



The Outlook for the U.S. Economy

Finding Shelter: Assessing Texas Residential Real Estate

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Driving Forces

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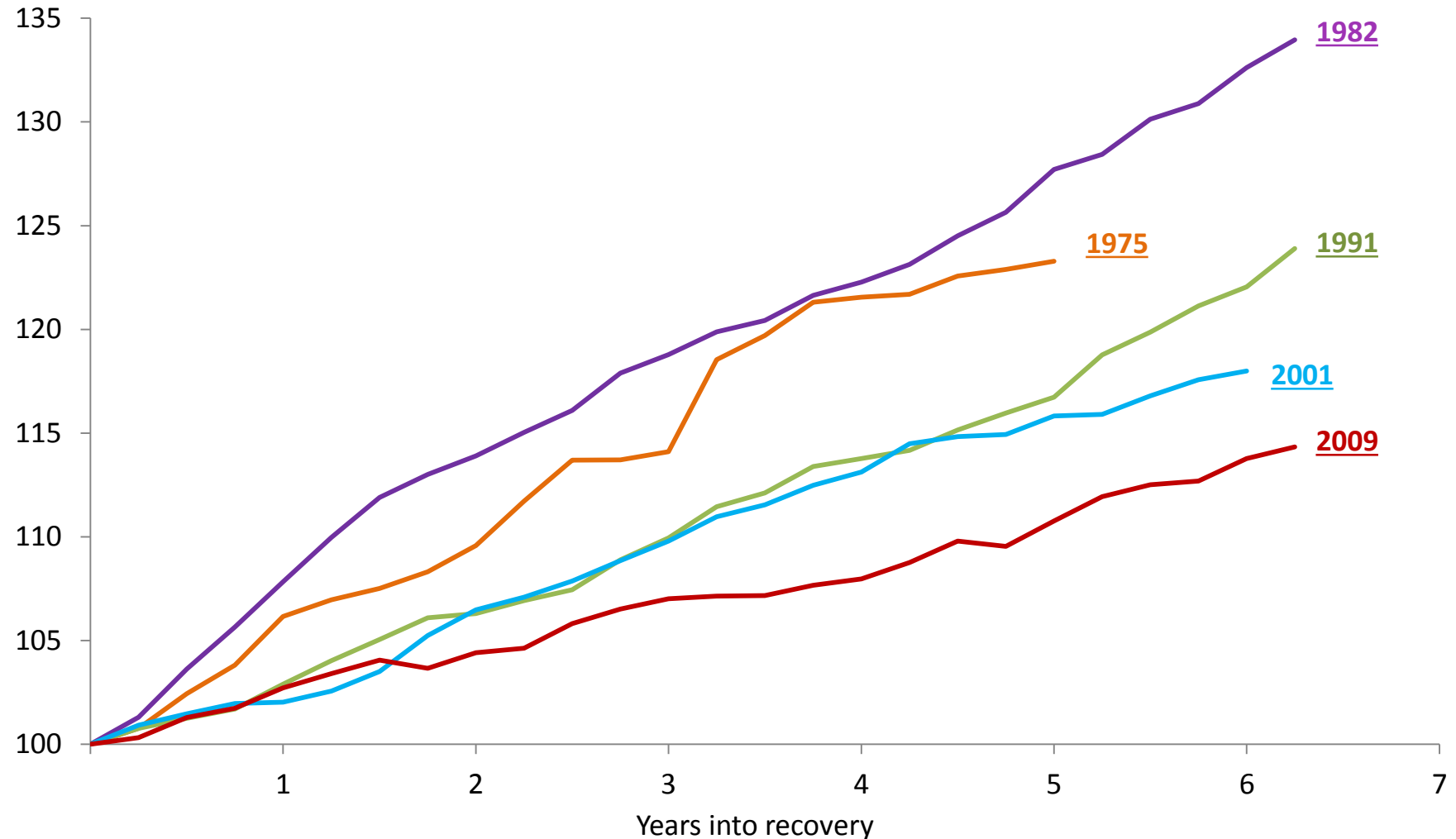
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- Accommodative monetary policy and reduced fiscal drag

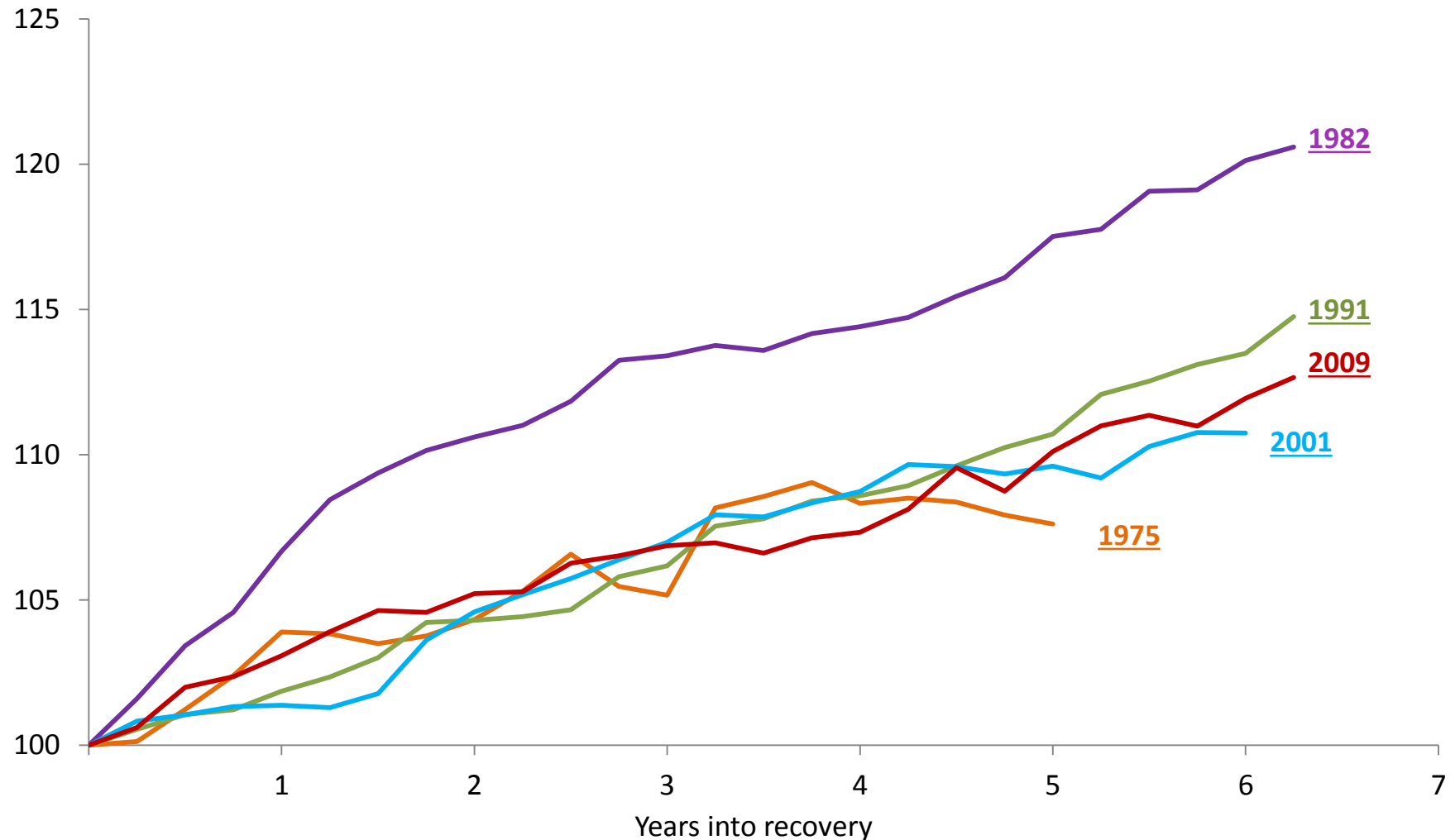
Demographics: Judging by the path of real GDP, the current expansion has been unusually weak

Index, business cycle
trough = 100



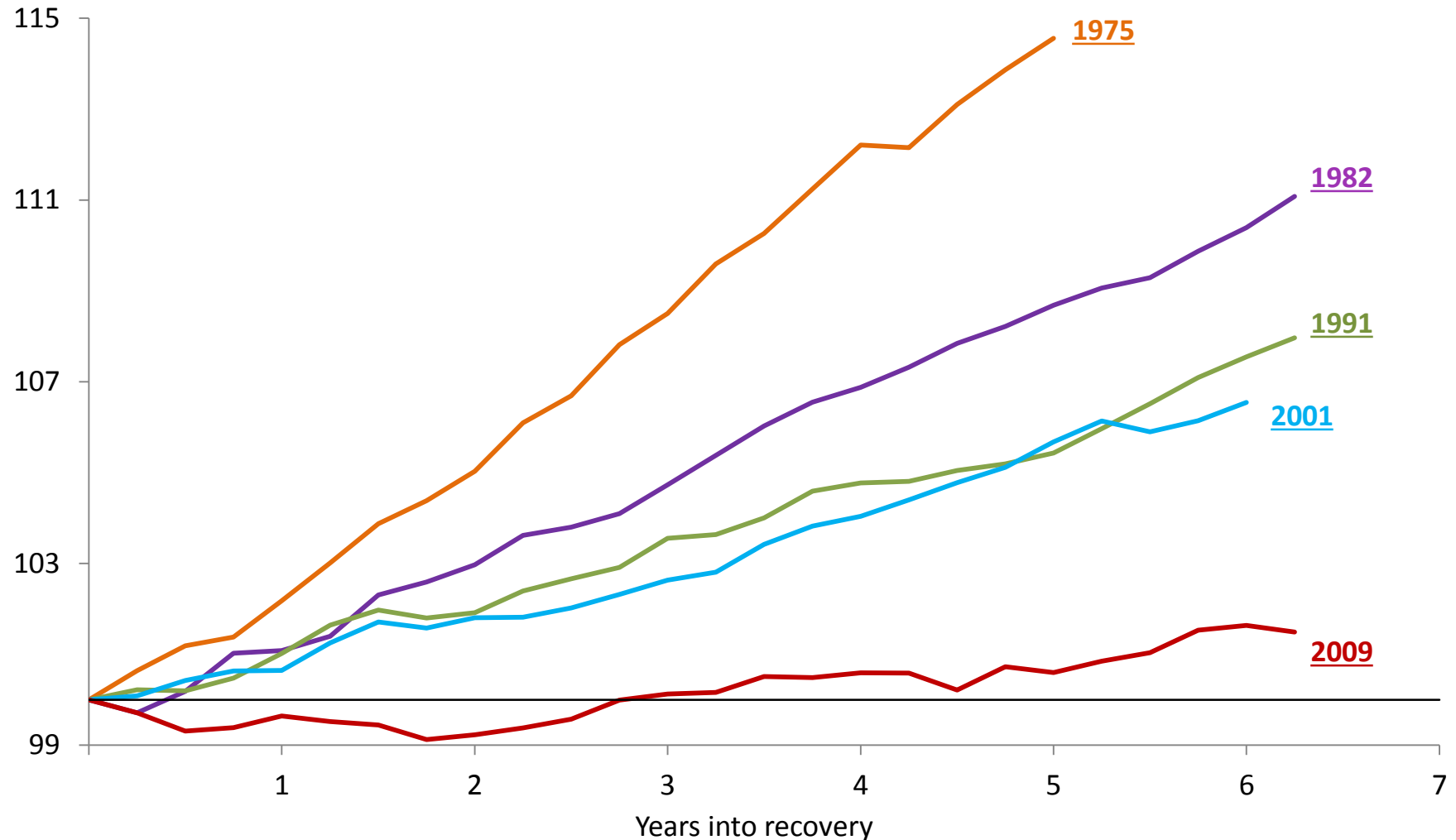
But divide real GDP by the size of the labor force, and this expansion looks ordinary

