

## 2018: Out from the Shadow of the Great Recession

With the end of 2017 came a noteworthy anniversary. December 2017 marked ten years since the onset of the Great Recession. One generalized conclusion from Reinhart and Rogoff's masterpiece, *This Time is Different: Eight Centuries of Financial Folly*, is that it can take about 10 years for an economy to recover from a severe financial crisis. While there is no calendar to check off milestones of crisis and response, that ten year time span feels about right. So we can think about the U.S. economy in 2018 less in terms of recovery from crisis, and more in terms of what can foster positive momentum, what is sustainable and what is not.

As we look ahead to 2018 and beyond, we see that the U.S. economy is generating more consistent momentum. We still have a good shot at three consecutive quarters of 3 percent or more real GDP growth beginning in 2017Q2. It would be the first such winning streak in this expansion. We will get the first estimate of 2017Q4 real GDP growth on January 26. In addition to more consistent U.S. momentum, global economic demand is improving. Europe and Japan are both gaining momentum after years of underperformance. With the recent passage of tax reform, U.S. fiscal policy is stimulative. If Congress can cobble together an infrastructure spending program as promised, that could add to fiscal stimulus later this year. Although interest rates are gradually rising, monetary policy remains accommodative. The Federal Reserve has so far raised short-term interest rates from exceptionally low, to merely very low. Also, the crisis-driven regulatory response is easing. We expect to see more examples of regulatory rollback this year.

Productivity growth is key to sustaining a long expansion. We define productivity as real output per hour of all nonfarm private-sector employees. It tends to be cyclical, often peaking at the end of recessions after labor has been shed and output starts to ramp up. It often declines ahead of recessions as businesses hire more workers to keep up with growing demand. So far in this expansion, productivity growth has been weaker than expected. However, through the first three quarters of 2017 productivity growth improved, with 2017Q3 registering 1.5 percent year-over-year productivity growth -the strongest since 2015Q2. We expect the recent reforms to the corporate tax code to be positive for business investment, and therefore positive for productivity growth. Productivity growth is the key lever that will determine if wage growth is inflationary or not. Strong productivity growth allows businesses to pay higher wages without raising their prices. Otherwise, wage growth can lead to higher inflation which could cause the Federal Reserve to raise interest rates more than expected, which can eventually lead to the next recession.

What is not sustainable? Reinhart and Rogoff offer a master class in the dangers of rapid debt accumulation. Also, financial bubbles are non sustainable. The recent rallies in both the U.S. stock market and in Bitcoin add to the "wall of worry." Mismanaged government finances are not sustainable. The Soviet Union, Greece and Zimbabwe are modern examples of self imposed fiscal crises that led to collapse and chaos.

We expect to see an ongoing economic expansion for the U.S. in 2018, helped by rest-of-world growth, expansive fiscal policy and restrained monetary tightening. Productivity growth will be a key sustaining element of the U.S. expansion. By mid-year we will see the second-longest U.S. expansion ever, reaching 107 months in May.

### U.S. Economic Outlook, Summary

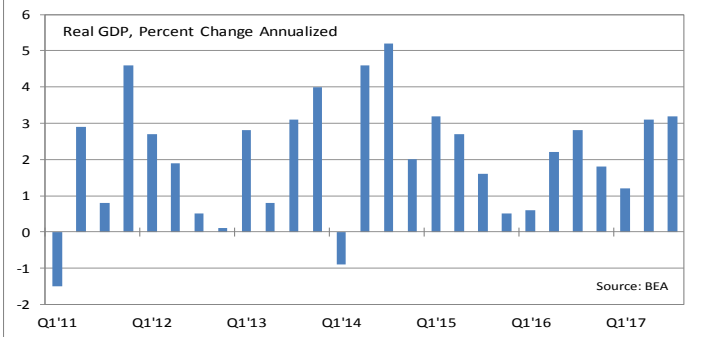
	2Q'17a	3Q'17a	4Q'17f	1Q'18f	2Q'18f	3Q'18f	4Q'18f	1Q'19f	2016a	2017f	2018f
Real GDP (Percent Change Annualized)	3.1	3.2	3.0	2.4	3.2	2.5	2.6	2.4	1.5	2.3	2.8
CPI (Percent Change Year-over-Year)	1.9	2.0	2.1	1.8	2.4	2.4	2.0	2.1	1.3	2.1	2.2
Payroll Jobs (Average Monthly Diff., Ths.)	161.4	159.2	174.3	146.9	149.8	140.9	139.0	132.7	194.3	169.2	144.2
Unemployment Rate (Percent)	4.3	4.3	4.1	4.1	4.0	3.9	3.9	3.9	4.9	4.3	4.0
Federal Funds Rate (Effective)	0.95	1.15	1.20	1.42	1.67	1.91	2.13	2.17	0.40	1.00	1.78
10-Yr. Treasury Rate	2.26	2.24	2.37	2.52	2.78	2.97	3.15	3.17	1.84	2.33	2.86

