Federal Reserve Bank of Dallas

United States Economic Outlook

Current conditions and near-term outlook

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Vistas from Texas: an Economic Outlook, 6/27/18

The views expressed are my own and do not necessarily reflect official positions of the Federal Reserve System.

Roadmap

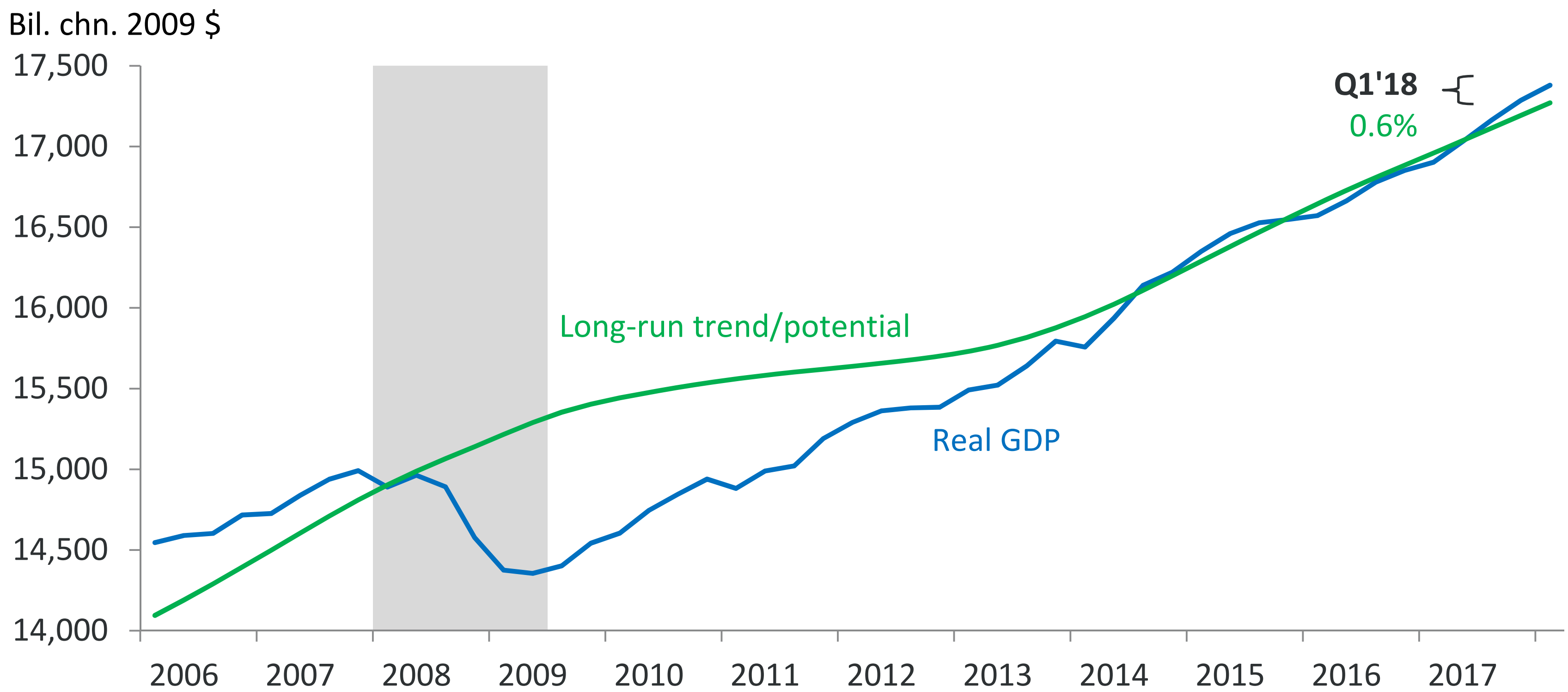
- Current conditions: where we are now
- Looking ahead
- A longer-run perspective on the U.S. economy

Current conditions: Where we are now

Quick sketch of current conditions

- Economy operating at or near potential
- Continued solid growth in economic activity
- Some headwinds have turned to tailwinds—e.g., overseas growth—plus fiscal stimulus
- Labor market tight & tightening further
- Inflation getting close to the Fed’s long-run goal of 2 percent, and has picked up noticeably in recent months

US Economy operating at or near potential



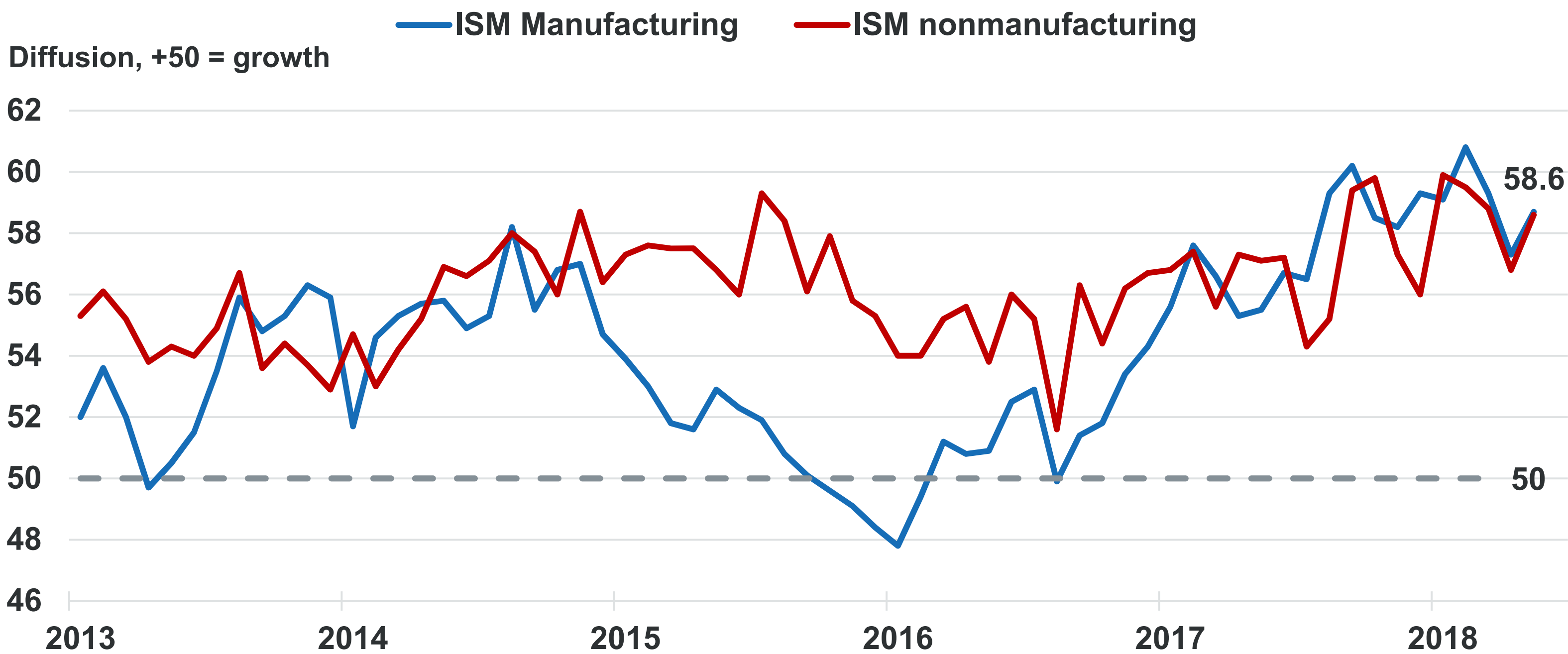
Sources: BEA; BLS; CBO; NBER; author's own calculations.

Q2 real GDP growth expected at 3+ percent

- Real GDP grew at a 2.2 percent annualized clip in Q1.
- That's in line with average growth over the past 5 years: 2.3 percent.
- Projections for current quarter, Q2, around 4 percent.

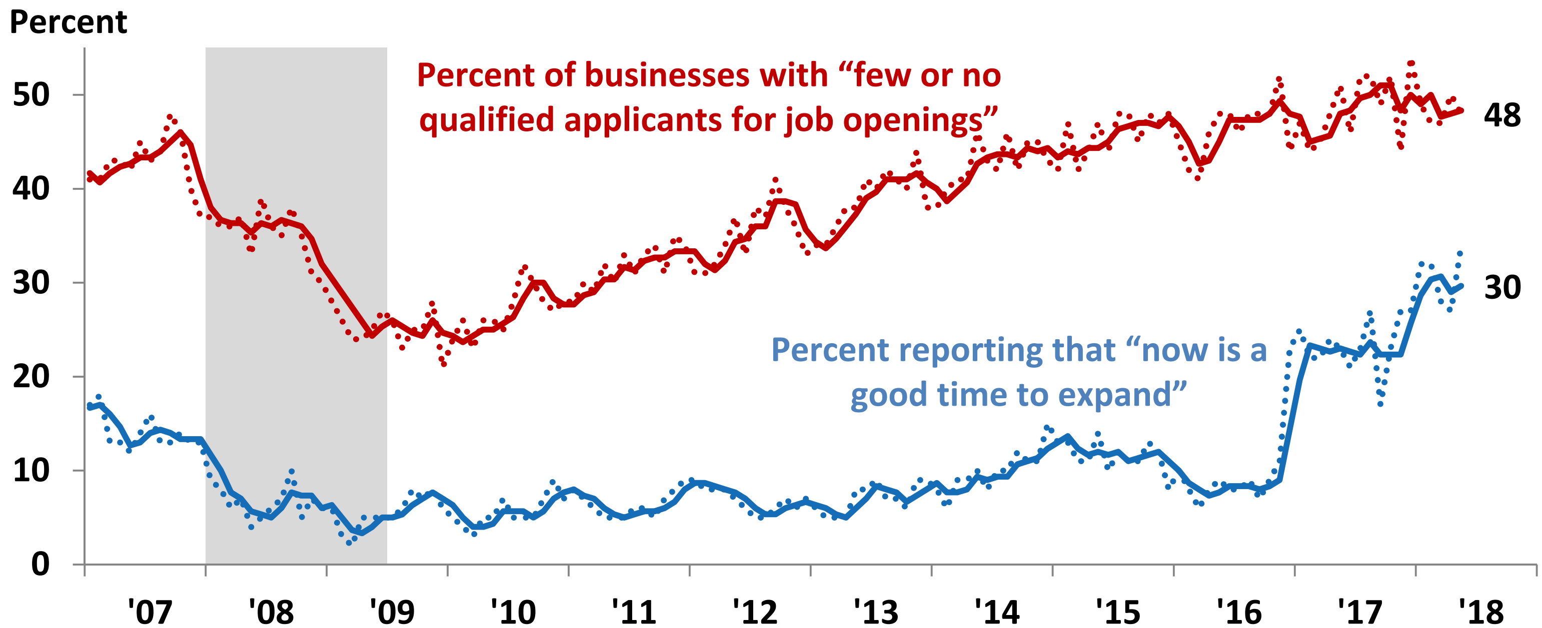
	Q2 growth projection
Simple new orders + ADS index model	3.4
Blue Chip	3.5
New York Fed nowcast	3.1
Atlanta Fed nowcast	4.7

Purchasing manager surveys point to robust growth in manufacturing, services



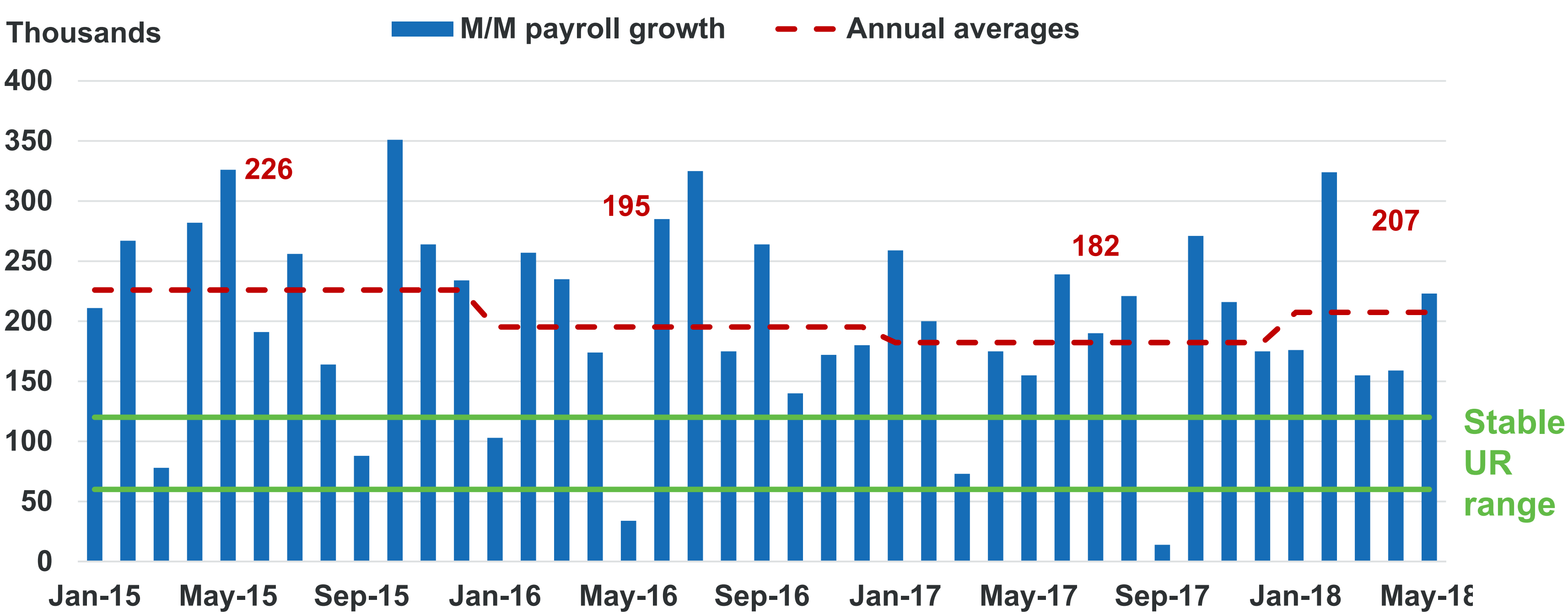
Source: Institute for Supply Management

Small business survey shows a gradually tightening labor market and markedly improved optimism