Index, business cycle
trough = 100

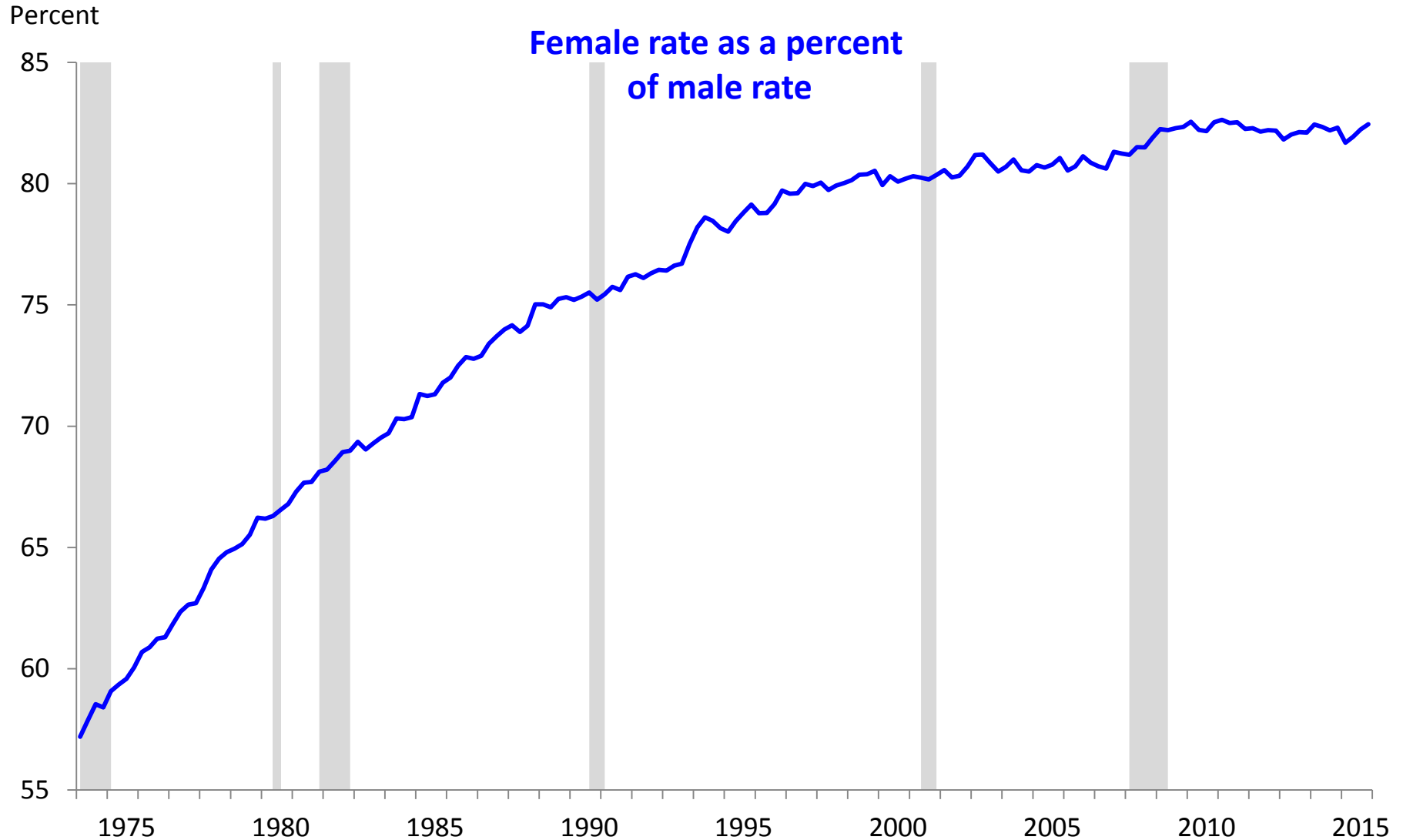


The explanation: Labor-force growth has been exceptionally slow

Index, business cycle
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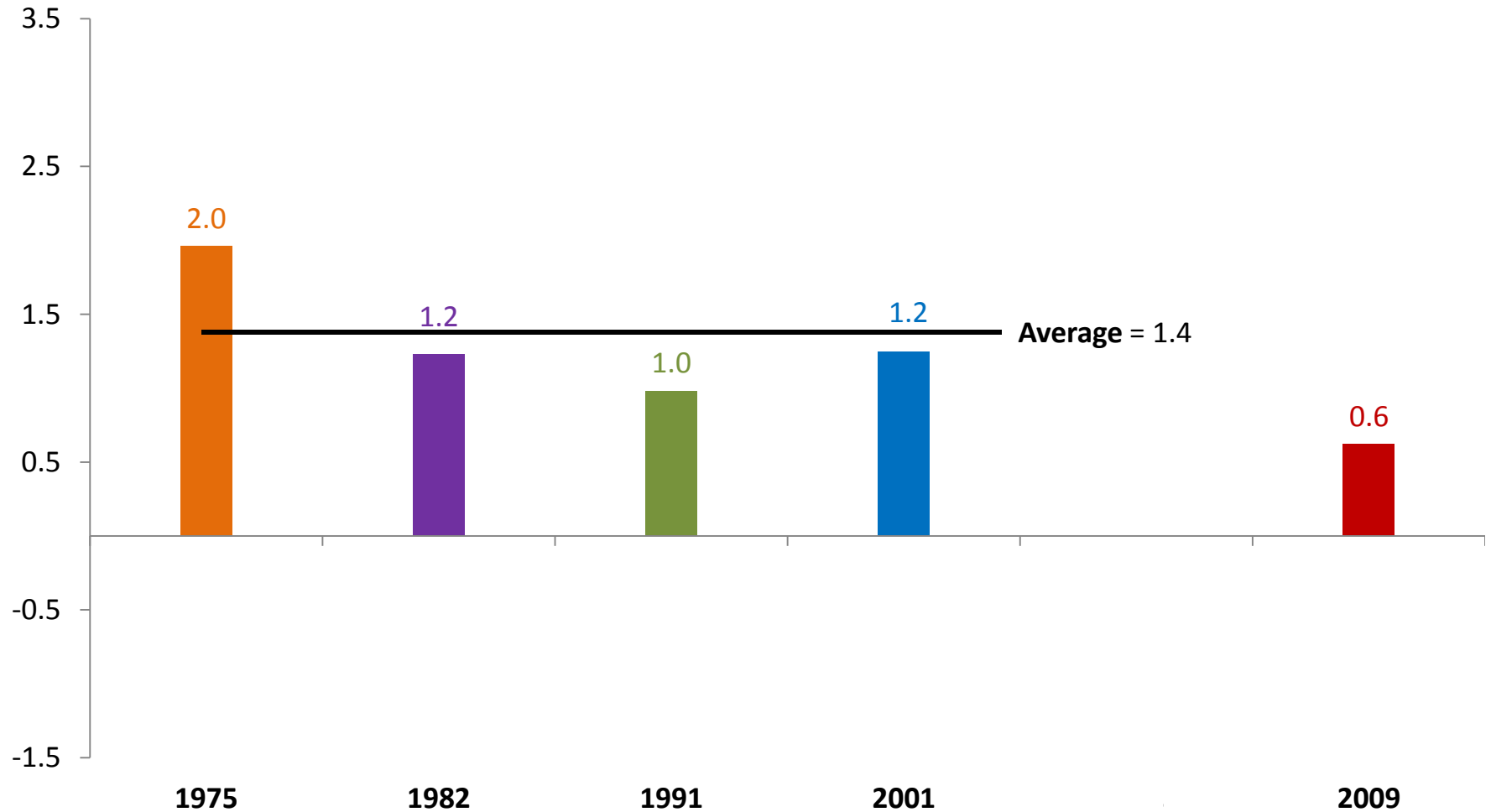
Labor-force growth has been slow partly because the female participation rate has leveled off



Also, the 20-64 age group has been expanding at less than half the pace seen in prior expansions

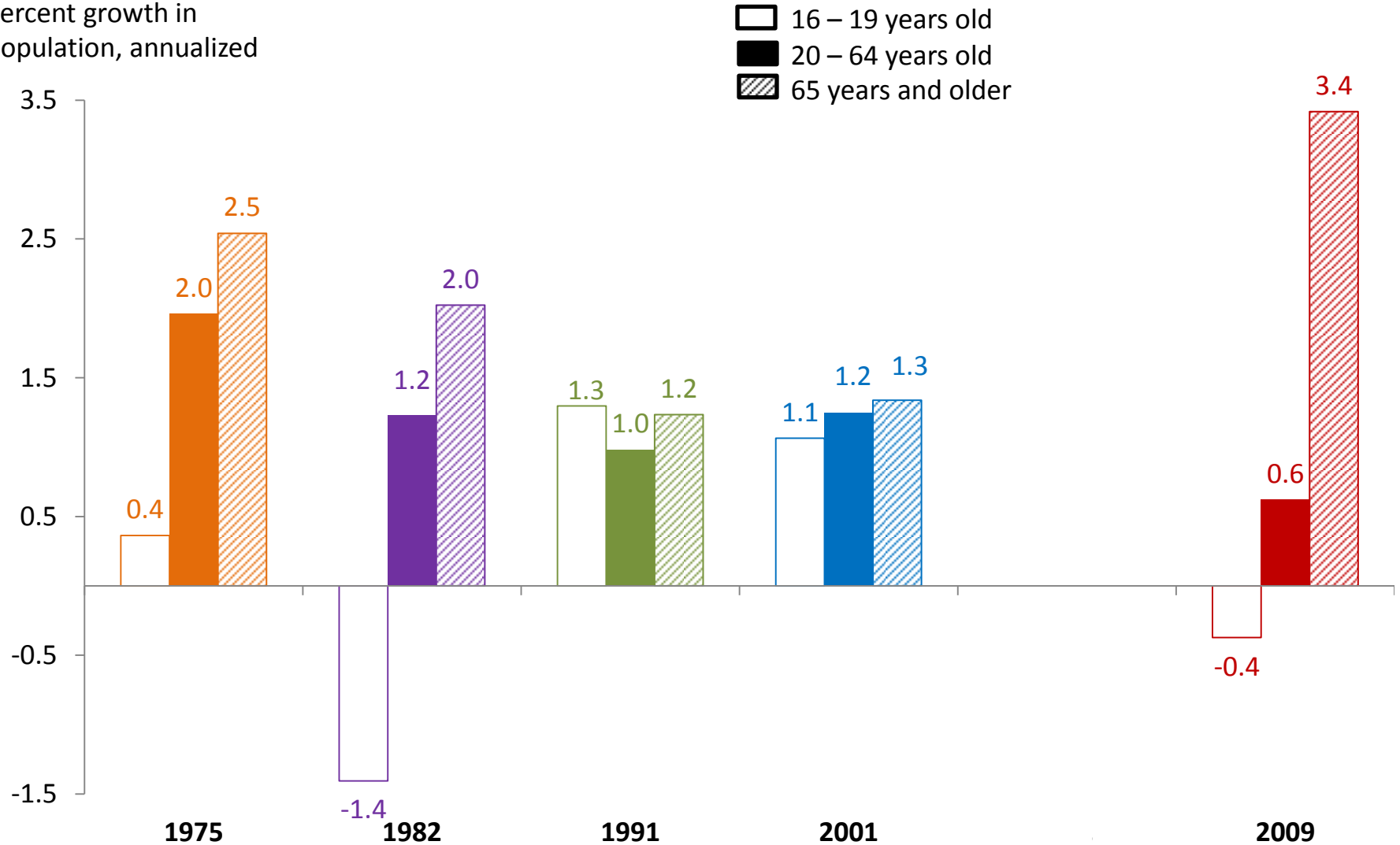
Percent growth in population, annualized

20 – 64 years old



Meanwhile, the ranks of seniors are exploding, and the population of teenagers is shrinking

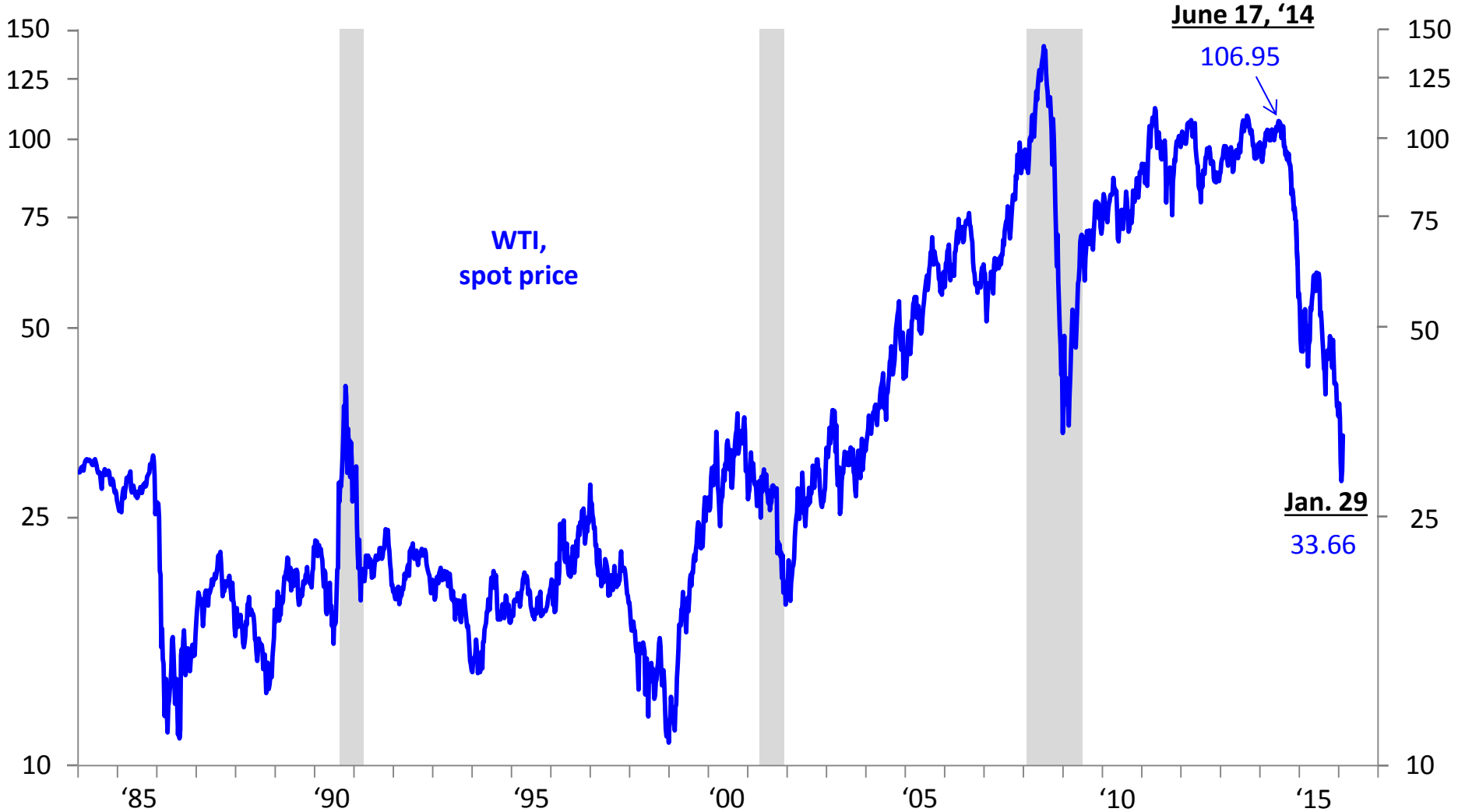
Percent growth in population, annualized



Oil: Oil's price has fallen steeply since June 2014, to its lowest levels since 2003

Dollars/Barrel

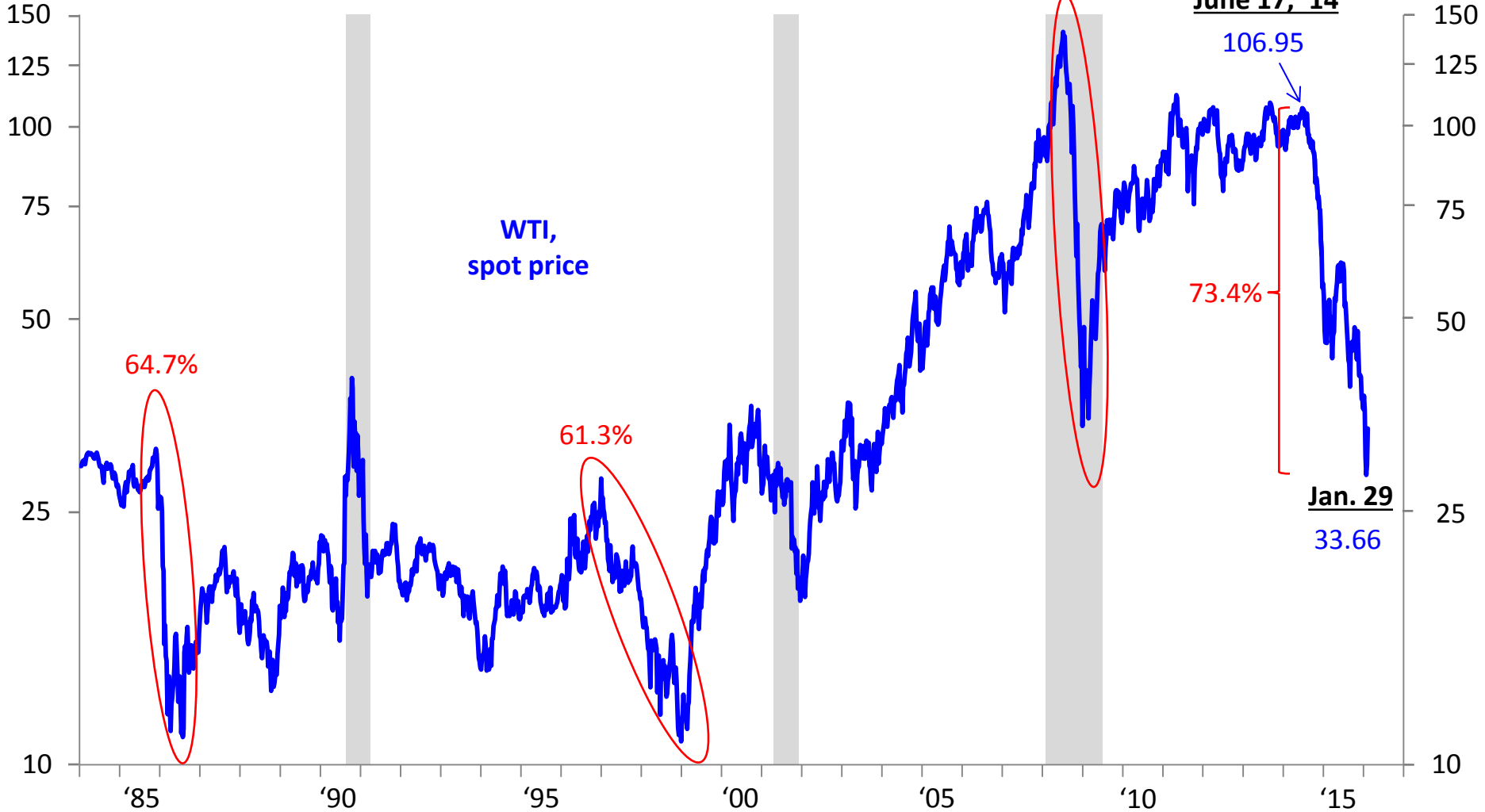
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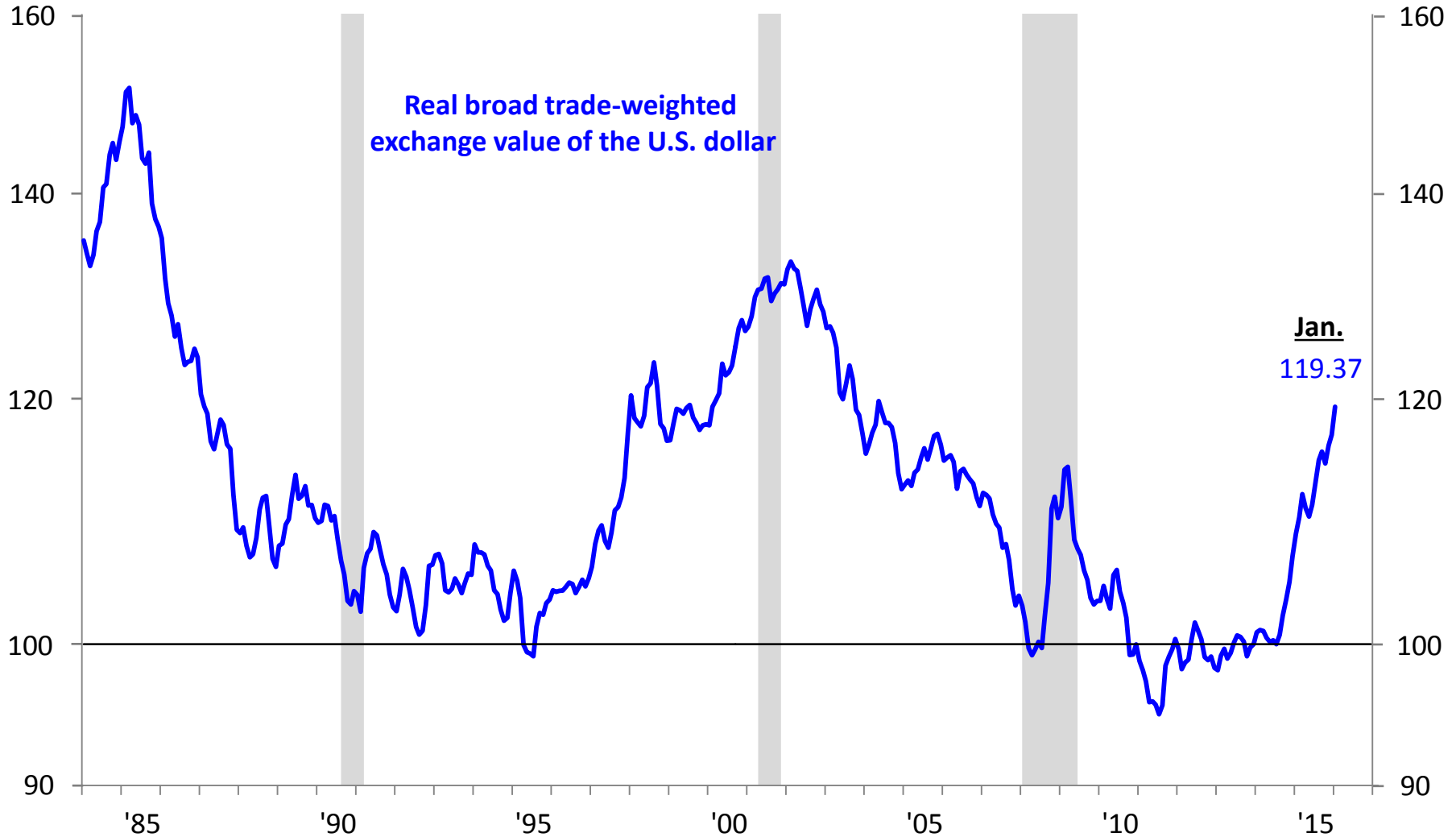
Dollars/Barrel