**a = actual f = forecast**

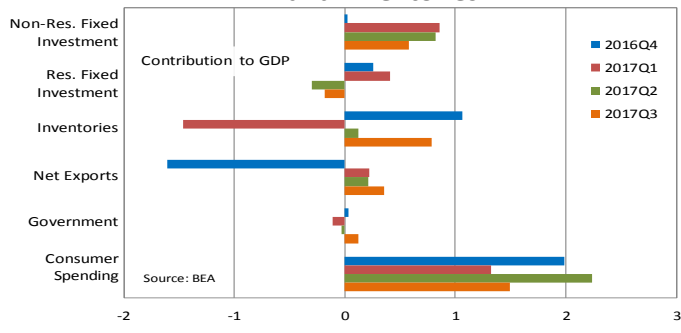
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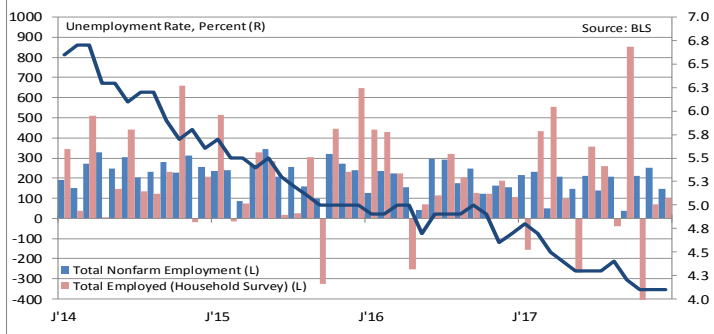
**Q3 GDP Revised to 3.2%**



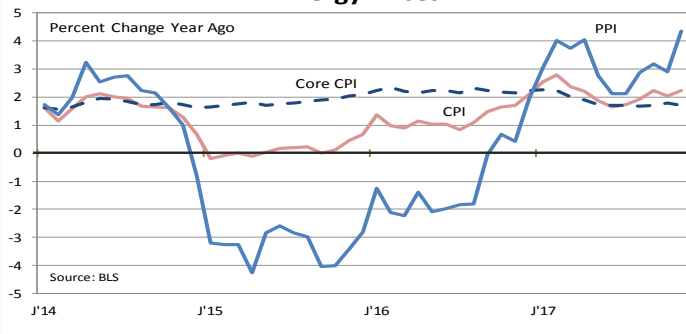
**Q3 GDP Bolstered by Consumer Spending and Inventories**



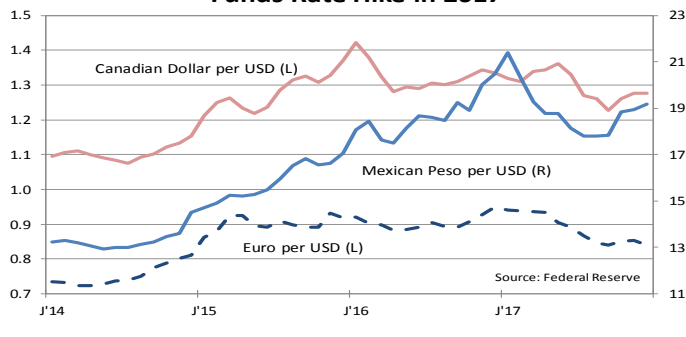
**December U.S. Payrolls Up by 148,000**



