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An Examination of Current Economic Conditions in the Nation and in the Louisville Area

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Charles Gascon, Regional Economist

March 7, 2019

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The Big Picture

• Conflicting data and the delayed release of several key economic reports have been a challenge for forecasters.

• Still, labor markets remain strong and last year’s GDP growth was the strongest since 2005. Inflation remained below 2%.

• Lower oil prices have helped throttle back inflation pressures. Financial market conditions are improving.

• The Fed is in a wait-and-see mode.
Four Questions for 2019

- Will job growth remain strong?
- Is inflation headed higher?
- Will the Fed raise rates again in 2019?
- Will there be a recession in 2019?
#1: Will Job Growth Remain Strong?

- The U.S. unemployment rate is near a 50-year low.
- Many firms—especially in construction and transportation—continue to report labor shortages.
- Forecasts suggests solid job growth this year, further stretching tight labor markets.
Forecasters Expect the U.S. Unemployment Rate to Fall Further

Unemployment Rate: Actual and February Blue Chip Forecast
Four-quarter percent changes

SOURCE: Feb. 2019 Blue Chip Economic Indicators and Haver Analytics
A Wage Puzzle?

• Labor compensation rose 3% in 2018, the largest increase since 2007. Is faster growth possible?

• Solid economic growth and strong labor demand should continue to put upward pressure on labor compensation.

• To achieve faster growth of real labor compensation will depend importantly on productivity growth. But we have been in an era of weak productivity growth since around 2005. There are reasons to be optimistic.
#2: Will Inflation Accelerate in 2019?

- Inflation in 2018 remained below 2% for the seventh straight year.
- But many see increased risk of higher inflation because the unemployment rate is near a 50-year low. I don’t.
- Others see trade-related developments (i.e., tariffs) raising inflation. But a stronger dollar and low oil prices help to offset some of these risks.
- Tame inflation expectations also help anchor inflation.
The 2% Inflation Forecast for 2019

CPI Inflation: Actual and February Blue Chip Forecast
Four-quarter percent changes

SOURCE: Feb. 2019 Blue Chip Economic Indicators and Haver Analytics
Our “Big Data” Model has Signaled Lower Inflation Since Last June

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Headline PCE Price Inflation: Actual, Current Forecast and Previous Forecast Vintages
Percent change from 12 months earlier

- **ACTUAL**
- **October**
- **June**

Source: BEA; FRB St. Louis (Jackson, Kliesen, Owyang).
#3: Is the Fed Done Tightening?

• At its December meeting, Fed policymakers raised rates for the fourth time in 2018.

• They also signaled that more rate increases were likely in 2019 and in 2020.

• Financial markets did not react well; stocks sold off, and some forecasters raised the specter of a recession this year or next.
Patience is a Virtue

• In the face of rising financial market turmoil, signs of weaker growth in Europe and China, and slowing inflation, Fed policymakers called an audible.

• In early January, Chairman Powell and other Fed policymakers said that they will be patient in assessing how the economy responds to rate increases.

• This is data-dependent policy in action.
So, More Rate Hikes in 2019?

• Unless inflation accelerates or financial stability concerns mount, don’t count on it. Again, my view.

• What’s the case for more hikes? It mostly boils down to strong labor markets (Phillips curve). Others want policy “space”—raise more to cut more.

• What’s the case for staying put? Inflation doesn’t appear to be a threat. There are some downside risks to the real economy. That leads to the final question.
#4: A Recession in 2019?

- That’s not my forecast, but the probability isn’t zero.

- Recession signals are mixed: The yield curve is flat and housing has weakened, but labor markets and consumer spending suggest continued solid growth.

- Headwinds, tailwinds, and whirlwinds: Trade policy; fiscal stimulus; and financial market volatility.

