

Adding Up the Economy, It Looks Like 2018Q1 GDP May Disappoint

In the March edition of the U.S. Economic Outlook, we talked about the strong start for 2018. We stand by that statement, as corroborated by several economic indicators that were strongly positive in early 2018. Among them are both the ISM Manufacturing and Non-manufacturing Indexes. If we take a quarterly average of these two series and add them together, the combined reading of 119.1 for the first quarter of 2018 was the highest combined reading for those two indexes since 2004Q1. Likewise, unemployment insurance claims have been historically low, and the February payroll gain of 326,000 net new jobs was the biggest gain since October 2015.

However, when we look at how 2018Q1 GDP is shaping up, some components are looking weaker than expected. We have revised down our 2018Q1 real GDP growth forecast to just a 1.6 percent annualized rate. This is about two full percentage points below where some forecasts were at the start of the first quarter. We will get the first estimate of 2018Q1 real GDP growth from the Bureau of Economic Analysis on the morning of April 27. Even if there is a weaker-than-expected first estimate of Q1 GDP, we believe that the U.S. economy is still strong and that will show up in better second and third quarter GDP numbers.

In order to understand how many economic indicators can be strong while GDP is not, it is useful to deconstruct GDP. GDP was designed to be a measure of the flow of production from the U.S. economy. There is no single observable flow of production that we can say is representative of GDP. Instead, GDP is the summation of several different flows within the economy, that can all behave differently at different times. Mathematically $GDP = C + I + G + X$. That is to say, GDP is the sum of consumer spending, investment, government spending and net exports.

Consumer spending is the largest component of GDP, and is divided into consumer spending on durable goods, nondurable goods and services. In our April forecast we show real consumer spending growing at a fairly weak 1.2 percent annualized rate, after a strong 4.0 percent growth rate in 2017Q4. The main culprit behind the surge and slow-down in consumer spending growth from 2017Q4 to 2018Q1 is auto sales, which show up in consumer spending for durable goods. In 2017Q4, we saw strong auto sales as a result of the damage wrought by Hurricanes Harvey and Wilma. In the first quarter of 2018, unit auto sales declined at a 12 percent annualized rate, normalizing to the pre-storm trend.

Investment is divided into business fixed investment (on buildings and machinery), business investment on inventories, and residential investment (on new houses and improvements to existing houses). Residential investment looks like it will be a weak link in 2018Q1. Three sets of housing-related data look like they will be soft in 2018Q1. In January and February, the value of new residential construction was flat. Single-family housing starts for January and February were flat. Also, single-family home sales for January and February were well below the November peak, pointing to a quarter-to-quarter decline.

Finally, net exports are expected to be a drag on real GDP growth in 2018Q1. Net exports equals the value of exports minus the value of imports. Imports have exceeded exports for the U.S. since 1981Q4, meaning that the U.S. has been running a trade deficit since then, which subtracts from GDP. For the first quarter of 2018, we estimate that imports grew faster than exports, due in part to the television coverage of the Winter Olympics. The roughly \$1 billion in television royalties paid to broadcast the games in the U.S. reduced 2018Q1 nominal GDP by a billion dollars.

U.S. Economic Outlook, Summary

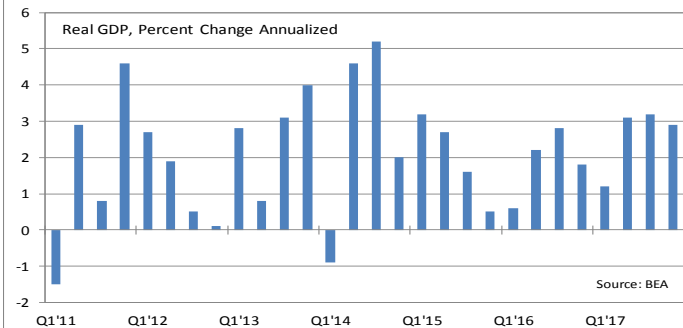
	3Q'17a	4Q'17a	1Q'18f	2Q'18f	3Q'18f	4Q'18f	1Q'19f	2Q'19f	2017a	2018f	2019f
Real GDP (Percent Change Annualized)	3.2	2.9	1.6	3.4	2.9	2.6	2.5	2.5	2.3	2.7	2.6
CPI (Percent Change Year-over-Year)	2.0	2.1	2.3	2.9	2.9	2.6	2.2	2.1	2.1	2.7	2.1
Payroll Jobs (Average Monthly Diff., Ths.)	184.3	185.4	205.4	182.6	172.6	166.5	159.4	155.8	181.4	181.8	151.8
Unemployment Rate (Percent)	4.3	4.1	4.1	3.9	3.9	3.8	3.7	3.7	4.3	3.9	3.7
Federal Funds Rate (Effective)	1.15	1.20	1.45	1.67	1.91	2.13	2.17	2.42	1.00	1.79	2.53
10-Yr. Treasury Rate	2.24	2.37	2.76	2.86	3.00	3.14	3.13	3.34	2.33	2.94	3.45

