JOINT ECONOMIC COMMITTEE — UNITED STATES CONGRESS
RANKING DEMOCRAT CAROLYN B. MALONEY

This is the second edition of the *Quarterly Economic Digest* (QED), a publication by the Democratic staff of the Joint Economic Committee. It is designed as a resource for individuals interested in following national economic trends. The QED is distributed each quarter, following the release of major economic indicators.

The QED offers detailed analysis on key economic issues and data releases, including GDP, job growth, personal income and spending and housing. In addition, the QED offers perspective on new developments in the global economy and a look at recent trends in monetary and fiscal policy. The current issue covers the second quarter of 2016. The QED includes analysis of newly released data for July and August where available.

The data show that the economy continues to expand at a moderate pace. There are notable bright spots—inflation is low, consumer spending is strong, and the unemployment rate remains below 5 percent. There are also areas of concern—GDP growth is modest, the percentage of Americans in the labor force has decreased slightly, and slower growth in China, the United Kingdom's vote to leave the European Union and other international headwinds are constraining global growth. Due to the uncertain global growth prospects and moderate growth and low inflation in the United States, the Federal Reserve continues to hold interest rates low.

The QED is organized into 10 sections:

- **JOB GROWTH AND OPENINGS**: Job Growth Slowed, then Rebounded
- **EMPLOYMENT:** Trend Towards Full Employment Continues, But Some Slack Remains
- **GDP GROWTH:** Slow Growth Despite Gains in Consumer Spending
- **PRIVATE INVESTMENT:** Business Investment Declined Sharply
- **PERSONAL INCOME AND SPENDING:** Consumer Spending Picked Up
- **HOUSING:** Mixed Signals
- **GLOBAL ECONOMY:** Uncertainties Continue to Put a Drag on Global Growth
- **FINANCIAL MARKETS:** Equity Markets Remain Volatile; Credit Market Bearish
- **MONETARY POLICY:** The Federal Reserve Continues to Hold Off on Additional Interest Rate Increases
- **FISCAL POLICY:** State and Local Government Spending Declined; Federal Spending Edged Lower

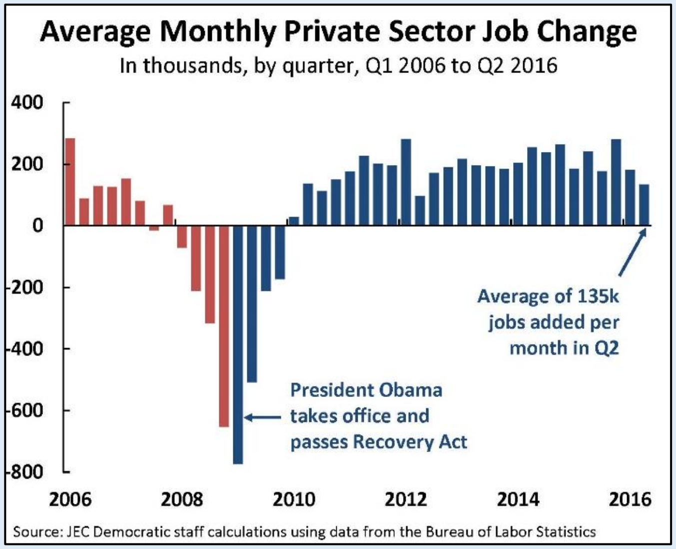
In addition to the Quarterly Economic Digest, the Democratic staff of the Joint Economic Committee also provides a wide variety of reports and briefs on issues from women's economic security and the changing role of fathers to the economic situation in all 50 states and the critical role Social Security plays for millions of retirees.

Prepared by the Democratic staff of the Joint Economic Committee

JOB GROWTH AND OPENINGS: Job Growth Slowed, then Rebounded

Job growth slowed to an average of 153,000 per month in Q2, down from an average of 196,000 in the first quarter. This average masks a very choppy pattern, as the economy added just 24,000 jobs in May but 292,000 in June and a further 255,000 in July. Nonetheless, recent job growth has been sufficient to keep the unemployment rate from rising while absorbing the flow of new workers into the labor force. As the economy approaches full employment, we should expect average monthly job growth to slow somewhat.