- Headwinds + whirlwinds = rising uncertainty.
Riding the Storm Out: Rising Uncertainty

Economic Policy Uncertainty Index
Index, Sept. 1985 = 101

The No-Recession Forecast

Recession Probabilities

2019: 26%
2020: 39%

Real GDP Growth: Actual and February Blue Chip Forecast
Four-quarter percent changes

SOURCE: Feb. 2019 Blue Chip Economic Indicators and Haver Analytics
Main Takeaways

• Although recession risks are modestly elevated, most forecasters expect weaker, though still solid, growth in 2019. The unemployment rate could fall a bit more.

• Inflation has slowed, helped by the plunge in crude oil prices. I see some risk of lower inflation in 2019.

• Financial markets expect the FOMC keep its powder dry in 2019. The data and forecasts will guide the Fed.
Economic Overview: 
Geography of US Economic Growth

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March 7, 2019

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Regional economic growth slowed in 2017, picked up during 2018

Source: BEA, Federal Reserve Bank of St. Louis. Map shows average county growth 2012-15
There are significant differences in economic growth across US Metro areas.

**Real GDP Growth**
Percent change from one year ago

![Graph showing real GDP growth with years from 2002 to 2017 and percentage changes from -15% to 15% with standard deviations and US RGDP Growth trends.](image-url)
Metro area real GDP growth rates can be a world apart

Distribution of Avg. Real GDP Growth 2011-2016
Percent of regions

Note: “Global” is 185 countries with complete data for 2011-2016 from the IMF/FRED
Far West/Rocky Mountain Regions experience fastest growth

Real GDP Growth
Average 2011-2016

- Far West
- Rocky Mountain
- Southwest
- Southeast
- Plains
- Great Lakes
- Mid East
- New England
Slower growth is typical for the region
Breaking down GDP

ECON 101 (NIPA): \[ \text{GDP} = \text{Consumption} + \text{Investment} + \text{Government Spending} + \text{Net Exports} \]

Growth Accounting: \[ \text{GDP} = \text{Workers} \times \text{Productivity} \]

Workers are a function of the population and their propensity to work.

Productivity is a function of human and physical capital.
A Decomposition US Real GDP Growth (2011-16)

- Population Growth, 0.8%
- Labor Force Participation Rate (LFPR), 0.0%
- Declines in Unemployment Rate, 0.9%
- Hours Worked, 0.0%
- Productivity, 0.5%

United States
A Decomposition of US Real GDP Growth (2011-16)

- Net Births, 0.4%
- Migration (Dom.), 0.0%
- Migration (Intl), 0.4%
- LFPR, 0.0%
- UR, 0.9%
- HRS, 0.0%
- Productivity, 0.5%
Decomposition of Louisville Real GDP Growth

Net Birth, 0.3%
Migration (Dom.), 0.1%
Migration (Intl), 0.2%
LFPR, 0.0%
UR, 1.1%
HRS, 0.1%
Productivity, 0.9%

Louisville
Some important caveats on this analysis

• **A person is assumed to be the same within a metro area**
  • Same LFPR, UR, HRS for a local, migrant, or immigrant

• **Very young and very old people work**
  • This assumption is OK if net births are unchanged over time.
  • Nationally, net birth rates are slowly falling (death rates up, birth unchanged)
    • Contribution from LFPR captures aging population
    • Slower birth rate → overestimate productivity
    • Faster birth rate → underestimate productivity

• **Regional data are always subject to measurement error**
Population growth accounts for regional differences in economic growth.
Domestic migration key determinant of population growth for most MSAs

Population Growth 2011 to 2016
Energy sector accounts for productivity contributions in Plains/Southwest

- Far West: 2.2%
- Rocky Mountain: 2.0%
- Southwest Southeast: 1.5%
- Plains: 1.0%
- Great Lakes: 0.5%
- Mid East: 0.0%
- New England: -0.5%

Productivity, Other, RGDP Growth
Why is Louisville growing slower than Nashville? The same as Tampa?