a = actual f = forecast

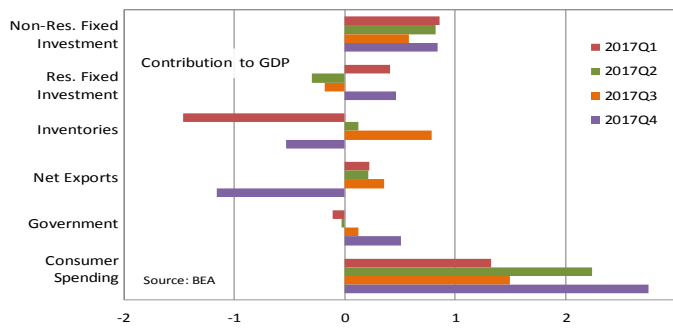
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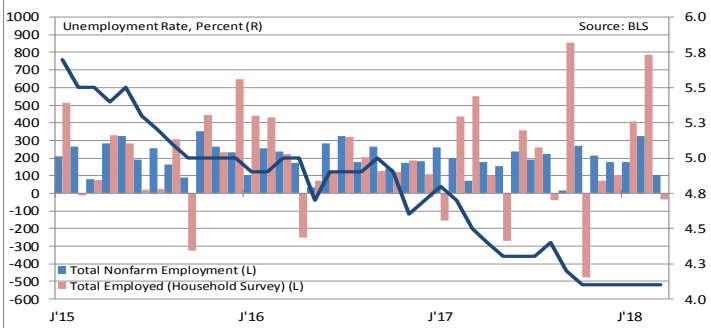
Q4 GDP 3rd Estimate at 2.9%



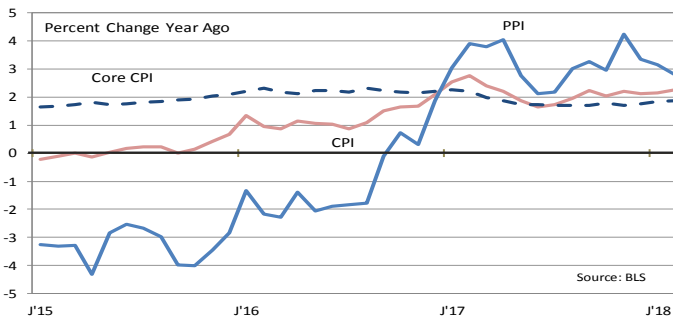
Q4 GDP Dragged by Imports and Inventories



