



FEDERAL
RESERVE
BANK *of*
ST. LOUIS

The Outlook for the U.S. Economy

National Association of Credit Union
Supervisory and Auditing Committees
Annual Conference and Expo
Louisville, KY

Kevin L. Kliesen

Business Economist and Research Officer

June 15, 2018

Disclaimer

The views I will express today are my own and do not necessarily reflect the positions of the Federal Reserve Bank of St. Louis or the Federal Reserve System.

DATA HEAVEN RESIDES HERE!



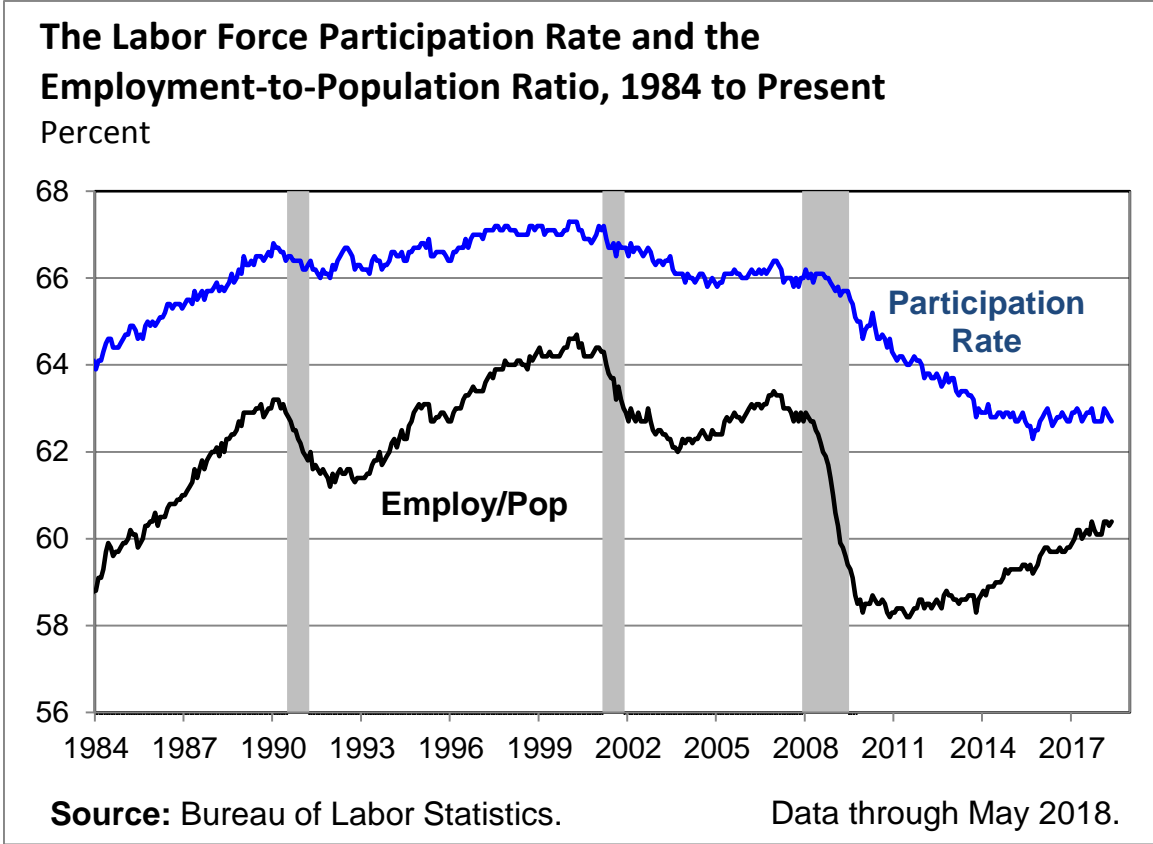
The Big Picture

- The business expansion is now 9 years old. The average expansion lasts about 5 years. The record is 10 years.
- Real GDP growth during this expansion has averaged about 2.25% per year. The historical norm is about 3% per year.
- Inflation has finally reached the FOMC's 2% target, after mostly remaining below the target since January 2012.
- Monetary and fiscal policies are boosting growth, but the Fed is in the process of gradually “normalizing” monetary policy.

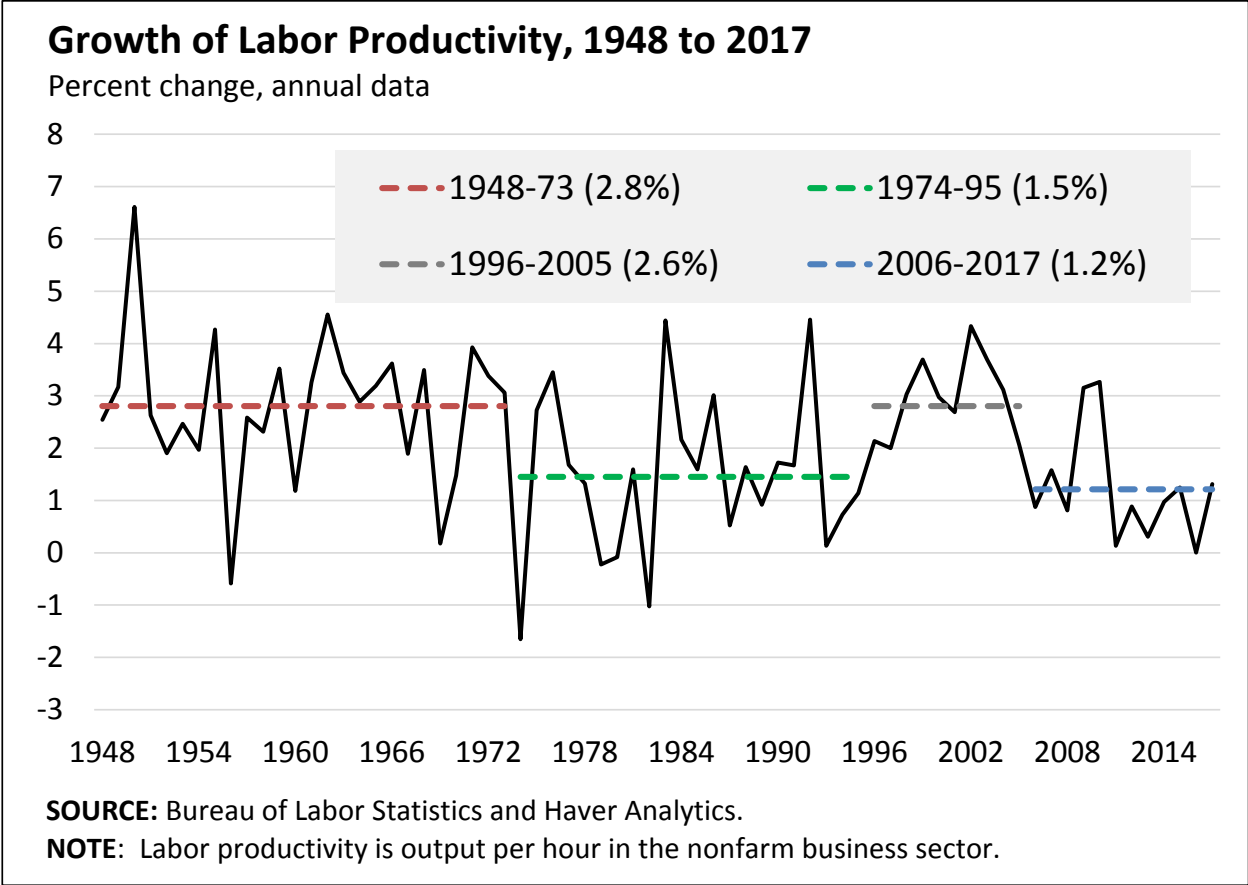
Forecasting Basics

- Joke of the Day! Economic forecasting is an imprecise exercise.
- Forecasters have a lot of hurdles to overcome: Imperfect data and models, assumptions about economic policy, unexpected developments (shocks) can't be accounted for.
- So, we largely assume that the past is prologue, but recognize that households, firms, and governments can change their behavior. Incentives matter!
- Bottom line: Look at long-run trends and then attempt to assess where the economy is currently relative to trend.

