

The U.S. Economic Outlook



FEDERAL RESERVE BANK *of* KANSAS CITY

September 22, 2014

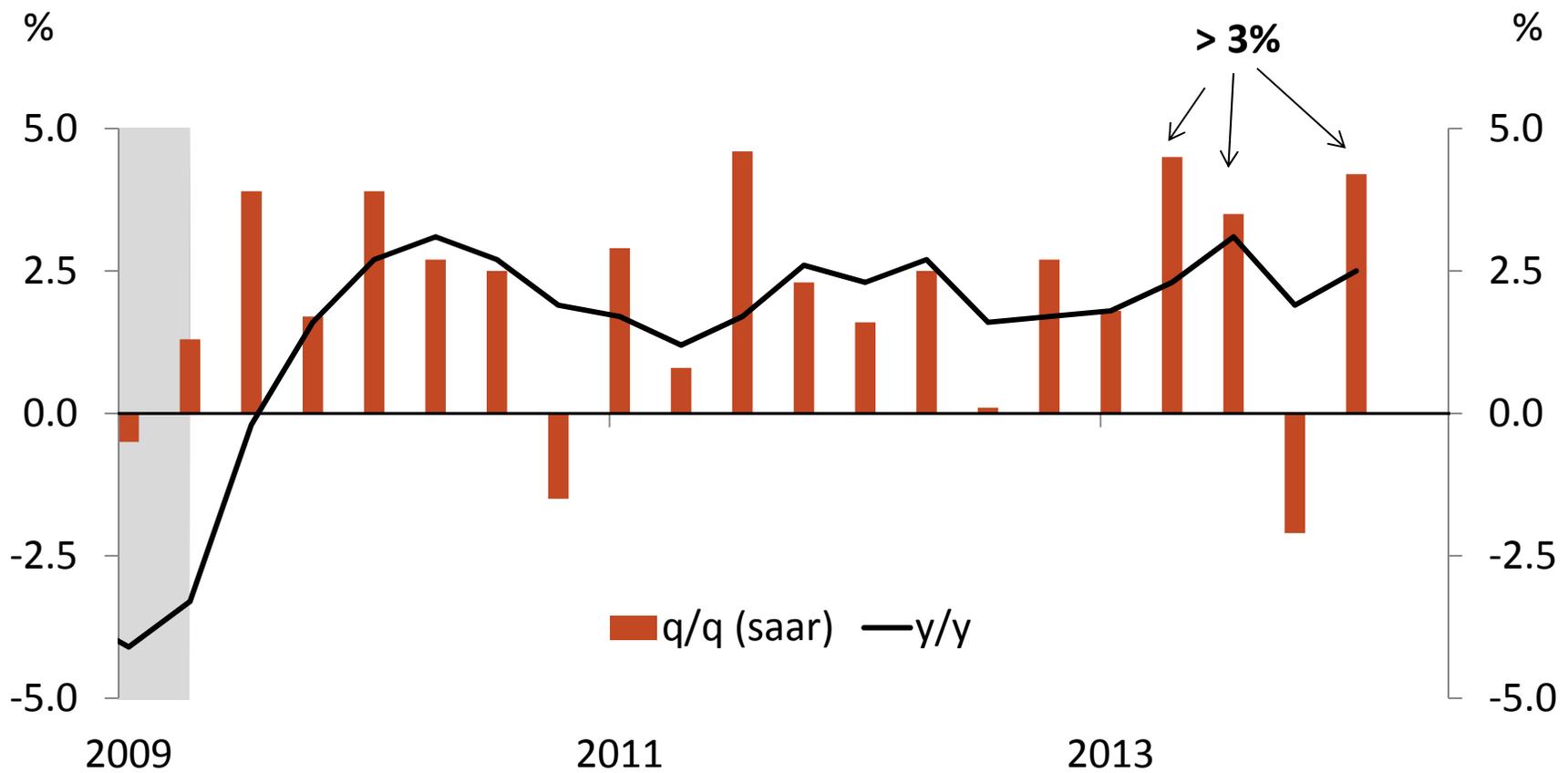
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Outlook themes

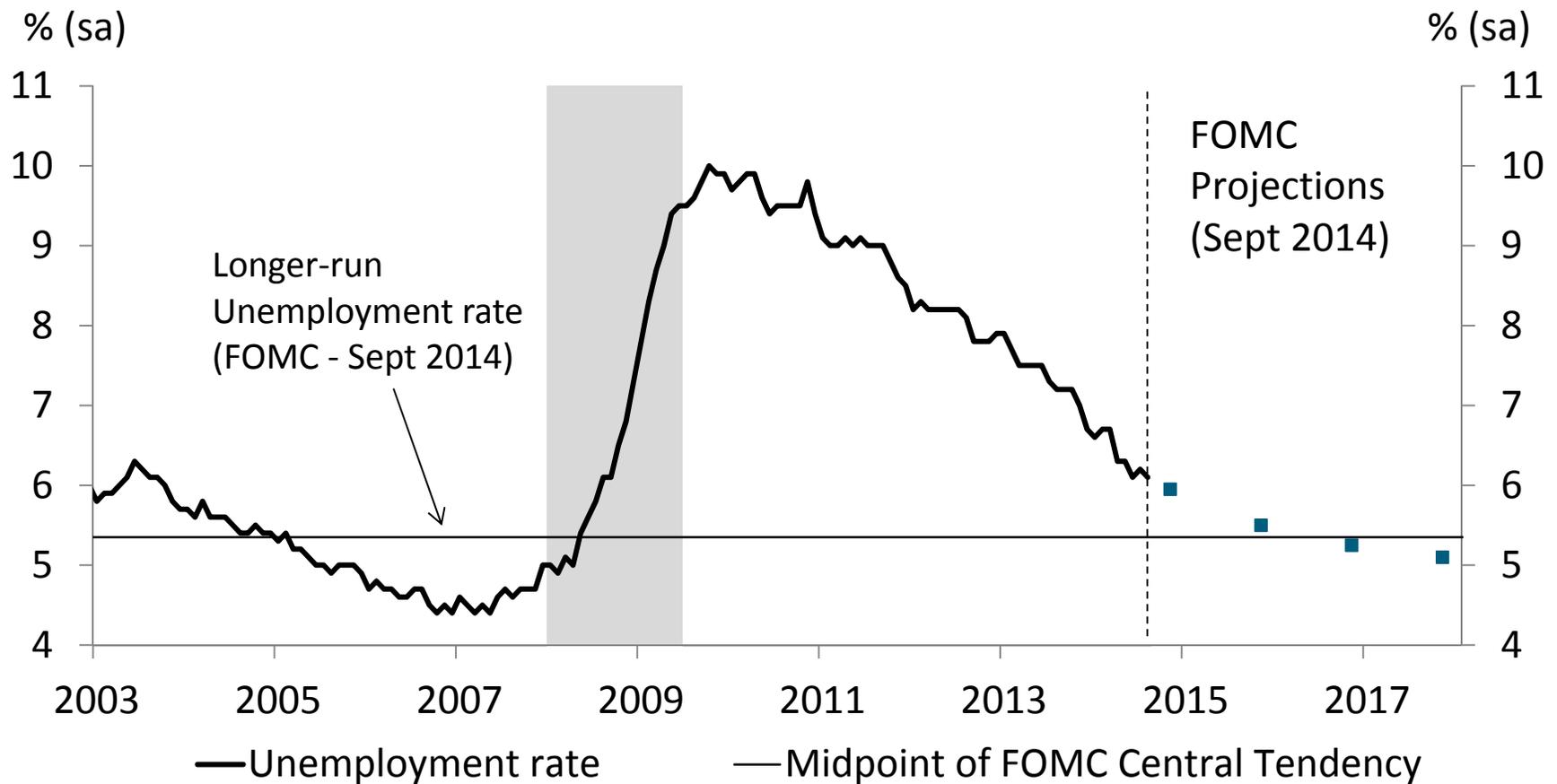
- Growth has rebounded following a soft Q1
- Labor markets continue to heal, as full employment is likely to be reached in 2015 and wage growth continues to edge higher
- Activity in the manufacturing and service sector is increasing
- Measures of inflation remain below the 2% goal, but are rising
- The euro and pound have fallen sharply against the US dollar

Growth has exceeded 3% in three of the last four quarters



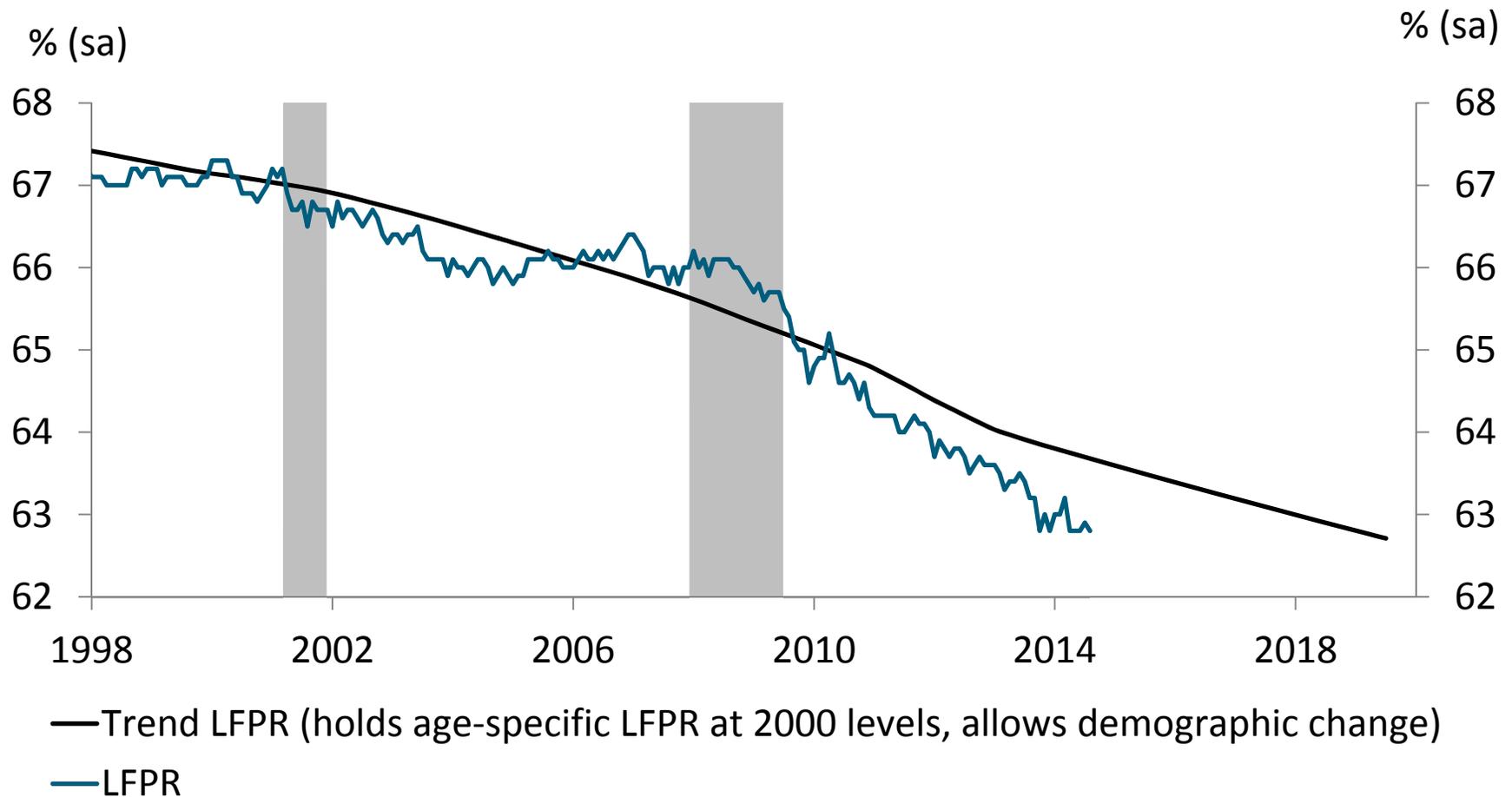
Source: Bureau of Economic Analysis, Haver Analytics

