U.S. Economic Outlook

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• National economic conditions
• Technological change, productivity, and wages
• Forecast and monetary policy

The views expressed today are my own and not necessarily the views of the Federal Reserve Bank of Cleveland or the Federal Reserve System
FRB Cleveland’s role in the Federal Reserve System

- Payments and cash processing
- Bank supervision and regulation
- Community development
- Research
- Monetary policy
National Economic Conditions
Economic growth usually slows down when output is greater than “potential output”
Output growth has slowed to range many economists consider trend growth rate, ~2 percent.
Growth in second quarter was driven primarily by strong consumption growth.

Contributions to Real GDP Growth

Major components

Source: Bureau of Economic Analysis via Haver Analytics
Last data point: 2019:Q2.
As of first quarter of 2019, all states except Rhode Island grew year-over-year by at least 1 percent.
Consumers and businesses remain confident, but confidence softened a bit in August and September.

Confidence Indexes
Consumers and small businesses

Conference Board: 125.1
University of Michigan: 93.2
NFIB: Small Business Optimism: 101.8

Sources: Conference Board, University of Michigan, and NFIB via Haver Analytics
Last data point: Sep 2019 for Conference Board, Sep 2019 for UMich, Sep 2019 for NFIB.
Employment growth continues, but at a little slower rate than in 2018

Change in Nonfarm Payroll Employment
Change in Nonfarm Payroll Employment and 12-month Moving Average

Source: Bureau of Labor Statistics via Haver Analytics
Line represents 12-month moving average.
Last data point: Sep 2019.
Labor force participation rate has been steady even though demographics suggest it should be falling...

... which has kept the unemployment rate fairly stable at a low level even as employment has grown.

Unemployment Rates
Various Definitions

- Unemployed, Marginally Attached, and Part Time for Economic Reasons (U6): 6.9
- Unemployed and Marginally Attached Workers (U5): 4.3
- Unemployed and Discouraged Workers (U4): 3.7
- Official Unemployment Rate: 3.5

Source: Bureau of Labor Statistics via Haver Analytics
Last data point: Sep 2019.
The job openings rate is 42 percent higher than its peak in prior expansion.

Number of job openings per 100 employees (12-month moving average)

US: 4.7

Last observation: July 2019
Source: Bureau of Labor Statistics via Haver Analytics
Even though labor market is unusually tight, wage growth remains modest

**Employment Cost Index**

**Total Compensation and Wages and Salaries**

<table>
<thead>
<tr>
<th>Year-over-year percent change</th>
<th>Jan 2006</th>
<th>Jan 2008</th>
<th>Jan 2010</th>
<th>Jan 2012</th>
<th>Jan 2014</th>
<th>Jan 2016</th>
<th>Jan 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Compensation</strong></td>
<td>3.5</td>
<td>3.0</td>
<td>2.5</td>
<td>2.0</td>
<td>1.5</td>
<td>1.0</td>
<td>1.5</td>
</tr>
<tr>
<td><strong>Wages and Salaries</strong></td>
<td>3.0</td>
<td>2.5</td>
<td>2.0</td>
<td>1.5</td>
<td>1.0</td>
<td>0.5</td>
<td>1.5</td>
</tr>
</tbody>
</table>

Source: Bureau of Labor Statistics via Haver Analytics
Last data point: 2019:Q2.
Inflation remains subdued, but measures of underlying trend inflation have increased.

Source: Bureau of Economic Analysis via Haver Analytics
Home prices continue to rise, but the rate of increase slowed in the first half of 2019.

Growth in CoreLogic Home Price Index

Source: CoreLogic
Last Data Point: Jul 2019 for the United States
Due to a variety of global headwinds, industrial production declined in Q2 of 2019.
One of those global headwinds is the rising strength of the dollar.
Most countries are projected to grow more slowly in 2019 than they did in 2018

2018 and 2019 GDP Growth Rates From Around the World

Projected GDP growth in 2019 (percent)

GDP growth in 2018 (percent)

Note: Orange line shows where 2018 and 2019 growth rates are equal.

Source: International Monetary Fund
The 1-year Treasury yield has been greater than 10-year Treasury yield since early August, but it is not clear that this is a signal of an approaching recession.

