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TD Economics

Data Release: Economic activity expanded modestly towards year-end as wage and price pressures intensified

- The most recent Beige Book, for the period between late-November through December indicated that the economy continued to expand at a modest pace across most regions at the end of 2016.
- Labor markets were reported to be tight or tightening during the period with employment growth ranging from slight to moderate. Wages in some Districts were being pushed up a bit by increases in the minimum wage and most Districts reported that wage pressures had increased – something that is expected to continue as labor markets tighten further.
- Price pressures, more broadly speaking, also intensified since the last report. Aside for the Atlanta District, all Districts saw prices rise, with a majority of the Districts reporting modest price increases. Prices of retail goods were mixed, but for the most part went the other way, as contacts highlighted competitive discounting in the retail sector.
- Residential construction and sales were generally mixed. Contacts in San Francisco reported strong real estate market activity, while contacts in New York cited continued weakness in housing markets, particularly at the high end.
- Manufacturing activity continued to improve in most Districts, with Chicago citing robust growth and Philadelphia receiving a boost from manufacturing after a period of slight growth. Contacts in Dallas indicated that manufacturing activity had expanded, although job growth remained weak, while those in Cleveland and San Francisco cited little change.

Key Implications

- The Beige Book continues to paint a relatively bright picture of the domestic economy and outlook, corroborating our view of ongoing economic improvement in the U.S. At the forefront of the report was the American labor market, which continued to tighten as demand for workers increases amidst limited supply of workers. This has led to shortages, particularly in higher-skilled sectors, but scarcity issues are becoming increasingly apparent as far as less-skilled workers.
- These factors are resulting in intensifying wage pressures, which are likely to begin to feed through into higher prices that are already being boosted by rebounding energy price. Inflation rose above 2% in December for the first time since 2014 with the metric expected to accelerate further to the high-2% mark later this year lifted by higher wage and energy costs.
- All told, these developments appear to support the hawkish views on the FOMC. Although the Federal Reserve's preferred inflation gauge, the core PCE deflator, remains under its medium-term goal of 2%, all signs are pointing to continued progress towards the target. This should provide the Fed with enough justification to continue on its gradual hiking cycle, with the next hike expected by the middle of the year.

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