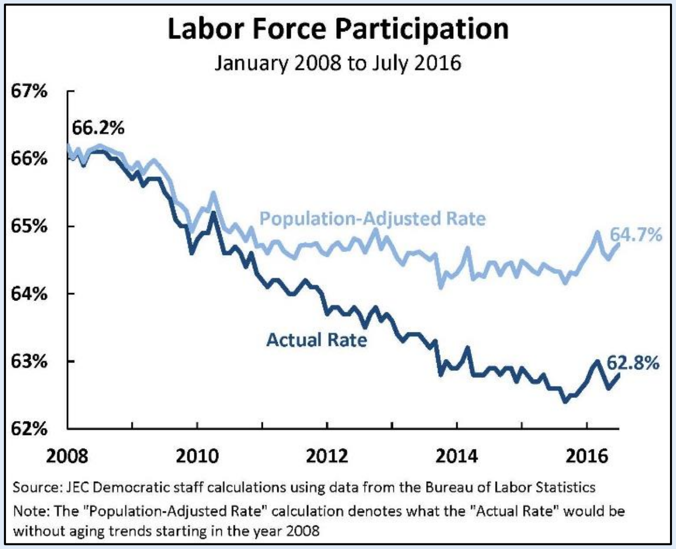
- ***Weak job growth in May appears to be an anomaly:*** In May, private employment fell by 1000, ending a record 74 month streak of job growth in the private sector. The decline partly reflected a strike by 35,000 Verizon workers. In June, renewed growth together with the strikers' return resulted in an increase of 259,000 private sector jobs.
- ***Job openings ease from record high:*** The Job Openings and Labor Turnover Survey (JOLTS) reports 5.6 million job openings at the end of June. The number of job openings remains above its average level in 2015 and substantially above the average number of openings in the years immediately preceding the recession. The number of new hires dipped slightly to an average of 5.1 million in the second quarter. On average, there were 1.4 unemployed workers and 2.8 underemployed workers for every job opening in the second quarter, compared with monthly highs of 6.6 unemployed and 11.7 underemployed workers per job opening in 2009.



EMPLOYMENT: Trend Towards Full Employment Continues, But Some Slack Remains

The unemployment rate averaged 4.9 percent in the second quarter, unchanged from the previous quarter's average. This is considered to be very close to full employment. Labor force participation fell 0.2 percentage points in the second quarter, but recovered partially in July. Involuntary part-time employment remained high relative to prerecession levels.

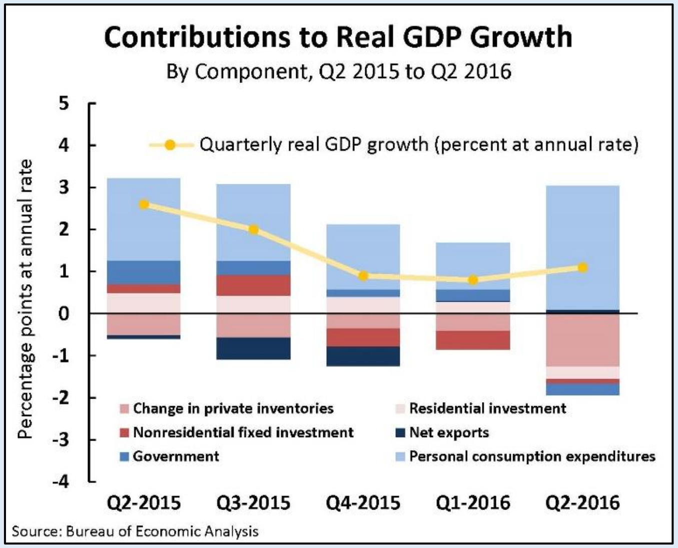
- ***Part-time work remains elevated:*** The number of people employed part-time who would have preferred a full-time job averaged about 6.1 million in Q2, little changed from the previous quarter. Involuntary part-time employment has fallen by about a third from its peak of around 9 million in 2010. Nonetheless, it remains significantly elevated compared with its pre-recession level (an average of 4.3 million between 2005 and 2007).
- ***Labor force participation fell:*** The share of adults that are in the labor force fell 0.2 points to 62.7 percent in Q2, partially reversing the previous quarter's advance. The participation rate remained significantly below its 66.0 percent average level in 2007. However, at least half of the decline can be directly attributed to the aging population, and some of the rest continues to reflect effects of the Great Recession. In July, the participation rate rose a tenth to 62.8 percent.
- ***Initial claims for unemployment insurance reached its lowest level since 1973:*** Initial claims continued to edge down in Q2 to an average of 266,000 per week. This indicates that very few people are currently losing jobs, and implies that the risk of imminent recession is minimal.



