Assistant Secretary Michael Faulkender Economy Statement for the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association

February 3, 2020

The U.S. economic recovery, the longest on record at 10½ years, maintained its momentum at the end of 2019. According to the advance estimate, real GDP grew by 2.1 percent in the fourth quarter, matching the pace in the third quarter. On a fourth quarter over fourth quarter basis, the U.S. economy grew by 2.3 percent in 2019, only marginally slower than 2018's 2.5 percent pace.

Other measures of the economy's performance continue to exhibit strength: consumer and business sentiment remain elevated, the housing sector continues to consolidate its gains and home affordability has improved further. Moreover, labor markets remained tight according to a variety of measures. Employers added an average of 176,000 workers per month in 2019, and the total number of payroll jobs added since the November 2016 election rose to 7.2 million by December 2019. The unemployment rate stood at a 50-year low at the end of 2019, and strong nominal wage growth has propelled real wage gains amid moderate rates of inflation.

The performance in 2019 reflected the economy's underlying resilience in the face of headwinds throughout the year, including slowing global growth, a labor dispute at General Motors, and the grounding of the Boeing 737 MAX aircraft. Bolstered by the Tax Cuts and Jobs Act of 2017 (TCJA), as well as the Administration's deregulatory measures, the economy has continued to grow, create new jobs, and provide meaningful increases in nominal and real wages.

GDP Growth

Real GDP grew at an annualized rate of 2.1 percent in 2019 Q4, consistent with the pace in the previous quarter. However, the pace of private domestic final purchases – the sum of personal consumption, business fixed investment, and residential investment – decelerated to 1.4 percent in the fourth quarter from 2.3 percent in the third quarter, hindered by slower growth of personal consumption expenditures.

Real consumer spending slowed to 1.8 percent in the fourth quarter, after rising 3.2 percent in the third quarter and surging 4.6 percent in the second quarter. Purchases of services and durable goods drove fourth quarter growth in real consumption, rising 2.0 percent and 2.1 percent, respectively. Yet consumption of nondurable goods increased only 0.8 percent in the fourth quarter. On balance, real personal consumption expenditures in Q4 added 1.2 percentage points to growth, making the second-largest contribution of any component of GDP.

Although business fixed investment again constrained GDP growth, it posed only a modest drag in the fourth quarter, subtracting 0.2 percentage point from real GDP. Total business fixed investment declined 1.5 percent in the fourth quarter, less than the 2.3 percent decrease in the previous quarter. Equipment investment was down 2.9 percent, also tapering a bit from the third quarter's 3.8 percent decline. Spending on structures fell 10.1 percent, about in line with declines in the previous two quarters. Lower structures investment was broadly based – from decreased investment in oil and gas drilling rigs to fewer expenditures on commercial and health care structures. In contrast to equipment and structures investment, expenditures on intellectual property products, considered key to innovation and future economic growth, has been consistently solid for the past several quarters. This category of business investment even accelerated in the final quarter of 2019, picking up to 5.9 percent after gaining 4.7 percent in the third quarter.

Notably, the change in private inventories posed the largest drag on economic growth in the fourth quarter, subtracting 1.1 percentage points. Albeit a volatile component, the sharp decline in private inventory investment in the fourth quarter was largely due to a significant decrease in inventories at motor vehicle dealers, reflecting in part retailers' inability to replace inventories during the labor strike at General Motors from mid-September to late October.

After several quarters of retrenchment, residential investment activity improved in the second half of 2019, making small positive contributions to real GDP growth. In the fourth quarter, residential investment advanced 5.8 percent – extending the 4.6 percent gain in the third quarter – and added 0.2 percentage point to GDP growth. The stabilization and improvement in the housing sector has been widespread. Existing home sales, which account for 90 percent of all home sales, rose to a near two-year high in December and were almost 11 percent higher over the past year. New single-family home sales rose to a 12-year high last September and, after retracing a bit, were 23 percent higher on the year through December. Strong sales growth has weighed on inventories of homes available for sale, which remain at relatively low levels. However, new construction is rising and builders are confident in the sector's outlook: total housing starts surged by almost 17 percent in December, and the National Association of Home Builder's home builder confidence index rose in December to its highest level since June 1999, before edging down one point in January. Moreover, house affordability continued to improve in 2019, with 12-month home price growth rates slowing significantly, and mortgage rates about 1¼ percentage point below levels in mid-November 2018.

Total government spending rose 2.7 percent at an annual rate in the fourth quarter, accelerating from the 1.7 percent pace in the third quarter. Federal outlays rose 3.6 percent in the fourth quarter, picking up from a 3.3 percent increase in the third quarter. State and local government spending has been growing more consistently since the end of 2017 and accelerated to 2.2 percent in the fourth quarter, after advancing 0.7 percent in the third quarter. Altogether, government spending added 0.5 percentage point to real GDP growth in the fourth quarter.