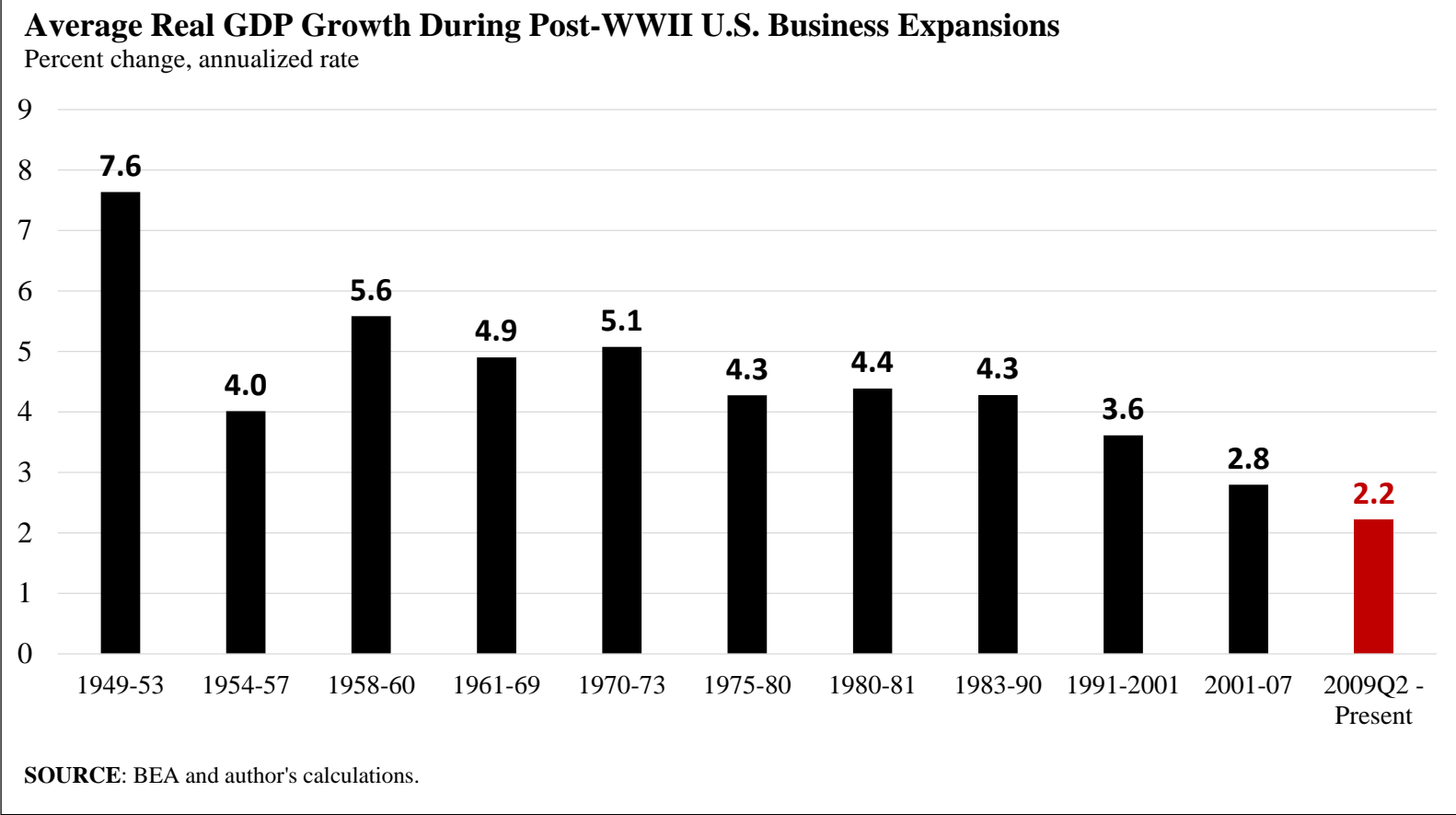
Key Ingredient #1: Labor Input



Key Ingredient #2: Productivity



Final Product: Real GDP Growth



So Many Questions!

- Is 2.25% economic growth still the norm?
- Or, will tax reform boost the economy's short- and long-term prospects?
- How should we think about the increase in the budget deficit arising from tax cuts and increased spending?
- How will potential disruptions to the international trading framework affect the U.S. and world economies?
- Will inflation continue to move higher?
- If so, what does that imply for the economy and monetary policy?

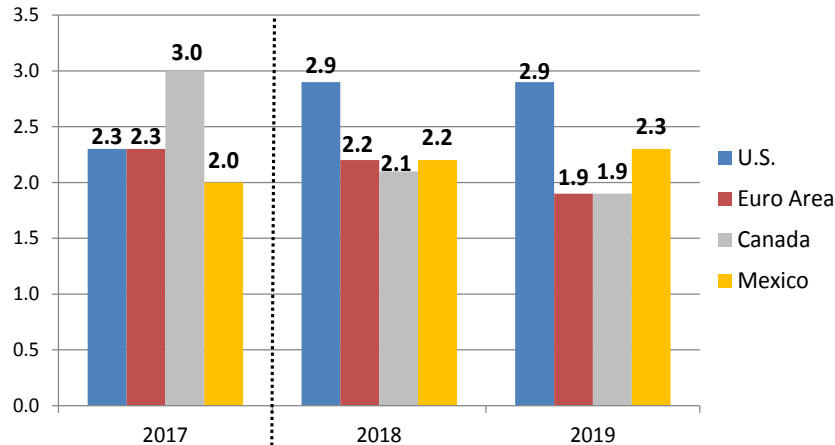
Digging a Little Deeper

Global Economic Growth is Solid.

- U.S. is forecast to grow faster, but with higher inflation, than most of our key international trading partners.

Projected Real GDP Growth: The U.S., the Euro Area and Canada

Percent changes

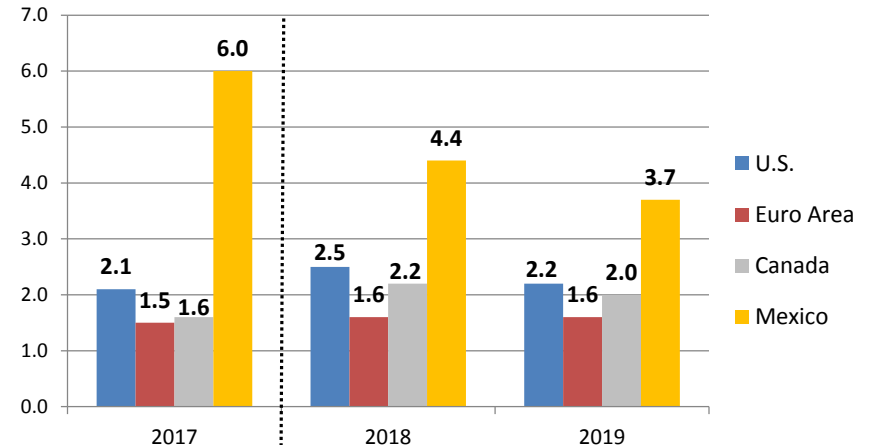


SOURCE: Blue Chip Economic Indicators

Economic Activity

Projected Inflation: The U.S., the Euro Area and Canada

Percent changes



SOURCE: Blue Chip Economic Indicators

Inflation

Momentum Building for U.S. Growth

- Solid labor market conditions and low inflation.
- Good fundamentals support spending on autos and other big-ticket items. House prices continue to increase.
- Businesses are also optimistic—especially in the aftermath of tax and regulatory reform efforts.
- Financial market conditions are supportive of growth.
- Healthy forward momentum in the first half of 2018 bodes well for second half of 2018 and 2019.

Fiscal Stimulus Spurs Forecasters to Boost Their Near-Term Outlook

Results from March 2018 NABE Outlook Survey Special Questions

1. How much do you forecast federal fiscal policy changes will add to or subtract from real GDP growth? (measured Q4/Q4)

2018		2019	
Amount	Percent of Respondents	Amount	Percent of Respondents
< 0	0.0%	< 0	2.3%
0	4.5%	0	6.8%
.01 - .19	0.0%	.01 - .19	6.8%
.2 - .39	29.5%	.2 - .39	45.5%
≥ .4	65.9%	.4 - .59	22.7%
Median	0.45	.6 - .79	4.5%
		≥ .8	11.4%
		Median	0.30

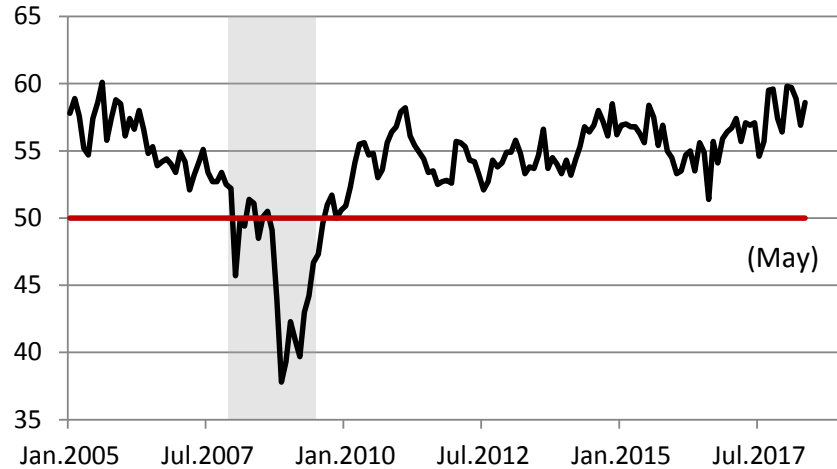
Where do you expect to see the largest positive effects?

- Capital spending
- M&A activity
- R&D activity
- Compensation
- Employment

Two Key Barometers Looking Good

Total Economy ISM

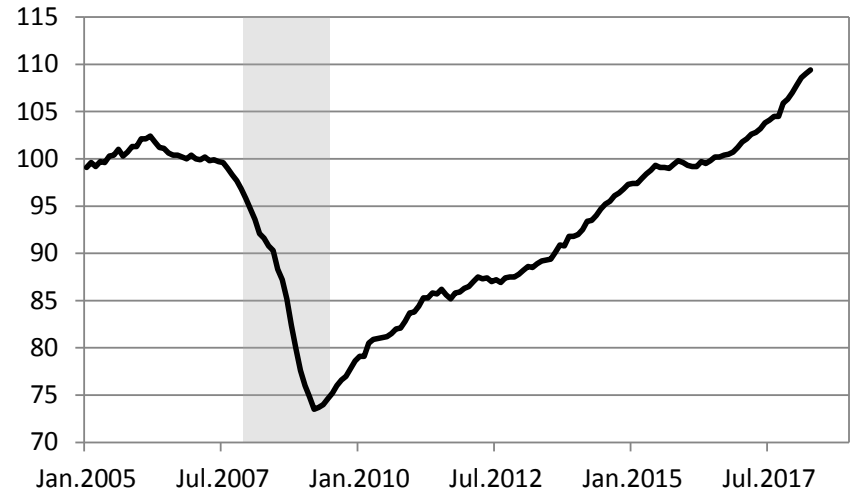
Index, 50+ = Expansion



Source: Author's calculations based on data published by Institute for Supply Management and the Bureau of Economic Analysis.