The Dollar: Cumulative increase in the real value of the dollar since July 2014 now exceeds 19%

Index,
July 2014 = 100

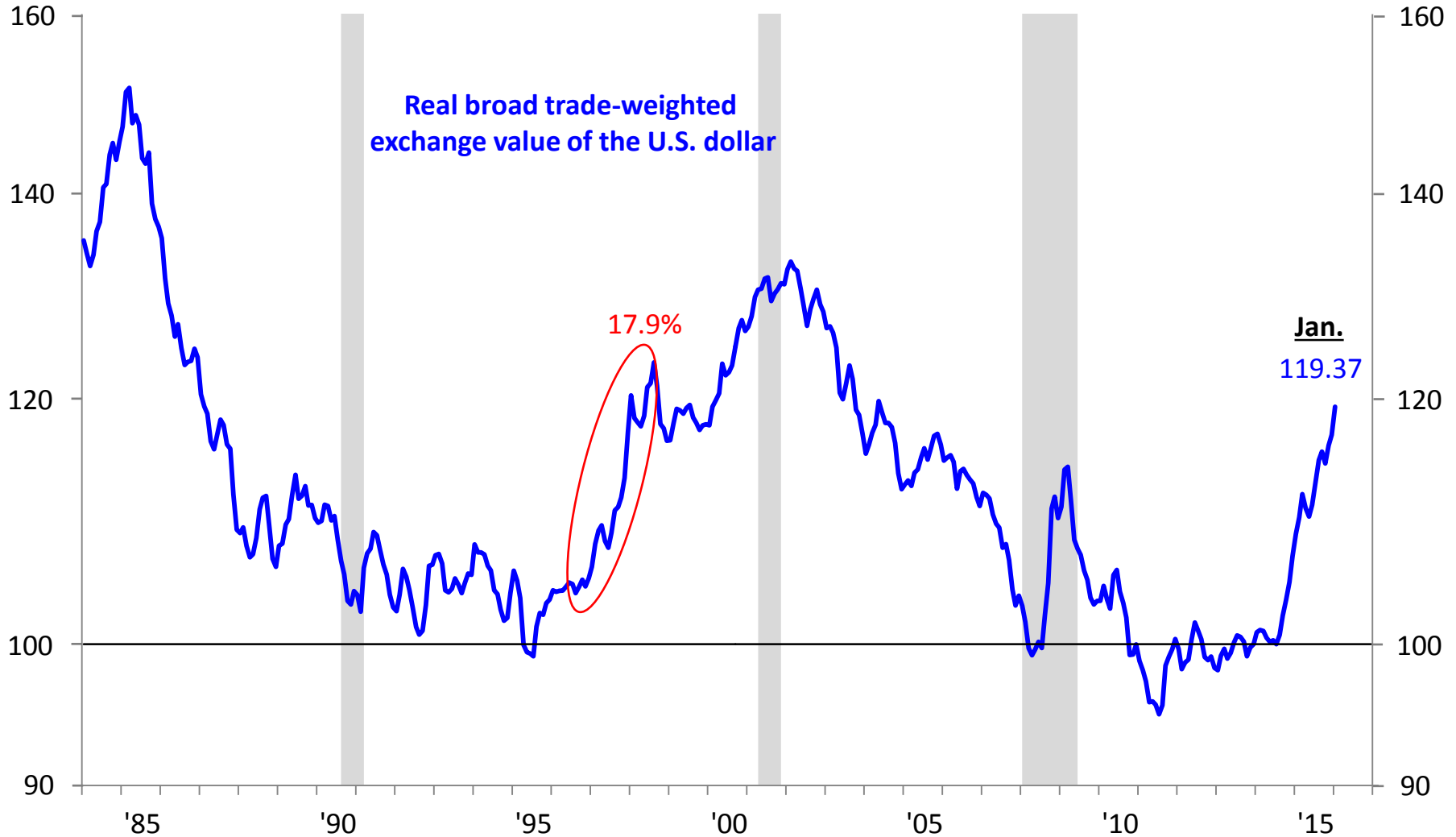
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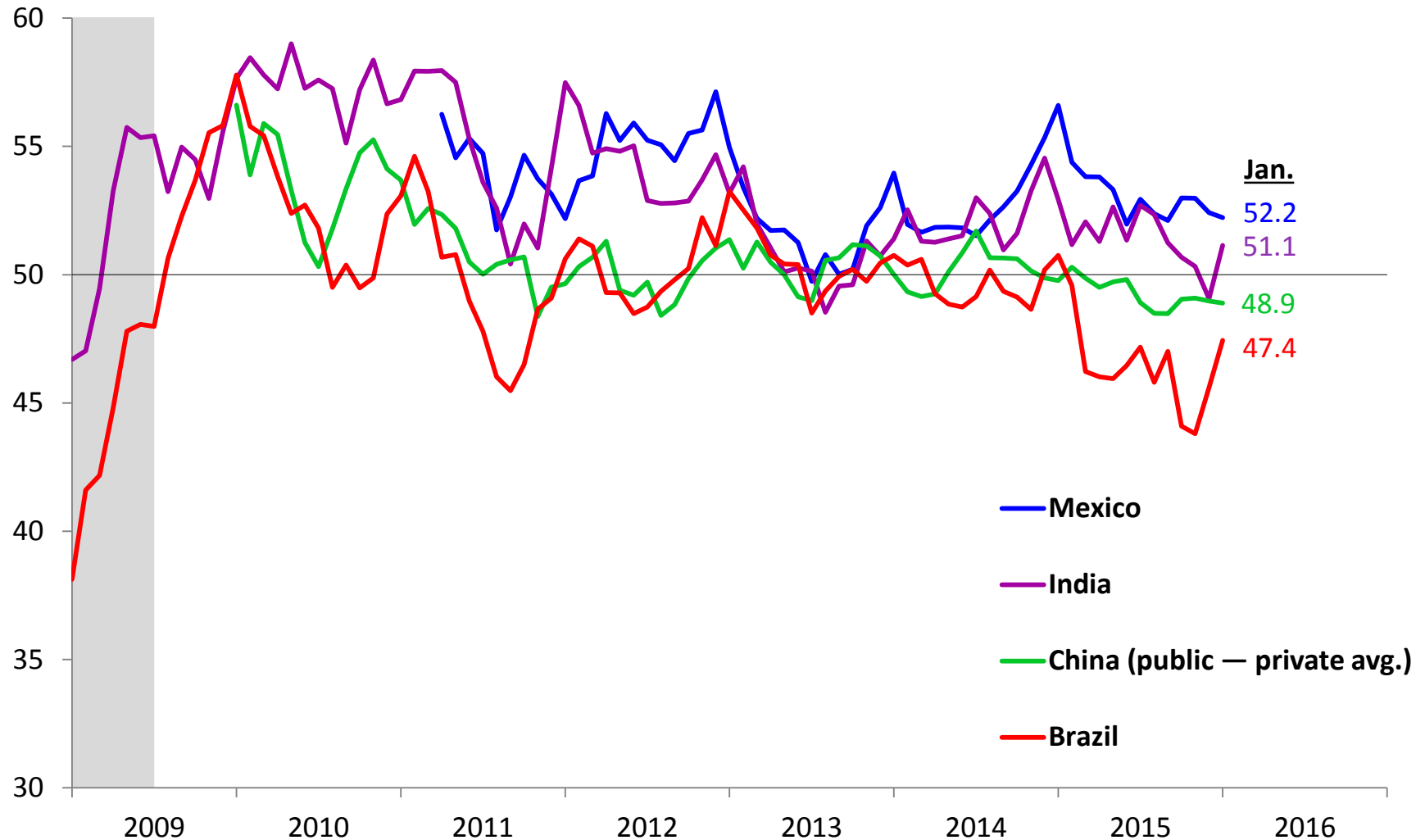
Index,
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One reason for a stronger dollar: Emerging-market growth prospects dimmed during 2015

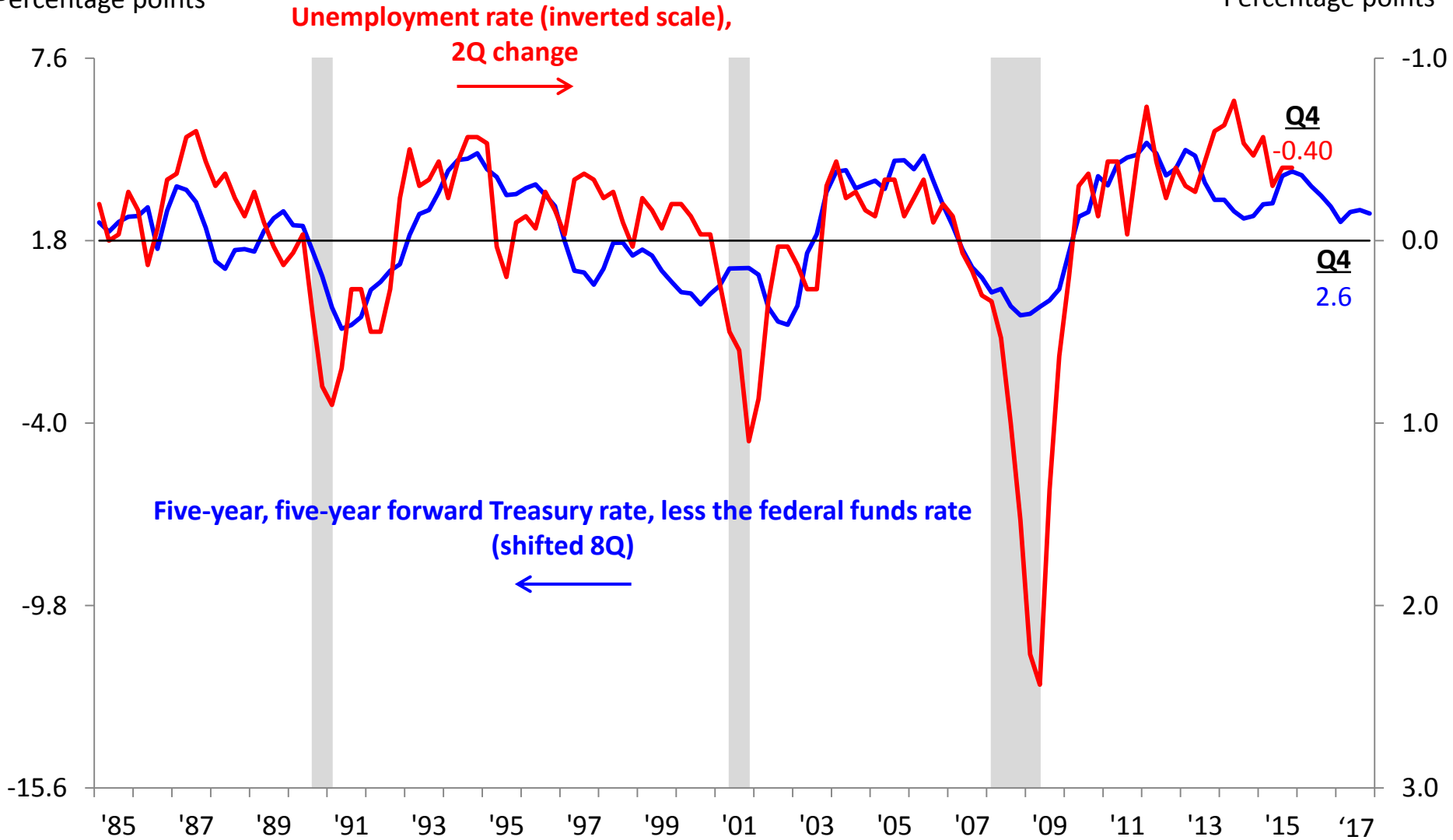
Purchasing Managers' Index,
50+ = expansion



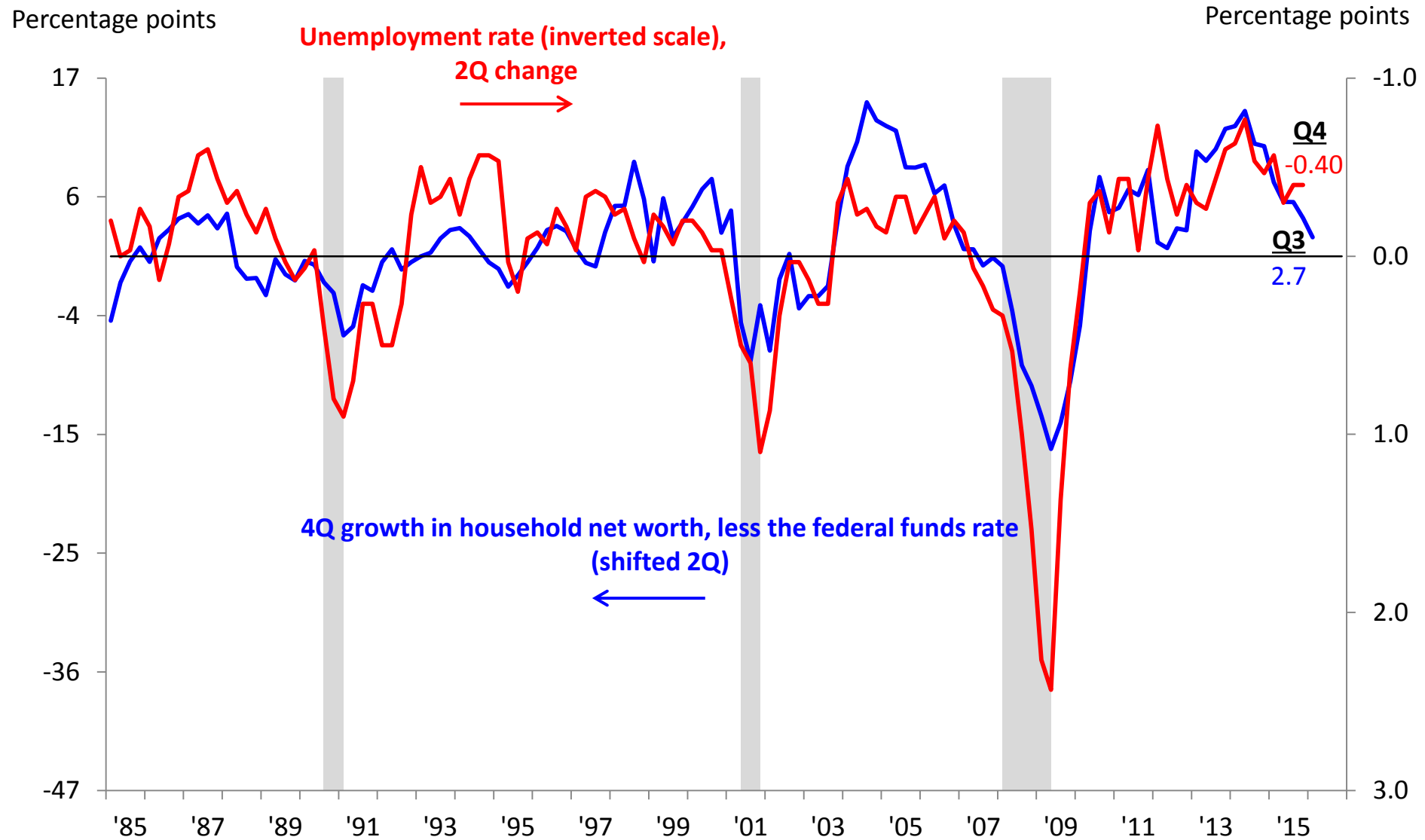
Monetary Policy: Remains accommodative, whether as measured by the yield curve's slope...