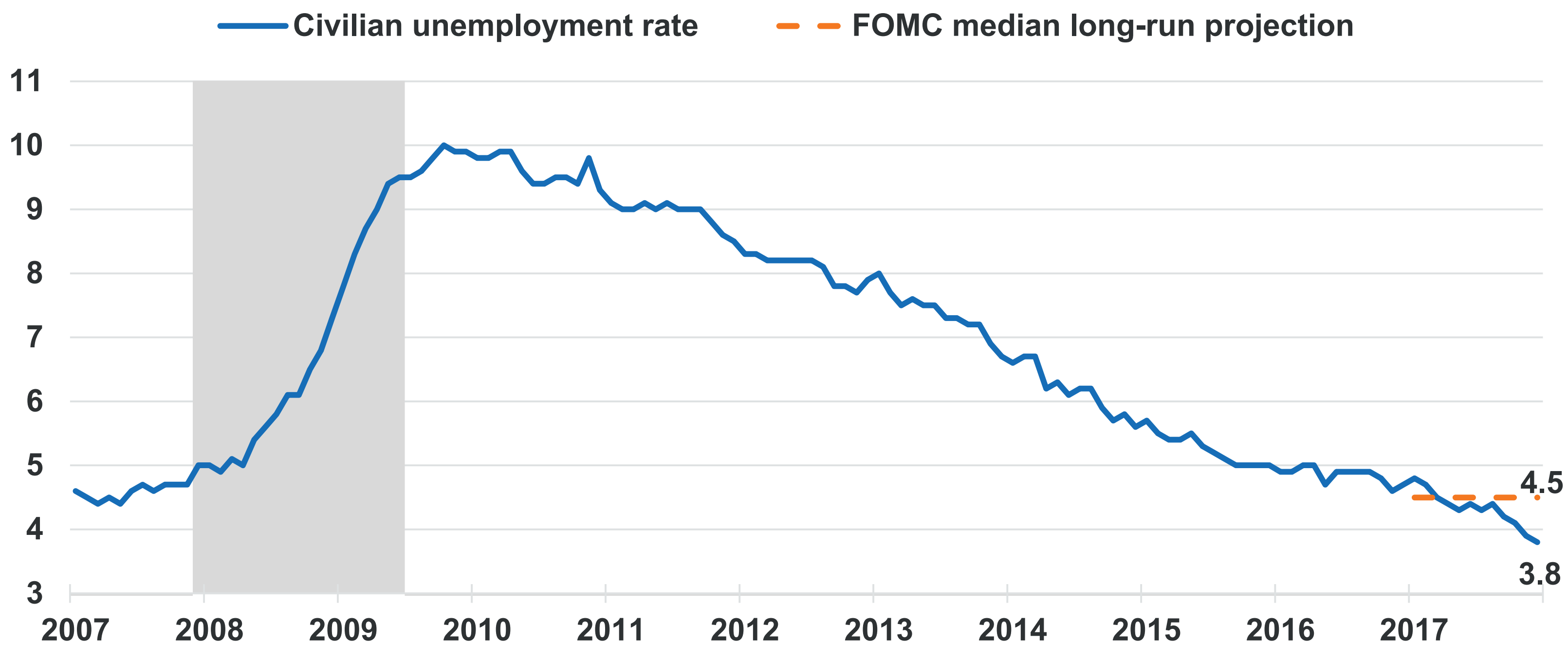
Sources: National Federation of Independent Businesses, author's calculations