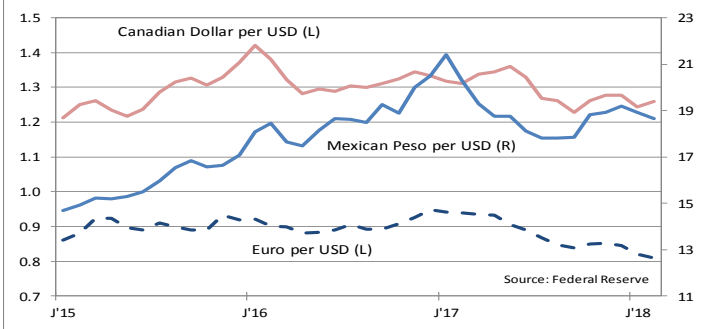
Feb. U. Rate at 4.1% for 6th Month



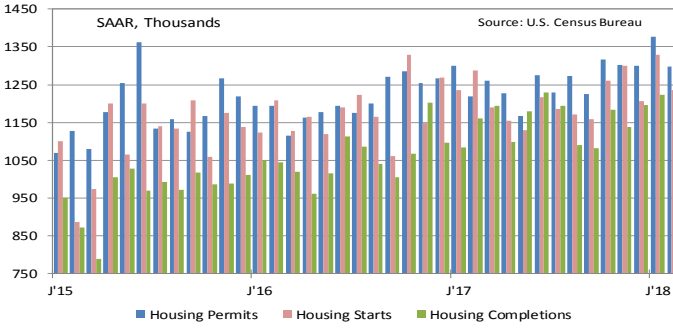
Core CPI Still Tame



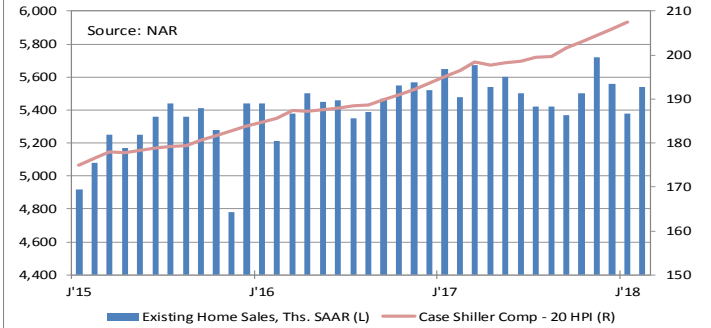
Mexican Peso Strengthened in Early 2018



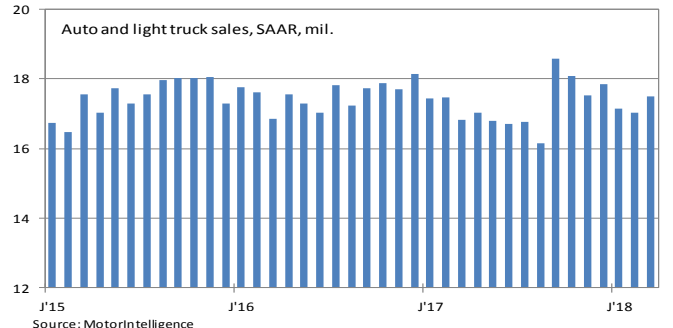
Housing Starts Eased in February



Home Prices Advance With Tight Supply



Q1 Auto Sales Lower



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	3Q'17a	4Q'17a	1Q'18f	2Q'18f	3Q'18f	4Q'18f	1Q'19f	2Q'19f	2017a	2018f	2019f
Output											
Nominal GDP (Billions \$)	19501	19754	19937	20200	20445	20679	20909	21141	19391	20315	21257
Percent Change Annualized	5.3	5.3	3.8	5.4	4.9	4.7	4.5	4.5	4.1	4.8	4.6
Real GDP (Chained 2009 Billions \$)	17164	17286	17357	17502	17629	17743	17854	17967	17096	17558	18019
Percent Change Annualized	3.2	2.9	1.6	3.4	2.9	2.6	2.5	2.5	2.3	2.7	2.6
Pers. Consumption Expenditures	11917	12035	12071	12150	12217	12282	12344	12412	11891	12180	12444
Percent Change Annualized	2.2	4.0	1.2	2.6	2.2	2.1	2.1	2.2	2.8	2.4	2.2
Nonresidential Fixed Investment	2327	2366	2409	2443	2476	2507	2538	2568	2314	2459	2582
Percent Change Annualized	4.7	6.8	7.5	5.8	5.5	5.2	4.9	4.8	4.7	6.2	5.0
Residential Investment	587	605	597	608	618	627	636	644	598	613	648
Percent Change Annualized	-4.7	12.8	-5.2	7.6	6.8	6.2	5.7	5.3	1.8	2.5	5.8
Change in Private Inventories	39	16	35	47	60	59	60	60	15	51	60
Net Exports	-598	-654	-677	-678	-683	-683	-684	-686	-622	-680	-689
Government Expenditures	2900	2922	2924	2934	2942	2952	2962	2971	2903	2938	2976
Percent Change Annualized	0.7	3.0	0.3	1.4	1.1	1.3	1.3	1.3	0.1	1.2	1.3
Industrial Prod. Index (2007=100)	104.8	106.9	108.2	108.6	108.9	109.2	109.6	110.0	105.1	108.7	110.2
Percent Change Annualized	-1.2	8.4	4.9	1.3	1.3	1.2	1.3	1.4	2.0	3.4	1.3
Capacity Utilization (Percent)	76.2	77.5	78.4	78.7	79.0	79.1	79.2	79.4	76.5	78.8	79.5
Prices											
CPI (1982-84=100)	245.3	247.3	249.6	251.1	252.5	253.9	255.1	256.4	245.1	251.8	257.0
Percent Change Annualized	2.1	3.3	3.7	2.5	2.2	2.1	2.1	2.0	2.1	2.7	2.1
PCE Price Index (2009=100)	112.7	113.5	114.3	115.0	115.6	116.1	116.7	117.3	112.7	115.2	117.6
Percent Change Annualized	1.5	2.7	3.1	2.3	2.0	2.0	2.0	2.1	1.7	2.3	2.0
GDP Price Index (2009=100)	113.6	114.3	114.9	115.5	116.0	116.6	117.2	117.8	113.4	115.7	118.1
Percent Change Annualized	2.1	2.3	2.1	2.0	2.0	2.0	2.0	2.0	1.8	2.0	2.0