Percentage points

Percentage points



...or by the low level of short-term interest rates relative to the rate of household wealth growth

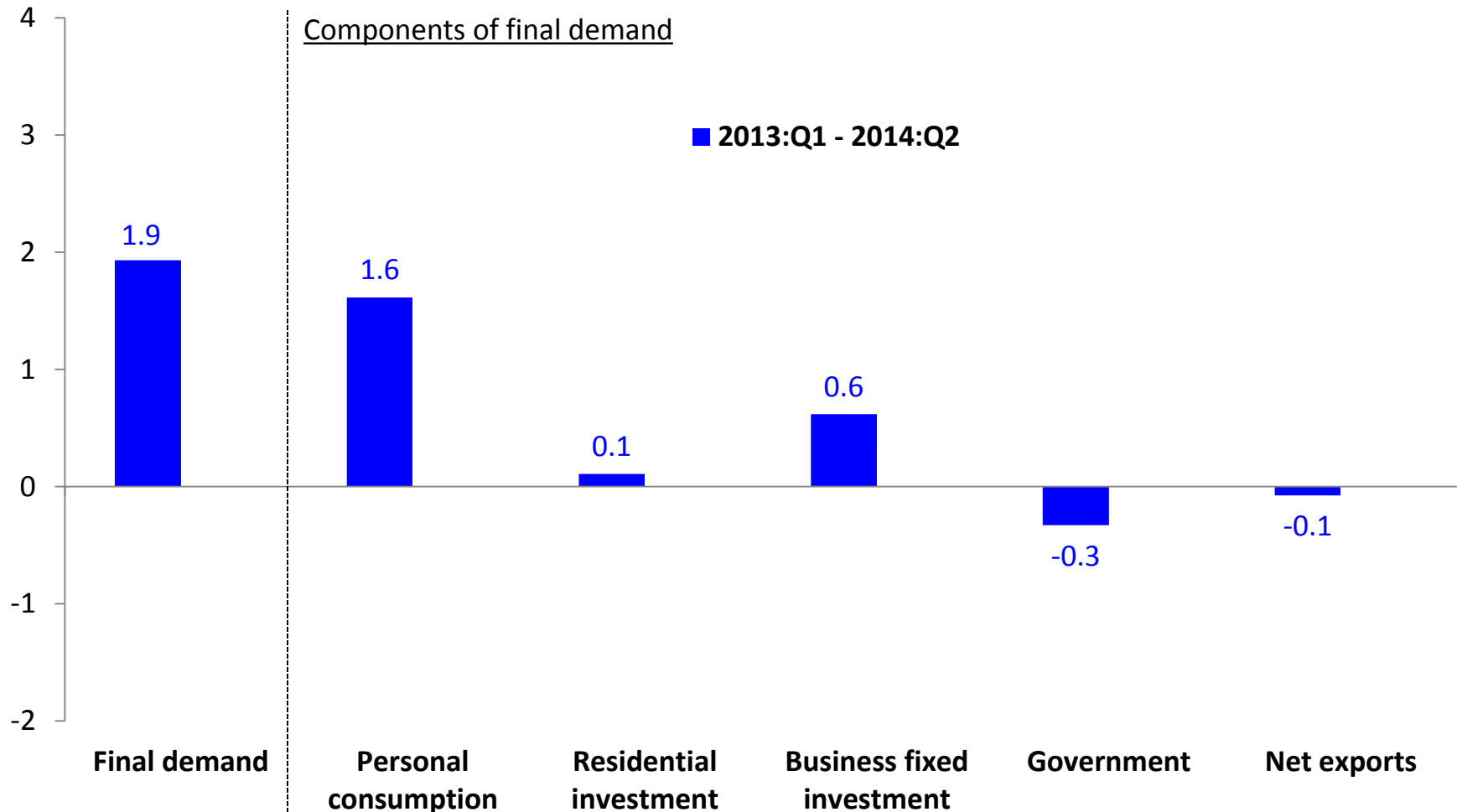




The Fallout

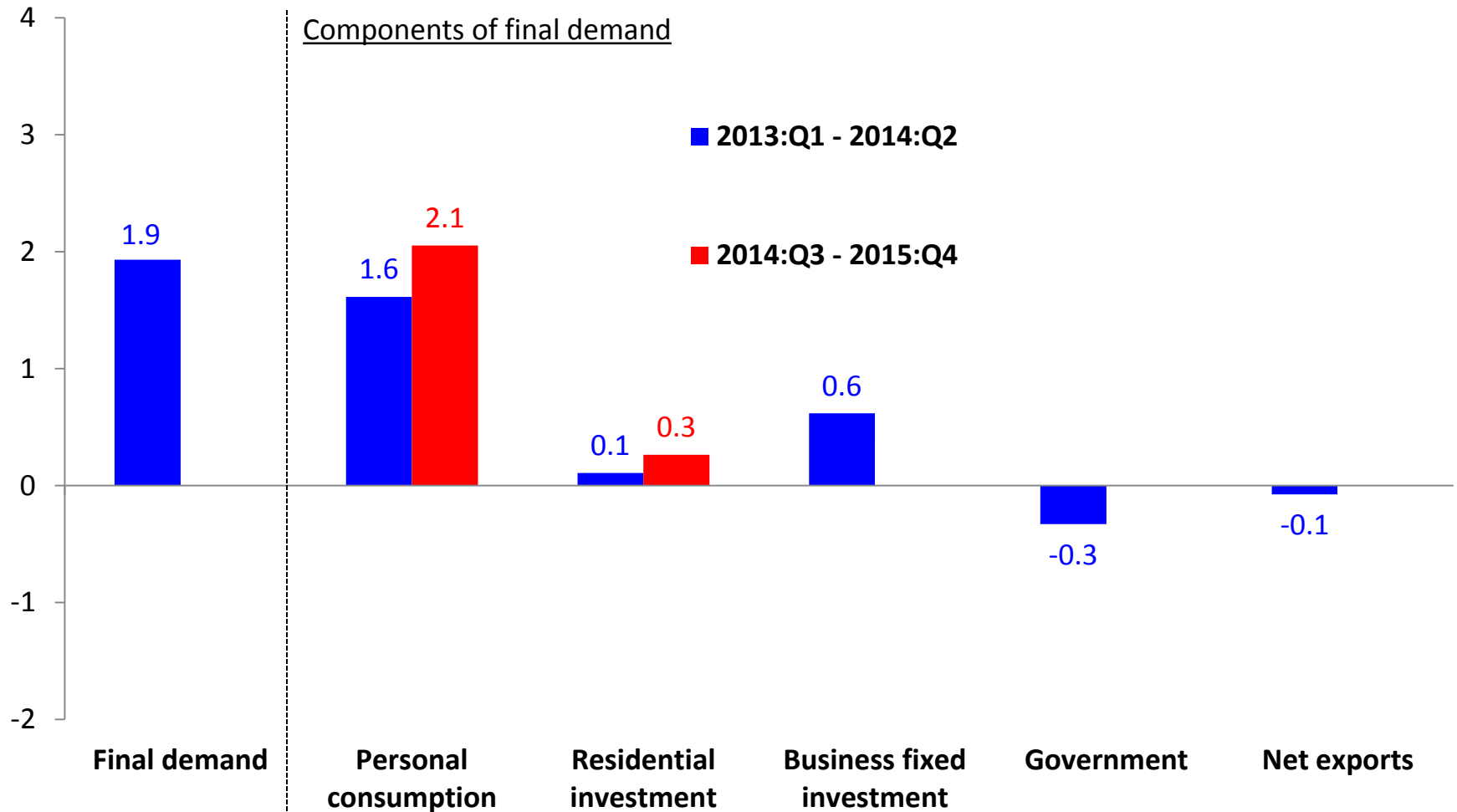
The oil-price drop and soaring dollar have had the expected impact on demand and its composition

Contribution to real growth,
percentage points, SAAR



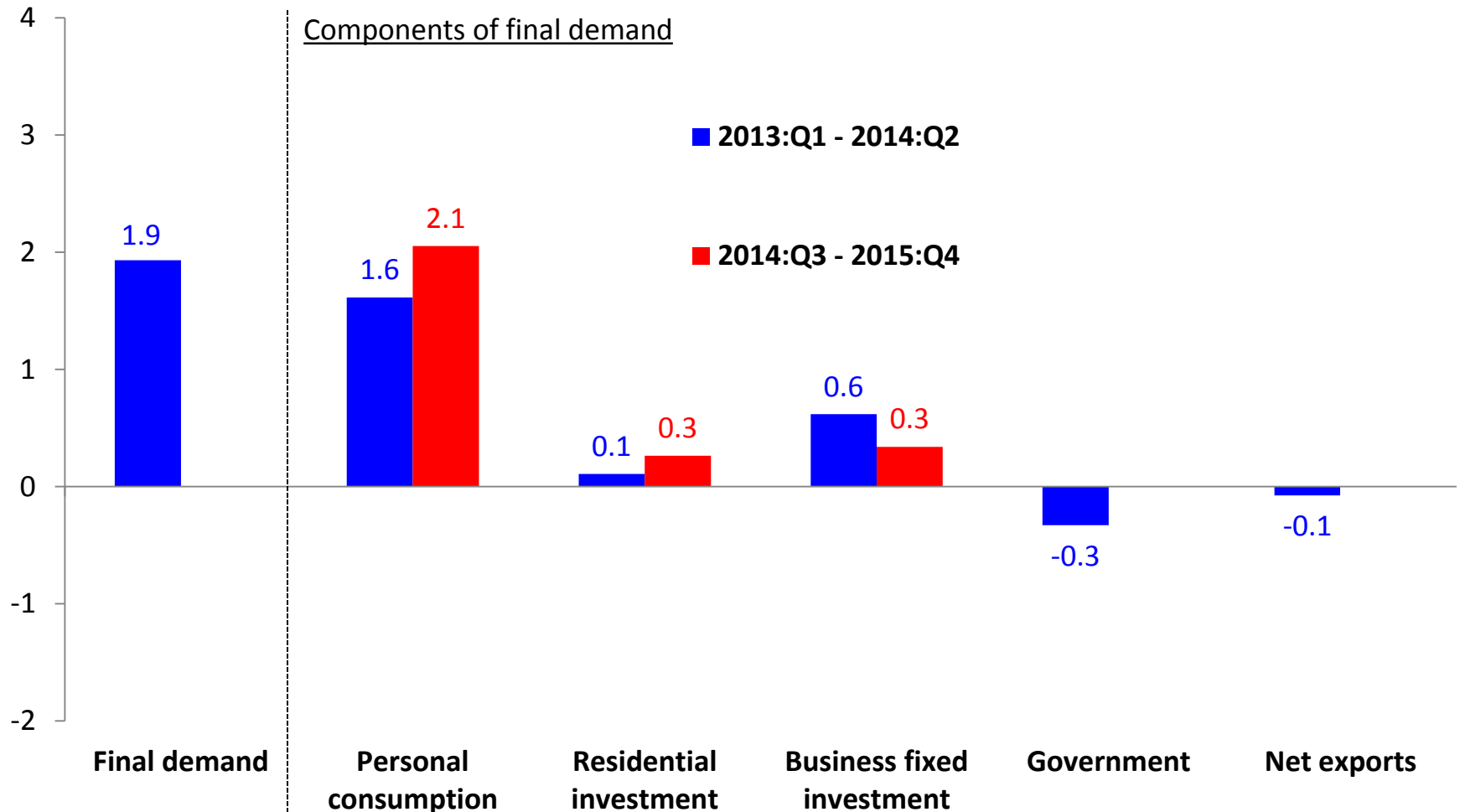
Households have benefited: their spending has accelerated

Contribution to real growth,
percentage points, SAAR



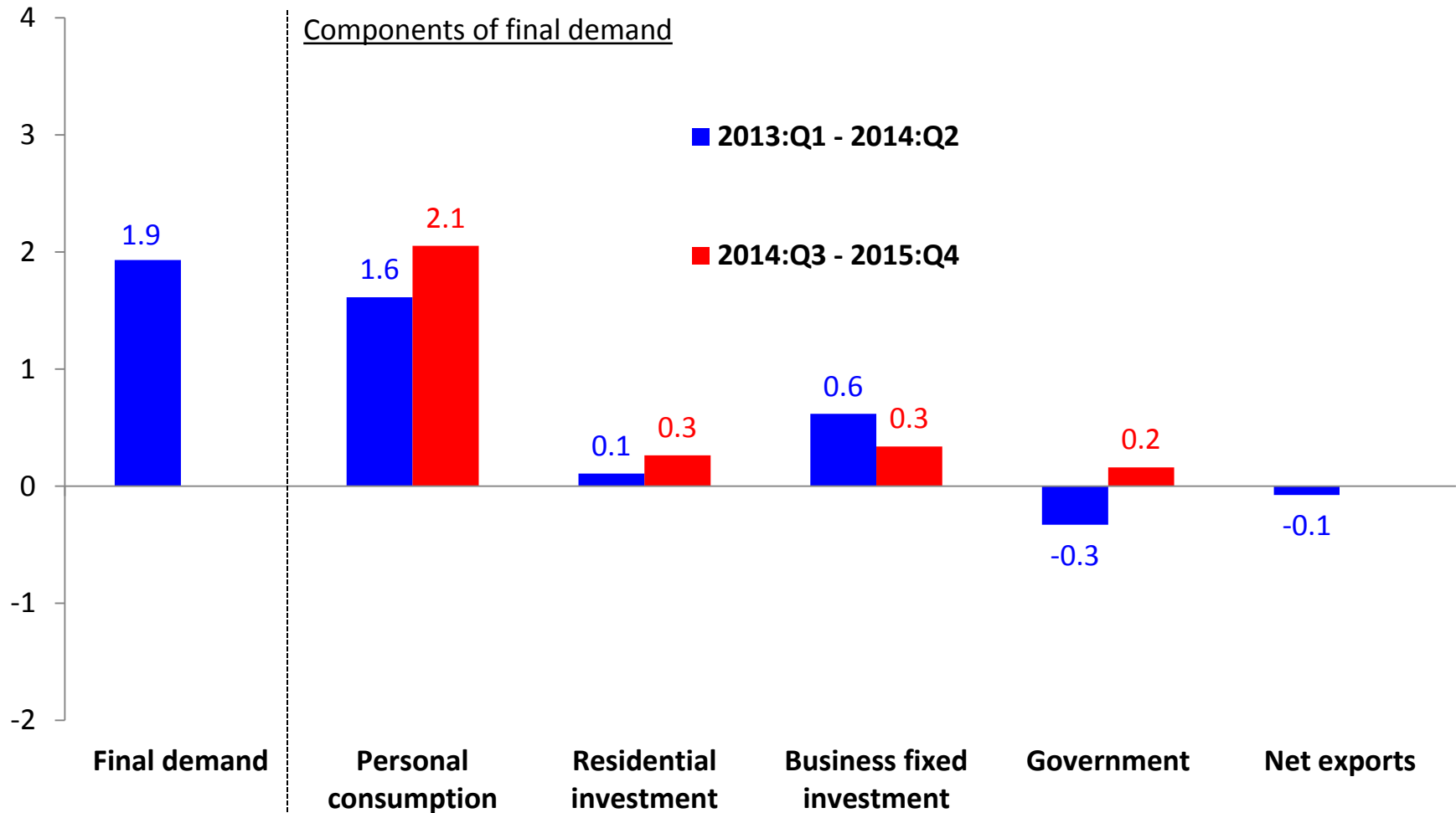
But capex plans have been scaled back in mining & manufacturing: BFI has decelerated

