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VIEWPOINT

# THE ECONOMY

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## GDP GROWTH SLOWS A BIT IN 1Q

The U.S. Department of Commerce announced that its first estimate for 1Q18 GDP growth was 2.3%. This was a slight drop from the 2.9% rate recorded in 4Q17, but above consensus estimates that had fallen in response to the expected impact of the dismal winter weather. Below the surface, we note several areas of strength — and we expect to see a pick-up in growth later this year.

### Recent Results

As we expected, consumer-spending growth weakened during the quarter, led by a pullback in spending on durable goods. Personal Consumption Expenditure growth in 1Q was 1.1%, down from 4.0% in the prior quarter. Drilling deeper, spending on Durable Goods declined 3.3% — expected, as durable goods spending had soared on average 9% in the previous three quarters. Spending on Consumer Services rose a solid 2.1%.

Capital spending strengthened, with investments into Equipment increasing 4.7% and investments into Intellectual Property increasing 3.6%. Exports, benefiting from a lower dollar, advanced at a 4.8% pace. Elsewhere, Housing was flat, Government spending climbed 1.2% and Inventories rose. Offsetting growth, Imports were higher.

Pricing pressures picked up a bit; ex food and energy, the price index for GDP rose 2.5%, up from 1.9% in 4Q. The Federal Reserve is no doubt paying close attention.

### The Look Ahead

Since the current economic expansion began in the fourth quarter of 2009, the economy has grown for 34 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 several more quarters without breaking longevity records. As we have frequently said, expansions don't die of old age, but rather from problems that emerge as they evolve.

Looking ahead into 2018-19, we are forecasting continued growth, as we think the positives in the economy can outweigh the negatives. For the year 2018, we think overall growth will average in the 2.9% range, up from the 2.6% average in 2017 and the 2.0% average in 2016. At the 2.9% pace of growth, we anticipate a total of three Fed rate hikes this year (one is already in the books). Given higher rates, we think 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 assumptions about fiscal policy.

Our estimates are slightly higher than or 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: 2.7%, with a range of 2.6*-3.0%;
* 2019: 2.4%, with a range of 2.2%-2.6%;
* 2020: 2.0%, with a range of 1.8%-2.1%.

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

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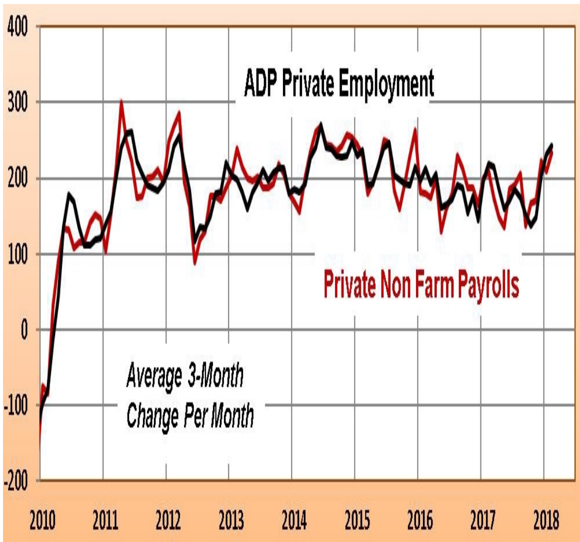
**TABLE 1**

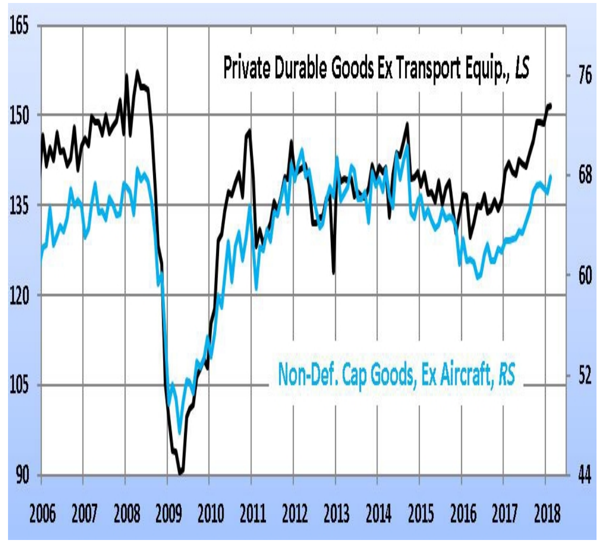
## JOB GROWTH




Jobs growth softened in the fall, but has picked up sharply since October. We think anticipation and passage of tax reform was key to the turnaround in both jobs and business investment. This is a key driver behind the all-important Consumer sector.

