Economic Update
National

Gains in Employment, Consumption Mark Start of Fourth Quarter

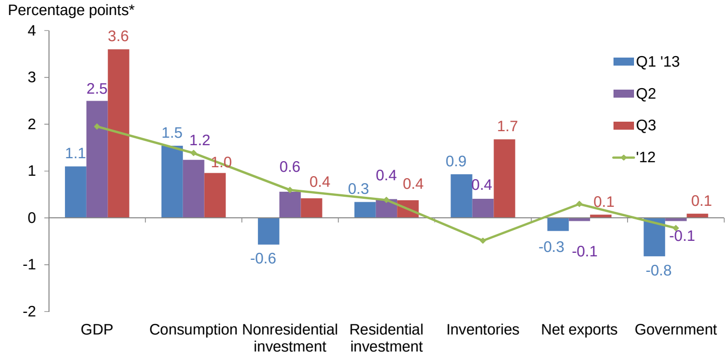
December 20, 2013

Economic indicators released in November and December present a picture of modest to moderate growth in the second half of 2013.

Output growth for the third quarter beat analysts' expectations, mostly due to unexpectedly strong growth in private inventories. The employment situation showed improvement in October and November, driven by payroll gains and another decrease in unemployment.

In addition, real consumer spending data for October and retail sales data for November indicate a stronger pace of consumption growth in the fourth quarter. Headline inflation measures trended down, but core measures, by and large, continued a long pattern of stability.

Chart 1
Output Grows Sharply in Third Quarter



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

Output Rises Sharply, but Underlying Detail Less Robust

Real gross domestic product (GDP) grew at an annualized rate of 3.6 percent in the third quarter (*Chart 1*). This shows strong acceleration from the first half's average annualized rate of 1.8 percent and represents a significant revision from the previous third-quarter estimate of 2.8 percent. Almost half of the third-quarter growth, though, was driven by the change in private inventories, which contributed 1.7 percentage points to real GDP growth over the quarter. Compared with growth in final purchases, a surge in inventories says relatively little about the economy's underlying strength. A positive contribution from inventory investment is as likely to be followed by a negative contribution as it is by another positive one.

Real personal consumption expenditures (PCE) contributed a single percentage point to third-quarter real GDP growth as real PCE grew at a very modest 1.4 percent annualized rate—below its average 2 percent rate over the first half of the year. Nonresidential fixed investment contributed 0.4 percentage points, in line with its first-half average, although that contribution came almost entirely from investment in nonresidential structures. Investment by businesses in equipment posted a zero percent growth rate for the quarter.

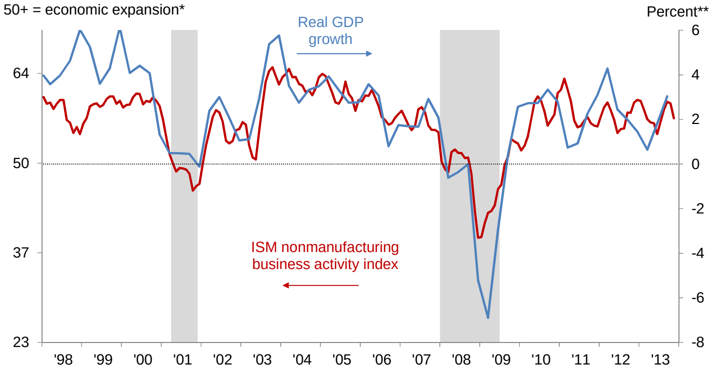
Among the bright spots in the third-quarter GDP release were a healthy positive contribution from residential investment and—for the first time since third quarter 2012—a positive contribution from real government expenditures. A mild drag from federal government expenditures—at –0.1 percentage points, smaller than in the past few quarters—was more than offset by a 0.2 percentage-point positive contribution from state and local government expenditures.

Early Fourth-Quarter Data Mixed; Spending Looks Strong

More current data have been mixed, but, on net, positive. The Institute for Supply Management (ISM) nonmanufacturing business activity index declined in November to 53.9, closer to its postrecession lows than to its postrecession highs. Given that the index has been strongly positively correlated with real GDP growth in the past (*Chart 2*), this decline may point to weaker output growth in the fourth quarter. In contrast, November readings on industrial production (up 1.1 percent) and the ISM manufacturing index (which reached its highest level since April 2011) point to upswings in activity.

