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ECONOMIC TALKING POINTS
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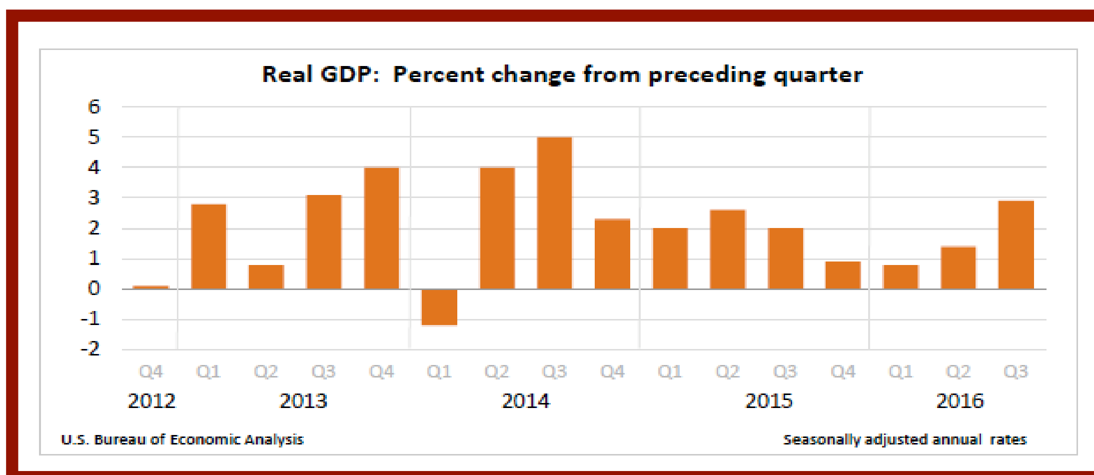
A GDP Report That Says This Business Cycle is Far From Over

The economy's three quarter sleep walk of below 2% growth has come to an end. Equally important, we do not see it nodding off back to that stupurous pace anytime soon.

This assessment is not just because the economy expanded at a better than expected 2.9% pace in the last quarter. A look at the GDP's internal components show encouraging signs that long dormant sectors, such as business spending, trade and government outlays, are showing signs of life again. If this revival is sustained, as we project, it will rejuvinate the now seven-year old business cycle



Sure, some analysts may zero in on the marked slowdown in personal consumption expenditures, which rose at a half hearted 2.1% pace in the 3rd quarter, compared to 4.3% the previous period. But this hardly means consumers are suddenly in retreat.

For the fact is none of the precursors that usually keep shoppers at home are present. The job market is still strong. Layoffs are at their lowest levels in nearly half a century. Americans households are in the best financial shape in decades. Wages are rising faster than inflation, and interest rates remain very low.

Indeed, a look closer at what they actually spent on last summer should reassure you that consumers are not backing away. Purchases of consumer durable goods jumped 9.5%, after rising 9.8% in 2nd. That's the best back-to- back performance in two years. Consumer durables are typically costly items --- like autos, major appliances, electronics --- and are often financed with credit. Such expensive and usually discretionary purchases take place when consumers are comfortable about the economic outlook. So we're quite confident consumers will continue their vital role in keeping this expansion moving forward.

But let's not stop there. It appears the long slump in business capital spending is coming to an end as well. And its about time! For a decade S&P 500 firms have allocated nearly 90% of their earnings to stock buybacks and beefing up dividends. That sure makes shareholders happy. But the failure to adequately reinvest those profits back into these companies has left them with increasingly antiquated equipment and production facilities. Case in point: The average age of America's private capital stock is 22 years, the oldest in 60 years. Industries with particularly aging assets are airlines, communications, and manufacturing.

So what has changed? There's evidence that the deep freeze in business investments is beginning to thaw. For one, energy prices are firming and this has set the stage for the country's more efficient oil producers to ramp up spending again. These firms know which fields can be profitable with oil at $50 a barrel.

Non-energy related companies that failed to reinvest profits realize they, too, must invest internally for the most basic reason: It has resulted in a prolonged period of dismal productivity growth and that is something that cannot continue if you are competing in a tough global marketplace. And so after three consecutive quarters of declining gross domestic private investments, business outlays turned up in the 3rd quarter at a 3.1% rate. And while spending on equipment still did disappoint, more recent economic data (ISM and advanced durable goods) show companies are moving ahead with modernizing their production facilities. Our take is that once the election is over and the economic outlook becomes less foggy, more funds will be allocated towards improving business productivity.

