Federal Reserve Bank of Dallas

The National Economy

Current conditions, outlook, and perspectives on the labor market

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37th Annual National UI Issues Conference, 6/27/18

The views expressed are my own and do not necessarily reflect official positions of the Federal Reserve System.

Roadmap

- Higher frequency indicators / current conditions
- Closer look at the labor market
  - Long-run shifts
- Outlook for next several quarters

Higher-frequency indicators: Where we are now

Quick sketch of current conditions

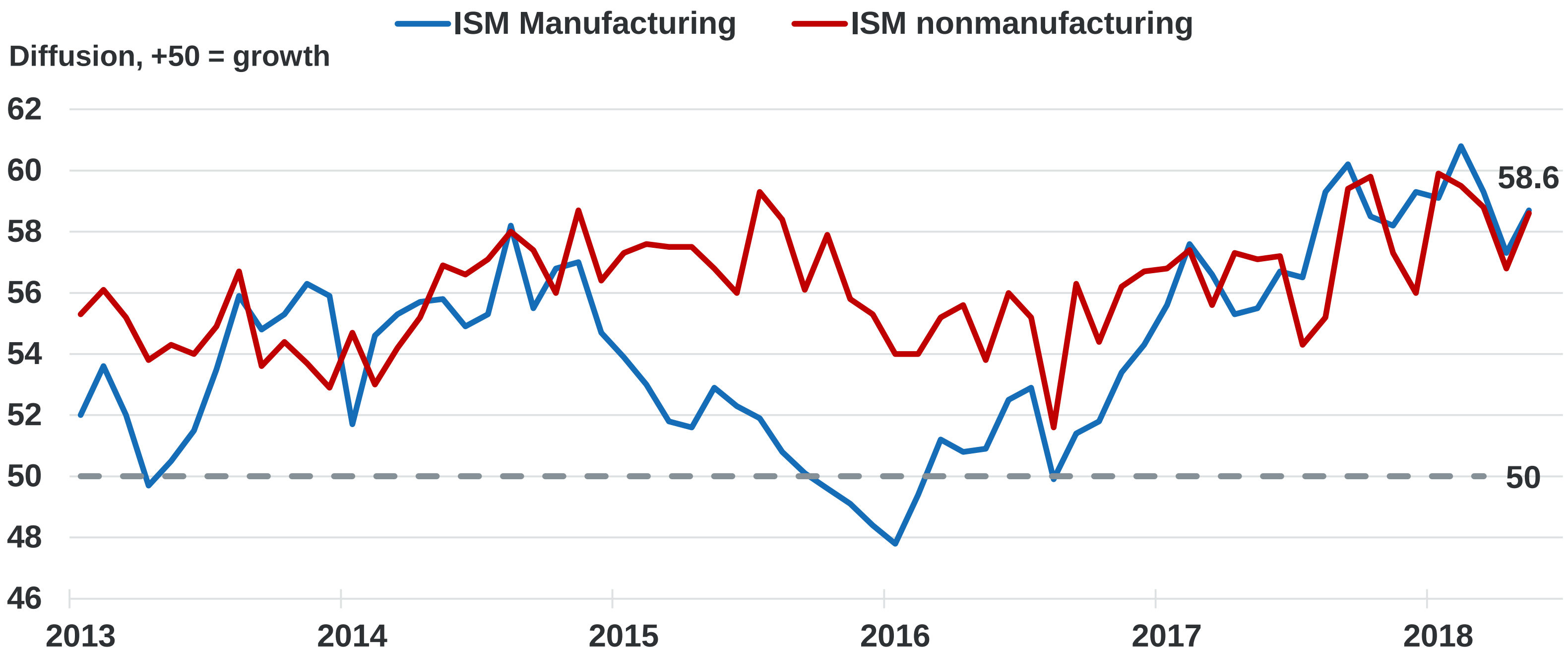
- Economy operating at or near potential
- Continued solid growth in economic activity
- Some headwinds have turned to tailwinds—e.g., overseas growth—plus fiscal stimulus
- Labor market tight & tightening further
- Inflation getting close to the Fed’s long-run goal of 2 percent, and has picked up noticeably in recent months

Q2 real GDP growth expected at 3+ percent

- Real GDP grew at a 2.2 percent annualized clip in Q1.
- That's in line with average growth over the past 5 years: 2.3 percent.
- Projections for current quarter, Q2, between 3–4 percent.

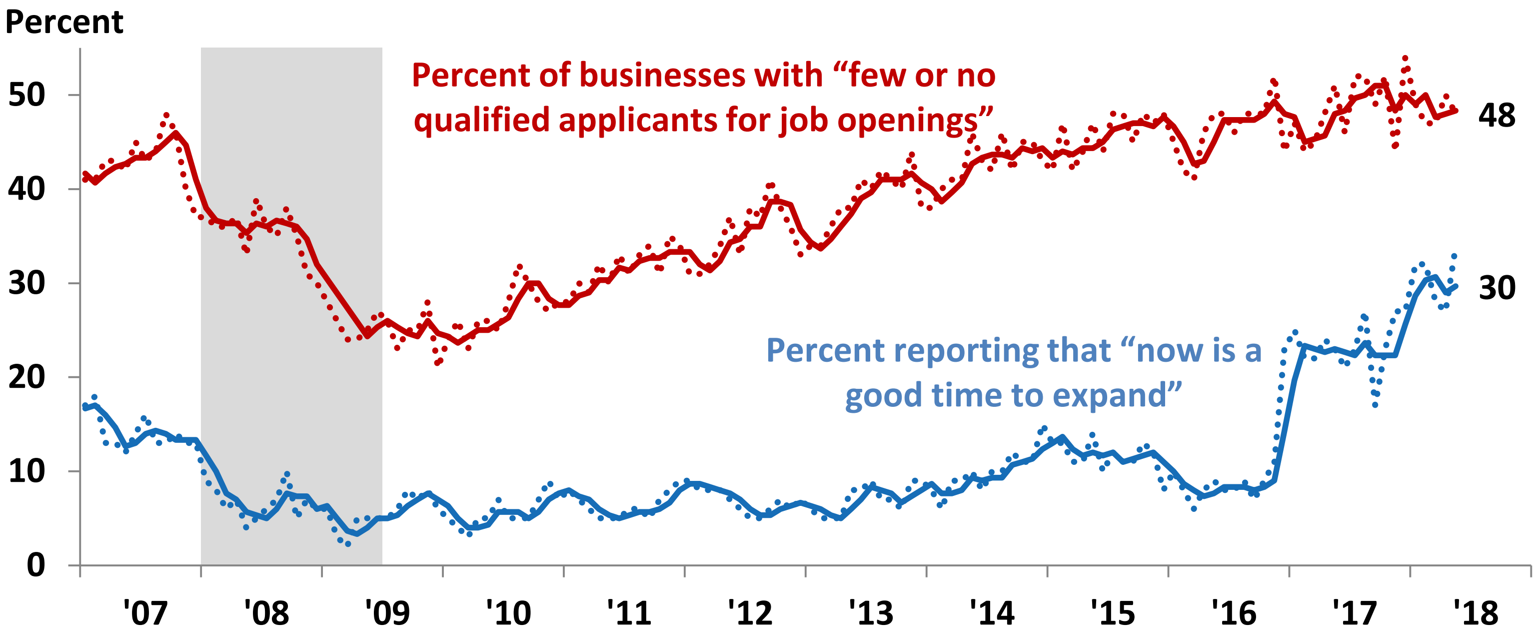
	Q2 growth projection
Simple new orders + ADS index model	3.4
Blue Chip	3.5
New York Fed nowcast	3.1
Atlanta Fed nowcast	4.6

Purchasing manager surveys point to robust growth in manufacturing, services



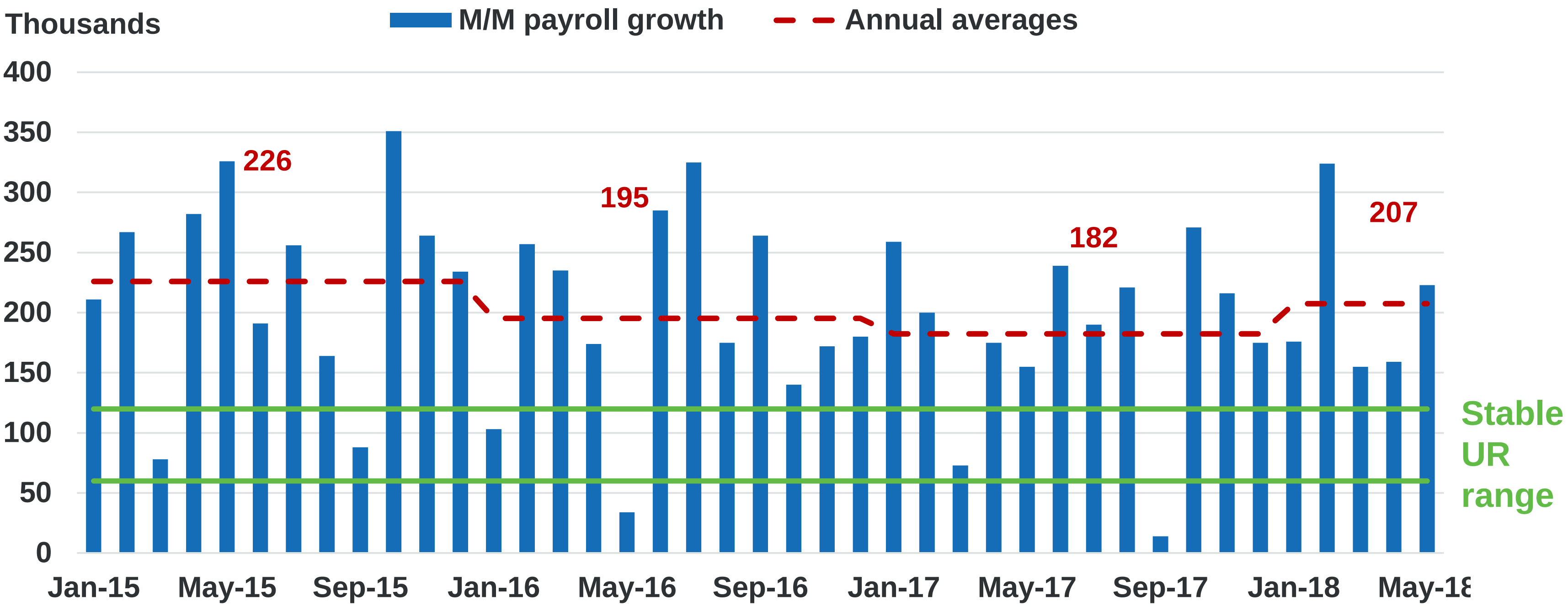
Source: Institute for Supply Management

Small business survey shows a gradually tightening labor market and markedly improved optimism



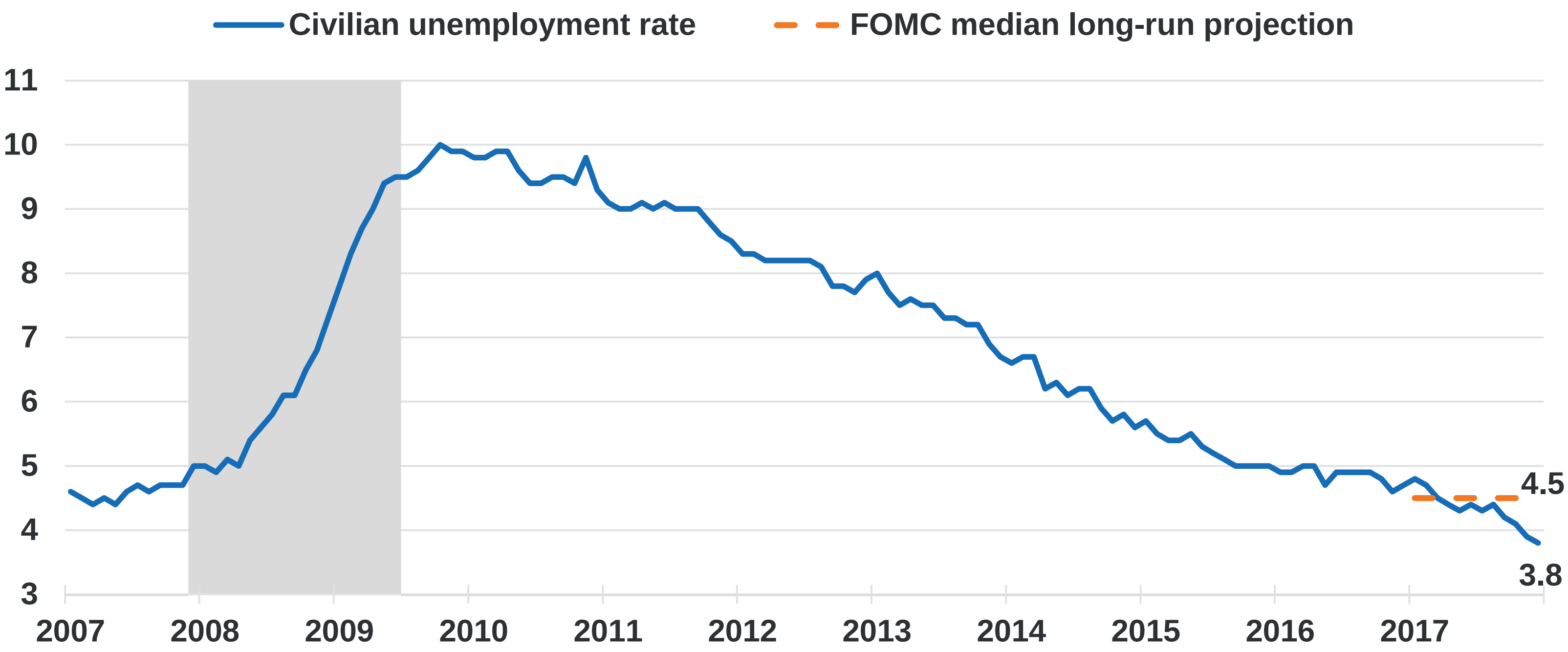
Sources: National Federation of Independent Businesses, author's calculations

