The U.S. Economic Outlook: Why is inflation still low?

Robinson Economic Forecasting Conference

Georgia State University
November 15, 2017
The signals now suggest GDP growth is proceeding about as we expected…

<table>
<thead>
<tr>
<th></th>
<th>First Half, 2017</th>
<th>Q3 adv. estimate</th>
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<tr>
<td>Real GDP</td>
<td>2.1</td>
<td>3.0</td>
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All entries are annualized growth rates, in percent

Sources: Bureau of Economic Analysis, Federal Reserve Bank of Atlanta, Haver Analytics
... but there may be less underlying strength in Q3 than meets the eye. Hurricanes?

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<td>Real GDP</td>
<td>2.1</td>
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<td>Final Sales</td>
<td>2.8</td>
<td>2.3</td>
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Sources: Bureau of Economic Analysis, Federal Reserve Bank of Atlanta, Haver Analytics
Consumer spending appears to be holding up....

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<td>Personal Consumption Expenditures</td>
<td>2.6</td>
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Sources: Bureau of Economic Analysis, Federal Reserve Bank of Atlanta, Haver Analytics
… but business fixed investment?

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<td><strong>Business Fixed Investment</strong></td>
<td>6.9</td>
<td>3.9</td>
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Sources: Bureau of Economic Analysis, Federal Reserve Bank of Atlanta, Haver Analytics
Not to worry? Most of the investment fall off is in structures – coming off of a strong (energy-related) first half.

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<td>Equipment</td>
<td>6.6</td>
<td>8.6</td>
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<td>Intellectual Property Products</td>
<td>4.7</td>
<td>4.3</td>
</tr>
<tr>
<td>Structures</td>
<td>10.9</td>
<td>-5.2</td>
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Sources: Bureau of Economic Analysis, Federal Reserve Bank of Atlanta, Haver Analytics
May as well not give up now.

2.3 percent is our GDP growth story, and we’re (for the most part) sticking to it.
Headline inflation over the past 3 months remained on its 12-month trend – over \( \frac{1}{2} \) percentage below the FOMC’s 2-percent target.

Sources: Bureau of Economic Analysis; Haver Analytics

Data through September 2017
The story is the same if we focus on core (rather than headline) inflation....
... and the same is true for more sophisticated measures of trend inflation, such as the Dallas Fed trimmed-mean PCE.

Sources: Bureau of Economic Analysis; Dallas Fed; Haver Analytics

data through September 2017,
What can account for persistently soft inflation?

• The world is changing
What can account for persistently soft inflation?

• The world is changing
  --- Technology
Though the Q3 pop is a hopeful sign, productivity growth has been exceptionally weak over the course of this recovery.
What can account for persistently soft inflation?

• The world is changing
  --- Technology
  --- Competition
Mark-ups have risen sharply since 1980, a sign of more market concentration, not less.

What can account for persistently soft inflation?

• The world is changing
  --- Technology
  --- Competition
  --- Anxiety
Wage growth, though somewhat higher than earlier in the recovery, is still well below pre-crisis levels.

Measures of wage, earnings and compensation growth
4-quarter or 12-month percent change

- Employment Cost Index: Total Compensation
- Payroll survey: Average hourly earnings

Sources: Bureau of Labor Statistics, Haver Analytics

ECI data through Q3-2017, payroll survey data through October 2017
Wage growth looks relatively soft even controlling for some of the compositional effects associated with new workers.

![Graph showing measures of wage, earnings, and compensation growth](Image)

**Measures of wage, earnings and compensation growth**

4-quarter or 12-month percent change

- Employment Cost Index: Total Compensation
- Payroll survey: Average hourly earnings
- Atlanta Fed Wage Growth Tracker

Sources: Bureau of Labor Statistics, Federal Reserve Bank of Atlanta, Haver Analytics

ECI data through Q3-2017, Wage growth tracker through September 2017 and payroll survey data through October 2017
Perhaps nominal wage growth isn’t low at all, given fundamentals?

Nominal Wage Growth, Inflation, and Productivity
percent change, annual rate over past three years

Notes: Productivity is nonfarm business sector output per hour worked. Inflation is the PCE price index. Compensation per hour (from BLS) includes wages and salaries of employees plus employers’ contributions for social insurance and private benefit plans.
Sources: Bureau of Labor Statistics; Bureau of Economic Analysis; Haver Analytics
What can account for persistently soft inflation?

• The world is changing
  --- Technology
  --- Competition
  --- Anxiety

• Nobody believes 2 percent
If the inflation goal was 1.75 percent, the inflation rate of the past 5 years would look just about right.
The typical respondent in our Business Inflation Expectations Survey panel says 2% inflation is the target, but the target is not symmetric.

Source: Atlanta Fed Business Inflation Expectations (BIE) Survey, April 2017
What can account for persistently soft inflation?

• The world is changing
  --- Technology
  --- Competition
  --- Anxiety

• Nobody believes 2 percent

• Stuff happens
The smoking low-inflation gun? “Other”

Figure 3
Why Has PCE Inflation Been Running below 2 Percent?

Note: Deviation of PCE inflation (4th quarter to 4th quarter) from 2 percent, total and portion attributable to specific factors. Source: Federal Reserve Board calculations using data from the BEA, BLS, CBO and SPF. See the appendix for further details.

Source: Janet Yellen, "Inflation, Uncertainty, and Monetary Policy” Speech to the Annual Meeting of the National Association of Business Economists, September 26, 2017.
Why is inflation still low?