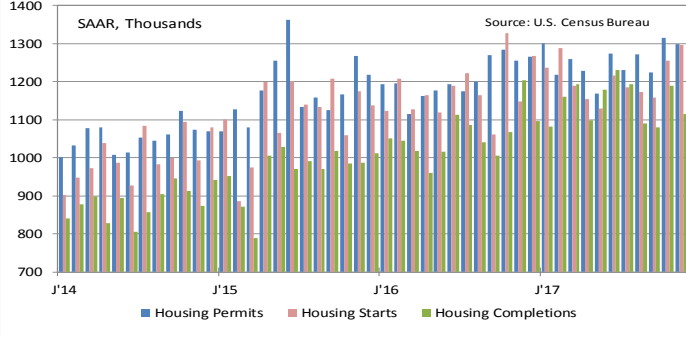
**November Inflation Increases with Rising Energy Prices**



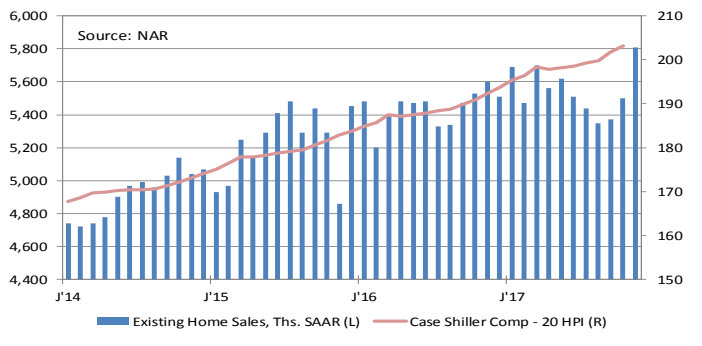
**Mexican Peso Weakens as US Sees Third Fed Funds Rate Hike in 2017**



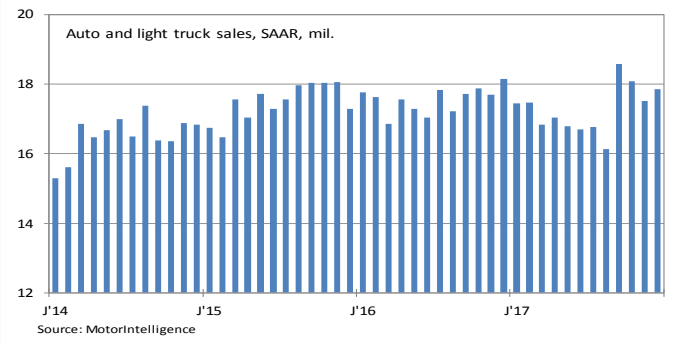
**Single-Family Starts Gain Momentum in Q4**