Contribution to real growth,
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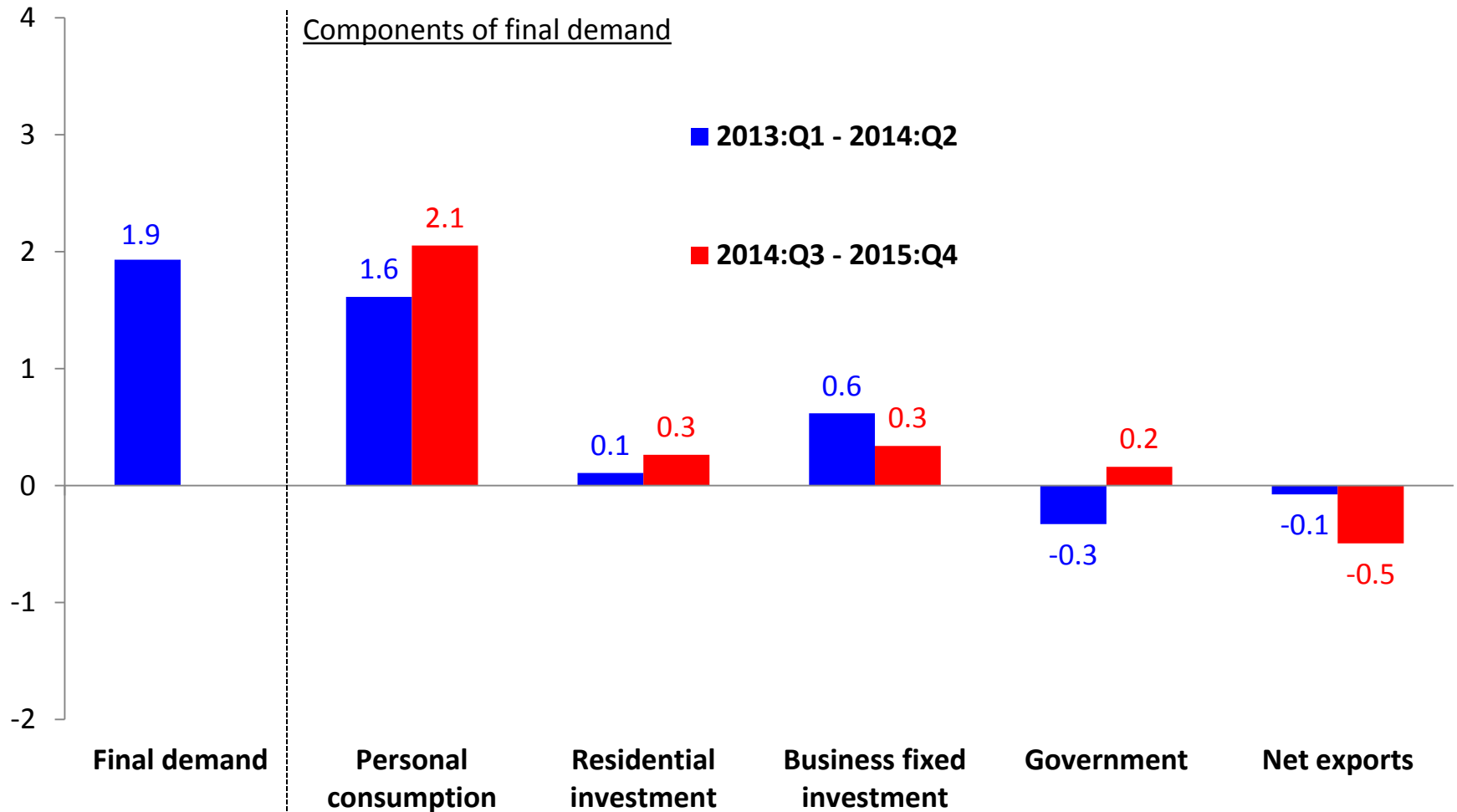
Government purchases are now a small plus for growth, rather than a small minus

Contribution to real growth,
percentage points, SAAR



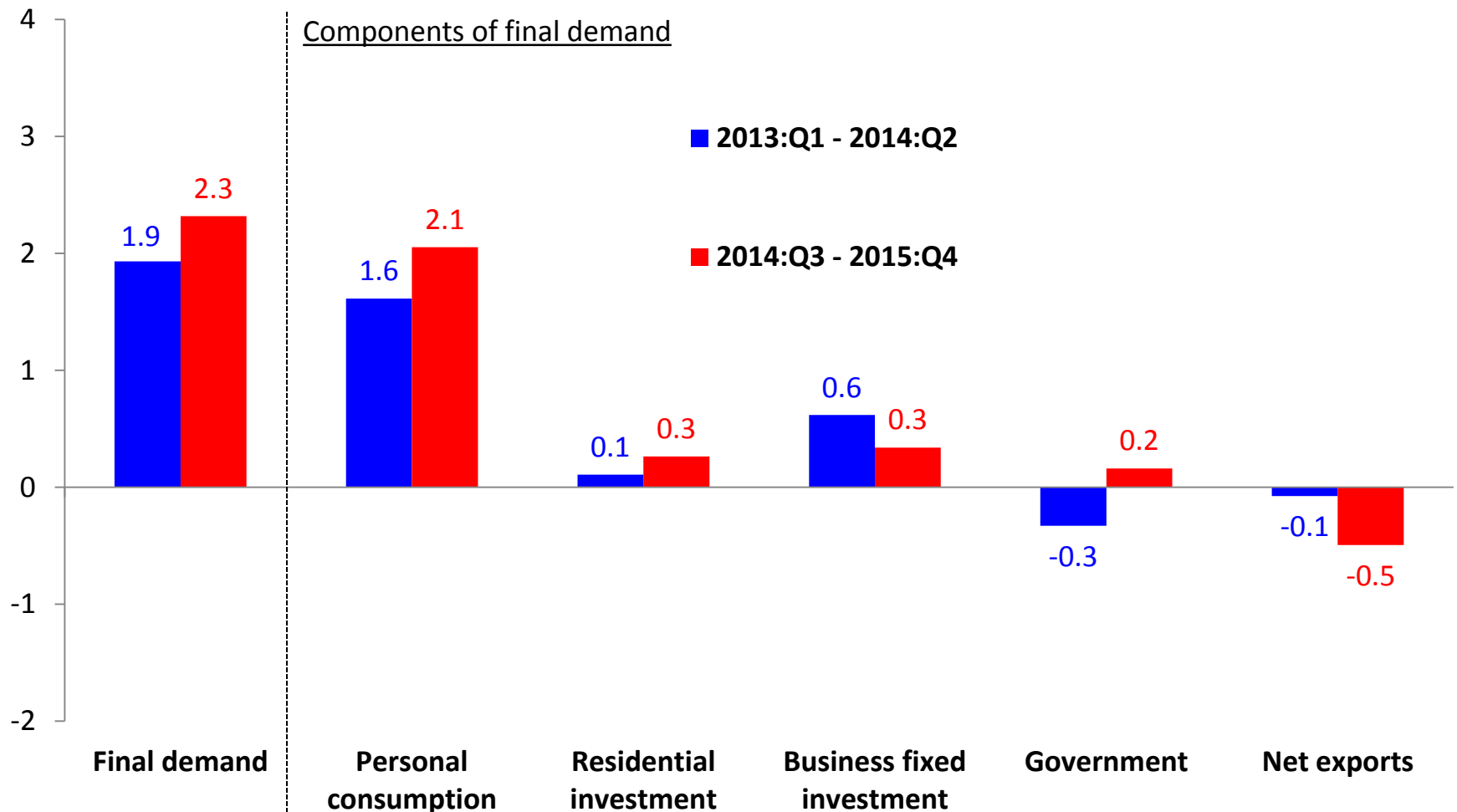
The strong dollar has encouraged substitution of foreign-made goods for U.S.-made goods

Contribution to real growth,
percentage points, SAAR



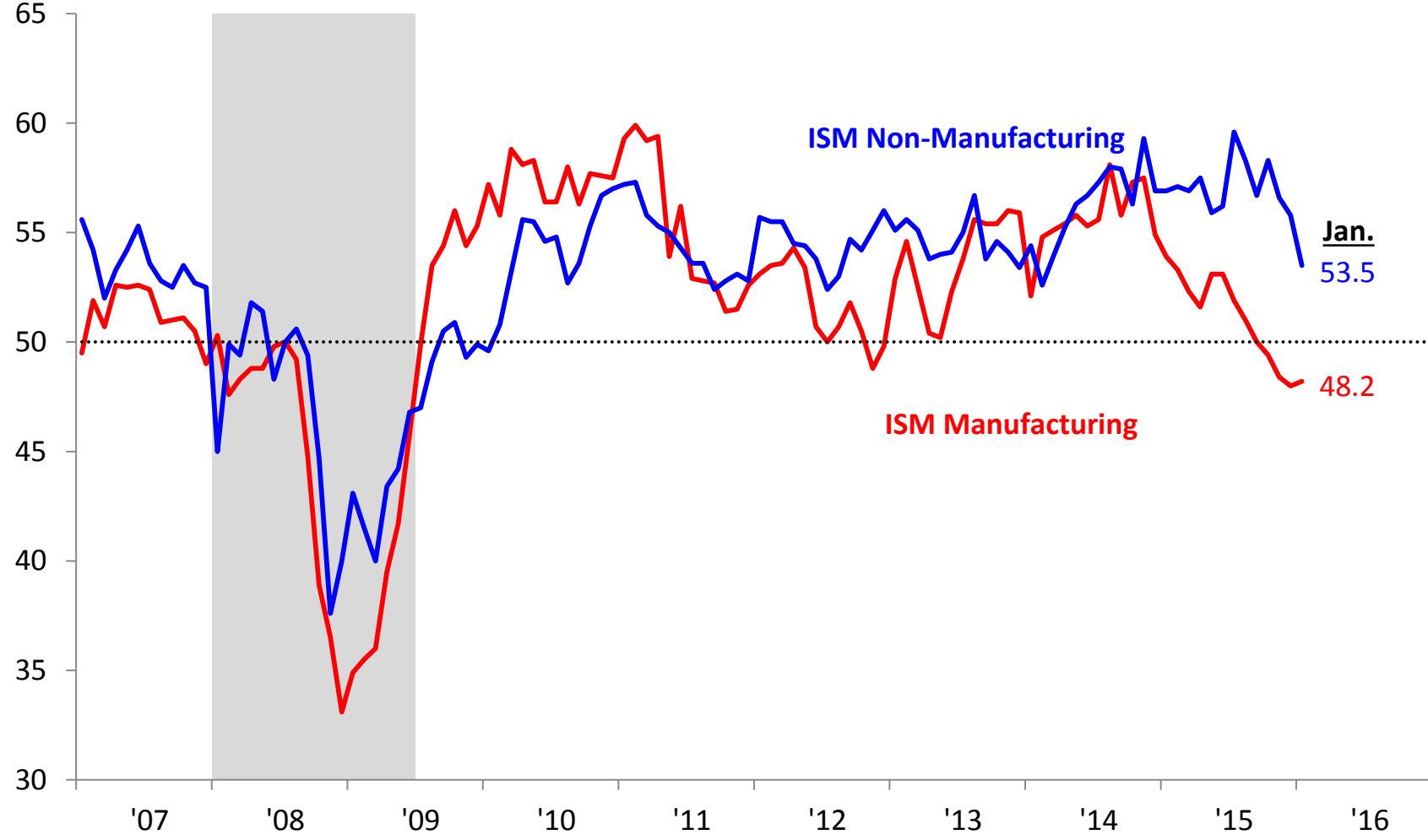
The net effect of the conflicting forces has been to boost final demand for domestic product

Contribution to real growth,
percentage points, SAAR



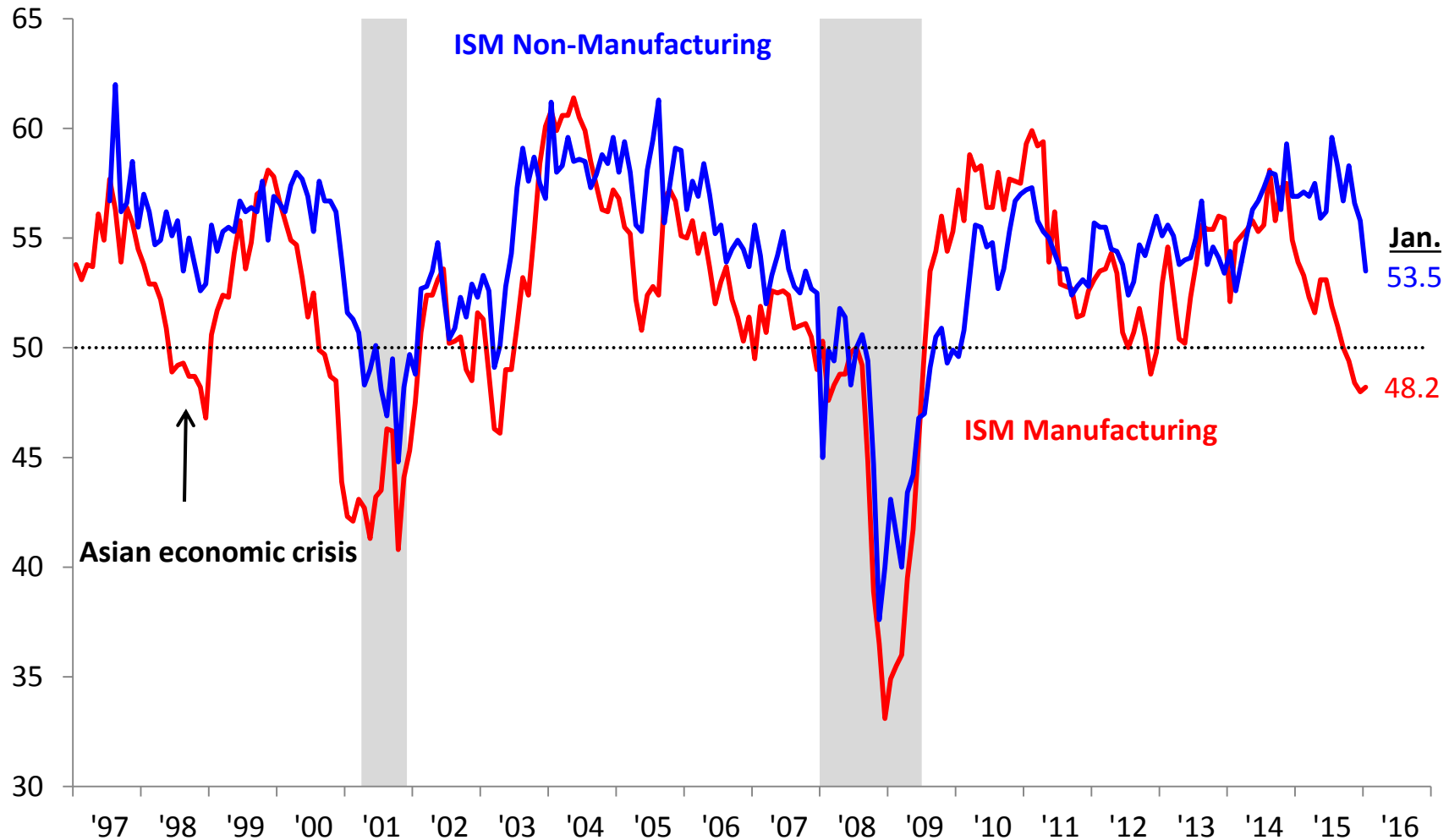
The latest data show service-sector growth continuing as manufacturing sector stagnates

