

2017 Policy Moves Will Spur Economic Growth in 2018 and Budget Battles

This year saw important changes in both fiscal and monetary policy. The tax reform initiative will have a major impact on federal spending and federal budget deficit management for years to come. Both the House of Representatives and the Senate have passed versions of tax reform. The committee process to reconcile the two bills is being launched this week. A reconciled bill must still be approved by final votes in the House and Senate before being signed into law by the President. We expect that to happen before the end of this year. Even under dynamic scoring, which allows feedback loops in the scoring models to increase tax revenues over time, both the House and the Senate versions of the tax bill will tend to increase the federal budget deficit according to various scoring models. This in turn may reduce maneuvering room on any spending initiatives that the Trump Administration may propose in 2018, including infrastructure spending and spending on the proposed border wall with Mexico. Next year, the Trump Administration may push for entitlement reform before it pushes for new legislation on infrastructure spending because entitlement reform has the potential to free up some funding for infrastructure.

In both the House and Senate bills, the largest economic benefits from a new federal tax code will accrue to corporations, less so to households. U.S. corporations will benefit from tax reform as effective tax rates are lowered and overseas profits are more easily repatriated. This will be a support to corporate profits coming at a critical time when corporate profit margins are being squeezed by higher operating costs in a late-cycle economy. Equity prices may also be supported by share buybacks funded with repatriated dollars. We expect most households to see a small-to-moderate reduction in their federal tax bills once the final legislation is passed. However, that may be countered by the loss of the state and local tax deduction, especially for residents of high tax states such as California and New Jersey.

We expect that the net short-term effects on the U.S. economy from a new tax code will be moderately positive, resulting in increased business investment and consumer spending. However, if there is too much pressure on the federal budget deficit from reduced tax revenues, then there is at least some potential for increased federal taxes later on. Also, if states and local governments feel less support from federal revenue sharing, then there is potential for the tax burden to shift downhill to state and local governments, requiring them to raise taxes later.

Federal Reserve monetary policy also changed significantly this year. In October, the Federal Reserve began to reduce the amount of maturing assets that it is reinvesting. A decrease in the amount of assets being reinvested will gradually reduce the size of the Federal Reserve's \$4.5 trillion balance sheet. The Fed has not issued a final target for the size of its balance sheet. That may be in the range of \$2 to \$3 trillion. The shift away from reinvesting maturing assets will gradually reduce the demand for Treasury bonds, putting a small amount of upward pressure on Treasury bond yields. Also, we expect the Fed to increase the fed funds rate range for the third time this year at the conclusion of the Federal Open Market Committee meeting on Wednesday, December 13. As the Fed puts upward pressure on interest rates, there is potential for higher interest rates to increase the borrowing costs of the federal government, adding to the federal budget deficit already under pressure from tax reform.

U.S. Economic Outlook, Summary

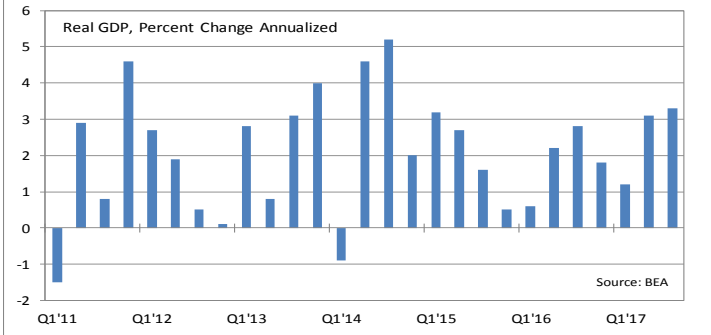
	2Q'17a	3Q'17a	4Q'17f	1Q'18f	2Q'18f	3Q'18f	4Q'18f	1Q'19f	2016a	2017f	2018f
Real GDP (Percent Change Annualized)	3.1	3.3	3.1	2.4	2.8	2.3	2.4	2.3	1.5	2.3	2.8
CPI (Percent Change Year-over-Year)	1.9	2.0	2.0	1.7	2.3	2.3	2.0	2.0	1.3	2.1	2.1
Payroll Jobs (Average Monthly Diff., Ths.)	161.4	159.2	183.8	167.6	164.4	159.8	153.0	154.3	194.3	171.6	161.2
Unemployment Rate (Percent)	4.4	4.3	4.1	4.1	4.0	3.9	3.8	3.8	4.9	4.4	3.9
Federal Funds Rate (Effective)	0.95	1.15	1.18	1.38	1.42	1.63	1.67	1.88	0.40	1.00	1.53
10-Yr. Treasury Rate	2.26	2.24	2.36	2.43	2.47	2.64	2.66	2.85	1.84	2.33	2.55

