U.S. Economy: No crying at this party!

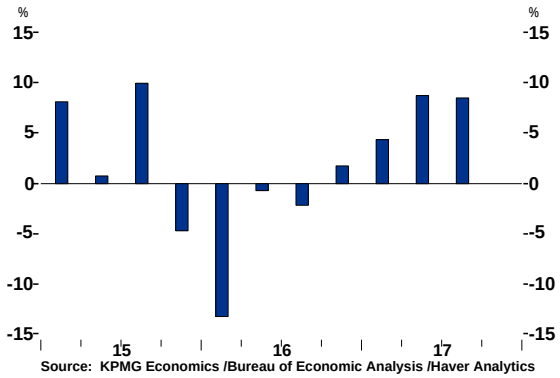
Office of the Chief Economist

October 30, 2017

GDP	Core CPI[1]	Unemployment	Total Home Sales	o/n rate	10-year bond
3.0%	1.7%	4.2%	0.3% (Y/Y)	1.0 – 1.25%	2.4%

- The upside surprise **of headline GDP at 3.0% gives the impression the hurricanes had little effect on GDP**
- GDP would likely have been closer to **3.7% without the hurricanes and final sales of domestic goods shows a decline in the recent trend of consumption for businesses**
- **Services consumption** slowed to 1.5%, likely due in part to the **hurricanes which curtailed eating out and recreation in the third quarter**
- Higher inflation measures **support the Fed's belief that the economy can generate inflation levels consistent with a normal recovery**
- The preliminary Q3 data support a **Fed rate hike in December** and a **steeper yield curve going into 2018**

Business Investment in Equipment and Software



Source: KPMG Economics /Bureau of Economic Analysis /Haver Analytics

The **domestic economy is driven by consumers and business investment**. For 2016 business investment fell by 3.4%[2]. This caused concern about the ability of the economy to sustain growth momentum and yield higher productivity numbers in the years to come. 2017 has seen a reversal of this worisome trend. So far this year **business investment in equipment has risen steadily growing by 8.6%[3] in the third quarter.**

The **consumer held up despite the hurricanes** causing the closure of restaurants, shopping centers and other recreational activity in effected areas. However, consumer spending only expanded by **2.4%[4] compared** with a more robust growth rate of **3.3% in the second quarter and 3.6% in 2016.**

One worrying trend in recent quarters has been **investment** in **residential real estate** which has been **down for two consecutive quarters.** This has occurred two previous times since the recovery got underway, so it may not be predicting a slowdown in residential real estate; indeed some of the decline in Q3 may be related to the hurricanes' impact. However, **housing starts** for the last two quarters are **below the 2016 level of 1.17 million homes**[5] with Q3 logging only 1.165 million starts on an annualized basis. Housing affordability is declining as the recovery has boosted prices and the ever important entry level home category has seen the steepest rise in prices.

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[1] Core CPI is inflation excluding the volatile food and energy components

[2] The chart shows a decline at an annualized rate for the first three quarters of 2016

[3] Bureau of Economic Analysis, % Change - Annual Rate SAAR, Bil.Chn.2009$

[4] Bureau of Economic Analysis, % Change - Annual Rate SAAR, Bil.Chn.2009$

[5] US Census Bureau

All this suggests wage increases are needed to prevent housing from going from a bright spot to a soft spot in the final quarters of the recovery. When thinking about how **another 9-12 months of near 3.0% GDP** growth will impact the economy one must consider that at 4.2% unemployment, **bottlenecks will likely emerge in greater measure** over the next year; in sum this means **the party's end could be in sight by late 2018.**

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