<table>
<thead>
<tr>
<th></th>
<th>Real GDP Growth</th>
<th>Change in Population</th>
<th>Net Births</th>
<th>Net Migration</th>
<th>Domestic Migration</th>
<th>International Migration</th>
<th>Change in Labor Force Participation Rate</th>
<th>Change in Unemployment Rate</th>
<th>Change in Hours Worked</th>
<th>Change in Productivity</th>
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<tr>
<td>(GDP)</td>
<td>(POP)</td>
<td>(NB)</td>
<td>(NM)</td>
<td>(DM)</td>
<td>(IM)</td>
<td>(LFPR)</td>
<td>(UR)</td>
<td>(HRS)</td>
<td>(PROD)</td>
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<td>Louisville (LOI)</td>
<td>2.8%</td>
<td>0.6%</td>
<td>0.3%</td>
<td>0.4%</td>
<td>0.1%</td>
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<td>2.9%</td>
</tr>
<tr>
<td>Tampa (TPA)</td>
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<td>1.6%</td>
<td>1.1%</td>
<td>0.5%</td>
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<td>0.2%</td>
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<tr>
<td>LOI minus TPA</td>
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<td>0.4%</td>
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</tr>
</tbody>
</table>

GDP=POP+LPFR+UR+HRS+PROD
POP =NB+NM
NM=DM+IM
What does this analysis tell us about Where we’re going?

The following information is from the East-West Gateway Council of Governments 2018 “Where We Stand” report.
Spider Web Charts!

Indicator A

Louisville  Peer Avg  Avg.
It’s unlikely that growth in the number workers will drive GDP growth

Where We Stand on Population

- Natural Pop Change
- Immigrant Population
- Families with Children
- Young Adults
- Children
- Net Domestic Migration
- Net International Migration
- Median Age

Where We Stand on Workforce

- Employment-Population Ratio
- Empl. Rate for Adults with Disabilities
- Disconnected Youth
- Adults Aged 18-64 with Disabilities

Note: All values are normalized and reported as Standard Deviations from the average. Indicators were adjusted to greater values are always positive. Peer MSAs include: Austin, Birmingham, Buffalo, Cincinnati, Indianapolis, Memphis, Nashville, Oklahoma City and Richmond.
Investments in human/physical capital could produce returns

Where We Stand on Human Capital

- College-Educated Young Adults
- Advanced Placement Enrollment
- Chronic Absenteeism
- Absent Teachers
- Education Spending
- Pupil-Teacher Ratio

Where We Stand on Physical Capital

- Venture Capital
- Patents
- Manufacturing and Tech Startups
- Incorporated Self-Employment
- Interstate Travel Time Reliability
- Travel Time Index
- Truck Travel Time Reliability Index

Note: All values are normalized and reported as Standard Deviations from the average. Indicators were adjusted to greater values are always positive. Peer MSAs include: Austin, Birmingham, Buffalo, Cincinnati, Indianapolis, Memphis, Nashville, Oklahoma City and Richmond.
Racial disparity metrics are mixed

Where We Stand on Racial Disparity

- Racial Disparity in Unemployment Rate
- Racial Disparity in Homicides
- Poverty Rate of Adults by Disability Status
- Segregation of School Districts
- Racial Disparity in Education
- Racial Disparity in Higher Education

- Orange: Louisville
- Purple: Peer Avg
- Dashed: US

Note: All values are normalized and reported as Standard Deviations from the average. Indicators were adjusted to greater values are always positive. Peer MSAs include: Austin, Birmingham, Buffalo, Cincinnati, Indianapolis, Memphis, Nashville, Oklahoma City and Richmond.
Final Thoughts

• The pace of the economic growth is very different from one region to the next.
  • San Jose (6% per year) is closer to China (7%) than Louisville (2.8%)

• Decomposing growth can help explain what is accounting growth, but not why a region will grow in the future.
  • Tampa (+Population) and Louisville (+LFPR/HRS) economies have been growing at the same rate.

• Knowledge economy (share of population with college degree in 2011) is positively correlated with domestic migration rates and productivity growth between 2011-16.
Interested in more regional research and data?

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