SOLID GDP GROWTH IN 3Q
The U.S. economy advanced at a 3.5% rate in 3Q18 – down a bit from the robust 4.2% recorded in 2Q but impressive nonetheless. The quarter featured solid growth in personal consumption expenditures, capex, and government spending, as well as inventory building. Looking ahead, we expect positive trends in several segments to keep the economy on a solid, though somewhat slower, growth path for the next 3-4 quarters.

Recent Results
Personal Consumption Expenditure growth in 3Q was 4.0%, up slightly from 3.8% in the prior quarter. Drilling deeper, we note that spending on Durable Goods increased a healthy 6.9% and spending on Services rose 3.2%.

Capital investment increased, boosted by a 7.9% increase in spending on intellectual property. Exports declined, as we had expected; in 2Q, export spending spiked ahead of the implementation of tariffs. Elsewhere, Housing declined 4% (the fifth negative reading for this segment of the economy in the past six quarters). And Government spending rose 3.3% — the highest government growth rate in at least four years.

Pricing pressures eased a bit; excluding food and energy, the price index for Personal Consumer Expenditures rose 1.6%, down from 2.0% in 2Q.

The Argus Outlook
Since the current economic expansion began in the fourth quarter of 2009, the economy has grown for 36 quarters in a row. In the post-World War II era, the U.S. has experienced 10 periods of economic growth; these expansions have averaged 20 quarters, or five years. The longest expansion was 39 quarters; the shortest was five. Recently, expansions have been more durable. The six expansions since 1960 have averaged 27 months. Based on the historical record, the current expansion could certainly continue for a few more quarters without breaking longevity records. And as we have frequently said, expansions don’t die of old age, but rather from problems that emerge as they evolve.

Looking ahead into 4Q18 and 2019, we currently forecast continued growth, as we think the positives in the economy will outweigh the negatives. For all of 2018, we expect overall growth to average in the 3.2% range, up from an average of 2.5% in 2017 and 1.9% in 2016. At a 3.2% pace, we would anticipate a total of four Federal Reserve rate hikes this year (three are already in the books). Given higher rates, we think that economic growth in 2019 will cool to a 2.4% rate. These forecasts are based on our assumptions for macroeconomic factors such as the employment environment, commodity prices, the dollar and interest rates, as well as on our assumptions about fiscal policy.

Our estimates are essentially in line with the Federal Reserve’s recently published economic projections for 2018-2020. The Fed forecasts that the central tendencies for economic growth by year are:
* 2018: 3.1%, with a range of 2.9-3.2%.
* 2019: 2.5%, with a range of 2.1-2.8%.
* 2020: 2.0%, with a range of 1.7-2.4%.

The Fed’s longer-run GDP forecast for the U.S. economy is 1.8%.

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Risk of Recession
We note that neither our current estimates nor the Fed’s forecasts call for a recession in the U.S. through 2019. We believe that key forward-looking indicators — jobless claims, housing starts, the yield curve, and new orders from purchasing managers — are positive enough to keep the economy on a growth track over the next few quarters, despite the unpredictable impact of the stock market – which has entered a correction phase — weather events, and other noneconomic shocks such as geopolitical threats.

Our interest rate forecasts now call for the Fed to hike rates once more in 2018 and then twice in 2019. We expect longer-term rates to rise modestly as the Fed reduces its balance sheet, which is bloated from the days of quantitative easing. Our preliminary forecast for the 10-year yield in 4Q18 calls for a range of 2.75%-3.75%. The Federal Reserve is in a bit of a tight spot: seeking to raise rates in order to rebuild its recession-fighting tool chest, but not wanting to raise short-term rates so high that the yield curve inverts.

Other risks to growth include volatile oil and commodity prices that could spike higher on geopolitical developments; a weaker-than-expected recovery in China; additional economic trouble in Italy and elsewhere in Europe; a dollar that continues to rise and limits export growth; an unexpected sharp stumble in the housing market, which has weakened in recent months; a bear market in stocks; or deflationary conditions, such as Venezuela is currently facing.

We also think it is important to point out that the Federal Reserve currently forecasts its next rate cut in 2021.

Q: Why does the Fed cut rates?
A: To stimulate an economy in recession.

So as 2020-2021 approaches, we may start calling for a conclusion to the current economic expansion. (John Eade, President, Argus Research)
Purchasing Managers data confirms strong manufacturing growth. ISM Manufacturing dipped 1.5 points in September, but at 59.8 it remains near its cycle high.

Fiscal policy measures of the Trump administration have contributed to a sharp rise in orders for Durable and Capital goods. And while both interest rates and the dollar have moved up in the past year, and concerns about tariffs and trade have risen, the uptrend in orders remains strong.

Small business sentiment has hit an historic high. Small Business Optimism was up 0.9 points in August to 108.8, surpassing the all-time high of 107.7 made in 3Q83. This year, the index is up 3.9 points, despite concerns about interest rates, trade and a rising U.S. dollar.

Industrial commodities are known to trade against the trend of the U.S. dollar, largely because most global materials are priced in USD. However, other types of stimulus, such as easy money, low interest rates and fiscal stimulus, may significantly alter the USD counter-trends.