Index of Leading Economic Indicators

2004=100

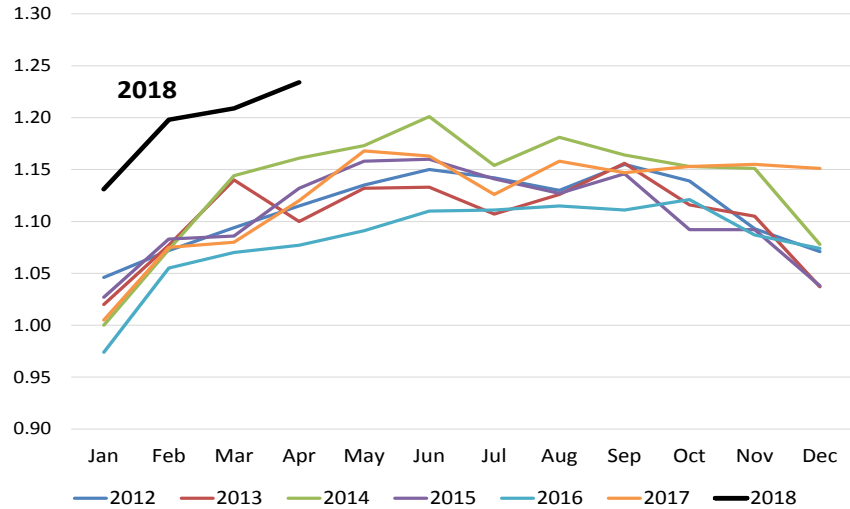


Last actual observation is April 2018

The Movement of Goods is Picking Up

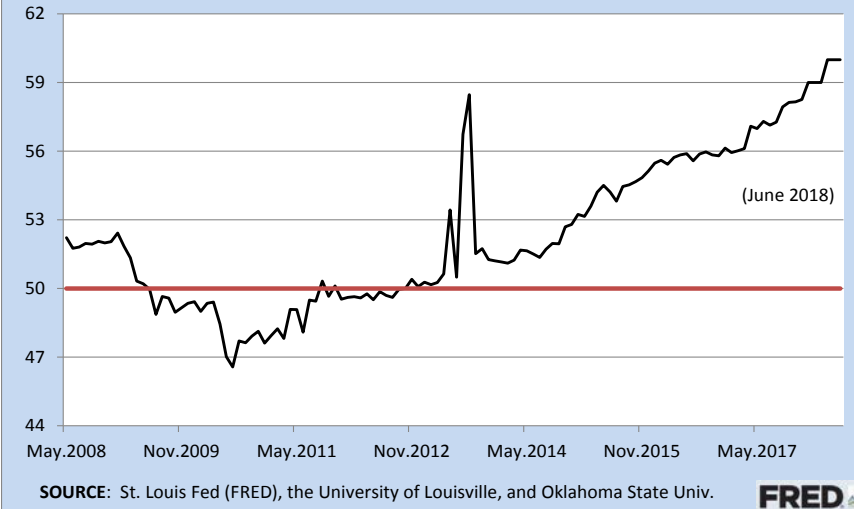
Cass Freight Index, Shipments, 2012 to Present

Index, Jan. 1990 = 100



University of Louisville/OSU Logistics and Distribution Activity Index

Values above 50 indicates healthy economic activity.



SOURCE: St. Louis Fed (FRED), the University of Louisville, and Oklahoma State Univ.



The LoDi measures national activity in the rail, barge, air, and trucking industries.

Current Economic Conditions

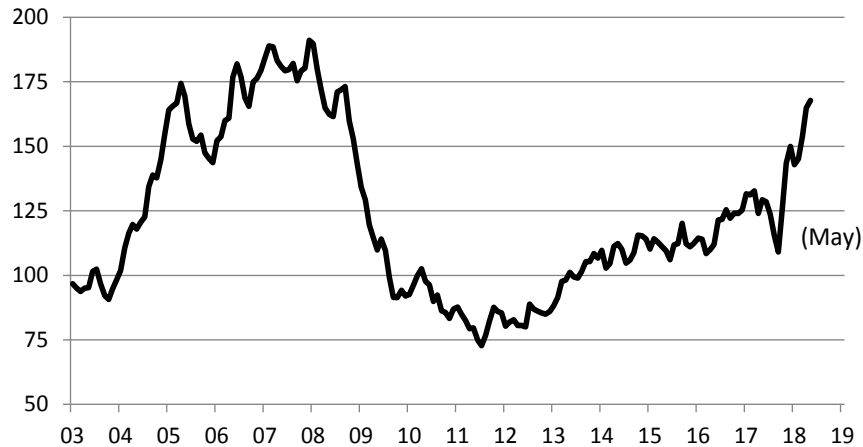
WHAT BUSINESSES ARE SAYING (ISM REPORTS) ...

- “We are currently overselling our forecast and don’t see an end to the upswing in business. We are very concerned, however, about the tariffs proposed in Section 301.” (Transportation Equipment)
- “Very difficult to hire skilled and unskilled labor.” (Food & Beverage)
- “Sales over the last month have been very strong. We are still struggling with the fluctuation in commodity costs and the weakening U.S. dollar.” (Retail Trade)
- “The supply chain is shuttering because of a lack of drivers and equipment causing delays in multiple modes of transportation. We are increasing inventory levels in anticipation of worsening conditions.” (Wholesale Trade)