Robust payroll gains continue



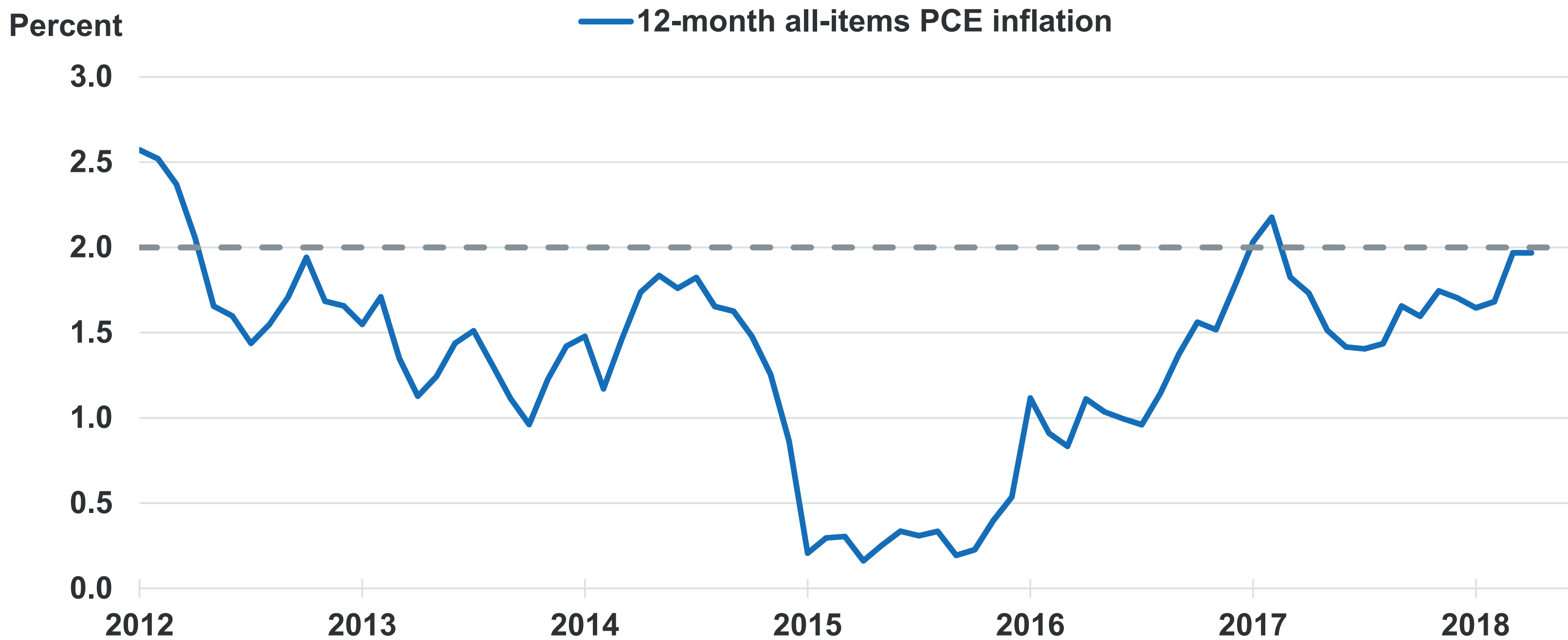
Source: BLS, author's calculations

Unemployment rate now 3.8 percent, well below policymakers' long-run projection



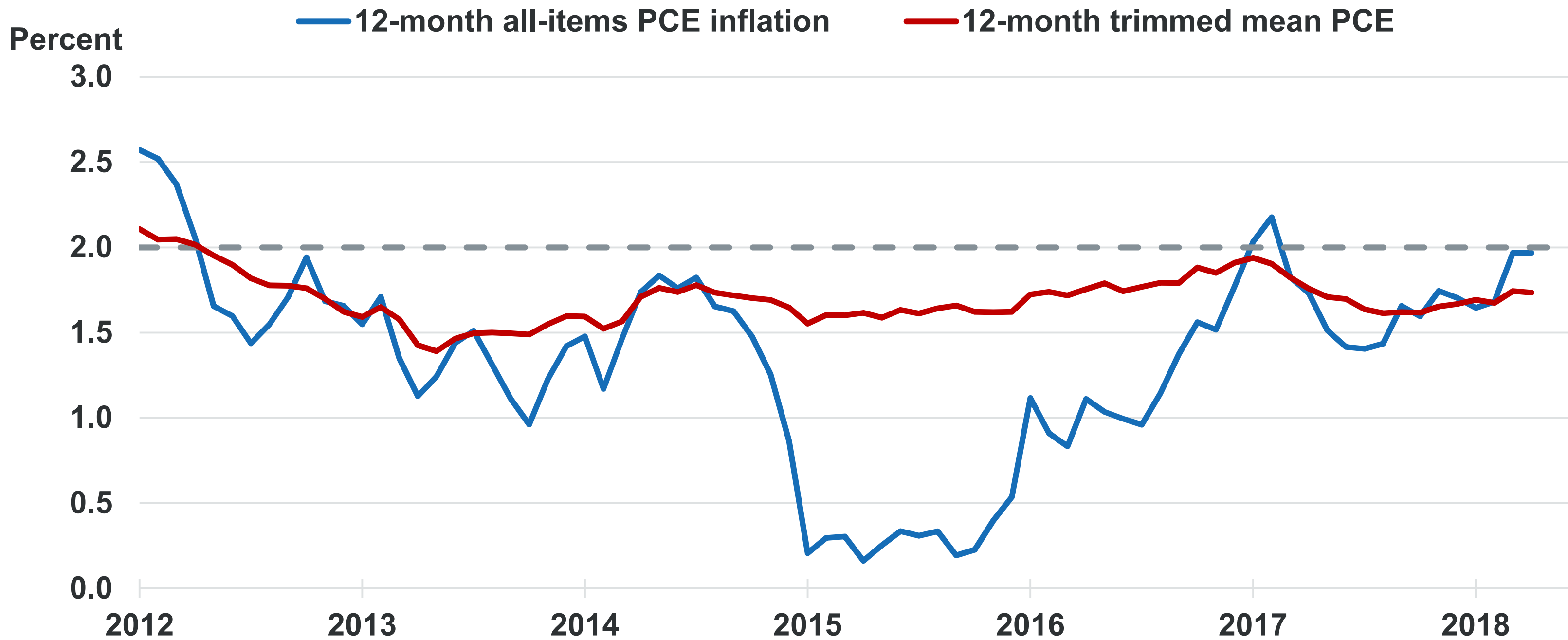
Source: BLS, FRB-FOMC

Headline PCE inflation slowed in early 2017, now rebounding



Sources: BEA

Early 2017 slowing also present in core inflation measures



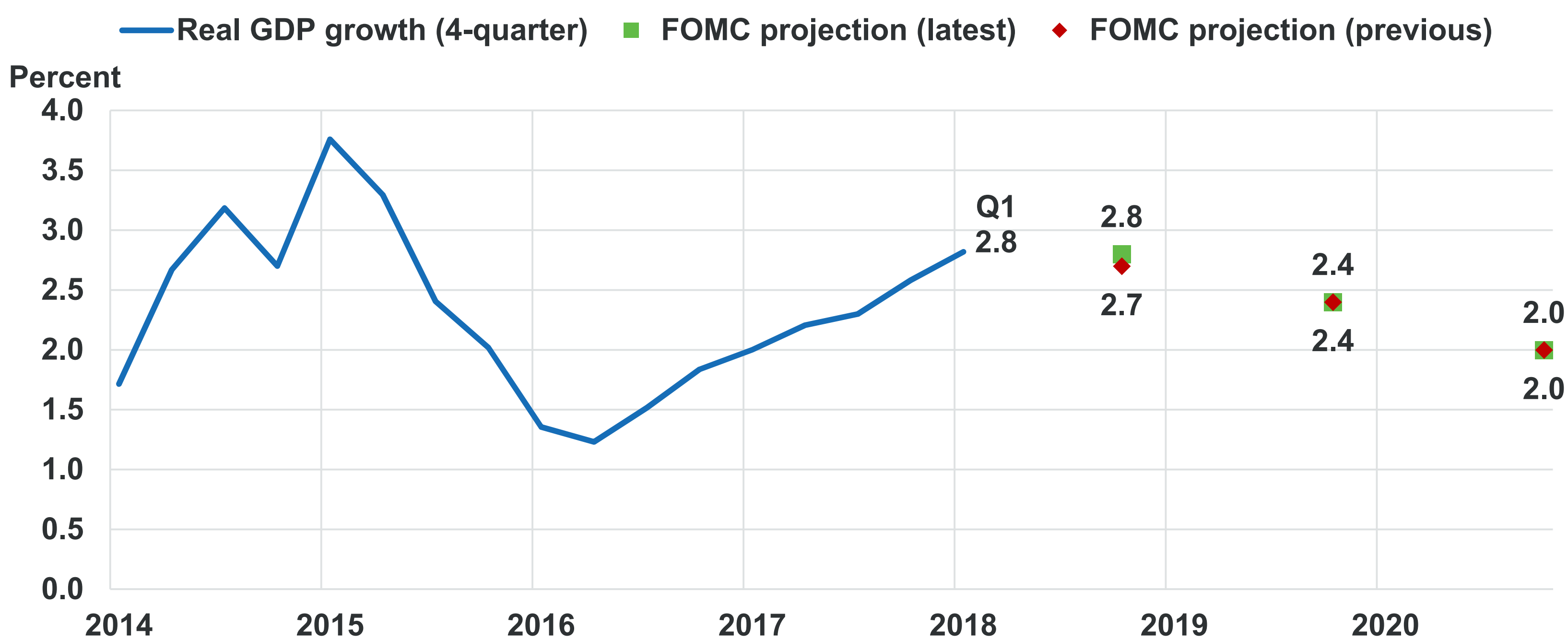
Sources: BEA, FRB Dallas

Looking ahead

The view from the FOMC: 2018 and beyond

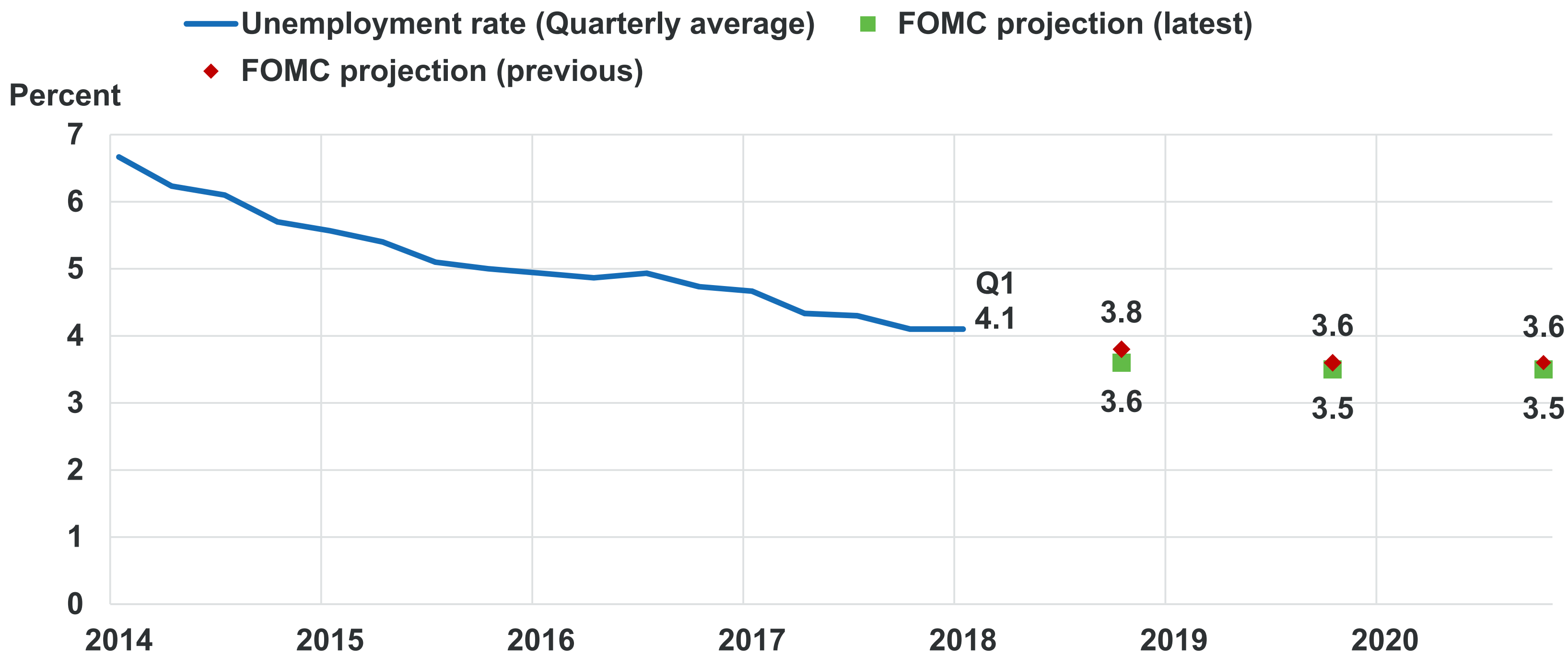
- At four of the eight FOMC meetings – March, June, September, and December – members give projections for GDP, unemployment and inflation over the coming two or three years
- Last "Summary of Economic Projections" ("SEP") was in June
- As of June, FOMC members saw:
  - GDP growth tapering from 2.8 percent to 2.0 percent over 2018 – 2020
  - Unemployment dipping to 3.5 percent in 2019 & 2020
  - Inflation rising to over 2.1 percent
- Slightly stronger outlook compared with March SEP

GDP growth expected to slow toward long-run potential rate



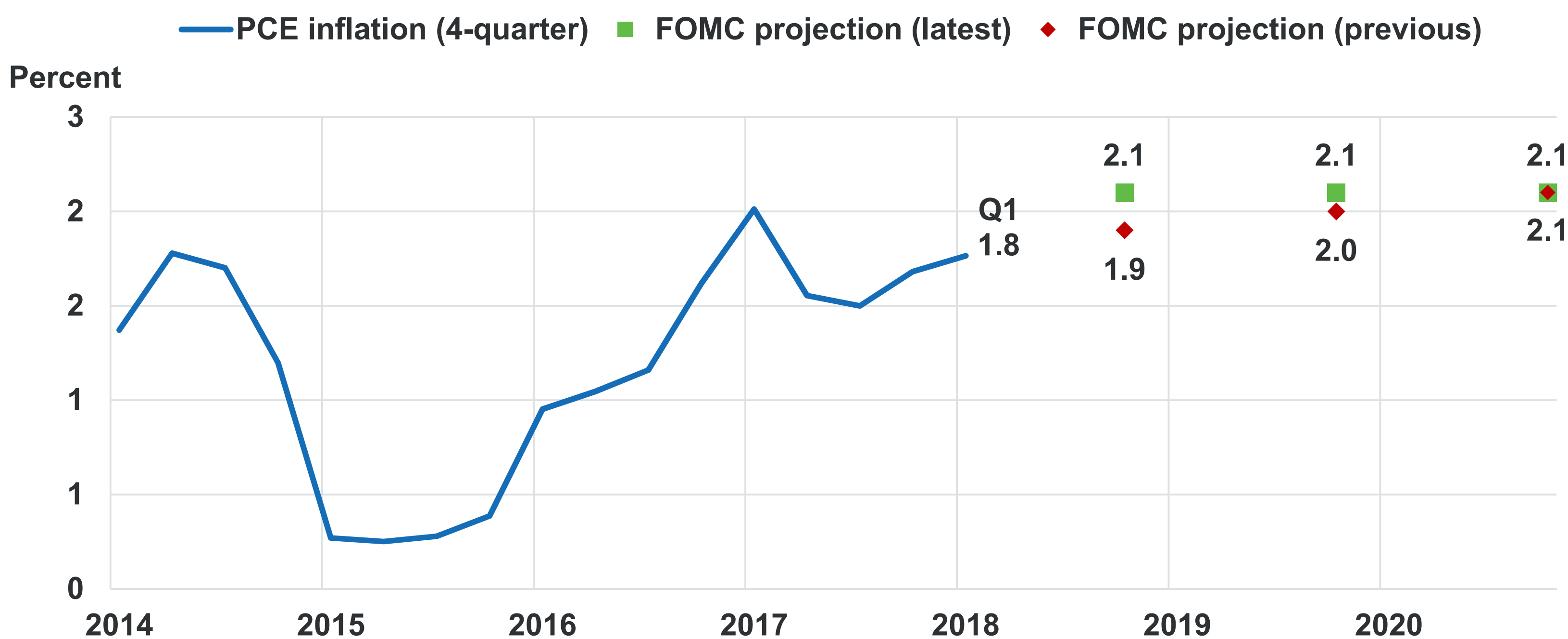
Sources: BEA, FR FOMC

Unemployment expected to be in the mid-3s



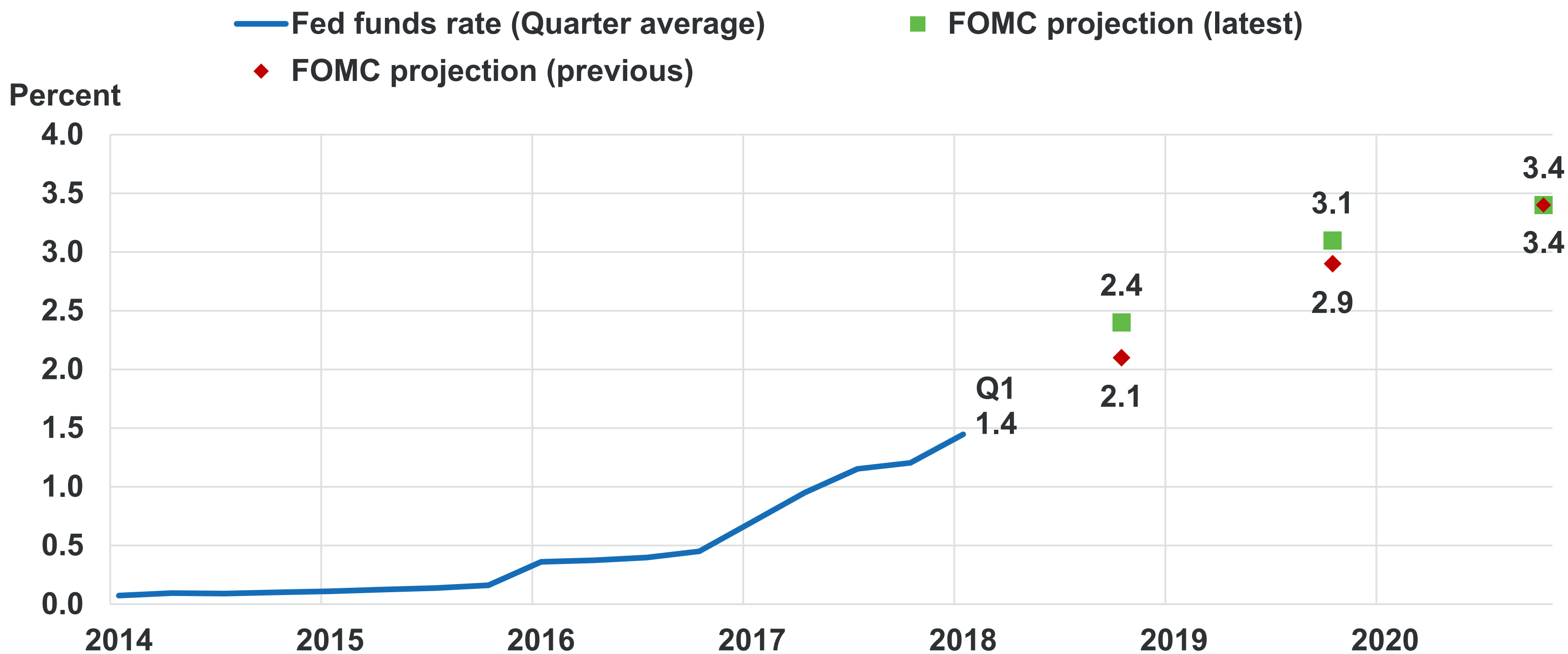
Sources: BEA, FR FOMC

Inflation expected to rise to long-run target level



Sources: BEA, FR FOMC

Fed funds rate expected to rise gradually above 3 percent



Sources: BEA, FR FOMC

Summing up

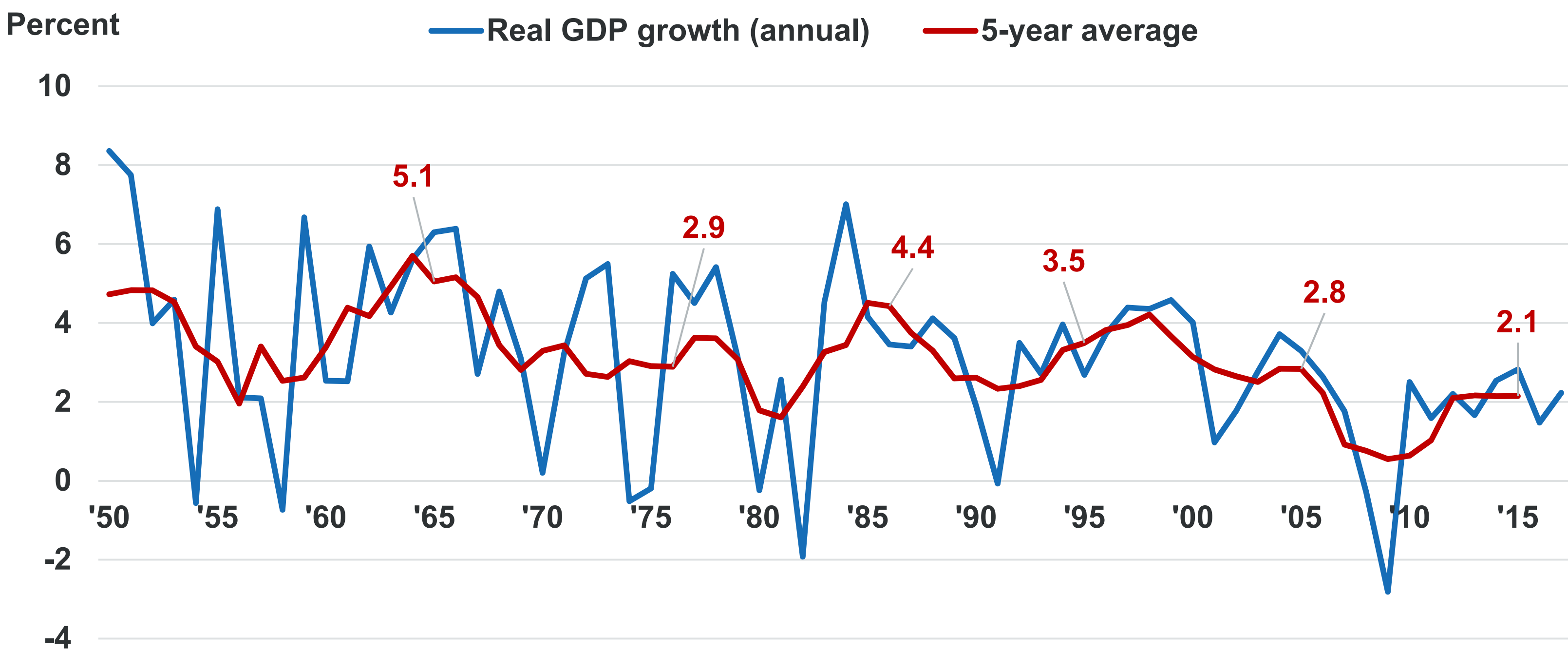
- U.S. economy currently experiencing solid growth, a tightening labor market, and – at least over the past several months – inflation rising from subdued levels
- Labor market is strong; important secular trends
- The outlook over the next several quarters is for solid GDP growth that eventually slows to a long-run sustainable rate, unemployment dipping further below 4 percent, and inflation gradually rising to the Fed’s long-run 2 percent goal

