

Macroeconomic Outlook

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❖ **The Jobless Recovery is no longer jobless.**

- Strong productivity gains boost U.S. output, but limit employment gains.

In the past year, the U.S. economy has strengthened. U.S. gross domestic product surged in the last half of 2003. Despite an economic soft spot that emerged in the second quarter of 2004, economic output is almost 5 percent above a year, on a year ago basis. Strong growth has been driven by robust productivity gains in the U.S. economy. Productivity gains reached historical highs at the end of 2003 and at the start of 2004.

Another jobless recovery emerged following the 2001 recession. It was more than 2 years after the recession before the U.S. economy started to post job gains. Strong productivity gains allowed business to boost output without adding workers. Job gains have been posted recently. These gains have led to a fall in the unemployment rate. After peaking above 6 percent in 2003, the unemployment rate now rests at 5.4 %.

Rural areas are leading metro areas in job gains. Rural job growth is approaching 2% above year ago levels, while metro job growth is near 1% above a year ago. Stronger rural job growth at the early stages of recovery is typical as rural labor markets appear to lead metro labor markets. Growth is strongest in micropolitan counties, nonmetro counties with a town between 10 and 50 thousand in population. These counties often serve as regional centers for rural regions.

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How soft is the soft spot?

- Consumer spending is causing the soft spot.

The soft spot is driven by slower consumer spending. In the second quarter, the contribution of consumer spending to GDP fell to 1.1 percent. The biggest drop occurred in nondurable goods. Weakness also emerged from durable goods and services. Most attribute this softness to rising energy prices. Oil prices nearing \$50 per barrel have put a damper on the U.S. economy. Consumer debt may also limit the ability of consumer spending to increase. Debt service burdens remain high. Fortunately, debt burdens appear to have reached a plateau. Credit card delinquencies are on the rise, but installment and mortgage delinquencies have edged down.
- Business activity is robust

Corporate profits and equity markets are bolstering business confidence. Business investment is on the rebound. Equipment and software investment has rebounded sharply in 2004. Structures investment is not above year ago levels.
- Government sectors are a fiscal stimulus

The federal government continues to provide fiscal stimulus. A slower U.S. economy cut government revenues during the recession. Tax cuts and increased federal spending do pump stimulus into the economy, but also raise the deficit. State and local tax revenues have surged in the past 3 quarters indicating that economy activity has strengthened.
- A stronger trade balance in the future

The value of the dollar has fallen 20 percent since August 2001. The falling dollar makes U.S. goods cheaper in foreign markets and should help boost exports. World GDP growth is expected to strengthen in 2004 and 2005. While a cheaper dollar and strong world economies should boost exports, the trade deficit is expected to remain large.

❖ Is inflation on the rise?

Inflationary pressures have emerged in 2004. Capacity constraints have intensified in the manufacturing sector. Labor costs continue to rise, especially benefits costs associated with medical insurance premiums. Commodity prices have surged in 2004. Stronger global economies, especially China's economy, have increased the demand for commodities such as food, lumber, oil, and steel. Rapid price increases appear to have slowed. While inflation is expected to rise in 2004, economists expect inflation to ease in 2005.

❖ What is a "measured" response?

With economic growth and low inflation, the FOMC is raising the Fed Funds Rate at a measured pace. They will continue to act to maintain price stability.