

## U.S. Data Green Lights Fed for December Rate Hike

After a weak first half of the year, third quarter real GDP growth improved to a 2.9 percent annualized rate. The inventory sell-off that weighed heavily on GDP growth in H1 looks like it is reversing in late 2016 and should contribute to above-potential growth over the next few quarters. Payroll job growth in the third quarter was strong, averaging 206,000 net new jobs per month and the unemployment rate averaged 4.9 percent. The October employment data suggests that job growth is stepping down a little; only 161,000 jobs were added for the month. But that was enough to tighten the unemployment rate back to 4.9 percent. We look for the unemployment rate to bottom out somewhere around 4.6 to 4.7 percent in this cycle. Labor markets across the country are tightening and wages are going up, including some by mandate as minimum wage legislation in several states complements raises already granted by some major employers. Average hourly earnings increased by 0.4 percent in October and were up by 2.8 percent over the previous 12 months. With wages heading up, energy prices moving up, house prices and rents going up and medical costs still increasing, there is a whiff of inflation in the air. The September Consumer Price Index increased by 0.3 percent for the month, and was up 1.5 percent over the previous 12 months. We expect headline inflation indicators to continue to warm up through early next year.

At the recent Federal Open Market Committee meeting of November 1-2, the Fed did exactly as expected by not raising the fed funds rate while hinting that a rate hike at their next meeting, over December 13-14, is a strong possibility. According to the November 2 press release, the FOMC “judges that the case for an increase in the federal funds rate has continued to strengthen but decided, for the time being, to wait for some further evidence of continued progress towards its objectives.” They received more evidence with the October jobs report, and we expect them to get even more evidence of tightening labor market conditions and increasing wage pressure with the release of the November jobs report on December 2. The implied probability of a fed funds rate hike is now about 76 percent according to the fed funds futures market. Expectations are set and the door is open for the Fed. All that is needed is another month of benign economic data. We also see hints that other central banks are expecting more inflation and preparing for eventual monetary policy tightening. The Bank of England modified its forward guidance in its Monetary Policy Summary of November 3, effectively taking another interest rate cut off the table. Likewise, the Bank of Japan refrained from adding more stimulus in their monetary policy statement of November 1.

The U.S. general election, and its aftermath, is still potentially market moving. The slide in major equity indexes, that began in September, accelerated through October. Solid Q3 GDP data and expectations for a repeat in Q4 are supportive of equities, but election uncertainty is high and anxiety about the aftermath of the election, on both sides of the political aisle, also appears to be high. This is obviously not a normal election, and so the expectation of a post-election bounce in equities that spills over into a generalized consumer bliss needs to be discounted. Still, we expect to see a well performing economy after the election and ongoing economic momentum through 2017.

### U.S. Economic Outlook, Summary

	2Q'16a	3Q'16a	4Q'16f	1Q'17f	2Q'17f	3Q'17f	4Q'17f	1Q'18f	2015a	2016f	2017f
Real GDP (Percent Change Annualized)	1.4	2.9	2.9	3.1	3.0	2.4	2.1	2.0	2.6	1.6	2.8
CPI (Percent Change Year-over-Year)	1.1	1.1	1.6	2.3	2.4	2.4	2.3	2.1	0.1	1.2	2.4
Payroll Jobs (Average Monthly Diff., Ths.)	150.7	207.2	180.7	174.3	171.8	167.0	162.9	162.8	231.3	189.6	169.0
Unemployment Rate (Percent)	4.9	4.9	4.8	4.8	4.7	4.7	4.6	4.6	5.3	4.9	4.7
Federal Funds Rate (Effective)	0.37	0.40	0.43	0.63	0.67	0.88	0.92	1.13	0.13	0.39	0.78
10-Yr. Treasury Rate	1.75	1.56	1.78	1.89	1.93	2.08	2.11	2.27	2.14	1.75	2.00