**Existing Home Sales Spike in November**



**Auto Sales Get a Post-Hurricane Bump**



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	2Q'17a	3Q'17a	4Q'17f	1Q'18f	2Q'18f	3Q'18f	4Q'18f	1Q'19f	2016a	2017f	2018f
<b>Output</b>											
Nominal GDP (Billions \$)	19250	19501	19740	19950	20206	20433	20666	20886	18624	19387	20314
<b>Percent Change Annualized</b>	<b>4.1</b>	<b>5.3</b>	<b>5.0</b>	<b>4.3</b>	<b>5.2</b>	<b>4.6</b>	<b>4.6</b>	<b>4.3</b>	<b>2.8</b>	<b>4.1</b>	<b>4.8</b>
Real GDP (Chained 2009 Billions \$)	17031	17164	17291	17394	17531	17640	17756	17860	16716	17097	17580
<b>Percent Change Annualized</b>	<b>3.1</b>	<b>3.2</b>	<b>3.0</b>	<b>2.4</b>	<b>3.2</b>	<b>2.5</b>	<b>2.6</b>	<b>2.4</b>	<b>1.5</b>	<b>2.3</b>	<b>2.8</b>
Pers. Consumption Expenditures	11853	11917	12038	12090	12169	12224	12293	12359	11572	11891	12194
<b>Percent Change Annualized</b>	<b>3.3</b>	<b>2.2</b>	<b>4.1</b>	<b>1.7</b>	<b>2.6</b>	<b>1.8</b>	<b>2.3</b>	<b>2.2</b>	<b>2.7</b>	<b>2.8</b>	<b>2.5</b>
Nonresidential Fixed Investment	2301	2327	2349	2381	2416	2449	2482	2512	2210	2310	2432
<b>Percent Change Annualized</b>	<b>6.7</b>	<b>4.7</b>	<b>3.8</b>	<b>5.6</b>	<b>5.9</b>	<b>5.7</b>	<b>5.4</b>	<b>4.9</b>	<b>-0.6</b>	<b>4.5</b>	<b>5.3</b>
Residential Investment	594	587	599	607	612	618	623	627	587	596	615
<b>Percent Change Annualized</b>	<b>-7.3</b>	<b>-4.7</b>	<b>8.6</b>	<b>5.1</b>	<b>3.7</b>	<b>3.7</b>	<b>3.5</b>	<b>2.7</b>	<b>5.5</b>	<b>1.5</b>	<b>3.1</b>
Change in Private Inventories	5	39	27	34	45	53	55	55	33	18	46
Net Exports	-614	-598	-621	-623	-622	-623	-626	-631	-586	-614	-624
Government Expenditures	2895	2900	2906	2913	2919	2927	2936	2945	2900	2900	2924
<b>Percent Change Annualized</b>	<b>-0.2</b>	<b>0.7</b>	<b>0.9</b>	<b>0.9</b>	<b>0.9</b>	<b>1.1</b>	<b>1.3</b>	<b>1.2</b>	<b>0.8</b>	<b>0.0</b>	<b>0.8</b>
Industrial Prod. Index (2007=100)	105.1	104.9	106.4	106.4	105.7	105.4	105.5	105.9	103.1	105.0	105.7
<b>Percent Change Annualized</b>	<b>5.6</b>	<b>-0.9</b>	<b>5.8</b>	<b>-0.1</b>	<b>-2.6</b>	<b>-1.2</b>	<b>0.7</b>	<b>1.2</b>	<b>-1.2</b>	<b>1.9</b>	<b>0.7</b>
Capacity Utilization (Percent)	76.6	76.2	77.1	77.2	76.8	76.5	76.5	76.5	75.7	76.4	76.7
<b>Prices</b>											
CPI (1982-84=100)	243.9	245.2	247.4	248.4	249.9	251.1	252.3	253.6	240.0	245.1	250.4
<b>Percent Change Annualized</b>	<b>-0.3</b>	<b>2.0</b>	<b>3.7</b>	<b>1.7</b>	<b>2.3</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>	<b>1.3</b>	<b>2.1</b>	<b>2.2</b>
PCE Price Index (2009=100)	112.3	112.7	113.5	113.9	114.5	115.0	115.6	116.2	110.8	112.7	114.8
<b>Percent Change Annualized</b>	<b>0.3</b>	<b>1.5</b>	<b>2.8</b>	<b>1.4</b>	<b>2.1</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>	<b>1.2</b>	<b>1.7</b>	<b>1.9</b>
GDP Price Index (2009=100)	113.0	113.6	114.2	114.7	115.3	115.9	116.5	117.0	111.4	113.4	115.6
<b>Percent Change Annualized</b>	<b>1.0</b>	<b>2.1</b>	<b>2.0</b>	<b>1.9</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>	<b>1.3</b>	<b>1.8</b>	<b>1.9</b>