Index,
50+ = expansion

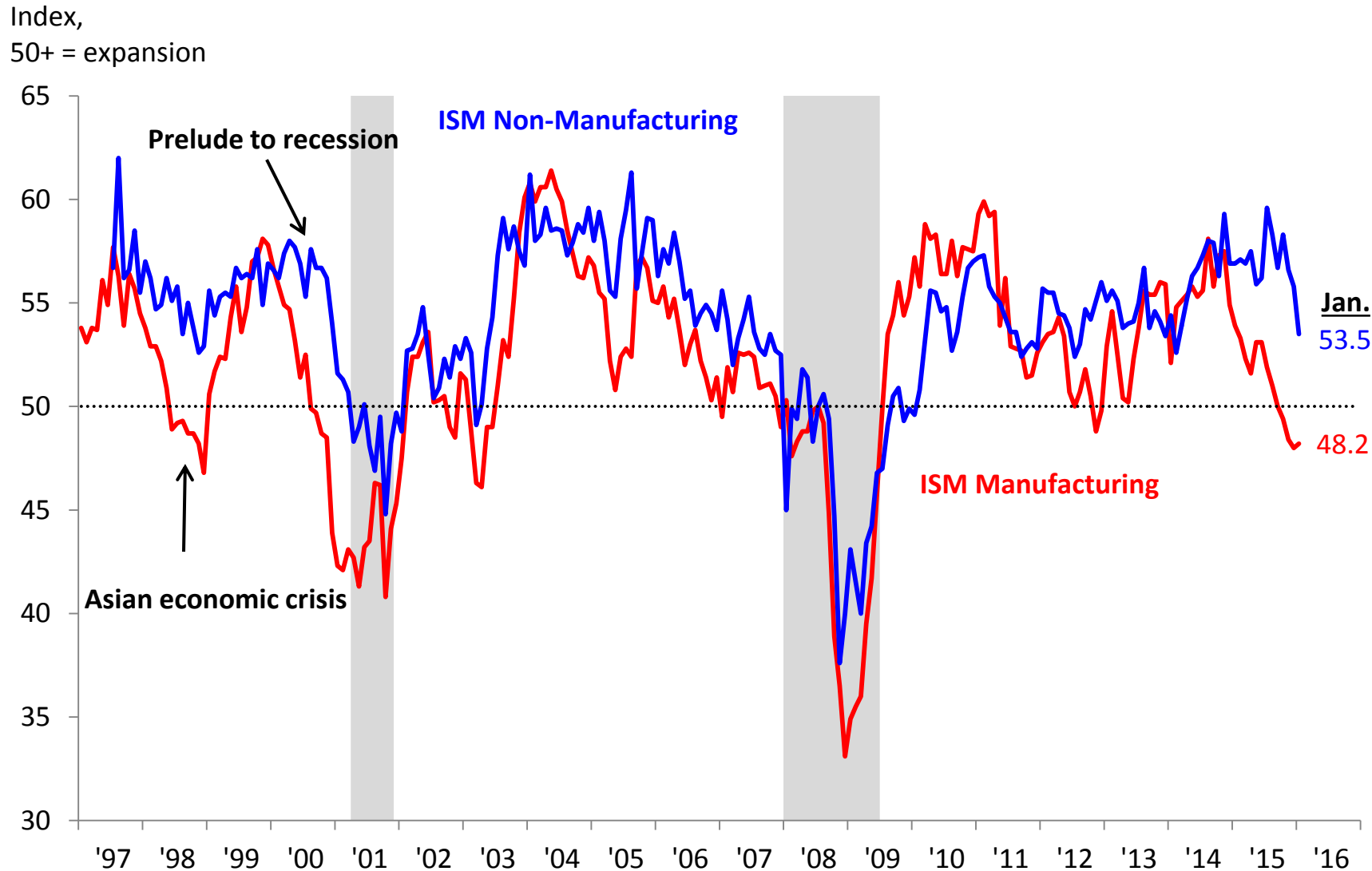


This isn't the first time we've seen a sharp cross-sector split: the prognosis is mixed

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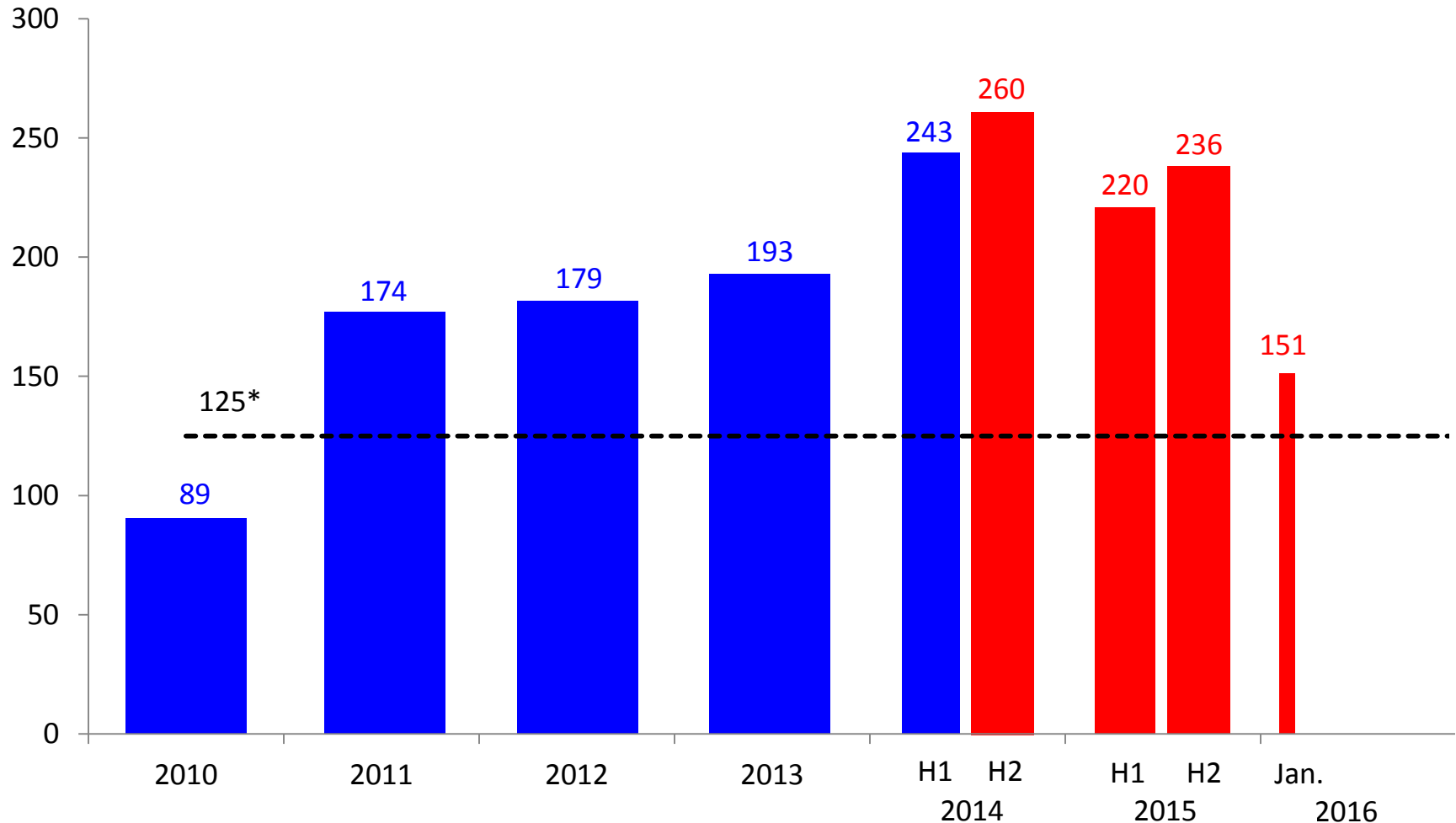


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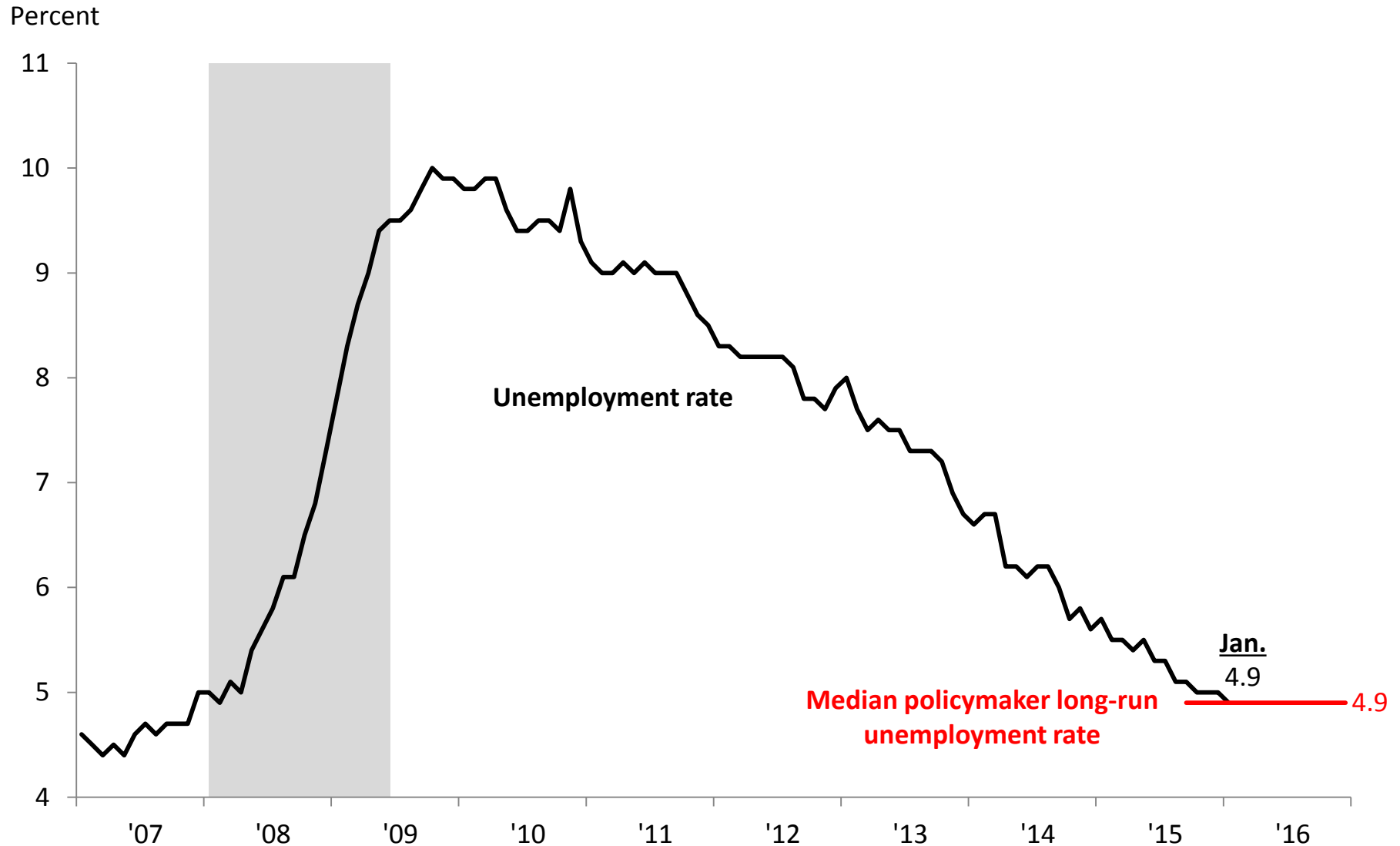
The slowdown in the goods-producing sector has, so far, failed to put a damper on job growth

Avg. monthly change,
thousands

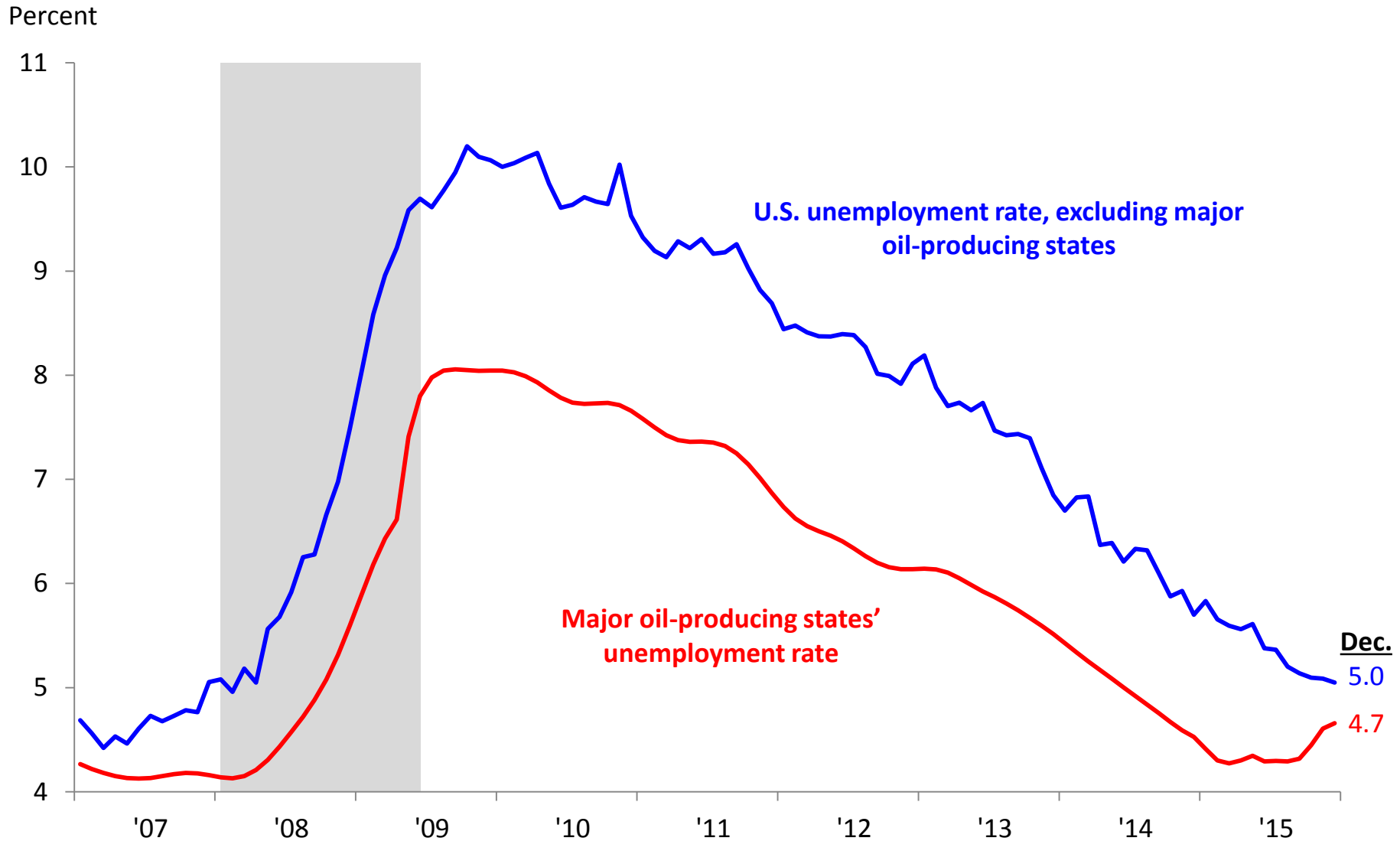


*Job growth likely needed for a steady unemployment rate.