The labor market is likely to reach full employment in 2015



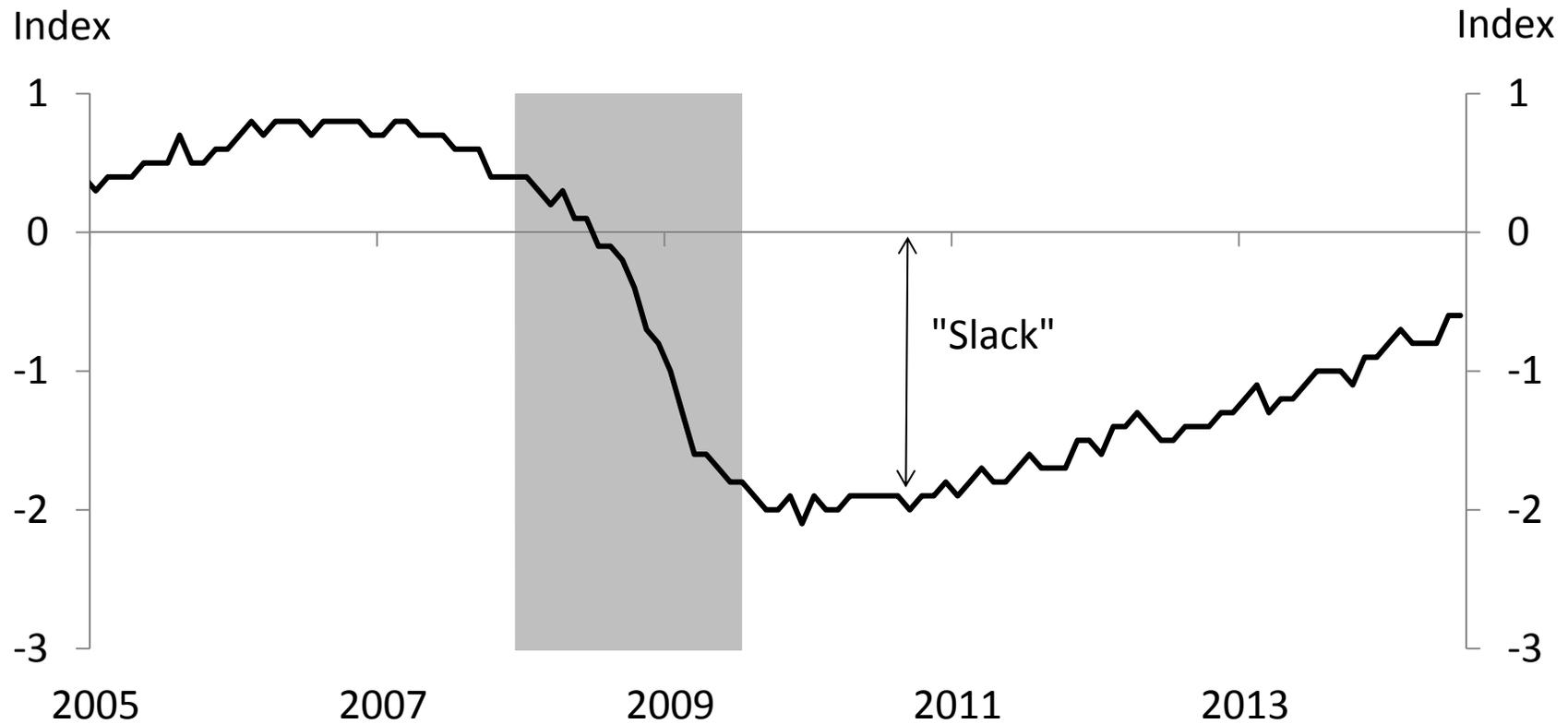
Source: Bureau of Labor Statistics, Federal Reserve, Haver Analytics

The labor force participation rate has stabilized, but remains below its demographically-adjusted trend



Source: Bureau of Labor Statistics, KC Fed Staff, Haver Analytics

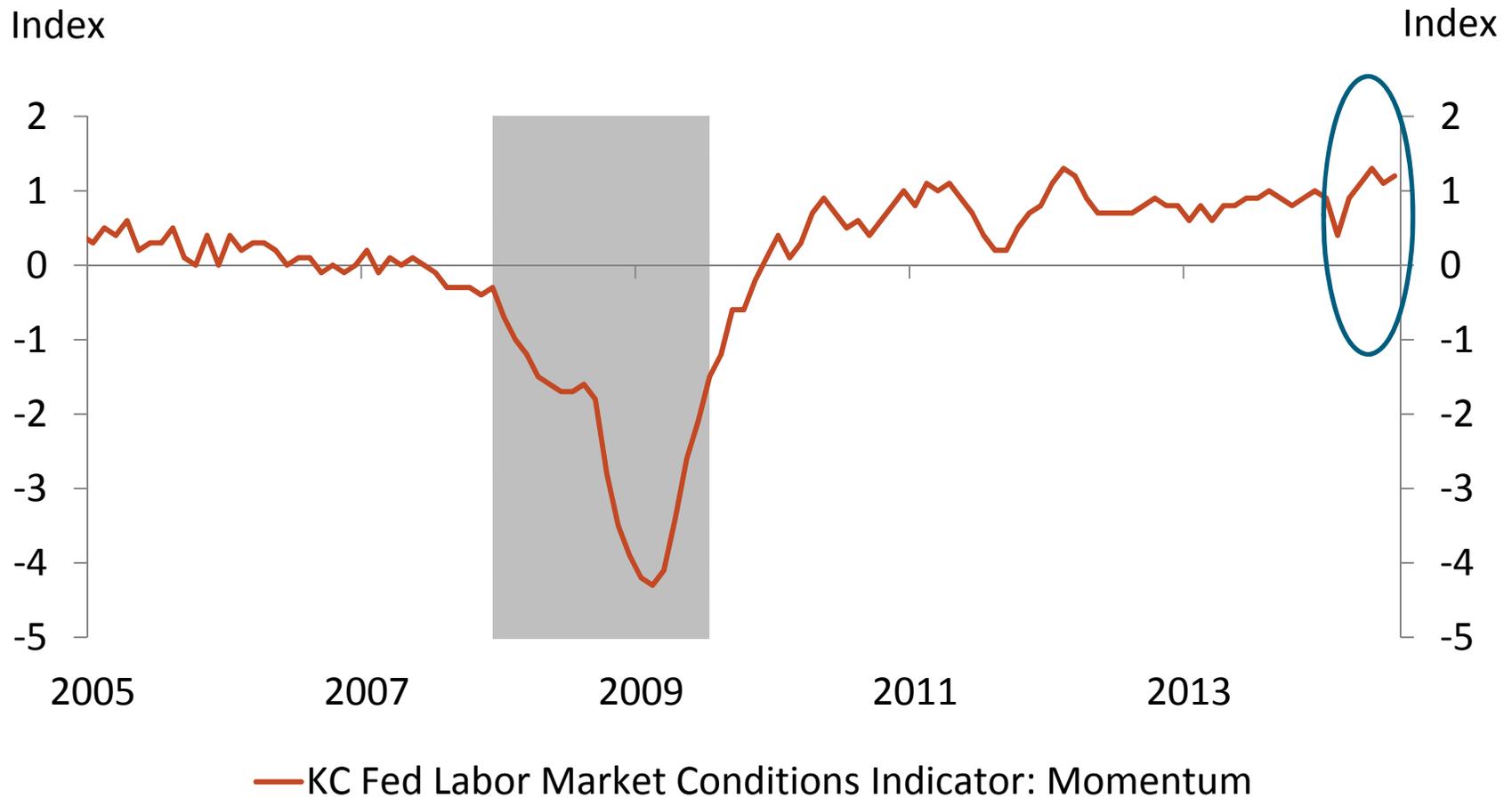
Based on a wide set of indicators, labor markets are approaching more normal conditions



—KC Fed Labor Market Conditions Indicator: Activity

Source: KC Fed Staff, Haver Analytics

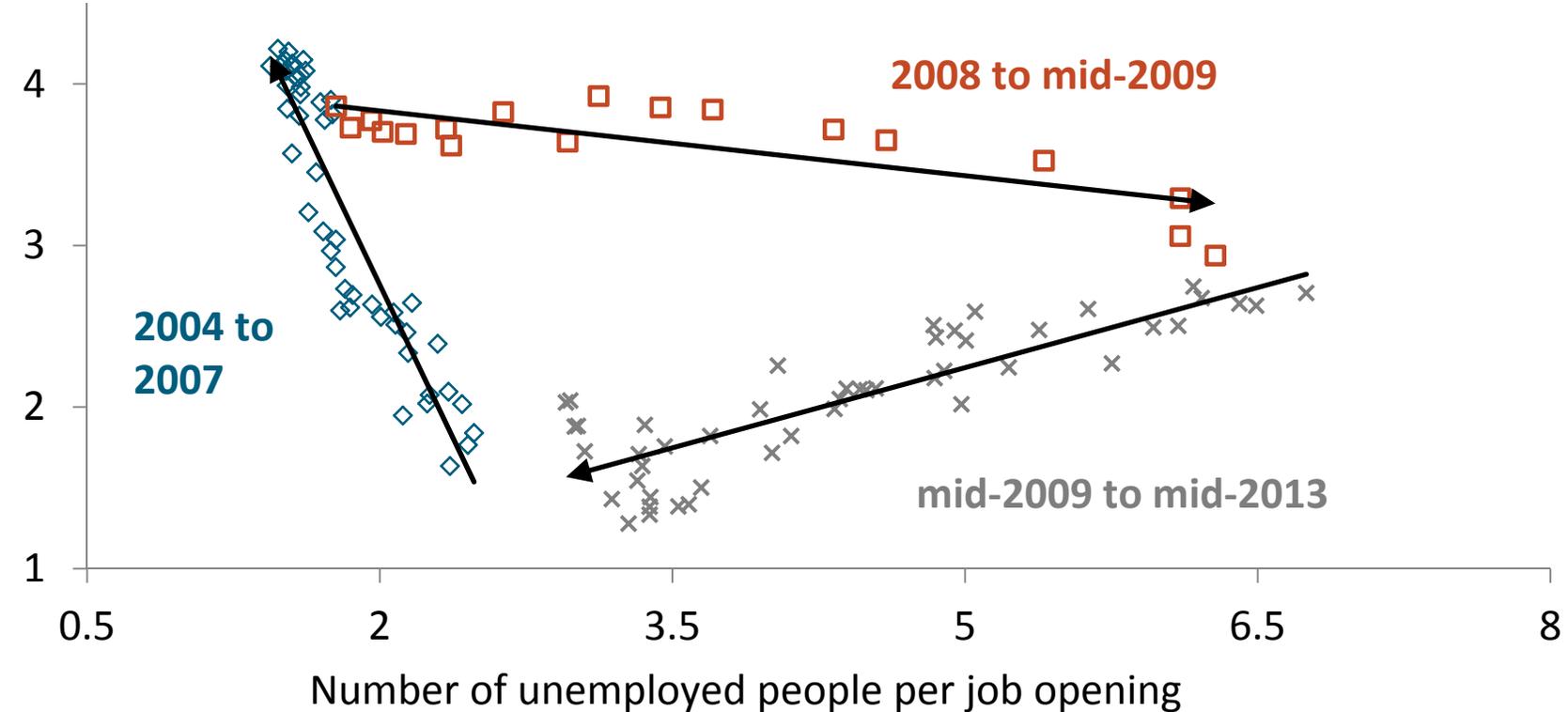
The pace of improvement in the labor market is above average



