DALLASFED Economic Update
National

Outlook Largely Unchanged Despite Disappointing Jobs Report

June 20, 2016

Recent economic data send mixed signals on U.S. economic activity in the second quarter. The May employment report shows some deceleration in labor market momentum. Even so, the outlook for U.S. output growth remains good. The economy is close to full employment, and private consumption is supported by high levels of household confidence, low gasoline prices, low debt burdens, higher net worth ratios and low interest rates. However, downside risks remain. Though global financial conditions have eased since mid-February, a strong dollar, weak global growth and the U.K. "Brexit" decision present headwinds in the near term.

Output Growth Revised Upward

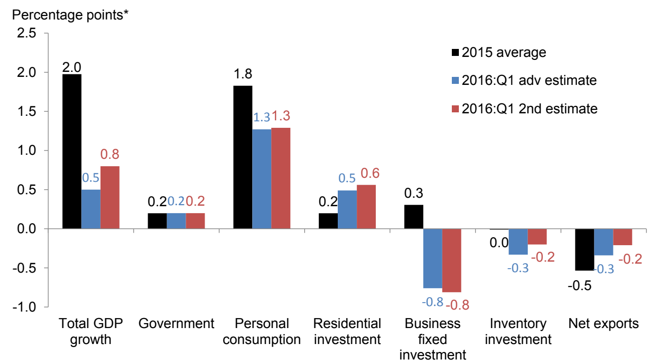
First-quarter U.S. real gross domestic product (GDP) growth was revised up from 0.5 percent to a still-disappointing 0.8 percent *(Chart 1)*. The new estimates primarily reflect upward revisions to private inventory investment, residential fixed investment and net exports (downward revision to imports). Business fixed investment remains a drag on growth, subtracting 0.8 percentage points. Growth in real business investment would have been higher if energy prices and energy-related capital expenditures had not slumped. *Chart 2* shows the collapse of investment in mining and exploration-related structures and equipment.

There are reasons to think that underlying U.S. economic growth is stronger than the GDP numbers suggest. In recent years, first-quarter readings of GDP growth have been lower than in subsequent quarters. This may be the result of "residual seasonality" in the Bureau of Economic Analysis' seasonally adjusted GDP estimates.[1] The growth in real gross domestic income (GDI) was 2.2 percent in first quarter 2016. GDI is an alternate income-based measure of national output, whereas GDP is expenditure based. In theory, the GDI and GDP numbers should be exactly the same; however, timing and source data differences result in different measures. An average of the two growth rates suggests that first-quarter output growth was 1.5 percent.

Labor Market Disappoints in May

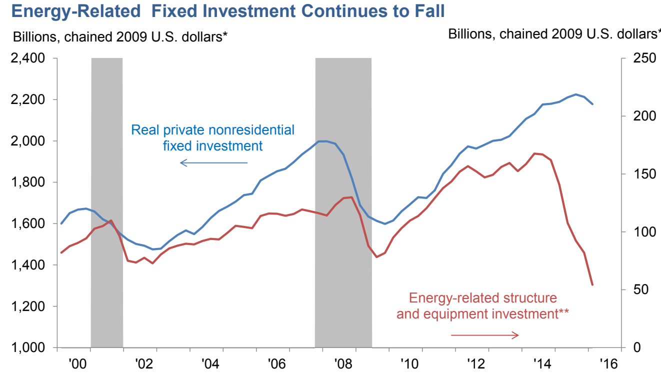
The May employment report surprised on the downside. Nonfarm payrolls rose 38,000 in May, and even if the 35,000 telecom workers who were on strike are added back, the number is still well below the consensus of 160,000 *(Chart 3)*. March and April changes in nonfarm payrolls were revised down by a total of 59,000. The headline, or U-3, unemployment rate, which had flattened at 5 percent, fell to 4.7 percent. Since the U-3 unemployment rate measures the number of unemployed as a percent of the labor force, the drop in unemployment rate reflected a fall in the labor force participation rate, which was down 0.2 percentage points to 62.6 percent, as opposed to an in-