The unemployment rate is now at policymakers' estimate of the sustainable minimum

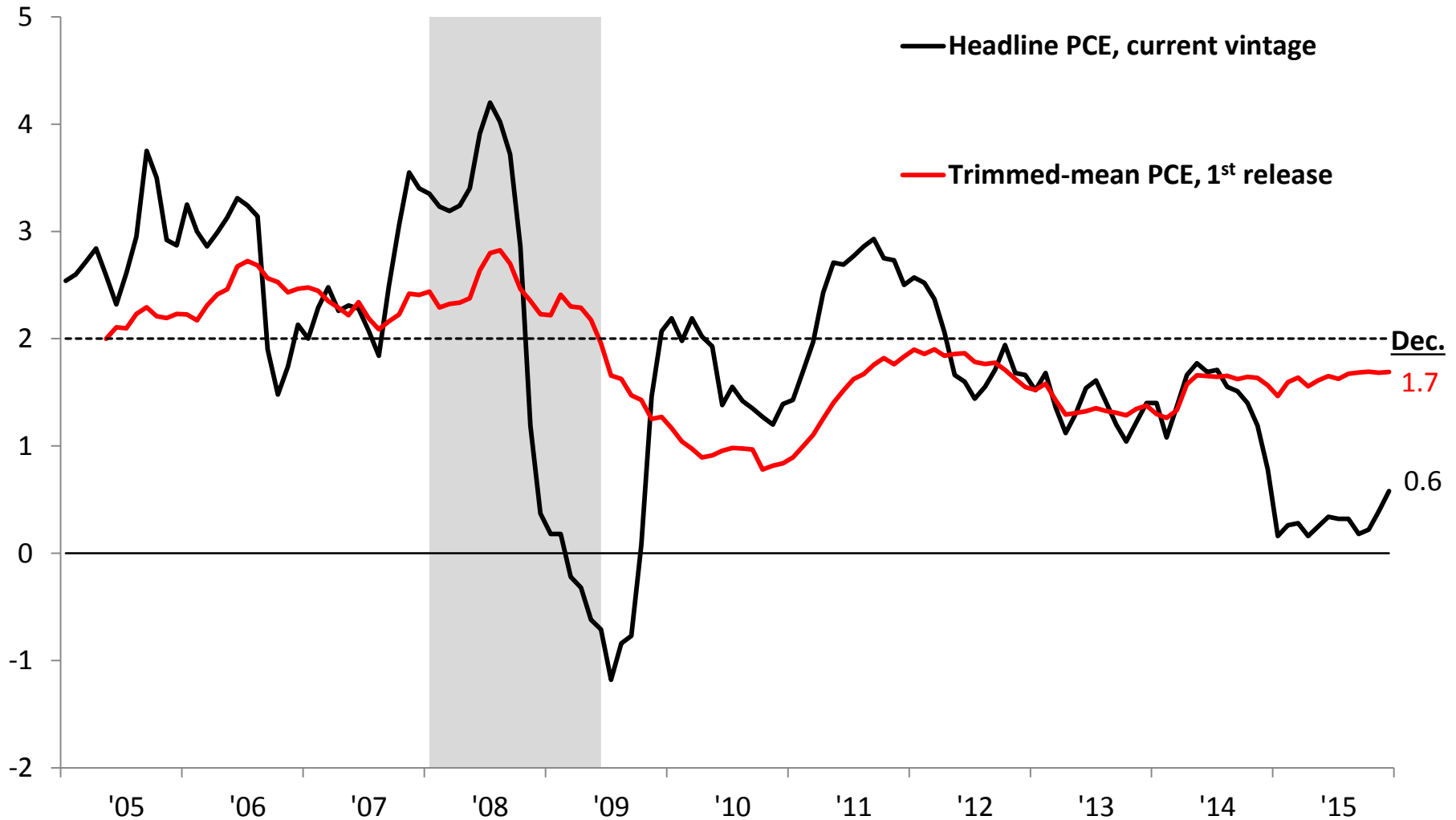


Unemployment increases have been limited to the oil-producing states (NM, ND, OK, TX, & WY)

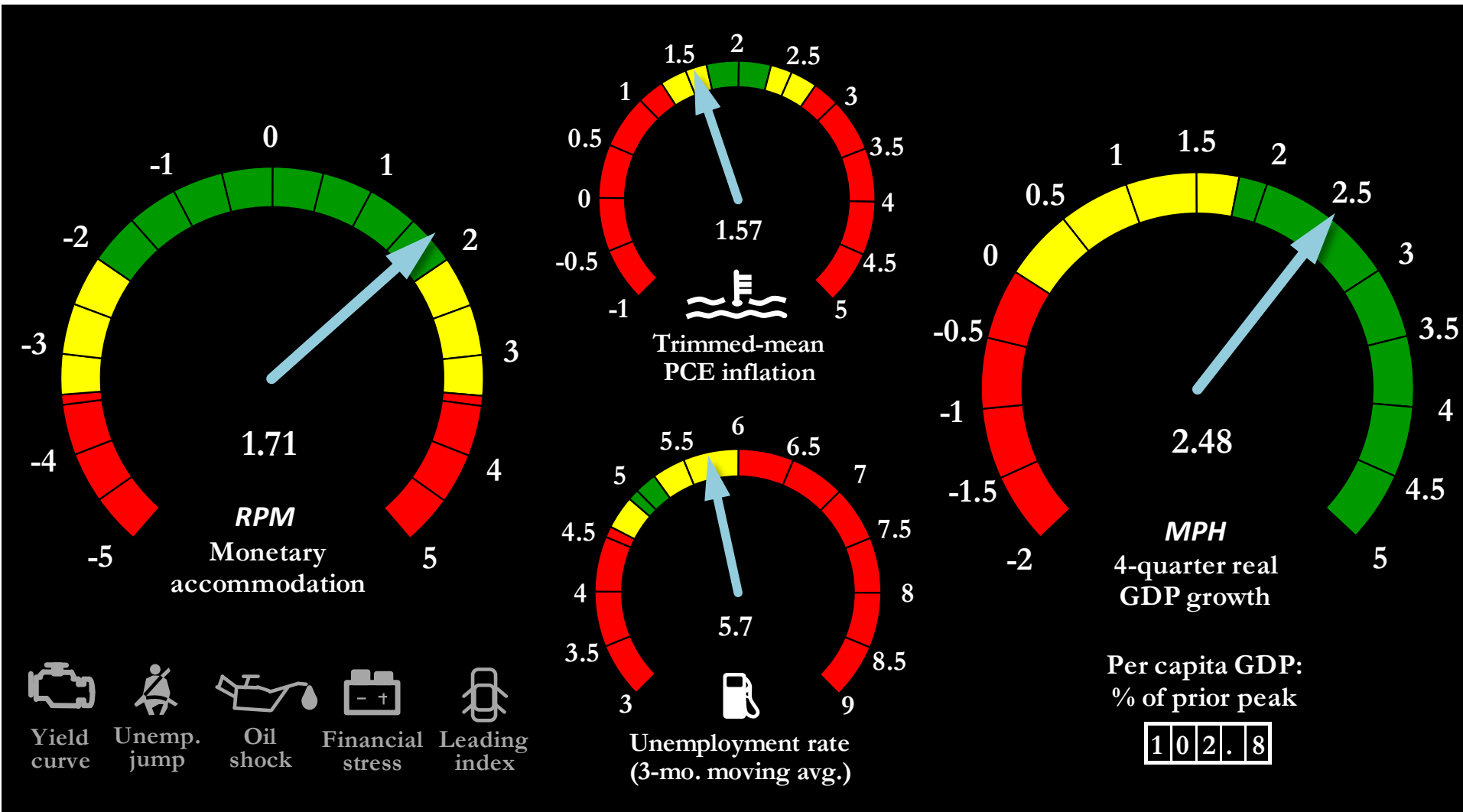


And while headline inflation is below target, the shortfall is due mostly to transitory factors

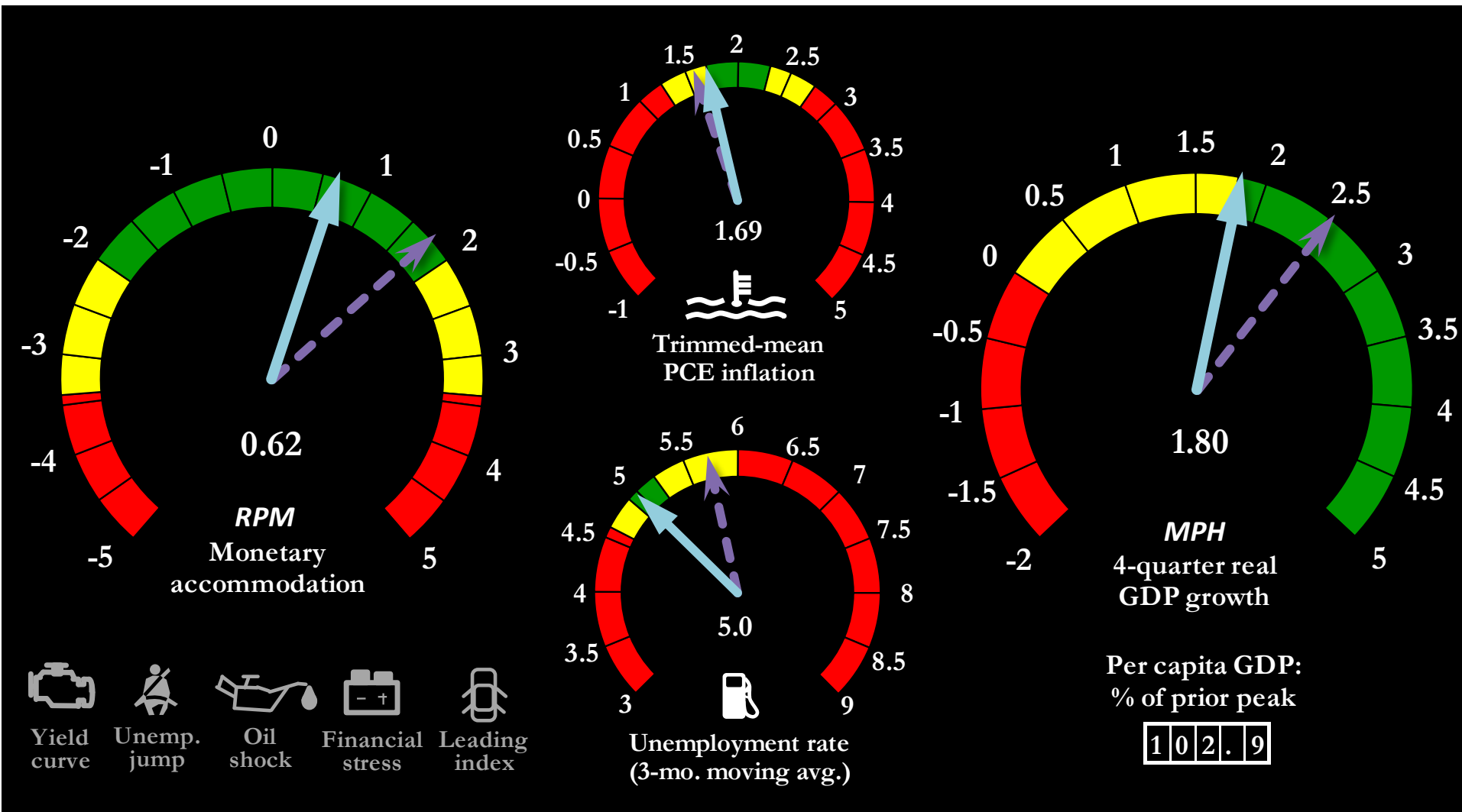
12-month % change



A year ago, unemployment was above its long-run minimum & trend inflation was lower than desired



Today, unemployment approximates its long-run minimum and trend inflation is close to target



Summary

- Accommodative Fed policy, a less-restrictive fiscal policy, and a supply-driven plunge in energy prices have boosted domestic demand.
- But relatively soft growth prospects overseas and a strong dollar have damped demand for our manufactured goods.
- The economy as a whole continues to grow, despite challenges to certain sectors and regions.
- The stability of trimmed-mean inflation suggests that current low headline inflation is transitory.

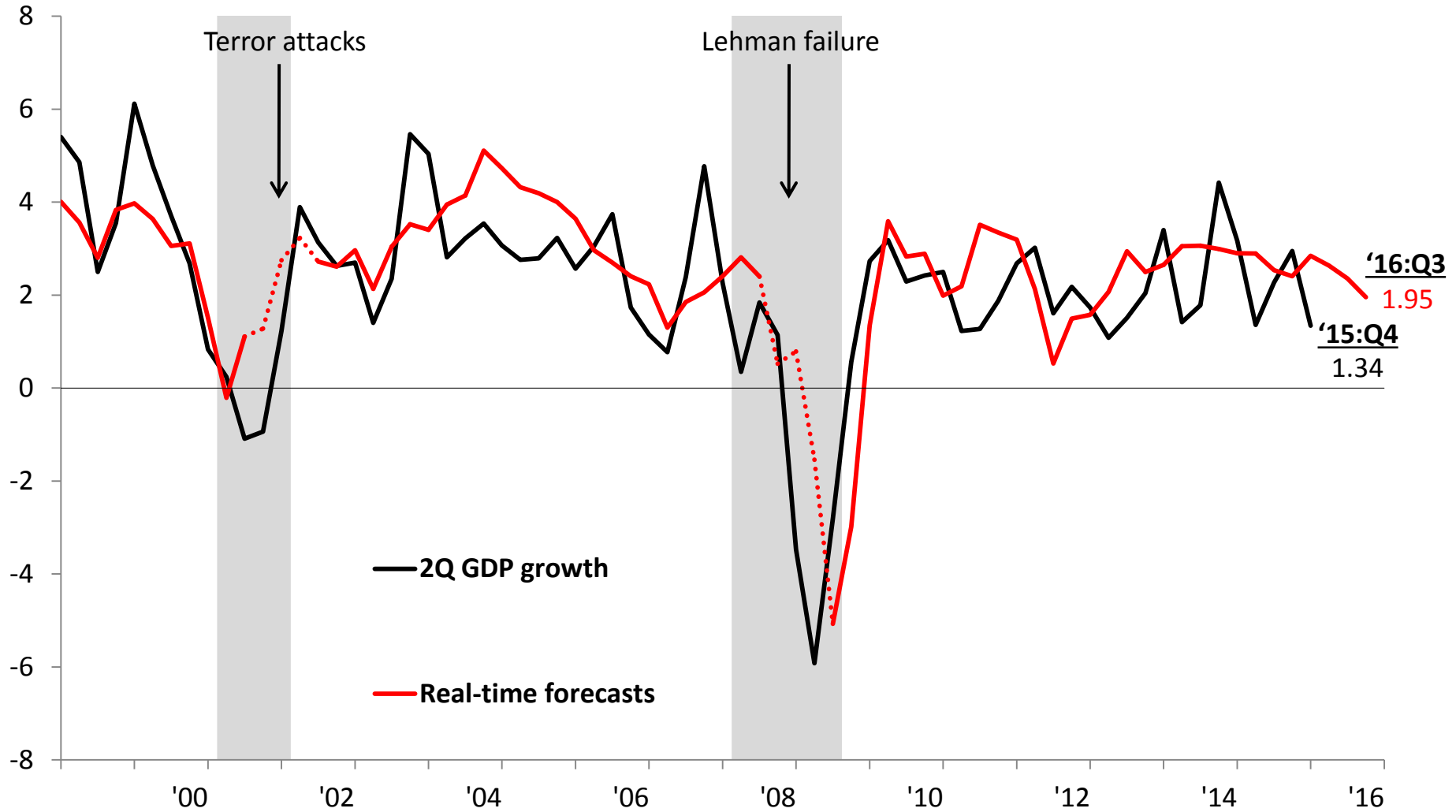
So far, so good, but where do we go from here?



Looking Ahead

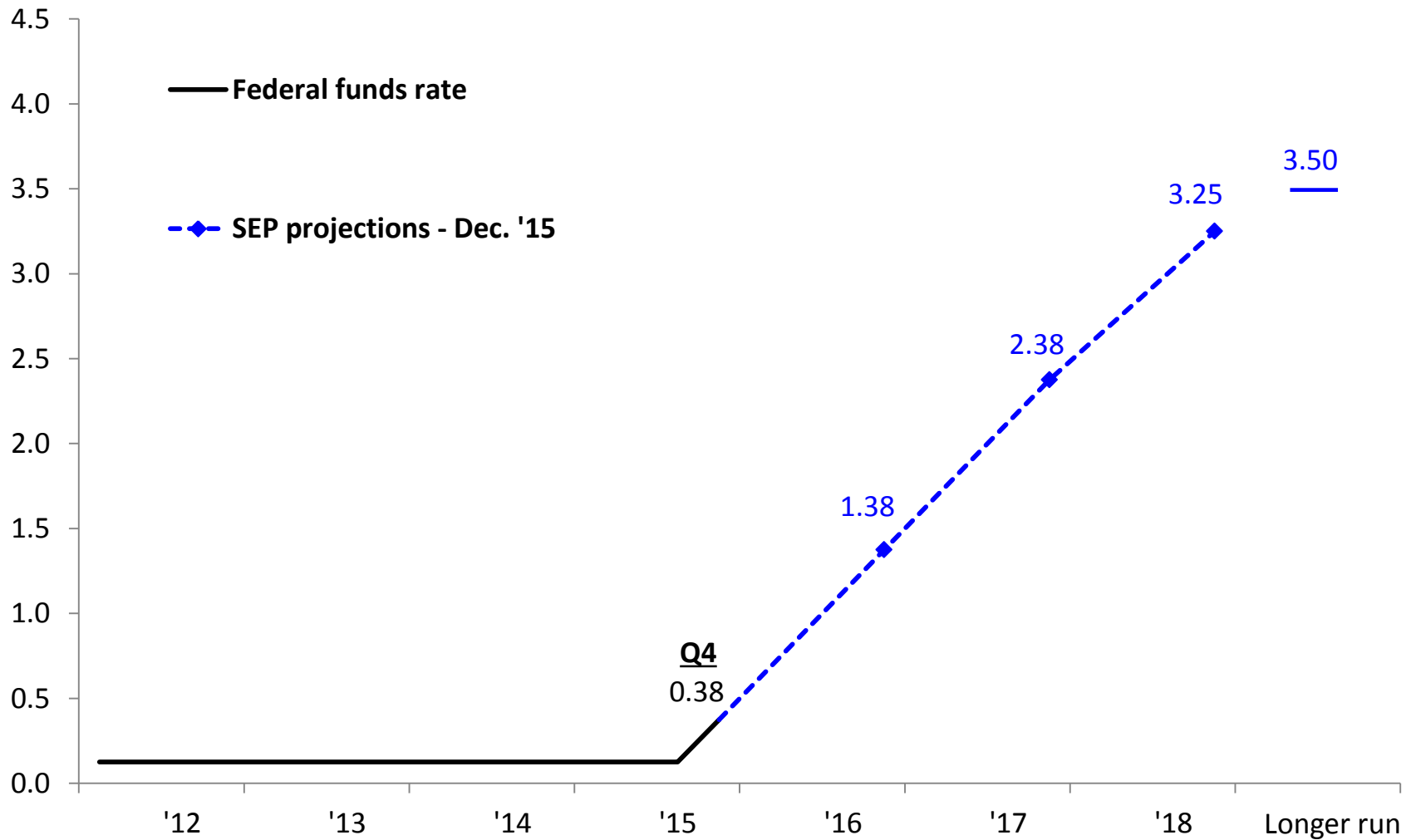
Financial variables (junk-bond & term spreads, stock & oil prices) suggest 2% GDP growth thru Q3