Robust payroll gains continue



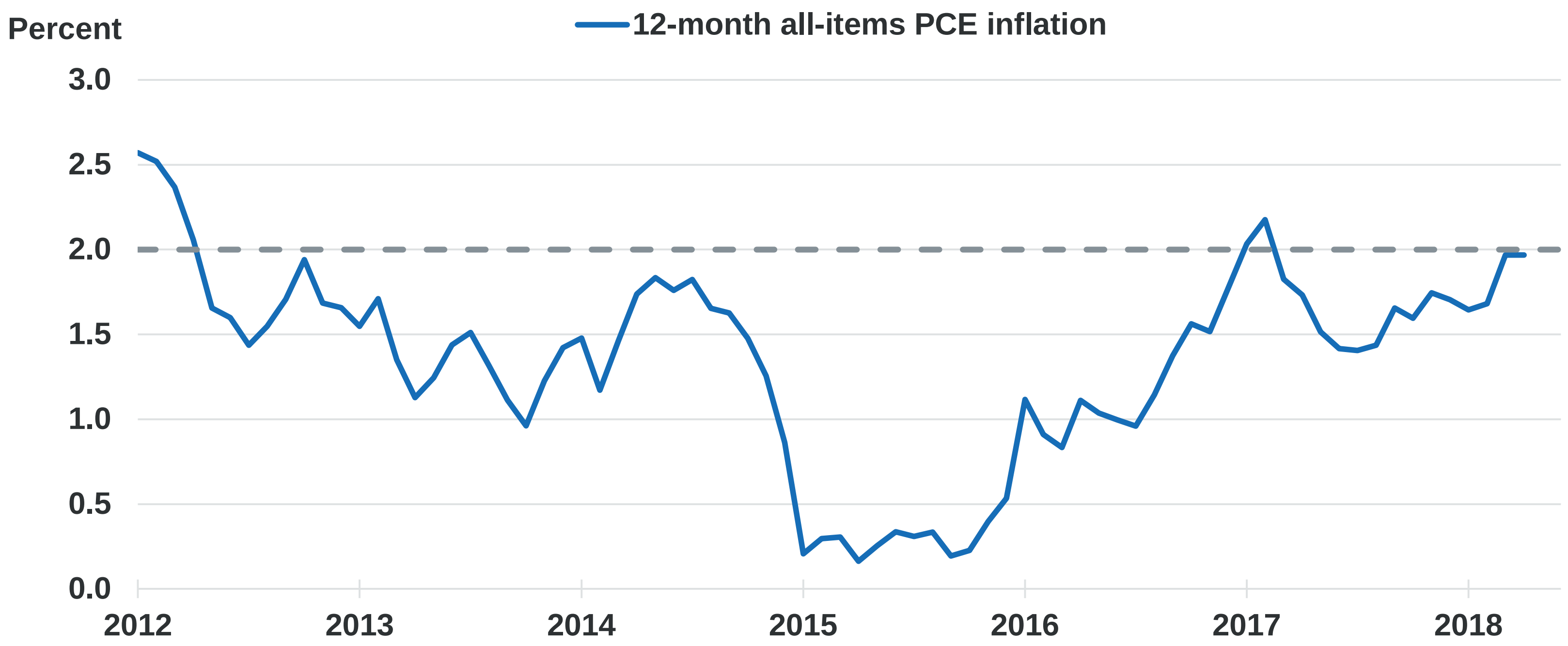
Source: BLS, author’s calculations

Unemployment rate now 3.8 percent, well below policymakers’ long-run projection



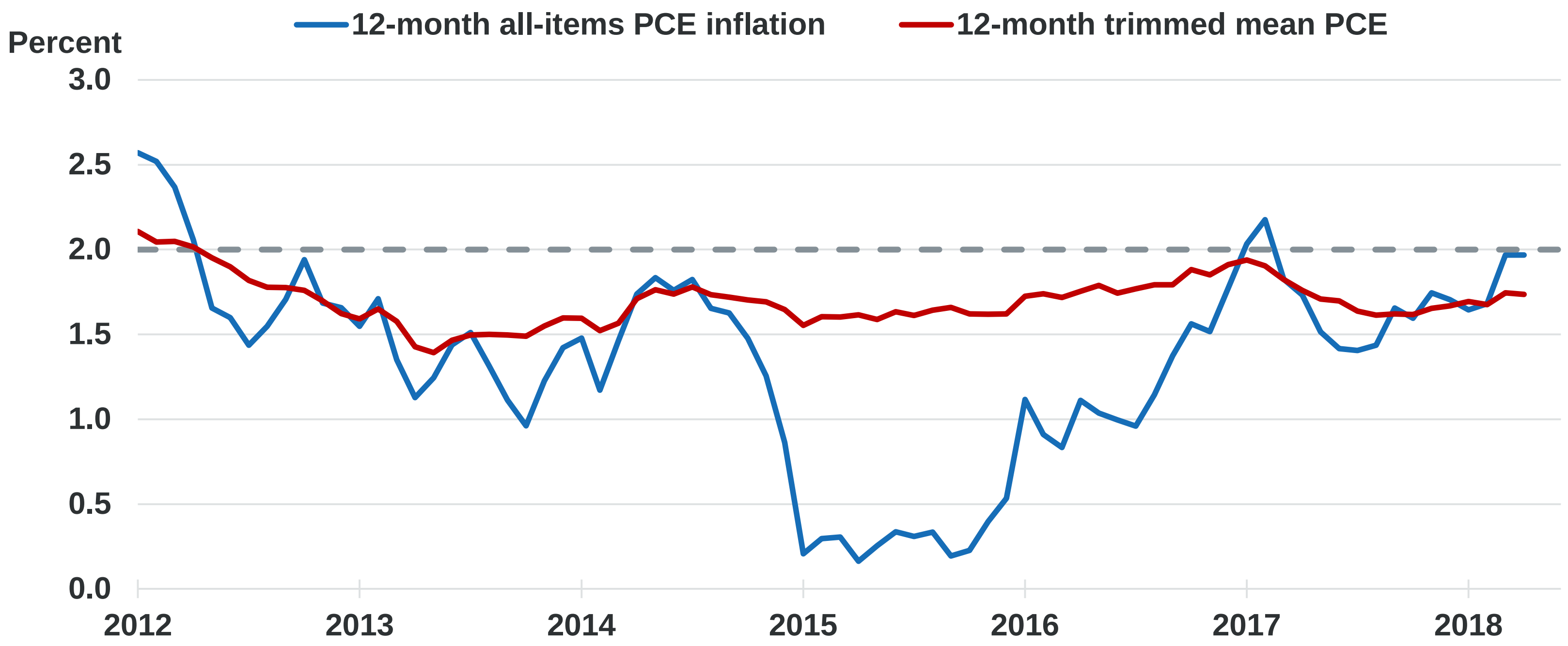
Source: BLS, FRB-FOMC

Headline PCE inflation slowed in early 2017, now rebounding



Sources: BEA

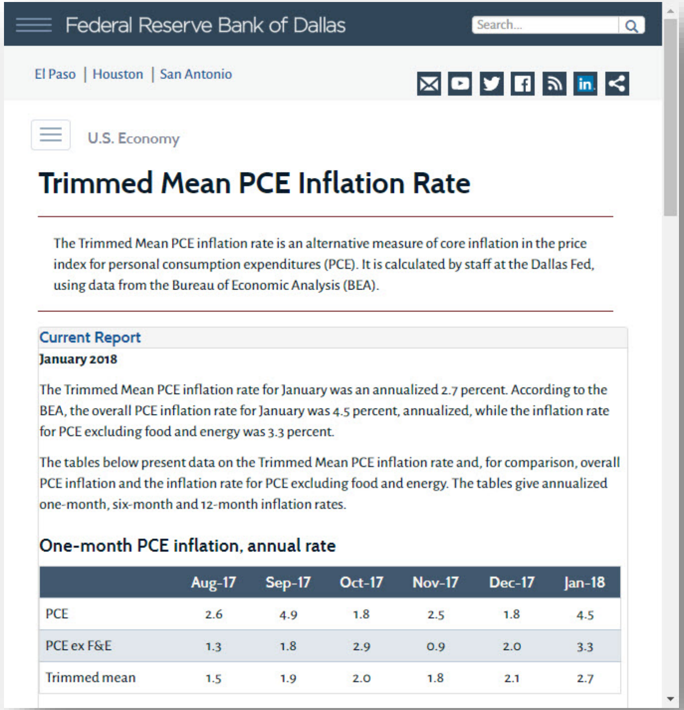
Early 2017 slowing also present in core inflation measures



Sources: BEA, FRB Dallas

Self-serving digression: The Dallas Fed's trimmed mean PCE inflation measure

- Unlike "ex food and energy," trimmed mean doesn't always exclude the same set of items
  - Not all F&E volatile, not all volatile items are F&E
- We trim out the most extreme price movements, whatever the items, then aggregate
- Proven to be good gauge of underlying inflation trends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U.S. Economy

Trimmed Mean PCE Inflation Rate

The Trimmed Mean PCE inflation rate is an alternative measure of core inflation in the price index for personal consumption expenditures (PCE). It is calculated by staff at the Dallas Fed, using data from the Bureau of Economic Analysis (BEA).

Current Report

January 2018

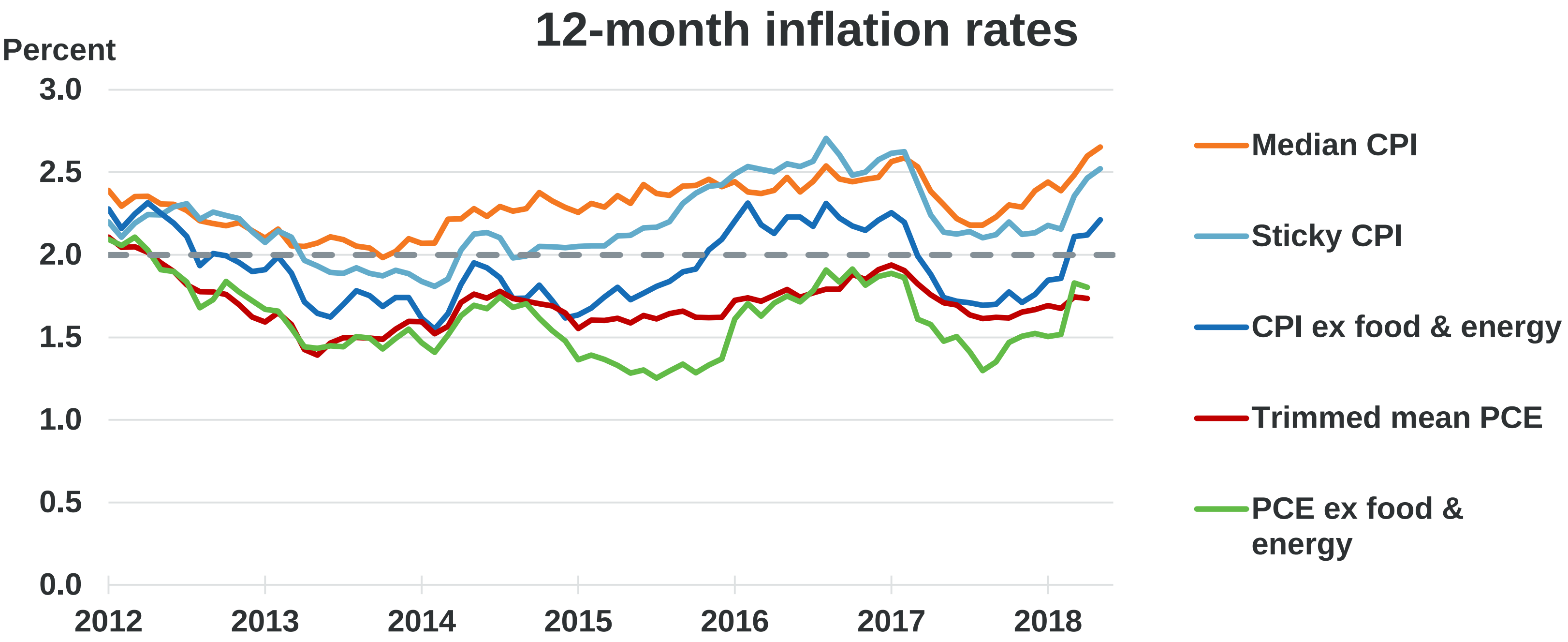
The Trimmed Mean PCE inflation rate for January was an annualized 2.7 percent. According to the BEA, the overall PCE inflation rate for January was 4.5 percent, annualized, while the inflation rate for PCE excluding food and energy was 3.3 percent.