GDP GROWTH: Slow Growth Despite Gains in Consumer Spending

Real GDP rose at an annual rate of 1.1 percent in Q2, based on the second estimate. This was up from 0.8 percent in the first quarter. Consumer spending, which accounts for slightly more than two-thirds of GDP, rose at a brisk rate. However, declines in both business and residential investment and a pronounced drawdown of inventories restrained the growth of GDP.

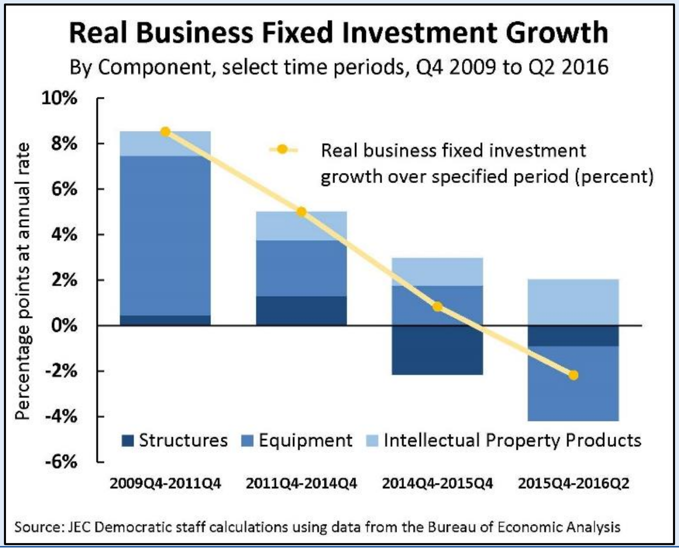
- ***Consumption growth picked up:*** Consumer spending rose at an annual rate of 4.4 percent in Q2, up from just 1.6 percent in the first quarter and more than fully accounting for the growth of real GDP during the quarter. In 2015, real consumer spending rose by 2.6 percent.
- ***Investment again fell:*** Business fixed investment declined by 0.9 percent, at an annual rate, in the second quarter. Real residential investment, which has been a significant source of strength during most of the past two years, fell at a 7.7 percent annual rate in the second quarter. And the drawdown of inventories subtracted 1.3 percentage points from GDP growth.
- ***Government spending declined:*** Government consumption expenditures and gross investment fell at a 1.5 percent annual rate in Q2. State and local government spending fell at a 2.2 percent annual rate, while total federal spending edged lower by 0.3 percent.
- ***Net exports contributed slightly to growth:*** Real net exports rose by a modest $4 billion, adding 0.1 percentage point to real GDP growth. Exports rose at a 1.2 percent annual rate from the previous quarter, while imports rose at a 0.3 percent rate. In 2015, net exports fell by $113 billion.



PRIVATE INVESTMENT: Business Investment Declined Sharply

Business (nonresidential) fixed investment declined at a 0.9 percent annual rate in Q2, a smaller rate of decline than in the previous two quarters. The decline in business investment subtracted about 0.1 percentage point from the overall GDP growth rate in Q2.

