THE ECONOMIC OUTLOOK GROUP

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ECONOMIC TALKING POINTS

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July 22, 2016

The Fed Won't Raise Rates This Summer, Though It Should. Blame The Election For The Delay

Had this not been a Presidential election year, a Fed rate increase this summer would have been an easy call to make. The financial markets have not only stabilized since the outcome of the Brexit vote, with stock and bond prices at or near record highs, but there has been a cascade of recent indicators --- employment, industrial production, housing, consumer spending --- all showing the US economy on the rebound.

Yet, even with these robust reports, the Fed is likely to make no changes in monetary policy, at least until the end of the year. The reason: The economic outlook for 2017 remains terribly murky largely because we have two polarizing candidates in a tight race for the White House, each advocating radically different domestic and foreign policy proposals. Whoever is victorious will likely have an impact on the economy's path almost immediately.

Now let me be clear. The US economy is a massive $18 trillion living organism that typically does not abruptly change course during and immediately after a Presidential election year. But polls show business leaders are very uncertain about how the economy will perform if Donald Trump becomes victorious,

and thus are pulling back on capital spending plans until there is greater clarity about the outlook.

Hillary Clinton is already a known entity and her tax and spending proposals can roughly be modeled to see how the economy might react. But there are huge challenges when we attempt to do the same for Trump. While his objectives are to rev up the economy by accelerating job growth and boosting defense and infrastructure outlays, his proposals are awfully light on specifics. For example, many will hail Trump's call for lowering personal and corporate income taxes. But he wants to avoid any cuts in entitlements and still ramp up government spending elsewhere. Yet Trump also claims he will make the country's $19 trillion debt disappear by the end of his second term.

It's not just Democrats and business leaders that find Trump's economic ideas difficult to reconcile. The Tax Policy Center concluded that his plans would shrink tax revenue by $9.5 trillion over 10 years. (Clinton's proposals, according to them, would actually raise revenue by $1.1 trillion.) The Tax Foundation determined that Trump's tax spending policy would add $10 trillion to the national debt over the next decade. The nonpartisan Committee for a Responsible Federal Budget believed his policies would add an additional $11.5 trillion to the debt over the next decade.

And if Fed policymakers have trouble figuring out the logic of Trump's fiscal plans, they must have been especially vexed when the Presidential candidate suggested that one way to reduce the nation's $19 trillion sovereign debt is to play hard ball with US and foreign investors and negotiate a payment plan that would return less than 100 cents on the dollar! Such an utterance, if taken seriously, could trigger another global financial crisis.

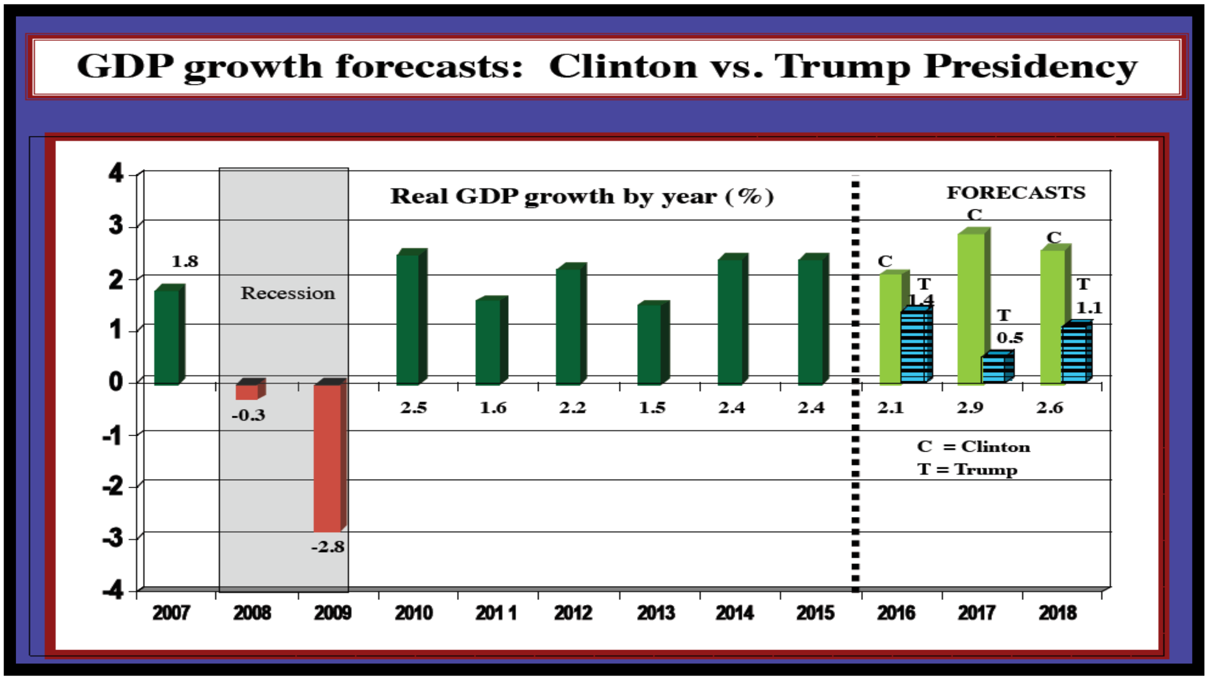
The Fed also projected the US economy will be grow at a modest 2% pace the next few years. That's not much of a buffer in the event of another shock. Yet Trump is prepared to do just that ---- disrupt trade by imposing massive tariffs on goods coming from China and Mexico, undo NAFTA, derail talks on TPP and TTIP, and penalize American firms that relocate their manufacturing plants outside the US. If the US Chamber of Commerce and most GOP leaders see a trade war as a threat to the US economy, the Federal Reserve is quietly turning queasy as well.

Given the closeness of the race at this time and the unusual (to be diplomatic) proposals that have been articulated, many CEOs are simply sitting out the campaign storm. Why invest billions of dollars into capital and labor when this election brings so much uncertainty about the return on those investments. It's not that the hurdle rate is too low. It's the difficulty of even estimating what that hurdle rate may be if Trump gets into the Oval Office.

Our own projections for growth in 2017 and 2018 vary greatly when we incorporate the published proposals of Hillary Clinton and Donald Trump.

We estimate GDP growth to be 2.9% in 2017 and 2.6% in 2018 with a Clinton Administration. A Trump victory brings so much more uncertainty to the private sector that it would effectively slow growth to about 0.5% in 2017 and 1.1% in 2018.

Given this wide divergence in growth trends and its repercussions for employment and inflation, we expect the Fed will wait until December, at the earliest, before it chooses its next step.



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):												
%	0.6	3.9	2.0	1.4	1.1	2.5	2.4	2.5	2.0	3.0	2.9	2.6
Personal Consumption Expenditures:												
PCE	1.8	3.6	3.0	2.4	1.5	2.3	2.4	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	1.3	1.4	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	4.7	4.5	4.5	4.5	4.5	4.9
Non-farm Payrolls, monthly avg. thousand:												
	195	231	174	282	196	147	140	165	210	220	220	210
Treasury 10-yr Note Yield % (end of period)												
	1.93	2.38	2.06	2.27	1.78	1.49	1.58	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