a = actual f = forecast

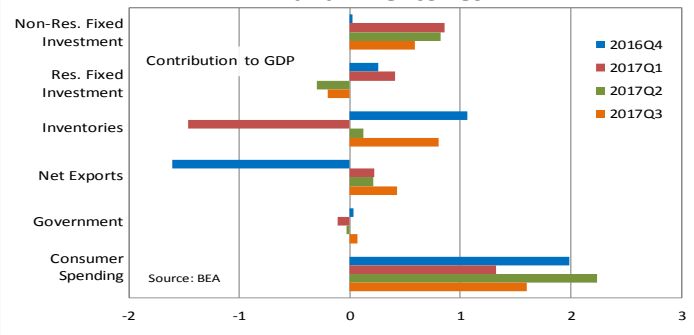
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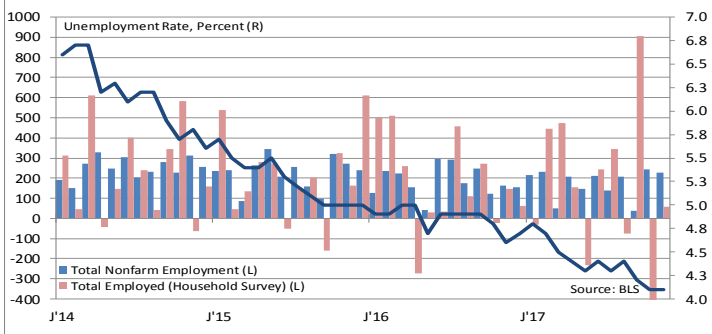
Q3 GDP 2nd Estimate at 3.3%



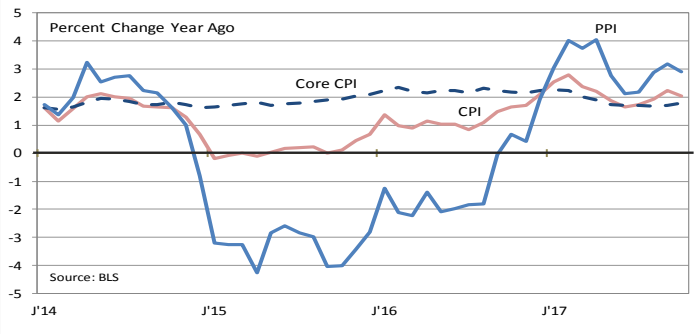
Q3 GDP Bolstered by Consumer Spending and Inventories



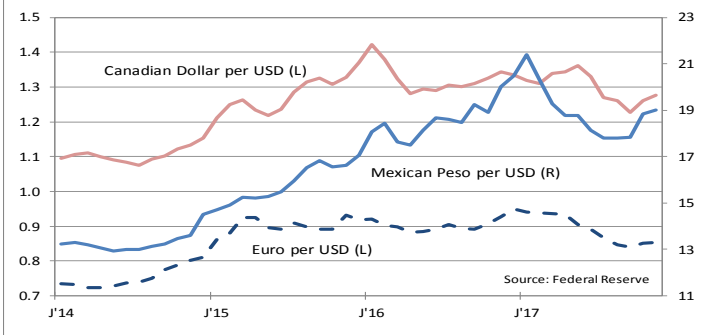
U. Rate Unchanged at 4.1 Percent in Nov.