Chart 1
Business Fixed Investment a Drag on First-Quarter Growth



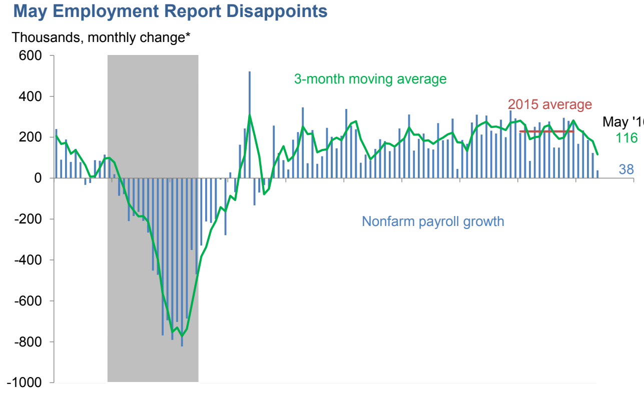
*Contribution to percent change in real gross domestic product growth; quarter/quarter, seasonally adjusted annualized rate.
SOURCE: Bureau of Economic Analysis.

Chart 2
Energy-Related Fixed Investment Continues to Fall



*Seasonally adjusted, annualized rate.
**Approximate chain-weighted structures and equipment aggregates.
NOTES: Energy-related investment refers to the BEA's "Mining Exploration, Shaft, Wells" and "Mining and Oilfield Machinery." Shaded areas indicate recession.
SOURCES: Bureau of Economic Analysis (BEA); author's calculations.

Chart 3
May Employment Report Disappoints

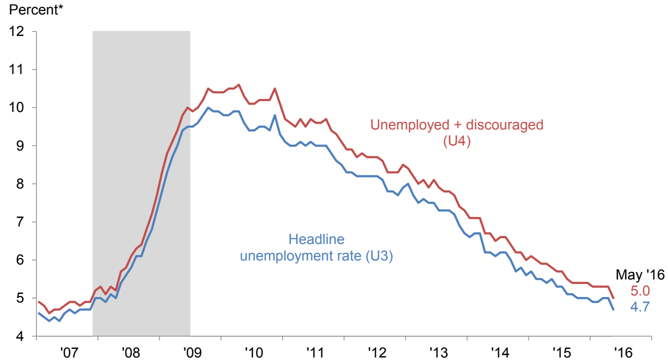


*Seasonally adjusted.
NOTE: Shaded area indicates recession.
SOURCE: Bureau of Labor Statistics.

crease in employment. The employment-to-population ratio remained unchanged at 59.7 percent.

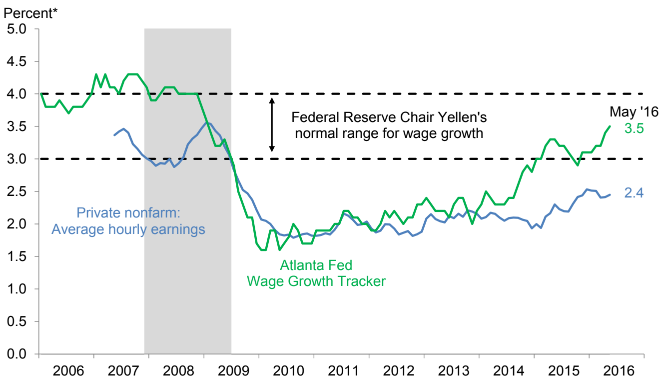
One should not place too much weight on a single month's job numbers since they are subject to large sampling variation; however, the jobs report is still an important indicator. The headline U-3 unemployment rate as well as the U-4 unemployment rate, which includes discouraged workers, both fell 0.3 percentage points, to 4.7 percent and 5.0 percent, respectively *(Chart 4)*.[2] Combined, the dip in the both rates suggests that those who left the labor force did not leave due to poor labor market conditions.