The U.S. trade deficit narrowed significantly in the fourth quarter of 2019, as export growth accelerated for the second consecutive quarter and import growth turned sharply negative. Thus, after posing a drag on growth in the second and third quarters, net exports made the largest contribution of any component of GDP, adding 1.5 percentage points to real economic growth.

Labor Markets and Wages

During 2019, the economy generated 176,000 payroll jobs per month on average. Although slower than 2018's average monthly pace of 223,000, the pace of job growth remained well above the 80,000 to 130,000 net hires private analysts consider necessary each month in order to absorb new entrants into the labor force and maintain a stable unemployment rate. By the end of 2019, the pace of job creation had brought the number of payroll jobs added in the economy since the November 2016 election to 7.2 million.

In December, the unemployment rate remained at 3.5 percent, a 50-year low, where it stood in November and September as well. Notably, the most comprehensive measure of labor market slack, which includes those marginally attached to the labor force as well as those working part-time for economic reasons (the U-6 rate), declined to 6.7 percent, a series low (series dates from 1994). By way of comparison, that rate is 2.4 percentage points below the pre-recession average of 9.1 percent. Despite these low rates, employers have a surplus of job openings, also indicating a significant degree of labor market tightness. For 21 consecutive months through December, the number of job openings have exceeded the number of unemployed persons.

The extent of the availability of jobs is even more remarkable given rising labor force participation rates, which themselves are noteworthy as the population ages. The overall labor force participation rate (LFPR) stood at 63.2 percent in December, just below the six-year high reached last October but 0.2 percentage point higher over the past year. The LFPR for prime-age workers (ages 25-54) rose to 82.9 percent in December, a 10-year high. The employment report for January 2020 will be released this Friday, February 7.

Meanwhile, workers saw solid wage growth in 2019: nominal wages for private-sector production and nonsupervisory workers were up 3.0 percent over the year ending in December. This was the seventeenth consecutive month in which wage growth was at or above a 3 percent pace – a first since early 2009. Combined with still-moderate inflation, this strong nominal growth has helped real wage growth. Throughout most of 2019, 12-month growth of real wages of private-sector production and nonsupervisory workers exceeded 1.5 percent, whereas growth in 2018 was negligible. Looking at another measure of wage and salary growth, the Employment Cost Index, private wages and salaries grew by 3.0 percent year-over-year in the fourth quarter; growth of this measure has remained at or above the 3.0 percent market for six consecutive quarters, a first since 2007.

Prices

For much of 2019, headline consumer price inflation was slow, reflecting decreasing energy prices. However, inflation picked up at the end of 2019 as energy prices began to recover. Despite this acceleration, inflation remains moderate: over the 12 months through December, the Consumer Price Index (CPI) for all items rose 2.3 percent, above the 1.9 percent pace a year earlier. After seven consecutive months of year-over-year declines, energy prices rose 3.4 percent over the 12 months through December, a noticeable acceleration from the 0.3 percent decline over the previous year. Food price inflation has picked up only modestly, rising 1.8 percent over the over the 12 months through December, compared with the 1.6 percent, year-earlier advance. In contrast, core inflation, which excludes food and energy, has been relatively steady for much of 2019. Core CPI was 2.3 percent over the year through December, a touch faster than the 2.2 percent pace of a year earlier.

Other price measures, however, show a continued deceleration in inflationary pressures. The headline Personal Consumption Expenditures (PCE) Price Index (the preferred measure for the FOMC's 2 percent inflation target) has held below the target since November 2018. The 12-month headline PCE inflation rate slowed to 1.6 percent over the 12-months through December 2019 from 1.8 percent over the year through December 2018. Core PCE inflation was also 1.6 percent over the year through December 2019, decelerating from the 2.0 percent pace over the year-earlier period.

Conclusion

The U.S. economy has demonstrated a remarkable resilience in the face of global and domestic headwinds. Real GDP growth was solid and steady in the fourth quarter of 2019, and by the end of the year, economic weakness was only apparent in the manufacturing sector. Yet, the outlook for this sector remains favorable, with the conclusion of the strike at General Motors, achievement of the “phase one” trade deal with China, and expected progress in other trade negotiations. While some downside risks have receded, others remain, such as further production cuts at Boeing and growing uncertainty over the likely impact of the Coronavirus on global and domestic economic growth. Nonetheless, the underlying fundamentals of growth remain strong in the U.S., including strong labor markets, solid wage gains, elevated business and consumer sentiment, firming housing markets, and muted inflation. Private forecasters predict real GDP growth of 2.2 percent in 2020 on a Q4-over-Q4 basis and 2.0 percent in 2021. Even so, the Administration foresees growth nearing 3 percent as temporary headwinds fade, leading to renewed business investment and stronger productivity growth.