The tables below present data on the Trimmed Mean PCE inflation rate and, for comparison, overall PCE inflation and the inflation rate for PCE excluding food and energy. The tables give annualized one-month, six-month and 12-month inflation rates.

One-month PCE inflation, annual rate

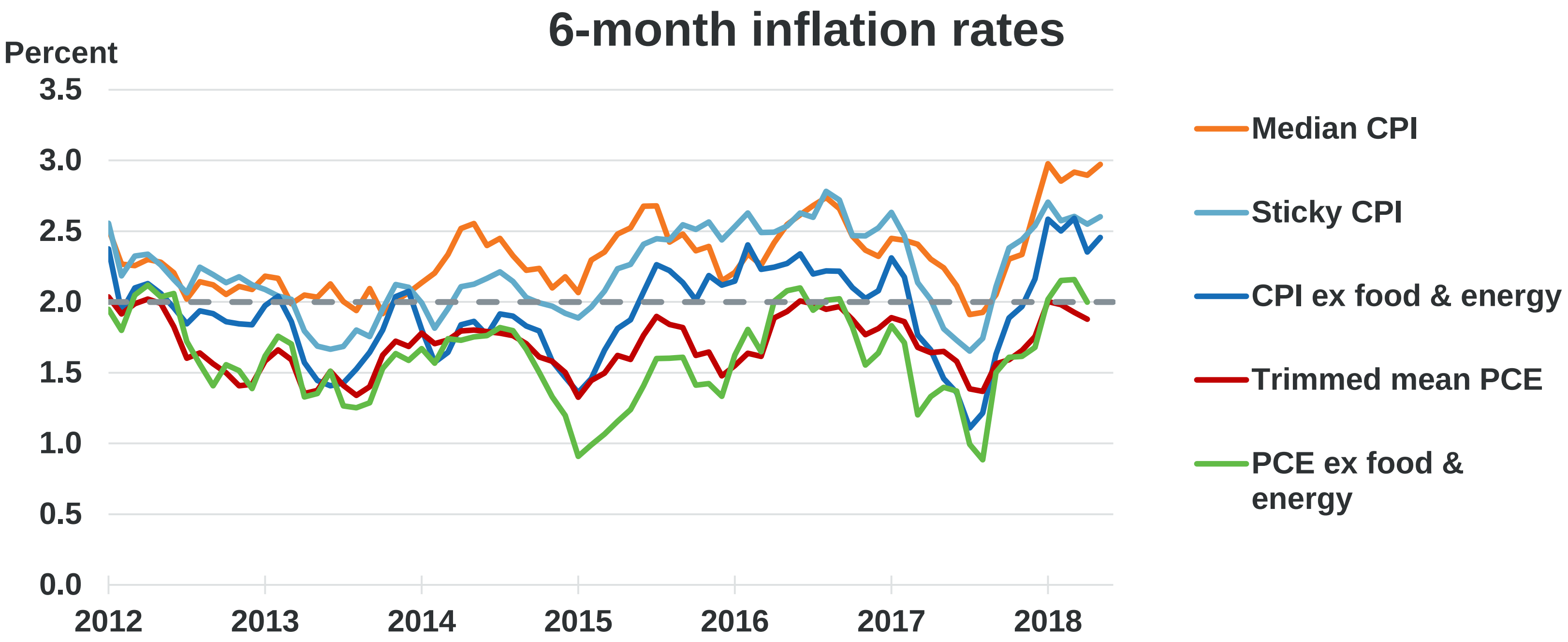
	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18
PCE	2.6	4.9	1.8	2.5	1.8	4.5
PCE ex F&E	1.3	1.8	2.9	0.9	2.0	3.3
Trimmed mean	1.5	1.9	2.0	1.8	2.1	2.7

12-month core inflation rates rebounding after dipping early last year…



Sources: BEA, BLS, FRBs Cleveland, Dallas, Atlanta

...and six-month rates show even sharper pick-up

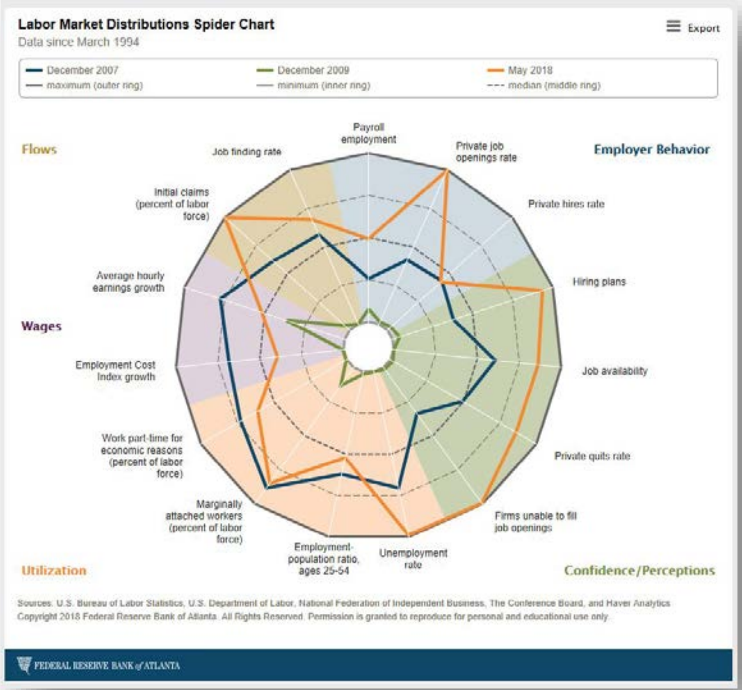


Sources: BEA, BLS, FRBs Cleveland, Dallas, Atlanta

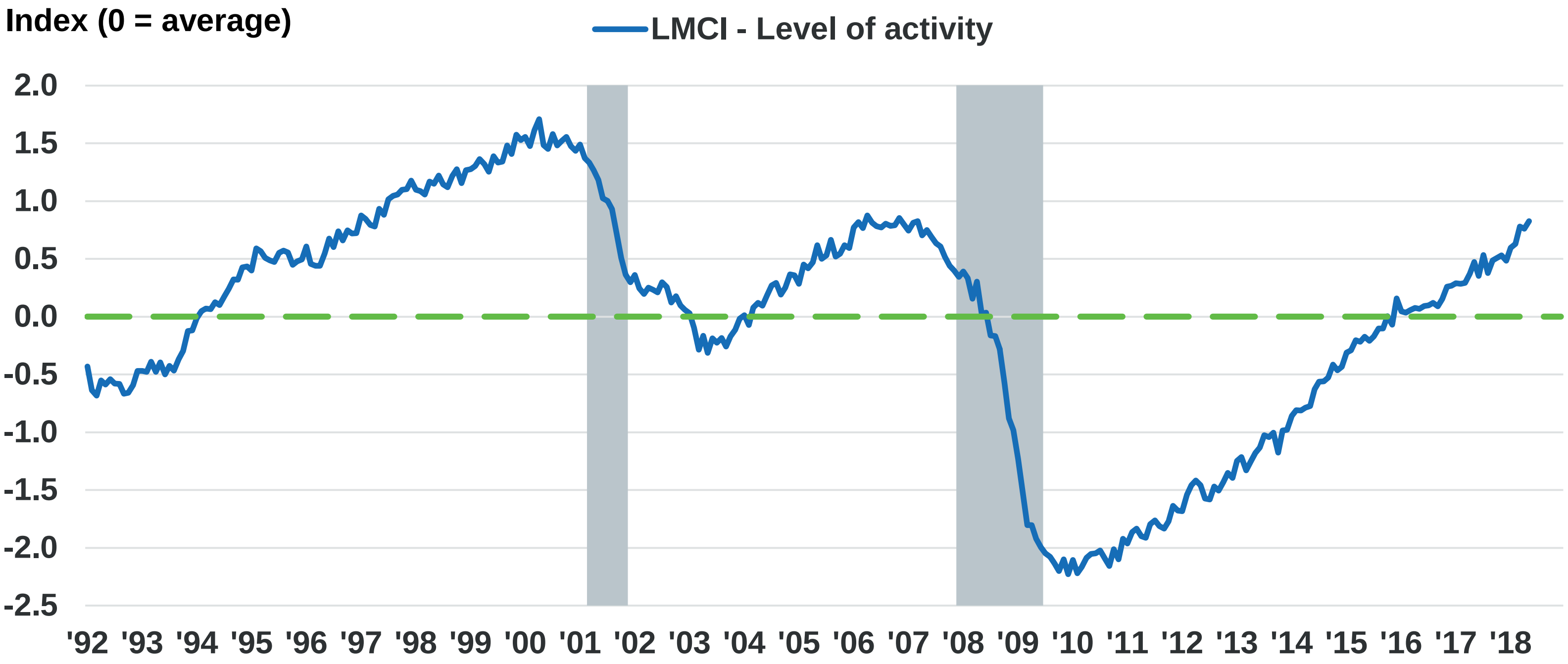
A closer look at the labor market

A closer look at the labor market

- Highlight some data, resources from the Fed system
- Impact of long-run trends, like aging of the labor force
- Put some context around recent striking numbers
- Highlight some longer-run challenges, like declining prime-age participation