A longer-run perspective on the U.S. economy

Long run overview

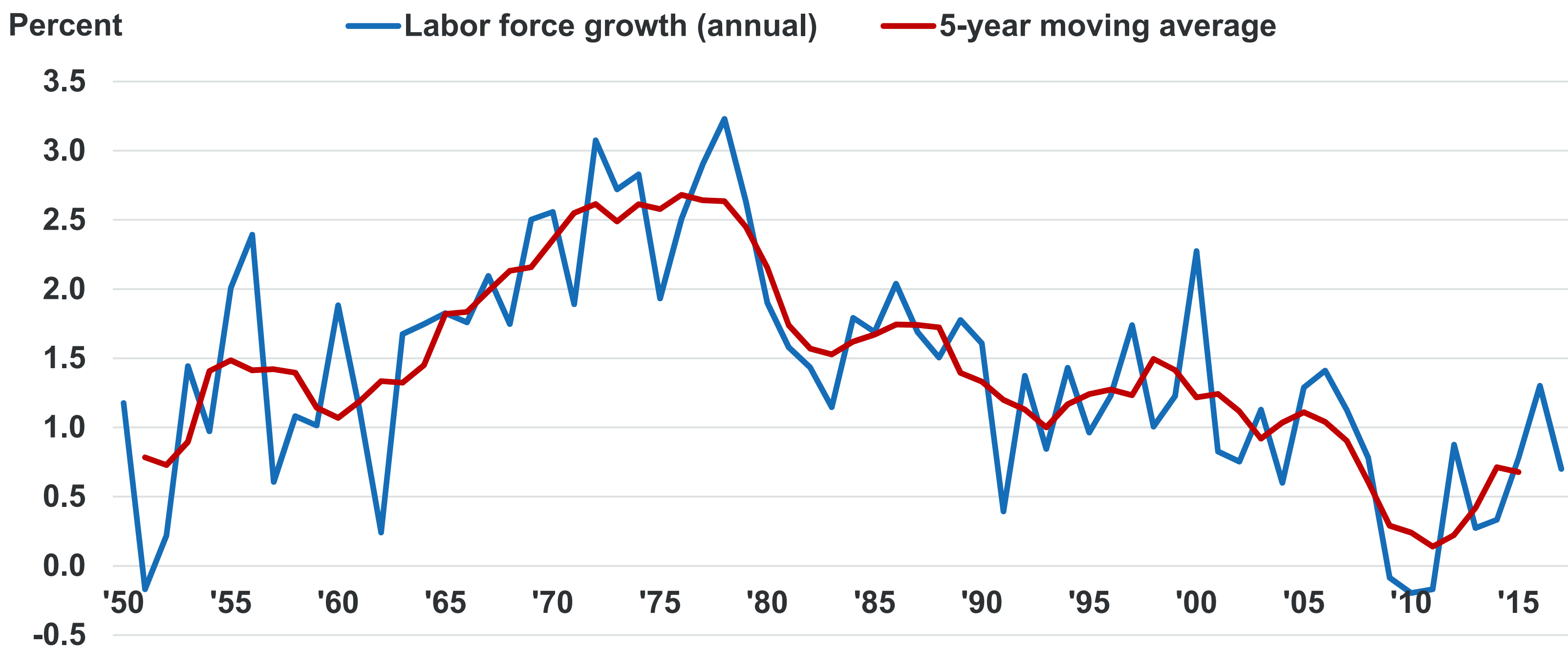
- Real output growth has slowed considerably over the past few decades
  - Mostly a result of demographics, but also slower productivity growth
- Inflation is also much lower now than it was 25 years ago
- Interest rates are also a lot lower than they were 25 years ago
  - Partly reflects lower inflation
  - Also lower real (inflation-adjusted) interest rates
- Many of these patterns are not unique to the U.S., may indicate a new normal

Real GDP growth has slowed over the past few decades



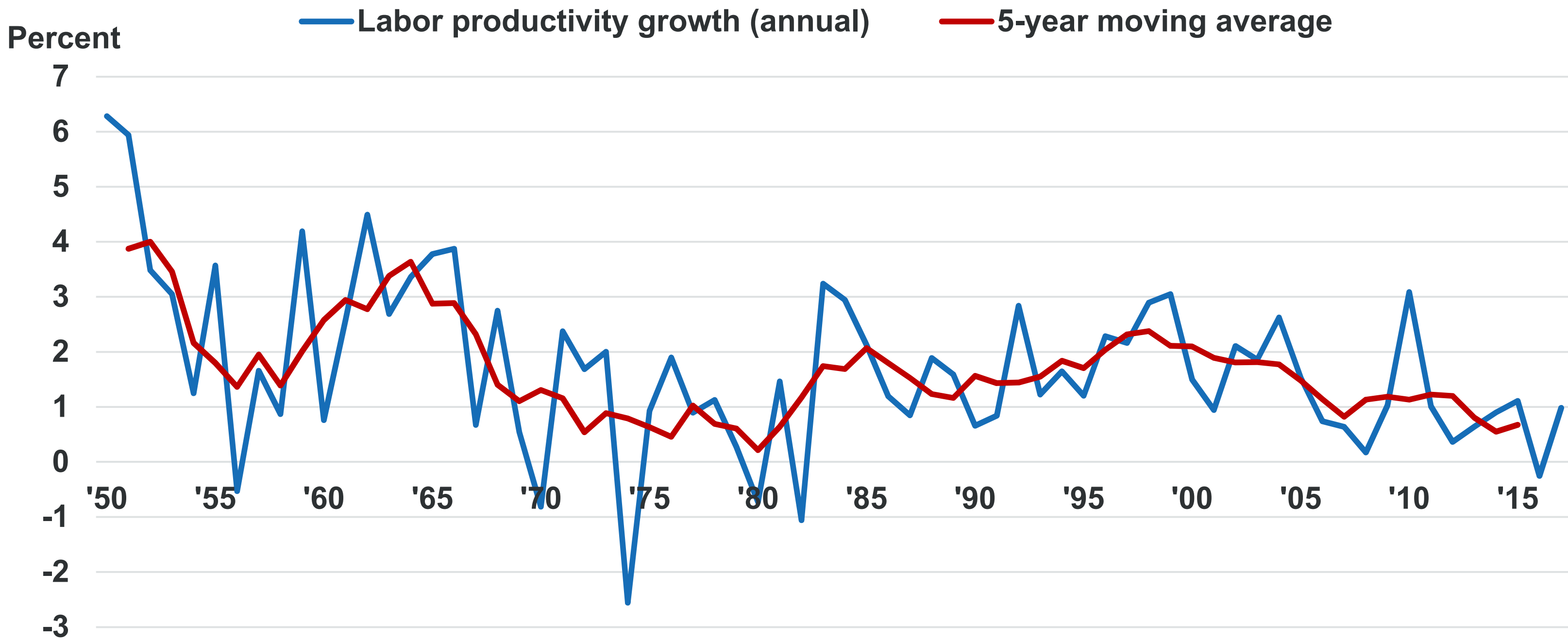
Sources: BEA, author's calculations

This partly reflects slower labor force growth…



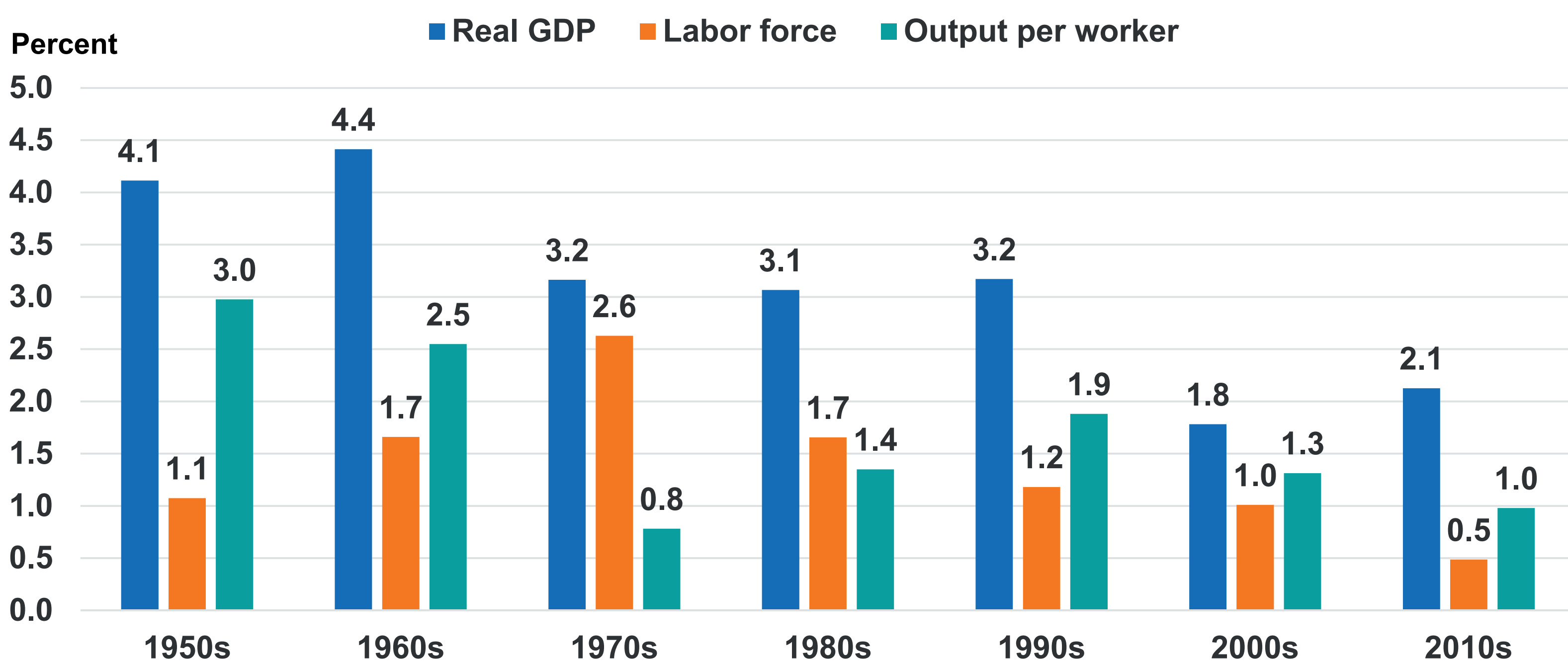
Sources: BLS, author's calculations

…but also slower productivity growth since the 1990s



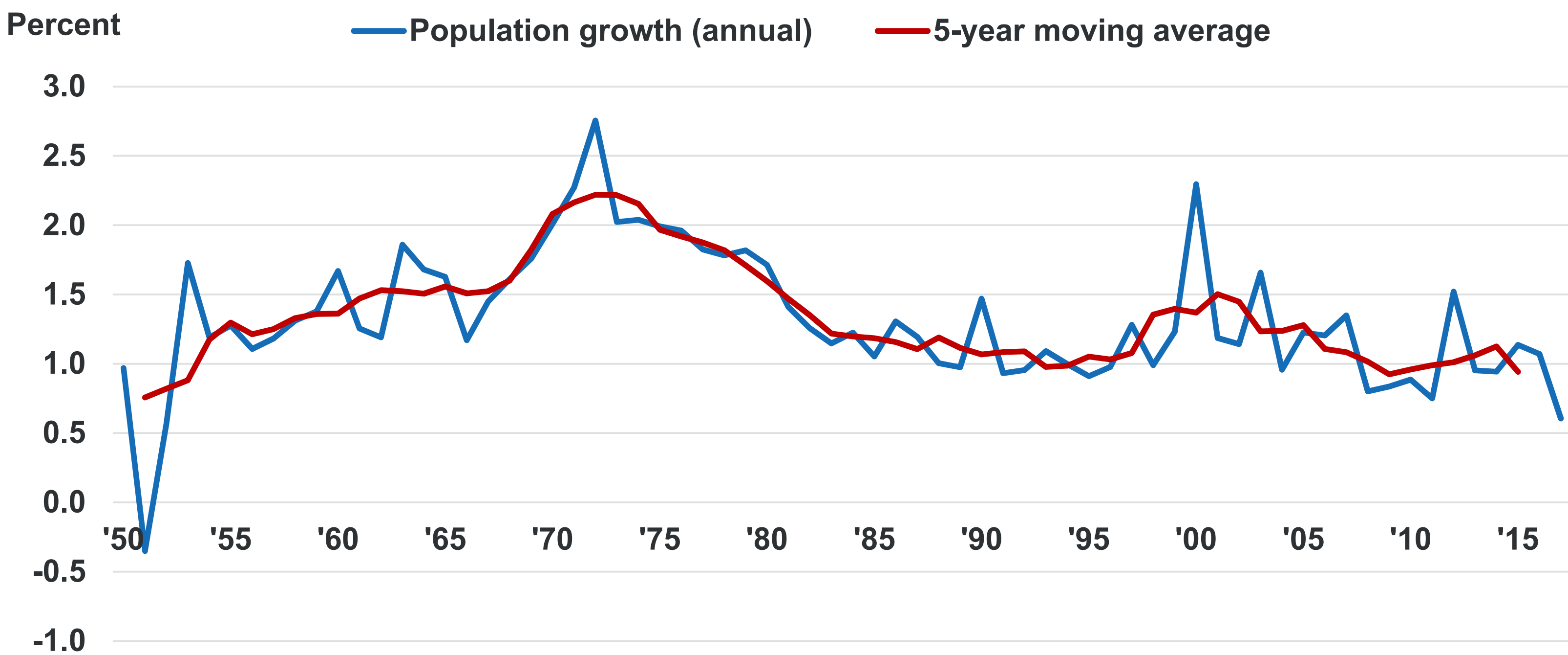
Sources: BEA, BLS, author's calculations

