

## The Economy That We Do Not See

After a step down in real GDP growth in the first quarter of 2018, to 2.2 percent, we expect to see stronger real GDP growth in the second quarter, up to about 3.6 percent. The first estimate of Q2 GDP is due out on July 27. We look for stronger business investment in Q2, aided in part by federal tax reform. We assume that federal government spending will increase in line with the new budget agreement. After a stronger second quarter, we bring real GDP growth down, closer to 3.0 percent for the second half of the year, and then lower in 2019 and 2020. In making the case for cooler GDP growth later, it is important to note what we do not see when we look down the list of GDP components. We do not see a positive trend in U.S. auto sales. Auto sales in early 2018 are essentially in the same range that they occupied in all of 2016 and 2017. Flat to declining auto sales will be a weight on overall consumer spending. We do not see a robust trend in home sales and construction. Both sets of housing-related indicators have been flat since early 2017. Residential investment is clearly not an accelerator in this economy. We do not see a push from inventory accumulation. Inventory growth over the last two years has been below average and is contributing only modestly to GDP growth. Finally we do not see strong state and local government spending. State and local government spending is about 50 percent larger than federal government spending. Even if we see more spending on the federal ledger, overall government spending remains subdued.

May employment data was better than expected. The U.S. economy added a net 223,000 new jobs, with positive net revisions to the previous two months. The manufacturing sector continues to add jobs, posting an 18,000 job increase in May. The average workweek was unchanged at 34.5 hours. The U.S. unemployment rate ticked down to 3.8 percent in May, the lowest since April 2000. What we still do not see in the labor data is evidence of accelerating wage gains. Average hourly earnings were up 2.7 percent over the 12 months ending in May. This is about where the rate of change has been since early 2016.

There are good things that we do not see. We do not see an increase in credit-related stress that is often associated with the end of a business cycle. Both business bankruptcy and personal bankruptcy filings are still trending down. Charge-off rates for all commercial banks remain very low as a percentage of total loans. The household financial obligations ratio, as a share of total disposable income, remains very low.

We expect to see another 25 basis point fed funds rate hike at the upcoming Federal Open Market Committee meeting over June 12/13. This will put the fed funds rate in the range of 1.75-2.00 percent. The Fed may choose to raise the interest rate on excess reserves by only 20 percent (instead of moving it up 25 basis points in lock-step with the target fed funds rate range). This will allow the Fed to better manage the fed funds rate in the middle of the target range. In addition to a fed funds rate hike on June 13, we will also see a new set of economic projections and a new “dot plot” from the Fed, showing FOMC members’ expectations about the economy and about appropriate interest rate policy.

We have been moving toward making the call for a fourth fed funds rate hike this year in December, after the third rate hike in September. However, economic uncertainty has increased in the last two weeks. International trade issues have become more contentious. Downside risks for European economic and political outcomes have increased. The price of oil dropped swiftly in late May. Until June 13, we will go with a 45 percent subjective probability for a December 19 fed funds rate hike.

### U.S. Economic Outlook, Summary

	4Q'17a	1Q'18a	2Q'18f	3Q'18f	4Q'18f	1Q'19f	2Q'19f	3Q'19f	2017a	2018f	2019f
Real GDP (Percent Change Annualized)	2.9	2.2	3.6	2.8	2.8	2.5	2.5	2.5	2.3	2.9	2.6
CPI (Percent Change Year-over-Year)	2.1	2.3	3.0	3.2	3.1	2.8	2.5	2.2	2.1	2.9	2.4
Payroll Jobs (Average Monthly Diff., Ths.)	185.4	210.8	194.7	176.2	165.7	149.3	146.0	139.9	181.4	186.8	142.7
Unemployment Rate (Percent)	4.1	4.1	3.9	3.8	3.8	3.7	3.7	3.7	4.3	3.9	3.7
Federal Funds Rate (Effective)	1.20	1.45	1.71	1.91	2.13	2.17	2.42	2.66	1.00	1.80	2.53
10-Yr. Treasury Rate	2.37	2.76	2.93	3.05	3.18	3.16	3.37	3.59	2.33	2.98	3.48