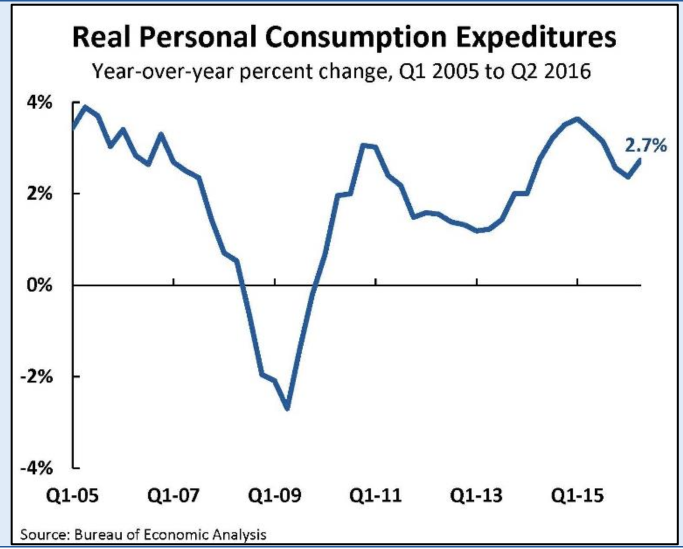
- ***Investment in structures fell:*** Structures investment fell at an 8.4 percent annual rate in Q2, as the collapse in investment in oil drilling and mining structures continued.
- ***Investment in equipment fell by 3.7 percent:*** Investment in equipment had already fallen at a 9.5 percent annual rate in the first quarter. Weak foreign demand and falling oil prices have weighed on equipment investment, which is the largest component of business fixed investment.
- ***Investment in intellectual property products rose*****:** Driven by a surge in research and development, investment in intellectual property products rose at an 8.6 percent rate.
- ***Inventory investment fell by $53 billion:*** The decline in inventories subtracted 1.3 percentage point from GDP growth in Q2, as businesses chose to draw down inventories rather than ramp up production. However, to the extent that the drawdown was unplanned by businesses, this is likely to lead to *higher* output in coming quarters as those businesses rebuild inventories.



PERSONAL INCOME AND SPENDING: Consumer Spending Picked Up

Consumer spending, which accounts for about two-thirds of GDP, picked up in Q2. Real income rose at a slightly faster pace than in the first quarter. Nonetheless, because spending rose faster than income, the personal saving rate dipped from 6.1 to 5.7 percent in Q2.

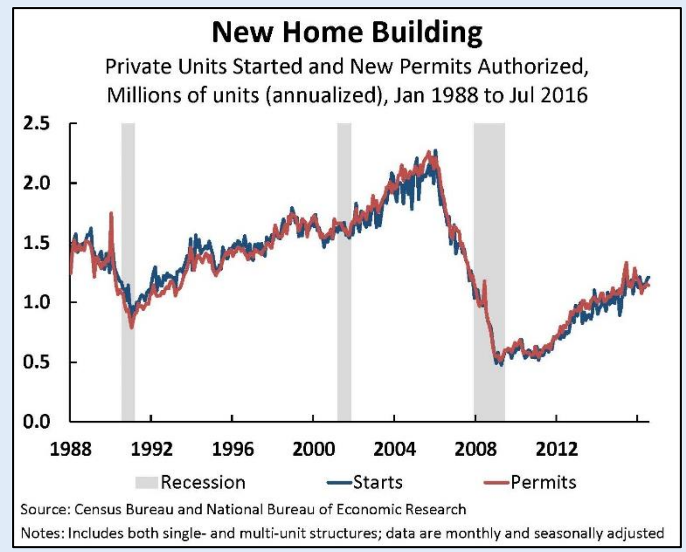
- ***Faster growth in consumer spending:*** Spending on consumer durables ("big ticket" items such as autos and furniture), which had fallen slightly in the first quarter, rose at a 9.9 percent annual rate in Q2. Spending on nondurables and on services also contributed substantially to the pickup.
- ***Real income growth slowed:*** Real disposable personal income rose at a 2.3 percent annual rate in Q2, up from 2.1 percent in the previous quarter (a figure that has been revised significantly downward since the last QED) but still somewhat slower than the average rate of growth over the past several years.
- ***Other key drivers of consumer spending remain supportive:*** Despite a slow start to the year, stock prices are currently up about 6 percent for the year, which has helped boost consumer spending. Both major indicators of consumer sentiment were little changed in the second quarter, remaining at levels consistent with ongoing expansion.