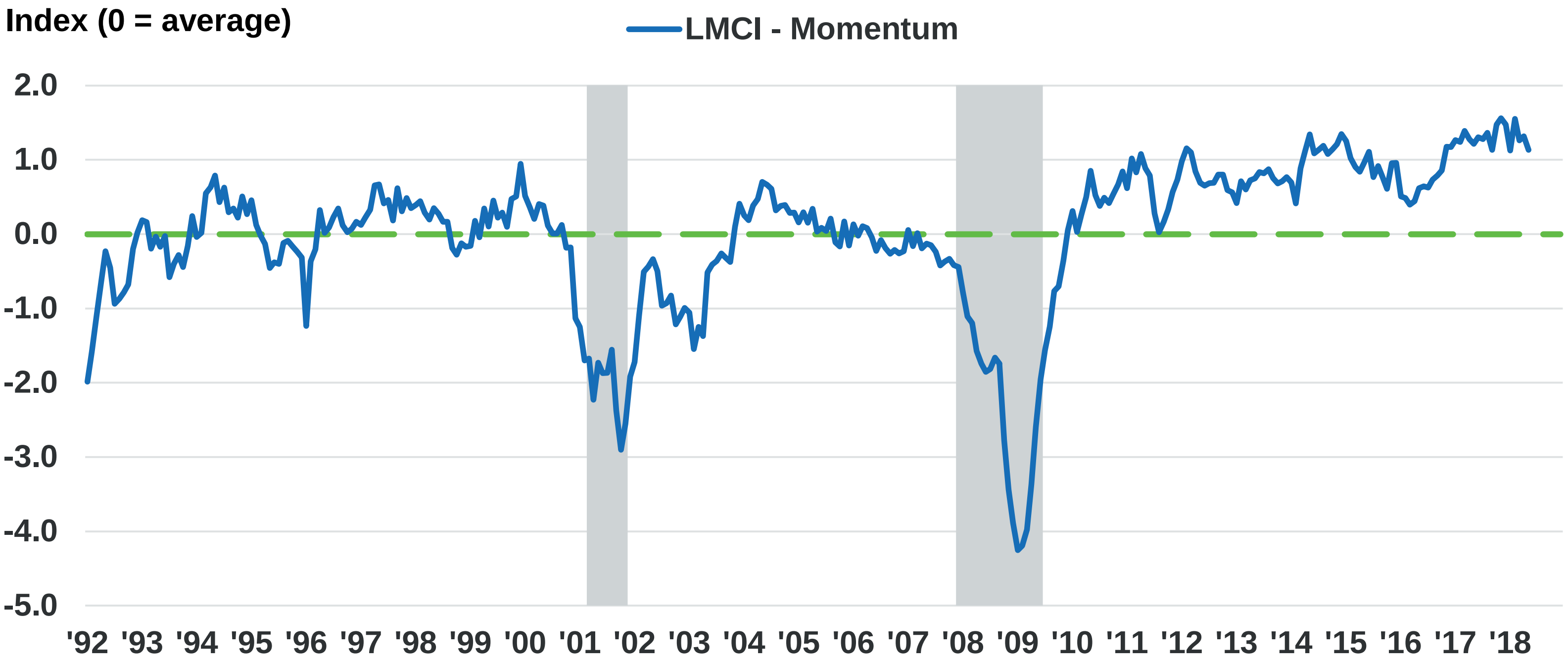


KC Fed labor market conditions index near its pre-recession level



Source: FRB Kansas City

Labor market also has a lot of forward momentum

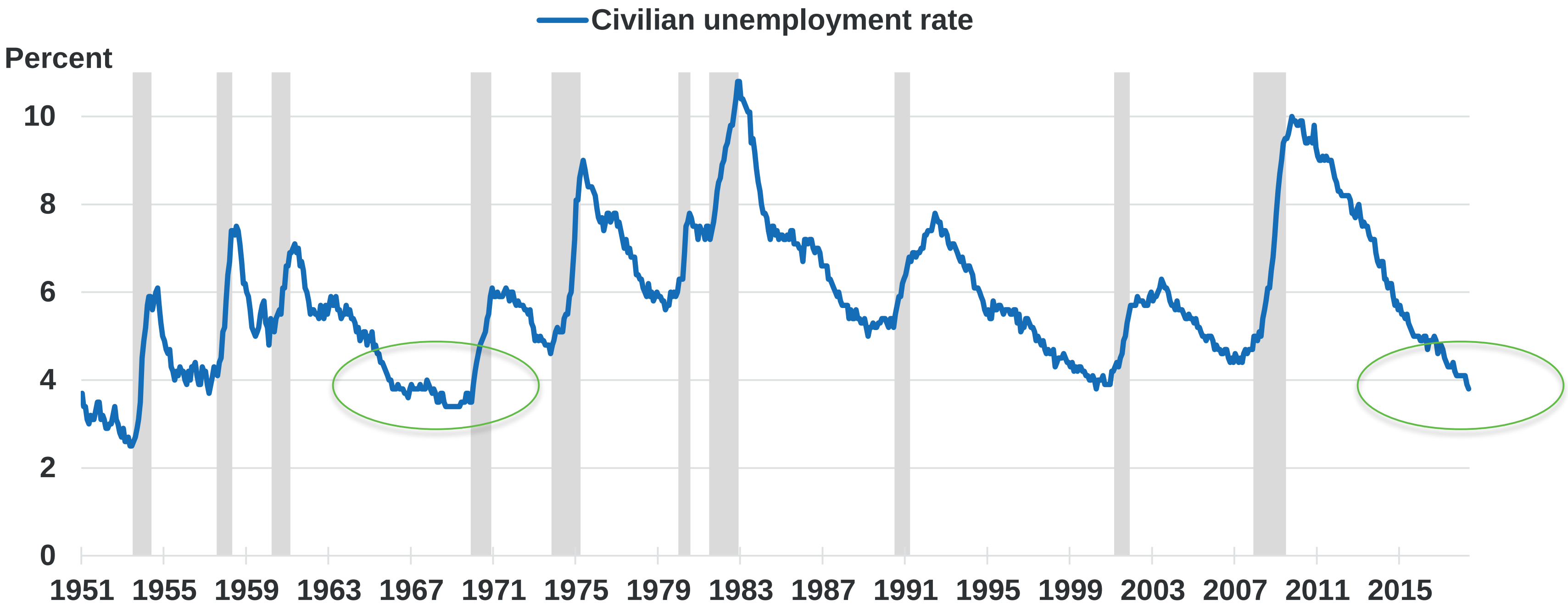


Source: FRB Kansas City

Ratio of unemployment to job vacancies near all-time low levels

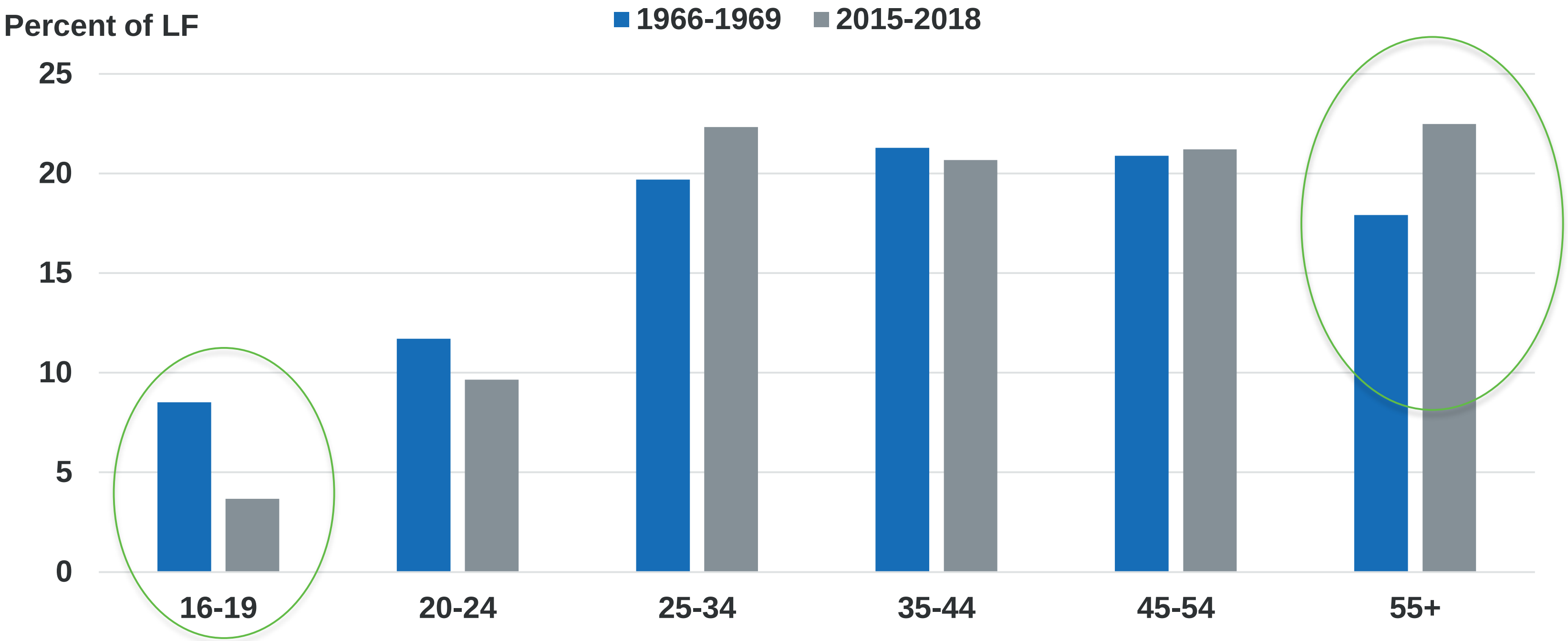
Sources: BLS, NBER and Regis Barnichon (FRB San Francisco)

Unemployment rate dips below 4 percent; this doesn't happen often!



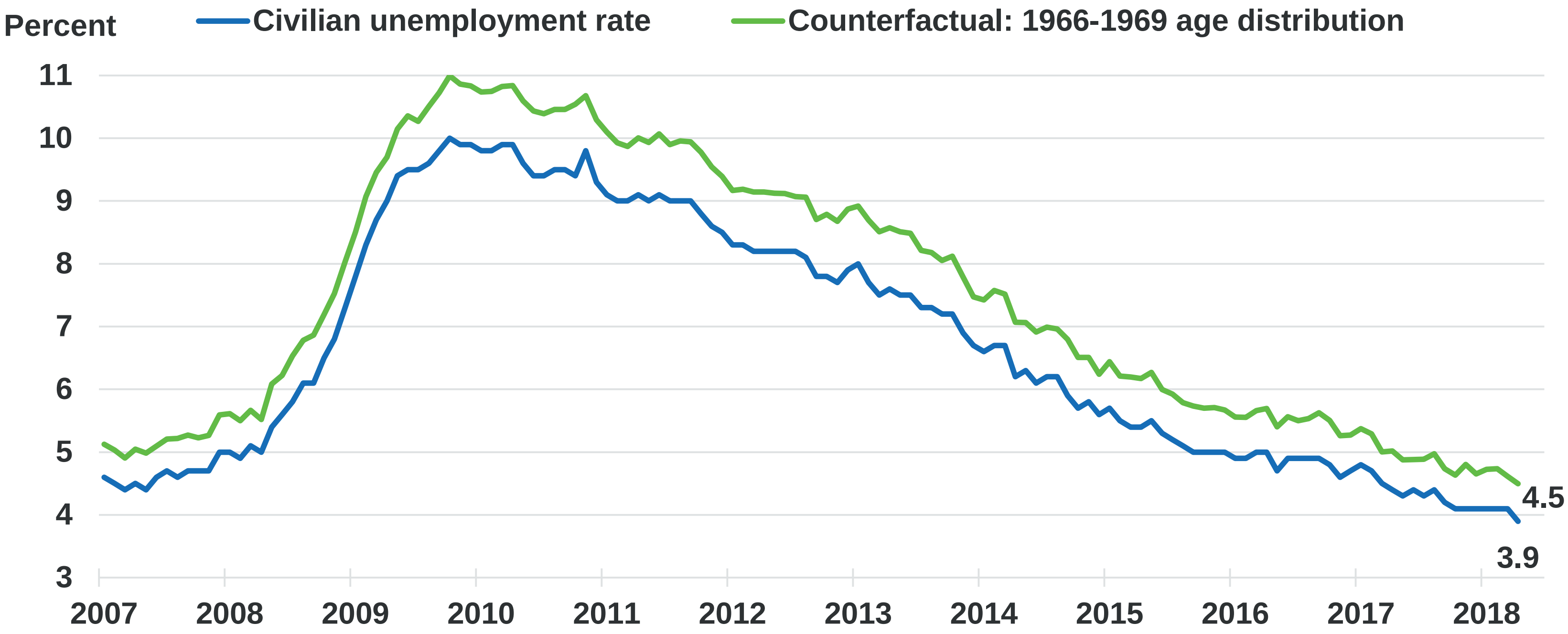
Sources: BLS, NBER

Shift in age distribution away from young, toward old since 1960s



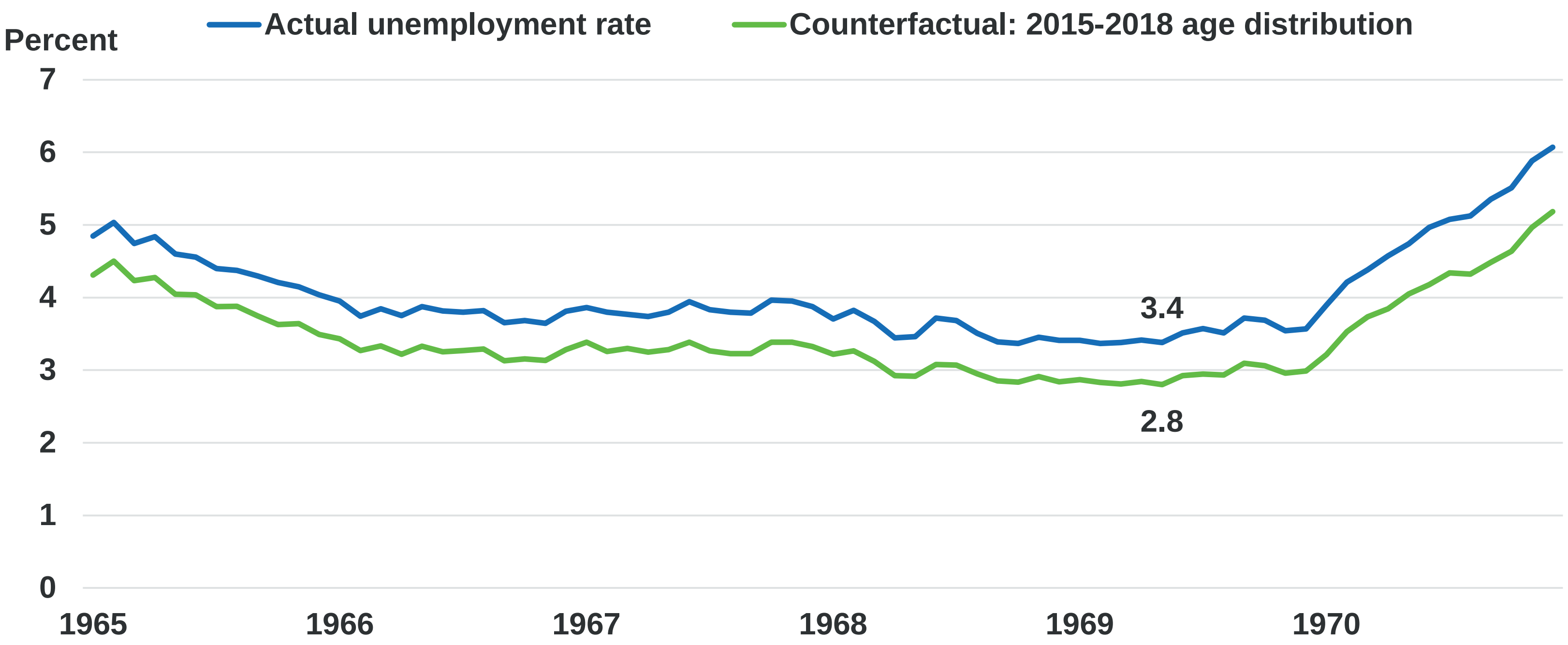
Sources: BLS, author’s calculations

Demographic shifts make comparison to late 1960s unemployment more subtle than meets the eye



