THE ECONOMIC OUTLOOK GROUP

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ECONOMIC TALKING POINTS

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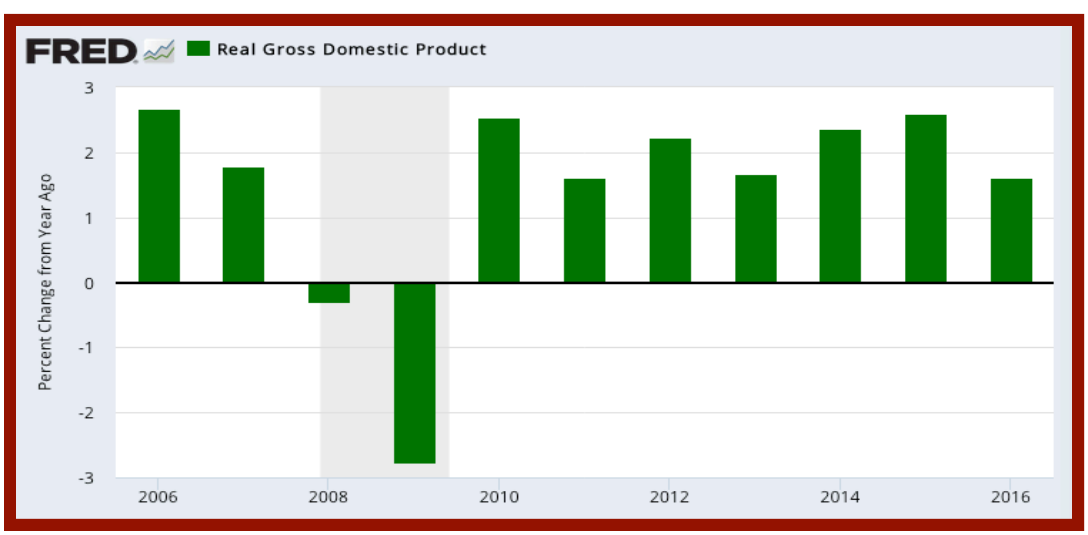
U.S. Economy Enters 2017 With Momentum.
But Could The White House Jeopardize It All?

We're now well into our 8th year of this expansion and there is nothing to suggest this business cycle is close to ending. We still do not see any of the prerequisites that usually suggest a downturn is near, such as surging energy prices, sharply higher interest rates, punishing inflation or excess inventory.

Indeed, the U.S. economic fundamentals look very good. The latest release on GDP shows business activity in the second half of 2016 grew at a 2.7% annual pace, more than double the rate in the first half, and the fastest since the final six months of 2014.

Leading the charge in the final quarter of 2016 were consumer spending, business investments and government spending. Together they contributed nearly 3.6 percentage points to GDP growth. What dragged down aggregate output to 1.9% was our trade imbalance. Net exports slashed 1.7 points off headline growth, which is hardly surprising given the strength in the dollar and the fact that demand for goods and services in this country is a lot stronger than our trading partners.



For the year as a whole, the economy expanded just 1.6%, the slowest since 2011. Though this underscored once again that the post recession-recovery is the weakest since WW II, it is worth noting that such soft GDP numbers are to be expect given the following points;

(1) A long sluggish recovery often follows a severe and corrosive credit-fueled downturn;
(2) Other countries are still struggling to emerge from the vestiges of the last global recession;
(3) The collapse of U.S. business investment in recent years, especially those in the energy industry;
(4) How sequestration froze government spending and paralyzed changes in fiscal policy;
(5) The challenges faced by U.S. exporters who saw foreign customers walk away due to the strong dollar.

So, yes, the U.S. recovery has been mediocre when viewed strictly in terms of GDP activity. However, when looked at from the perspective of Gross Domestic Income (GDI), which theoretically should be identical to GDP but often is not, a more upbeat picture emerges. Gross domestic income represents all income that is generated from producing GDP. What is spent on output (GDP) must flow as income (GDI) to someone else and the two therefore should match. Yet we have seen year after year how GDI increases faster than GDP, and we expect that trend will be repeated for 2016 when the government releases its revised figures on fourth quarter GDP later next month.

The key takeaway is that those who wonder how it is possible to have a full employment economy with such anemic GDP numbers should take note of the fact there is a stronger historical correlation between job creation and Gross Domestic Income.