Producer Price Index, Finished Goods	197.8	200.7	202.5	203.6	204.7	205.8	206.9	208.0	198.1	204.2	208.5
Percent Change Annualized	1.6	5.9	3.6	2.3	2.2	2.2	2.1	2.0	3.2	3.1	2.1
Crude Oil, WTI (\$/barrel)	48.1	55.4	62.9	63.0	63.0	63.0	63.0	64.0	50.8	63.0	64.3
Labor Markets											
Payroll Jobs (Average Monthly Diff., Ths.)	184.3	185.4	205.4	182.6	172.6	166.5	159.4	155.8	181.4	181.8	151.8
Unemployment Rate (Percent)	4.3	4.1	4.1	3.9	3.9	3.8	3.7	3.7	4.3	3.9	3.7
Average Weekly Hours, Prod. Works.	33.6	33.7	33.7	33.7	33.7	33.7	33.6	33.6	33.7	33.7	33.6
Population (Millions)	326.4	327.0	327.7	328.3	329.0	329.7	330.3	331.0	326.0	328.7	331.3
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 (\$)	22.12	22.24	22.38	22.52	22.69	22.85	23.02	23.19	22.05	22.61	23.27
Percent Change Annualized	2.6	2.1	2.5	2.6	2.9	2.9	3.0	2.9	2.3	2.5	2.9
Real Disp. Income (2009 Billions \$)	12787	12821	12887	12940	12993	13045	13102	13154	12763	12966	13183
Percent Change Annualized	0.7	1.1	2.1	1.6	1.7	1.6	1.7	1.6	1.2	1.6	1.7
Personal Saving Rate (Percent)	3.3	2.6	3.3	3.2	3.1	3.0	3.0	3.0	3.4	3.2	3.0
Housing											
Housing Starts (Ths., Ann. Rate)	1172	1256	1291	1302	1312	1320	1328	1335	1208	1306	1339
Ext. SF Home Sales (Ths., Ann Rate)	4793	4960	4872	4909	4943	4973	4998	5017	4910	4924	5024
New SF Home Sales (Ths., Ann Rate)	587	660	623	628	631	634	636	637	617	629	638
Case/Shiller HPI (Jan. 2000=100)	192.5	196.3	199.6	202.8	205.9	209.1	212.3	215.6	191.7	204.3	217.2
Year/Year Percent Change	5.9	6.2	6.2	6.8	7.0	6.5	6.4	6.3	5.9	6.6	6.3
Consumer											
Household Economic Stress Index	0.3	0.1	0.3	0.1	-0.2	-0.1	-0.4	-0.5	0.6	0.0	-0.5
Auto Sales (Millions)	17.2	17.8	17.2	17.1	16.8	16.4	16.4	16.2	17.3	16.9	16.2
Interest Rates (percent per year)											
Federal Funds Rate (Effective)	1.15	1.20	1.45	1.67	1.91	2.13	2.17	2.42	1.00	1.79	2.53
Prime Rate	4.25	4.30	4.53	4.77	5.01	5.23	5.27	5.52	4.10	4.89	5.63
1-Month LIBOR	1.23	1.34	1.65	1.94	2.17	2.34	2.34	2.59	1.11	2.02	2.71
3-Month LIBOR	1.31	1.47	1.93	2.34	2.45	2.57	2.57	2.81	1.26	2.32	2.92
1-Yr. Treasury Rate	1.24	1.55	1.94	2.09	2.22	2.38	2.38	2.60	1.20	2.16	2.70
5-Yr. Treasury Rate	1.82	2.07	2.54	2.66	2.79	2.93	2.92	3.13	1.91	2.73	3.24
10-Yr. Treasury Rate	2.24	2.37	2.76	2.86	3.00	3.14	3.13	3.34	2.33	2.94	3.45
30-Year Fixed Rate Mortgage	3.88	3.92	4.27	4.46	4.63	4.78	4.76	4.95	3.99	4.54	5.05

a = actual f = forecast

April 10, 2018

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