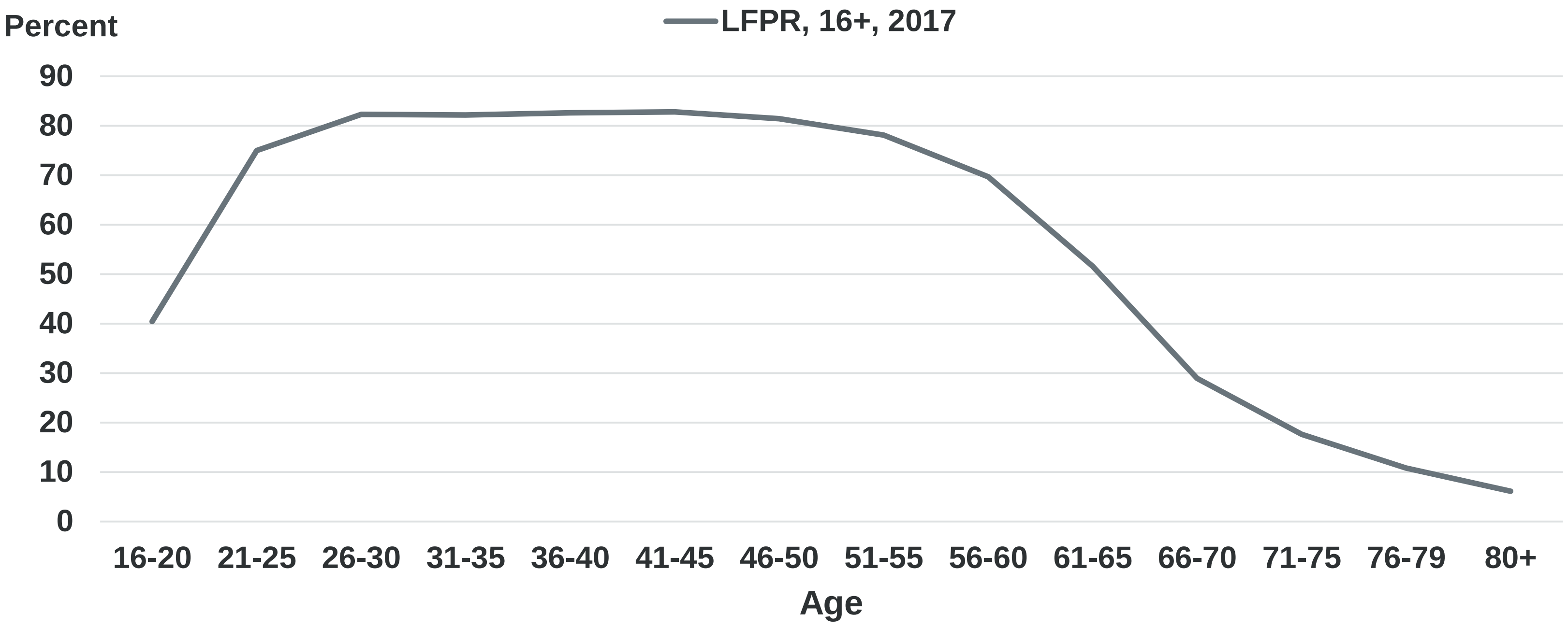
Sources: BLS, author’s calculations

Or flipping things around: If the late 1960s had our age distribution



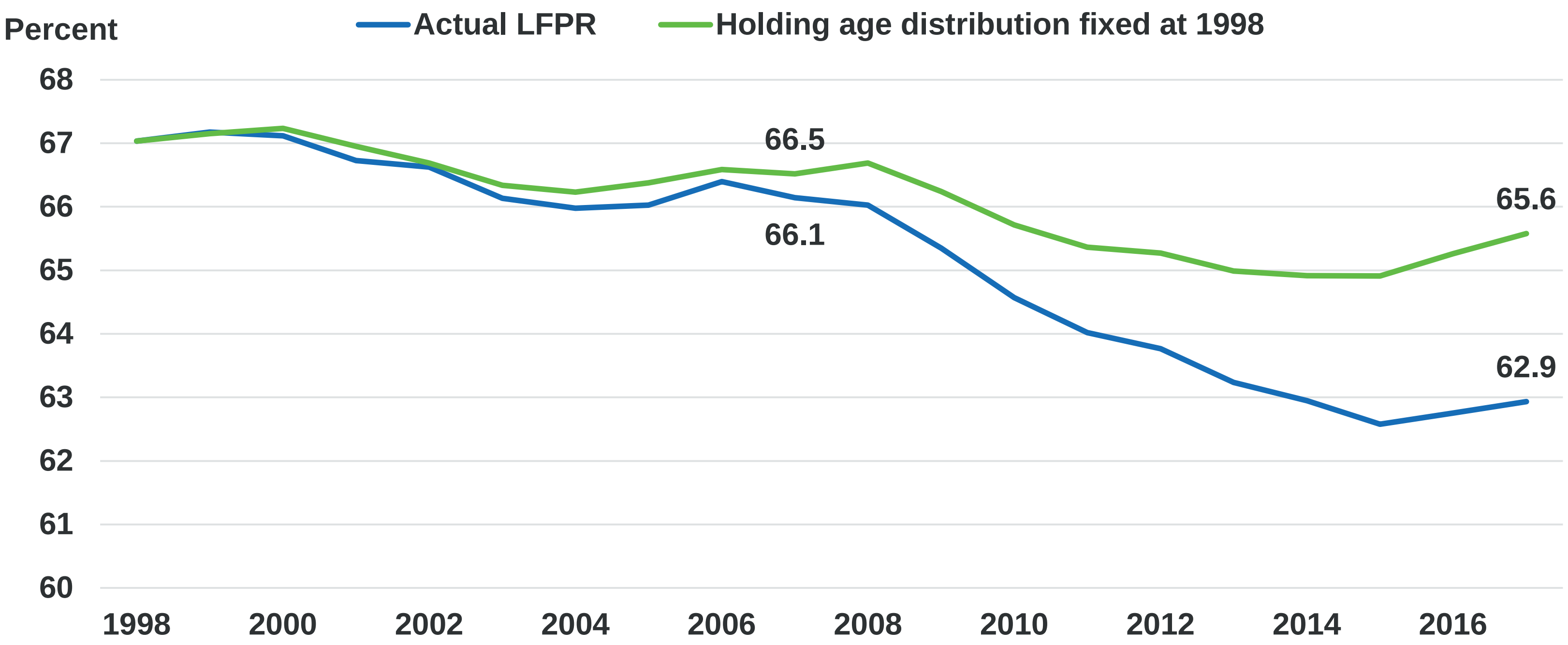
Sources: BLS, author's calculations

Labor force participation rates by age: Lower for the young and old, higher for prime ages