HOUSING: Mixed Signals

Residential investment fell in the second quarter and housing starts were flat. However, sales of both new and existing homes were strong and house prices posted modest gains.

- ***Real residential investment fell:*** Real residential investment fell at a 7.7 percent annual rate in the second quarter. Residential investment had risen 13.1 percent in 2015, and at a 7.8 percent rate in Q1. One possible explanation for the decline in residential investment is a lower average value of housing units under construction, which suggests that builders may be shifting toward more starter homes.
- ***Housing starts were stable:*** Housing starts edged up 0.4 percent in the second quarter. At about 1.2 million units per year, housing starts remain well below not only the 2.1 million units per year average at the height of last decade's bubble but also the pre-bubble long-run average of about 1.5 million. Single-family starts edged lower in the second quarter, while starts in the more volatile multifamily category were up.
- ***Home sales were strong:*** New home sales rose 9 percent in the second quarter, and 17 percent year-over-year. The much larger category of existing home sales rose 3.8 percent in the second quarter, reaching the highest level since early 2007.
- ***House prices continued to edge higher:*** All of the major house price indexes (the FHFA Purchase Only Index, the S & P Case Shiller U.S. National and 20-city Indexes, and the CoreLogic Home Price Index) were up between 5 and 6 percent compared with a year earlier.



GLOBAL ECONOMY: Uncertainties Continue to Put a Drag on Global Growth

The global economy grew at a moderate pace in Q2. Uncertainty surrounding Brexit, questions about the long-term health of China's economy and persistently low commodity prices are likely to continue to restrain global growth.

- ***Brexit heightens concerns in UK and Europe:*** Following the June 23 vote to leave the European Union, the British pound has fallen sharply, partly due to a substantial outflow of investment funds from the UK stock market. Both investment and employment in the UK are expected to be weakened significantly due to uncertainty surrounding its future trading relationship with the EU. The Bank of England cut interest rates to a historic low and implemented a round of quantitative easing. Some experts are forecasting the UK economy to enter a mild recession at the end of this year and continuing into the beginning of 2017. Although the impact has thus far been largely contained to the UK, renewed uncertainty over ties between the UK and the rest of Europe and over implications for the EU as a whole—including fears that other members may also seek to withdraw—has led forecasters to downgrade the outlook for both the UK and the Euro area.
- ***China's outlook is uncertain:*** GDP growth in China slowed to 6.7 percent year-over-year in Q2, its lowest growth rate since 2009, with private investment particularly weak. There are concerns that China's growth has been largely driven by stimulus from the government, and that prolonged state-led growth could undermine both long-term sustainability and efforts toward structural reform.
- ***Commodity prices continued to recover but remain low:*** Commodity prices rebounded further in Q2. The price of Brent crude oil rose from about $34 to $46 per barrel during Q2, though it remained well below its 2015 level. Agricultural commodities posted modest gains in Q2. Forecasters believe that commodity prices as a whole have bottomed and will start to rise, but that they will remain low overall for some time due to soft global demand. This will continue to put downward pressure on growth in commodity-producing countries such as Canada.

IMF July 2016 World Economic Outlook Projections

Real GDP Growth in Percent Change (Q4/Q4)

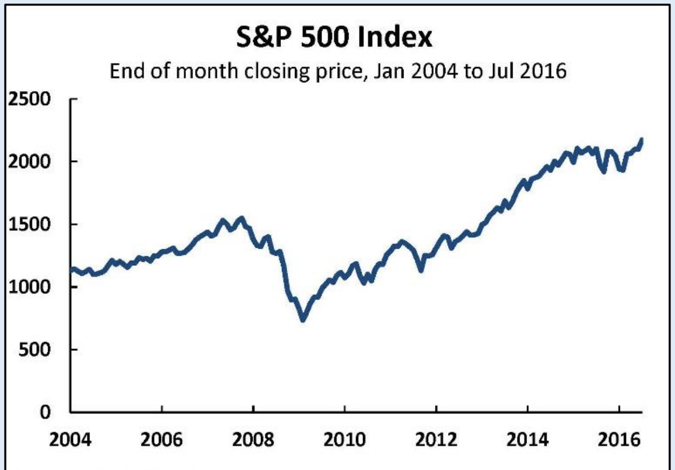
	Actual 2015 GDP	2016	2017
World	3.0	3.2	3.5
Advanced Economies	1.8	1.8	1.9
United States	2.0	2.5	2.3
Euro Area	1.7	1.4	1.5
UK	1.8	1.2	1.5
Japan	0.8	0.6	0.2
Canada	0.3	1.8	2.2
Emerging Markets	4.1	4.4	4.9
Brazil	-5.9	-1.2	1.1
Mexico	2.4	2.4	2.8
China	6.8	6.5	6.1

