August 8, 2014

Getting There?

To say that last week was somewhat eventful on the macroeconomic data front is probably an exercise in understatement. Relevant numbers on GDP growth (past and present), employment and unemployment, and consumer price inflation came in quick succession.

These data provide some of the context for our local Federal Open Market Committee participant's comments this week (for example, in the *Wall Street Journal*'s Real Time Economics blog, with similar remarks made in an interview on CNBC's *Closing Bell*). From that Real Time Economics blog post:

> Although the economy is clearly growing at a respectable rate, Federal Reserve Bank of Atlanta President Dennis Lockhart said Wednesday it is premature to start planning an early exit from the central bank's ultra-easy policy stance.
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> "I'm not ruling out" the idea the Fed may need to raise short-term interest rates earlier than many now expect, Mr. Lockhart said in an interview with The Wall Street Journal. But, at the same time, "I'm a little bit cautious" about the policy outlook, and still expect that when the first interest rate hike comes, it will likely happen somewhere in the second half of next year.
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> "I remain one who is looking for further validation that we are on a track that is going to make the path to our mandate objectives pretty irreversible," Mr. Lockhart said. "It's premature, even with the good numbers that have come in...to draw the conclusion that we are clearly on that positive path," he said.

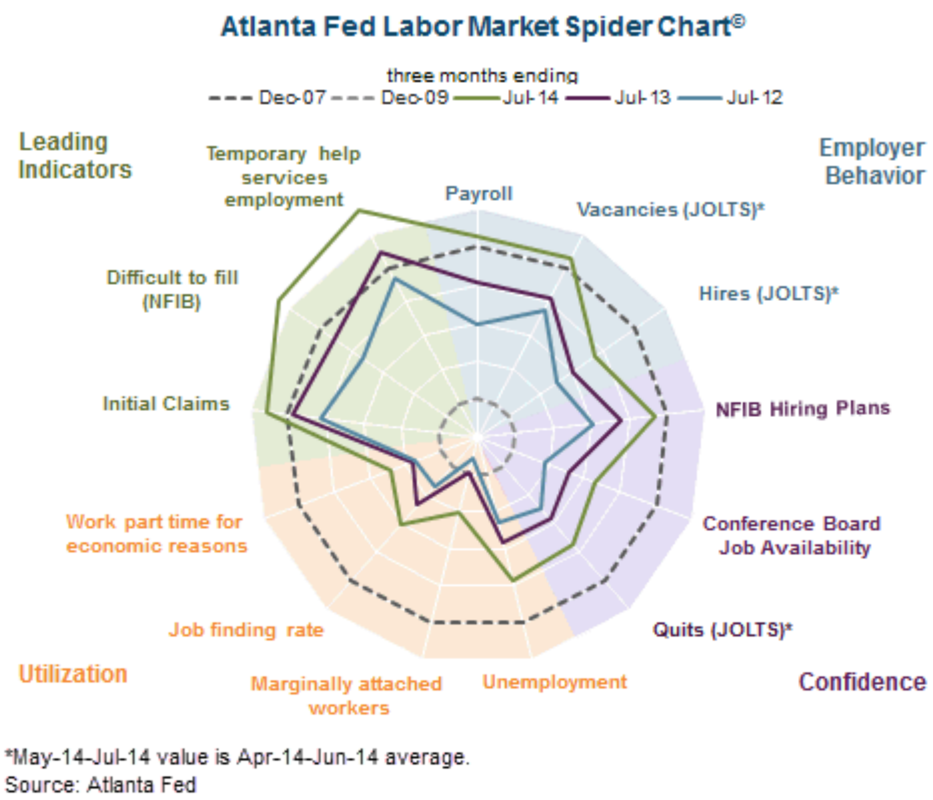
Why so "cautious"? Here's the Atlanta Fed staff's take on the state of things, starting with GDP:

With the annual benchmark revision in hand, 2013 looks like the real deal, the year that the early bet on an acceleration of growth to the 3 percent range finally panned out. Notably, fiscal drag (following the late-2012 budget deal), which had been our go-to explanation of why GDP appeared to have fallen short of expectations once again, looks much less consequential on revision.

