DALLASFED Economic Update

National

U.S. Output Growth Moderately Strong Amid Slower Global Growth

September 18, 2015

Economic data released in the past six weeks suggest that the U.S. economic growth was moderately strong at the beginning of the third quarter. A large upward revision to second-quarter real gross domestic product (GDP) coupled with several reports on July economic activity implied that the economy started the third quarter with a good deal of momentum. As a result, the U.S. economy seems strong enough to sustain an economic expansion despite drags from recent Chinese economic developments, softness in global economic growth and year-to-date strength in the dollar.

Output Growth Revised Upward

After growing a lackluster 0.6 percent in the first quarter, real gross domestic product (GDP) expanded a brisk 3.7 percent in the second quarter (*Chart 1*). The second estimate of GDP growth marked a substantial upward revision from the original estimate of 2.3 percent. The acceleration of GDP growth in the second quarter partly reflected unwinding of temporary effects of a harsh winter and the West Coast port strike. The 1.4 percentage point revision exceeded market expectations amid widespread upward revisions to each component's contribution to GDP growth. Contribution from nonresidential fixed investment was substantially revised upwards by 0.5 percentage points to a positive 0.4 percentage points, while contribution from inventories and government were upwardly revised by 0.3 percentage points each. Other components' contributions were slightly revised upward by 0.1 percentage points.

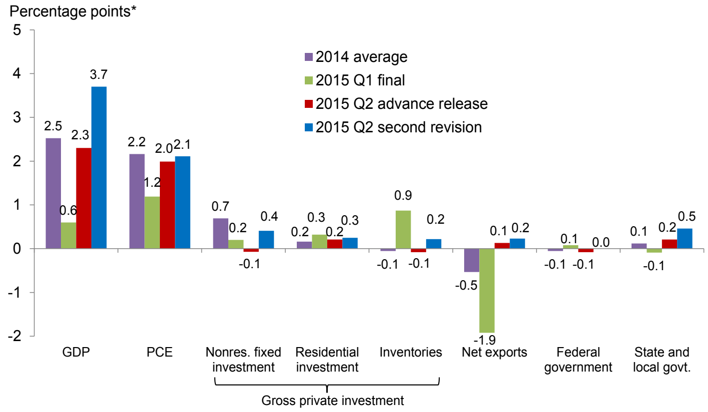
Even with the revision, nonresidential fixed investment in the first half of 2015 contributed less to GDP growth than in 2014. One factor behind the slowing was a collapse in energy-related investment that directly lowered GDP growth by 0.4 and 0.6 percentage points in the first and second quarters, respectively (*Chart 2*). Although oil prices continued their downward trend since the previous update, the bulk of the downshift in energy-related investment contribution to GDP growth in the third quarter seems behind us.

The rebound in second-quarter GDP also reflected the impact of the West Coast port strike, which held down first-quarter GDP by boosting inventories and depressing net exports. The second quarter unwound this effect. Both the second-quarter uptick and the large first-quarter plunge in net exports are anomalous. We are likely to see, on average, negative net contributions from net exports in the coming quarters from the slowdown in global growth, a strong dollar and the latest developments in China.

Labor Market Reports Suggest Solid Growth Ahead

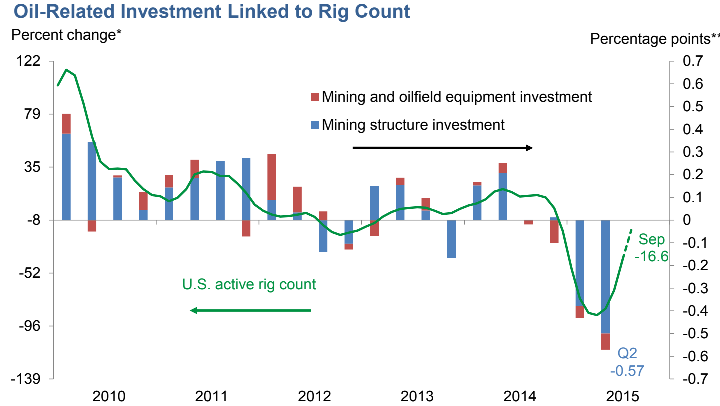
Nonfarm payroll employment gains registered at 173,000 in August, lower than the gains seen in earlier months and short of market expectations (*Chart 3*). However, the shortfall roughly equaled the 44,000 combined upward revisions to June and July data. In the past, the August figure tends to be revised upward, and this seems likely for the initial 2015 reading as well. From 2000–14, estimates of August nonfarm payroll employment were revised upward by an average of

Chart 1
Second-Quarter Real GDP Growth Revised Substantially Upward



*Contribution to percent change in real gross domestic product growth; quarter/quarter, seasonally adjusted annualized rate.
SOURCE: Bureau of Economic Analysis.

