STEUBEN TRUST COMPANY

ONE STEUBEN SQUARE • HORNELL, N Y 14843
WWW.STEUBENTRUST.COM • TELEPHONE (800) 588-5010

V I E W P O I N T

THE ECONOMY

December / 2018
Vol. 85, No. 173

3Q GDP GROWTH RATE STEADY AT 3.5%

The Commerce Department left its estimate of the 3Q18 GDP growth rate at 3.5%. The results portray a U.S. economy that is in excellent shape; the long-term growth forecast for GDP is 2.0%. But we don't anticipate that the current rate of growth is sustainable, given the upward trajectory of interest rates, global economic turmoil and the potential for reduced exports in the wake of tariffs.

As we typically do for the second estimate, let's take a closer look at the key contributing sectors to GDP.

* First, the Consumer. During 3Q, Personal Consumption Expenditures grew at a healthy 3.6% pace, just above the rate of overall growth and contributed 60.8% of core demand (which we define as Personal Consumption Expenditures, Information Technology and Intellectual Property spending, Housing, Exports and Government Expenditures). This is in line with the 10-year average of 60.7%, as the Consumer continues to drive the U.S. economy. Drilling deeper, we note a pick-up in spending on services. For the past two quarters, spending on services has increased at a 3% pace — twice as fast as the average over the previous four quarters.

* Spending on Equipment (generally Cap ex, including Information Technology) and Intellectual Property advanced at a faster rate in the quarter (up 4% on average) and accounted for 9.4% of core demand versus the historical average of 8.4%. Looking ahead, we expect that low interest rates and technological innovations will continue to support solid cap-ex spending, though growth may slow if oil prices fall below $50 per barrel.

* Housing has struggled in recent quarters. In 3Q, residential investment declined 2.6%. That's the fifth decline in the past six quarters. The housing market has recovered from the collapse of 2008-2009 (somewhat slowly, at least compared to the auto market) and does not appear to be in bubble territory. But the Federal Reserve's campaign to raise interest rates is having a clear and negative impact on the sector.

* Exports declined in 3Q, as we had expected. Export spending spiked 9% in 2Q as exporters filled pipelines and inventory shelves ahead of expected tariffs. That led to a 4.4% drop in 3Q. Looking ahead, we continue to anticipate a slowdown in export growth in the next few quarters.

* Government spending remains weak on an historical basis but has strengthened somewhat over recent quarters. Typically, government spending accounts for 17.0% of total demand; however, in 3Q18, the share was only 15.4%. We note, though, that the trend in government spending generally has been toward improvement over the past two years, as the government's balance sheet has improved.

Looking ahead, our forecasts for GDP growth call for economic expansion in the 2.0%-3.0% range through 2019. On average, we are modeling 2.5% growth for the next 3-4 quarters, reflecting strength in the consumer sector and capex, offset by slowdowns in the housing market and exports. A stable dollar and historically low interest rates could also be positive factors for economic growth.

Risks of Recession

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, which have averaged 20 quarters, or five years. The longest expansion was 39 months; the shortest was five.

(continued on next page)

Recently, expansions have been more durable. The six expansions since 1960 have averaged 27 quarters. But they all end at some point, and it is reasonable to believe that the current expansion is closer to an end than it is to the beginning.

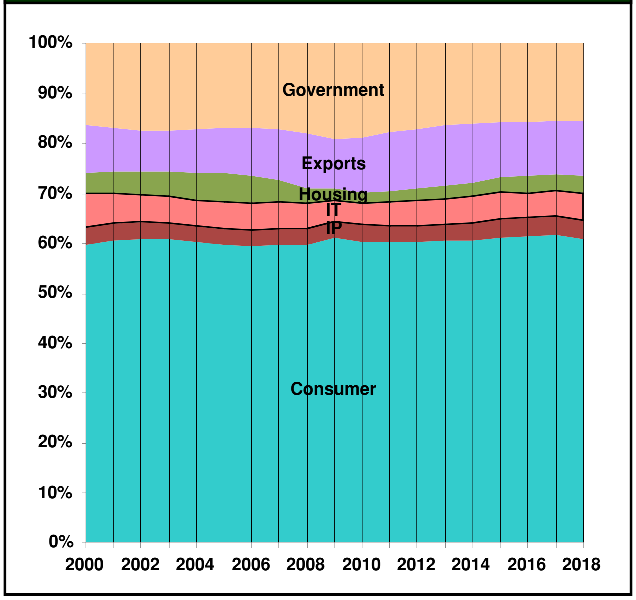
That said, we note that neither our current estimates nor the Fed's forecasts call for a recession in the U.S. through 2020. We believe that key forward-looking indicators — jobless claims, housing starts, new orders from Purchasing Managers, the stock market and the slope of the yield curve — are positive enough to keep the economy on a growth track, despite the unpredictable impacts of stock-price swings, global events, weather and other non-economic shocks.

Other risks to growth include volatile oil prices; a weaker-than-expected recovery in China; additional economic trouble in Europe related to Brexit or government finance problems; a dollar that continues to rise and limits export growth; a steep stumble in the housing market or in consumer confidence; or inflationary conditions, which cooled off a bit in the latest GDP report.