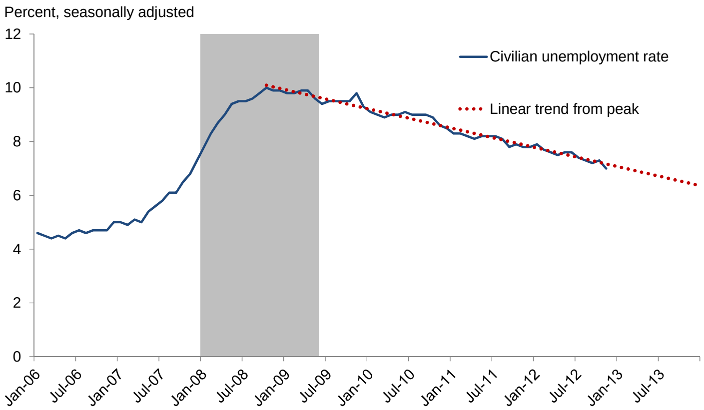
Perhaps most important, given the recent tepid growth in real PCE, consumption spending looks to have begun the quarter on a strong note. The monthly personal income report for October showed real PCE increasing 0.3 percent at a monthly rate, or 3.8 percent annualized. While much could change as data for the second and third months of

Chart 2
Business Activity Index Hints at Weaker Output Growth



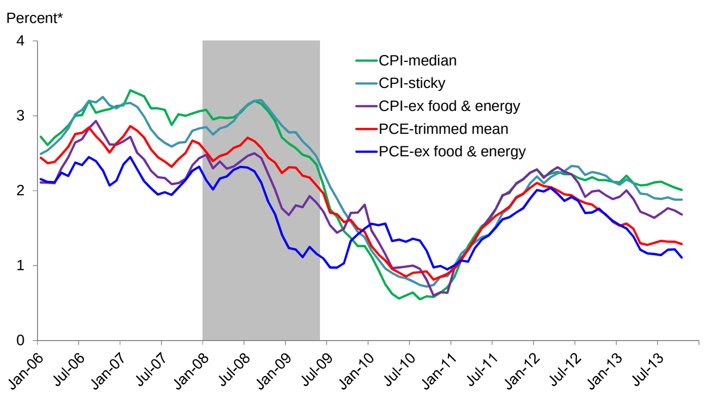
*Three-month moving average, seasonally adjusted.
**Quarter/quarter; seasonally adjusted, annualized rate.
NOTE: Shaded bars indicate recessions.
SOURCES: Institute for Supply Management; Bureau of Economic Analysis.

Chart 3
Unemployment Maintains Downward Trend



NOTE: Shaded bar indicates recession.
SOURCE: Bureau of Labor Statistics.

Chart 4
Core Measures Show Varying Degrees of Deceleration



*Year/year, seasonally adjusted.
NOTE: Shaded bar indicates recession.
SOURCES: Bureau of Economic Analysis; Bureau of Labor Statistics; Federal Reserve Bank of Dallas; Federal Reserve Bank of Cleveland; Federal Reserve Bank of Atlanta.

the quarter come in, based solely on October's reading, real PCE growth in the fourth quarter projects to an annualized rate of 2.4 percent—a full percentage point higher than the third quarter growth rate.

Real PCE data for November come out Dec. 23. In the meantime, retail sales for November are available. These data are nominal—so their value can be affected by price changes—and they neglect services, which make up the bulk of consumption expenditures. Nevertheless, they can give some indication of the strength of consumer spending. November's data look quite robust. Retail sales excluding sales at gasoline stations—which are especially sensitive to price swings—rose 0.9 percent in November, their fastest rate of increase since September 2012.

Labor Market Sees Solid Gains in October, November

Employment reports covering October and November show continued improvement in labor market conditions. Total nonfarm employment grew by 200,000 in October and 203,000 in November—the first back-to-back increases of at least 200,000 jobs since November and December of last year. Private sector nonfarm payrolls increased by 196,000 in November, while the government sector added 7,000 jobs. Also, upward revisions to payrolls in August and September brought gains over those two months to a combined 413,000 jobs. For the year through November, nonfarm payroll gains have averaged 189,000 jobs per month.

The unemployment rate, which had ticked up from 7.2 to 7.3 percent in October, declined sharply to 7 percent in November (*Chart 3*). Importantly, November's decline came even as the labor force participation rate ticked up to 63 percent from 62.8 percent in October.

Gas Prices Weigh on Headline Rates; Core Measures Mostly Steady

Headline Consumer Price Index (CPI) inflation, on a 12-month basis, was 1.2 percent in November after dipping to 0.9 percent a month earlier. Headline PCE inflation, available only through October, was 0.7 percent on a 12-month basis. Falling gasoline prices have been a drag on headline inflation rates over the past several months. For the 12 months through November, the seasonally adjusted price of gasoline in the CPI was down roughly 6 percent; the 12-month decline through October was an even deeper 10 percent.

Core inflation measures, which have shown varying degrees of deceleration over the past two years, have been mostly stable over the past several months (*Chart 4*). CPI-based core measures—like the Federal Reserve Bank of Cleveland's median CPI, the Atlanta Fed's sticky-price CPI or the more conventional CPI excluding food and energy—have been steady in a range of 1.7 to 2 percent on a 12-month basis in data through November. PCE-based measures have been running at a noticeably lower level, between 1.1 and 1.3 percent. The Dallas

Fed's Trimmed Mean PCE inflation rate—a good indicator of the underlying trend in PCE inflation, as well as a good predictor of future headline PCE inflation—has been steady on a 12-month basis at 1.3 percent for the seven months through October.

—Alan Armen and Jim Dolmas

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About the Authors

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