

October 24, 2024

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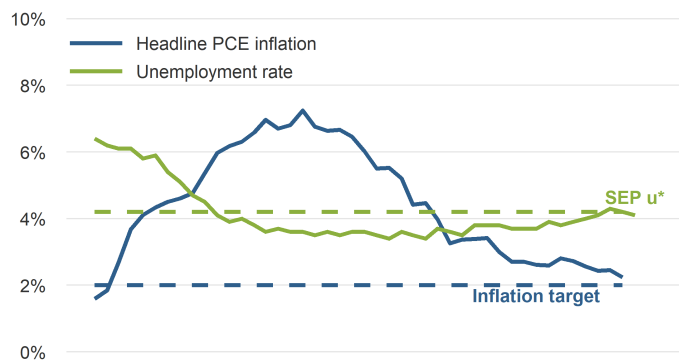
Sylvain Leduc, executive vice president and director of research at the Federal Reserve Bank of San Francisco, stated his views on the current economy and the outlook as of October 24, 2024.

- The economy appears to be approaching a soft-landing. The 12-month change in the headline personal consumption expenditures (PCE) price index declined markedly over the past two years from 7.2% in June 2022 to 2.2% in August 2024. The most recent reading is just slightly above the Fed's 2% longer-run goal. Over the same period, the unemployment rate rose about half a percentage point to 4.1% in September 2024, a level that remains low by historical standards and is roughly in line with the longer-run level of unemployment projected by the Federal Open Market Committee (FOMC).
- A combination of demand and supply factors have contributed to recent developments. On the demand side, tighter monetary policy has reduced the growth rate of interest rate sensitive consumption of durable goods by roughly 50% compared to the pre-pandemic period. This slowing has helped moderate overall consumption growth.
- Supply-side developments have helped boost the availability of goods and services while simultaneously easing inflationary pressures. For example, prime-age labor force participation improved notably over the past three years, helping to boost production. After falling 3 percentage points at the height of the pandemic, the prime-age participation rate has recovered steadily and now exceeds its 2019 level. This recovery owes to significant gains in the participation rate of prime age women, which is at a historical high.
- A second supply-side factor is the recent surge in immigration. In fiscal year 2023, the net increase in immigration represented 85% of the growth in total U.S. population. The Congressional Budget Office expects immigration to remain elevated over the near term.
- A third supply-side factor is the recent increase in labor productivity which has been growing at an annualized pace of roughly 2.5% over the past year. This growth rate is about 1.5 percentage points higher than the pace observed during the 2011-2019 period following the Great Recession. Recent productivity growth is close to the rate observed during the 1995-2005 period, which coincided with major advances in information and communications technologies. Recent advances in artificial intelligence and related technologies have the potential to further boost productivity growth, but this will take time given the typical lags between technology adoption and observable productivity gains.

- One version of the Phillips curve relationship links the 12-month core PCE inflation rate to the unemployment-to-vacancy ratio, an indicator of labor market slack. The empirical relationship between inflation and labor market slack has steepened in response to pandemic-induced demand and supply factors. The resulting nonlinearity implies that inflation can decline without inducing a large rise in labor market slack. Moreover, labor market slack can rise due to a fall in the job vacancy rate rather than an increase in the unemployment rate.
- Recent job gains have remained solid. Nonfarm payroll employment increased by 254,000 jobs in September while previous monthly job gains were revised upward. The six-month moving average of monthly job gains remains above 150,000.
- The health-care sector has been an important source of employment growth since the pandemic. The contribution of job gains by this sector over the two most recent quarters has been more than double the amount observed during the pre-pandemic period.
- The health-care sector has more than recouped the job losses experienced during the pandemic. Health-care employment is now approaching levels consistent with its pre-pandemic trend.
- Other indicators show that the labor market is cooling. The job vacancy rate has declined over the past two years and is now close to its pre-pandemic level. In line with this evidence of slowing labor demand, the employee quits rate has also returned to its pre-pandemic level.
- The core goods sector has experienced deflation over the past several quarters, representing a return to its pre-pandemic pattern. Inflation in the core services sector has declined but remains about 1.5 percentage points above its pre-pandemic level. Further declines in core services inflation are needed for headline PCE inflation to reach the Fed's 2% longer-run goal.
- Following the conclusion of the FOMC meeting on September 18, 2024, the Committee announced its decision to lower the target range for the federal funds rate by $\frac{1}{2}$ percentage point to 4.75 to 5%. Still, continued monetary policy restraint is expected to put downward pressure on inflation. Consequently, we expect headline PCE inflation to decline gradually before reaching 2% by the end of 2027.