**TABLE 2**

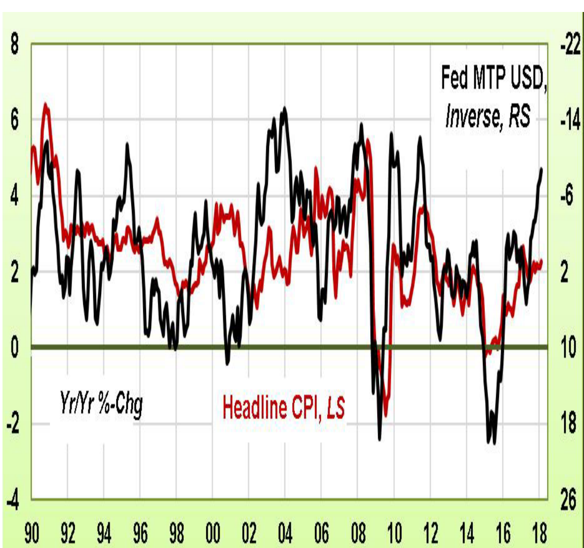
## NON-DEFENSE ORDERS




Non-Defense orders for durable and capital goods have made a strong recovery in the past 15 to 18 months, along with oil prices.

**TABLE 3**

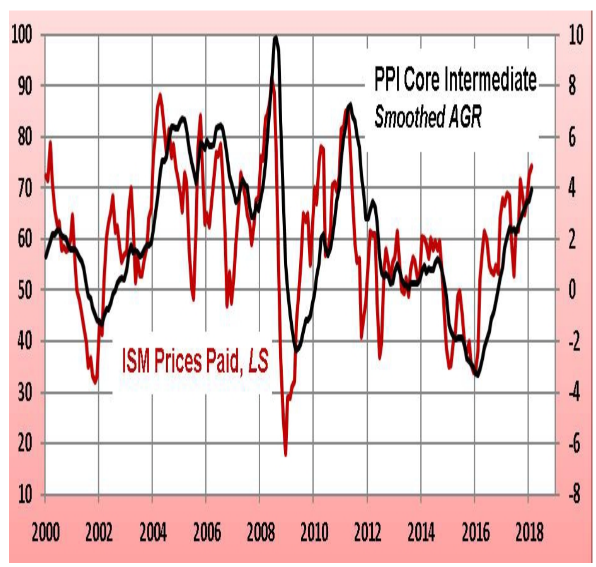
## INFLATION FOLLOWS THE US DOLLAR




After four major swings since 2008, the 10% drop in the Fed USD since 2016 represents a major easing in monetary policy and corresponds with export growth, as well as an increase in the CPI from 0% in 2015 to 2.3% in February 2018.

**TABLE 4**

## INFLATION IN THE PIPELINE




Higher inflation is in the pipeline. The falling U.S. dollar already is lifting ISM Prices Paid and Intermediate PPI. We expect the Fed to raise rates 4-to-5 times through 2019.

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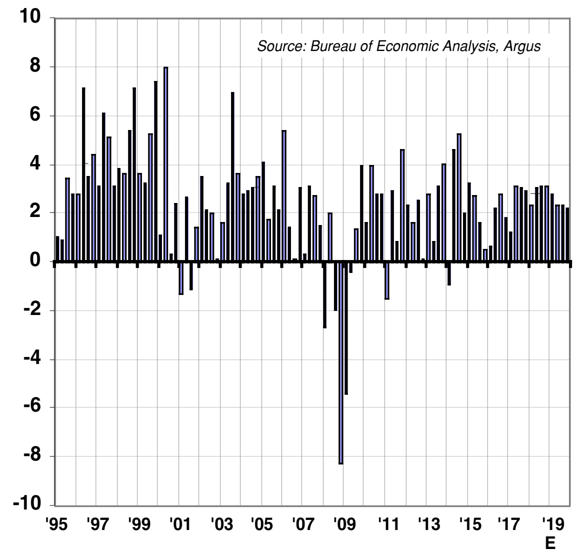
## Risk of Recession

We note that neither our current estimates nor the Fed's forecasts call for a recession in the U.S. through 2020. 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, despite the unpredictable impacts of the stock market, weather events, and other non-economic shocks such as geopolitical threats.

Our interest-rate forecasts now call for the Fed hike interest rates two more times in 2018 and then two-to-three times in 2019. We expect longer-term rates to rise modestly as the Federal Reserve 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%. Thus, within the year, the yield curve could continue to flatten — implying slower growth in 2019. By 2020, we look for the Federal Reserve to have lifted the fed funds rate to 3.0% and to have strengthened its balance sheet (assets on the balance sheet currently total $4.39 trillion, down from the peak of $4.5 trillion in 2015), moving into position to address any future economic slowdowns or crises. (John Eade, President, Argus Research)

TABLE 5

**REAL GDP (% GROWTH/QTR & SMOOTHED 4 QTRS)**




The U.S. economy advanced at a 2.3% rate in 1Q, down slightly from the previous three quarters but still a good showing, particularly considering the inclement winter weather. We see better growth ahead in 2018.