Twelfth Federal Reserve District

FedViews

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Rob Valletta, research advisor at the Federal Reserve Bank of San Francisco, states his views on the current economy and the outlook.

- Recent data have been uneven but on balance consistent with a continued moderate recovery of overall economic activity and the labor market, with modest price inflation. We expect that the pace of gross domestic product (GDP) growth will pick up over the next few years and that the unemployment rate will decline only gradually. Hence, a large degree of labor market slack is likely to persist at least through 2015.

- The initial estimate of real GDP growth in the third quarter of 2012 was revised upwards in November from a modest 2.0% pace to a more solid 2.7%. However, an upward adjustment to business investment in inventories can account for the entire change. Business stockpiling of goods is not likely to be as strong an impetus to growth in the fourth quarter. This factor, the effects of Superstorm Sandy, and the persistent drought in some U.S. farming areas are expected to slow fourth-quarter growth to a pace around 1%. Nonetheless, we expect growth to steadily accelerate in 2013 as the economy bounces back from harsh weather conditions and as the underlying expansion of consumer spending reemerges. We expect growth to register 1.7% in 2012 and 2.6% in 2013.

- The November unemployment rate fell to 7.7% from 7.9%, and was down a full percentage point from November 2011. But the most recent monthly decline was due mostly to a drop in the size of the labor force accompanied by a decline in employment, according to the Bureau of Labor Statistics (BLS) survey of households. By contrast, according to the BLS survey of employers, total employment outside the farm sector grew at the solid pace registered earlier in the year. The average payroll gain for the first 11 months of 2013 was about 150,000 jobs, equaling the pace during the economic expansion from June 2003 to January 2008. At that pace, total employment will reach its previous peak of 138 million jobs in early 2015. However, we expect that the unemployment rate will be 7½% at the end of 2013 and 7% at the end of 2014, and that significant labor market slack will remain into 2016 and perhaps beyond.

- Although the household survey has registered significant net job gains over the first 11 months of the year, many of those new positions have been part-time jobs held by workers who want to work full time. This sharp increase in part-time work for economic reasons indicates that the labor market has not improved as much in recent months as the unemployment rate suggests.

- Job losses during the labor market downturn and subsequent gains during the recovery have been unevenly distributed across occupations. Managerial and professional jobs posted little or no reduction and have grown substantially more recently. Meanwhile, low-skill manual labor jobs initially registered large losses, although personal and food services jobs were exceptions. All these groups have seen significant recent gains. By contrast, middle-skill white-collar and blue-collar jobs declined severely, and no bounce back has been evident.

- The lack of job growth for middle-skilled workers raises concerns about whether they have the skills appropriate for available jobs, and whether such skill mismatches may be prolonging unemployment. Unemployment due to skill mismatches may be structural in nature in contrast with cyclical job losses stemming from a weak economy. The percentage of the labor force that is unemployed long term, that is, for more than six months, reached historical highs during the recession and its immediate aftermath. Since then, long-term unemployment has been dropping along with the unemployment rate. At the same time though, the average duration of unemployment has stayed stubbornly high, hovering around 40 weeks since mid-2011.

- High unemployment durations are mirrored in the low rates at which unemployed people are finding jobs. Compared with the previous expansion from 2005-07, job-finding rates during the 2008-10 period dropped for individuals at all unemployment durations. From 2011 through August 2012, job-finding rates have improved, mainly at the longest unemployment durations. This may partly reflect the gradual unwinding of extended unemployment insurance benefits. Thus, while long-term unemployment remains a challenge, improvements in the job-finding prospects of the very-long-term unemployed suggest that the problem is not permanent.

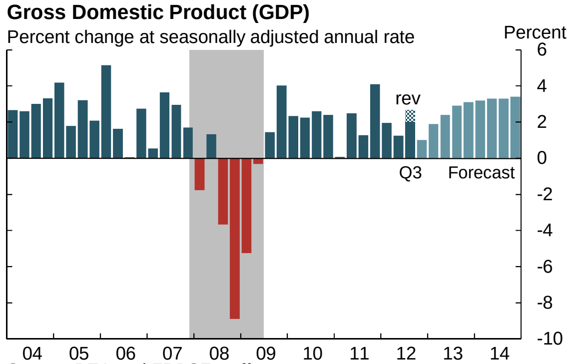
- Wage inflation slowed substantially during the recession and has remained quite low since, hovering at or slightly above a 1½% rate. Including employer benefits, total compensation costs have risen at around a 2% pace. Limited wage gains support our expectation that overall price inflation will stay contained. Recent figures on overall personal consumption expenditure price inflation have been running below the Federal Reserve's 2% target. Except for short-run fluctuations in the prices of energy and other commodities, we expect inflation to remain below that target over the next few years.

- After its most recent meeting, the Fed's policy committee announced that it is extending its open-ended asset purchases, including $40 billion per month of mortgage-backed securities and $45 billion in longer-term Treasury securities, to support economic recovery. The committee also said that exceptionally low levels of the federal funds rate, the Fed's main policy rate, will be appropriate at least as long as the unemployment rate remains above 6½%, inflation is no more than a half percentage point above the Fed's 2% target, and longer-term inflation expectations remain in check. The conditions for changing policy are not expected to be met until sometime in the second half of 2015.

GDP uneven, gradual recovery continues

Gross Domestic Product (GDP)

Percent change at seasonally adjusted annual rate

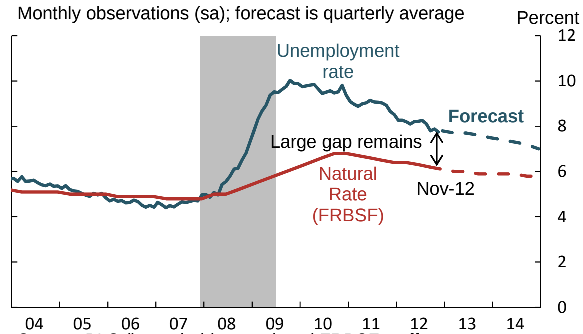


Source: BEA and FRBSF staff.

