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Economic Research

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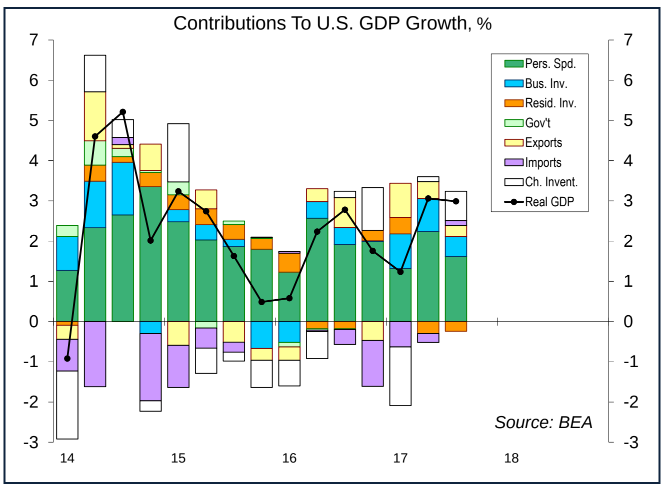
Economic Trends

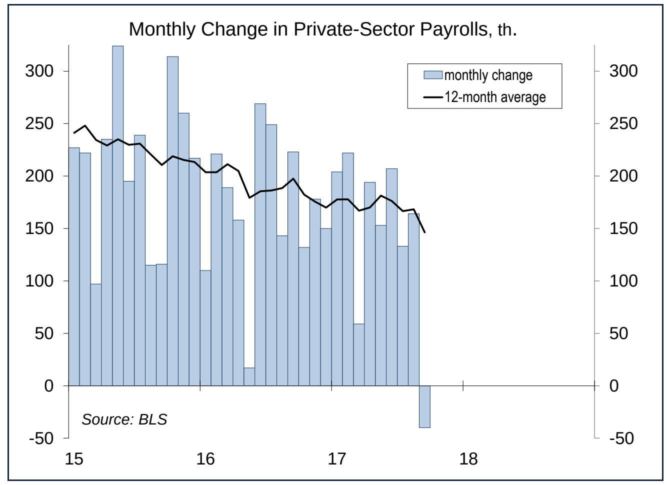
Bumpy Data, Moderate Trends

- *The hurricanes had positive and negative impacts on 3Q17 GDP growth, but the effects should unwind. The job market is expected to be a greater restraint on growth into 2018.*
- *President Trump is expected to nominate current Fed governor Jerome Powell to replace Janet Yellen as Fed chair. That would be a comfortable choice for the financial markets.*
- *The Russian investigation is an important risk for the markets, which haven't focused much on developments. The Congressional road to tax cuts is expected to be difficult, but there is much haste to complete a package by yearend.*

Real GDP rose at a 3.0% annual rate in the advance estimate for 3Q17 (vs. +3.0% in 2Q17). That estimate is subject to revisions, but the story is unlikely to change much. As expected, the hurricanes appeared to dampen consumer spending, which had already been tracking at a lackluster pace (positive, but not especially strong). However, motor vehicle sales, which had been trend down this year, popped higher as dealers cleared inventories in September. The rebound in energy exploration contributed significantly to business fixed investment in the first half of the year, but improvement was restrained by hurricane Harvey in 3Q17. The hurricanes likely contributed to a pickup in inventory growth, which added 0.7 percentage point to overall GDP growth. Harvey also restrained petroleum imports, adding 0.4 percentage point to growth (imports have a negative sign in the GDP calculation).



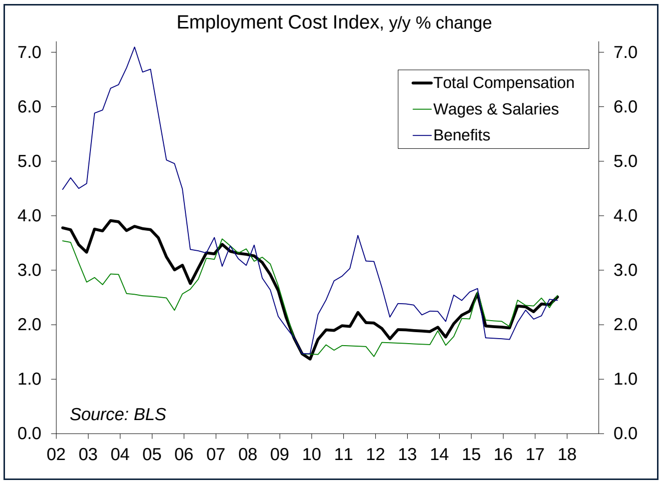
The hurricane's impacts on consumer spending and business investment should unwind quickly. There may be a little more room for inventory clearance in autos, but the pace is expected to fall back. There is also more room to recover oil and gas well drilling, but the pace of improvement seen in the first half of the year cannot continue forever. Inventory growth is likely to slow and petroleum imports should rebound.