Getting a lot closer to a soft landing

Inflation and unemployment



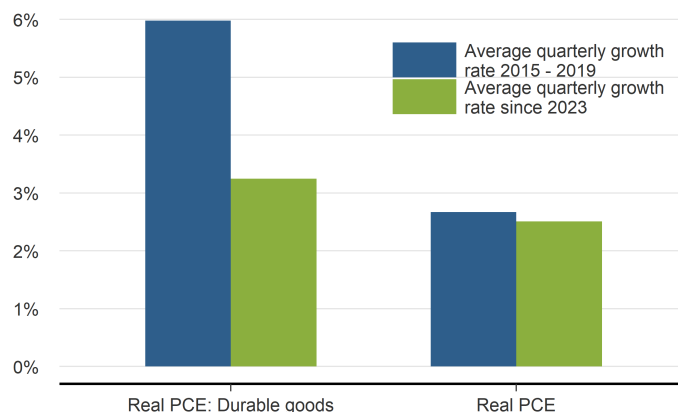
Jan 2021 Jul 2021 Jan 2022 Jul 2022 Jan 2023 Jul 2023 Jan 2024 Jul 2024

Notes: Green dashed line indicates median estimate of long-run unemployment rate from the FOMC Summary of Economic Projections (SEP), and blue dashed line indicates Fed's inflation target.

Sources: Bureau of Economic Analysis and Federal Reserve Board of Governors

Slower consumption growth on durable goods

Growth in personal consumption expenditures (PCE)

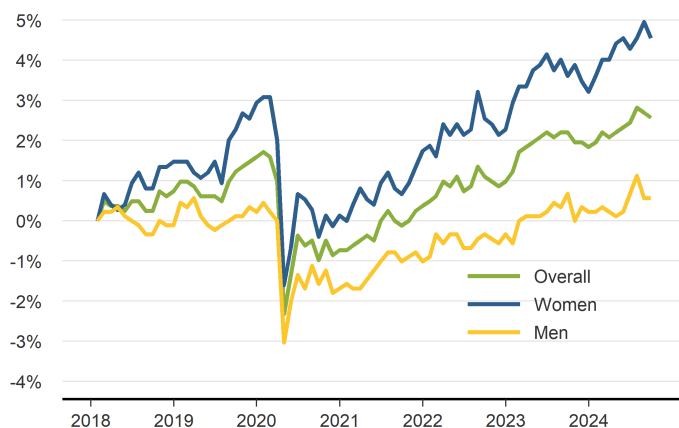


Note: Annualized rates.

Source: Bureau of Economic Analysis and FRBSF staff

Surprising strength in labor participation

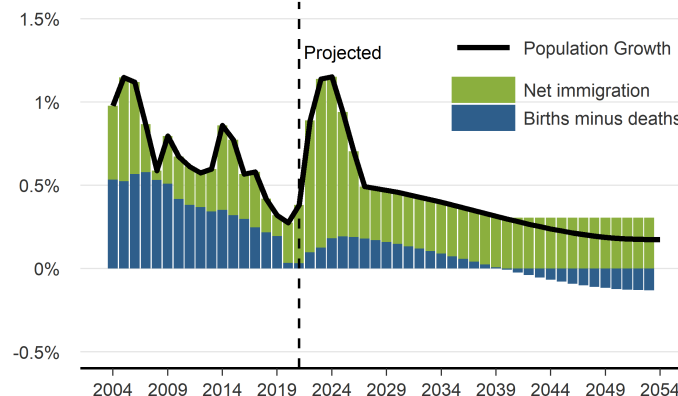
Prime-age participation rates



Note: Indexed to January 2018.
Source: Bureau of Labor Statistics

Higher immigration boosted population growth

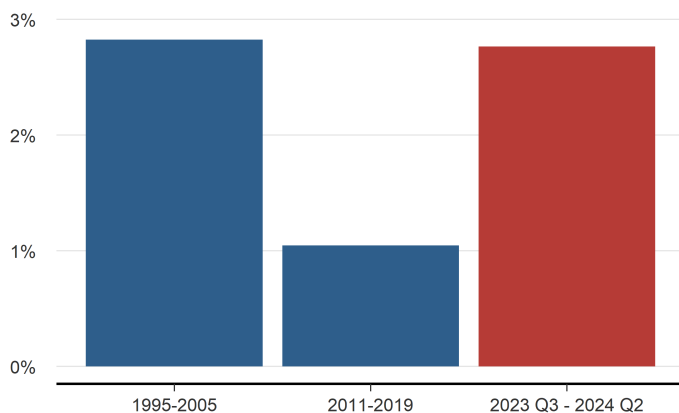
Immigration and population growth



Sources: Congressional Budget Office, U.S. Customs and Border Protection, Transactional Records Access Clearinghouse, Office of Homeland Security Statistics, and FRBSF staff