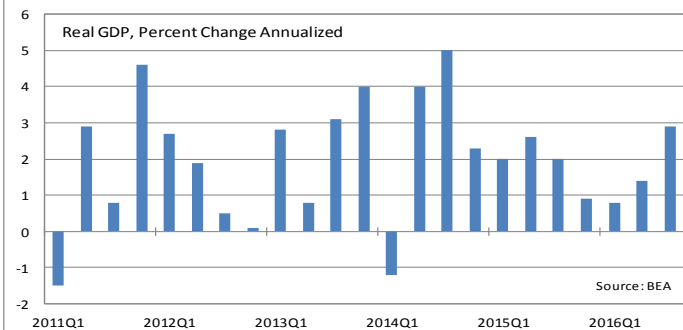
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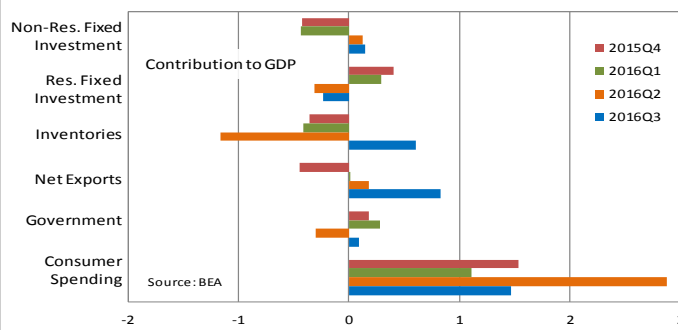
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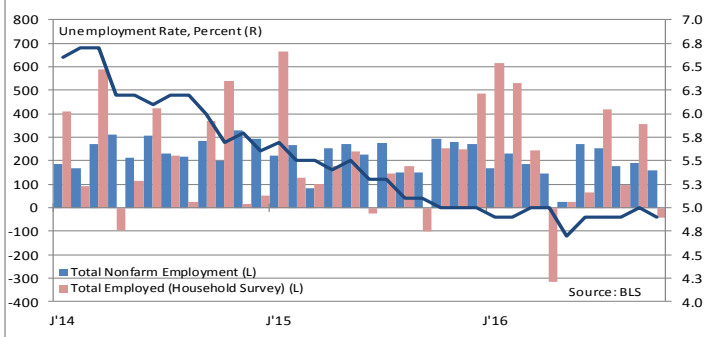
**GDP Growth Q3 Up 2.9%**



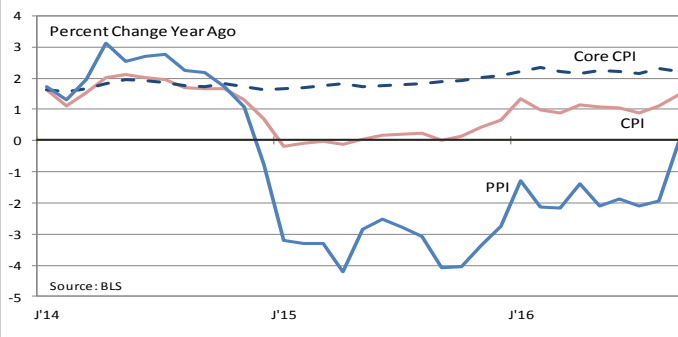
**Inventories and Net Exports Boost Q3 GDP**



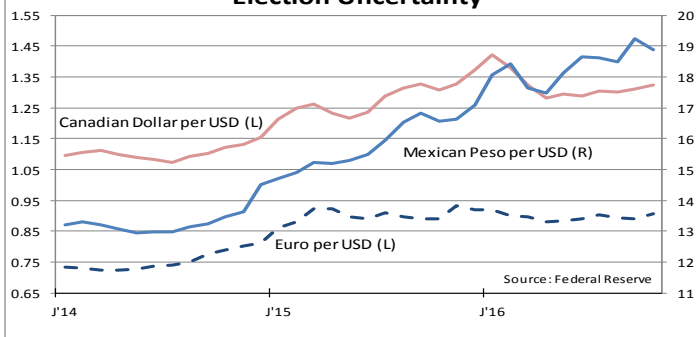
**U.S. Adds Net 161,000 Jobs in October**