Is 2014 on track for a repeat (or, more specifically, comparable performance looking through the collection of special factors that weighed on the first quarter)? The second-quarter bounce of real GDP growth to near 4 percent seems encouraging, but we are not yet overly impressed. Final sales—a number that looks through the temporary contribution of changes in inventories—clocked in at a less-than-eye-popping 2.3 percent annual rate.

Furthermore, given the significant surprise in the first-quarter final GDP report when the medical-expenditure-soaked Quarterly Services Survey was finally folded in, we're inclined to be pretty careful about over-interpreting the second quarter this early. It's way too early for a victory dance.

Regarding labor markets, here is our favorite type of snapshot, courtesy of the Atlanta Fed's Labor Market Spider Chart:

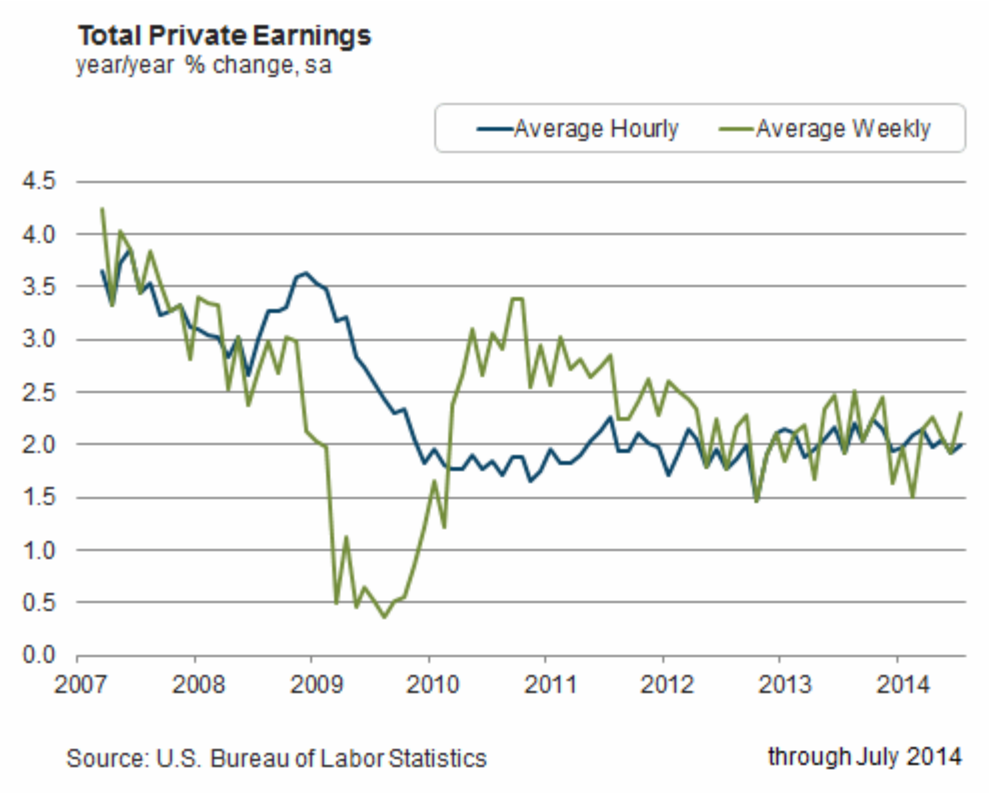


There is a lot to like in that picture. Leading indicators, payroll employment, vacancies posted by employers, and small business confidence are fully recovered relative to their levels at the end of the Great Recession.

On the less positive side, the numbers of people who are marginally attached or who are working part-time while desiring full-time hours remain elevated, and the overall job-finding rate is still well below prerecession levels. Even so, these indicators are noticeably better than they were at this time last year.

That year-over-year improvement is an important observation: the period from mid-2012 to mid-2013 showed little progress in the broader measures of labor-market performance that we place in the resource "utilization" category. During the past year, these broad measures have improved at the same relative pace as the standard unemployment statistic.

