

Economic Growth Accelerates; Job Openings Outpace Hires

September 19, 2014

Economic indicators released over the past two months indicate a moderate upturn in growth in the United States. In its second estimate, second-quarter real gross domestic product (GDP) growth came in at an annualized 4.2 percent, putting first-half average growth at 1.0 percent. Job gains slowed from July to August, ending a six-month hot streak. Meanwhile, the unemployment rate dipped to 6.1 percent, returning to one of its lowest points since September 2008.

Output Growth Revised Upward in Latest Release

Second-quarter GDP growth was revised up by 0.2 percentage points from its advance-release estimate because of upward revisions to nonresidential investment and net exports. The second-quarter output growth is well above the recovery average of 2.0 percent (*Chart 1*).

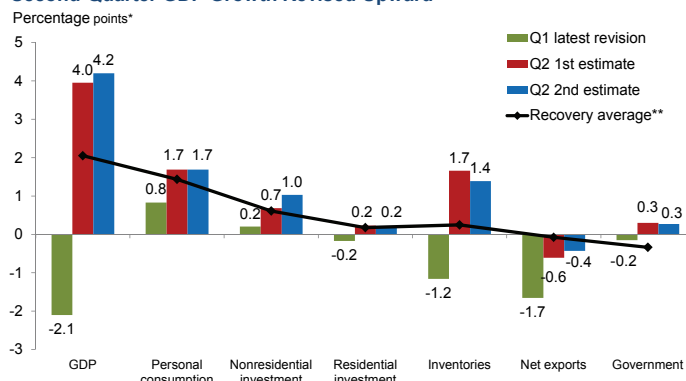
Nonresidential investment contributed 1.0 percentage points, up from 0.7 percentage points in the earlier estimate. Residential investment and government contributions remained mostly unchanged from the previous estimate. Private inventories, a volatile component, contributed a historically large 1.4 percentage points (down from its advance estimate of 1.7 percentage points). Since higher contributions by this component generally precede lower contributions by it in future quarters, private inventories represent some downside risk ahead.

One component that may see a boost in the final release is real personal consumption expenditures (PCE). This is in part due to the Commerce Department's recent upward revisions to medical service expenditures from its earlier second-quarter figure.¹

Job Gains Slow with August Data

The payroll survey showed a slight slowdown in job gains (*Chart 2*). Total nonfarm employment grew by 142,000 in August. Private-sector nonfarm payrolls increased by 134,000, while the government sector added 8,000 jobs. Additionally, the strong gains over the previous two months were revised downward, on net, by 28,000. August job growth fell short of expectations, marking the end of a six-month streak of above 200,000 gains per month—a pace not sustained since 1997.

Chart 1
Second-Quarter GDP Growth Revised Upward

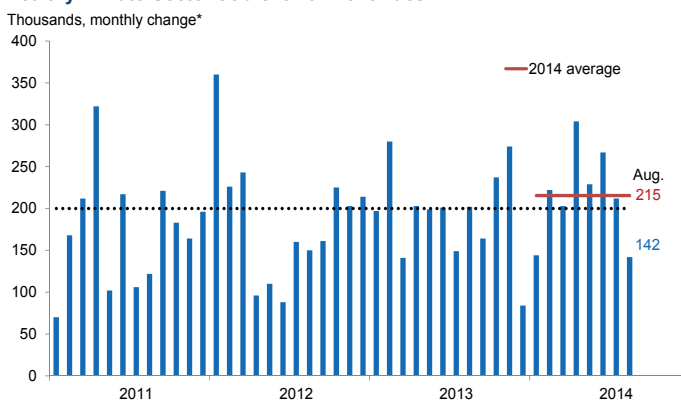


*Contribution to percent change in gross domestic product growth; quarter/quarter, seasonally adjusted annualized rate.

**2009:Q3 through 2014:Q1.

SOURCE: Bureau of Economic Analysis.

Chart 2
Healthy Private-Sector Job Growth Continues



*Seasonally adjusted.