Source: IMF Overview of the World Economic Outlook Projections

FINANCIAL MARKETS: Equity Markets Remain Volatile; Credit Market Bearish

Financial markets conditions improved in the second quarter.

- ***The stock market advanced*****:** The S&P 500 rose about 2 percent in the second quarter. A sharp sell-off during the first two days following the Brexit vote turned out to be short-lived. Stock prices have since continued to rise; by the end of August they were up about 3 percent from the end of the second quarter and about 6 percent year-to-date.
- ***The dollar exchange rate was little changed in Q2:*** The exchange rate as measured against a broad index of currencies was virtually unchanged in the second quarter. Around the end of the quarter, the dollar posted a sizeable gain against the British pound and a small advance against the euro in the wake of the Brexit vote. However, the dollar depreciated significantly against the Japanese yen in June following the Bank of Japan's announcement that it would refrain from further monetary easing.
- ***The U.S. bond market rallied:*** Uncertainty following the Brexit vote and ensuing stock market volatility drove up demand for risk-free assets, particularly U.S. Treasuries. Some further volatility in Treasury yields can be expected, with low returns driving investors away from Treasuries and toward corporate bonds.



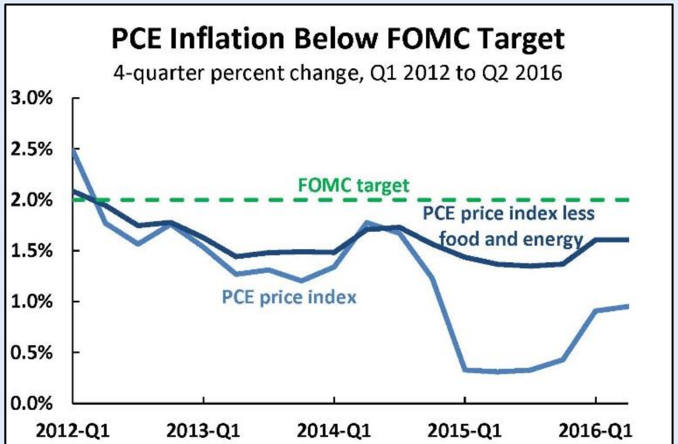
Source: Standard and Poor's

Note: The S&P Composite 500 Index is a stock market index that tracks 500 leading equities and is used to measure the overall performance of the U.S. equity market.

MONETARY POLICY: The Federal Reserve Continues to Hold Off on Additional Interest Rate Increases

Due to concerns about slow growth and low inflation domestically, as well as uncertain prospects globally, the Federal Reserve has continued to hold interest rates low, even though it has signaled the likelihood of future rate hikes.

- ***There have been no rate hikes so far in 2016:*** At its June 14-15 and July 26-27 meetings, the FOMC left the target range for the federal funds rate unchanged at ¼ to ½ percent.
- ***Concerns about growth and global developments have slowed the pace of rate increases:*** At June's meeting the weak job numbers reported for May and concern over the pending Brexit referendum led the FOMC to refrain from raising rates. By the July meeting those concerns had eased, but the Committee still chose not to change rates. Some committee participants appear ready to raise rates at September's meeting, but others are inclined to wait for further evidence that inflation is moving toward its target.
- ***Inflation may be firming, but core measures still running low:*** Low inflation over the past year has been due mostly to falling prices of energy and for imported goods. Although energy prices recovered somewhat in the second quarter, core measures (those excluding food and energy) continued to run low. In July gasoline prices fell again, and the core Consumer Price Index rose just 0.1 percent.