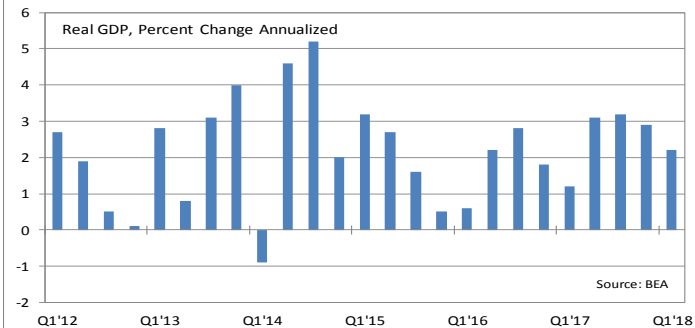
a = actual f = forecast

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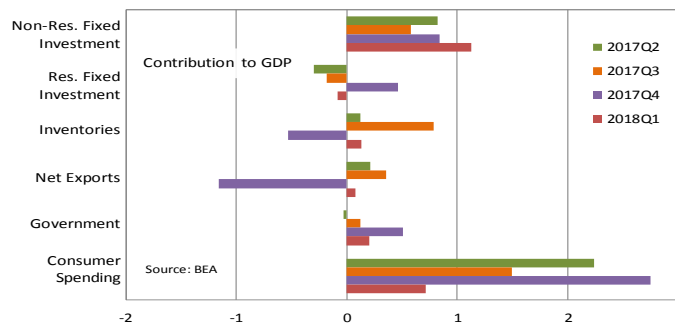
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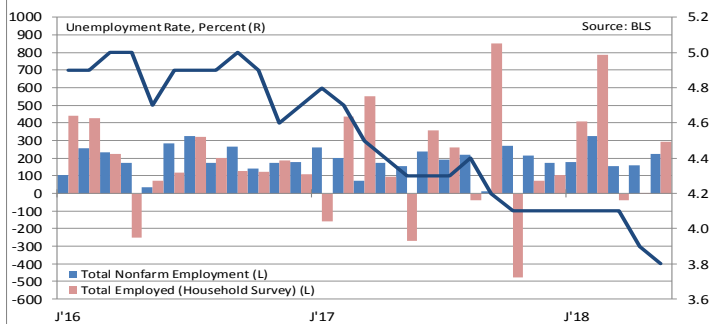
### Q1 GDP 2nd Estimate at 2.2%



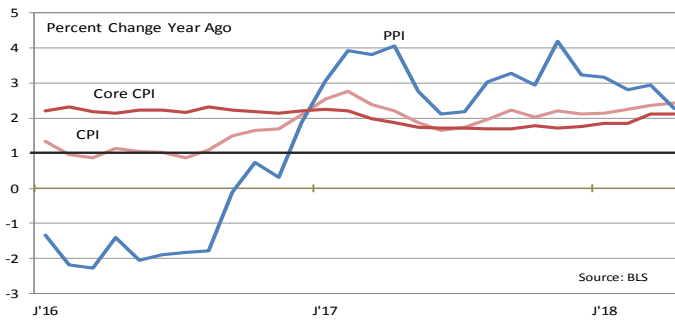
### Auto Sales Dragged Q1 Consumer Spending