Average growth rates by decade



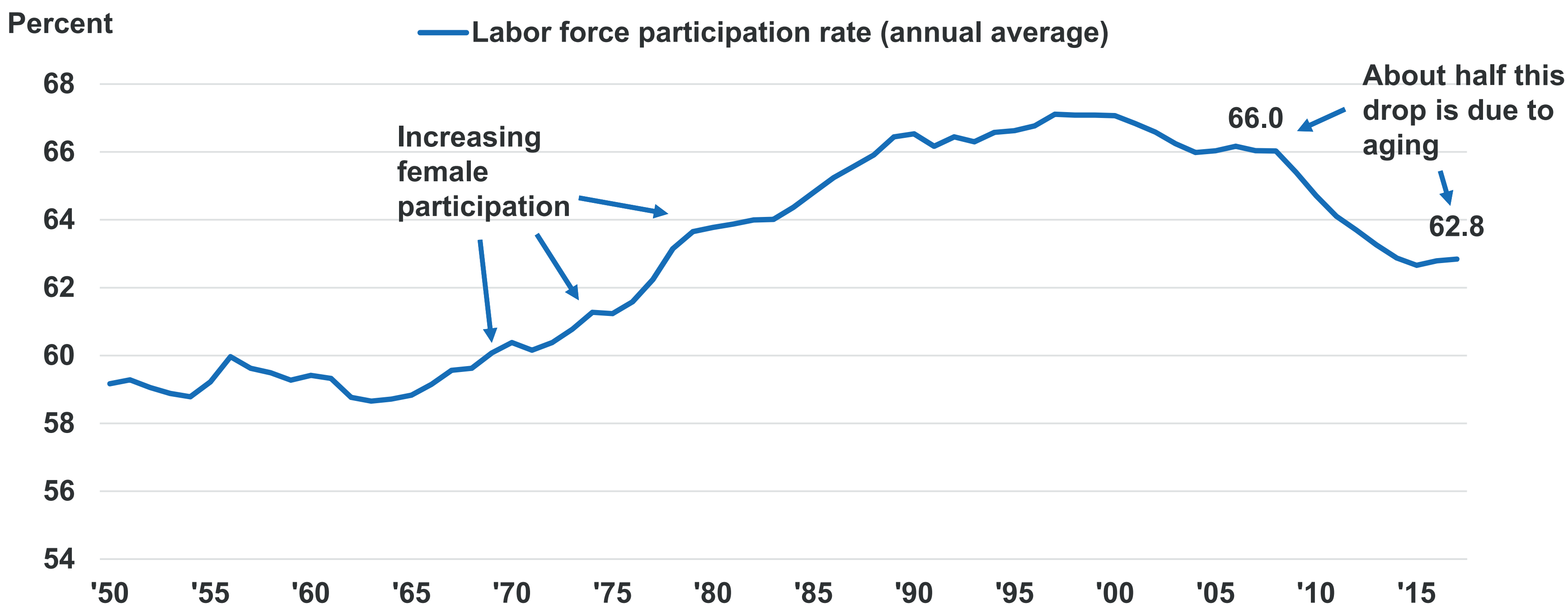
Sources: BEA, BLS, author's calculations

Labor force growth shaped in part by long-run movements in population growth



Sources: BLS, author's calculations

Labor force participation rose in the 1970s and 1980s, has declined since the 1990s

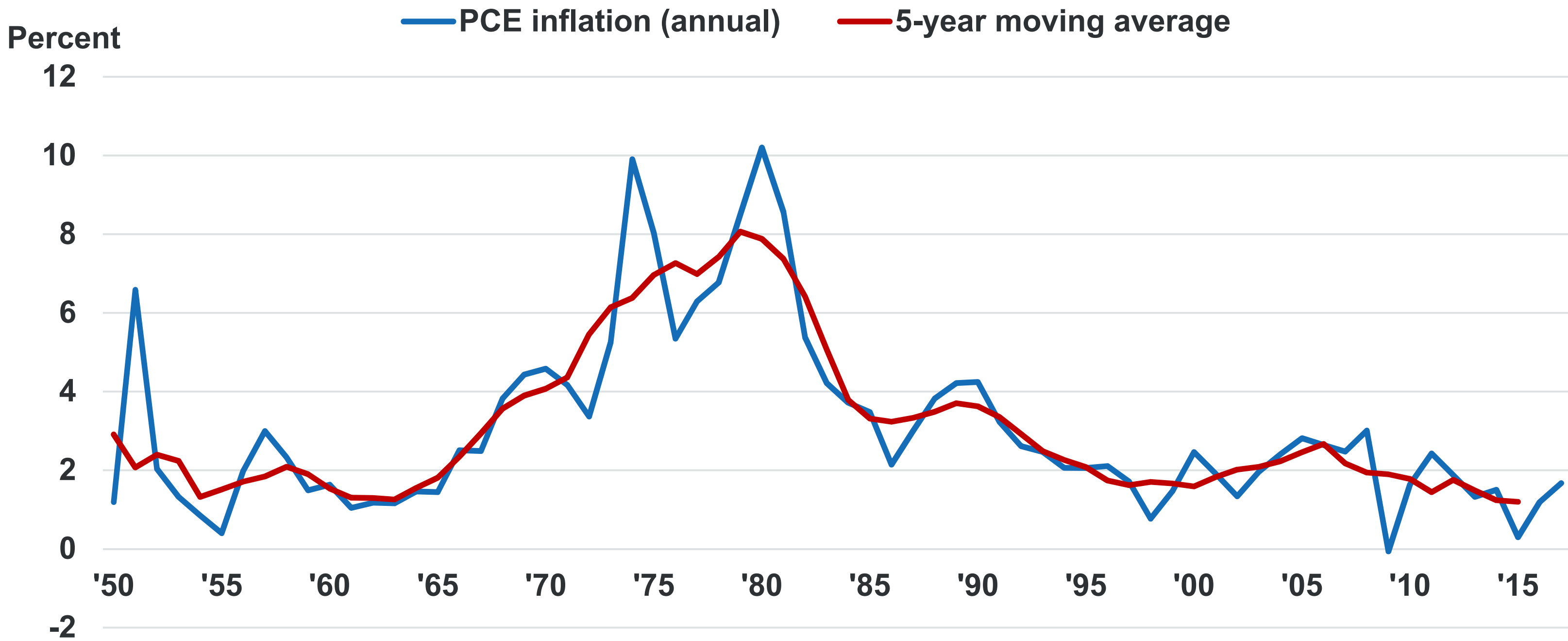


Sources: BLS, author's calculations

Why has productivity growth slowed?

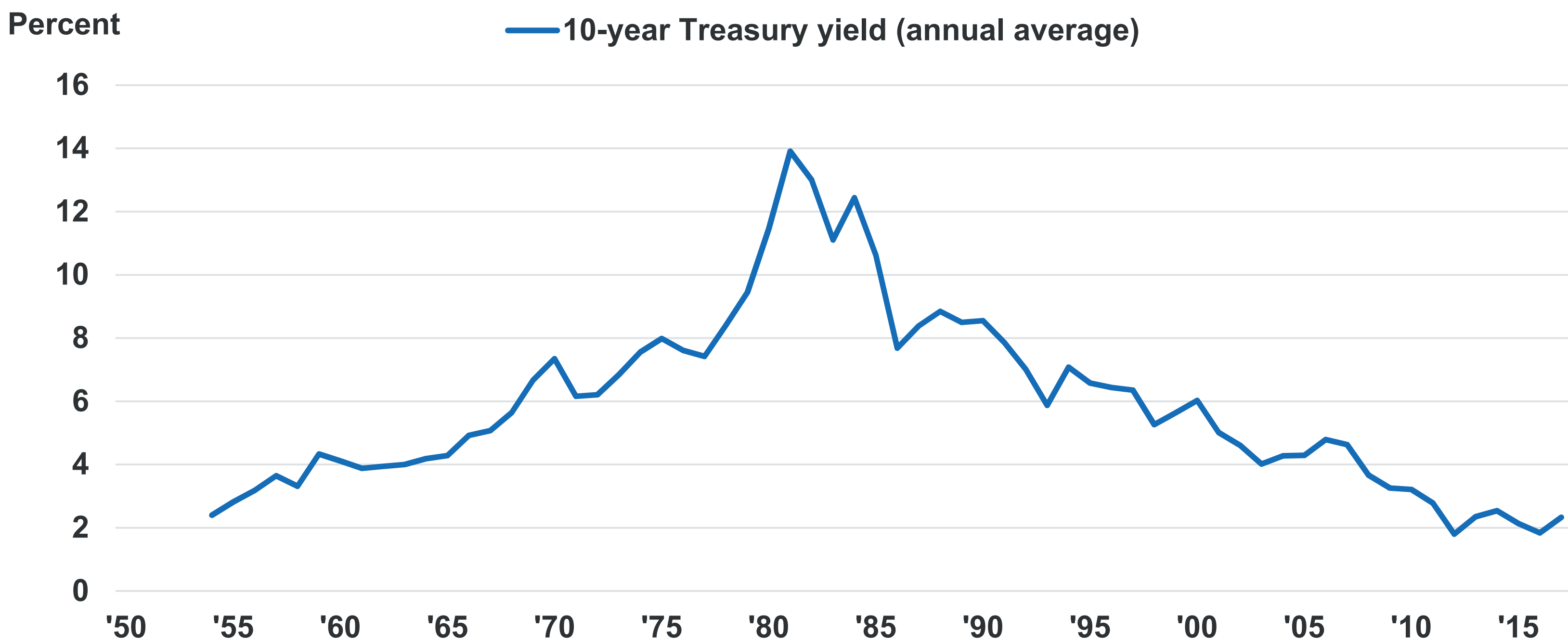
- Not U.S.-specific, happening quite broadly
- Open question, different views on why—some more pessimistic, some more optimistic
  - Pessimistic: All the big-impact innovations have already been made
  - Optimistic: Innovation comes in waves, takes time for full potential of general purpose technologies to be realized
- Difference between 1.7 percent/year (average of 1980s, 1990s) and 1.0 percent/year (2010s) is huge for long-run well-being
  - Do average living standards double every 40 years or every 70 years?

Inflation rose in the 1960s and 1970s, has fallen since the early 1980s



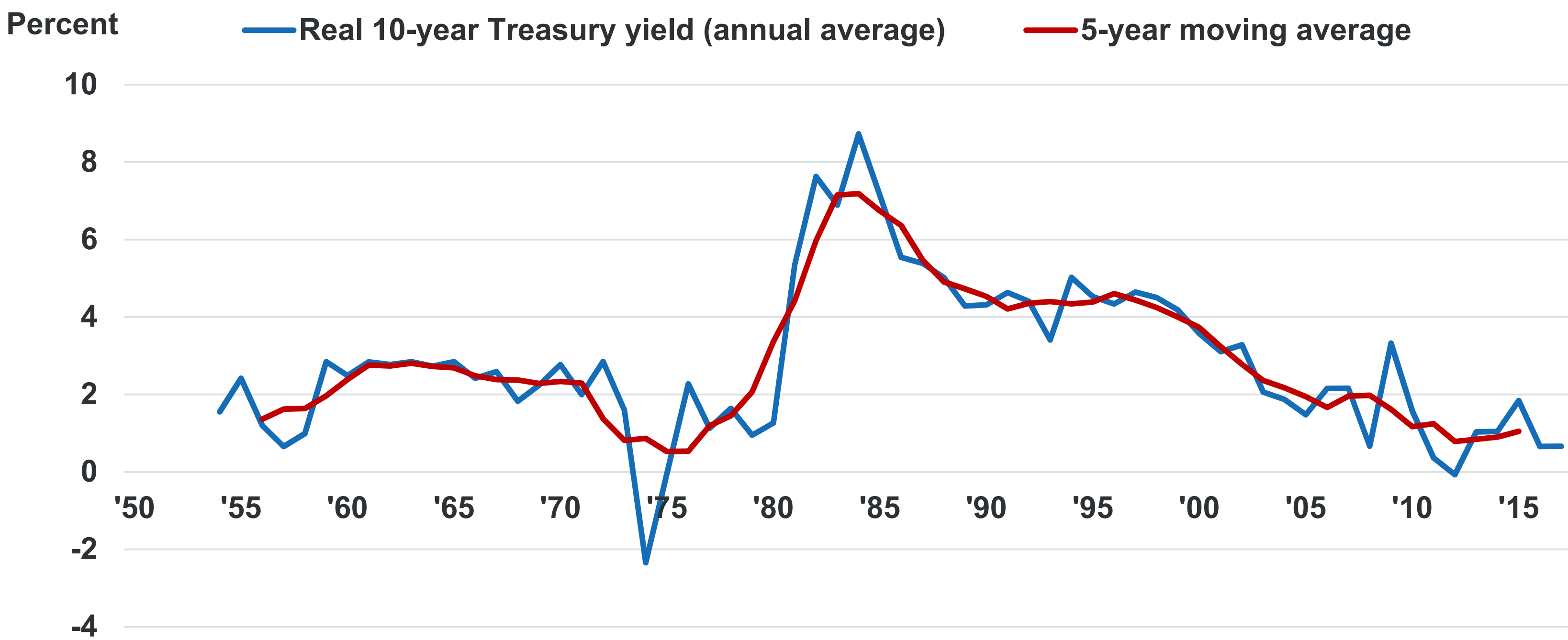
Sources: BEA, author's calculations

Long-term nominal interest rates have also declined



Sources: FRB Board of Governors, author's calculations

Real interest rates also declined since the 1980s



Sources: FRB Board of Governors, BEA, author's calculations

The new normal?

