The Outlook for the U.S. Economy

Finding Shelter: Assessing Texas Residential Real Estate

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The views expressed are those of the speaker and should not be attributed to the Federal Reserve Bank of Dallas or the Federal Reserve System.
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  o Slow growth in the working-age population limits sustainable output and job growth, and raises concerns about long-term gov’t finances
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• A strong dollar
  o Reflects relative strength of the U.S. economy and prospects for relatively high risk-adjusted returns on U.S. investments
  o Encourages U.S. consumption of foreign-produced goods at the expense of U.S.-produced goods
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- Accommodative monetary policy and reduced fiscal drag
Demographics: Judging by the path of real GDP, the current expansion has been unusually weak.
But divide real GDP by the size of the labor force, and this expansion looks ordinary.
The explanation: Labor-force growth has been exceptionally slow
Labor-force growth has been slow partly because the female participation rate has leveled off.

Female rate as a percent of male rate
Also, the 20-64 age group has been expanding at less than half the pace seen in prior expansions.

Percent growth in population, annualized

- 1975: 2.0
- 1982: 1.2
- 1991: 1.0
- 2001: 1.2
- 2009: 0.6

Average: 1.4
Meanwhile, the ranks of seniors are exploding, and the population of teenagers is shrinking.
Oil: Oil’s price has fallen steeply since June 2014, to its lowest levels since 2003

WTI, spot price

Jan. 29
33.66

June 17, ‘14
106.95
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The Dollar: Cumulative increase in the real value of the dollar since July 2014 now exceeds 19%

Index, July 2014 = 100

Real broad trade-weighted exchange value of the U.S. dollar

Jan. 119.37
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Real broad trade-weighted exchange value of the U.S. dollar

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Jan. 119.37
One reason for a stronger dollar: Emerging-market growth prospects dimmed during 2015

Purchasing Managers’ Index, 50+ = expansion
Monetary Policy: Remains accommodative, whether as measured by the yield curve’s slope...

Unemployment rate (inverted scale), 2Q change

Five-year, five-year forward Treasury rate, less the federal funds rate (shifted 8Q)
...or by the low level of short-term interest rates relative to the rate of household wealth growth

Unemployment rate (inverted scale), 2Q change

4Q growth in household net worth, less the federal funds rate (shifted 2Q)
The oil-price drop and soaring dollar have had the expected impact on demand and its composition.

Components of final demand:

- Final demand: 1.9
- Personal consumption: 1.6
- Residential investment: 0.1
- Business fixed investment: 0.6
- Government: -0.3
- Net exports: -0.1

Contribution to real growth, percentage points, SAAR

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Households have benefited: their spending has accelerated

Contribution to real growth, percentage points, SAAR

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2013:Q1 - 2014:Q2
- Final demand: 1.9
- Personal consumption: 1.6
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2014:Q3 - 2015:Q4
- Personal consumption: 2.1
- Residential investment: 0.3
- Government: -0.1

Households have benefited: their spending has accelerated.
But capex plans have been scaled back in mining & manufacturing: BFI has decelerated

Contribution to real growth, percentage points, SAAR

Components of final demand

Final demand | Personal consumption | Residential investment | Business fixed investment | Government | Net exports
---|---|---|---|---|---
2013:Q1 - 2014:Q2 | 1.9 | 1.6 | 0.1 | 0.6 | -0.3
2014:Q3 - 2015:Q4 | 2.1 | 0.3 | 0.3 | 0.3 | -0.1

But capex plans have been scaled back in mining & manufacturing: BFI has decelerated
Government purchases are now a small plus for growth, rather than a small minus

Components of final demand

- Residential investment: 0.1, 0.3
- Business fixed investment: 0.6, 0.3
- Government: 0.2, -0.3
- Net exports: -0.1

Contribution to real growth, percentage points, SAAR
The strong dollar has encouraged substitution of foreign-made goods for U.S.-made goods

Components of final demand

- Final demand: 1.9, 2.1
- Personal consumption: 1.6, 2.1
- Residential investment: 0.1, 0.3
- Business fixed investment: 0.6, 0.3
- Government: 0.2, -0.3
- Net exports: -0.1, -0.5

Contribution to real growth, percentage points, SAAR
The net effect of the conflicting forces has been to boost final demand for domestic product.

Components of final demand

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Contribution to real growth, percentage points, SAAR
The latest data show service-sector growth continuing as manufacturing sector stagnates.
This isn’t the first time we’ve seen a sharp cross-sector split: the prognosis is mixed

Index, 50+ = expansion

ISM Non-Manufacturing

ISM Manufacturing

Asian economic crisis

Jan. 53.5

48.2
This isn’t the first time we’ve seen a sharp cross-sector split: the prognosis is mixed.
The slowdown in the goods-producing sector has, so far, failed to put a damper on job growth.

*Job growth likely needed for a steady unemployment rate.
The unemployment rate is now at policymakers’ estimate of the sustainable minimum.
Unemployment increases have been limited to the oil-producing states (NM, ND, OK, TX, & WY)

- U.S. unemployment rate, excluding major oil-producing states: Dec. 2015 - 4.7%
- Major oil-producing states’ unemployment rate: Dec. 2015 - 5.0%
And while headline inflation is below target, the shortfall is due mostly to transitory factors.
A year ago, unemployment was above its long-run minimum & trend inflation was lower than desired.
Today, unemployment approximates its long-run minimum and trend inflation is close to target.
Summary

• Accommodative Fed policy, a less-restrictive fiscal policy, and a supply-driven plunge in energy prices have boosted domestic demand.

• But relatively soft growth prospects overseas and a strong dollar have damped demand for our manufactured goods.

• The economy as a whole continues to grow, despite challenges to certain sectors and regions.

• The stability of trimmed-mean inflation suggests that current low headline inflation is transitory.

So far, so good, but where do we go from here?
Looking Ahead
Financial variables (junk-bond & term spreads, stock & oil prices) suggest 2% GDP growth thru Q3.
The message from December FOMC: Monetary-policy accommodation to be gradually scaled back

Federal funds rate

SEP projections - Dec. '15

Percent/year

'12 | '13 | '14 | '15 | '16 | '17 | '18 | Longer run

0.38 | 1.38 | 2.38 | 3.25 | 3.50

Q4
With less accommodation, declines in the unemployment rate are likely to slow, then stop.
Our in-house model forecasts an unemployment path somewhat lower than the SEP median.
With a tight labor market, inflation will move rapidly upward, provided oil and the dollar hold steady.
Our in-house model predicts an inflation path slightly higher than the SEP median.

![Graph showing inflation growth from 2012 to 2018. The graph includes a line for Headline PCE, a blue dashed line for SEP projections as of December 2015, and a red line for Koenig/Armen forecasts. The graph indicates Q4 percent growth with values 1.7 in 2015, 1.9 in 2016, 2.0 in 2017, and 2.1 in 2018. The SEP projections show a trend slightly below the Koenig/Armen forecasts for the same period.]
Conclusions

• We’ve already reached policymakers’ estimate of the full-employment unemployment rate. Modest further unemployment declines are likely during 2016.

• Barring a further fall in the price of oil or a new surge in the dollar, Fed policymakers are likely to achieve their 2 percent longer-run inflation objective in 2017.