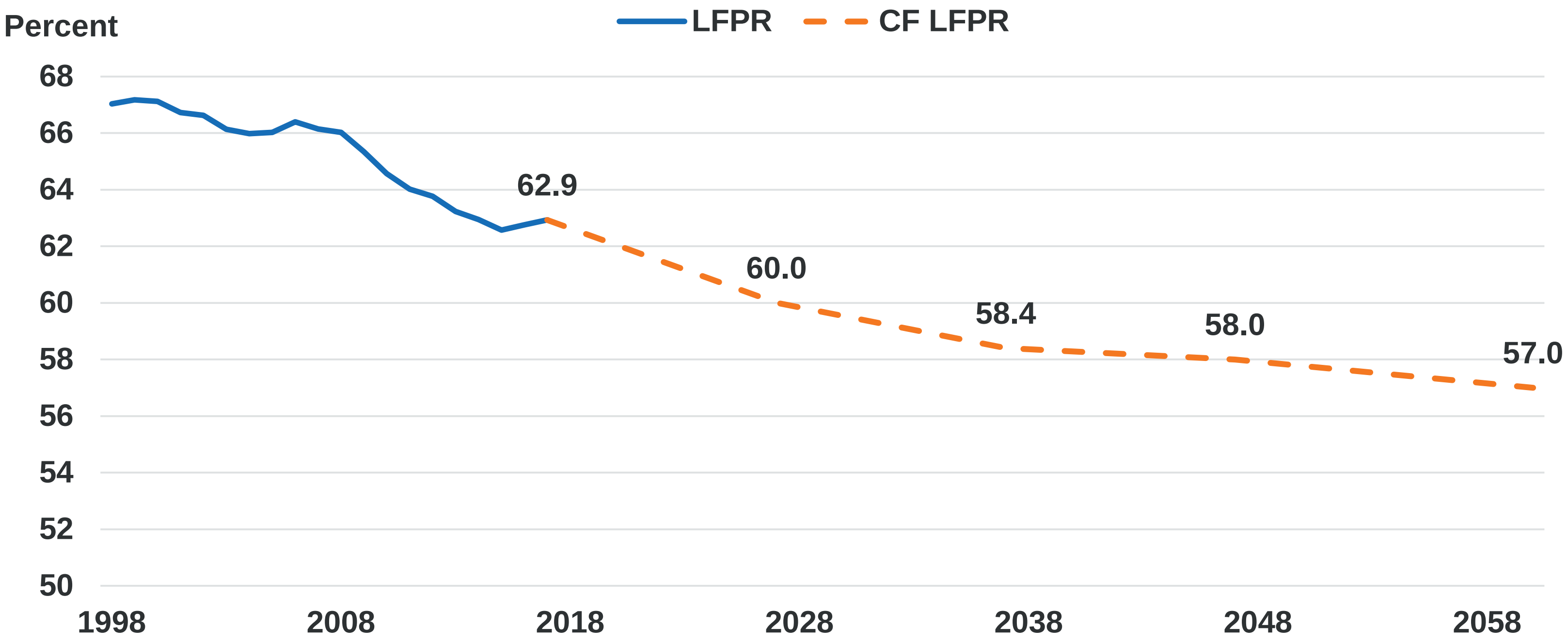
Sources: BLS, FRB Atlanta

Aging effects on labor force participation



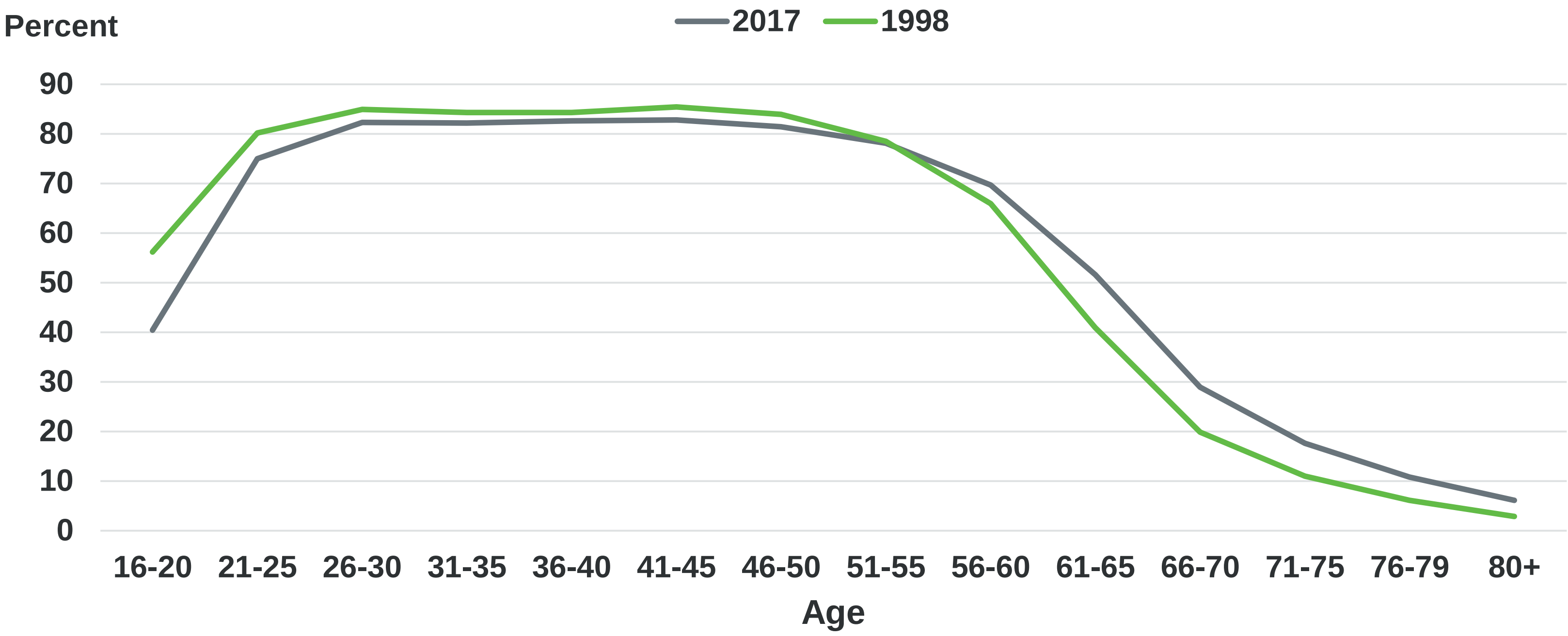
Sources: BLS, FRB Atlanta

Long run LFPR projections: Steady decline



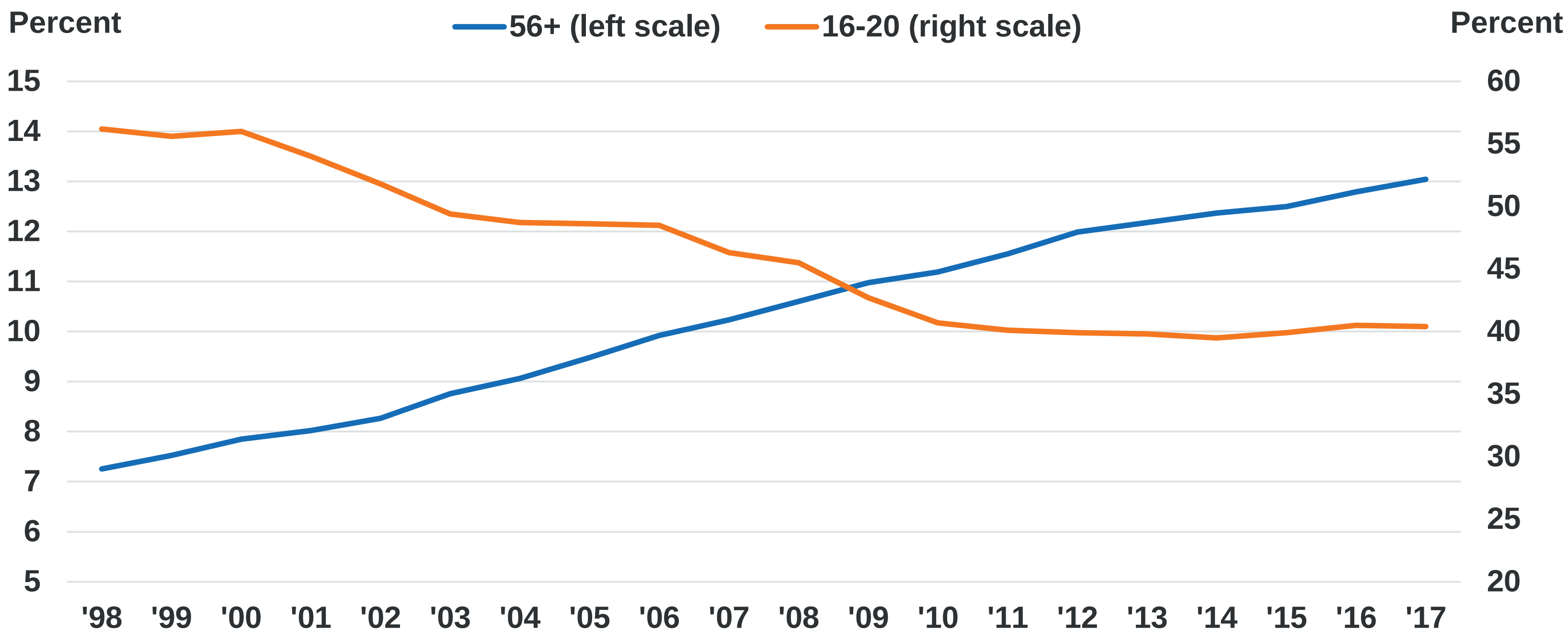
Sources: BLS

Over past 20 years, LFPRs have fallen for younger, risen for old



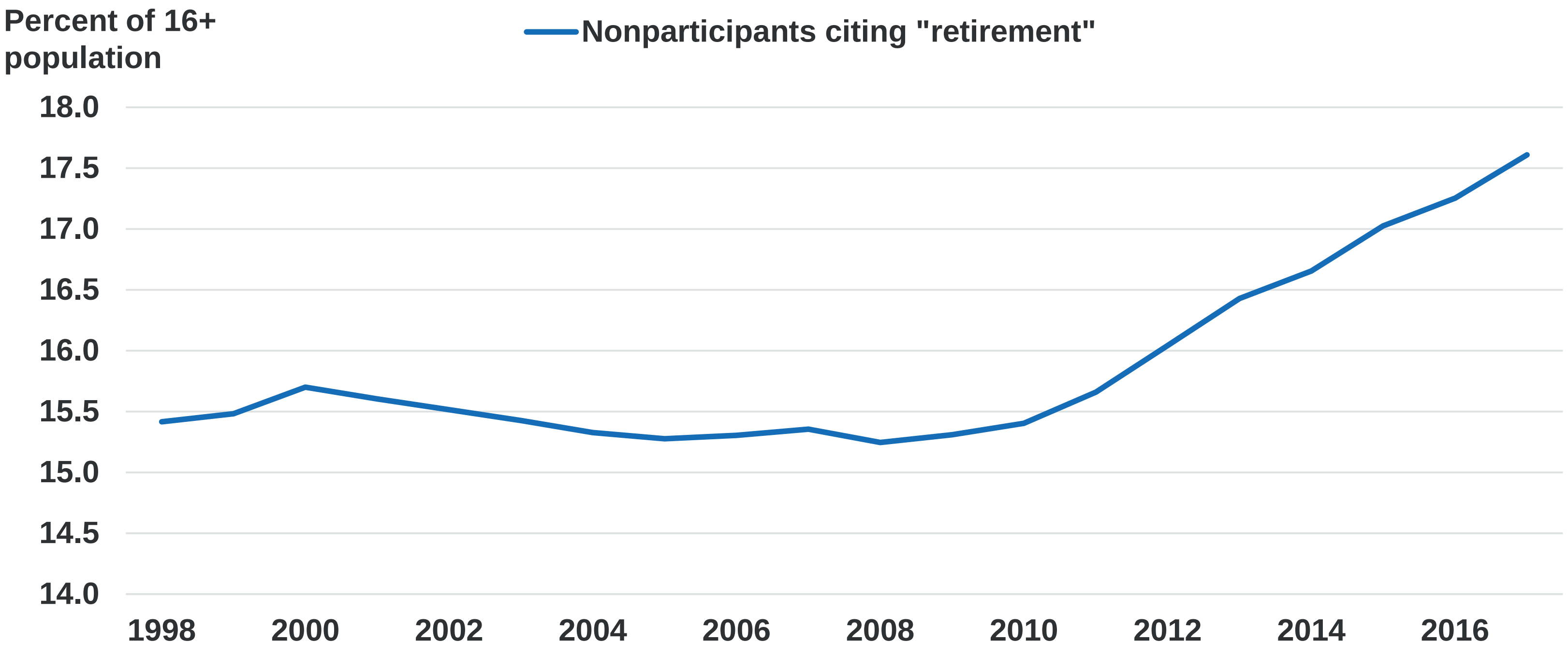
Sources: BLS, FRB Atlanta

LFPRs have fallen for young, risen for old



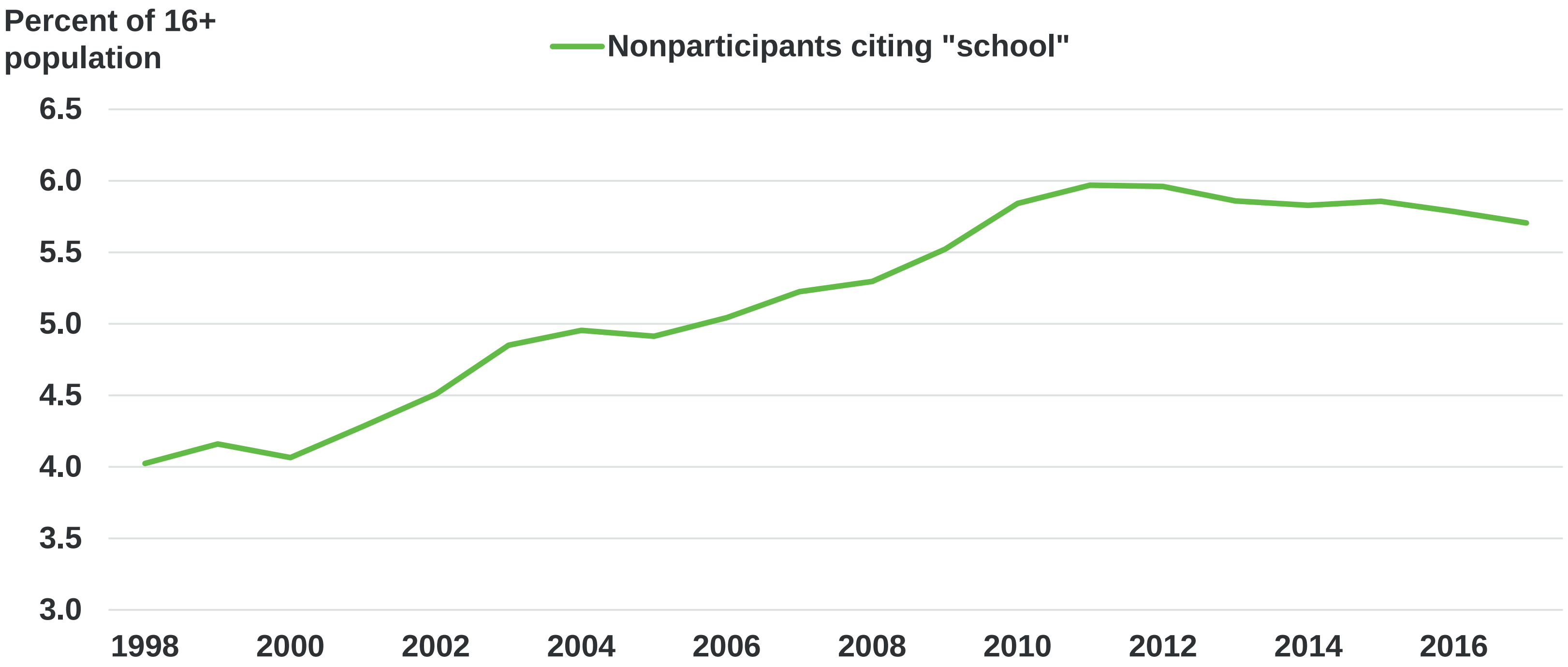
Sources: BLS, FRB Atlanta

In spite of rising LFPR for 55+, aging population means more nonparticipation due to retirement