- Recent behavior may represent the “new normal”
- Demographics → labor force growth around 0.6 percent per year for the next 20 years
- Productivity growth is a wildcard: pace over the past 10 years is 1.1 percent per year.
- Those numbers together → GDP growth of 1.7 percent per year
- That’s close to the long-run forecast of FOMC members, 1.8 percent growth rate

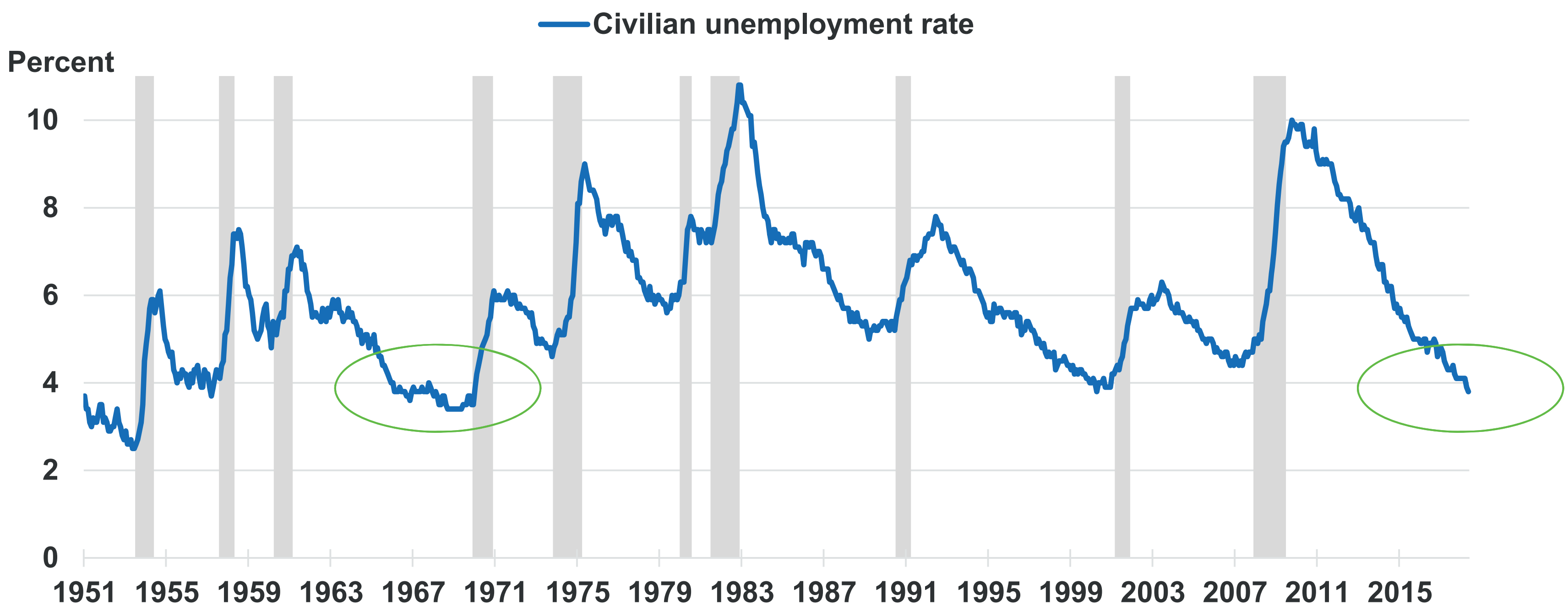
The new normal?

- FOMC also assumes low interest rates (nominal and real) are here to stay for awhile; they project a long-run federal funds rate of 2.8 percent
  - By comparison, FFR averaged about 4 percent for 15 years prior to Great Recession
  - Implies a long-run real rate of 0.8 percent, assuming inflation averages 2 percent
  - This is also in the ballpark of what you can extract from Treasury yield curve data

Thanks for your attention!

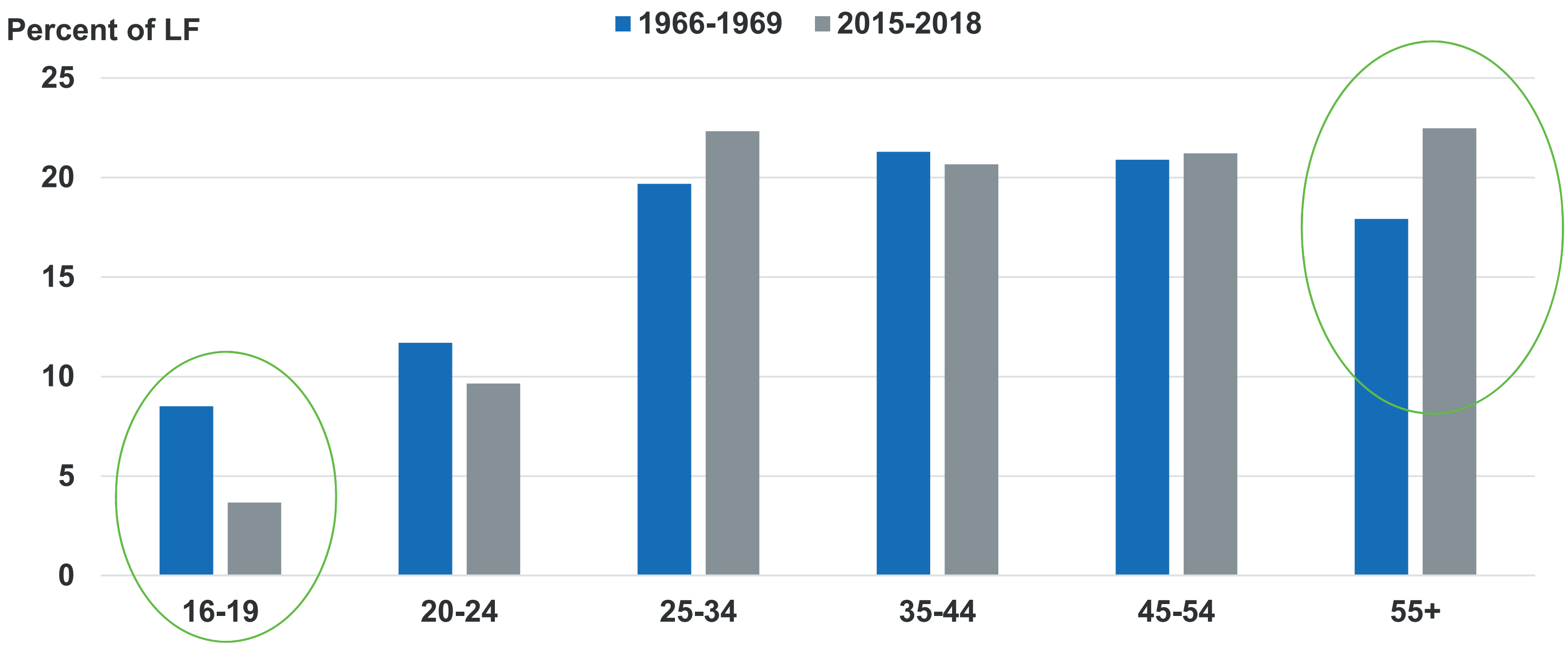
A closer look at the labor market

Unemployment rate dips below 4 percent; this doesn't happen often!



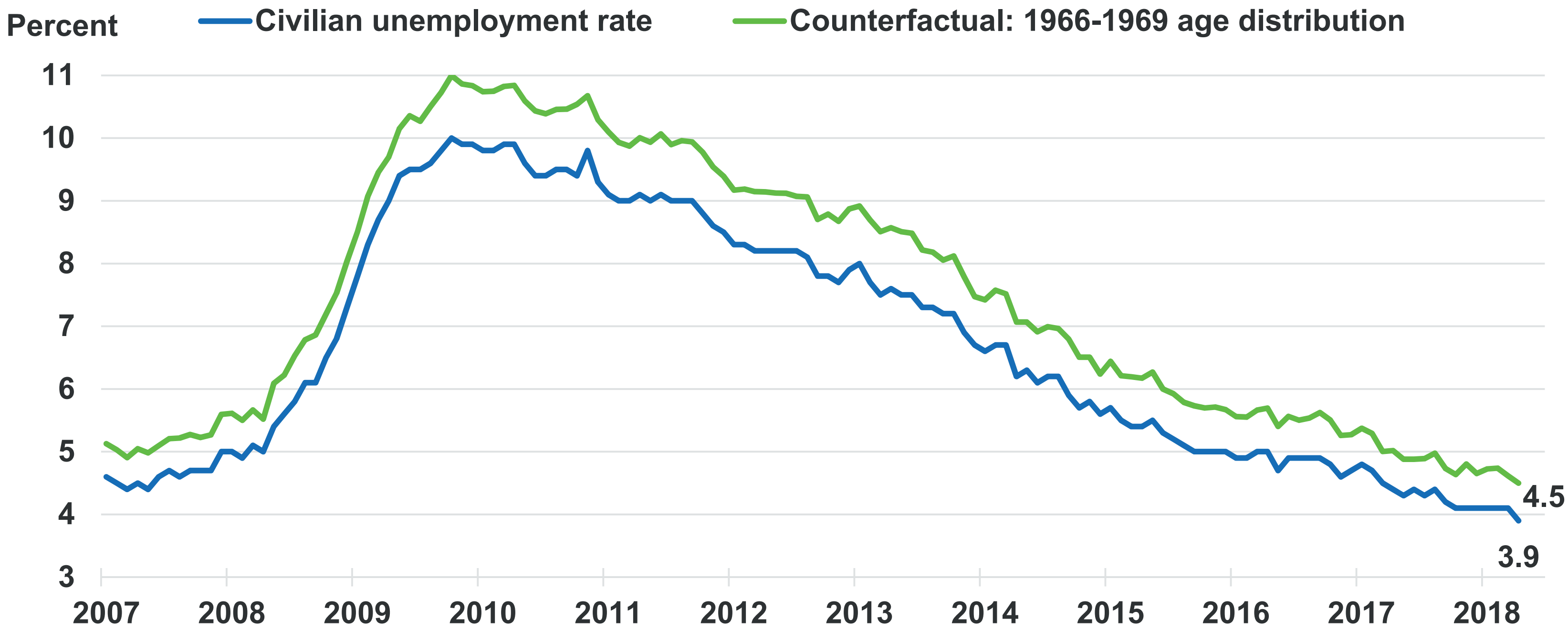
Sources: BLS, NBER

Shift in age distribution away from young, toward old since 1960s



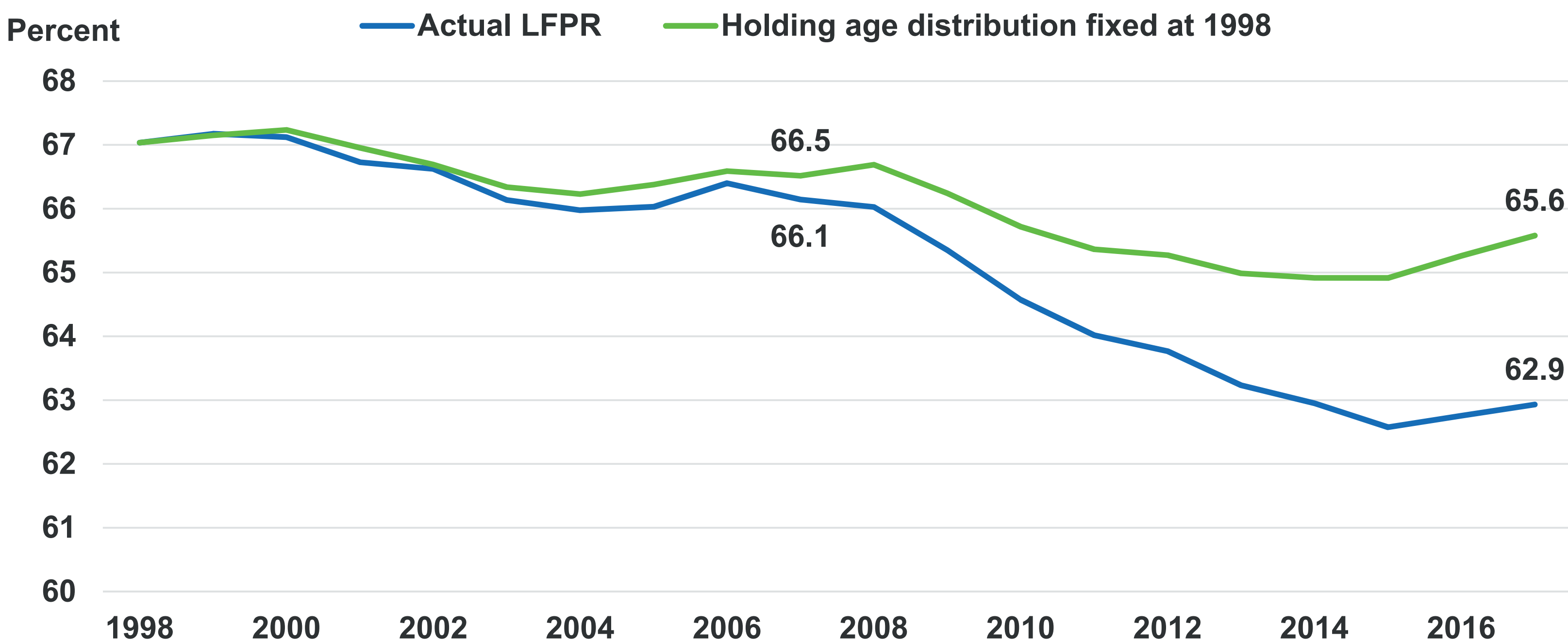
Sources: BLS, author's calculations

Demographic shifts make comparison to late 1960s unemployment more subtle than meets the eye