Source: KC Fed Staff, Haver Analytics

The wage cycle

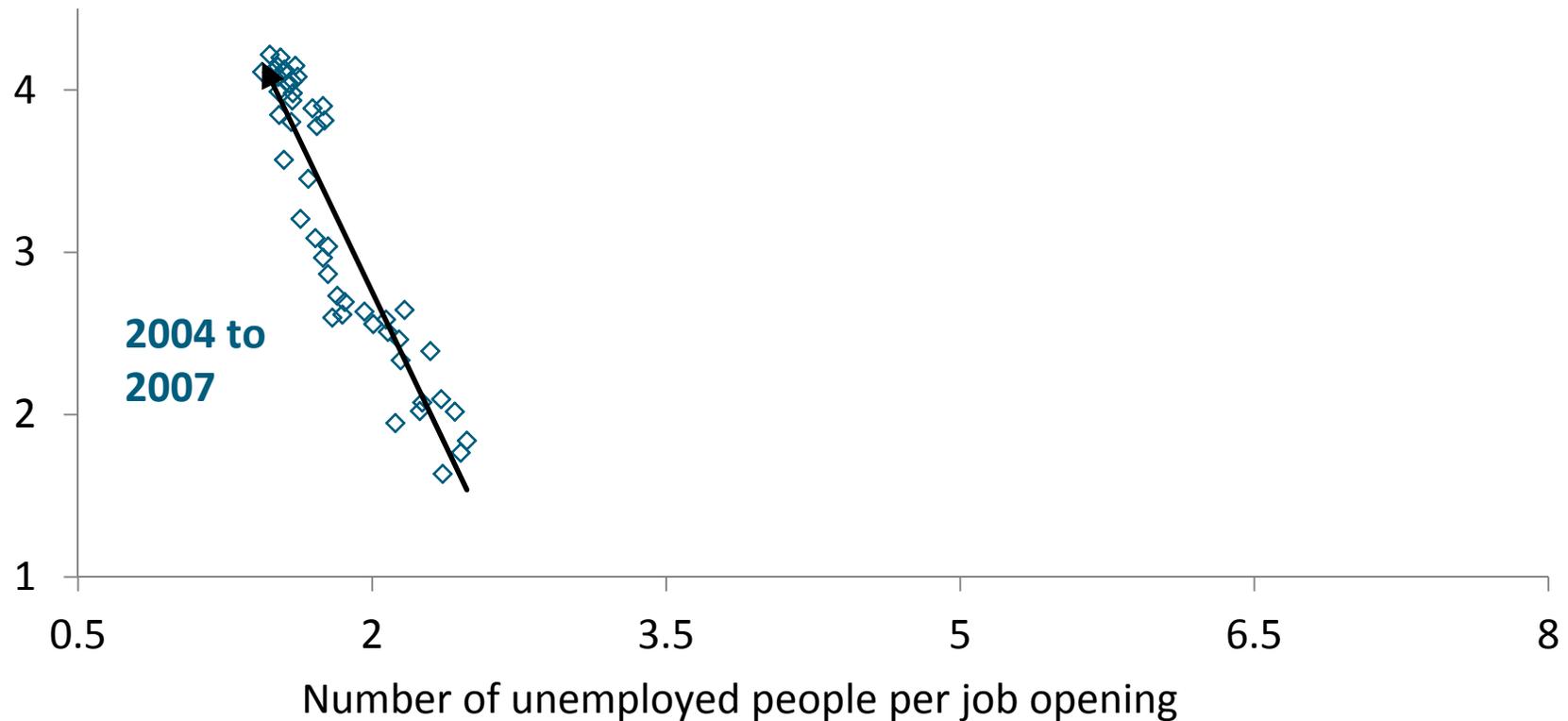
Avg hourly earnings (production and nonsupervisory workers),
y/y % chg



Source: Bureau of Labor Statistics, KC Fed Staff, Haver Analytics

Wage growth increased during the last expansion as the number of workers per job opening fell

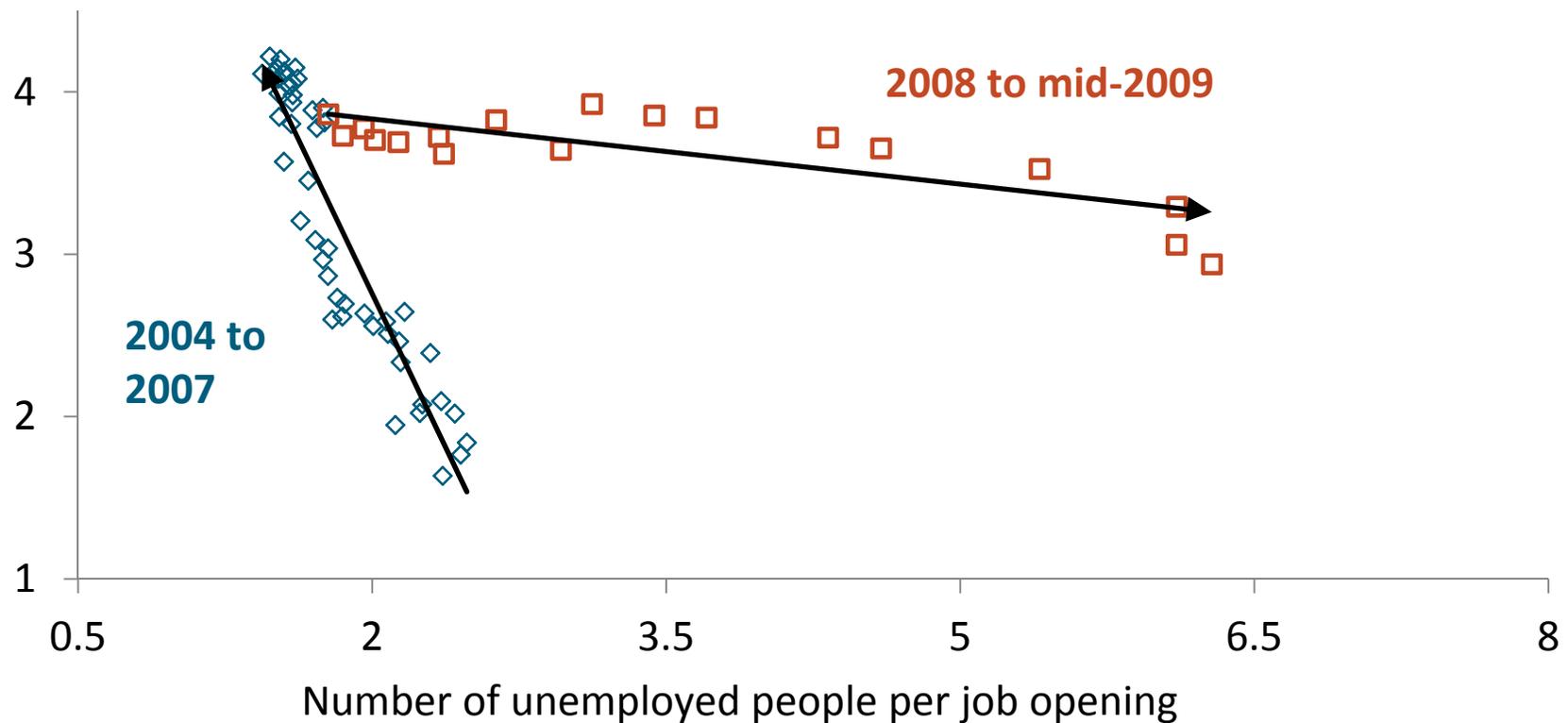
Avg hourly earnings (production and nonsupervisory workers),
y/y % chg



Source: Bureau of Labor Statistics, KC Fed Staff, Haver Analytics

Wage growth slowed as the economy entered the Great Recession...

Avg hourly earnings (production and nonsupervisory workers),
y/y % chg



Source: Bureau of Labor Statistics, KC Fed Staff, Haver Analytics

...and declined further during the recovery

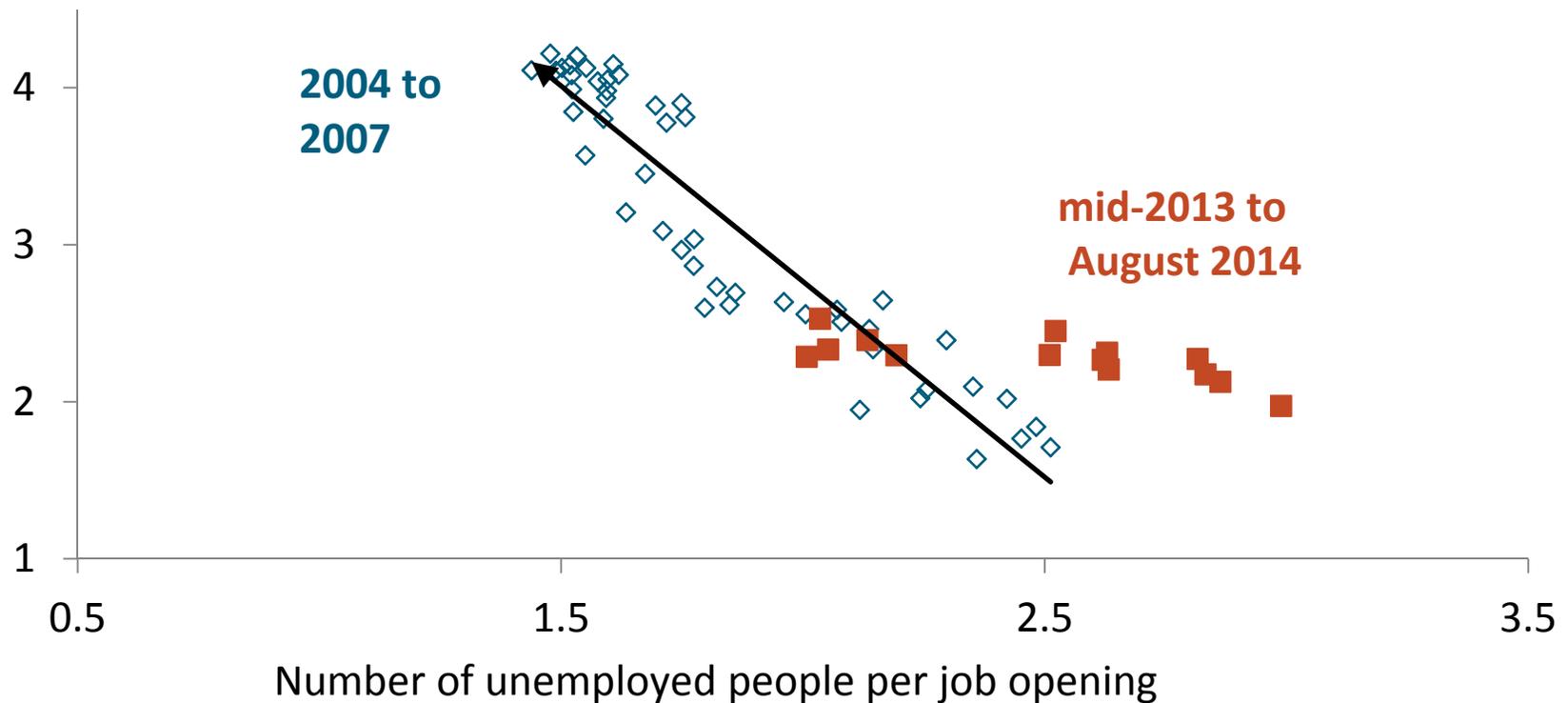
Avg hourly earnings (production and nonsupervisory workers),
y/y % chg