Construction Outlook Continues to Brighten

Dodge Momentum Index for Commercial Construction

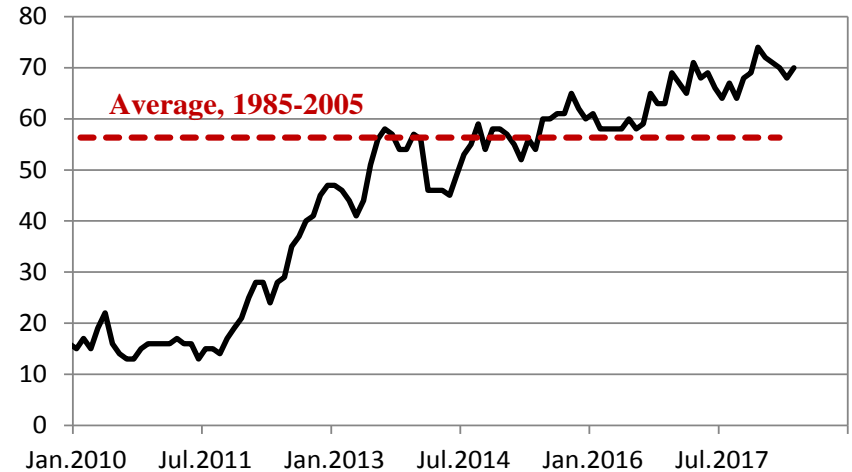
Year 2000 = 100



SOURCE: Dodge Data and Analytics

National Home Builders Housing Market Index

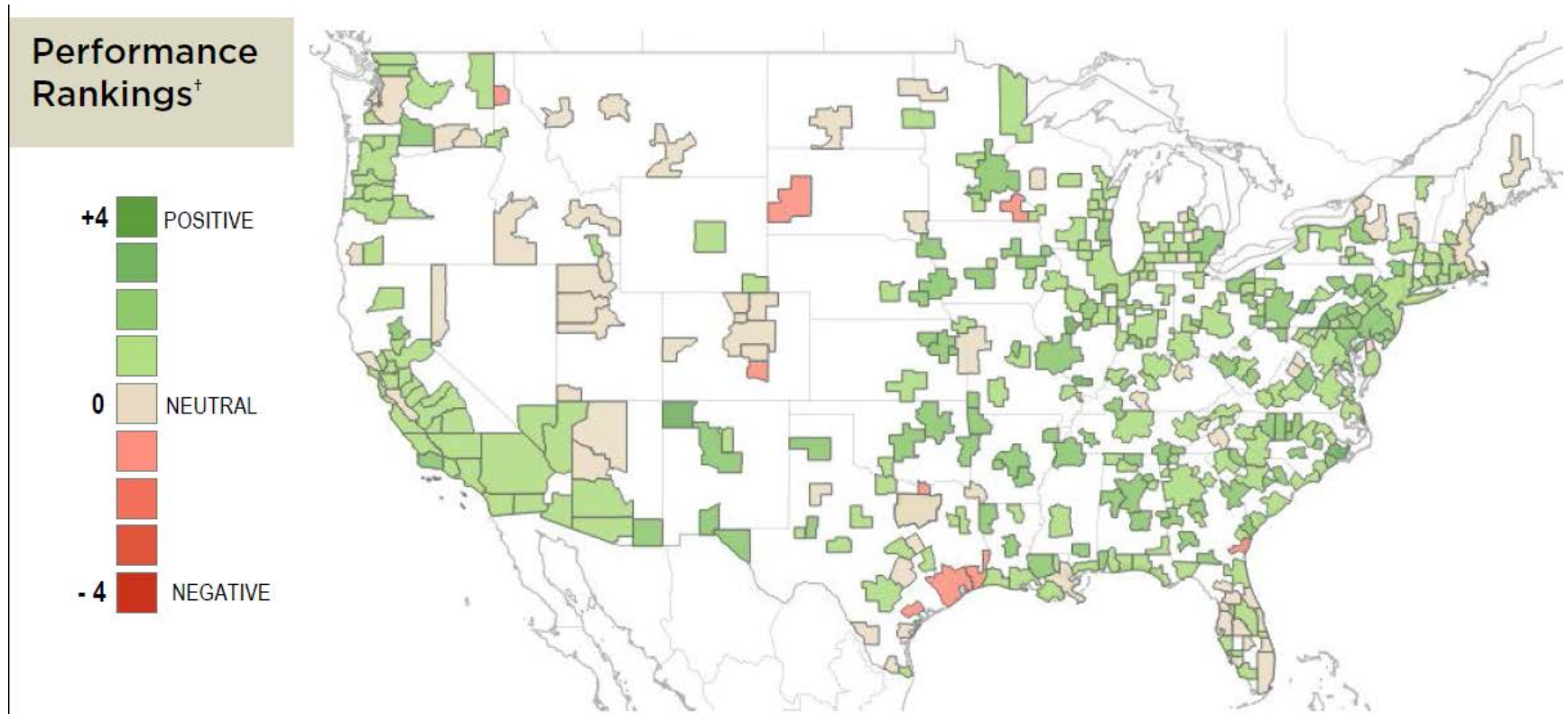
Index, All Good = 100



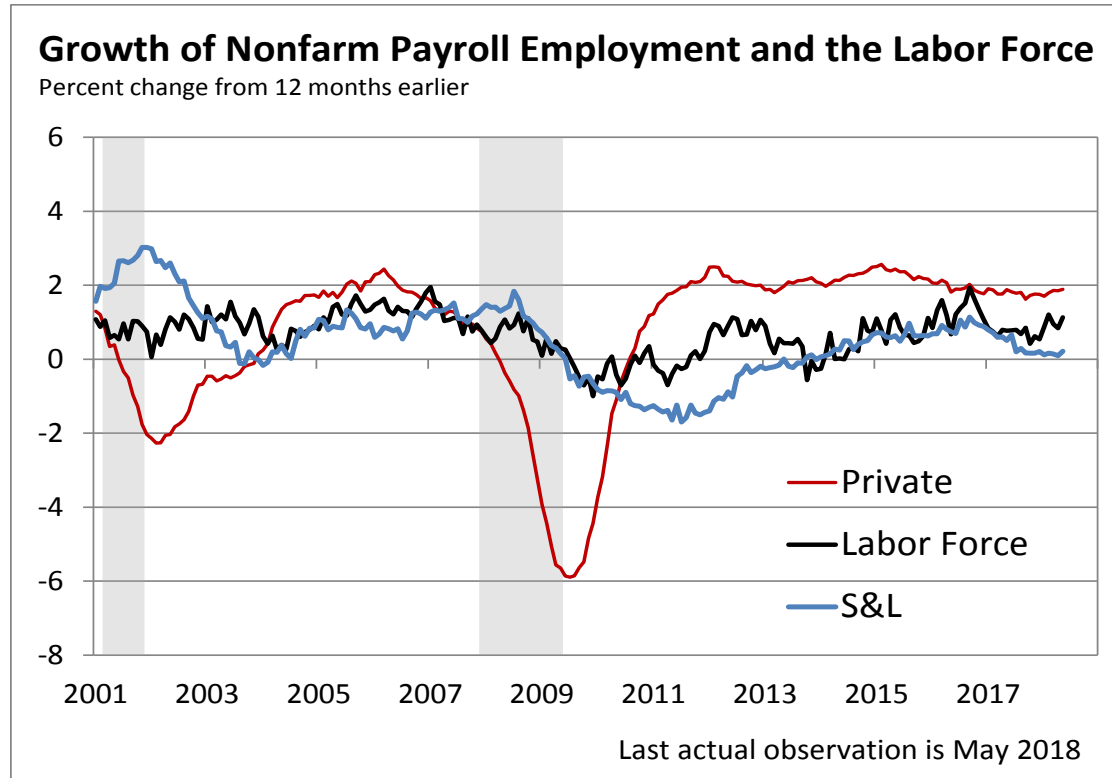
Source: NAHB

Last actual observation is May 2018.

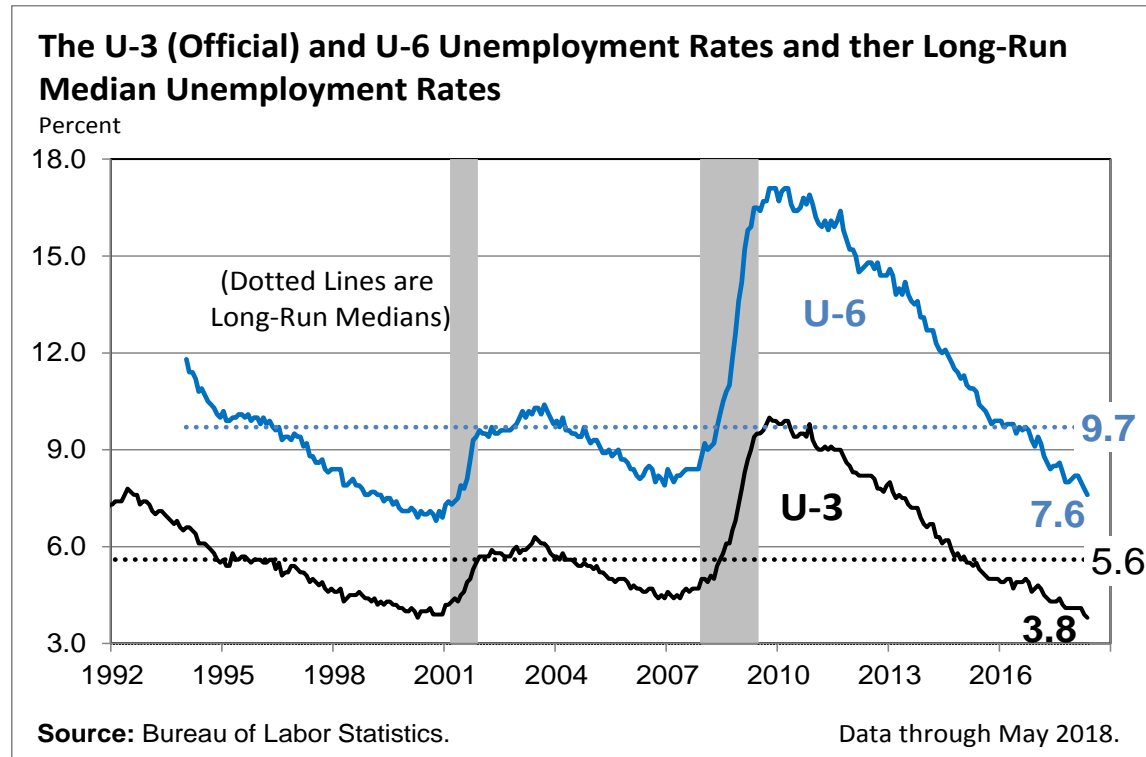
Nationally, Most Housing Markets Appear in Good Condition



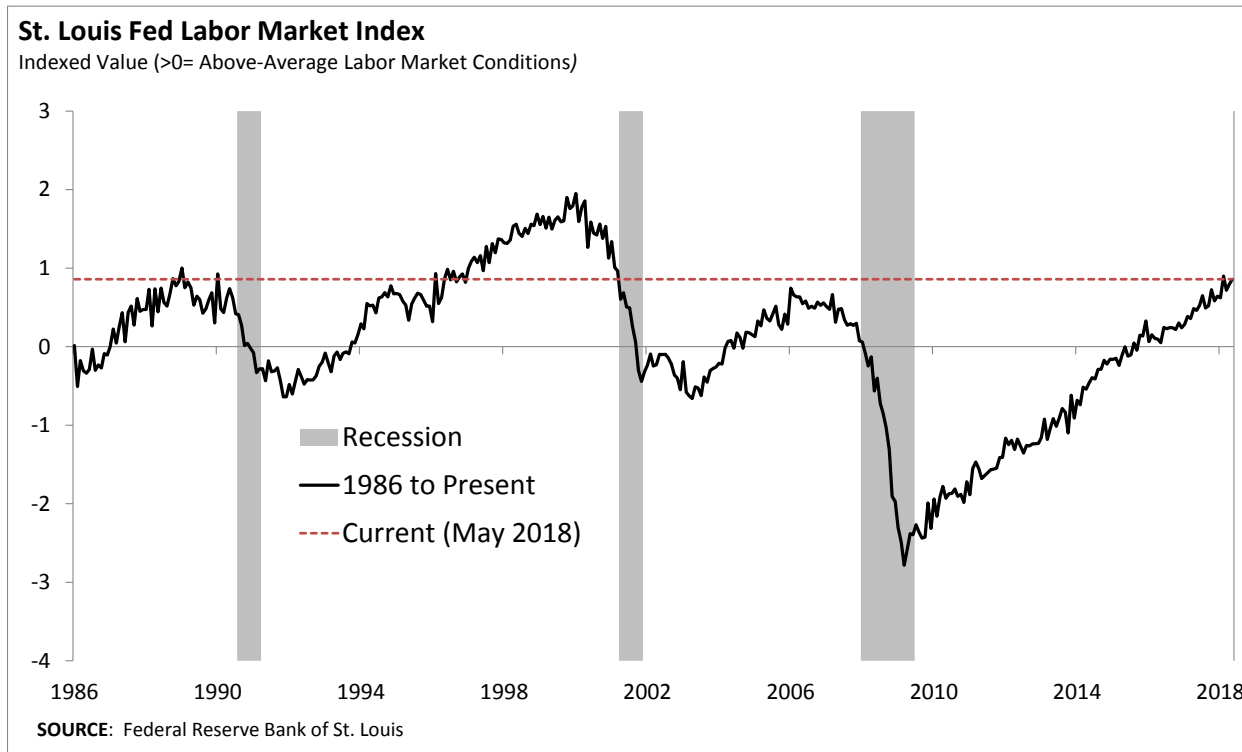
U.S. Job Growth has Outpaced Growth of the Labor Force



U.S. Unemployment Rates are Low, Regardless of How Measured



A Broader Measure Suggests We Were at Full Employment



Where are Job Openings the Most and Least Plentiful by Industry?

Change in Job Openings Over the Past Year

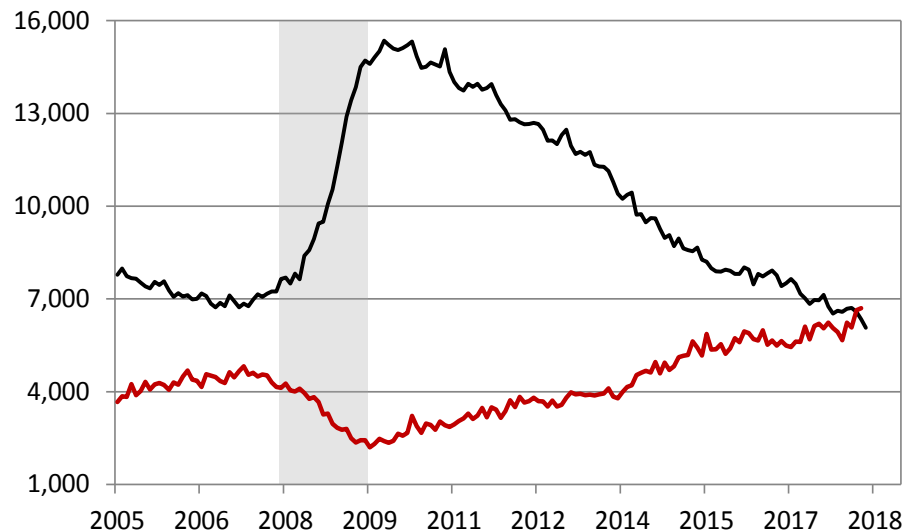
Percent change, April 2017 to April 2018

Professional Business Services	22.9%
Trade, Transportation & Utilities	21.0%
Manufacturing	20.9%
Leisure & Hospitality	11.0%
Education & Health Care Services	9.1%
Government	6.8%
Construction	-0.4%

