Economic Update

UNITED STATES

Federal Reserve Bank of Dallas

U.S. Expansion Remains on Solid Footing

November 13, 2018

The U.S. economy has now expanded for 112 consecutive months, the second-longest stretch on record, and recent data point to continued growth due to strong consumer spending, robust employment growth and elevated business and consumer confidence. The unemployment rate remains at a historical low of 3.7 percent, and various inflation measures are at the Federal Reserve's 2 percent target.

Third-Quarter GDP Report Sends Mixed Signals

The advance estimate of real (inflation-adjusted) gross domestic product (GDP) for third quarter 2018 indicates the economy continued to expand at a strong pace of 3.5 percent (*Chart 1*). Personal consumption expenditures (PCE) grew 4.0 percent, contributing 2.7 percentage points to GDP growth, up from 2.6 in the second quarter. Gross investment contributed 2.0 percentage points to output growth, driven exclusively by inventories (2.1 percentage points), while residential (-0.2 percentage points) and nonresidential investment (0.1 percentage points) had competing effects. Net exports were a major drag on GDP, reducing growth by 1.8 percentage points. Overall, the third-quarter gains build on the previous quarter's strong growth. However, given the headwinds from fixed investment and net exports and the volatility in inventories, the economy enters the fourth quarter with some uncertainty.

Survey Data Point to Continued Expansion

While fixed investment declined in the third quarter, recent business surveys suggest that it will likely rebound. Five Federal Reserve Banks (Dallas, Kansas City, New York, Philadelphia and Richmond) conduct monthly manufacturing surveys and ask about capital expenditures over the next six months. Chart 2 shows an employment-weighted monthly index of the five surveys. This index declined in October to 24.4, but the fact that it remains well above zero indicates that more respondents on net expect to increase rather than decrease capital expenditures. Overall, the reading is a positive sign for investment over the next two quarters.

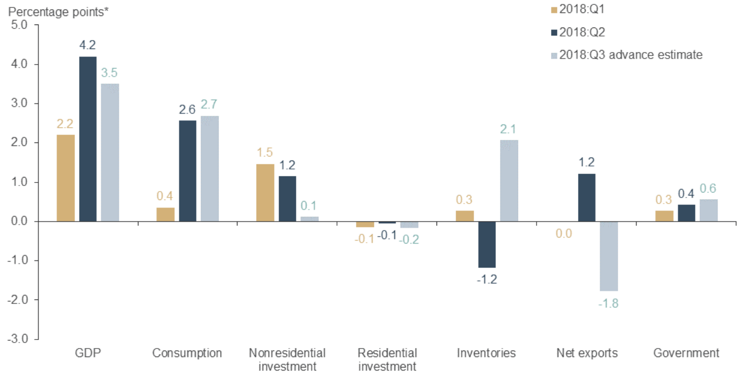
Likewise, consumer confidence remains strong. The Conference Board's Consumer Confidence Index increased to 137.9 in October, up from 135.3 in September and 124.3 in January. The University of Michigan's Consumer Sentiment Index tells a similar story with a reading of 98.3 in November. Consumer confidence about current conditions and future expectations is near record levels.

Labor Market Continues to Strengthen

The U.S. economy added 250,000 jobs in October, bringing 2018 average monthly job gains to 213,000 (*Chart 3*). The 2018 gains are outpacing average monthly job growth in 2017 (182,000) and 2016 (195,000). Furthermore, this year's pace exceeds the average gain of 209,000 jobs on a monthly basis over the 2013–17 period, when the unemployment rate was higher and there was more room for expansion.

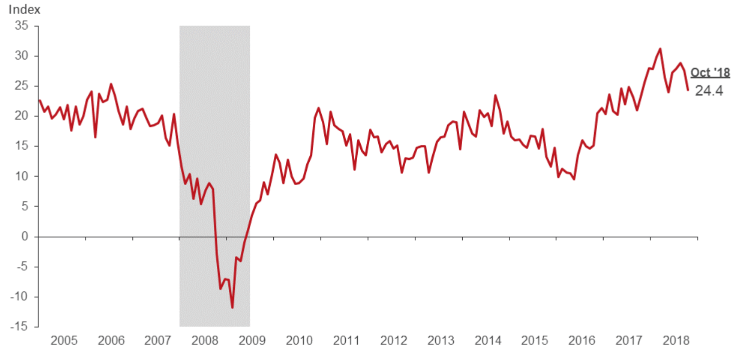
The headline unemployment rate (U-3) remained at 3.7 percent, while the broader U-6 rate—which includes discouraged workers, other marginally attached workers and those working part time for economic reasons—ticked down from 7.5 percent to 7.4 percent. The labor force participation rate increased slightly to 62.9 percent in October from 62.7 percent; however, it has been between 62.7 percent and 63.0 percent since 2015. Recently, wage inflation has trended higher. The 12-month rise in average hourly earnings was 3.2 percent in October, up from 2.8 percent in September. Similarly, the employment cost index of wages and salaries for civilian workers increased to 2.9 percent year over year in third quarter 2018, up from 2.7 percent in the second quarter.

Chart 1
Consumption and Inventories Drive GDP Growth in Third Quarter



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

Chart 2
Six-Month-Ahead Investment Expectations Remain Elevated



NOTES: The index is an employment-weighted monthly index compiled from various monthly Federal Reserve Bank surveys of manufacturers measuring six-month capital expenditures plans. The shaded area denotes U.S. recession.
SOURCES: Federal Reserve Banks of Dallas, Kansas City, New York, Philadelphia and Richmond.