Source: Bureau of Labor Statistics, KC Fed Staff, Haver Analytics

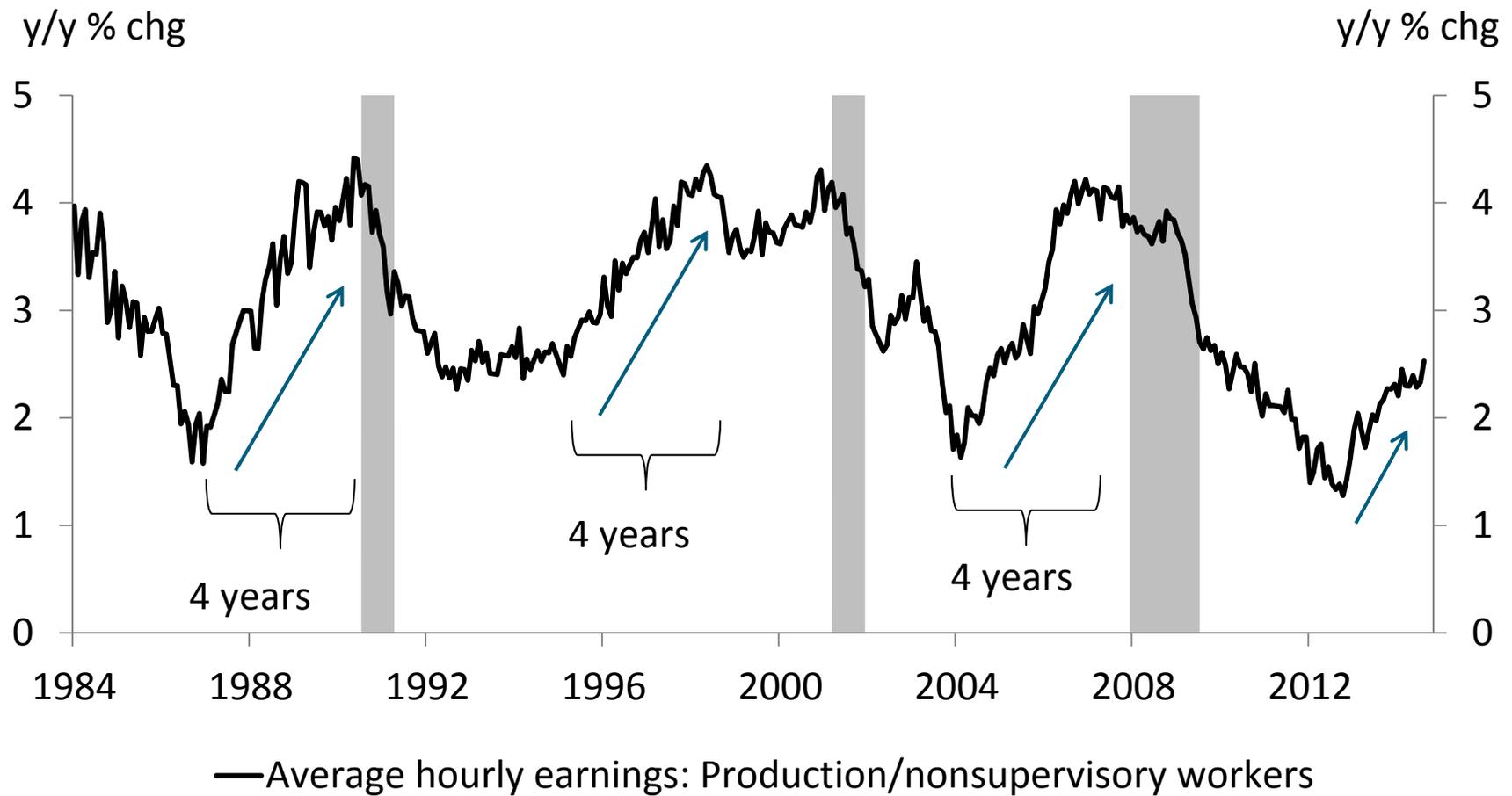
Wage growth is well aligned with the last recovery and is likely to increase with further labor market improvement

Avg hourly earnings (production and nonsupervisory workers),
y/y % chg



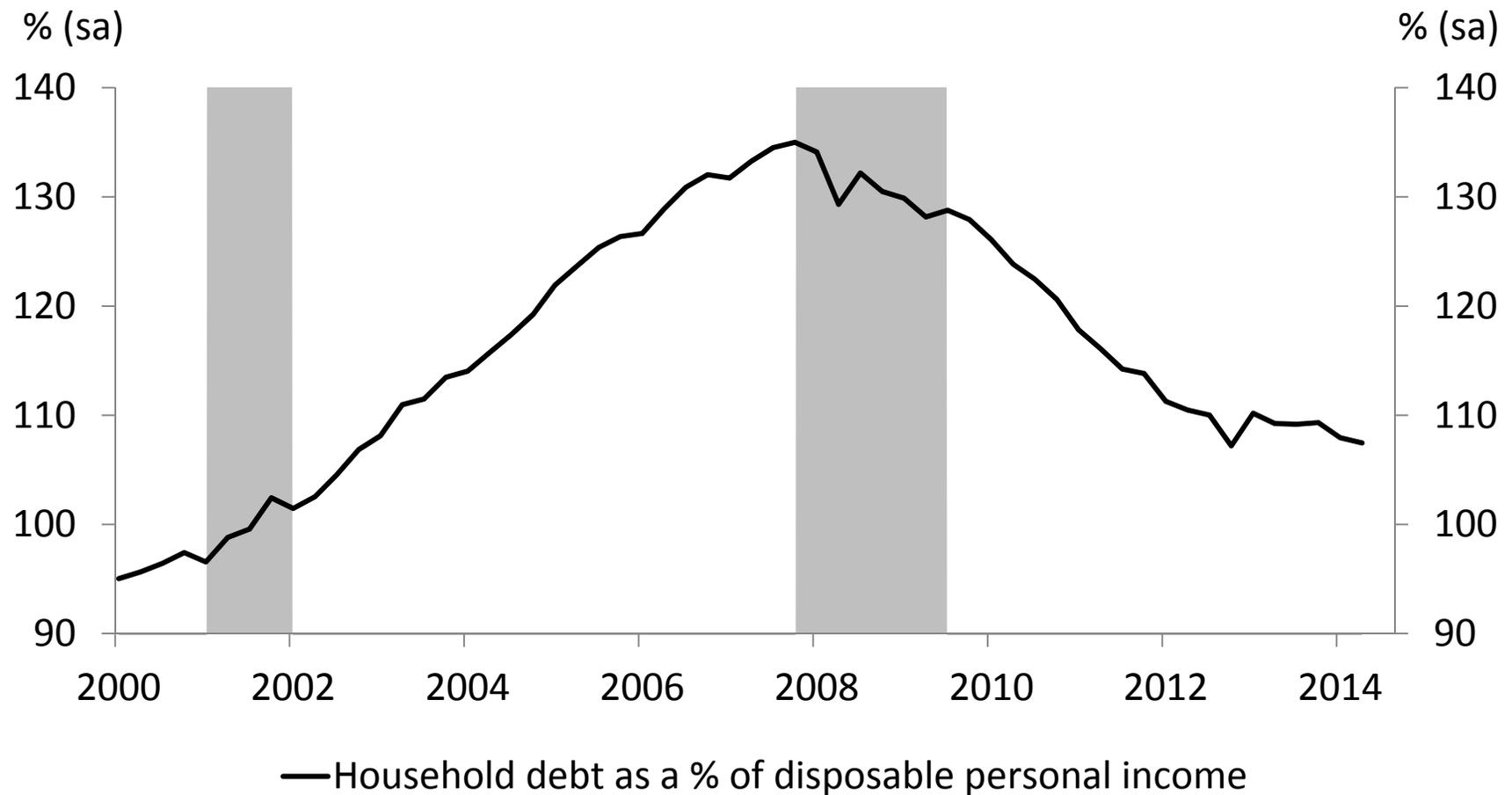
Source: Bureau of Labor Statistics, KC Fed Staff, Haver Analytics

Wage growth in a broader context also suggests further gains



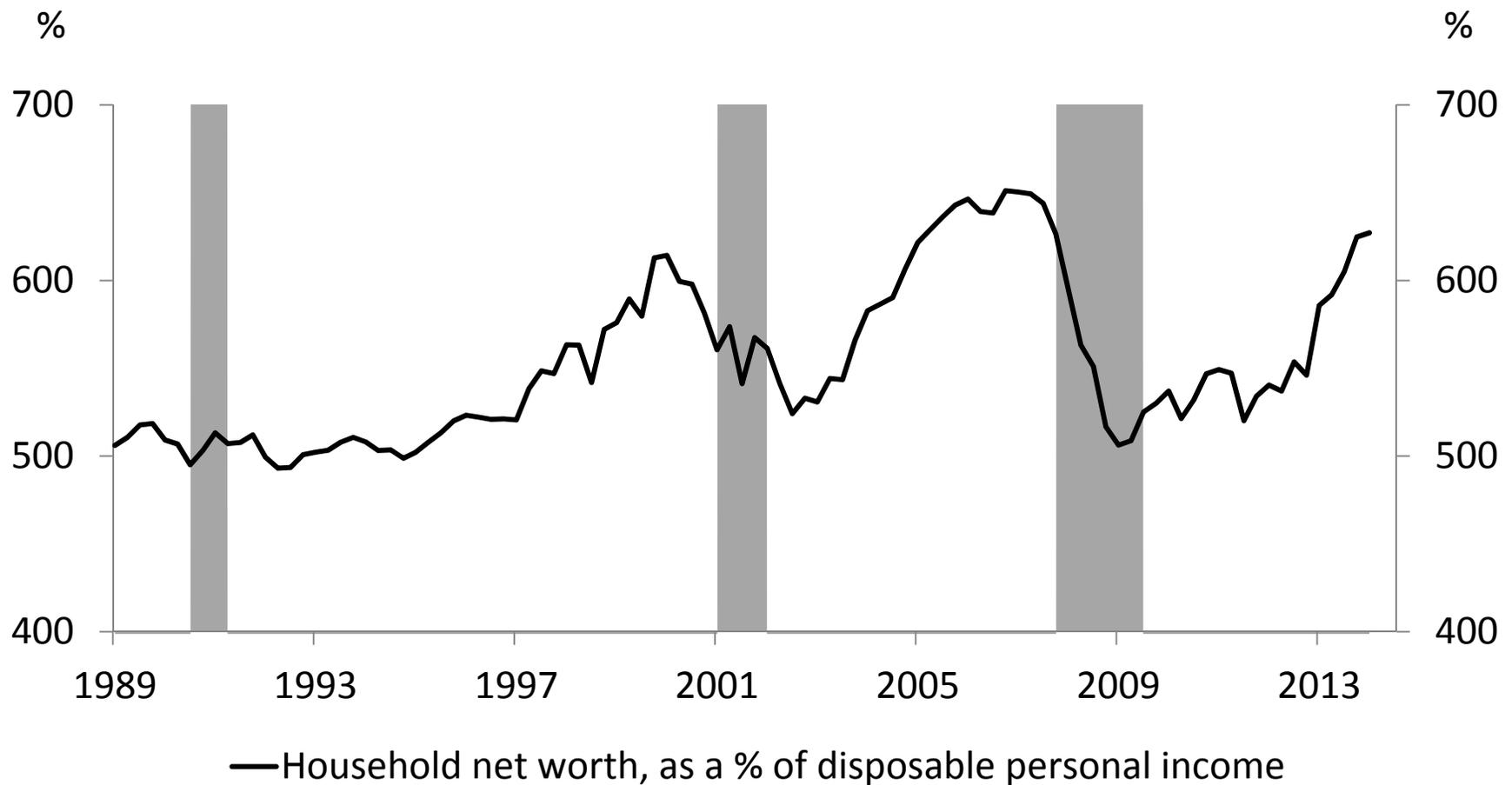
Source: Bureau of Labor Statistics, Haver Analytics