Hurricane Irma arrived during the Bureau of Labor Statistics survey period for nonfarm payrolls. Payrolls were reported to have fallen by 33,000 in September, but that figure will be revised. Looking at the unadjusted data, seasonal hiring in education (+1.5 million in September) was essentially the same as a year earlier. Outside of education, seasonal job losses (-1.2 million), related to the end of the summer travel season, were substantially larger than a year earlier (-893,000). That suggests that Irma likely pulled forward seasonal job losses (making the adjusted payroll number weaker). In the adjusted numbers, job losses were more concentrated in leisure and hospitality, reinforcing this hypothesis. As a consequence, we should see a sharp snapback in October.

The Bureau of Labor Statistics recently revised its 10-year outlook for the labor market. Labor force growth is expected to average 0.6% per year over 2016-2026 (vs. 0.5% for 2006-2016 and 1.2% for 1996-2006). This is consistent with monthly gains in nonfarm payrolls of less than 100,000 per month. The BLS anticipates that productivity growth will pick up to 1.6% per year (vs. +1.2% for 2006-2016), which will help offset slow labor force growth. However, these projections are consistent with real GDP growth of around 1.8% per year (vs. +1.7% per year for 2006-2016). There is some upside risk to the job market outlook. There may be a lot more slack in the job market than is currently believed. Greater capital investment and technology advancements could boost productivity growth more substantially. However, as the population ages, there will be lower job market turnover. In manufacturing, job gains and losses are currently trending at roughly half of the pace we saw before the recession. Contrary to popular opinion, the early evidence suggests that millennials are just as inclined to stay with their job as earlier generations. Structural changes to the economy are likely to widen regional differences, presenting a major challenge to federal policymakers.

Tight job market conditions normally lead to faster wage growth. However, despite an unemployment rate of 4.2%, average hourly earnings are trending only moderately higher (+2.7% y/y for the three months ending in September). The Employment Cost Index is a better measure of labor costs. It adjusts for the changing mix of jobs (avoiding biases such as faster growth in lower-paying industries) and includes benefits. To gauge the inflationary pressure from labor, one needs to adjust for productivity growth, but firms have been generally reporting increased wage pressures in recent months.



For the Fed, tighter job market conditions are consistent with a further normalization of monetary policy. Financial markets are pricing in another 25-basis point rate hike following the December 12-13 Fed policy meeting. Inflation in the PCE Price Index ex-food & energy (+1.3% for the 12 months ending in September) has fallen further below the Fed's 2% goal. That won't prevent the Fed from raising rates, but it should help to keep future rate increases on a gradual path. The Fed's policy decisions will remain data-dependent.

President Trump is reported to be close to nominating current Fed Governor Jerome Powell to follow Janet Yellen as Fed chair. Powell is a lawyer, not an economist, but has plenty of experience in banking and the financial markets. Powell was nominated to the Fed by President Obama in December 2011 as a two-for-one, to appease Republicans in order to get the nomination of another candidate (Jeremy Stein) through the Senate. That appointment was to complete an existing 14-year term, but Obama re-nominated Powell to another term in June 2014. While Powell may not have been entirely on board with all Fed policy decisions during his tenure (such as QE3), he never formally dissented (always voting with the majority). For the financial markets, Powell is seen as the comfortable choice, providing a smooth transition. Janet Yellen has been widely respected among economists and financial market participants, but the main draw back to her re-nomination was that she had spoken out against rolling back the rules and regulations put in place following the financial crisis. Powell is expected to be somewhat softer on regulations. It's likely that his Senate hearing will be contentious, but there should be enough votes.

Meanwhile, Special Counsel Robert Mueller's indictments of Trump campaign officials has generated only a modicum of concern among investors. The stock market often climbs a wall of worry. However, the investigation could become more meaningful for investors in the weeks and months ahead. Budget blueprints were narrowly approved in the Senate (51-49) and the House (216-212), suggesting a difficult road ahead for tax cut legislation. Offsetting the lost revenue from lower corporate and individual tax rates has been the major difficulty. Special interests have advocated against the elimination of deductions (such as the deduction for state and local taxes) and have pushed for further tax breaks for their industries. With 2018 being an election year, there is considerable pressure for lawmakers to complete a tax package by the end of the year.