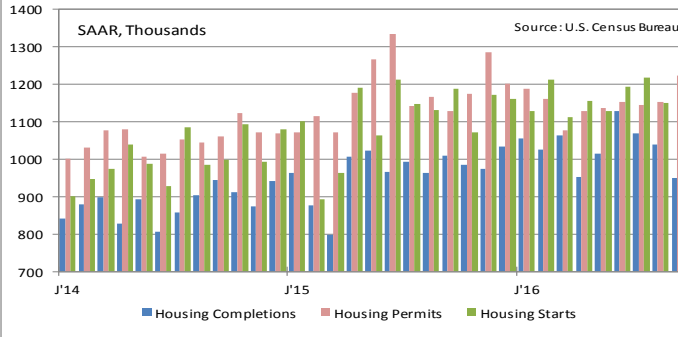
**Inflation Increasing with Energy Prices**



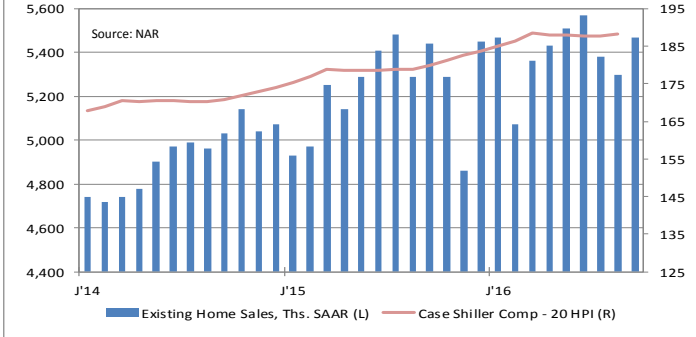
**Mexican Peso Sees Volatility from U.S. Election Uncertainty**



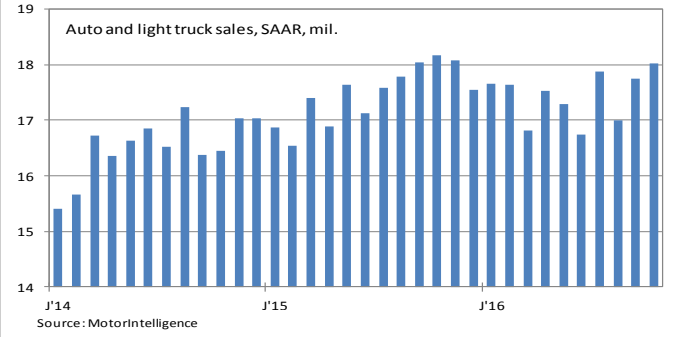
**Housing Starts Dip on Sluggish Multifamily**