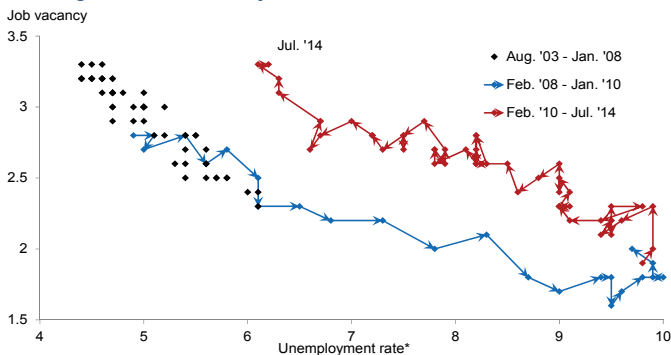
SOURCE: Bureau of Labor Statistics.

According to the household survey, the headline unemployment rate decreased 0.1 percentage points from July. This coincided with a decrease in the labor force participation rate from 62.9 to 62.8 percent. Twelve-month growth in real average hourly earnings for production and non-supervisory employees accelerated to 0.5 percent in July, up from 0.2 percent a month earlier.

Vacancies Increase Relative to Hiring

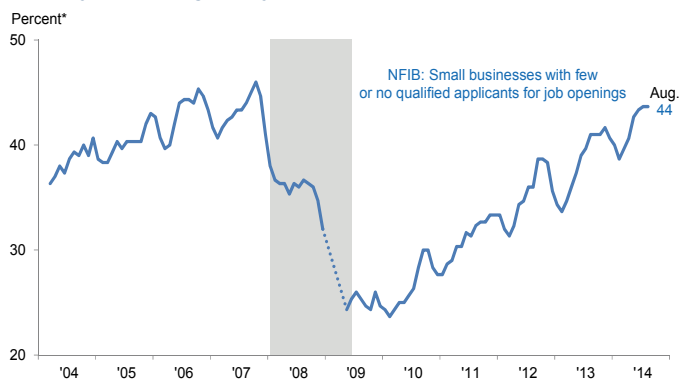
In addition to employment and unemployment figures, data on the efficiency of the labor market offer more clues to its health. One way to determine this is to examine the

Chart 3
Beveridge Curve: Abnormally Inefficient Movements in Recent Jobs Data



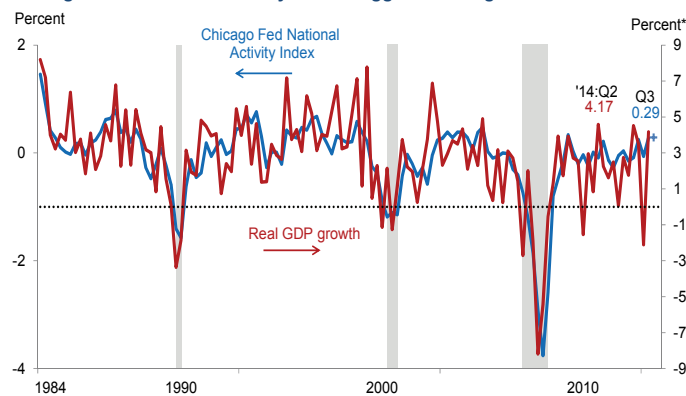
*Percent, seasonally adjusted.
NOTE: A high job vacancy rate with a low unemployment rate indicates economic expansion.
SOURCE: Bureau of Labor Statistics.

Chart 4
Survey of Small Businesses Shows Prerecession-Level Difficulty in Obtaining Quality Labor



*Three-month moving average, seasonally adjusted.
NOTE: Shaded bar indicates recession. The dotted portion of the line represents missing data.
SOURCES: National Federation of Independent Business; National Bureau of Economic Research.

Chart 5
Chicago Fed's National Activity Index Suggests Strong Third-Quarter Growth



*Percent change, quarter/quarter, seasonally adjusted annualized rate.
NOTE: Shaded bars indicate U.S. recessions.
SOURCES: Bureau of Economic Analysis; Federal Reserve Bank of Chicago; National Bureau of Economic Research; authors' calculations.

degree of labor mismatch occurring. The classic illustration demonstrating mismatch is the Beveridge curve, which shows an intuitive relationship between the rate of job vacancies and unemployment—a higher rate of unemployment usually occurs with a lower rate of vacancies, along with the reverse.

The current recovery's pattern has shown that for a given job vacancy rate, the unemployment rate is higher than what would have been the case prior to the

recession (*Chart 3*), implying a less efficient labor market. This behavior is consistent with that of previous recovery periods, since Beveridge curves tend to follow a counterclockwise loop once a recession hits.² But recent data going back to February 2014 do show an atypically high unemployment rate for the amount of vacancies, with the job-openings rate now at one of its highest points in 13 years.