Chart 2
Oil-Related Investment Linked to Rig Count



*Three-month percent change of the three-month moving average; annualized rate.
**Contribution to percent change in real GDP growth; quarter/quarter, seasonally adjusted annualized rate.
NOTE: The September average is as of Sept. 11, 2015.
SOURCES: Baker Hughes; Bureau of Economic Analysis; author's calculations.

62,000 between the initial and final estimates, reflecting the addition of more complete responses after the end of the summer vacation season. According to the household survey, the headline unemployment rate decreased 0.2 percentage points from July to 5.1 percent in August—its lowest level since April 2008.

Though mining employment continued to decline in August, state-level data through July suggest that much of the direct impact of the prior oil price declines on employment of energy-intensive states (North Dakota, New Mexico, Oklahoma, Texas and Wyoming) had waned by the start of the third quarter. After outpacing payroll growth rate in nonenergy intensive states from 2013 to early 2015, aggregate payroll growth of the five energy-intensive states fell for several months before rebounding toward the pace of the nonenergy states in July. Recent energy developments may impart some renewed drag on employment in energy-oriented states in coming months, depending on how energy markets evolve.

The July Job Openings and Labor Turnover Survey (JOLTS) release shows that the labor market had strong momentum when it entered the third quarter. The number of job openings jumped by 430,000, reflecting widespread increases across sectors, exceeding the market consensus of a 51,000 increase. The job opening rate jumped to 3.9 percent, the highest since the survey began in 2000. As the job opening rate seems to have a six-month lead on private payroll growth, the July report bodes well for the labor market for the remainder of 2015 (*Chart 4*).

Inflation Firming Before Chinese Developments

In contrast to the employment data, there have been more mixed readings on progress toward the Federal Reserve's inflation objective of 2 percent. The 12-month core and trimmed mean measures of Personal Consumption Expenditure (PCE) inflation rose 1.2 percent and 1.6 percent in July, respectively, and have shown little progress toward the 2 percent target through July *(Chart 5)*. Headline PCE inflation remained near zero, influenced by oil price declines and the strengthening dollar. However, when measuring inflation on a six-month annualized basis, the trimmed mean PCE—which is less affected by possible seasonal adjustment problems than other PCE inflation measures—converged toward 2 percent. However, these inflation rates do not reflect recent oil prices declines, slow global economic growth, earlier strength in the dollar and August developments in China, which drove down commodity prices. These factors will likely restrain headline inflation rates in the near term.

Impact from Chinese Developments Moderate

The sudden U.S. stock market correction in late August reflected concerns of downside risks emanating from the slowing Chinese economy. Thus far, its impact on the U.S. economy seems moderate at this point. In contrast to the euro crises, U.S. typically exports less to China (7.5 percent of U.S exports versus 13 percent for the euro zone), U.S. banks have less direct and indirect exposures in China, and the shocks to U.S. stock and bond markets seem smaller. The Shanghai Composite fell nearly 19 percent from June to mid-August with no noticeable spillover impact on the U.S. equity market until late August (*Chart 6*). Thus far, the effect seems likely to shave off a fourth to a half percentage points from U.S. GDP growth via possibly sustained stock market wealth effects on consumption and lower U.S. exports to China. Unless Chinese stock price declines signal a deeper economic slowdown in China and/or broader weakness in other emerging economies, Chinese developments currently pose only a modest headwind to the U.S. with a downside tail risk of morphing into a broader slowdown in emerging market economies.