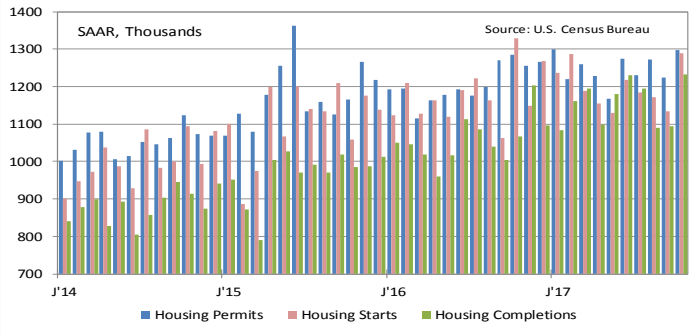
October Inflation Metrics Steady



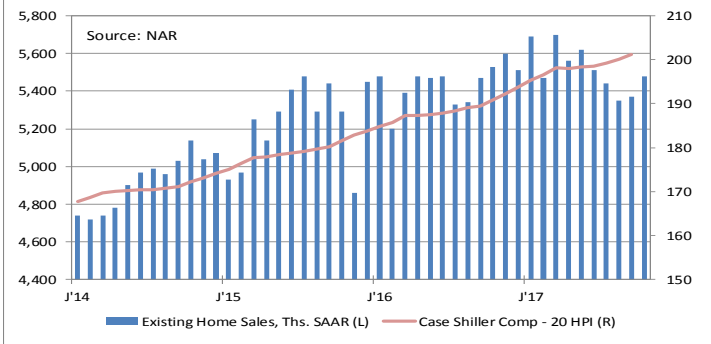
US Dollar Strengthening at Year End 2017