Wage Gains Consistent with Labor Market Conditions

Even with the recent upward trend in wages, nominal wages have experienced slower growth over the past five years than during the Great Moderation (1985–2007).

The discrepancy between the current rate and the 1985–2007 average, however, disappears when controlling for inflation. Real wage growth is either equal to or above the 1985–2007 average. Table 1 shows wage growth in 1989, 1997 and 2006—the three most recent years during which the unemployment rate gap was closest to the gap four quarters prior. The results are mixed. Current real wage growth is much lower than in 1997 and 2006 but higher than in 1989. These results suggest that differences in productivity growth are contributing to the differences in real wage growth. Labor productivity growth has had three distinct periods of trend growth since 1985: 1985–94, 1995–2007 and 2008–18. Over the first and third periods, productivity grew only 1.4 percent and 1.0 percent, respectively. In the middle period, however, productivity grew 2.1 percent. Given the higher productivity, it is not surprising that real wages were higher in 1997 and 2006.

Measures of Inflation at Federal Reserve's Target

Recent inflation data show various measures are at the Federal Reserve's 2 percent inflation target (*Chart 4*). The 12-month headline PCE rate ticked down to 2.0 percent in September from 2.2 percent in August. Year-over-year core PCE inflation and the Federal Reserve Bank of Dallas' Trimmed Mean PCE inflation rate both remained at 2.0 percent in September.

—Alex Richter and Laton Russell

About the Author

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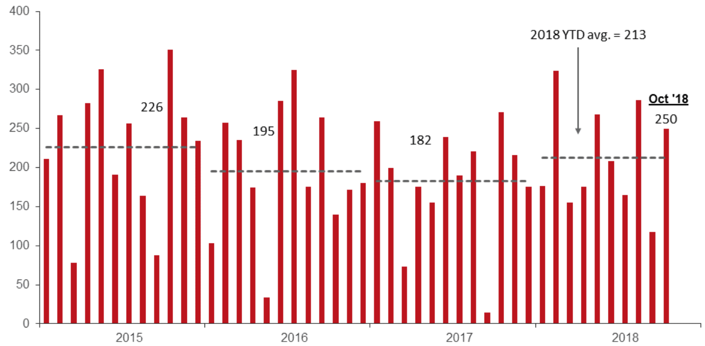
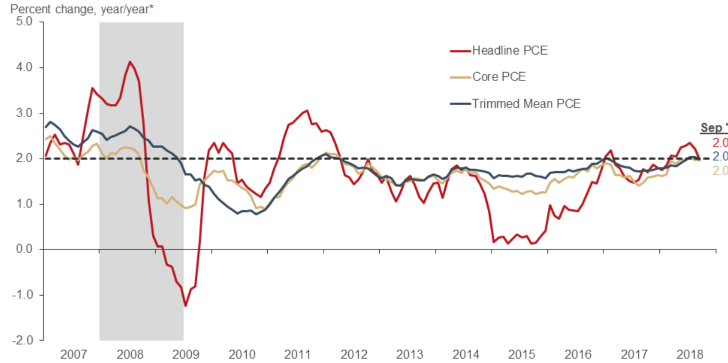
Chart 3
Job Growth Robust in 2018
Average monthly change, thousands



SOURCE: Bureau of Labor Statistics.

Chart 4
Inflation Readings at Fed's Target Rate
Percent change, year/year*



*Seasonally adjusted.
NOTES: The dashed line indicates the Federal Reserve target interest rate. The shaded area denotes U.S. recession. PCE is personal consumption expenditures.
SOURCES: Bureau of Economic Analysis; Federal Reserve Bank of Dallas; National Bureau of Economic Research.

Table 1. Latest Measures of Wage Growth								
Nominal	'85-'07	'89	'97	'06	'17	Aug. '18	Sep. '18	Oct. '18
Average hourly earnings	3.2	4.0	3.6	4.2	2.4	2.9	2.8	3.2
Atlanta Fed wage tracker	4.5	-	5.5	4.2	3.4	3.6	3.6	3.8
	'85-'07	'89	'98	'06	'17	Q1 '18	Q2 '18	Q3 '18
ECI: Wages and salaries	3.4	4.5	3.7	3.2	2.6	2.7	2.7	2.9
Compensation per hour	4.1	3.0	5.2	4.0	3.2	3.0	3.2	2.8
Real	'85-'07	'89	'98	'06	'17	Aug. '18	Sep. '18	Oct. '18
Average hourly earnings	0.0	-0.2	1.1	1.7	0.2	0.7	0.6	1.0
Atlanta Fed wage tracker	2.0	-	3.0	1.7	1.2	1.4	1.4	1.6
	'85-'07	'89	'98	'06	'17	Q1 '18	Q2 '18	Q3 '18
ECI: Wages and salaries	0.2	0.3	1.2	0.7	0.4	0.5	0.4	0.7
Compensation per hour	0.9	-1.2	2.7	1.5	1.0	0.8	0.9	0.6

NOTES: The Atlanta Fed wage tracker uses 1997–2007 data and is a weighted three-month moving average. Compensation per hour is for the nonfarm business sector. Real equals nominal growth minus the Survey of Professional Forecasters 10-year Consumer Price Index median rate. ECI refers to the Employment Cost Index.

SOURCES: Bureau of Labor Statistics; Bureau of Economic Analysis; Federal Reserve Banks of Atlanta and Philadelphia.