There are several possible reasons for the apparent increased inefficiency, with a frequently mentioned one being lack of qualified workers satisfying requirements for vacancies. However, since a qualified worker is more likely than an unqualified worker to be hired across any period, it's expected that once a recovery has progressed far enough, there is bound to be a relative surplus of lesser-qualified workers in the labor supply. Hence, recoveries at some point will typically exhibit such inefficiency, so some increased proportion of lesser-qualified labor in the current labor market shouldn't be surprising.

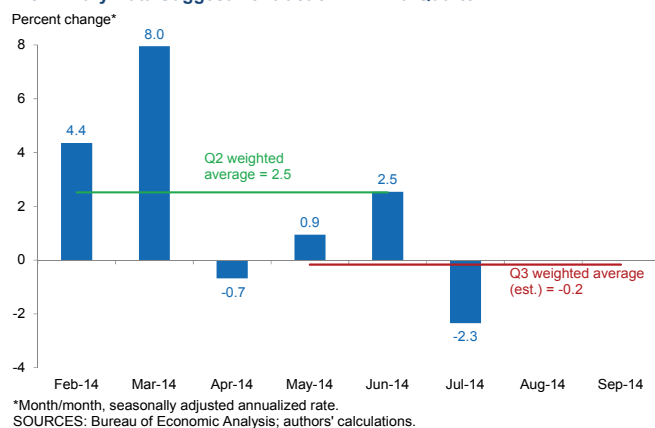
A more interesting question, then, is to what degree the labor market currently has such difficulty, especially compared with the prerecession period. *Chart 4* provides one way to answer this question. It shows the results of a survey conducted by the National Federation of Independent Business (NFIB), which asked participants (small business firms) if they are seeing few or no qualified applicants for open positions. The behavior is exactly what would be expected. Immediately following the recession, there was little difficulty filling vacancies among small businesses, but as the recovery progressed and hiring shifted into higher gear, these firms have had less success filling vacancies. However, the survey only extends back to 2004, so long-term behavior is not available for comparison. Still, it is worth noting that the most recent readings are near the record highs seen in October 2007. This implies that the inability of small businesses to get qualified applicants is near its prerecession peak.

Outlook Positive

The outlook for the third quarter is optimistic, but some downside risks remain. The Institute for Supply Management's (ISM) nonmanufacturing business activity subindex climbed in August to 59.6 following a rise in July. The index has been strongly positively correlated with real GDP growth in the past. The Chicago Fed's National Activity Index, in a preliminary estimate, remained at a level consistent with output growth above 3 percent (*Chart 5*).³ Our estimate based on partial data suggests poor growth for real PCE in the third quarter, driven by sharp decreases in July on car, gas, electricity, and gasoline expenditures (*Chart 6*).⁴ Expenditures on some of these items may bounce back in August, but even after excluding them, July growth in expenditures was weak.

Longer-term expectations are positive, according to consensus forecasts. The Blue Chip consensus and the Survey of Professional Forecasters project 3.0 and 3.1

Chart 6
Preliminary Data Suggest Contraction in Third-Quarter PCE



percent annualized output growth, respectively, over the second half, and the Blue Chip consensus calls for 2.9 percent growth in 2015. Moreover, increased wage and price pressures are likely to intensify over the coming year as economic gains further diminish labor market slack and prospective employers compete for available quality labor.

—Daniel Lin and Alan Armen

Notes

1. See <http://www.census.gov/services/>.
2. See "Why Has the U.S. Beveridge Curve Shifted Back? New Evidence Using Regional Data," by Robert G. Valletta, Federal Reserve Bank of San Francisco Working Paper no. 2005-25, December 2005.
3. The preliminary quarterly growth rate estimates are calculated using available monthly growth rate data. The formula, when data for all relevant months are available, is to apply a weight of 1/9 to the second month and 2/9 to the third month of the previous quarter, and 3/9 to the first month, 2/9 to the second month and 1/9 to the third month of the current quarter. Since there is currently only data for the series through July, just two-thirds of the data are available. Hence, the weights become 1/6, 2/6 and 3/6 instead.
4. The same formula was applied as described in note 3 to obtain estimate for third-quarter real PCE growth.

About the Authors

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