SOURCE: Bureau of Labor Statistics

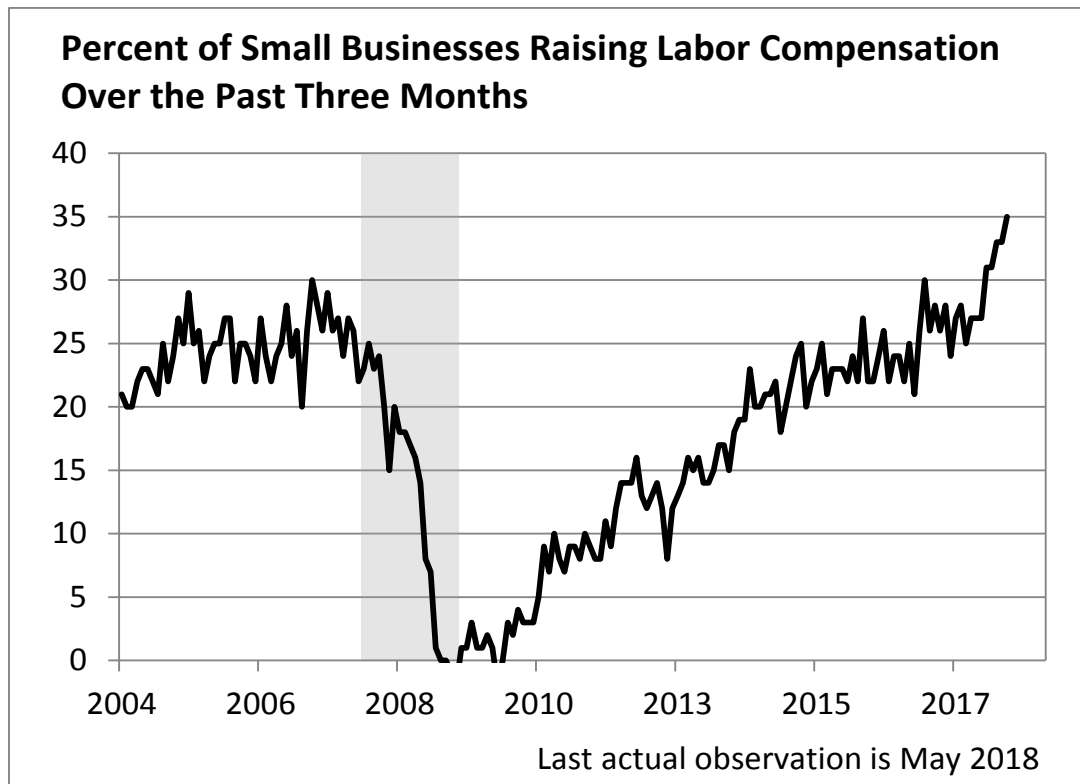
Total Job Openings and Total Unemployment

Thousands of Jobs

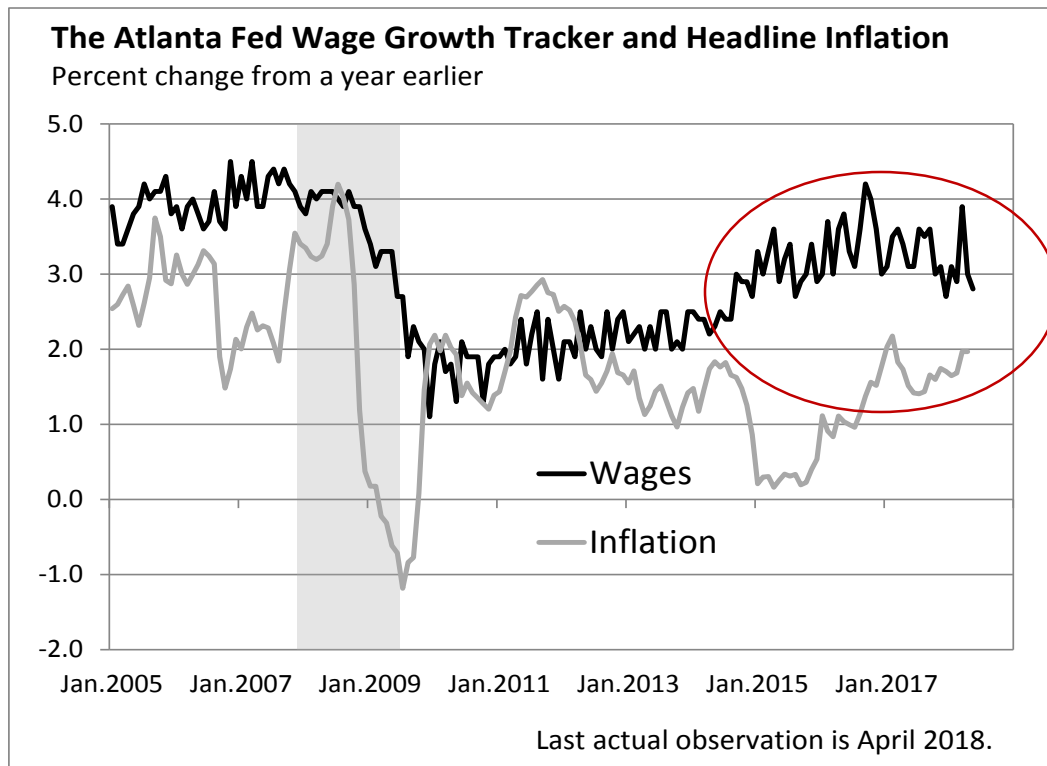


Last actual observation is April (Openings) or May (Unemployed) 2018

A Larger Percentage of Small Businesses are Raising Wages



Nationally, Wage Growth has Picked Up and Inflation Remains Below 2%.

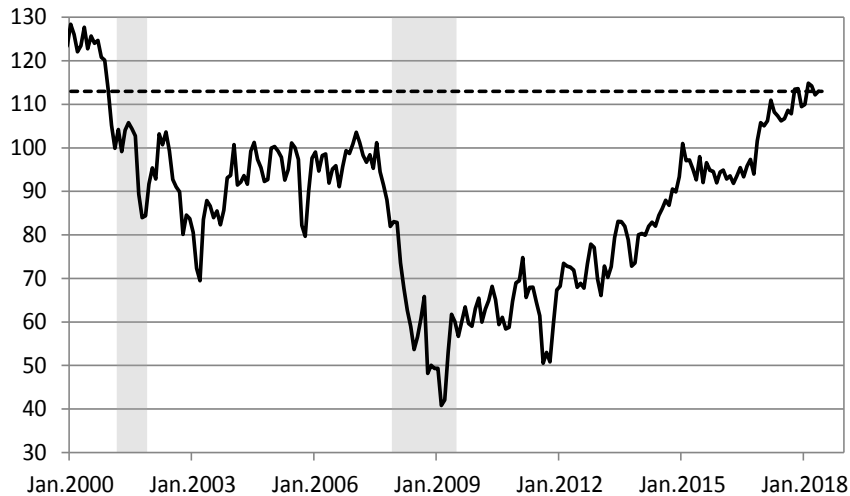


A widening gap is good because it signals improving purchasing power of households (inflation-adjusted wages).

Are Households Too Optimistic?

Consumer Confidence

Index

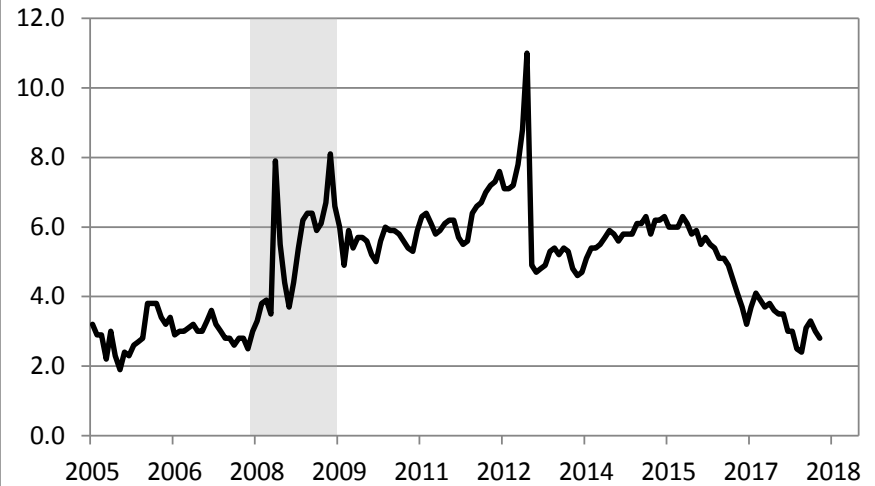


NOTE: Avg. of Michigan and Conference Board surveys.

Last monthly observation is May 2018.

Personal Saving Rate

Percent of disposable personal income



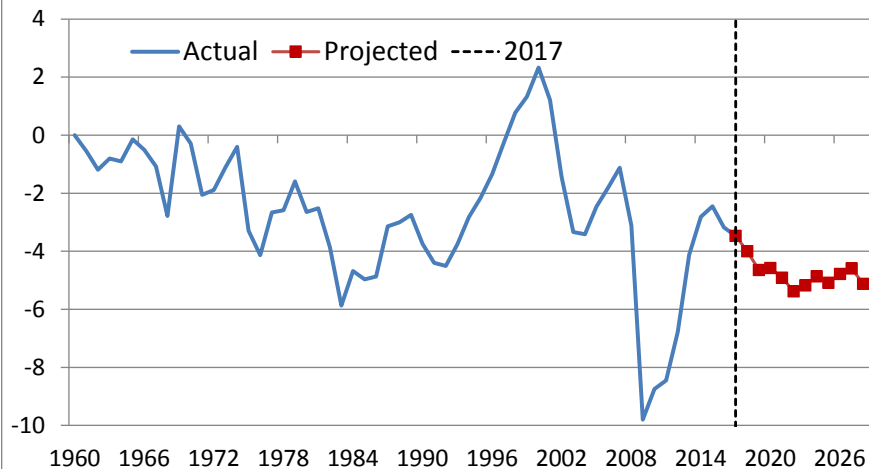
SOURCE: BEA

Last actual observation is April 2018

Are Households Too Optimistic? Yes, if you factor in future taxes.

Federal Budget Surplus and Deficit (-) as a Percent of GDP, 1960 to 2028 (P)

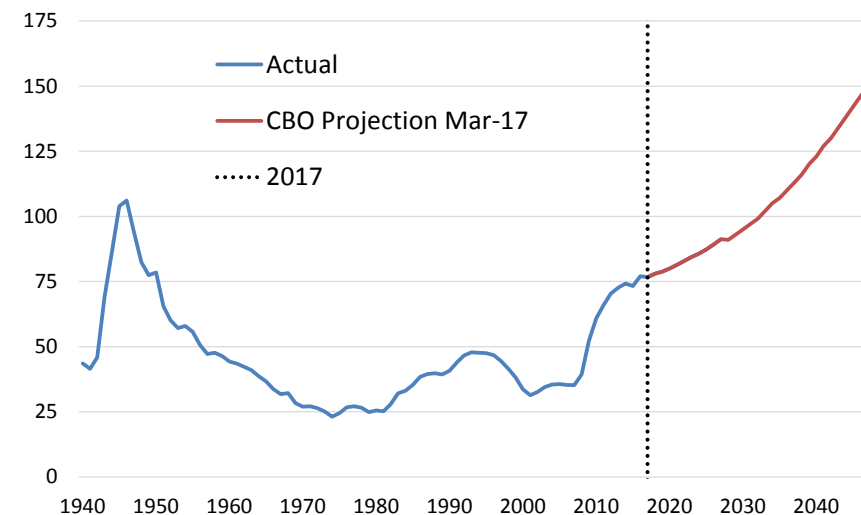
Billions of dollars



SOURCE: FRB St. Louis, Haver Analytics, CBO, OMB.