Household debt as a share of income has declined substantially



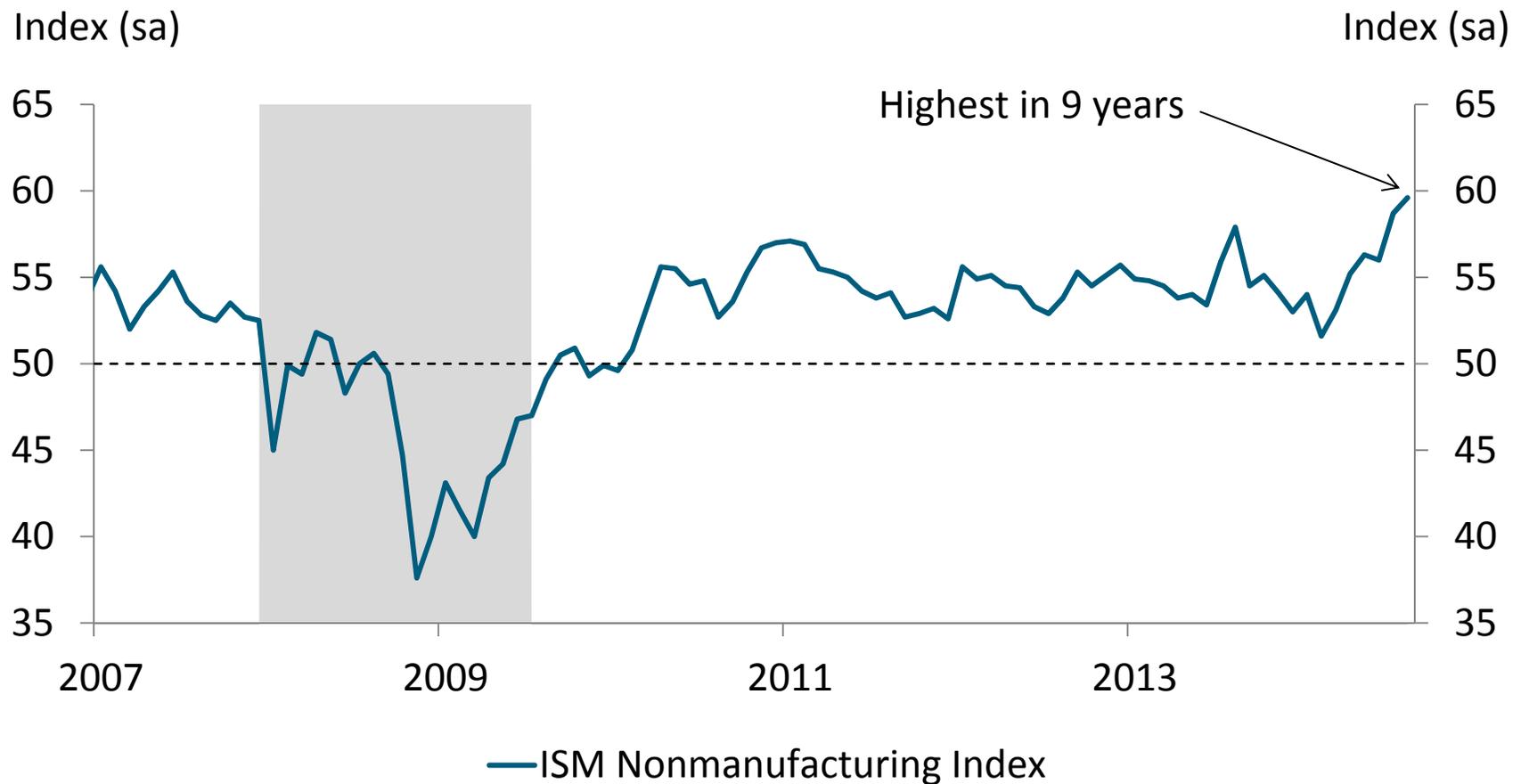
Source: Federal Reserve Board, Haver Analytics

Household net worth has climbed with rising home and equity prices



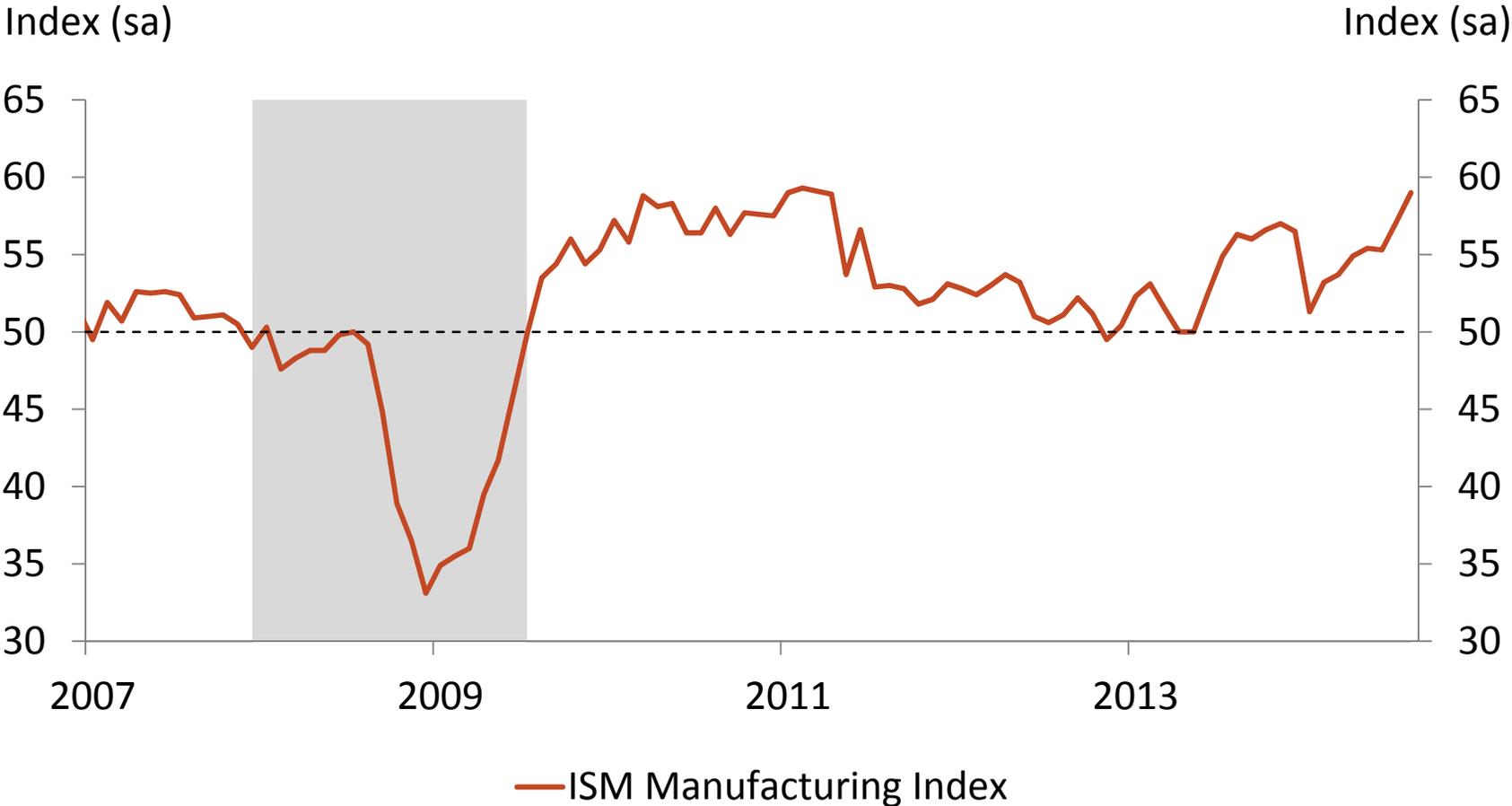
Source: Federal Reserve Board, Haver Analytics