**Existing Homes Sales Rebound in September**



**October Auto Sales Climb to 18.0 mIn**



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	2Q'16a	3Q'16a	4Q'16f	1Q'17f	2Q'17f	3Q'17f	4Q'17f	1Q'18f	2015a	2016f	2017f
<b>Output</b>											
Nominal GDP (Billions \$)	18450	18651	18866	19093	19324	19532	19731	19929	18037	18562	19420
<b>Percent Change Annualized</b>	<b>3.7</b>	<b>4.4</b>	<b>4.7</b>	<b>4.9</b>	<b>4.9</b>	<b>4.4</b>	<b>4.2</b>	<b>4.1</b>	<b>3.7</b>	<b>2.9</b>	<b>4.6</b>
Real GDP (Chained 2009 Billions \$)	16583	16702	16821	16952	17076	17179	17269	17356	16397	16658	17119
<b>Percent Change Annualized</b>	<b>1.4</b>	<b>2.9</b>	<b>2.9</b>	<b>3.1</b>	<b>3.0</b>	<b>2.4</b>	<b>2.1</b>	<b>2.0</b>	<b>2.6</b>	<b>1.6</b>	<b>2.8</b>
Pers. Consumption Expenditures	11485	11546	11604	11663	11720	11781	11836	11885	11215	11500	11750
<b>Percent Change Annualized</b>	<b>4.3</b>	<b>2.1</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>	<b>2.1</b>	<b>1.9</b>	<b>1.6</b>	<b>3.2</b>	<b>2.5</b>	<b>2.2</b>
Nonresidential Fixed Investment	2185	2191	2219	2247	2273	2296	2318	2340	2200	2194	2283
<b>Percent Change Annualized</b>	<b>1.0</b>	<b>1.1</b>	<b>5.2</b>	<b>5.1</b>	<b>4.6</b>	<b>4.2</b>	<b>3.9</b>	<b>3.9</b>	<b>2.1</b>	<b>-0.3</b>	<b>4.1</b>
Residential Investment	589	579	588	599	609	618	626	634	565	589	613
<b>Percent Change Annualized</b>	<b>-7.8</b>	<b>-6.2</b>	<b>6.3</b>	<b>7.5</b>	<b>6.9</b>	<b>6.0</b>	<b>5.5</b>	<b>5.0</b>	<b>11.7</b>	<b>4.4</b>	<b>4.0</b>
Change in Private Inventories	-10	13	25	42	60	60	61	60	84	17	56
Net Exports	-559	-523	-524	-521	-520	-526	-536	-542	-540	-543	-525
Government Expenditures	2901	2905	2917	2930	2943	2957	2971	2986	2884	2909	2950
<b>Percent Change Annualized</b>	<b>-1.7</b>	<b>0.5</b>	<b>1.8</b>	<b>1.7</b>	<b>1.8</b>	<b>1.9</b>	<b>2.0</b>	<b>2.0</b>	<b>1.8</b>	<b>0.9</b>	<b>1.4</b>
Industrial Prod. Index (2007=100)	103.9	104.4	104.7	104.9	105.1	105.3	105.4	105.6	105.2	104.3	105.2
<b>Percent Change Annualized</b>	<b>-0.8</b>	<b>1.8</b>	<b>1.3</b>	<b>0.8</b>	<b>0.7</b>	<b>0.7</b>	<b>0.6</b>	<b>0.7</b>	<b>0.3</b>	<b>-0.9</b>	<b>0.9</b>
Capacity Utilization (Percent)	75.2	75.5	75.6	75.6	75.6	75.5	75.5	75.4	76.7	75.4	75.6
<b>Prices</b>											
CPI (1982-84=100)	239.4	240.4	242.0	243.5	245.1	246.2	247.5	248.7	237.0	239.9	245.6
<b>Percent Change Annualized</b>	<b>2.5</b>	<b>1.6</b>	<b>2.7</b>	<b>2.5</b>	<b>2.8</b>	<b>1.8</b>	<b>2.0</b>	<b>2.0</b>	<b>0.1</b>	<b>1.2</b>	<b>2.4</b>
PCE Price Index (2009=100)	110.5	110.9	111.5	112.2	113.0	113.5	114.1	114.7	109.5	110.7	113.2
<b>Percent Change Annualized</b>	<b>2.0</b>	<b>1.4</b>	<b>2.2</b>	<b>2.5</b>	<b>2.9</b>	<b>1.8</b>	<b>2.0</b>	<b>2.0</b>	<b>0.3</b>	<b>1.1</b>	<b>2.2</b>
GDP Price Index (2009=100)	111.3	111.7	112.2	112.7	113.2	113.8	114.3	114.9	110.0	111.4	113.5
<b>Percent Change Annualized</b>	<b>2.3</b>	<b>1.5</b>	<b>1.8</b>	<b>1.8</b>	<b>1.9</b>	<b>1.9</b>	<b>2.0</b>	<b>2.0</b>	<b>1.1</b>	<b>1.3</b>	<b>1.8</b>