Source: FRB BOG via Haver Analytics
Last data point: Oct. 7, 2019
The yield spread is an input to the model used to produce the State Leading Indexes.

Source: Federal Reserve Bank of Philadelphia via Haver Analytics.
Sustained upticks in initial UI claims are another good indicator of recessions, though not as far-sighted

**Initial Unemployment Claims**

United States: 211,300

Source: Department of Labor via Haver Analytics
Last data point: Week ending Sep. 28, 2019. Actual values (4-week MA) shown in legend.
Takeaways about national economic conditions

- Growth has slowed, which is to be expected since output > potential output, but the economy remains fundamentally solid
  - Employment and labor force continue to grow
  - Business and consumer confidence remains high
  - Inflation may be firming

- But weakening global demand, strong dollar, and trade policy have been headwinds on manufacturing, agriculture, and transportation

- While a yield curve inversion has been a good early predictor of recessions, there are unusual factors now that muddy the signal from the yield spread
Technological Change, Productivity, and Wages
Technological change, productivity, and wages

- Bessen (2015) has an interesting theory that helps explain the “skills gap” and weak wage growth
- His theory is based on what happened during the industrial revolution
- Adapting to major technological change takes a long time
  - Change begets change begets change
  - Tech change reduces the value of the stock of human capital and machines by making them obsolete
  - Labor markets adapt slowly to technology change
- While the economy adapts, it is hard to see gains in wages and aggregate productivity
Implications of Bessen’s theory

- Employers that want to use the latest technology have two choices:
  - Outbid other employers for workers with the required skills
  - Invest in training to give workers the required skills

- For the economy as a whole, training is the better option because it:
  - Moves people from lower wage occupations to higher wage ones, thereby increasing incomes more than would outbidding
  - Directly increases the economy’s capacity
Forecast and Monetary Policy
It is expected that GDP will grow ~2.2 percent in 2019 and ~2.0 percent in 2020.

**FOMC GDP Projections**

- **Actual Growth and SEP projections**
- **Year-over-year percent change**
- **Median of Projections**
- **Central Tendency of Projections**
- **Range of Projections represented by error bars**

Sources: Bureau of Economic Analysis and Federal Reserve Board via Haver Analytics

Projections from: Sep 2019

Note: FOMC is abbreviation for Federal Open Market Committee
Inflation is expected to be ~1.5 percent in 2019 and ~1.9 percent in 2020.
The unemployment rate is expected to be at or below 4 percent through 2022

FOMC Unemployment Rate Projections

Actual past rate and SEP projections

Unemployment rate


Sources: Bureau of Labor Statistics and Federal Reserve Board via Haver Analytics
Projections from: Sep 2019
Note: FOMC is abbreviation for Federal Open Market Committee
FedWatch.com estimates that there is over a 90 percent chance of at least one further rate drop in 2019, but FOMC members have diverse views on the path of the target Federal Funds Rate.

Source: Federal Reserve Board via Haver Analytics
Projections from: Sep 2019
Note: FOMC is abbreviation for Federal Open Market Committee
Wrap Up
Takeaways

- The fundamentals of the US economy remain solid, but growth is expected to slow to about 2 percent
- Slowing global demand, strong dollar, and trade policy are headwinds
- Bessen’s “Learning By Doing” provides a compelling theory to explain why the IT revolution has not yet resulted in strong gain in aggregate productivity and wages and why skills gaps persist
- Forecast suggests that economic performance in 2020 will be similar to 2019
Bonus maps
Change in State Payroll Employment

Year-over-year percent change

Source: Bureau of Labor Statistics via Haver Analytics
Data for: Aug 2019
State Unemployment Rates
Seasonally Adjusted

Change in State Unemployment Rates
Percentage points, three month change

Source: Bureau of Labor Statistics via Haver Analytics
Data for: Aug 2019
Manufacturing Share of State Employment

All Manufacturing

Source: Bureau of Labor Statistics via Haver Analytics
Data for: Sep 2018
Total Exports: Share of GSP

Percent share of GSP

United States: 8.1
Source: Census Bureau via USA Trade Online and Bureau of Economic Analysis via Haver Analytics
Data for: 2018.