DALLASFED Economic Update National

Moderate Growth Heading Into 2014

January 30, 2014

Economic indicators released since the last national update suggest the economy accelerated in the second half of 2013. The final national income and product accounts release for third quarter 2013 revised real gross domestic product (GDP) growth upward for a second time to 4.1 percent at a seasonally adjusted, annualized rate. This reading improved from November's 3.6 percent estimate for the third quarter, with gains in real personal consumption expenditures (PCE) growth (Chart 1). Private-sector estimates for fourth quarter 2013 growth were revised upward, reflecting positive signals from consumption, manufacturing and investment.

The December employment report from the Bureau of Labor Statistics (BLS) revealed mixed news on the state of the labor market. The discrepancy between the payroll survey's employment figures and the household survey's decline in the unemployment rate may be due to weather. Core inflation continues to run below target, while long-run expectations remain anchored.

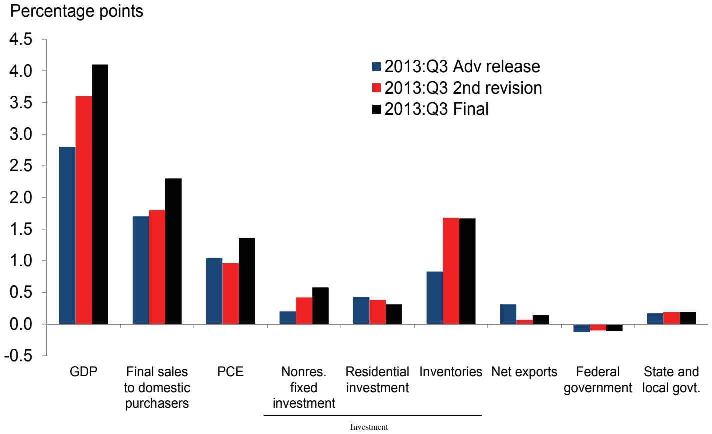
Consumption Leads Strong Fourth Quarter Growth

The January Blue Chip consensus estimates have edged up, putting fourth quarter 2013 GDP growth 0.8 percentage points higher than December's forecast of 1.6 percent. This upward revision is supported by strong real PCE growth at 5.0 and 6.4 percent annualized rates for October and November, with particularly strong growth contributions from durable goods purchases. This suggests a strong contribution from PCE to growth in the fourth quarter.

Despite revisions to third-quarter growth and strong PCE contributions in the fourth quarter, the Blue Chip consensus remains steady for first quarter 2014 at 2.5 percent. However, momentum from rising house prices and less household debt continues to improve household balance sheets, which will support consumption expenditures, thus strengthening growth in 2014.

Chart 1

Third Quarter 2013 Growth Estimates Kept Growing



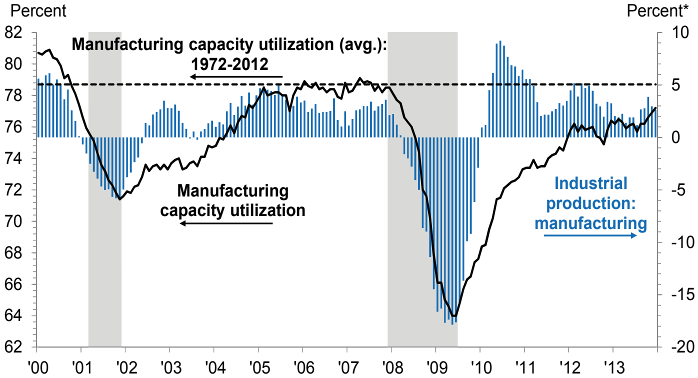
SOURCE: Bureau of Economic Analysis.

Capital Investment Steady

Investment growth remains steady despite a temporary drag from bad weather on residential investment indicators. According to the Census Bureau's advance report, durable goods orders continue to trend upward, despite some slowing in December and downward revisions to November estimates. Business equipment orders grew 2.6 percent in November, followed by a 1.3 percent decrease in December. However, with healthy balance sheets, less economic uncertainty from the euro zone and less fiscal drag with a new government spending deal, the downside risks to investment appear moderate.

