

THE ECONOMIC OUTLOOK GROUP



475 Wall Street
PRINCETON, NEW JERSEY 08540 Tel: 609 - 529 - 1300
www.economicoutlookgroup.com

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

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**Caution: The Economy Has Built Up a Head of Steam.
But It May Not Last For long!**

With the release of November's jobs report, we will have seen half a dozen different economic indicators since the election. Together, they suggest that whatever glee, shock or disappointment Americans felt at Donald Trump's victory, the economy continues its march forward.

Consumers have shown no inclination to pull back on spending in recent weeks and companies did not balk at hiring last month.

Indeed, employers added new workers in November at an even faster clip than October (178,000 vs. 142,000). Some of this acceleration in payrolls can be attributed to the 22,000 surge in government employment, the largest increase since August. But the private sector also ramped up hiring, adding 156,000 workers last month, versus a downward revised 142,000 in October. Moreover, if one were to average out payroll increases over the last three months, the outcome shows the same upward trend.

What about the "household survey?" Again, the numbers appear to confirm no major disruption in labor market activity has occurred following the election. Total employment jumped by 160,000 in November, compared to a drop of 43,000 the month before. Just as interesting was the fall in the number of Americans who said they were jobless; it plunged by 387,000, the biggest decline since last May.

As a result, November's unemployment rate fell by three-tenths, to 4.6%, the lowest level of joblessness since August 2007. If you broaden the definition of unemployment to include discouraged workers and those stuck with just part

time jobs, then the “underemployment rate” slipped to 9.3%, the least since April 2008.

What’s more, there are a host of other categories in the jobs report that are encouraging. For example, those grudgingly accepting part time work because they could not get full time employment fell by 220,000, to 5.67 million people, the lowest in more than eight years!

There’s good news on the income side too. Pay increases still exceed the rate of inflation. Average hourly earnings in November was up 2.5% over the last 12 months, while the cost of living as measured by the PCE price index rose 1.4%. That 1.1 percentage point difference represents real purchasing power and should help sustain consumer spending.

The ongoing improvement in the job market appears consistent with a host of other economic data points out since the election. Aside from the impressive record performances in the stock market lately, the Institute for Supply Management yesterday reported that manufacturing activity expanded to an index of 53.2 in November, up from 51.9 the month before. New orders also climbed to 53, up from 52.1 in October.

Certainly one big surprise was the huge (yes, this time “*huge*” is justified) leap in consumer confidence in November. The Conference Board noted that consumer optimism about the economic outlook rocketed up to 107.1, up from 98.6 in October, and the most upbeat level for this metric in nearly a decade (June 2007). That positive sentiment certainly helped lift auto sales by 3.7% last month, putting total motor vehicle sales this year within easy reach of the 17.45 million record set in 2015.

Now --- and we don’t mean to spoil the party here -- there is also a nagging feeling something is amiss. The economy certainly had lots of momentum going into the election. But we ought not infer there’s a causal relationship between November’s healthy economic activity and Donald Trump’s victory. To think so would be silly.

The President-elect still represents the mother of all uncertainties when it comes to domestic and foreign policies. He has absolutely no previous record of governing we can count on.

And if Trump believes he can simply rule over the economy much like he rules over his company, it would be a freshman’s mistake. For one, his grandiose proposals to slash personal and corporate taxes, yet boost federal spending on infrastructure and defense do not sit well with many conservative Republicans because it will explode the budget deficit. So I expect Congress will push back and dilute his stimulus program. That means we could see consumers and businesses also pull back on spending next year.

Trump has also promised to eviscerate NAFTA, cancel the TPP trade accord --- and if that’s not concerning enough--- to impose substantial tariffs against Mexico and China. If he goes through with those tariffs, it’s likely both countries

will retaliate against the U.S. That would trigger a trade war at a time when the U.S. economy is growing at barely 2 percent. That's not much of a buffer to protect the economy from slipping into a recession.

We haven't even touched on the many geopolitical hot spots that are likely to deteriorate in 2017 --- such as North Korea's nuclear missile program, China's illegal grab of the South China Sea, and the possible fragmentation of the EU.

These are just some of the reasons why we view the exuberance in the stock market as excessive. We did not expect investors to experience the full rapture with Trump's victory.

There is no argument, for now at least, that the economy has built up a head of steam. Inflation is edging higher and the labor market is at full employment. So we fully expect the Federal Reserve will raise its benchmark rate in two weeks by 25 basis points.

But we do not see that hike followed by another for at least six months, simply because there is still so much that is unknown about how this new Administration will govern, what Congress will pass, and how this inexperienced White House will respond to foreign crises.

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(Forecast tables below)

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 | 3.2 | 2.7 | 2.6 | 2.0 | 1.5 | 2.2 |
| Personal Consumption Expenditures: | | | | | | | | | | | | |
| PCE | 2.4 | 2.9 | 2.7 | 2.3 | 1.6 | 4.3 | 2.8 | 2.5 | 2.1 | 2.4 | 1.8 | 2.8 |
| Inflation, end of period, year-over-year: | | | | | | | | | | | | |
| CPI % | -0.1 | 0.1 | 0.0 | 0.7 | 0.9 | 1.0 | 1.5 | 2.0 | 2.0 | 2.1 | 2.2 | 2.3 |
| Unemployment Rate (end of period): | | | | | | | | | | | | |
| % | 5.5 | 5.3 | 5.1 | 5.0 | 5.0 | 4.9 | 5.0 | 4.7 | 4.9 | 5.0 | 5.3 | 5.0 |
| Non-farm Payrolls, monthly avg. thousand: | | | | | | | | | | | | |
| | 195 | 231 | 174 | 282 | 196 | 146 | 212 | 162 | 90 | 118 | 125 | 125 |
| Treasury 10-yr Note Yield % (end of period) | | | | | | | | | | | | |
| | 1.93 | 2.38 | 2.06 | 2.27 | 1.78 | 1.49 | 1.60 | 2.34 | 2.10 | 2.10 | 2.15 | 2.30 |
| Federal funds rate % (end of period) | | | | | | | | | | | | |
| | 0.13 | 0.13 | 0.13 | 0.38 | 0.38 | 0.38 | 0.38 | 0.63 | 0.63 | 0.63 | 0.63 | 0.88 |

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 | 2.0 | 2.1 |
| Eurozone | 2.6 | 0.6 | -4.1 | 1.7 | 1.4 | -0.6 | -0.4 | 0.9 | 1.5 | 1.4 | 1.1 |
| 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 | 0.8 | 0.8 |
| Canada | 2.7 | 0.7 | -2.8 | 3.1 | 3.1 | 1.7 | 2.2 | 2.5 | 1.2 | 1.4 | 2.1 |
| 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 | 2.1 | 1.9 |
| Australia | 4.0 | 2.3 | 1.2 | 2.8 | 2.6 | 3.6 | 2.4 | 2.6 | 2.5 | 2.5 | 2.9 |
| Russia | 8.1 | 5.6 | -7.9 | 4.0 | 4.3 | 3.4 | 1.3 | 0.6 | -3.7 | -2.0 | 0.0 |
| World | 5.4 | 1.6 | -1.9 | 4.2 | 3.0 | 2.6 | 2.9 | 3.0 | 2.6 | 2.4 | 2.7 |