Labor productivity growth has been strong

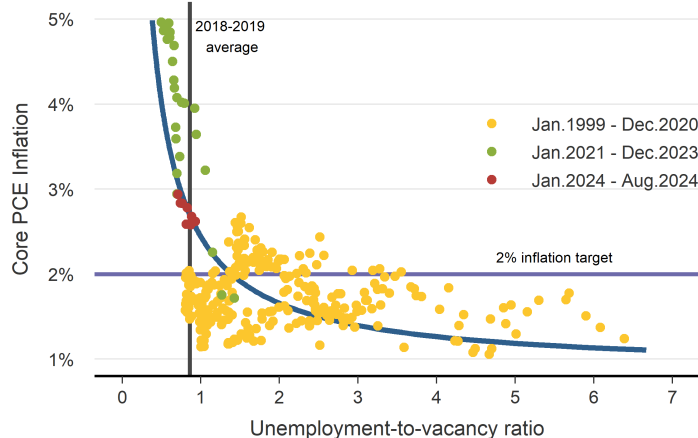
Average 4-quarter percent change in productivity



Note: Seasonally adjusted.
Source: Bureau of Labor Statistics

Supply constraints led to nonlinearities

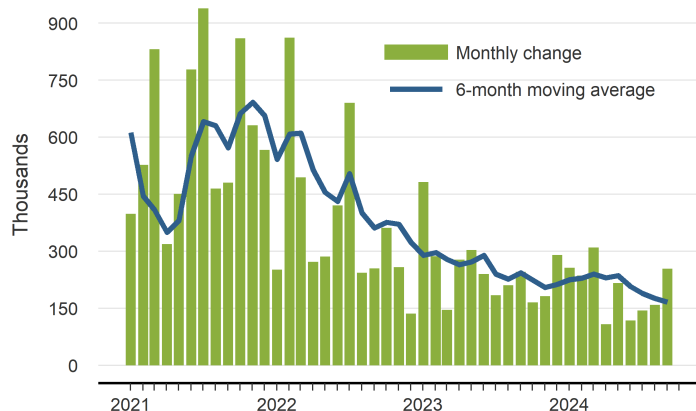
Phillips curve



Source: Crust, Lansing, & Petrosky-Nadeau, FRBSF Economics Letter, 2023-17

Job gains have remained strong

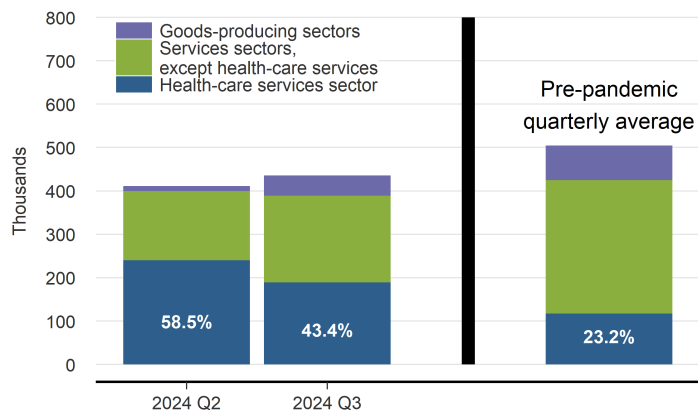
Changes in nonfarm payroll employment



Source: Bureau of Labor Statistics

Job gains in health-care sector remain outsized

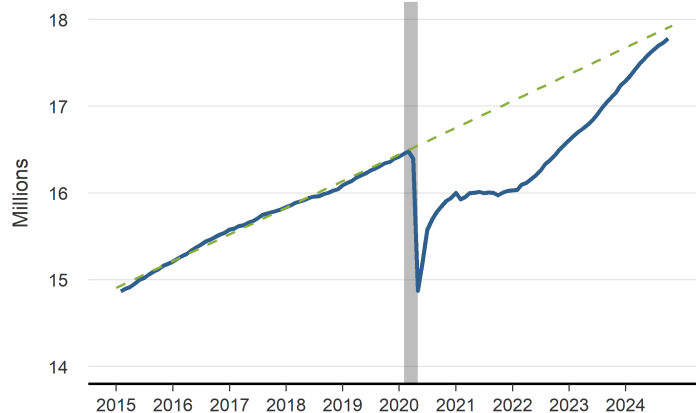
Contributions to employment gains



Note: Pre-pandemic quarterly average reflects data from 2016-2019.
Source: Bureau of Labor Statistics

Health-care employment now close to trend

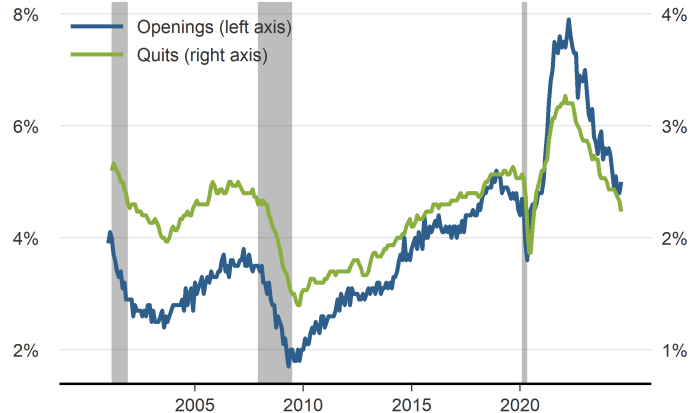
Health-care job gains