Housing data also showed fewer gains in December. Housing starts ticked down from 1,107,000 to 999,000 and permits from 1,017,000 to 986,000. However, growth continued in most areas not affected by inclement weather. The West added 35,000 starts at an

Chart 2
Manufacturing and Capacity Continue Normalizing

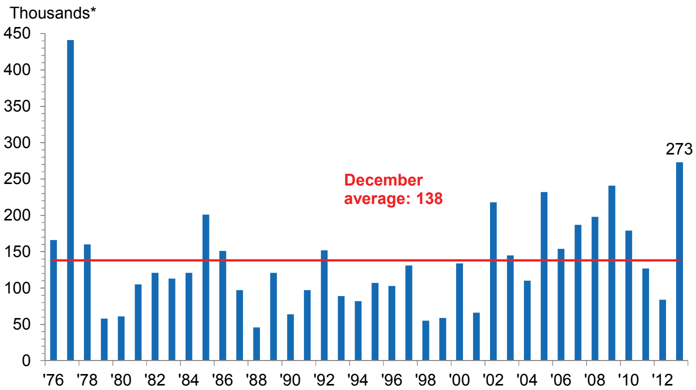


*12-month percent change

NOTE: Shaded areas indicate recessions.

SOURCE: Federal Reserve Board.

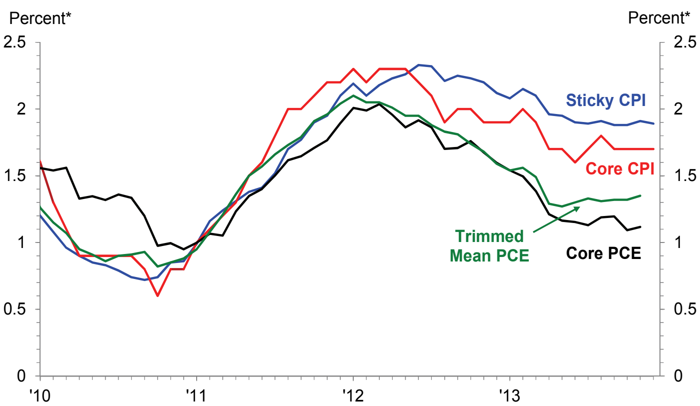
Chart 3
A Cold December Disrupts Work



*Not at work due to bad weather in December

SOURCE: Bureau of Labor Statistics.

Chart 4
Inflation Growth Is Level but Low



*12-month percent change

SOURCES: Bureau of Labor Statistics; Bureau of Economic Analysis; Federal Reserve Bank of Dallas; Federal Reserve Bank of Atlanta.

annualized rate, while heavily affected regions of the Midwest and South had 74,000 and 59,000 fewer housing starts, respectively. Housing permits, which are forward-looking, grew in both the West and the Northeast by 15,000 and 12,000 units at an annualized rate, while permits in the South and Midwest declined by 28,000 and 30,000, respectively. The coincident bad weather and weak housing reports are likely one-off events, and conditions should normalize in the coming months.

Manufacturing Trends Upward

Manufacturing continued to expand in December, according to the Institute for Supply Management's Manufacturing Index. The December survey was slightly below November's figure at 57.0 points but still above reports from the previous three years. The more current indicator of industrial production from the Federal Reserve Board firmed for the fifth consecutive month. Likewise, manufacturing capacity utilization continues to normalize, registering just 1.5 percentage points below long-run averages (Chart 2). This indicates improvements, but slack still remains.

December Payroll Numbers Chilled With Weather

The December Current Population Survey from the BLS ticked down headline unemployment from 7.0 to 6.7 percent. The four-week moving average of initial claims continues to trend downward after some unevenness in fourth-quarter weekly claims. This contrasts with the Current Employment Statistics report that the U.S. economy added 74,000 new jobs in December, disappointing forecasters' expectations of 200,000. This is most likely due to weather-related impediments. Chart 3 shows 273,000 employees not at work due to bad weather, the highest December reading since 1977 and approximately 135,000 above the historical December average. The weakness in payroll numbers is probably a one-time deviation from the trend and is anticipated to normalize in January.

Core Inflation Bottoms Out

Core inflation measures ticked up slightly in November and December. Chart 4 shows that the Federal Reserve's preferred measure of price growth, core PCE, grew 1.1 percent year over year in November. Comparable core Consumer Price Index (CPI) growth remained flat at 1.7 percent. These growth rates, along with alternative measures of the Atlanta Fed's sticky-price CPI and the Dallas Fed's Trimmed Mean PCE, are below Federal Reserve targets, but the University of Michigan's long-run inflation expectations for CPI remain anchored at 2.9 percent, according to its January Survey of Consumer Attitudes and Behavior.

The overall economy continues to show signs of improvement, and the increasing frequency of these signs is hopeful. Consumer demand is strengthening in regard to consumption and improved balance sheets, and businesses continue to grow production and utilize more capacity. A slowdown in emerging markets and lower-than-desired inflation pose downside risks, but on the whole, 2014 has a promising start.

—Camden Cornwell

About the Author

Cornwell is a research assistant in the Research Department at the Federal Reserve Bank of Dallas.