The service sector is expanding at its fastest pace in close to a decade



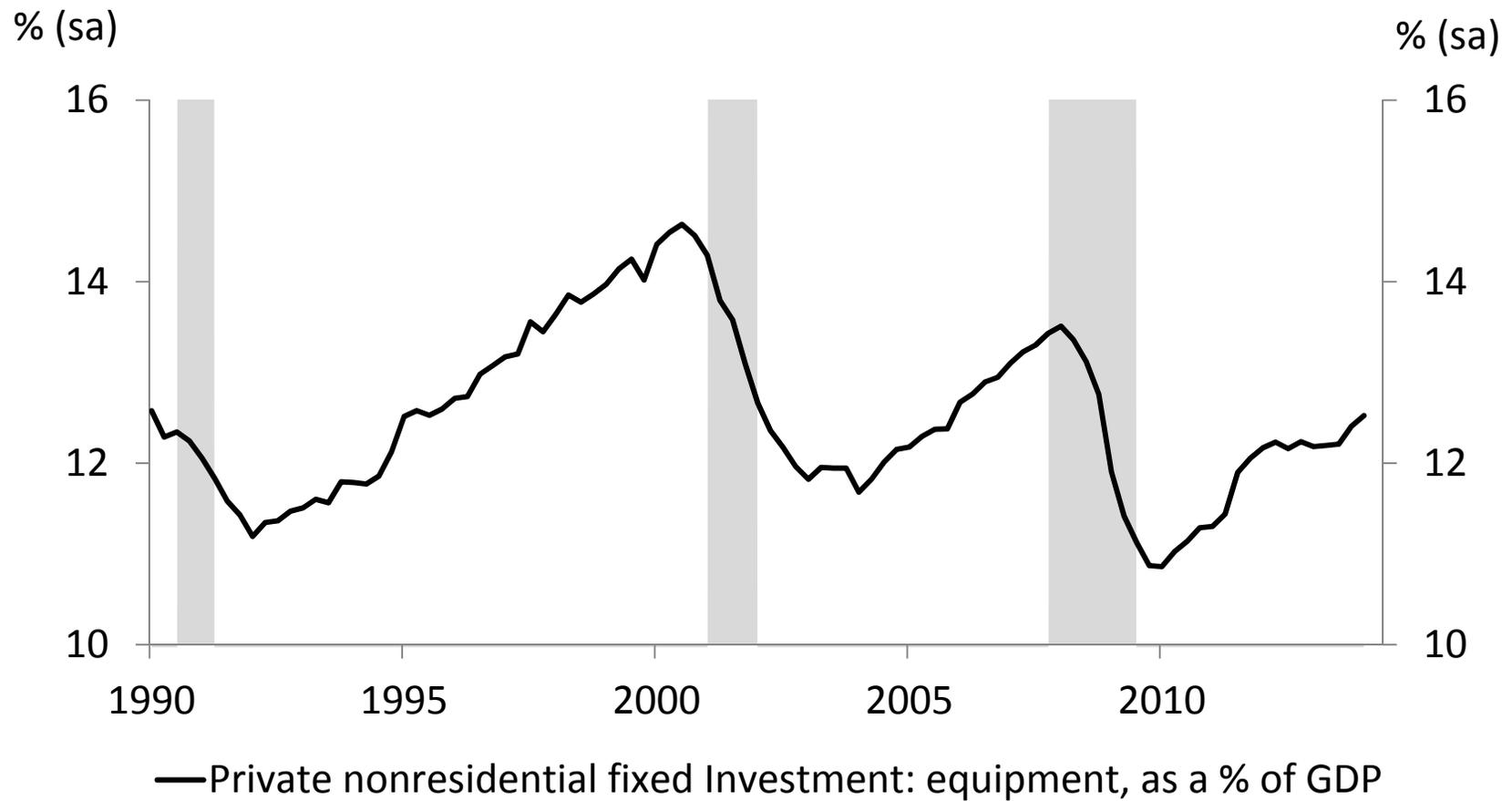
Source: ISM, Haver Analytics

Manufacturing is also increasing at a faster pace



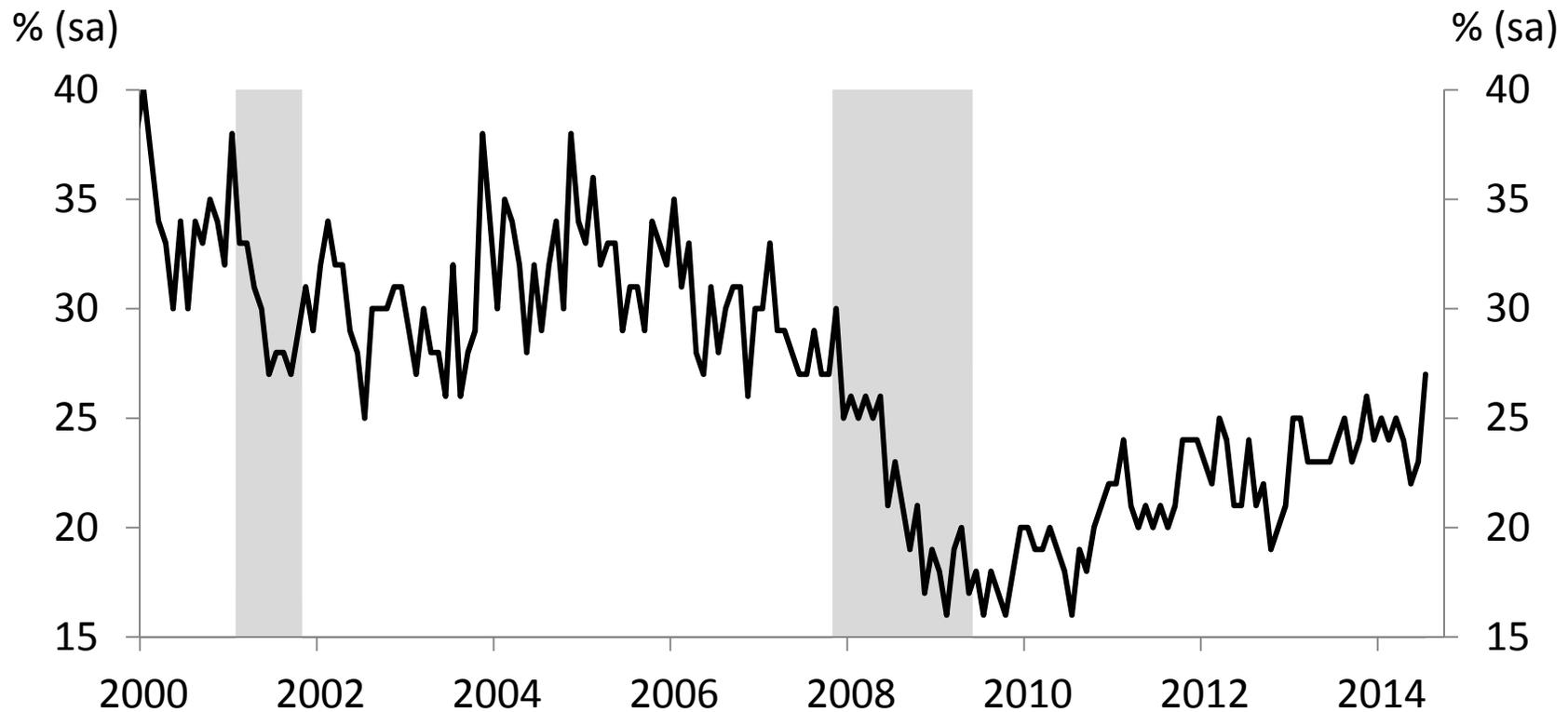
Source: ISM, Haver Analytics

Business fixed investment has recently moved higher



Source: Bureau of Economic Analysis, Haver Analytics

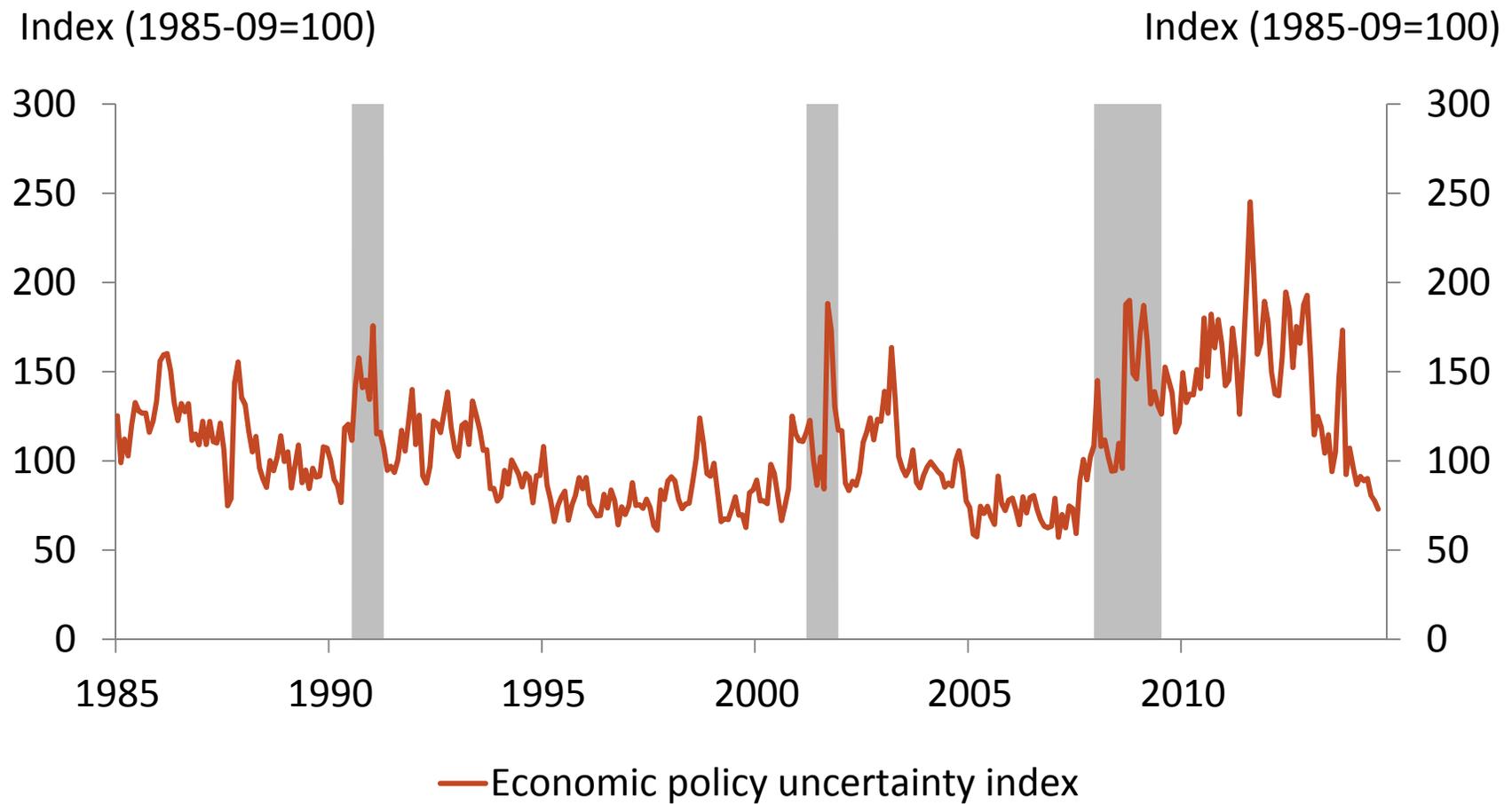
Spending on capital equipment appears poised to further increase