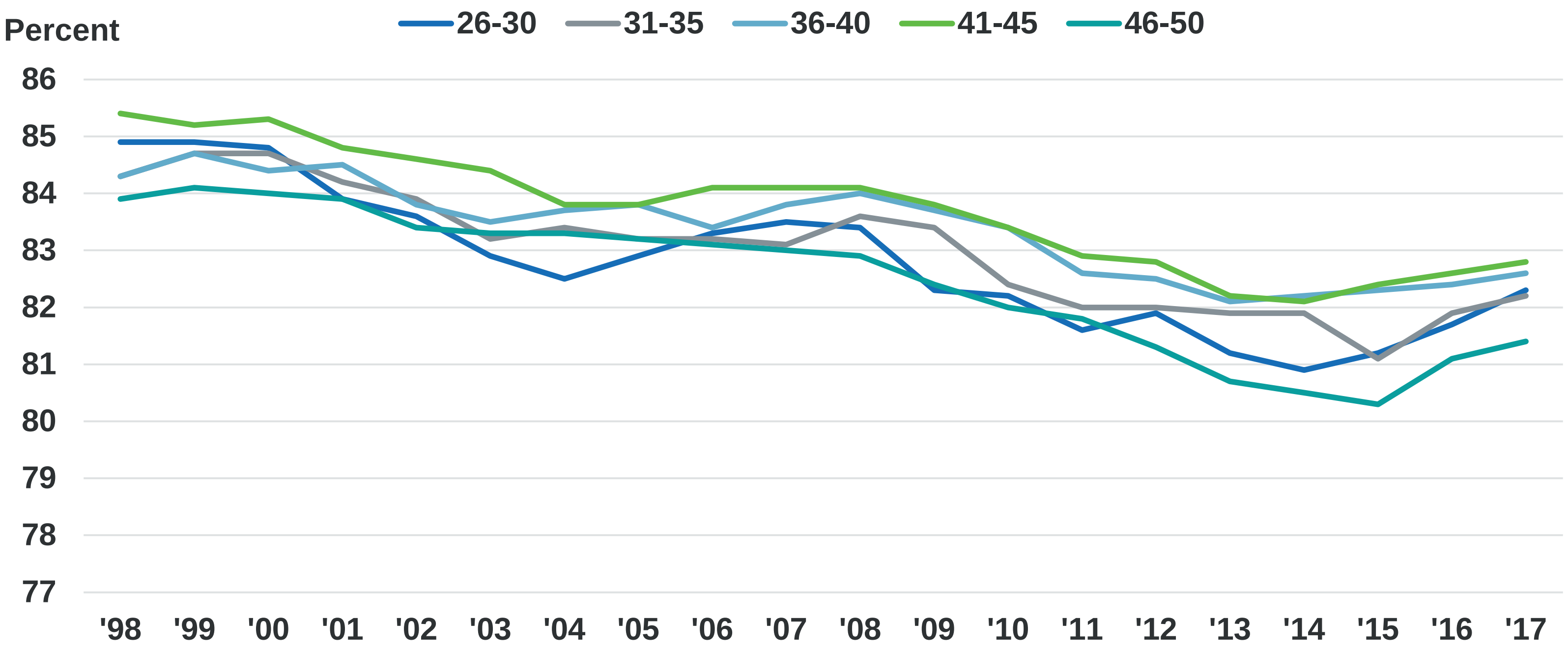
Sources: BLS, FRB Atlanta

Increasing nonparticipation by young reflects more school enrollment



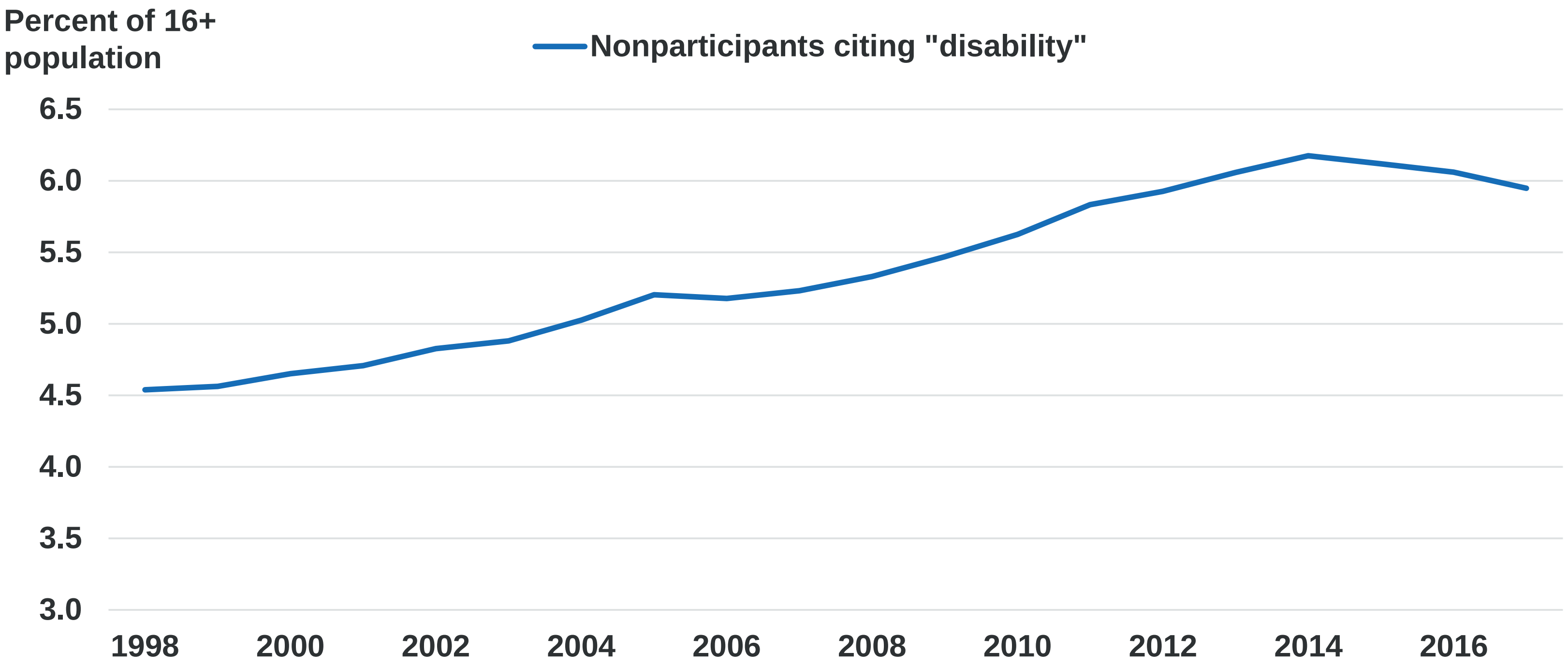
Sources: BLS, FRB Atlanta

Downward drift in prime age LFPRs



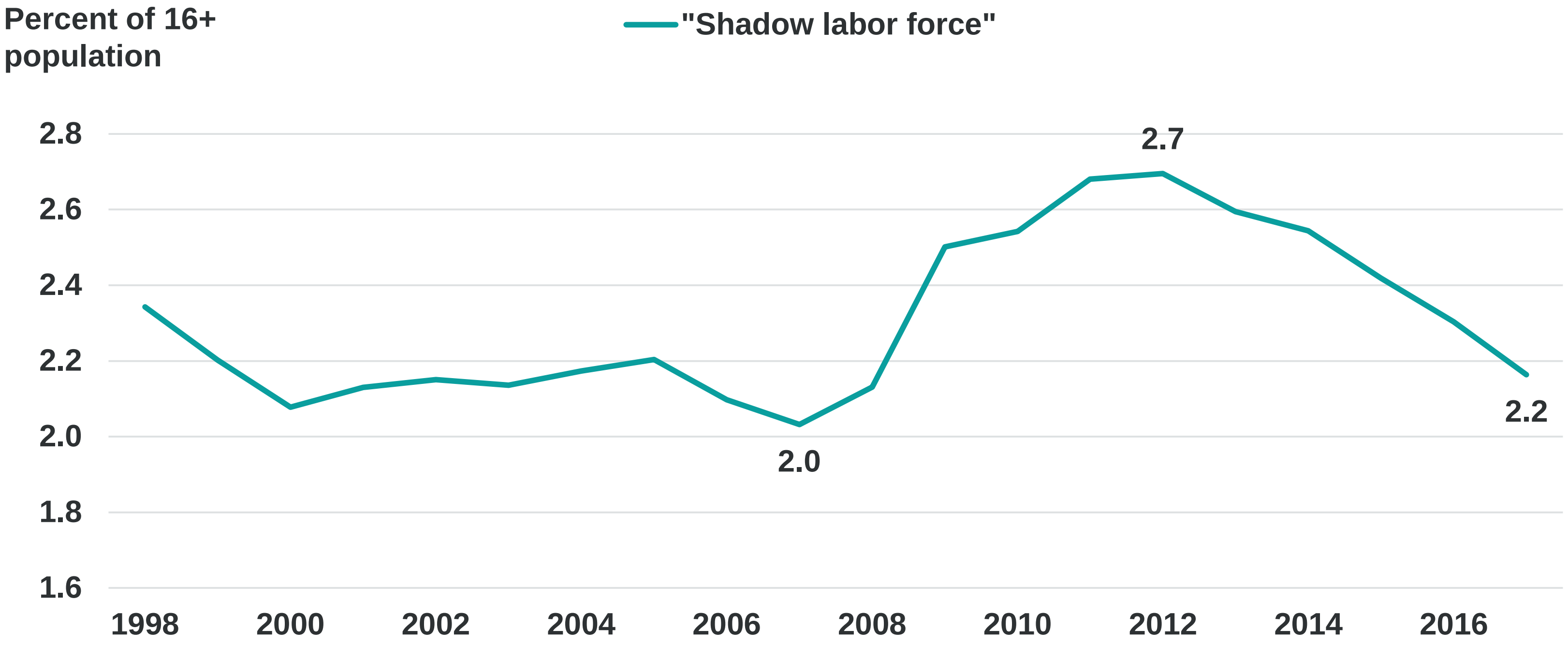
Sources: BLS, FRB Atlanta

Another growing reason for nonparticipation: disability



Sources: BLS, FRB Atlanta

A positive LFPR story: Nonparticipation due to discouragement almost back to pre-recession level



Sources: BLS, FRB Atlanta

Why do falling LFPRs matter?

- Lower LFPR means higher “dependency ratio”—i.e., more non-workers per worker.
- Output per person = (output per worker) x (workers per person)
- For given productivity, lower LFPR reduces output per person → lower standard of living.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Economic Letter

Declining U.S. Labor Force Participation Rates Stand Out

by Alexander W. Richter, Daniel Chapman and Emil Mihaylov

ABSTRACT: Male and female prime-age labor force participation rates

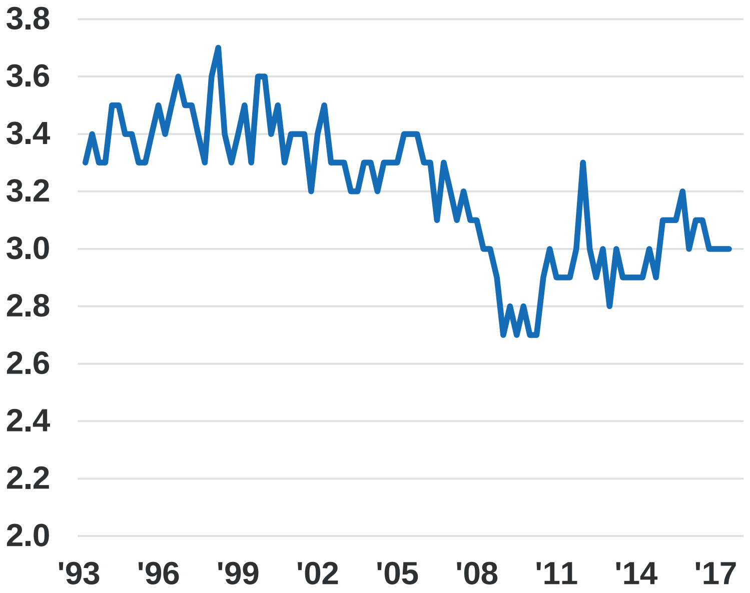
The U.S. labor force participation rate has declined over the past several decades, particularly since the Great Recession. The rate is defined as

factors include less-generous mater and child-care policies, higher incarc tion rates, poorer health outcomes less spending on on-the-job retraining

One last point on labor market: Declining dynamism

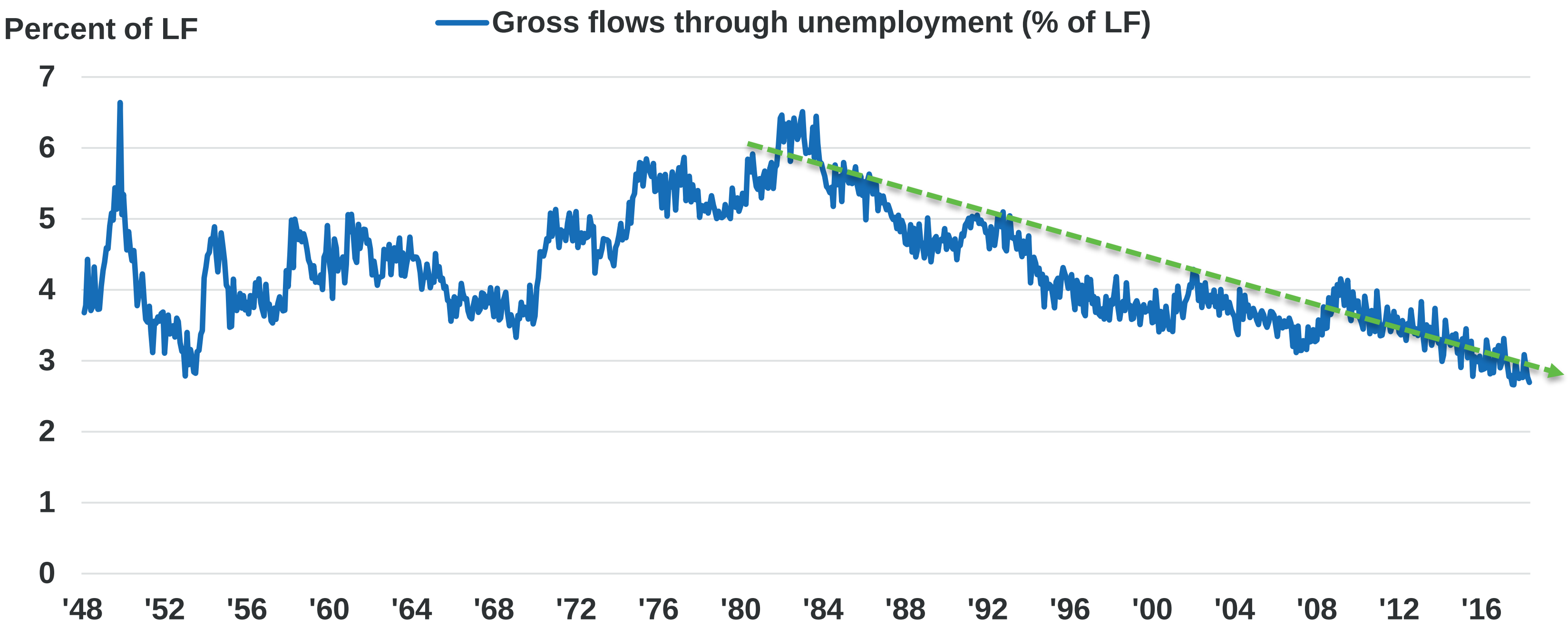
- Declining "dynamism" in US economy
- Lot of effort by economists to understand causes
- Usually thought of as less firm formation & entrepreneurship
- But also a labor market dimension: less turnover