—Daniel Lin

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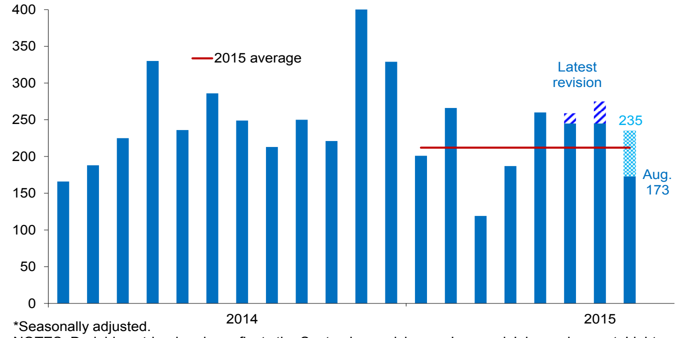
About the Author

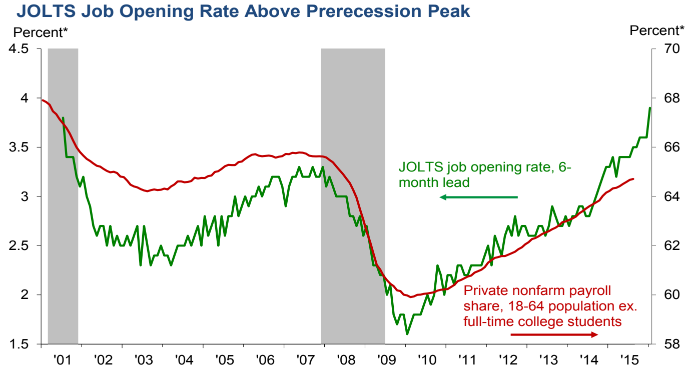
Lin is a research analyst in the Research Department at the Federal Reserve Bank of Dallas.

Chart 3
Nonfarm Job Growth Slows in August



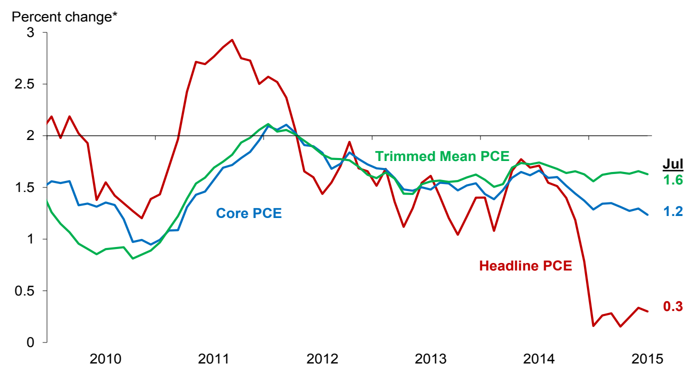
*Seasonally adjusted.
NOTES: Dark blue striped region reflects the September revision on June and July employment. Light blue region reflects the anticipated upward revision for the month of August based on the average August revision from 2000-14.
SOURCES: Bureau of Labor Statistics; author's calculations.

Chart 4
JOLTS Job Opening Rate Above Prerecession Peak



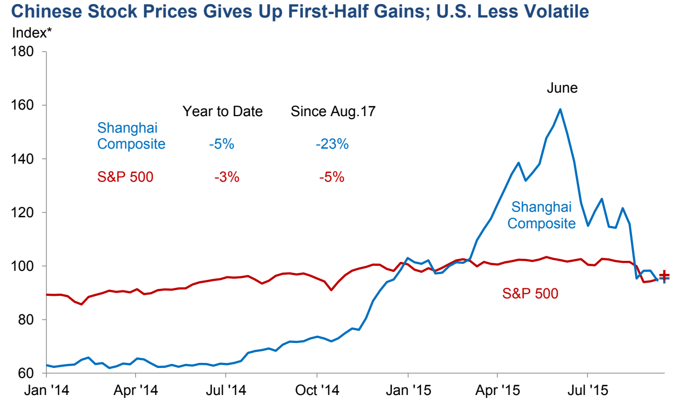
*Seasonally adjusted
NOTES: Shaded areas indicate recession. Private nonfarm payroll share is a percentage of working age population (ages 18-64) excluding full-time college students (2014-15 internal projections).
SOURCES: Bureau of Labor Statistics; Census Bureau; NBER; author's calculations.

Chart 5
PCE Inflation Measures Show Little Progress Toward 2 Percent Objective



*12-month percent change, seasonally adjusted.
SOURCES: Bureau of Economic Analysis; Federal Reserve Bank of Dallas.

Chart 6
Chinese Stock Prices Gives Up First-Half Gains; U.S. Less Volatile



*Dec. 31, 2014 = 100, weekly average
NOTE: The plus signs indicate the index value as of Sept. 17, 2015.
SOURCES: *Wall Street Journal*; author's calculations.