Percent/year

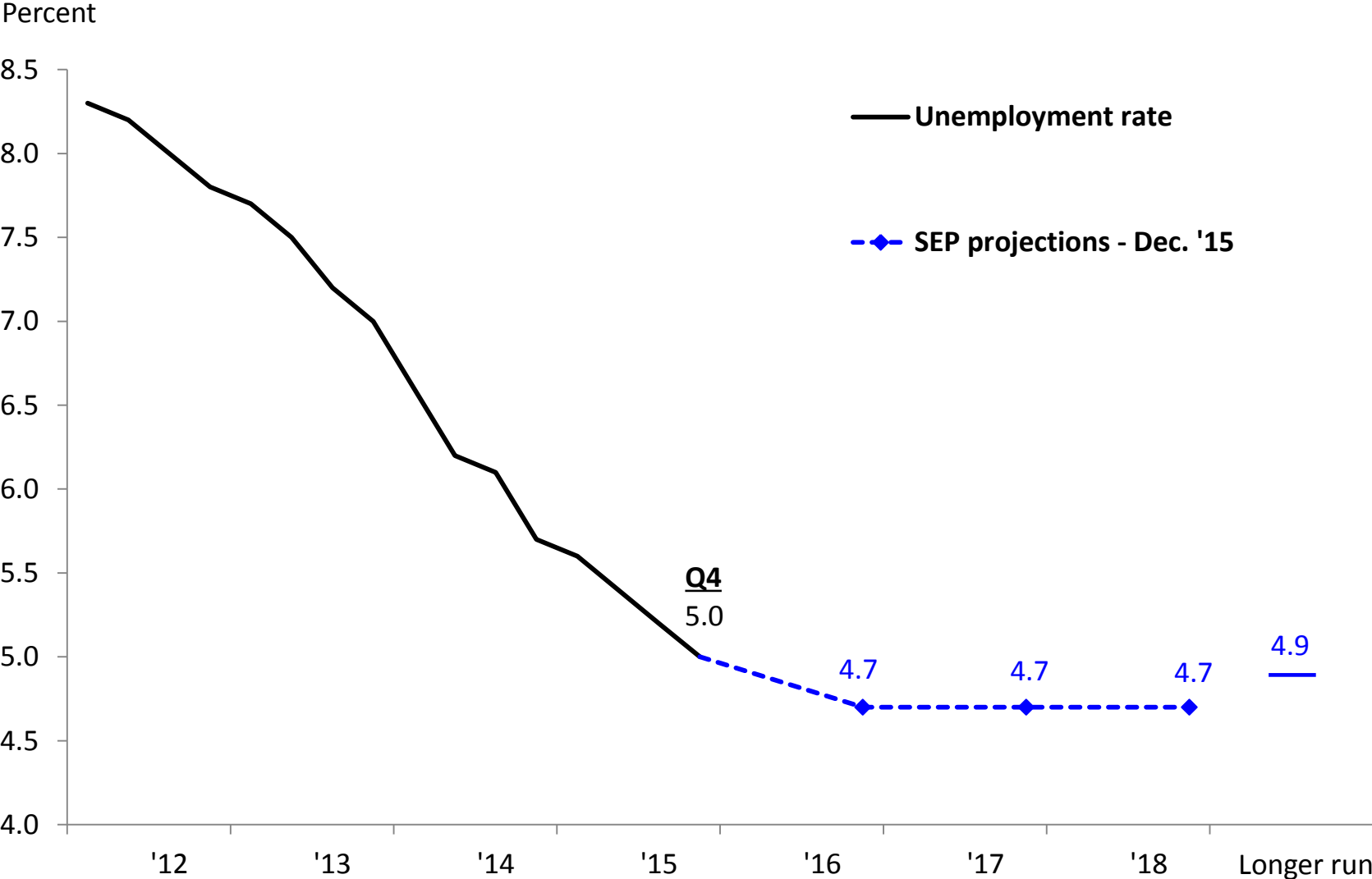


The message from December FOMC: Monetary-policy accommodation to be gradually scaled back

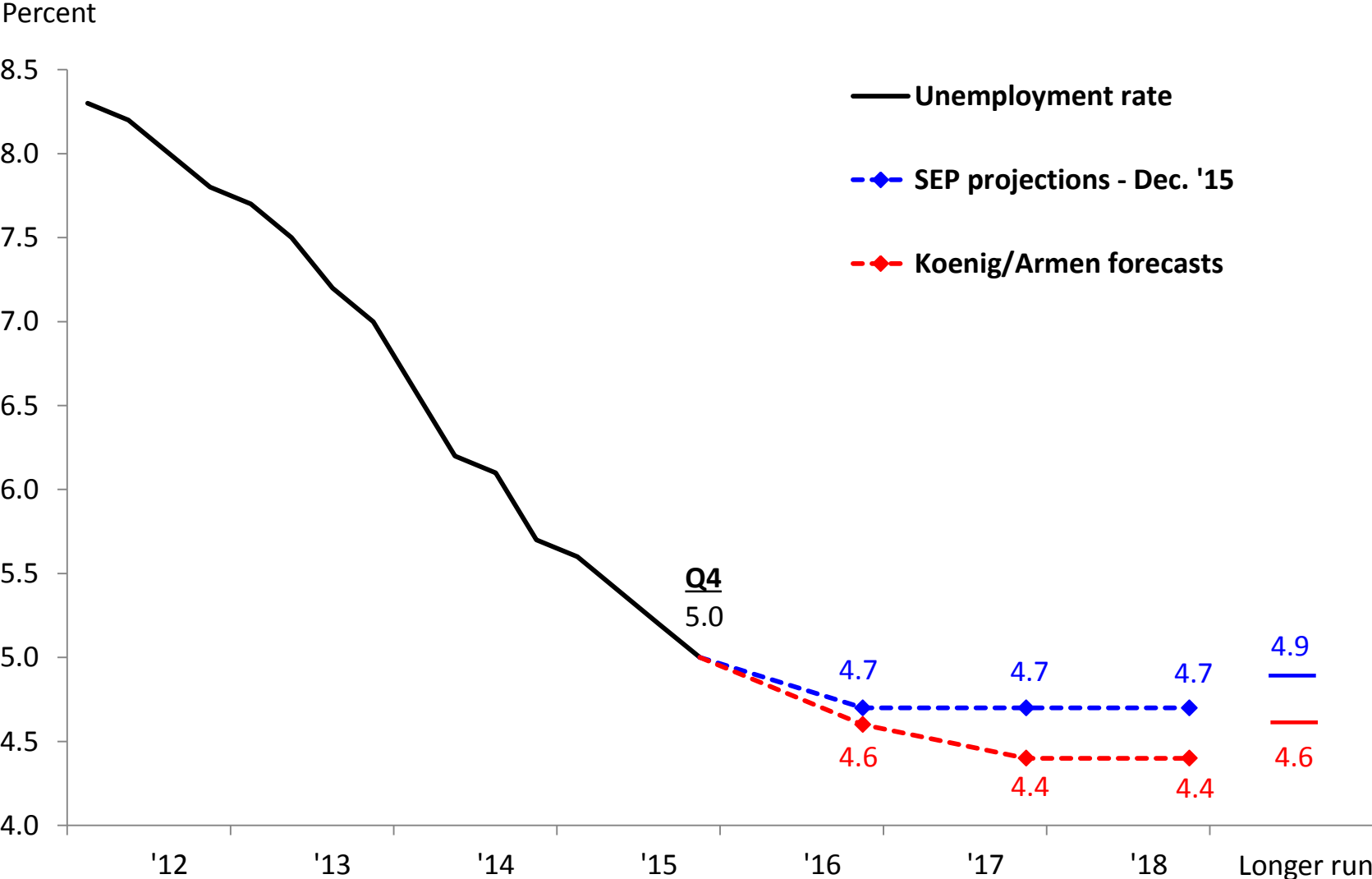
Percent/year



With less accommodation, declines in the unemployment rate are likely to slow, then stop

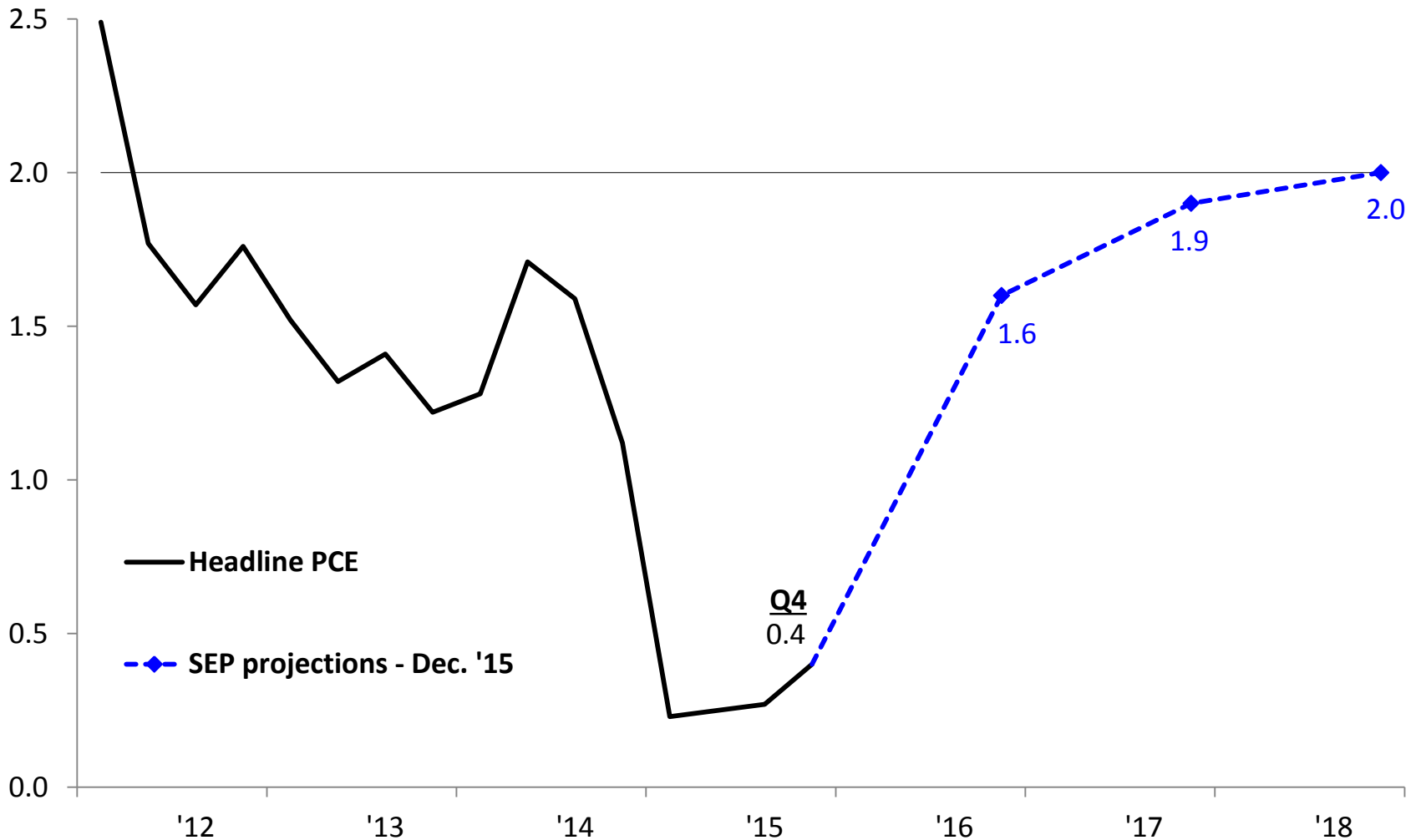


Our in-house model forecasts an unemployment path somewhat lower than the SEP median



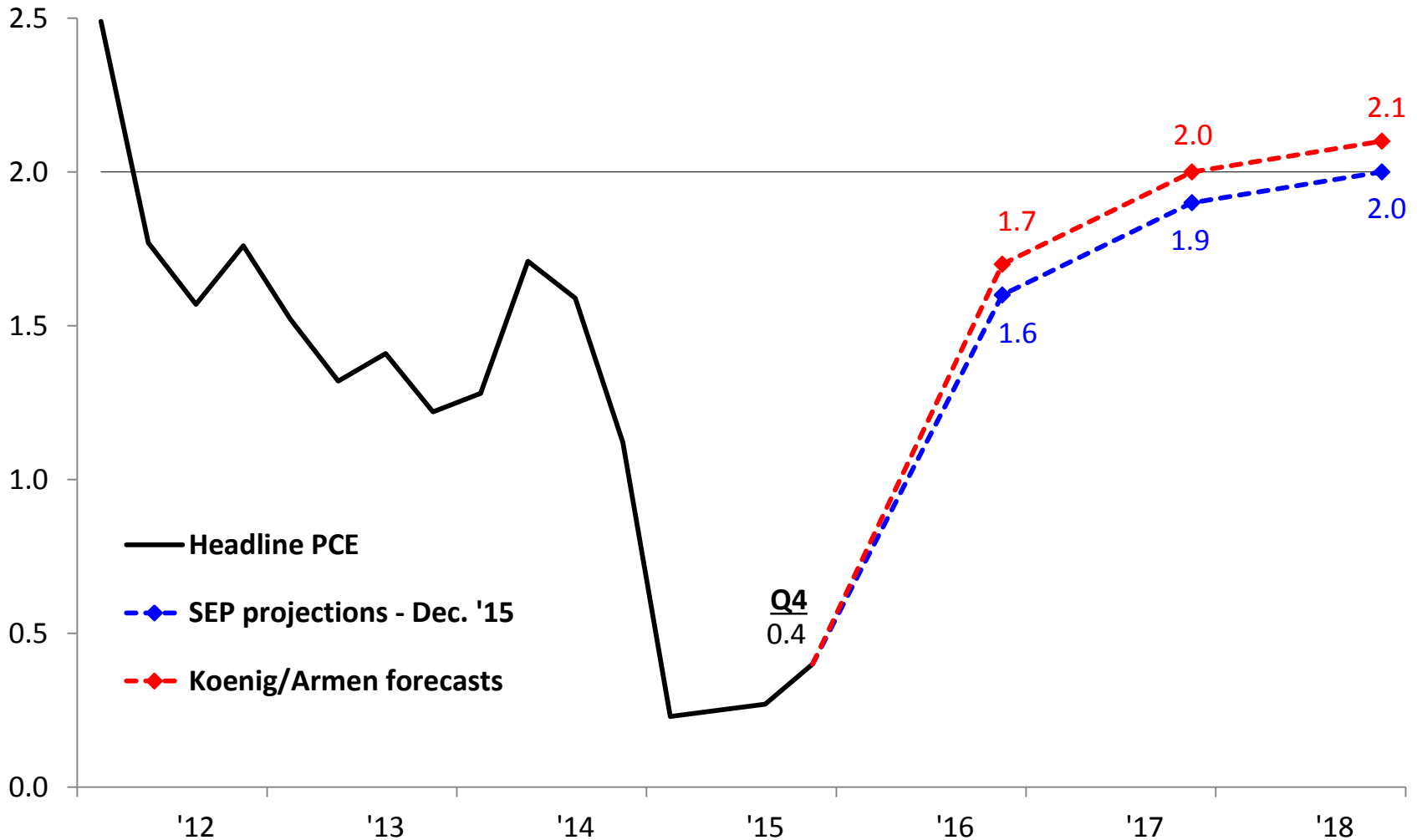
With a tight labor market, inflation will move rapidly upward, provided oil and the dollar hold steady

4Q percent growth



Our in-house model predicts an inflation path slightly higher than the SEP median

4Q percent growth



Conclusions

- We've already reached policymakers' estimate of the full-employment unemployment rate. Modest further unemployment declines are likely during 2016.
- Barring a further fall in the price of oil or a new surge in the dollar, Fed policymakers are likely to achieve their 2 percent longer-run inflation objective in 2017.