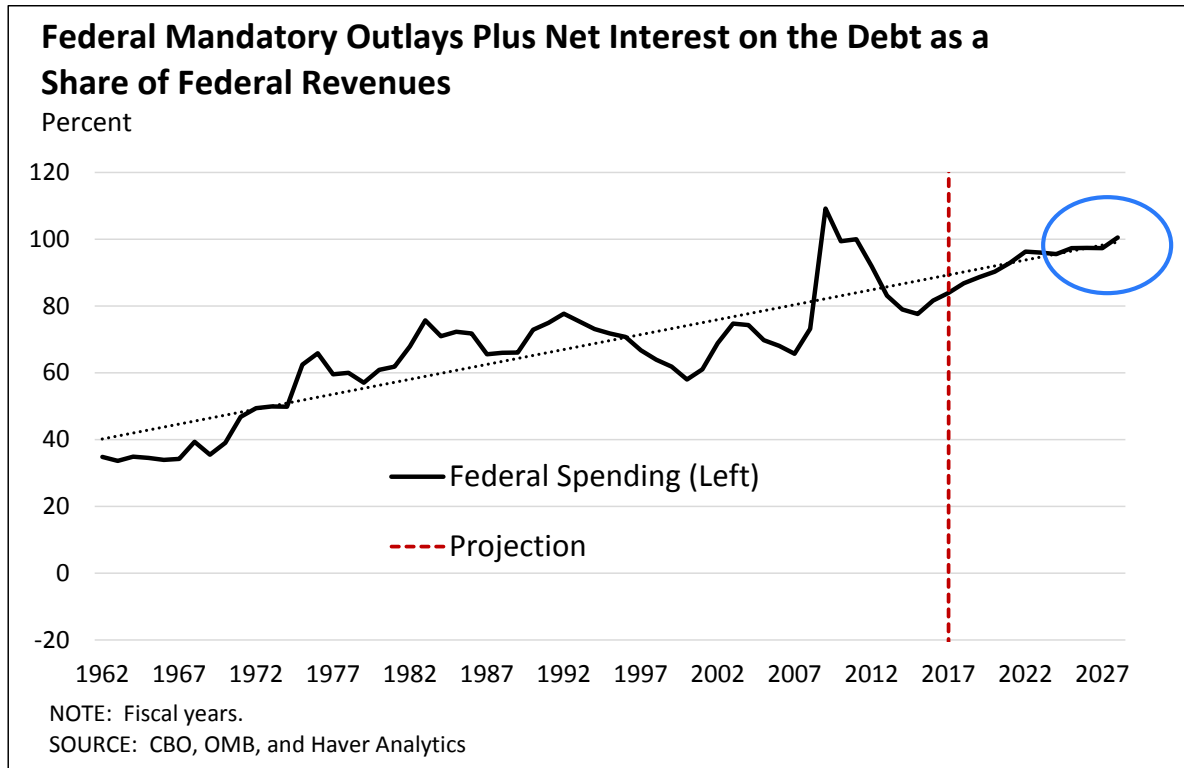
Federal Debt-to-GDP, 1940 to 2047 (P)

Percent of GDP



SOURCE: FRB St. Louis, Haver Analytics, CBO, OMB.

Federal Entitlements and Net Interest: A Growing Issue.

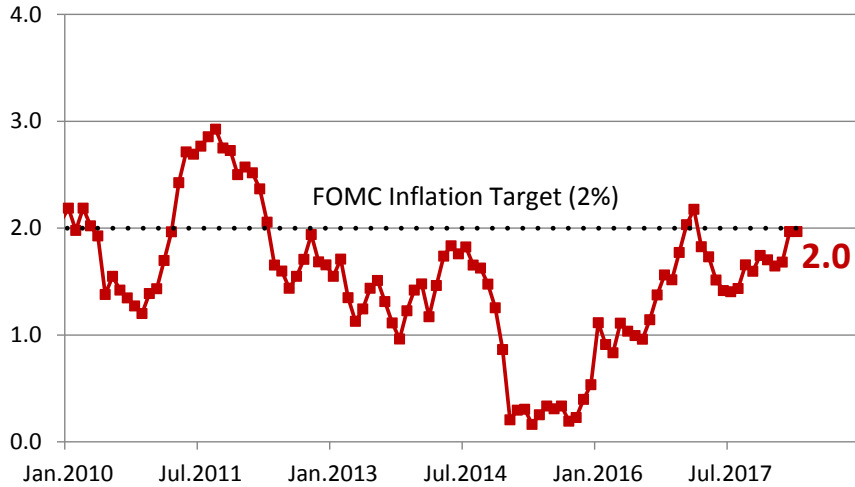


Turning to Inflation

Is Inflation Moving Higher?

The Fed's Preferred Inflation Measure

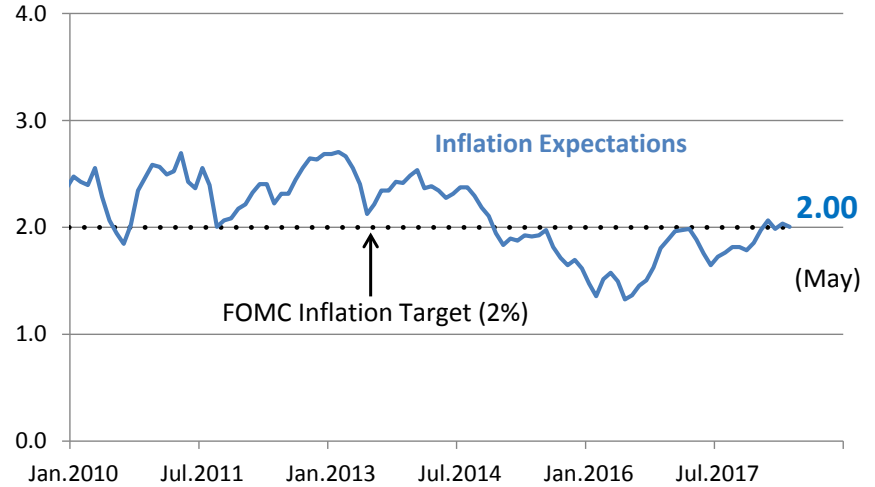
Percent change from a year earlier



NOTE: Inflation calculated from the personal consumption expenditures price index . Last observation is April 2018. Source is the Bureau of Economic Analysis.

Long-Term Inflation Expectations

(Inflation expectations based on TIPS)

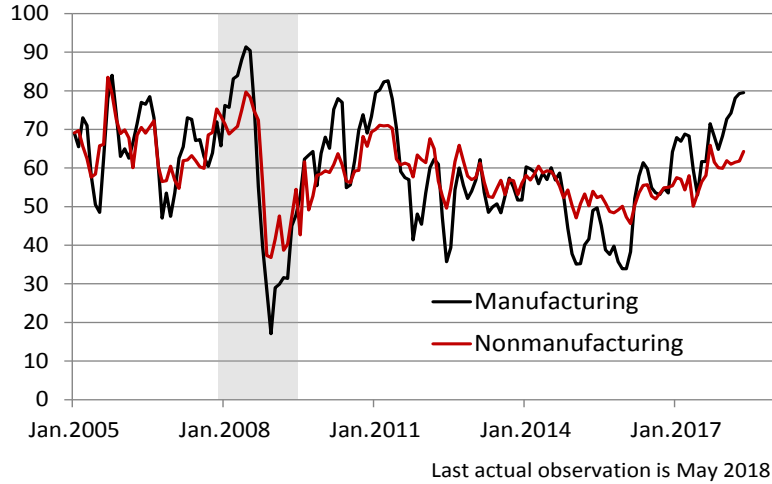


NOTE: Inflation calculated from the personal consumption expenditures price index . Inflation expectations are 5-year, 5-year forward break-even inflation rates.

Rising Price Pressures at the Firm Level

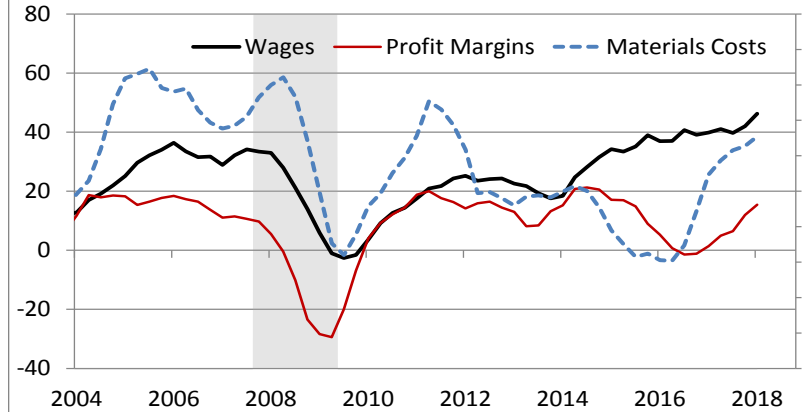
ISM Manufacturing and Nonmanufacturing Prices Indexes

