unchanged

The August employment report provides further evidence that the U.S. economy is approaching, if not already at, levels consistent with full employment. The headline unemployment rate (U-3) remained at its July level of 3.9 percent. The more comprehensive U-6 rate—which includes discouraged workers, other marginally attached workers and those working part time for economic reasons—slipped 0.1 percentage points to 7.4 percent in August, nearing the record low of 6.8 percent observed nearly 18 years ago. Total nonfarm payrolls increased by 201,000 in August compared with 147,000 in July, bringing average monthly job gains to nearly 207,000 in 2018 versus 182,000 in 2017 and 195,000 in 2016.

The labor force participation rate dipped to 62.7 in August from 62.9 in July (*Chart 2*). A broader view, however, reveals that the participation rate has remained within a narrow band of 62.5 to 63 percent since 2015.

Chart 2
Labor Force Participation Rate Since 2015 Remains Steady



NOTE: Shaded area indicates National Bureau of Economic Research (NBER) recession.
SOURCE: Bureau of Labor Statistics; NBER.

Of note is the participation rate of working-age adults (25–54 years old), which, at 82 percent, falls short of the 84 percent participation rate consistently achieved between the late 1980s and the onset of the Great Recession. This disparity is perhaps evidence that some slack is still present in the labor market.

Wage Growth Indicators Somewhat Mixed

Some indicators show wage growth continuing on its upward trajectory. Average hourly earnings for all private workers grew 2.9 percent in August, up from 2.7 percent in July (*Chart 3*). Similarly, year-over-year growth was 2.7 percent in the second quarter in the Bureau of Labor Statistics' Employment Cost Index of wages and salaries for civilian workers. The upward trajectory is not as apparent when examining the median wage growth of workers who have been employed over the past year, adjusting for workforce composition effects. The Atlanta Fed's weighted three-month moving average of median wage growth has been between 3.3 percent and 3.9 percent since mid-2015.

Inflation Rates at or Slightly Above Fed’s Target

Inflation rate indicators have changed little since early August, remaining near or slightly above the Federal Reserve’s 2 percent target (Chart 4). Headline personal consumption expenditures (PCE), the indicator used by the Fed in determining its inflation target, rose on a year-over-year basis to 2.3 percent in July, a 0.1 percentage-point increase from June. Core PCE, which excludes energy and food, grew at a year-over-year rate of 2 percent in July, up 0.1 percentage points from June. Meanwhile, the core Consumer Price Index (CPI) growth rate declined 0.2 percentage points to 2.2 percent in August. The Federal Reserve Bank of Dallas’ Trimmed Mean PCE inflation rate remained at 2 percent on a year-over-year basis.

Long-term inflation expectations remain relatively unchanged from July’s figures. However, there have been adjustments. The University of Michigan’s consumer survey of five-year inflation expectations—the expected average inflation rate over the next five years—rose 0.2 percentage points to 2.6 percent in August. Conversely, the Survey of Professional Forecasters’ five-year/five-year-forward median CPI expectation (expected average inflation over the five-year period beginning five years from now) fell 0.2 percentage points to 2.2 percent in the third quarter.

—Andrew Gross

About the Author

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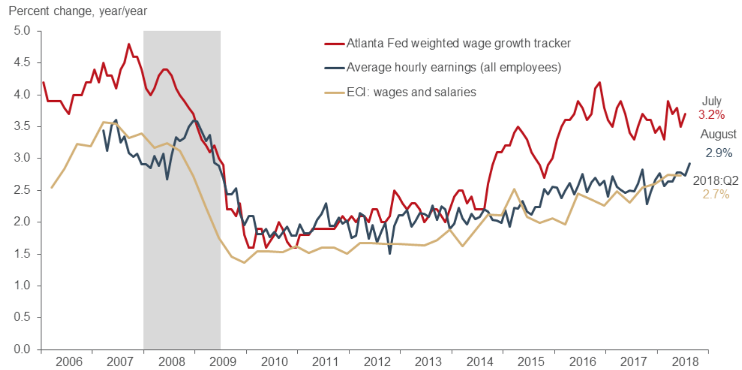
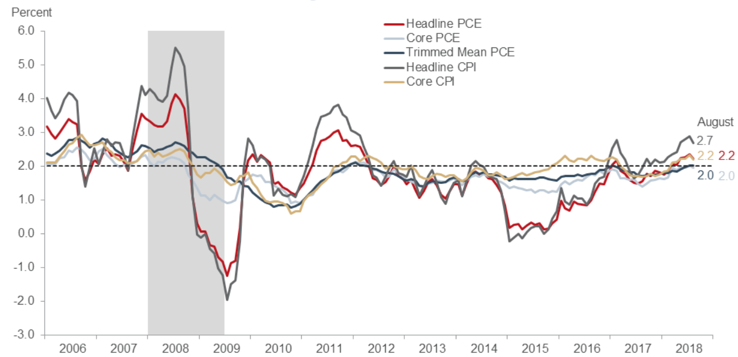
Chart 3
Wage Growth Slowly Rising



NOTES: ECI refers to the Employment Cost Index. Shaded area indicates National Bureau of Economic Research (NBER) recession.
SOURCES: Bureau of Labor Statistics; Federal Reserve Bank of Atlanta; NBER.

Chart 4
Inflation Remains Just Above 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. Dashed line indicates Federal Reserve's target inflation rate.
SOURCES: Bureau of Labor Statistics; Bureau of Economic Analysis; Federal Reserve Bank of Cleveland; Federal Reserve Bank of Dallas; NBER.