—% of small firms planning capital expenditures in the next 3 to 6 Months

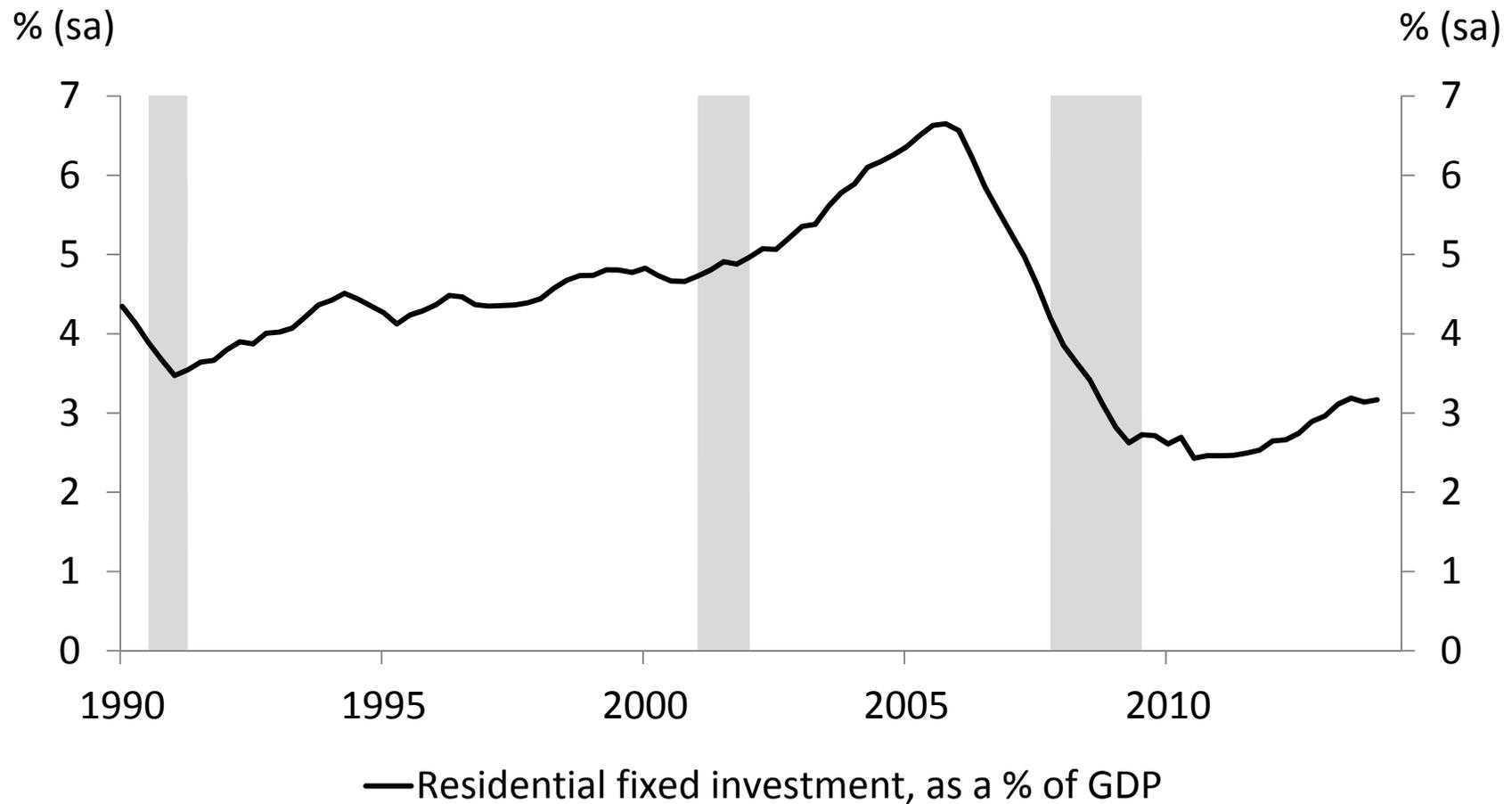
Source: NFIB, Haver Analytics

Economic policy uncertainty has declined notably



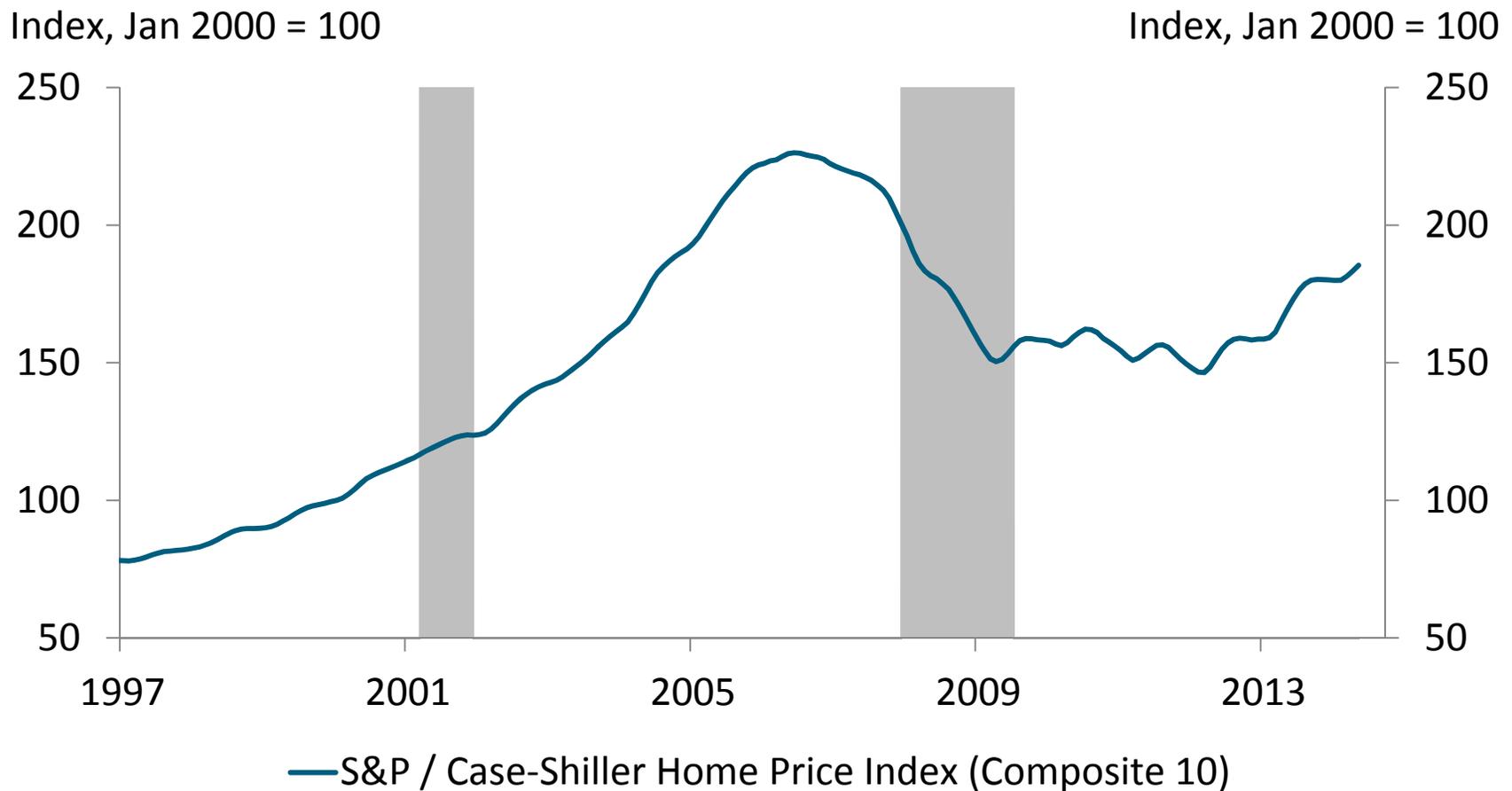
Source: Baker, Bloom and Davis, Haver Analytics

Housing construction remains a relatively low share of economic activity



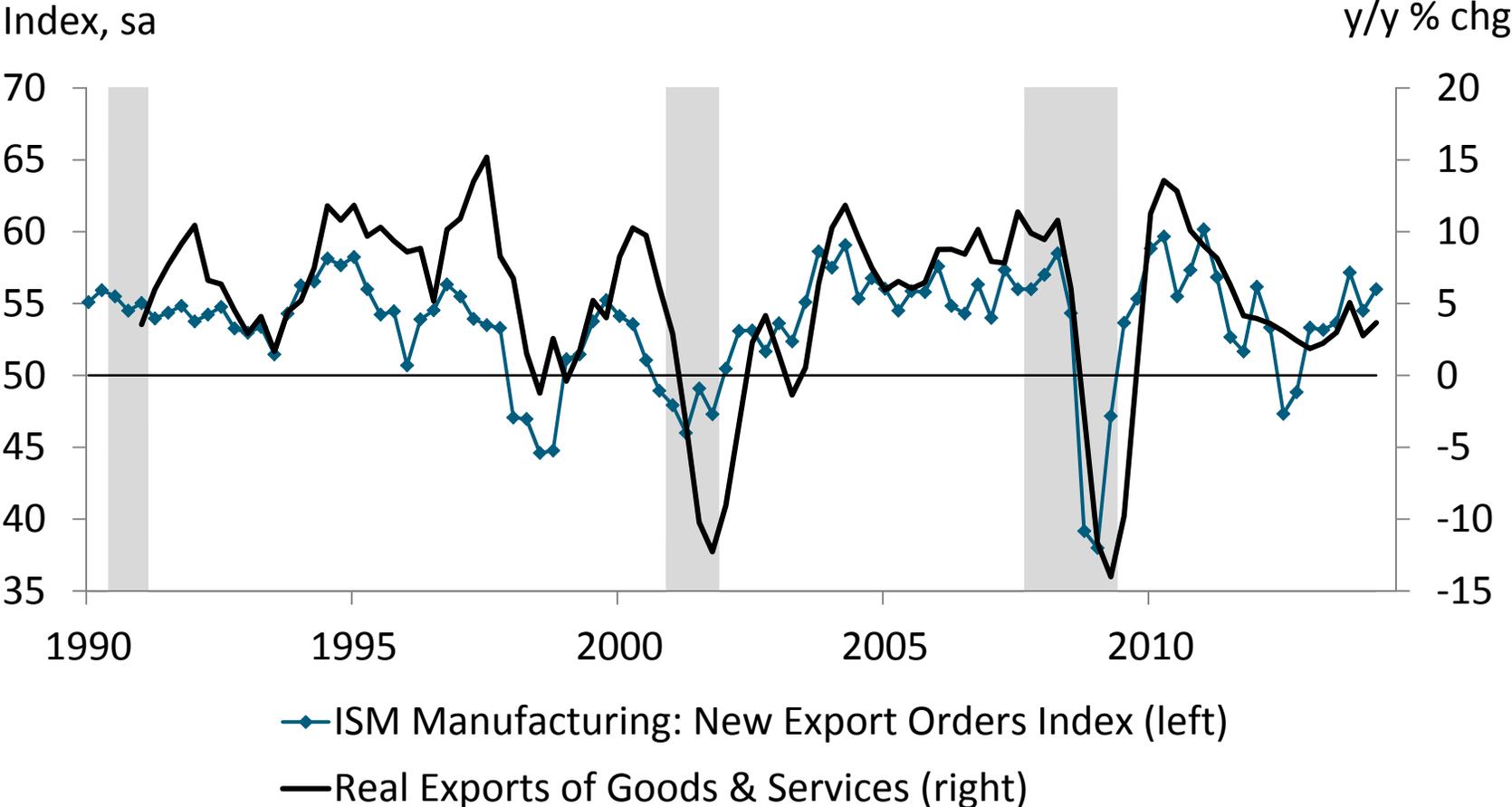
Source: Bureau of Economic Analysis, Haver Analytics

House prices have increased over the past few years



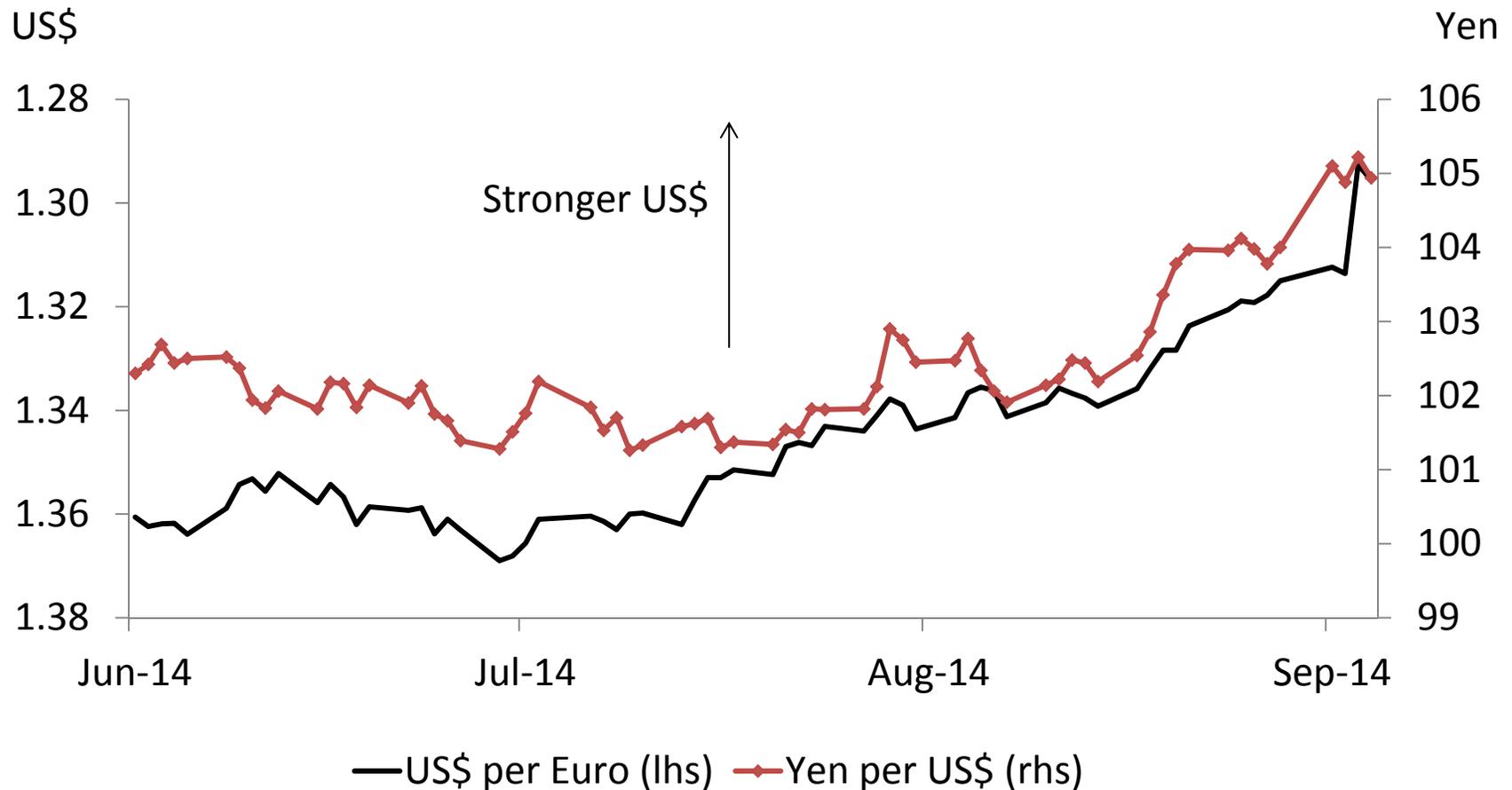
Source: S&P / Case-Shiller, Haver Analytics