Index, 50+ = More respondents reporting higher than lower prices



NABE Survey: CapEx, Profit Margins, & Materials Costs

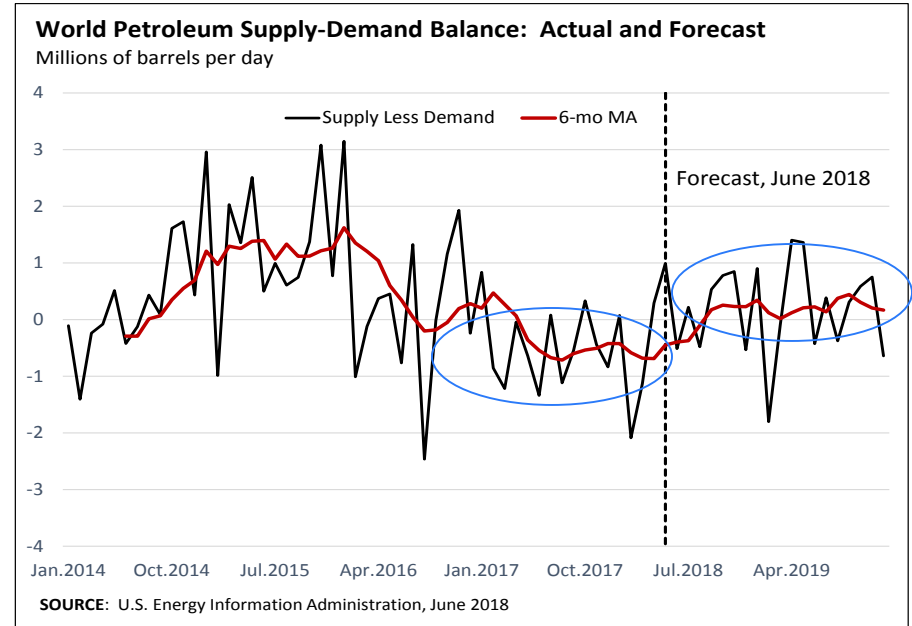
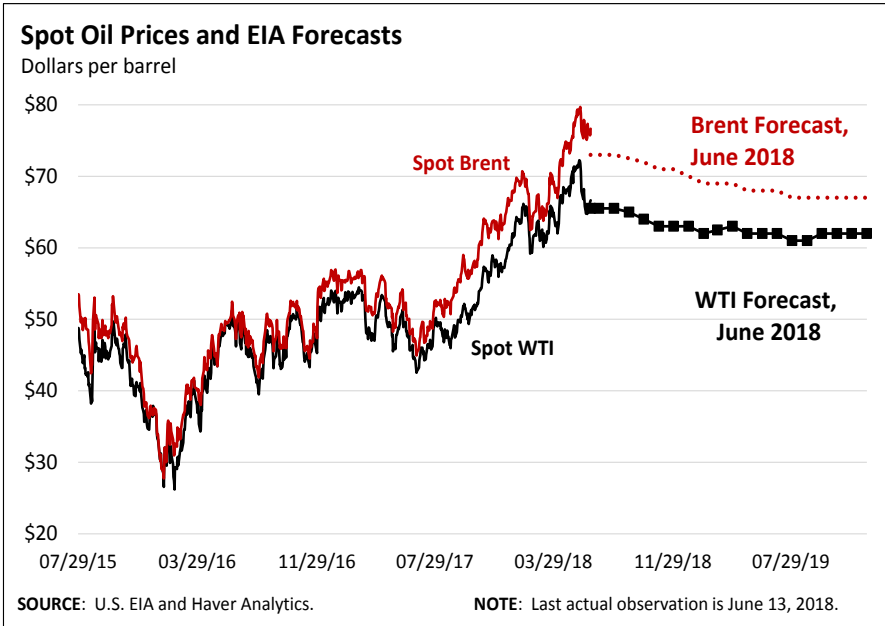
Four-quarter moving averages



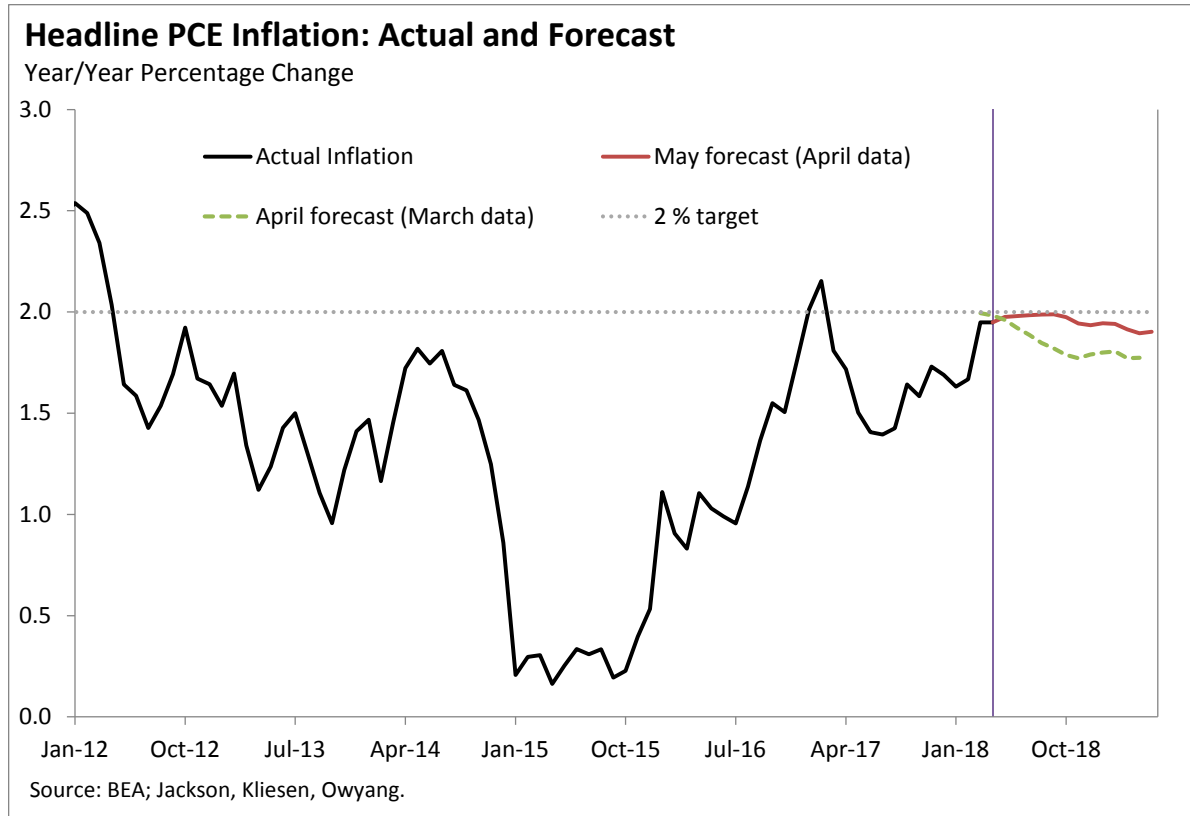
NOTE: Percent reporting rising less percent reporting falling.

Last actual observation is 2018:Q1

Oil Prices Fall; Global Supply Increasing



Inflation Forecast to Remain Near Target



A New Normal for Inflation?

- Some economists believe that inflation behaves differently than in the past.
- For example, the fracking revolution in the United States seems to have permanently lowered the price of crude oil (“shale band”).
- Others wonder whether the “Amazon effect” has exerted similar effects on retail prices.
- Regardless, most people have confidence that the Fed will keep inflation under control. That’s important!