Notes: Seasonally adjusted. Shaded area represents NBER recession dates.
Green dashed line indicates trend line.
Source: Bureau of Labor Statistics

Vacancy and quit rates are back to 2019 levels

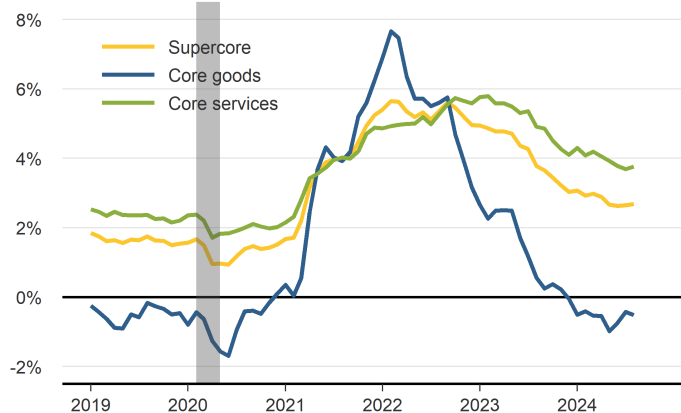
Job quits rate and job openings



Notes: Seasonally adjusted, 3-month moving average applied to quits series. Shaded areas represent NBER recession dates.
Source: Bureau of Labor Statistics

Core services inflation still too high

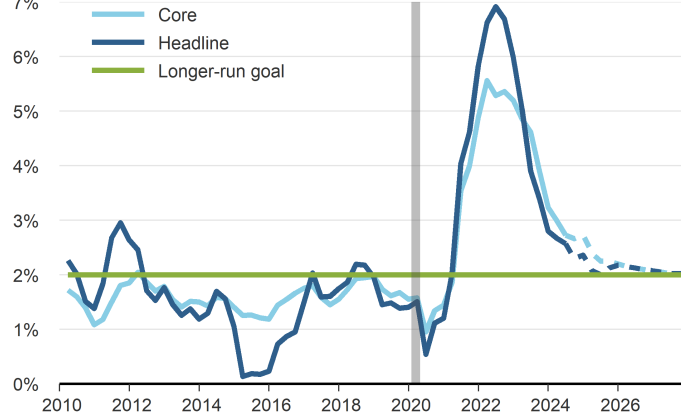
Goods and services inflation



Note: Shaded area represents NBER recession dates. Supercore is core services excluding housing.
Source: Bureau of Economic Analysis

Inflation to continue falling toward 2%

PCE price inflation



Notes: 4-quarter change in personal consumption expenditures price index. Dashed line represents the FRBSF forecast.
Source: Bureau of Economic Analysis and FRBSF staff