We note, though, that our growth forecasts into 2020 call for GDP expansion in the 1%-2% range, versus the current rate of growth in the 3%-4% range. Investors should be ready to expect heightened market volatility as the economy cools off.

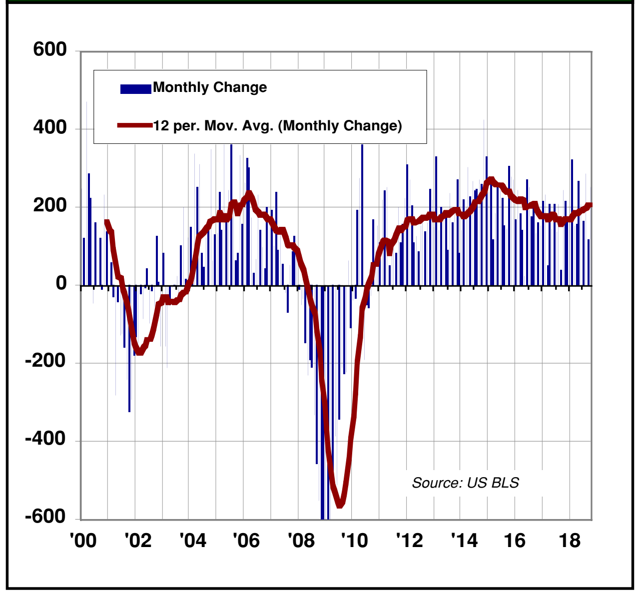
John Eade, President,
Argus Research

GDP CONTRIBUTORS



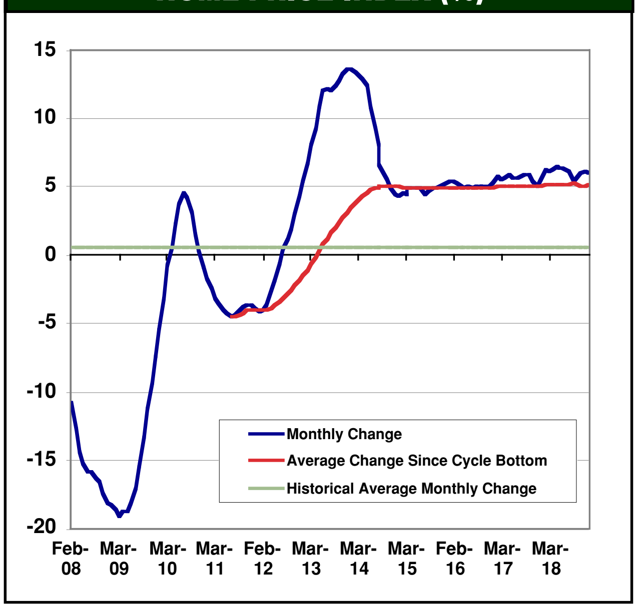
The Consumer and Cap-Ex sectors continue to drive the U.S. economy. In the latest quarter, exports and housing weakened somewhat.

NONFARM PAYROLLS (THOUSANDS OF JOBS)



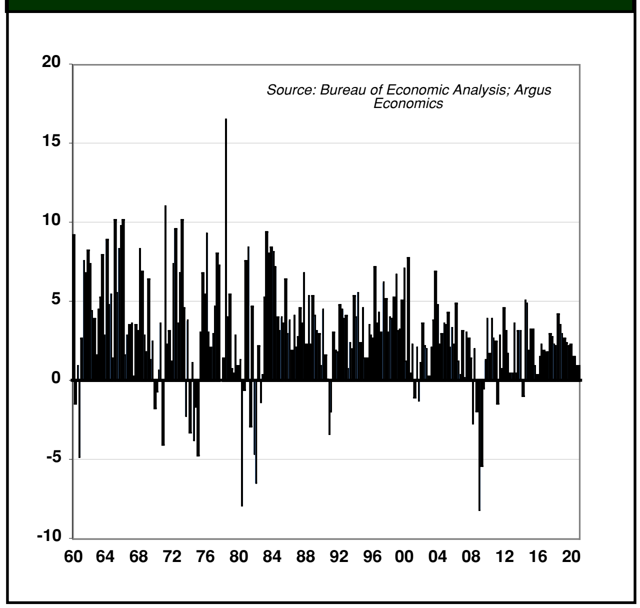
Consistently strong monthly Nonfarm Payrolls reports have buoyed consumer spending in recent quarters. The outlook for employment remains bullish.

S&P CASE/SHILLER NATIONAL HOME PRICE INDEX (%)



The housing market has been cooling off in recent quarters. Though prices have been rising, housing sales and starts have been slowing. Inventory is building.

GDP TRENDS & OUTLOOK (% CHANGE)



Our forecasts for GDP growth calls for economic expansion in the 2.0%-3.0% range through 2019. On average, we are modeling 2.5% growth for the next 3-4 quarters, reflecting strength in the consumer sector and capex, offset by slowdowns in the housing market and exports. A stable dollar and low interest rates could also be positive factors.