Export activity as improved, but is facing headwinds



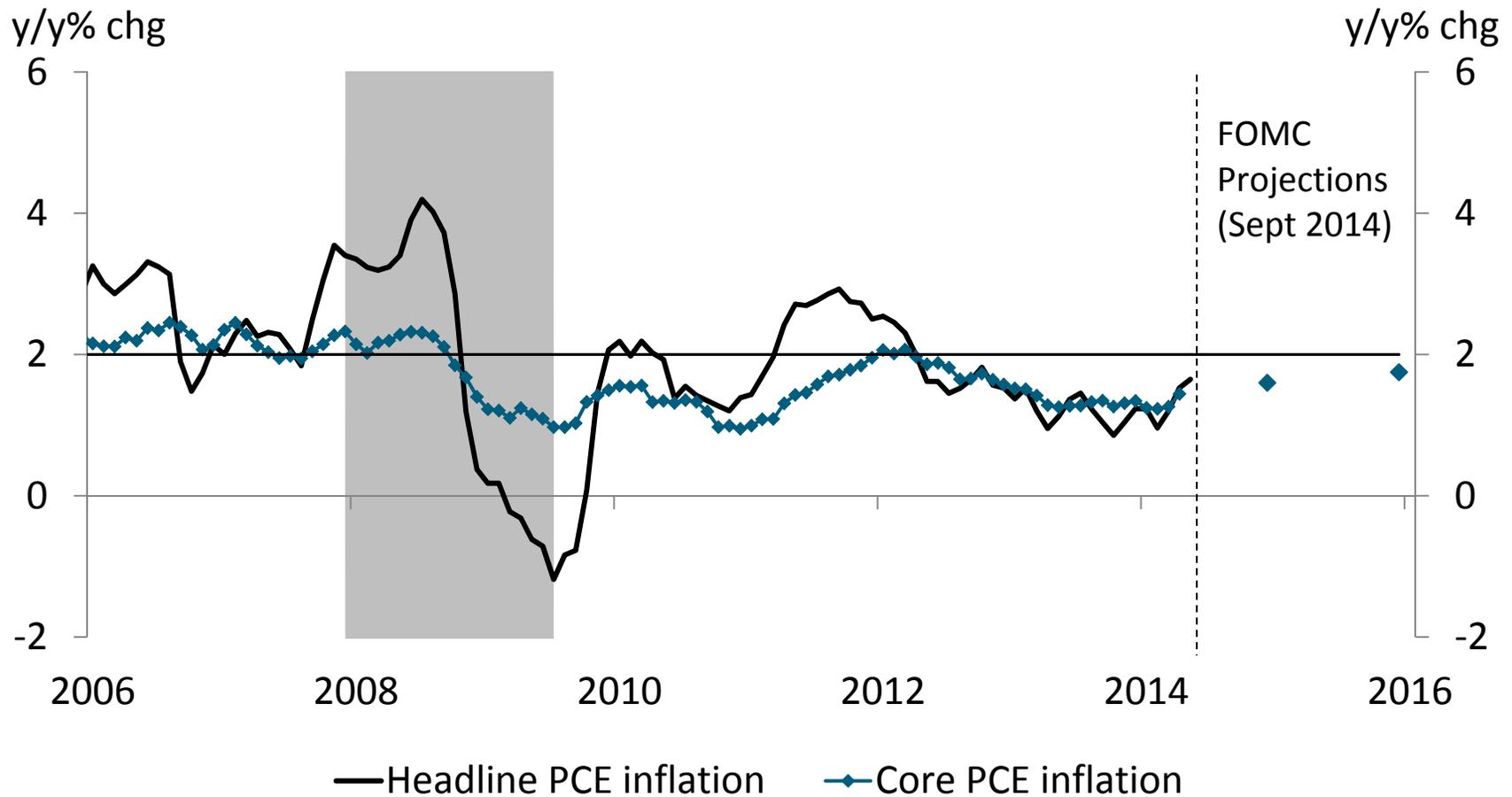
Source: ISM, Bureau of Economic Analysis, Haver Analytics

The US Dollar has recently strengthened against major currencies



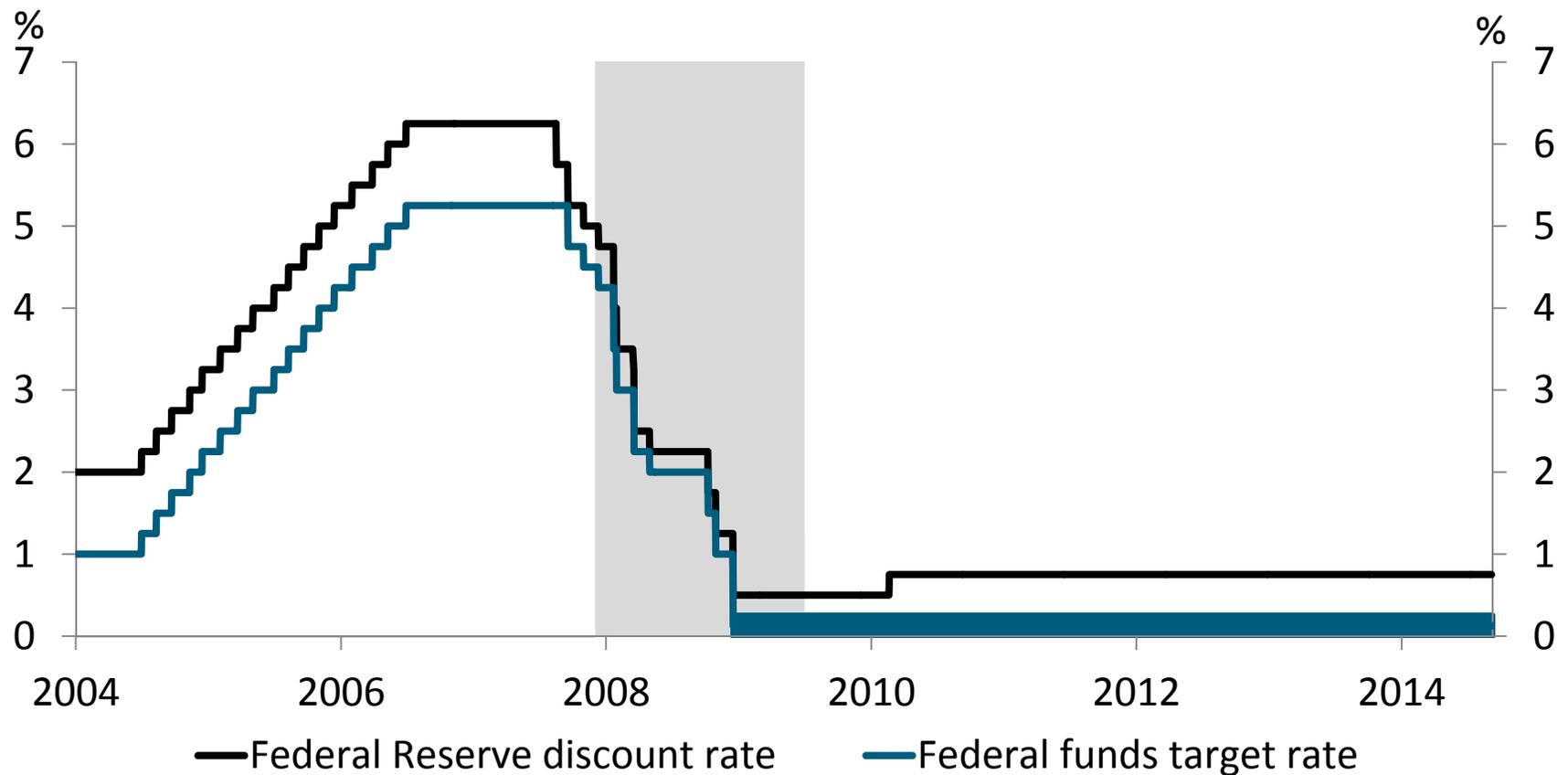
Source: Federal Reserve Board, Haver Analytics

Inflation is projected to return gradually towards 2%



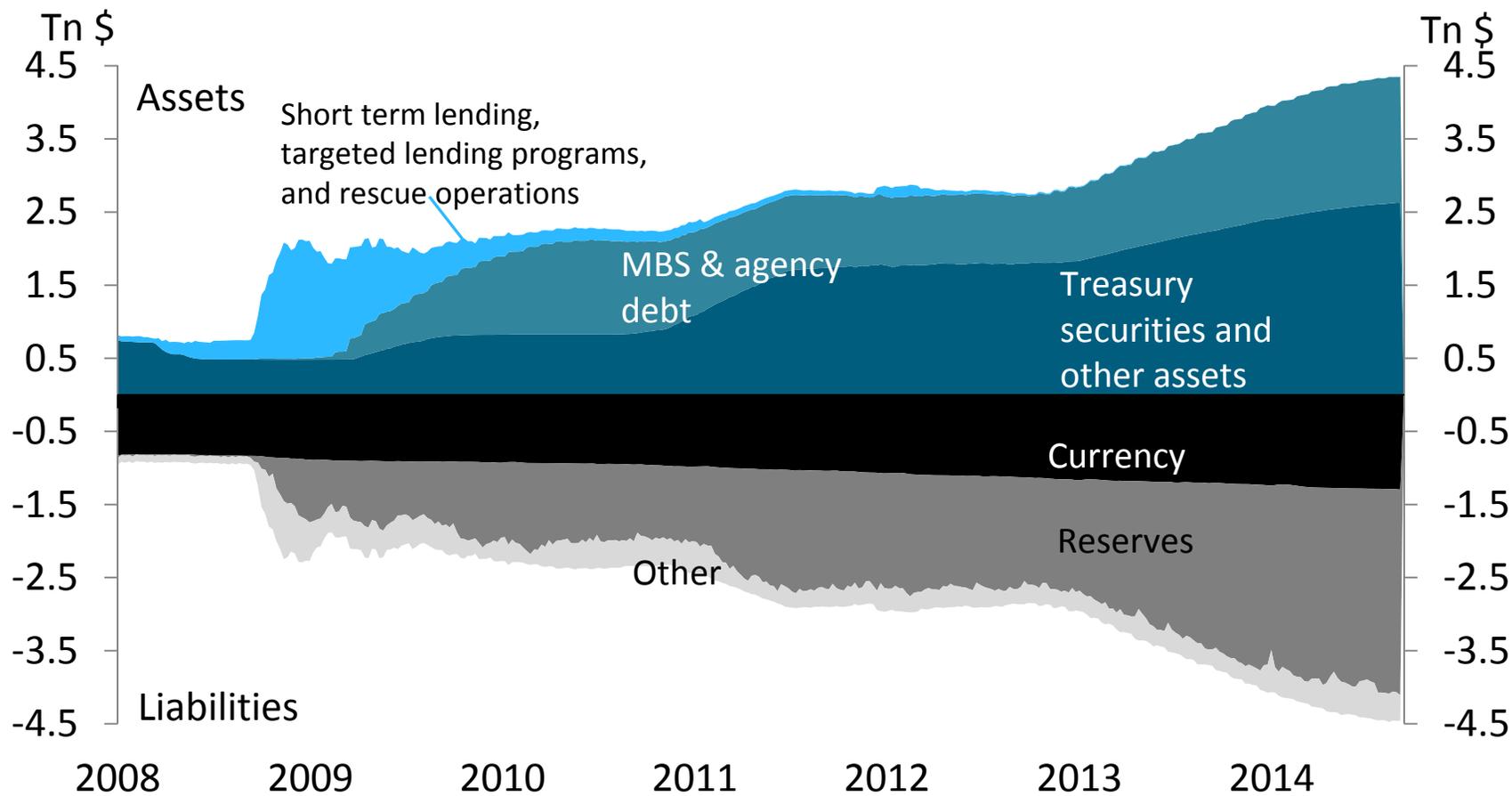
Source: Bureau of Economic Analysis, Haver Analytics

The federal funds rate target remains near zero



Source: Federal Reserve Board, Haver Analytics

The Federal Reserve's balance sheet continues to grow



Source: Federal Reserve Board, Haver Analytics

FOMC Economic Projections

- 15 of 17 FOMC participants view short-term rates should rise in 2015 or sooner
- The midpoints of the FOMC projections have the economy back to full employment and inflation near target at the end of 2016
- The midpoint of the funds rate projection remains below its longer-run level at the end of 2016

Monetary Policy Normalization Principles and Plans

- The federal funds rate will remain the target, but new tools will be used to influence the funds rate
- Holdings of US Treasury and agency-MBS securities will be reduced in a “gradual and predictable” manner
- In the long-run, the FOMC plans on holding only the amount of securities necessary to “efficiently and effectively” implement policy



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