Producer Price Index, Finished Goods	197.1	197.5	200.1	201.0	202.0	203.0	204.0	205.1	191.9	197.9	202.5
<b>Percent Change Annualized</b>	<b>0.6</b>	<b>0.7</b>	<b>5.5</b>	<b>1.7</b>	<b>2.1</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>	<b>-1.0</b>	<b>3.1</b>	<b>2.3</b>
Crude Oil, WTI (\$/barrel)	51.0	51.0	51.0	60.0	58.0	60.0	62.0	62.0	43.1	50.8	60.0
<b>Labor Markets</b>											
Payroll Jobs (Average Monthly Diff., Ths.)	161.4	159.2	174.3	146.9	149.8	140.9	139.0	132.7	194.3	169.2	144.2
Unemployment Rate (Percent)	4.3	4.3	4.1	4.1	4.0	3.9	3.9	3.9	4.9	4.3	4.0
Average Weekly Hours, Prod. Works.	33.7	33.6	33.8	33.7	33.7	33.6	33.6	33.6	33.6	33.7	33.7
Population (Millions)	325.7	326.4	327.0	327.7	328.3	329.0	329.7	330.3	323.7	326.0	328.7
<b>Percent Change Annualized</b>	<b>0.7</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>0.7</b>	<b>0.7</b>	<b>0.8</b>
<b>Personal Income</b>											
Average Hourly Earnings (\$)	21.99	22.15	22.24	22.39	22.55	22.72	22.88	23.06	21.56	22.06	22.64
<b>Percent Change Annualized</b>	<b>2.4</b>	<b>2.9</b>	<b>1.7</b>	<b>2.7</b>	<b>2.8</b>	<b>3.0</b>	<b>3.0</b>	<b>3.1</b>	<b>2.5</b>	<b>2.4</b>	<b>2.6</b>
Real Disp. Income (2009 Billions \$)	12765	12782	12833	12953	13035	13128	13228	13331	12608	12765	13086
<b>Percent Change Annualized</b>	<b>2.7</b>	<b>0.5</b>	<b>1.6</b>	<b>3.8</b>	<b>2.6</b>	<b>2.9</b>	<b>3.1</b>	<b>3.2</b>	<b>1.4</b>	<b>1.2</b>	<b>2.5</b>
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
<b>Housing</b>											
Housing Starts (Ths., Ann. Rate)	1167	1172	1249	1249	1256	1268	1275	1281	1177	1206	1262
Ext. SF Home Sales (Ths., Ann Rate)	4930	4783	4908	4939	4961	4992	5012	5025	4828	4904	4976
New SF Home Sales (Ths., Ann Rate)	605	586	634	631	636	642	646	649	561	611	639
Case/Shiller HPI (Jan. 2000=100)	189.9	192.6	196.5	199.5	202.4	205.3	208.2	211.1	181.1	191.8	203.8
<b>Year/Year Percent Change</b>	<b>5.8</b>	<b>6.0</b>	<b>6.2</b>	<b>6.1</b>	<b>6.6</b>	<b>6.6</b>	<b>6.0</b>	<b>5.8</b>	<b>5.1</b>	<b>5.9</b>	<b>6.3</b>
<b>Consumer</b>											
Household Economic Stress Index	0.5	0.3	0.1	-0.2	-0.2	-0.3	-0.1	0.1	1.0	0.6	-0.2
Auto Sales (Millions)	16.8	17.2	17.8	17.4	17.2	16.8	16.5	16.2	17.5	17.3	17.0
<b>Interest Rates (percent per year)</b>											
Federal Funds Rate (Effective)	0.95	1.15	1.20	1.42	1.67	1.91	2.13	2.17	0.40	1.00	1.78
Prime Rate	4.04	4.25	4.30	4.52	4.77	5.01	5.23	5.27	3.51	4.10	4.88
1-Month LIBOR	1.06	1.23	1.34	1.58	1.84	2.08	2.30	2.34	0.50	1.11	1.95
3-Month LIBOR	1.20	1.31	1.47	1.70	1.96	2.21	2.41	2.44	0.74	1.26	2.07
1-Yr. Treasury Rate	1.12	1.24	1.55	1.80	1.97	2.14	2.33	2.35	0.61	1.20	2.06
5-Yr. Treasury Rate	1.81	1.82	2.07	2.27	2.48	2.67	2.85	2.87	1.34	1.91	2.57
10-Yr. Treasury Rate	2.26	2.24	2.37	2.52	2.78	2.97	3.15	3.17	1.84	2.33	2.86
30-Year Fixed Rate Mortgage	3.99	3.88	3.92	3.93	4.08	4.22	4.36	4.36	3.65	3.99	4.15

a = actual f = forecast

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