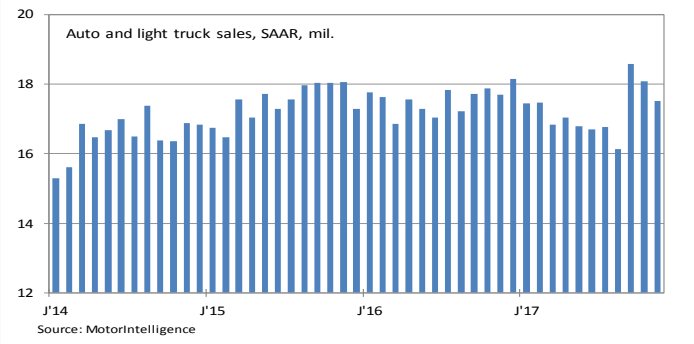
Multifamily Weighs on Housing Starts



Existing Home Sales Improved in October



Nov. Auto Sales Still High at 17.5 Mln Rate



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	2Q'17a	3Q'17a	4Q'17f	1Q'18f	2Q'18f	3Q'18f	4Q'18f	1Q'19f	2016a	2017f	2018f
Output											
Nominal GDP (Billions \$)	19250	19509	19755	19968	20208	20422	20640	20854	18624	19393	20310
Percent Change Annualized	4.1	5.5	5.1	4.4	4.9	4.3	4.3	4.2	2.8	4.1	4.7
Real GDP (Chained 2009 Billions \$)	17031	17170	17303	17406	17529	17629	17733	17833	16716	17102	17574
Percent Change Annualized	3.1	3.3	3.1	2.4	2.8	2.3	2.4	2.3	1.5	2.3	2.8
Pers. Consumption Expenditures	11853	11921	12022	12050	12116	12174	12235	12292	11572	11889	12144
Percent Change Annualized	3.3	2.3	3.4	0.9	2.2	1.9	2.0	1.9	2.7	2.7	2.1
Nonresidential Fixed Investment	2301	2327	2365	2400	2434	2466	2499	2529	2210	2314	2450
Percent Change Annualized	6.7	4.7	6.7	6.1	5.7	5.4	5.3	5.0	-0.6	4.7	5.9
Residential Investment	594	586	599	608	616	624	631	638	587	596	620
Percent Change Annualized	-7.3	-5.1	8.7	6.3	5.5	5.2	4.7	4.2	5.5	1.5	4.0
Change in Private Inventories	5	39	34	46	54	55	55	55	33	20	52
Net Exports	-614	-594	-615	-602	-603	-609	-614	-617	-586	-611	-607
Government Expenditures	2895	2898	2906	2911	2919	2926	2935	2943	2900	2899	2923
Percent Change Annualized	-0.2	0.4	1.1	0.7	1.0	1.1	1.1	1.2	0.8	0.0	0.8
Industrial Prod. Index (2007=100)	105.1	105.0	106.0	106.3	106.6	106.8	107.1	107.3	103.1	104.9	106.7
Percent Change Annualized	5.6	-0.3	3.5	1.3	1.1	1.0	0.9	0.8	-1.2	1.8	1.7
Capacity Utilization (Percent)	76.6	76.3	76.9	77.1	77.3	77.4	77.5	77.5	75.7	76.4	77.3
Prices											
CPI (1982-84=100)	243.9	245.2	247.0	248.3	249.5	250.7	252.0	253.2	240.0	245.1	250.1
Percent Change Annualized	-0.3	2.0	3.1	2.1	1.8	2.0	2.0	2.0	1.3	2.1	2.1
PCE Price Index (2009=100)	112.3	112.7	113.4	114.0	114.5	115.0	115.6	116.2	110.8	112.6	114.8
Percent Change Annualized	0.3	1.5	2.4	2.1	2.0	1.9	2.0	2.0	1.2	1.7	1.9
GDP Price Index (2009=100)	113.0	113.6	114.2	114.8	115.3	115.9	116.5	117.0	111.4	113.4	115.6
Percent Change Annualized	1.0	2.1	2.0	2.0	2.0	2.0	2.0	1.9	1.3	1.8	2.0
Producer Price Index, Finished Goods	197.1	197.5	199.5	200.5	201.5	202.6	203.6	204.7	191.9	197.7	202.1
Percent Change Annualized	0.6	0.7	4.1	2.2	2.0	2.1	2.1	2.1	-1.0	3.1	2.2
Crude Oil, WTI (\$/barrel)	51.0	51.0	55.0	55.0	55.0	55.0	55.0	55.0	43.1	51.8	55.0
Labor Markets											
Payroll Jobs (Average Monthly Diff., Ths.)	161.4	159.2	183.8	167.6	164.4	159.8	153.0	154.3	194.3	171.6	161.2
Unemployment Rate (Percent)	4.4	4.3	4.1	4.1	4.0	3.9	3.8	3.8	4.9	4.4	3.9
Average Weekly Hours, Prod. Works.	33.7	33.6	33.6	33.6	33.6	33.6	33.6	33.6	33.6	33.6	33.6
Population (Millions)	325.8	326.4	327.1	327.7	328.4	329.0	329.7	330.3	323.5	326.1	328.7
Percent Change Annualized	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.7	0.8	0.8
Personal Income											
Average Hourly Earnings (\$)	21.99	22.15	22.31	22.47	22.64	22.81	22.99	23.17	21.56	22.08	22.73
Percent Change Annualized	2.4	2.9	2.8	3.0	3.0	3.1	3.1	3.1	2.5	2.4	2.9
Real Disp. Income (2009 Billions \$)	12765	12780	12843	12914	12986	13063	13134	13205	12608	12767	13025
Percent Change Annualized	2.7	0.5	2.0	2.2	2.2	2.4	2.2	2.2	1.4	1.3	2.0
Personal Saving Rate (Percent)	3.7	3.3	3.2	3.2	3.2	3.2	3.2	3.2	4.9	3.5	3.2
Housing											
Housing Starts (Ths., Ann. Rate)	1167	1164	1215	1228	1234	1242	1251	1260	1177	1196	1239
Ext. SF Home Sales (Ths., Ann Rate)	4930	4783	4841	4867	4898	4922	4941	4957	4828	4887	4907
New SF Home Sales (Ths., Ann Rate)	605	591	632	631	636	641	646	651	561	611	639
Case/Shiller HPI (Jan. 2000=100)	189.9	192.7	196.1	199.5	202.9	206.4	209.7	213.0	181.1	191.7	204.6
Year/Year Percent Change	5.8	6.0	5.9	6.1	6.9	7.1	6.9	6.8	5.1	5.8	6.8
Consumer											
Household Economic Stress Index	0.5	0.3	0.2	-0.3	-0.6	-1.0	-1.1	-1.1	1.0	0.7	-0.8
Auto Sales (Millions)	16.8	17.2	17.5	16.5	16.1	16.0	15.8	15.6	17.5	17.2	16.1
Interest Rates (percent per year)											
Federal Funds Rate (Effective)	0.95	1.15	1.18	1.38	1.42	1.63	1.67	1.88	0.40	1.00	1.53
Prime Rate	4.04	4.25	4.28	4.48	4.52	4.73	4.77	4.98	3.51	4.09	4.63
1-Month LIBOR	1.06	1.23	1.32	1.54	1.59	1.80	1.84	2.05	0.50	1.11	1.69
3-Month LIBOR	1.20	1.31	1.44	1.66	1.71	1.91	1.93	2.13	0.74	1.26	1.80
1-Yr. Treasury Rate	1.12	1.24	1.54	1.71	1.67	1.81	1.84	2.04	0.61	1.20	1.76
5-Yr. Treasury Rate	1.81	1.82	2.06	2.16	2.17	2.34	2.36	2.55	1.34	1.91	2.26
10-Yr. Treasury Rate	2.26	2.24	2.36	2.43	2.47	2.64	2.66	2.85	1.84	2.33	2.55
30-Year Fixed Rate Mortgage	3.99	3.88	3.92	4.03	4.13	4.33	4.36	4.56	3.65	3.99	4.21

a = actual f = forecast

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