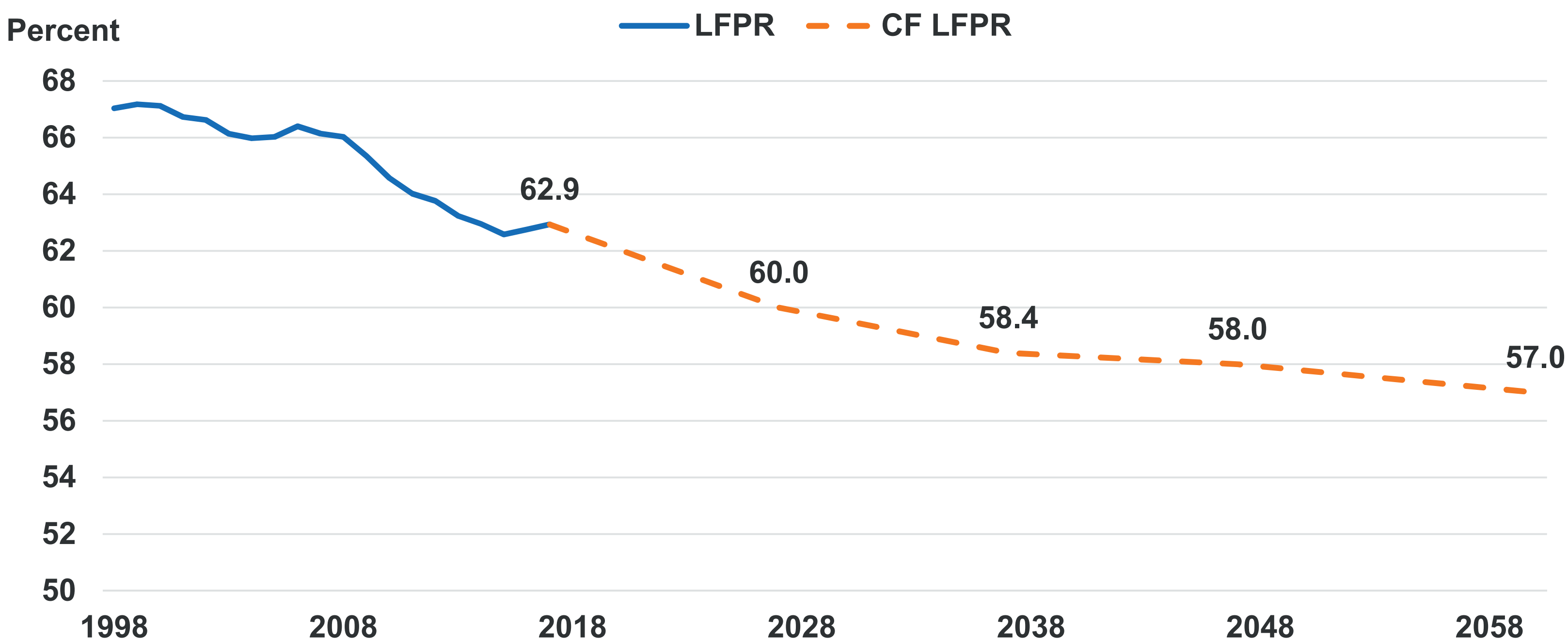
Sources: BLS, author's calculations

Aging effects on labor force participation



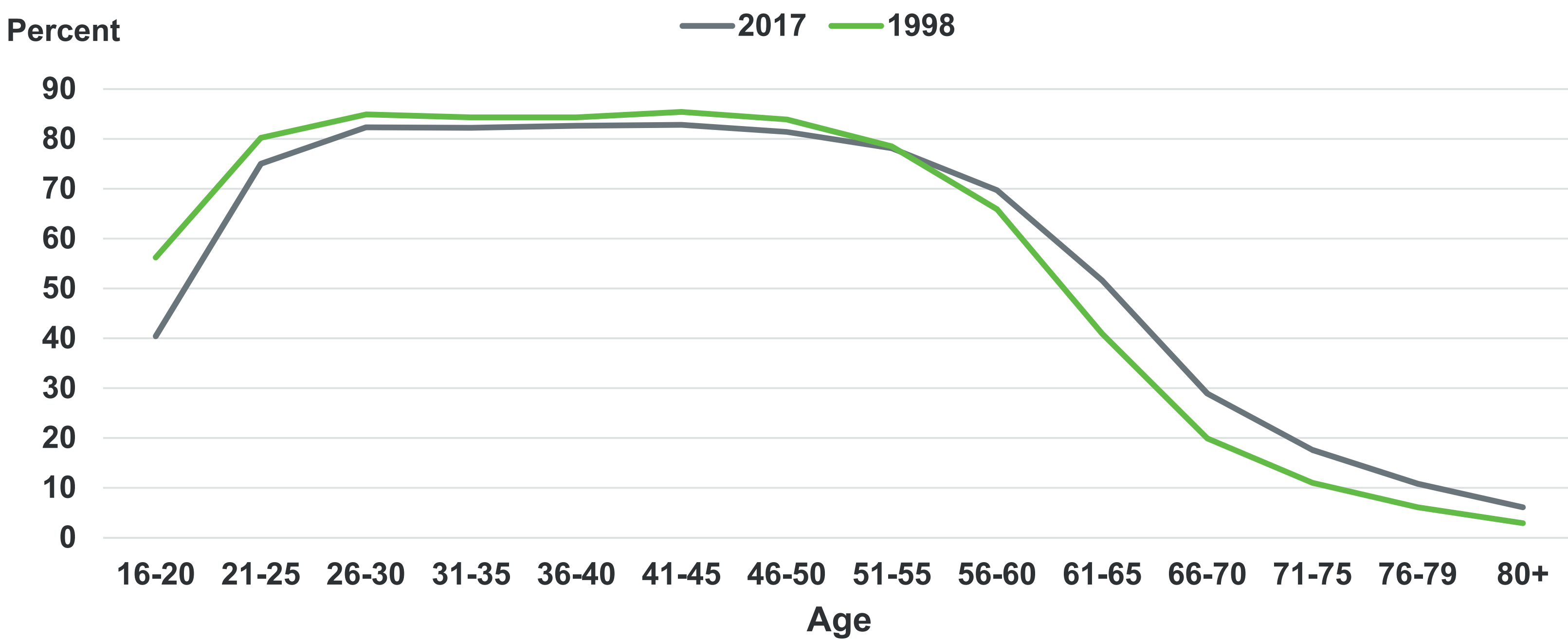
Sources: BLS, FRB Atlanta

Long run LFPR projections: Steady decline



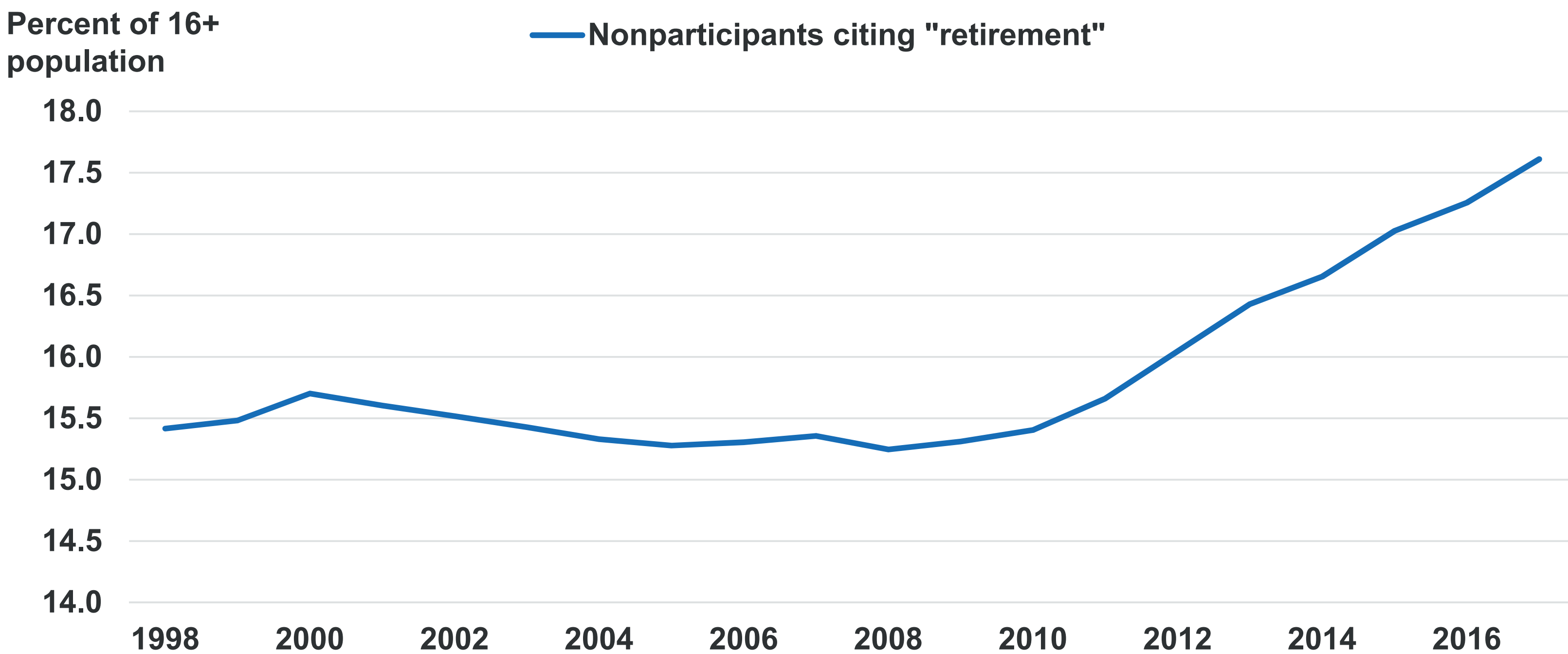
Sources: BLS

Over past 20 years, LFPRs have fallen for younger, risen for old



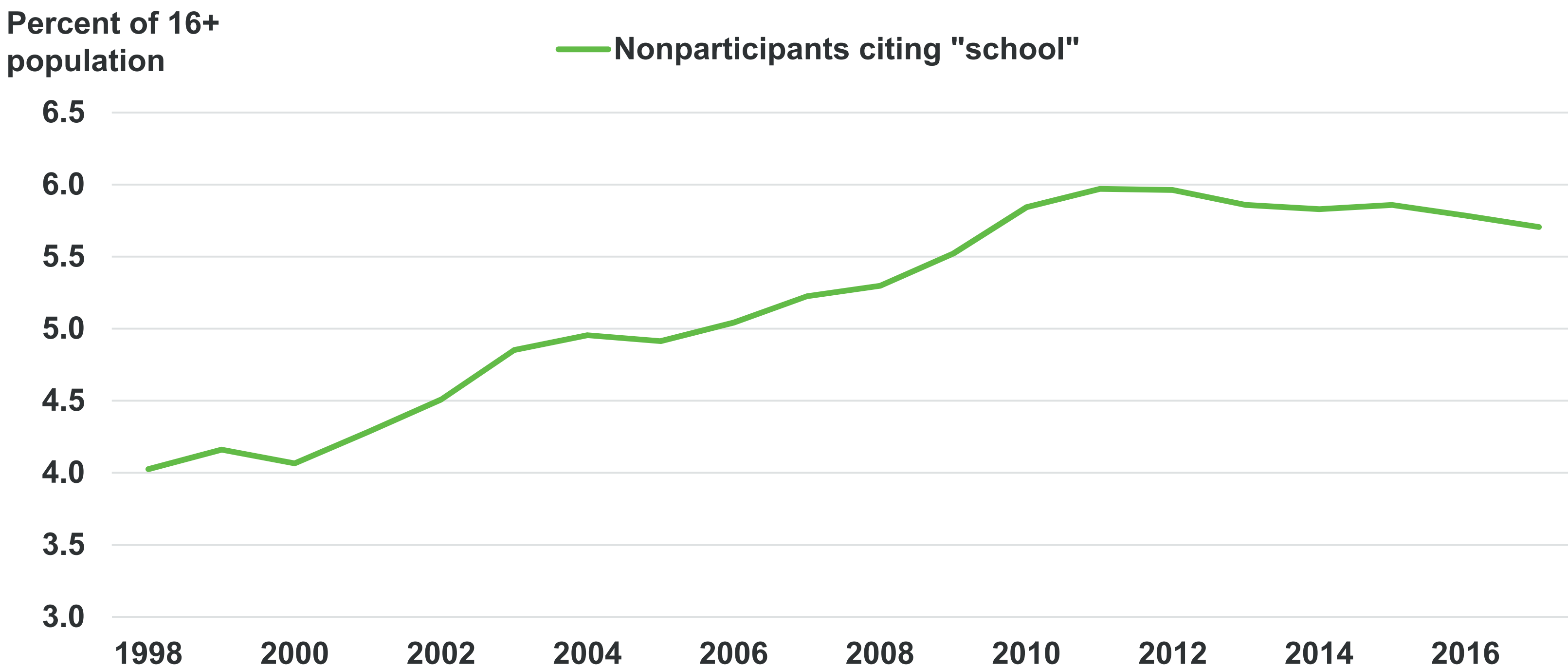
Sources: BLS, FRB Atlanta

In spite of rising LFPR for 55+, aging population means more nonparticipation due to retirement