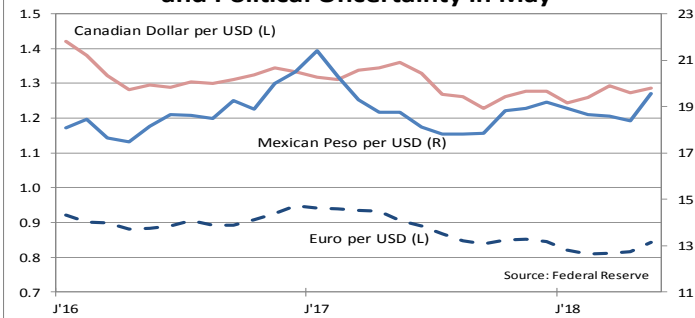
### U.S. Adds a Net 223,000 Jobs in May



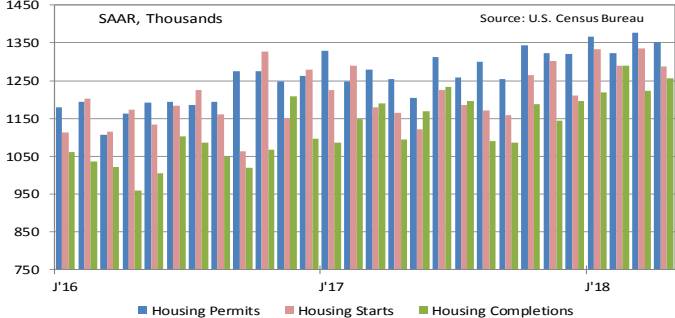
### Consumer Inflation has Warmed Up



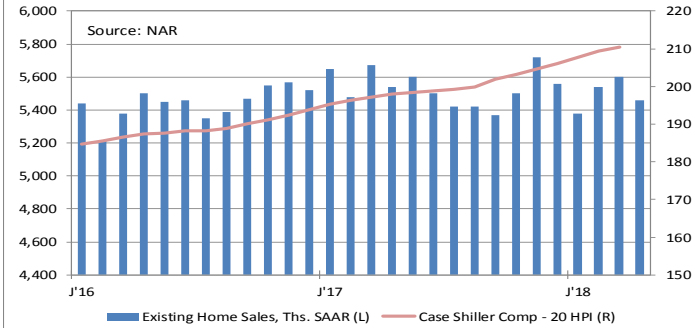
### US Dollar Strengthens on Global Economic and Political Uncertainty in May



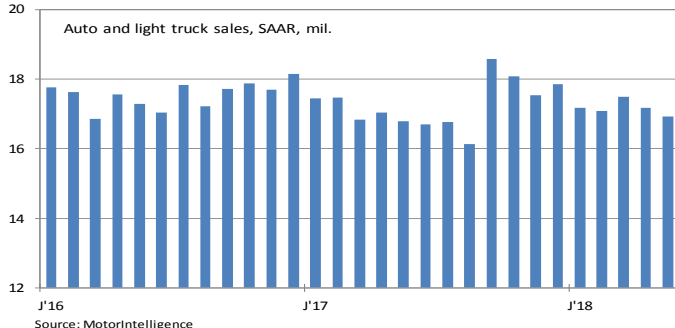
### Multifamily Drags on April Construction Data