For that reason we believe the U.S. economy enters 2017 with considerable momentum. Consumer sentiment as measured by the University of Michigan jumped to a 13 year high in February! Companies are also investing more into their operations. New orders for capital goods rose 0.8% in December, marking the third consecutive monthly increase.

And yet….with so many positive signs, there is also an emerging undercurrent of anxiety among business leaders and investors. Much of the optimism on both Main Street and Wall Street stems from the fumes of upcoming tax cuts and spending increases. Yet nothing is even close to passing Congress, in part because there are major difference between what President Trump has proposed and those that House Republicans seek.

Adding to the discomfort is that just days after taking office, President Trump may have triggered a full scale trade war with Mexico, continues to antagonize China, has abandoned most of America's Asian and South American trading allies by trashing TPP, revoked NAFTA, angered Arab countries by his temporary ban of Muslim immigrants, has upset most European by questioning the value of the European Union and relevance of NATO, unambigously supports the use of torture, and seems incapable of stopping his rhetorical tics about his campaign victory.

What all this boils down to is that the US economy is in solid shape with a recovery that still has the potential to be the longest ever. But there is also a disquieting

feeling about how the new President governs. Will this White House get back on track and pursue a more measured and deliberative domestic and foreign policy? Or will this economic momentum and confidence abruptly turn down as fear mounts that the nation is now being led by an impulsive, even infantile Presidency?

Key Economic Forecasts

- Actual
- Forecast

United States

	I 2016	II 2016	III 2016	IV 2016	I 2017	II 2017	III 2017	IV 2017	I 2018	II 2018	III 2018	IV 2018
Real Gross Domestic Product (GDP):												
%	0.8	1.4	3.5	1.9	2.2	2.2	2.4	2.7	2.5	2.7	3.0	2.7
Personal Consumption Expenditures:												
PCE	1.6	4.3	3.0	2.5	2.2	3.6	2.8	2.6	2.6	3.5	3.3	2.5
Inflation, end of period, year-over-year:												
CPI %	0.9	1.0	1.5	2.1	2.3	2.5	2.6	2.5	2.5	2.6	2.6	2.8
Unemployment Rate (end of period):												
%	5.0	4.9	5.0	4.7	4.8	4.9	4.9	5.0	4.8	4.7	4.5	4.3
Non-farm Payrolls, monthly avg. thousand:												
	196	146	212	165	135	115	155	160	155	140	150	155
Treasury 10-yr Note Yield % (end of period)												
	1.78	1.49	1.60	2.45	2.63	2.50	2.36	2.70	3.10	3.15	3.15	3.20
Federal funds rate % (end of period)												
	0.38	0.38	0.38	0.63	0.63	0.88	0.88	1.13	1.38	1.63	1.88	2.13

GDP Growth - Global Economy

Country	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
US	1.8	-0.3	-2.8	2.5	1.6	2.2	1.7	2.4	2.6	1.9	2.4	2.7
Eurozone	2.6	0.6	-4.1	1.7	1.4	-0.9	-0.3	1.2	1.8	1.5	1.3	1.7
United Kingdom	3.1	0.6	-5.2	1.7	0.7	0.3	1.8	2.9	2.2	2.0	1.2	1.5
Japan	2.1	-0.7	-5.4	4.6	-0.4	1.6	1.5	-0.1	1.1	0.9	1.3	1.3
Canada	2.7	0.7	-2.8	3.1	3.1	1.7	2.2	2.5	1.2	1.3	2.0	2.5
India	9.1	8.8	6.3	8.4	8.6	6.7	4.9	7.4	7.8	7.3	7.2	7.8
China	14.2	9.6	9.2	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.3	6.4
Brazil	5.7	5.1	-0.3	7.5	2.7	0.9	2.3	0.1	-3.8	-3.9	0.2	2.2
Mexico	3.3	1.4	-4.7	5.2	4.0	3.9	1.4	2.3	2.5	2.1	1.8	2.4
Australia	4.0	2.3	1.2	2.8	2.6	3.6	2.4	2.6	2.5	2.3	2.5	2.8
Russia	8.1	5.6	-7.9	4.0	4.3	3.4	1.3	0.6	-3.7	-0.2	1.1	1.8
World	5.4	1.6	-1.9	4.2	3.0	2.6	2.9	3.0	2.6	2.4	2.8	3.3

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