	3Q16	4Q16	1Q17	2Q17	3Q17	***4Q17***	***1Q18***	***2Q18***	***3Q18***	***4Q18***	2016	**2017**	**2018**
GDP (↓ *contributions*)	2.8	1.8	1.2	3.1	3.0	***1.9***	***1.9***	***1.8***	***1.8***	***1.7***	1.5	***2.2***	***2.0***
consumer durables	0.7	0.7	0.0	0.6	0.6	***-0.1***	***0.2***	***0.2***	***0.2***	***0.2***	0.4	***0.4***	***0.2***
nondurables & services	1.2	1.3	1.3	1.7	1.0	***1.4***	***1.2***	***1.2***	***1.1***	***1.1***	1.5	***1.4***	***1.2***
bus. fixed investment	0.4	0.0	0.9	0.8	0.5	***0.5***	***0.3***	***0.3***	***0.3***	***0.3***	-0.1	***0.5***	***0.4***
residential investment	-0.2	0.3	0.4	-0.3	-0.2	***0.2***	***0.1***	***0.1***	***0.1***	***0.1***	0.2	***0.0***	***0.1***
Priv Dom Final Purchases	2.6	2.7	3.1	3.3	2.2	***2.5***	***2.1***	***2.0***	***2.0***	***1.9***	2.3	***2.8***	***2.2***
government	0.1	0.0	-0.1	0.0	0.0	***0.0***	***0.1***	***0.1***	***0.1***	***0.1***	0.1	***0.0***	***0.1***
exports	0.7	-0.5	0.9	0.4	0.3	***0.4***	***0.4***	***0.4***	***0.4***	***0.4***	0.0	***0.4***	***0.4***
imports	-0.4	-1.1	-0.6	-0.2	0.1	***-0.6***	***-0.5***	***-0.4***	***-0.4***	***-0.4***	-0.2	***-0.5***	***-0.4***
Final Sales	2.6	0.7	2.7	3.0	2.3	***2.0***	***1.8***	***1.8***	***1.8***	***1.7***	1.9	***2.3***	***2.0***
ch. in bus. inventories	0.2	1.1	-1.5	0.1	0.7	***-0.1***	***0.0***	***0.0***	***0.0***	***0.0***	-0.4	***-0.1***	***0.1***
Unemployment, %	4.9	4.7	4.7	4.4	4.3	***4.2***	***4.2***	***4.2***	***4.2***	***4.3***	4.9	***4.4***	***4.2***
NF Payrolls, monthly, th.	239	148	166	187	91	***200***	***140***	***135***	***130***	***125***	187	***161***	***133***
Cons. Price Index (q/q)	1.8	3.0	3.1	-0.3	2.0	***2.8***	***1.9***	***2.0***	***2.0***	***2.0***	1.3	***2.1***	***2.0***
excl. food & energy	2.1	2.0	2.5	0.6	1.7	***1.9***	***2.0***	***1.9***	***1.9***	***2.0***	2.2	***1.8***	***1.8***
PCE Price Index (q/q)	1.7	2.0	2.2	0.3	1.5	***2.0***	***1.8***	***1.9***	***1.9***	***1.9***	1.2	***1.6***	***1.7***
excl. food & energy	2.0	1.3	1.8	0.9	1.3	***1.6***	***1.8***	***1.8***	***1.8***	***1.8***	1.8	***1.5***	***1.7***
Fed Funds Rate, %	0.40	0.45	0.70	0.94	1.16	***1.21***	***1.41***	***1.44***	***1.66***	***1.71***	0.39	***1.01***	***1.56***
3-month T-Bill, (bond-eq.)	0.3	0.4	0.6	0.9	1.0	***1.2***	***1.4***	***1.4***	***1.6***	***1.7***	0.3	***1.0***	***1.5***
2-year Treasury Note	0.7	1.0	1.2	1.3	1.5	***1.6***	***1.7***	***1.9***	***2.0***	***2.1***	0.8	***1.4***	***1.9***
10-year Treasury Note	1.6	2.1	2.5	2.3	2.2	***2.4***	***2.7***	***2.8***	***2.9***	***3.0***	1.8	***2.3***	***2.8***