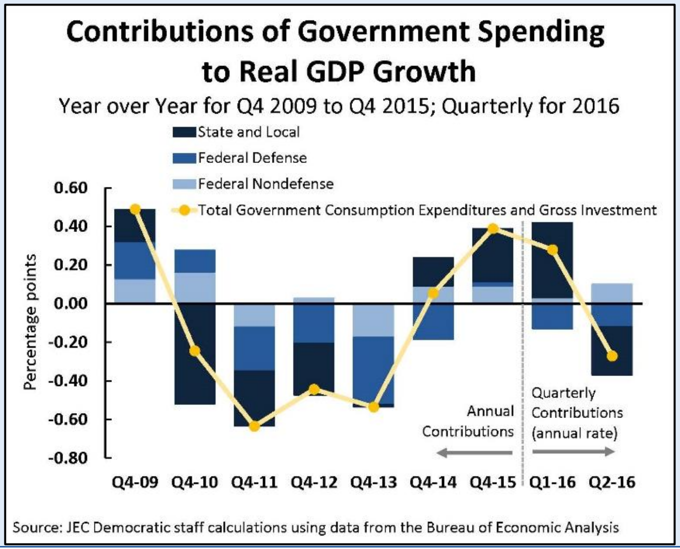
Source: JEC Democratic staff calculations using data from the Bureau of Economic Analysis

Note: PCE less food and energy excludes food and energy in order to measure the prices paid by consumers for goods and services without the volatility caused by movements in food and energy prices and in order to reveal underlying inflation trends

FISCAL POLICY: State and Local Government Spending Declined; Federal Spending Edged Lower

Overall government spending (combined federal, state and local) fell slightly from the previous quarter, reducing the growth of real GDP. State and local government spending accounted for most of the decline.

- ***Overall government spending fell modestly:*** Real government spending and investment fell by 1.5 percent, at a seasonally-adjusted annual rate, after rising 2.2 percent in 2015 and at a 1.6 percent annual rate in the first quarter. The decline in Q2 subtracted 0.3 percentage point from real GDP growth.
- ***Federal spending edged lower:*** Real federal spending fell at an annual rate of 0.3 percent in the second quarter. Nondefense spending rose by 3.8 percent, but defense spending fell 3.1 percent.
- ***State and local spending fell:*** Real state and local government spending declined at a 2.2 percent annual rate in Q2. State and local spending had risen by 2.5 percent in 2015, and at a 3.5 percent annual rate in Q1.



SUGGESTED READINGS

- Binyamin Appelbaum, "Central bankers hear plea: turn focus to government spending," *The New York Times* (8/28/2016)
- Jared Bernstein, "The 5, 3, 2 problem at the Federal Reserve," *The Washington Post* (8/22/2016)
- John C. Williams, "Monetary policy in a low r-star world," *Federal Reserve Bank of San Francisco* (8/15/2016)
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- Laura Kusisto, "Lopsided housing rebound leaves millions of people out in cold," *Wall Street Journal* (8/11/2016)
- Gillian B. White, "Are low-skill workers America's next great economic resource?" *The Atlantic* (8/8/2016)
- Neil Irwin, "We're in a low-growth world. How did we get here?" *The New York Times* (8/6/2016)
- Narayana Kocherlakota, "The U.S. can and should boost growth," *Bloomberg* (8/4/2016)
- Neil Irwin, "Here's what's going right, and wrong, in the U.S. economy," *The New York Times* (7/29/2016)
- Ylan Q. Mui, "Why the Federal Reserve is rethinking everything," *Washington Post* (7/27/2016)
- Alana Semuels, **"**When gains at the top hurt those at the bottom," *The Atlantic* (7/27/2016)
- Anna Louie Sussman, "What if there just aren't enough jobs to go around," *Wall Street Journal* (7/21/2016)
- Greg Ip, "Needed: a contingency plan for secular stagnation," *Wall Street Journal* (7/15/2016)
- Ben Casselman, "The jobs recovery may not be flashy, but it's strong," *FiveThirtyEight* (7/8/2016)