### Existing Home Sales Remain Range-Bound



### Auto Sales Slow Again in May



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	4Q'17a	1Q'18a	2Q'18f	3Q'18f	4Q'18f	1Q'19f	2Q'19f	3Q'19f	2017a	2018f	2019f
<b>Output</b>											
Nominal GDP (Billions \$)	19754	19957	20229	20462	20702	20933	21165	21401	19391	20337	21282
<b>Percent Change Annualized</b>	<b>5.3</b>	<b>4.2</b>	<b>5.6</b>	<b>4.7</b>	<b>4.8</b>	<b>4.5</b>	<b>4.5</b>	<b>4.5</b>	<b>4.1</b>	<b>4.9</b>	<b>4.6</b>
Real GDP (Chained 2009 Billions \$)	17286	17380	17532	17652	17776	17885	17994	18104	17096	17585	18047
<b>Percent Change Annualized</b>	<b>2.9</b>	<b>2.2</b>	<b>3.6</b>	<b>2.8</b>	<b>2.8</b>	<b>2.5</b>	<b>2.5</b>	<b>2.5</b>	<b>2.3</b>	<b>2.9</b>	<b>2.6</b>
Pers. Consumption Expenditures	12035	12066	12143	12206	12275	12343	12410	12477	11891	12172	12443
<b>Percent Change Annualized</b>	<b>4.0</b>	<b>1.0</b>	<b>2.6</b>	<b>2.1</b>	<b>2.3</b>	<b>2.2</b>	<b>2.2</b>	<b>2.2</b>	<b>2.8</b>	<b>2.4</b>	<b>2.2</b>
Nonresidential Fixed Investment	2366	2418	2467	2504	2539	2568	2594	2618	2314	2482	2605
<b>Percent Change Annualized</b>	<b>6.8</b>	<b>9.2</b>	<b>8.3</b>	<b>6.3</b>	<b>5.6</b>	<b>4.7</b>	<b>4.0</b>	<b>3.8</b>	<b>4.7</b>	<b>7.3</b>	<b>5.0</b>
Residential Investment	605	602	606	612	619	625	629	633	598	609	631
<b>Percent Change Annualized</b>	<b>12.8</b>	<b>-2.0</b>	<b>2.5</b>	<b>4.2</b>	<b>4.5</b>	<b>3.9</b>	<b>3.0</b>	<b>2.7</b>	<b>1.8</b>	<b>1.9</b>	<b>3.6</b>
Change in Private Inventories	16	20	25	30	40	39	40	41	15	29	40
Net Exports	-654	-651	-641	-643	-647	-650	-649	-647	-622	-646	-647
Government Expenditures	2922	2930	2939	2947	2956	2965	2975	2986	2903	2943	2981
<b>Percent Change Annualized</b>	<b>3.0</b>	<b>1.1</b>	<b>1.3</b>	<b>1.1</b>	<b>1.2</b>	<b>1.3</b>	<b>1.4</b>	<b>1.4</b>	<b>0.1</b>	<b>1.4</b>	<b>1.3</b>
Industrial Prod. Index (2007=100)	105.3	105.9	106.7	107.4	107.9	108.2	108.3	108.2	103.7	107.0	108.2
<b>Percent Change Annualized</b>	<b>7.7</b>	<b>2.3</b>	<b>3.2</b>	<b>2.7</b>	<b>2.0</b>	<b>1.0</b>	<b>0.3</b>	<b>-0.1</b>	<b>1.6</b>	<b>3.2</b>	<b>1.2</b>
Capacity Utilization (Percent)	77.0	77.2	77.6	78.1	78.4	78.5	78.5	78.5	76.1	77.8	78.5
<b>Prices</b>											
CPI (1982-84=100)	247.3	249.4	251.4	253.2	254.9	256.4	257.6	258.9	245.1	252.2	258.3
<b>Percent Change Annualized</b>	<b>3.3</b>	<b>3.5</b>	<b>3.2</b>	<b>2.9</b>	<b>2.7</b>	<b>2.3</b>	<b>2.0</b>	<b>2.0</b>	<b>2.1</b>	<b>2.9</b>	<b>2.4</b>
PCE Price Index (2009=100)	113.5	114.2	115.0	115.8	116.6	117.3	118.0	118.5	112.7	115.4	118.2
<b>Percent Change Annualized</b>	<b>2.7</b>	<b>2.6</b>	<b>3.0</b>	<b>2.9</b>	<b>2.8</b>	<b>2.4</b>	<b>2.1</b>	<b>2.0</b>	<b>1.7</b>	<b>2.5</b>	<b>2.4</b>
GDP Price Index (2009=100)	114.3	114.8	115.4	116.0	116.5	117.1	117.7	118.3	113.4	115.7	118.0
<b>Percent Change Annualized</b>	<b>2.3</b>	<b>1.9</b>	<b>2.0</b>	<b>1.9</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>	<b>2.1</b>	<b>1.8</b>	<b>2.0</b>	<b>2.0</b>