Persistent unemployment gap

Unemployment rate

Monthly observations (sa); forecast is quarterly average

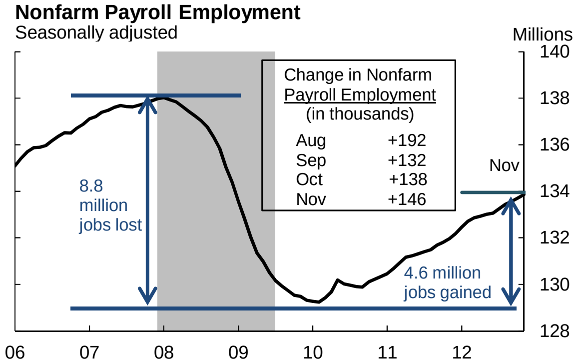


Source: BLS (household survey) and FRBSF staff.

Employment: Slowly working our way back

Nonfarm Payroll Employment

Seasonally adjusted



Source: BLS (payroll survey).

Part-time work is way up, rising this year

Part-time Employment for Economic Reasons

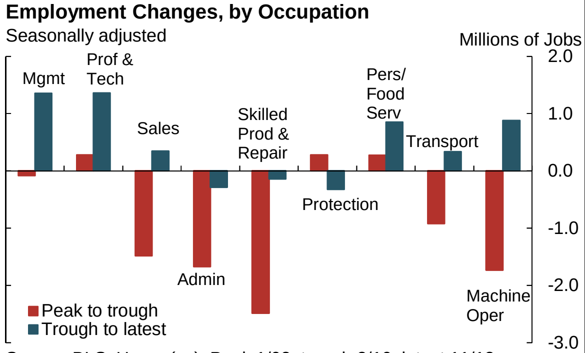
Percent of total employment, seasonally adjusted

Source: BLS and FRBSF adjustment for 1994 survey changes.

Little growth for mid-skill occupations

Employment Changes, by Occupation

Seasonally adjusted

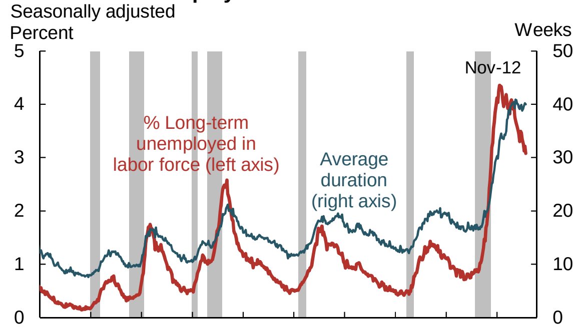


Source: BLS, Haver (sa). Peak 1/08, trough 2/10, latest 11/12.

Long-term unemployment: Structural?

Measures of unemployment duration

Seasonally adjusted

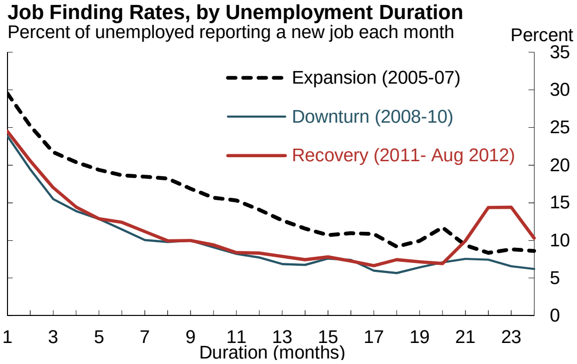


Source: BLS and FRBSF. Long-term is unemployed for >6 months.

Long-term unemployed: Better prospects

Job Finding Rates, by Unemployment Duration

Percent of unemployed reporting a new job each month

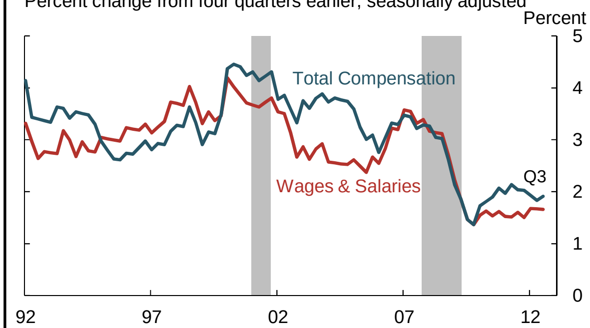


Source: FRBSF calculations using matched monthly CPS microdata.

Wage inflation very low

Employment Cost Index, all Civilian Workers

Percent change from four quarters earlier, seasonally adjusted

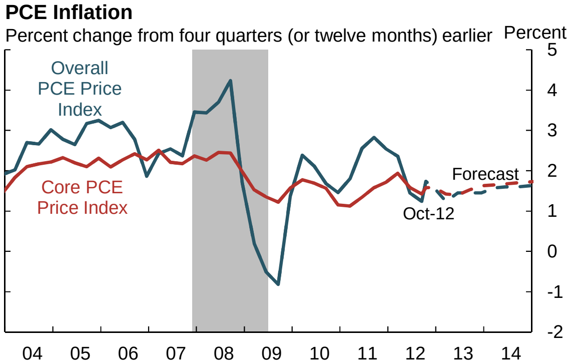


Source: BLS.

Expect inflation to remain below 2%

PCE Inflation

Percent change from four quarters (or twelve months) earlier



Source: BEA and FRBSF staff.