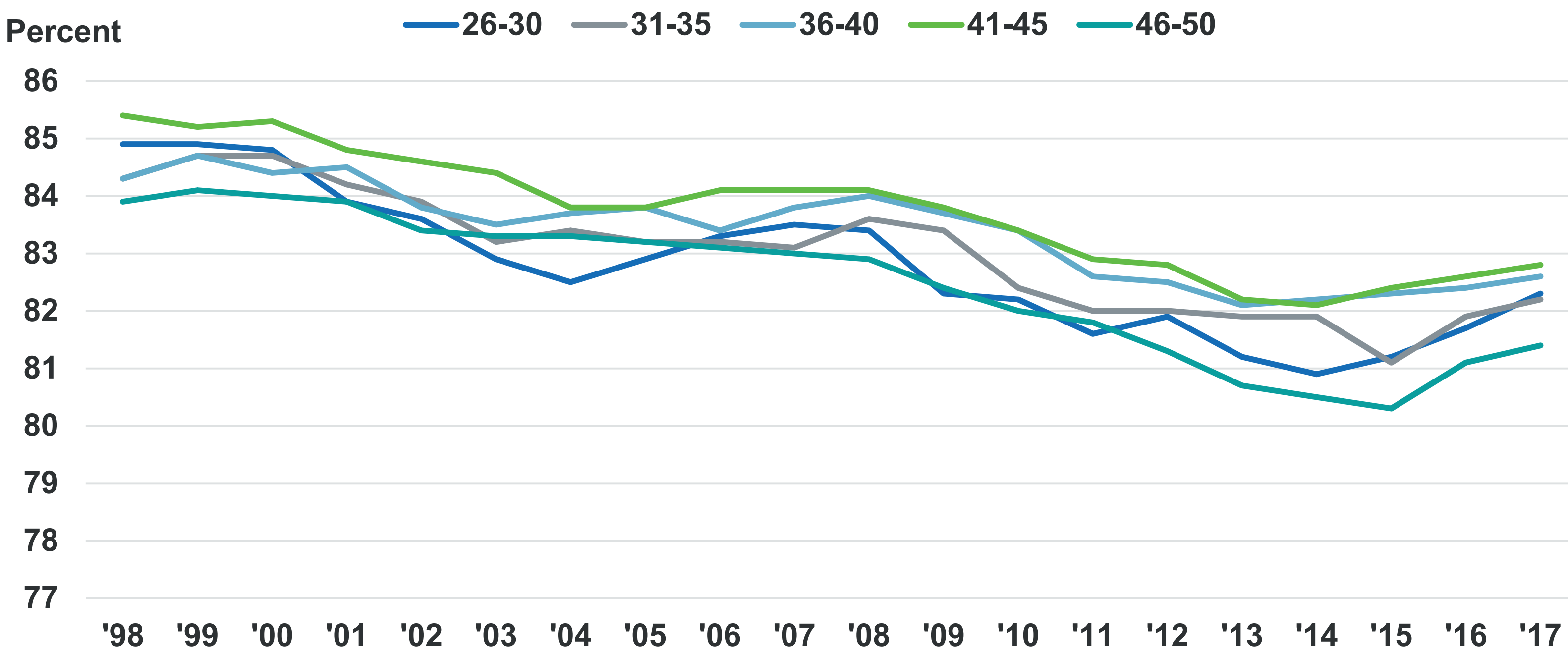
Sources: BLS, FRB Atlanta

Increasing nonparticipation by young reflects more school enrollment



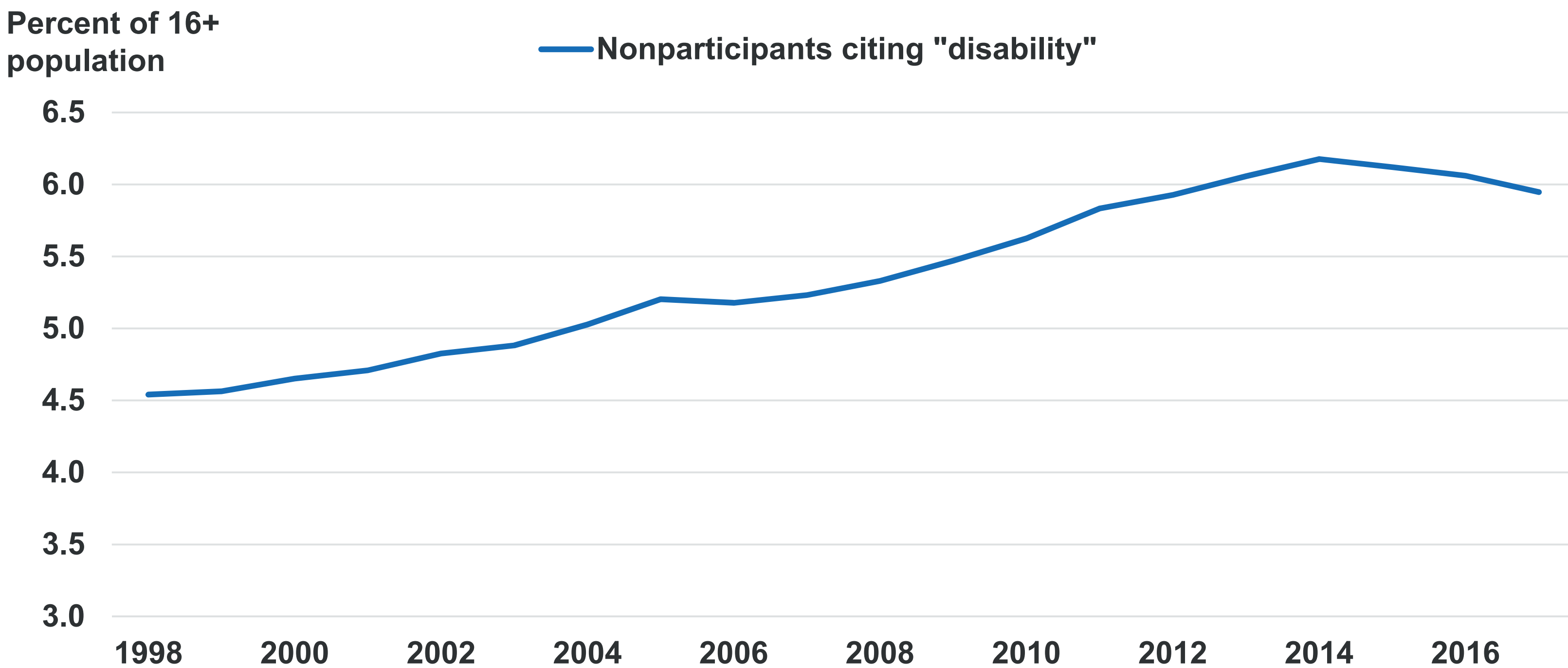
Sources: BLS, FRB Atlanta

Downward drift in prime age LFPRs



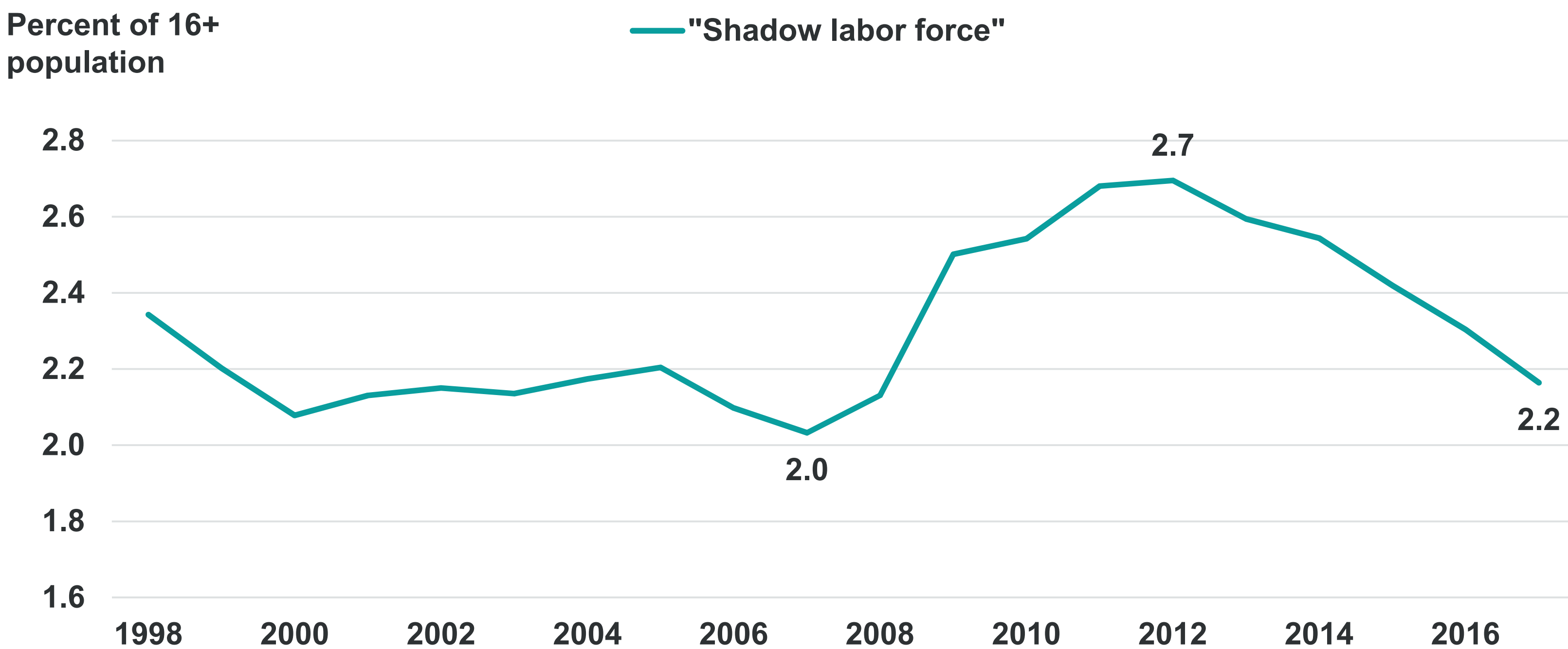
Sources: BLS, FRB Atlanta

Another growing reason for nonparticipation: disability



Sources: BLS, FRB Atlanta

A positive LFPR story: Nonparticipation due to discouragement almost back to pre-recession level



Sources: BLS, FRB Atlanta

Why do falling LFPRs matter?

- Lower LFPR means higher "dependency ratio"—i.e., more non-workers per worker.
- Output per person = (output per worker) x (workers per person)
- For given productivity, lower LFPR reduces output per person → lower standard of living.

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Economic Letter

Declining U.S. Labor Force Participation Rates Stand Out

by Alexander W. Richter, Daniel Chapman and Emil Mihaylov

ABSTRACT: Male and female prime-age labor force participation rates

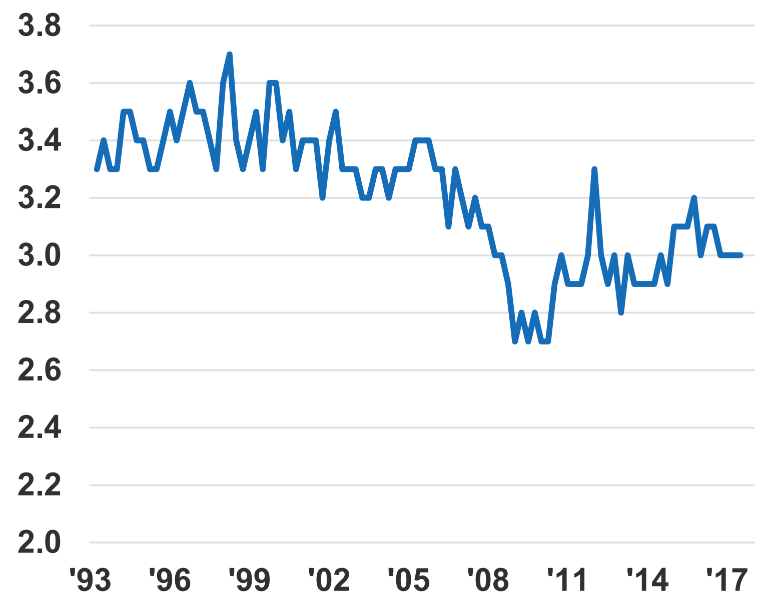
The U.S. labor force participation rate has declined over the past several decades, particularly since the Great Recession. The rate is defined as

factors include less-generous mater and child-care policies, higher incarc tion rates, poorer health outcomes less spending on on-the-job retraining

One last point on labor market: Declining dynamism

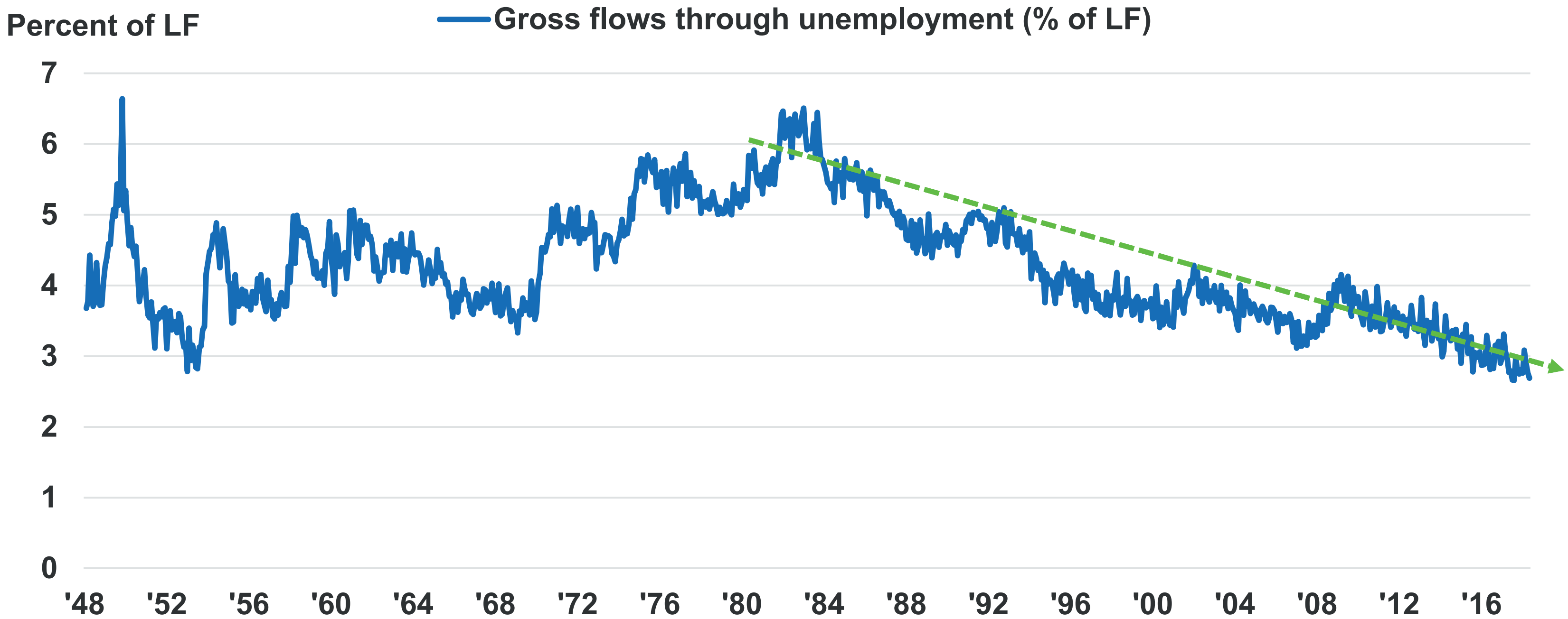
- Declining "dynamism" in US economy
- Lot of effort by economists to understand causes
- Usually thought of as less firm formation & entrepreneurship
- But also a labor market dimension: less turnover

Rate of establishment formation



Source: BLS, Business Employment Dynamics survey

Long run trend toward less "churning" in the labor market



Sources: BLS, author's calculations; series corrected for 1994 CPS redesign