Producer Price Index, Finished Goods	200.6	202.4	204.1	205.4	206.4	207.5	208.5	209.5	198.0	204.6	209.0
<b>Percent Change Annualized</b>	<b>5.7</b>	<b>3.7</b>	<b>3.3</b>	<b>2.6</b>	<b>2.1</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>	<b>3.2</b>	<b>3.3</b>	<b>2.2</b>
Crude Oil, WTI (\$/barrel)	55.4	62.9	68.0	72.0	75.0	75.0	75.0	75.0	50.8	69.5	75.0
<b>Labor Markets</b>											
Payroll Jobs (Average Monthly Diff., Ths.)	185.4	210.8	194.7	176.2	165.7	149.3	146.0	139.9	181.4	186.8	142.7
Unemployment Rate (Percent)	4.1	4.1	3.9	3.8	3.8	3.7	3.7	3.7	4.3	3.9	3.7
Average Weekly Hours, Prod. Works.	33.7	33.7	33.7	33.7	33.7	33.7	33.7	33.6	33.7	33.7	33.6
Population (Millions)	327.0	327.7	328.3	329.0	329.7	330.3	331.0	331.6	326.0	328.7	331.3
<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>0.7</b>	<b>0.8</b>	<b>0.8</b>
<b>Personal Income</b>											
Average Hourly Earnings (\$)	22.24	22.40	22.55	22.72	22.89	23.06	23.24	23.41	22.05	22.64	23.33
<b>Percent Change Annualized</b>	<b>2.1</b>	<b>2.8</b>	<b>2.8</b>	<b>3.0</b>	<b>3.0</b>	<b>3.1</b>	<b>3.0</b>	<b>3.1</b>	<b>2.3</b>	<b>2.7</b>	<b>3.0</b>
Real Disp. Income (2009 Billions \$)	12827	12930	12984	13037	13093	13162	13235	13312	12765	13011	13274
<b>Percent Change Annualized</b>	<b>1.2</b>	<b>3.3</b>	<b>1.7</b>	<b>1.7</b>	<b>1.7</b>	<b>2.1</b>	<b>2.2</b>	<b>2.3</b>	<b>1.2</b>	<b>1.9</b>	<b>2.0</b>
Personal Saving Rate (Percent)	2.6	3.1	2.9	3.0	3.0	3.0	3.0	3.0	3.4	3.0	3.0
<b>Housing</b>											
Housing Starts (Ths., Ann. Rate)	1259	1320	1313	1314	1319	1323	1325	1326	1208	1317	1325
Ext. SF Home Sales (Ths., Ann Rate)	4960	4903	4894	4900	4915	4911	4910	4910	4910	4903	4910
New SF Home Sales (Ths., Ann Rate)	655	655	672	673	675	676	677	677	616	669	677
Case/Shiller HPI (Jan. 2000=100)	196.3	199.9	202.5	205.2	207.7	210.2	212.8	215.3	191.6	203.8	214.0
<b>Year/Year Percent Change</b>	<b>6.1</b>	<b>6.4</b>	<b>6.7</b>	<b>6.6</b>	<b>5.8</b>	<b>5.1</b>	<b>5.0</b>	<b>4.9</b>	<b>5.8</b>	<b>6.4</b>	<b>5.0</b>
<b>Consumer</b>											
Household Economic Stress Index	0.1	-0.1	0.2	0.5	1.1	1.3	1.1	1.0	0.6	0.4	1.1
Auto Sales (Millions)	17.8	17.2	17.0	16.8	16.6	16.5	16.3	16.0	17.3	16.9	16.2
<b>Interest Rates (percent per year)</b>											
Federal Funds Rate (Effective)	1.20	1.45	1.71	1.91	2.13	2.17	2.42	2.66	1.00	1.80	2.53
Prime Rate	4.30	4.53	4.78	5.01	5.23	5.27	5.52	5.76	4.10	4.89	5.63
1-Month LIBOR	1.34	1.65	1.95	2.12	2.30	2.34	2.59	2.83	1.11	2.01	2.70
3-Month LIBOR	1.47	1.93	2.33	2.40	2.52	2.50	2.72	2.95	1.26	2.29	2.83
1-Yr. Treasury Rate	1.55	1.94	2.24	2.37	2.48	2.44	2.64	2.85	1.20	2.26	2.74
5-Yr. Treasury Rate	2.07	2.54	2.77	2.89	3.02	3.00	3.21	3.43	1.91	2.80	3.32
10-Yr. Treasury Rate	2.37	2.76	2.93	3.05	3.18	3.16	3.37	3.59	2.33	2.98	3.48
30-Year Fixed Rate Mortgage	3.92	4.27	4.54	4.71	4.88	4.86	5.06	5.26	3.99	4.60	5.16

a = actual f = forecast

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