Rate of establishment formation



Source: BLS, Business Employment Dynamics survey

Long run trend toward less “churning” in the labor market



Sources: BLS, author’s calculations; series corrected for 1994 CPS redesign

More labor market data, tools, research from around the Fed system

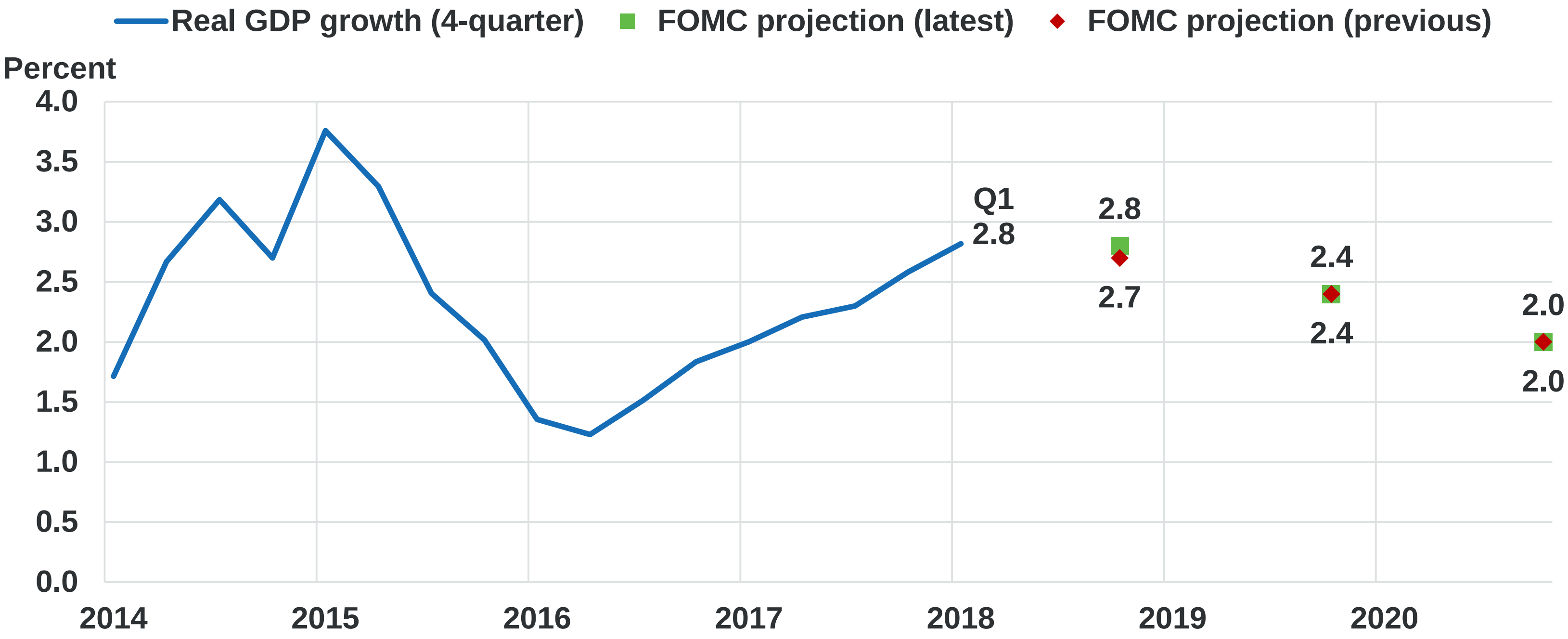
- Atlanta Fed: Center for Human Capital Studies
  - Wage growth tracker
  - Labor Mkt “spider chart”
- SF Fed: “wage rigidity” meter, weather-adjusted employment growth
- Richmond Fed: Hornstein/Kudlyak/Lange “nonemployment index”
- KC Fed: Labor market conditions indexes
- Cleveland Fed: Many Economic Commentaries on labor market topics
- New York Fed: “Eight Different Faces of the Labor Market”

Looking ahead

The view from the FOMC: 2018 and beyond

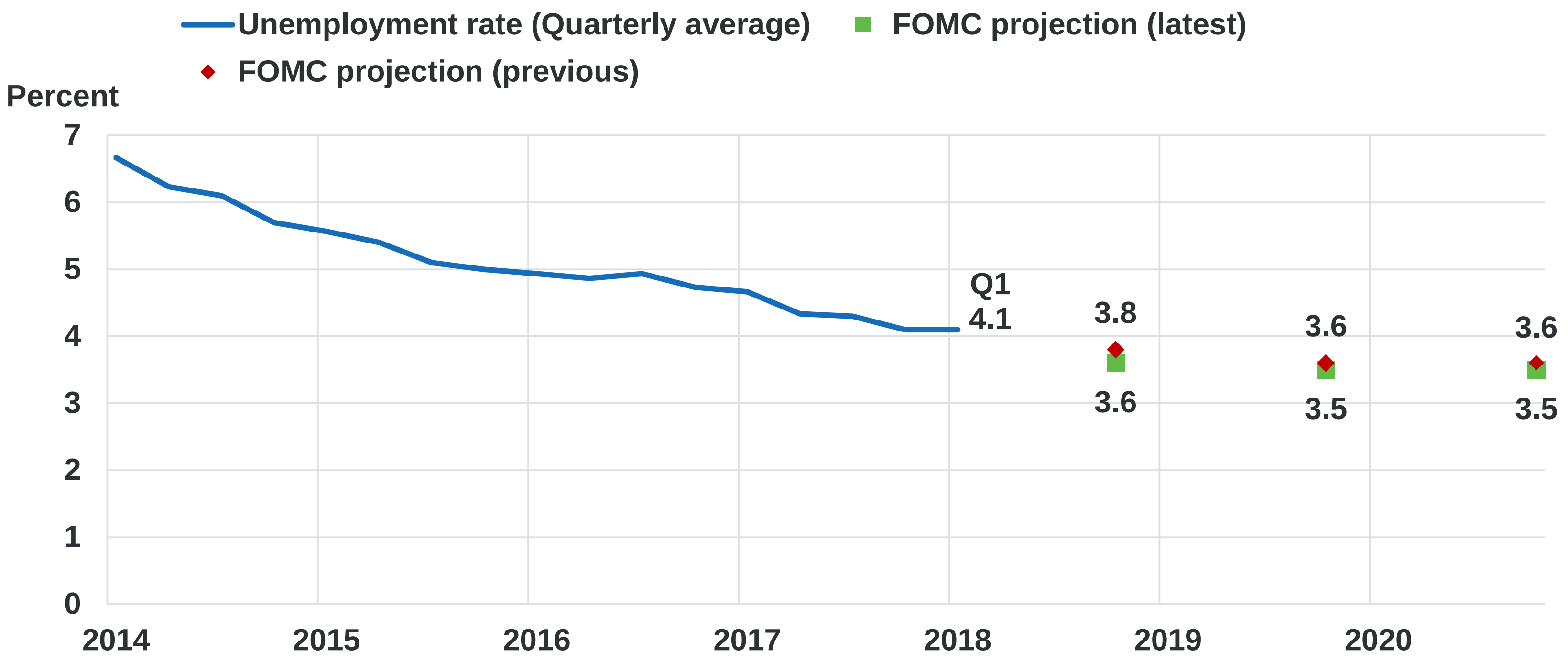
- At four of the eight FOMC meetings – March, June, September, and December – members give projections for GDP, unemployment and inflation over the coming two or three years
- Last “Summary of Economic Projections” (“SEP”) was in June
- As of June, FOMC members saw:
  - GDP growth tapering from 2.8 percent to 2.0 percent over 2018 – 2020
  - Unemployment dipping to 3.5 percent in 2019 & 2020
  - Inflation rising to over 2.1 percent
- Slightly stronger outlook compared with March SEP

GDP growth expected to slow toward long-run potential rate



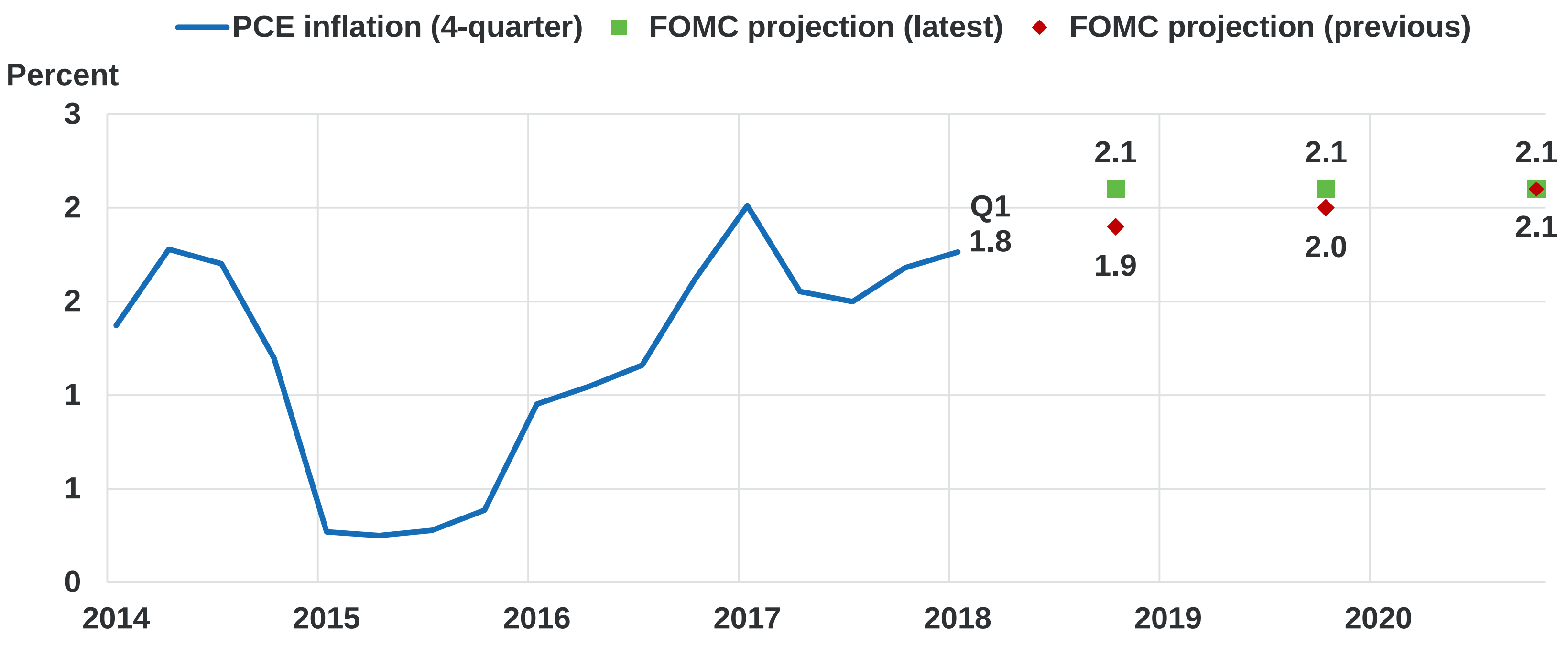
Sources: BEA, FR FOMC

Unemployment rate expected to be in the mid-3s



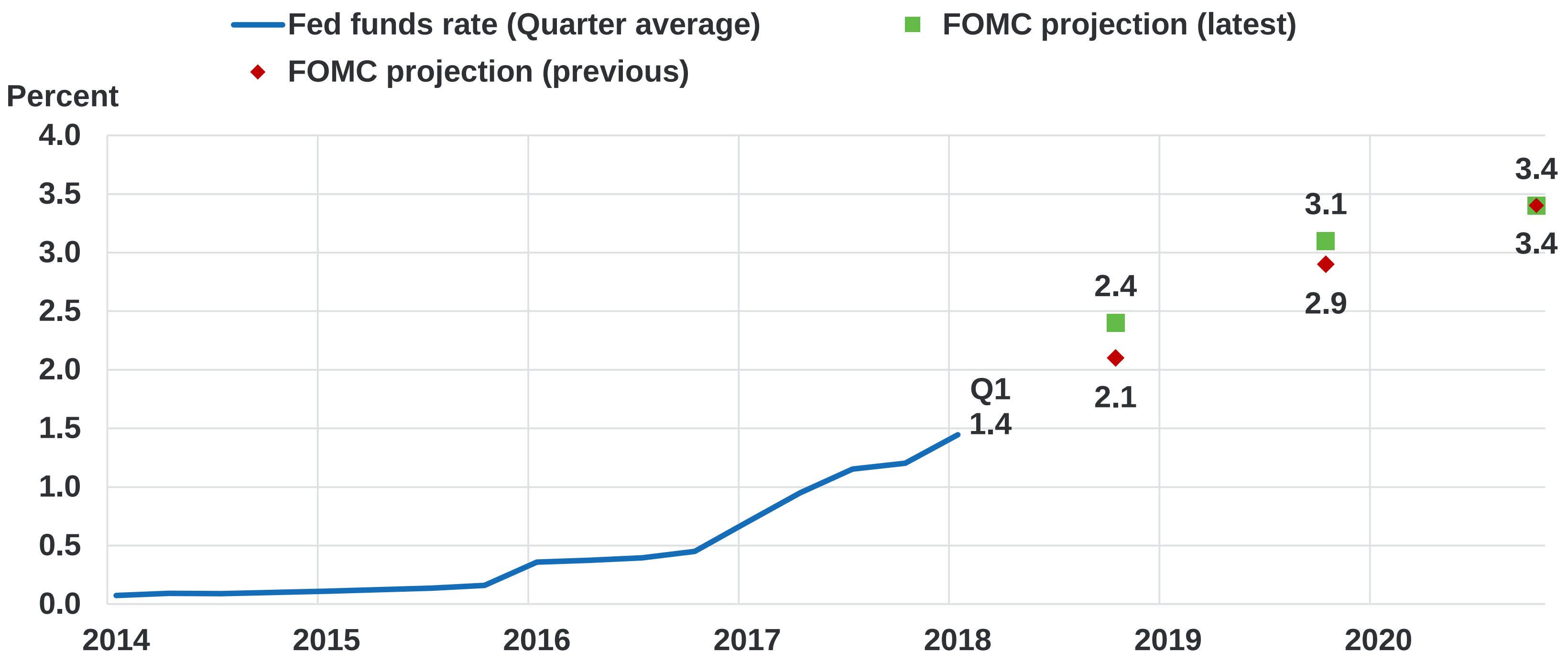
Sources: BEA, FR FOMC

Inflation expected to rise to long-run target level



Sources: BEA, FR FOMC

Fed funds rate expected to rise gradually above 3 percent



Sources: BEA, FR FOMC

Summing up

- U.S. economy currently experiencing solid growth, a tightening labor market, and – at least over the past several months – inflation rising from subdued levels
- Labor market is strong; important secular trends
- The outlook over the next several quarters is for solid GDP growth that eventually slows to a long-run sustainable rate, unemployment dipping further below 4 percent, and inflation gradually rising to the Fed's long-run 2 percent goal

Thanks for your attention!