Chart 4
Those Who Left Labor Force Did Not Indicate Discouragement



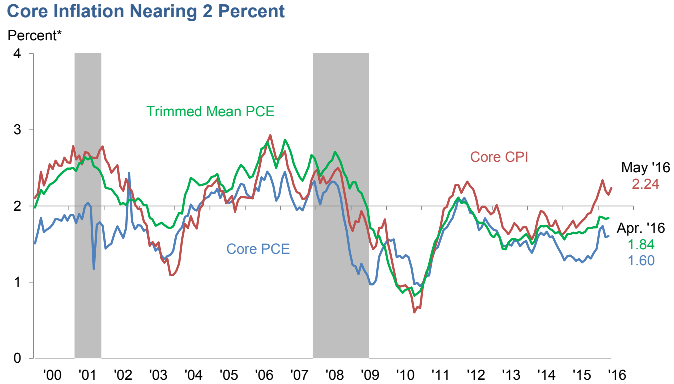
*Seasonally adjusted.
NOTES: Discouraged workers are persons not currently looking for work because they believe no jobs are available for them. Shaded area indicates recession.
SOURCE: Bureau of Labor Statistics.

Chart 5
Alternative Measure of Wage Growth Trending Upward



*Year/year percent change, seasonally adjusted; three-month moving average.
NOTE: Shaded area indicates recession.
SOURCES: Bureau of Labor Statistics; Federal Reserve Bank of Atlanta; Federal Reserve Chair Janet Yellen, press conference, March 19, 2014.

Chart 6
Core Inflation Nearing 2 Percent



*Year/year percent change, seasonally adjusted.
NOTES: The Federal Open Market Committee target for PCE inflation is 2 percent. Shaded areas indicate recession.
SOURCES: Bureau of Economic Analysis; Bureau of Labor Statistics; Federal Reserve Bank of Dallas.

Additionally, job vacancies are high by historic standards, and initial claims for unemployment insurance are historically low, suggesting labor market strength.

Alternative Wage Growth Indicator Rising

In recent years, wage growth has been relatively sluggish despite a strong labor market (excluding May). Growth in Bureau of Labor Statistics (BLS) average hourly earnings for private sector workers has been well below the 3 to 4 percent rate that Federal Reserve Chair Janet Yellen indicated to be normal. Average hourly earnings grew 2.5 percent year over year in May, while the Atlanta Fed's Wage Growth Tracker (WGT) rose 3.5 percent over the same period *(Chart 5)*. The WGT may better reflect underlying wage growth because it tracks the change in earnings of the same employees over a 12-month period.[3]

The BLS's average hourly earnings may be depressed as retiring baby boomers, who are typically high earners, are replaced by young people, who typically earn less. The WGT also takes into account earnings change as an individual moves from one job to another, whereas this change in earnings is not captured in average hourly earnings.

Downward Pressure on Inflation Waning

Core inflation was held down by falling import prices, due to a strong dollar, and the indirect effects of lower energy prices. In April, the core Personal Consumption Expenditures (PCE) price index over 12 months grew 1.6 percent, and in May, the core Consumer Price Index (CPI) grew 2.2 percent *(Chart 6)*.

Because oil prices dropped between July and August of 2015, the negative contribution of low energy prices to 12-month headline inflation should wane in coming months, assuming oil prices do not fall further. Import prices, another drag on inflation, have seen recent gains, and their deflationary pressure should also fade, assuming the dollar remains broadly stable.

In all, headline inflation should move closer to the 2 percent target in the medium term, as suggested by April's Trimmed Mean PCE inflation reading of 1.8 percent.

—Daniel Lin

Notes

1. "Residual Seasonality in GDP and GDI: Findings and Next Steps," Bureau of Economic Analysis, June 1, 2016.

2. Discouraged workers are those who are not looking for a job because they believe no jobs are available to them but have indicated they want and are available to work.

3. The Atlanta Fed Wage Growth Tracker tracks the median wage growth of individuals who are employed in the current month as well as 12 months prior

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About the Author

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