Another important support for business capital spending would be evidence that the international economy is gathering some steam. An encouraging sign of that can be seen in the GDP's report on exports, which jumped at a 10% rate last quarter, the largest since the final three months of 2014. US demand for foreign products also grew, but at a milder 2.3% pace. The difference allowed net exports to contribute 0.83 percentage points to headline GDP growth.

But let's step back a bit here. We believe the IMF was wrong in revising down its forecast of global GDP growth for 2017. The combination of easy monetary policy among major central banks and the growing realization that the policy of austerity has failed to revive growth suggest we will see more aggressive fiscal spending abroad. That should improve growth in Europe and Japan and further lift demand for US exports.

Even Washington is taking a more active role in stimulating growth. While both Hillary Clinton and Donald Trump have called for significantly greater spending on defense and on rebuilding this country's infrastructure, that upturn appears to be already underway with the current Administration. Washington has accelerated defense and nondefense spending in the 3rd quarter. It's the first time this year we have seen both move up simultaneously in the same period. That trend is likely to continue in 2017.

Bottom line:
If one views the US economy as a table supported by four legs --- consumers, business, government and trade --- then for the last several quarters the economy has been greatly weakened by the absence of three of those legs. The only support that kept this business cycle from ending has been the consumer. This GDP report, in conjunction with other fresh economic news in the US and abroad, tell us the other three legs are starting to firm up as well.

What this means for US monetary policy is now less uncertain. The long drum roll leading up to the next interest rate increase by the Fed will come to an end in December. Janet Yellen cannot hold out much longer given the latest economic reports and with five key voting members (Eric Rosengren, Esther George, Loretta Mester, Bill Dudley and yes even Stanley Fischer) saying that the time has come to act. This GDP report makes it a virtual certainty the Fed will lift rates before the year is out, to become --- amazingly --- just the second such increase in a decade.

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Key Economic Forecasts

- Actual
- Forecast

United States

	I 2015	II 2015	III 2015	IV 2015	I 2016	II 2016	III 2016	IV 2016	I 2017	II 2017	III 2017	IV 2017
Real Gross Domestic Product (GDP):												
%	2.0	2.6	2.0	0.9	0.8	1.4	2.9	2.6	2.4	3.3	2.8	2.4
Personal Consumption Expenditures:												
PCE	2.4	2.9	2.7	2.3	1.6	4.3	2.1	2.7	2.4	3.0	2.7	2.8
Inflation, end of period, year-over-year:												
CPI %	-0.1	0.1	0.0	0.7	0.9	1.0	1.5	1.5	1.8	1.9	2.2	2.3
Unemployment Rate (end of period):												
%	5.5	5.3	5.1	5.0	5.0	4.9	5.0	4.5	4.5	4.5	4.5	4.9
Non-farm Payrolls, monthly avg. thousand:												
	195	231	174	282	196	146	192	175	200	190	220	210
Treasury 10-yr Note Yield % (end of period)												
	1.93	2.38	2.06	2.27	1.78	1.49	1.60	1.78	2.10	2.30	2.55	2.90
Federal funds rate % (end of period)												
	0.13	0.13	0.13	0.38	0.38	0.38	0.38	0.63	0.88	1.13	1.38	1.63

GDP Growth - Global Economy

Country	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
US	1.8	-0.3	-2.8	2.5	1.6	2.2	1.7	2.4	2.6	1.8	2.7
Eurozone	2.6	0.6	-4.1	1.7	1.4	-0.6	-0.4	0.9	1.5	1.5	1.3
United Kingdom	3.1	0.6	-5.2	1.7	0.7	0.3	1.8	2.9	2.2	1.6	0.8
Japan	2.1	-0.7	-5.4	4.6	-0.4	1.6	1.5	-0.1	0.5	0.6	0.8
Canada	2.7	0.7	-2.8	3.1	3.1	1.7	2.2	2.5	1.2	1.4	2.5
India	9.1	8.8	6.3	8.4	8.6	6.7	4.9	7.4	7.8	7.5	7.6
China	14.2	9.6	9.2	10.5	9.5	7.8	7.7	7.3	6.9	6.2	6.0
Brazil	5.7	5.1	-0.3	7.5	2.7	0.9	2.3	0.1	-3.8	-4.0	0.2
Mexico	3.3	1.4	-4.7	5.2	4.0	3.9	1.4	2.3	2.5	2.2	2.6
Australia	4.0	2.3	1.2	2.8	2.6	3.6	2.4	2.6	2.5	2.5	3.0
Russia	8.1	5.6	-7.9	4.0	4.3	3.4	1.3	0.6	-3.7	-2.0	-0.2
World	5.4	1.6	-1.9	4.2	3.0	2.6	2.9	3.0	2.6	2.4	2.9

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