Producer Price Index, Finished Goods	191.4	192.1	193.3	194.1	195.3	196.2	197.2	198.1	193.8	191.6	195.7
<b>Percent Change Annualized</b>	<b>3.6</b>	<b>1.4</b>	<b>2.5</b>	<b>1.8</b>	<b>2.4</b>	<b>1.9</b>	<b>2.0</b>	<b>2.0</b>	<b>-3.3</b>	<b>-1.1</b>	<b>2.1</b>
Crude Oil, WTI (\$/barrel)	44.9	45.1	48.0	50.0	55.0	55.0	55.0	60.0	48.9	42.8	53.8
<b>Labor Markets</b>											
Payroll Jobs (Average Monthly Diff., Ths.)	150.7	207.2	180.7	174.3	171.8	167.0	162.9	162.8	231.3	189.6	169.0
Unemployment Rate (Percent)	4.9	4.9	4.8	4.8	4.7	4.7	4.6	4.6	5.3	4.9	4.7
Average Weekly Hours, Prod. Works.	33.6	33.6	33.6	33.6	33.6	33.6	33.6	33.6	33.7	33.6	33.6
Population (Millions)	324.0	324.7	325.4	326.0	326.7	327.3	328.0	328.6	321.7	324.4	327.0
<b>Percent Change Annualized</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>
<b>Personal Income</b>											
Average Hourly Earnings (\$)	21.49	21.63	21.79	21.95	22.11	22.28	22.46	22.65	21.04	21.57	22.20
<b>Percent Change Annualized</b>	<b>2.4</b>	<b>2.8</b>	<b>2.8</b>	<b>3.0</b>	<b>3.0</b>	<b>3.1</b>	<b>3.2</b>	<b>3.4</b>	<b>2.1</b>	<b>2.5</b>	<b>2.9</b>
Real Disp. Income (2009 Billions \$)	12620	12689	12769	12823	12862	12944	13019	13094	12343	12659	12912
<b>Percent Change Annualized</b>	<b>2.1</b>	<b>2.2</b>	<b>2.5</b>	<b>1.7</b>	<b>1.2</b>	<b>2.6</b>	<b>2.3</b>	<b>2.3</b>	<b>3.5</b>	<b>2.6</b>	<b>2.0</b>
Personal Saving Rate (Percent)	5.7	5.7	5.7	5.7	5.7	5.7	5.7	5.7	5.8	5.8	5.7
<b>Housing</b>											
Housing Starts (Ths., Ann. Rate)	1159	1138	1191	1222	1244	1259	1272	1285	1108	1160	1249
Ext. SF Home Sales (Ths., Ann Rate)	4870	4780	4864	4919	4966	5011	5053	5085	4627	4808	4987
New SF Home Sales (Ths., Ann Rate)	565	599	601	616	625	632	637	641	502	574	627
Case/Shiller HPI (Jan. 2000=100)	179.5	181.6	183.7	185.9	188.1	190.2	192.4	194.6	172.3	180.8	189.1
<b>Year/Year Percent Change</b>	<b>5.0</b>	<b>5.2</b>	<b>4.3</b>	<b>4.1</b>	<b>4.8</b>	<b>4.8</b>	<b>4.8</b>	<b>4.7</b>	<b>4.6</b>	<b>4.9</b>	<b>4.6</b>
<b>Consumer</b>											
Household Economic Stress Index	0.9	0.9	2.1	3.0	2.3	2.3	2.1	2.0	0.8	1.2	2.4
Auto Sales (Millions)	17.2	17.5	17.4	17.4	17.1	16.9	16.8	16.5	17.5	17.4	17.0
<b>Interest Rates (percent per year)</b>											
Federal Funds Rate (Effective)	0.37	0.40	0.43	0.63	0.67	0.88	0.92	1.13	0.13	0.39	0.78
Prime Rate	3.50	3.50	3.50	3.63	3.67	3.88	3.92	4.13	3.26	3.50	3.78
1-Month LIBOR	0.44	0.51	0.58	0.80	0.84	1.05	1.09	1.30	0.20	0.49	0.95
3-Month LIBOR	0.64	0.79	0.91	1.07	1.10	1.28	1.32	1.50	0.32	0.74	1.19
1-Yr. Treasury Rate	0.57	0.56	0.66	0.83	0.89	1.07	1.13	1.31	0.32	0.59	0.98
5-Yr. Treasury Rate	1.24	1.13	1.27	1.42	1.47	1.63	1.67	1.84	1.53	1.25	1.55
10-Yr. Treasury Rate	1.75	1.56	1.78	1.89	1.93	2.08	2.11	2.27	2.14	1.75	2.00
30-Year Fixed Rate Mortgage	3.59	3.45	3.52	3.66	3.69	3.84	3.87	4.02	3.85	3.58	3.76

a = actual f = forecast

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