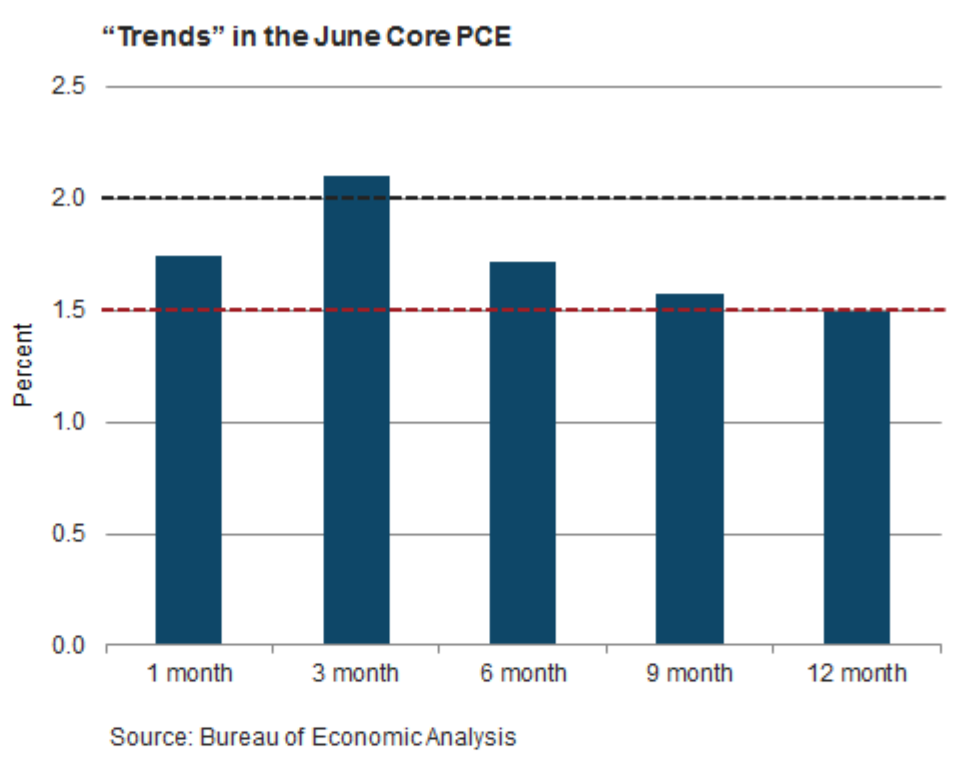
We have been contending for some time that part-time for economic reasons (PTER) is an important factor in understanding ongoing sluggishness in wage growth, and we are not yet seeing anything much in the way of meaningful wage pressures:



There was, to be sure, a second-quarter spike in the employment cost index (ECI) measure of labor compensation growth, but that increase followed a sharp dip in the first quarter. Maybe the most recent ECI reading is telling us something that hourly earnings are not, but that still seems like a big maybe. Outside of some specific sectors and occupations (in manufacturing, for example), there is not much evidence of accelerating wage pressure in either the data or in anecdotes we get from our District contacts. We continue to believe that wage growth is most consistent with the view that that labor market slack persists, and underlying inflationary pressures (from wage costs, at least) are at bay.

Clearly, it's dubious to claim that wages help much in the way of making forward predictions on inflation (as shown, for example, in work from the Chicago Fed, confirming earlier research from our colleagues at the Cleveland Fed). And in any event, we are inclined to agree that the inflation outlook has, in fact, firmed up. At this time last year, it was hard to argue that the inflation trend was moving in the direction of the Committee's objective (let alone that it was not actually declining).

But here again, a declaration that the risks have clearly shifted in the direction of overshooting the FOMC's inflation goals seems wildly premature. Transitory factors have clearly elevated recent statistics. The year-over-year inflation rate is still only 1.5 percent, and by most cuts of the data, the trend still looks as close to that level as to 2 percent.



We do expect measured inflation trends to continue to move in the direction of 2 percent, but sustained performance toward that objective is still more conjecture than fact. (By the way, if you are bothered by the appeal to a measure of *core* personal consumption expenditures in that chart above, I direct you to this piece.)

All of this is by way of explaining why we here in Atlanta are "a little bit cautious" about joining any chorus singing from the we're-moving-on-up songbook. Paraphrasing from President Lockhart's comments this week, the first steps to policy normalization don't have to wait until the year-over-year inflation rate is consistently at 2 percent, or until all of the slack in the labor market is eliminated. But it is probably prudent to be fairly convinced that progress to those ends is unlikely to be reversed.

We may be getting there. We're just not quite there yet.

By Dave Altig, executive vice president and research director of the Atlanta Fed

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