Turning to Monetary Policy

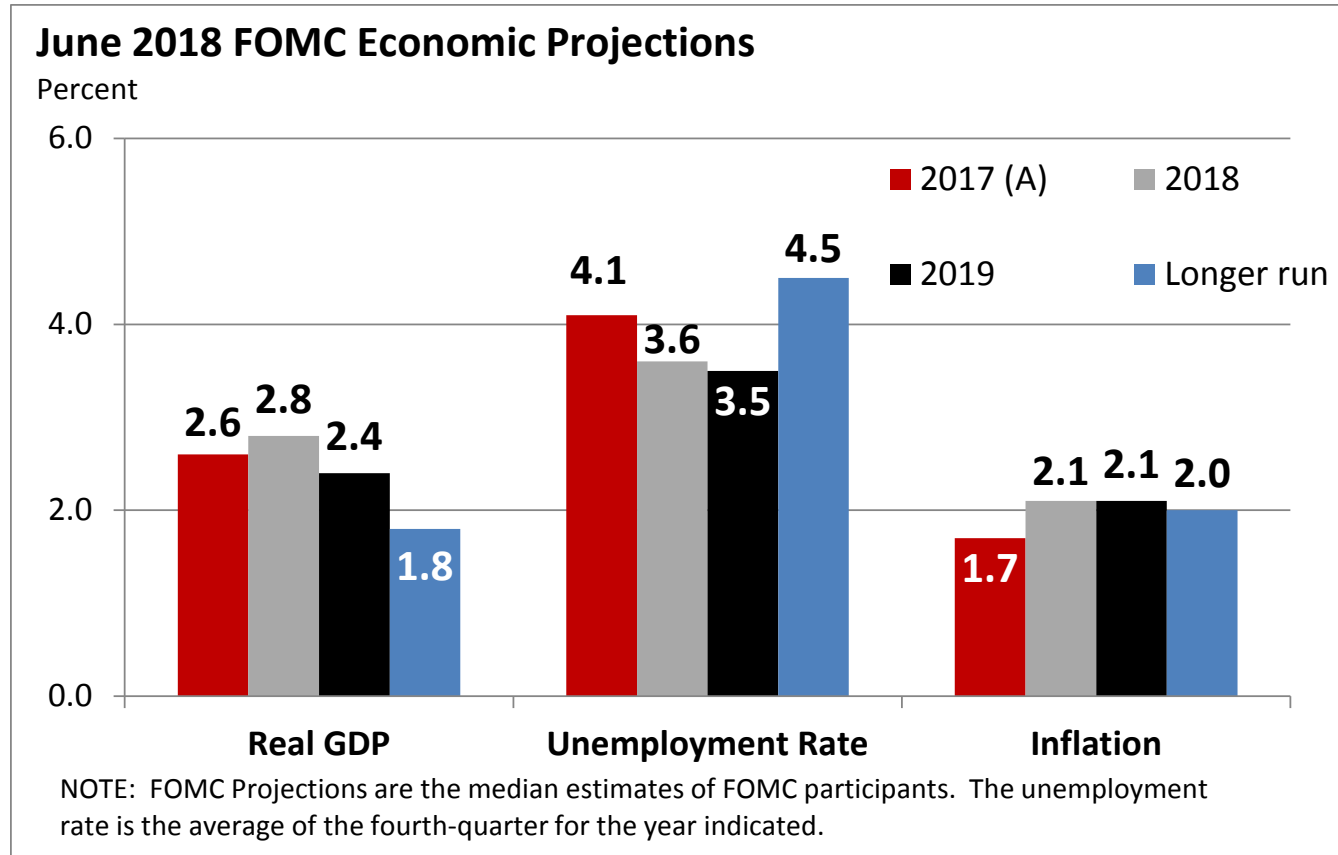


For release at 2 p.m. EDT

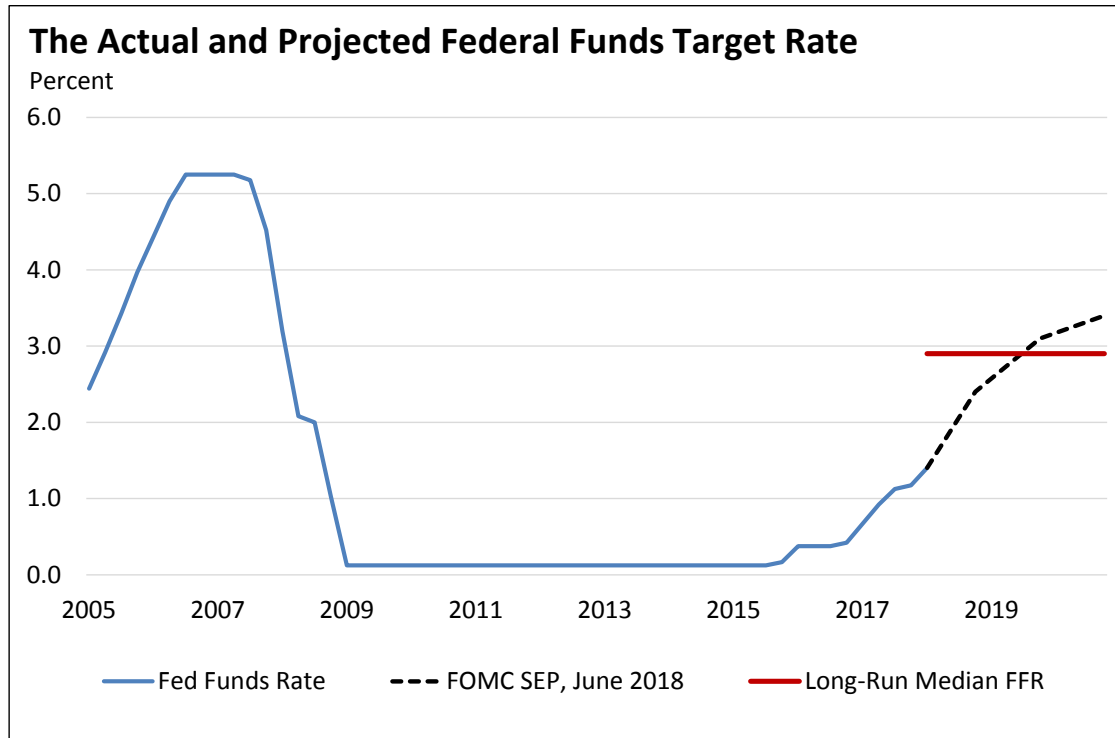
June 13, 2018

- The labor market continues to strengthen and economic activity has been rising at a solid rate.
- Growth of household spending has picked up, while business fixed investment has continued to grow strongly.
- Overall inflation has moved close to 2%; indicators of long-term inflation expectations are little changed.
- The Committee decided to raise the target range for the federal funds rate to 1.75% to 2%.

The Fed's Near-Term Outlook



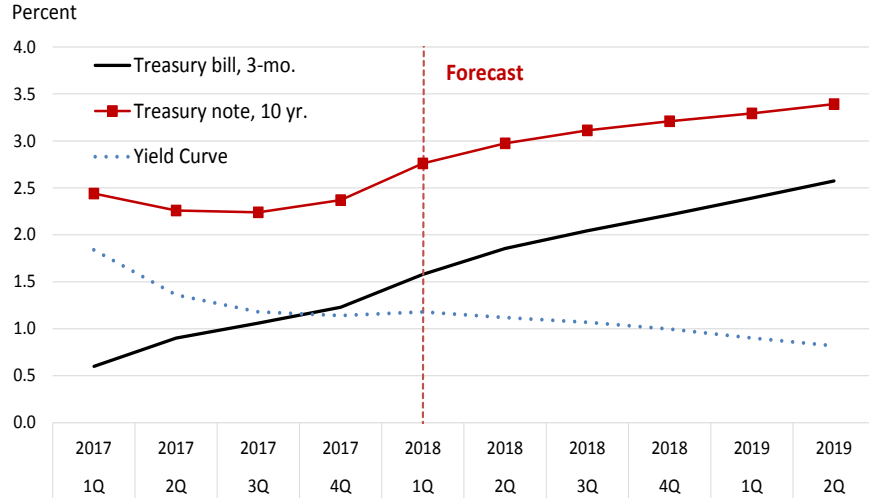
The FOMC: We're Bullish on the U.S. Economy!



“The Committee expects that further gradual increases in the target range for the federal funds rate will be consistent with sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective over the medium term.”
[FOMC Statement, June 13, 2018]

A Modest Projected Rise in Interest Rates

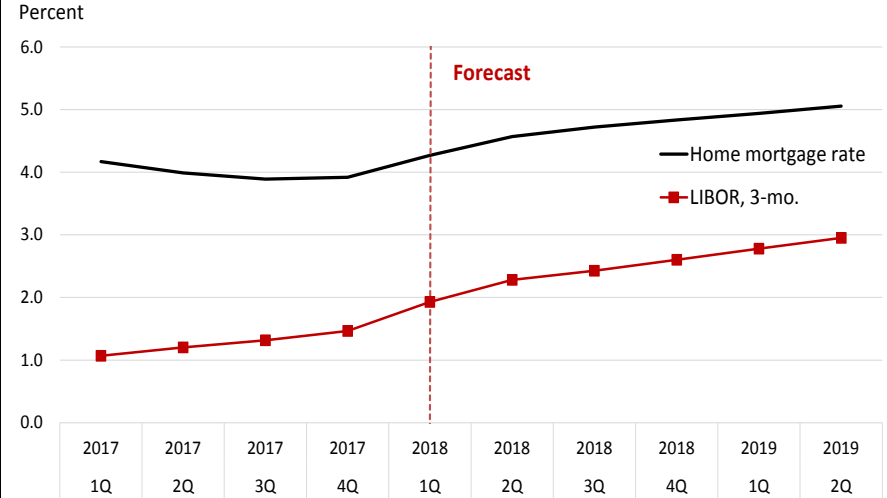
Blue Chip Consensus Treasury Yield Curve Forecast



SOURCE: Haver Analytics and Blue Chip Financial Forecasts (June 2018)

“Risk-Free” Rates

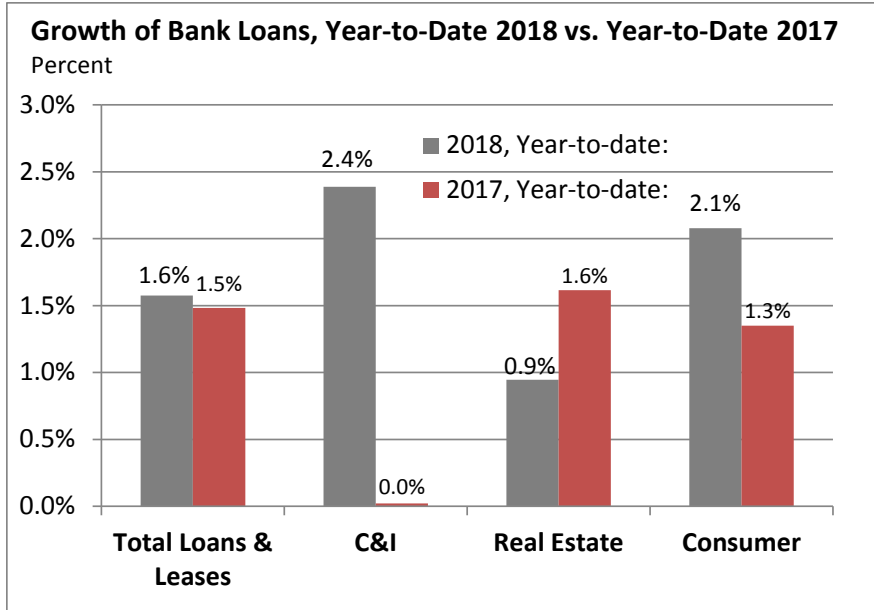
Blue Chip Consensus Forecasts: 30-Year Mortgages and LIBOR



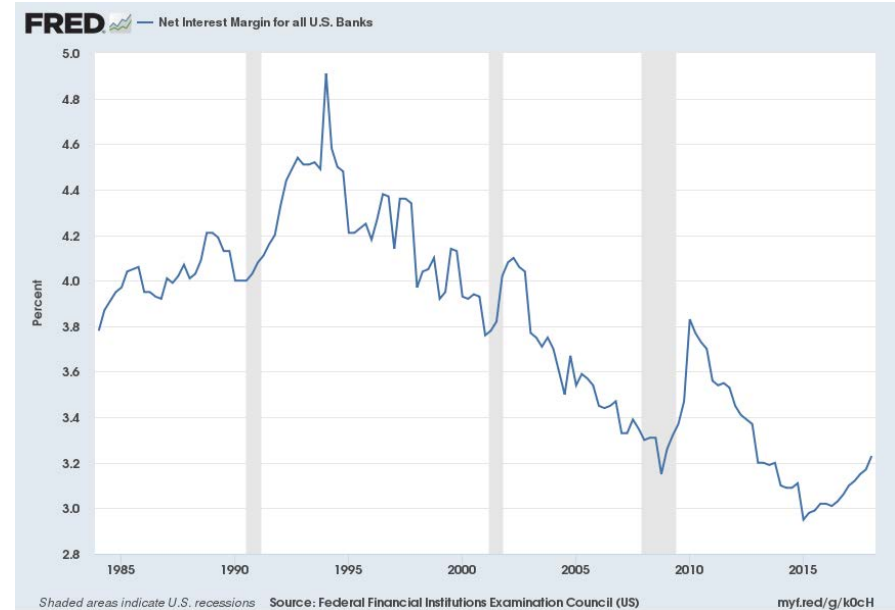
SOURCE: Haver Analytics and Blue Chip Financial Forecasts (June 2018)

“Risky” Rates

Commercial Bank Lending is Increasing

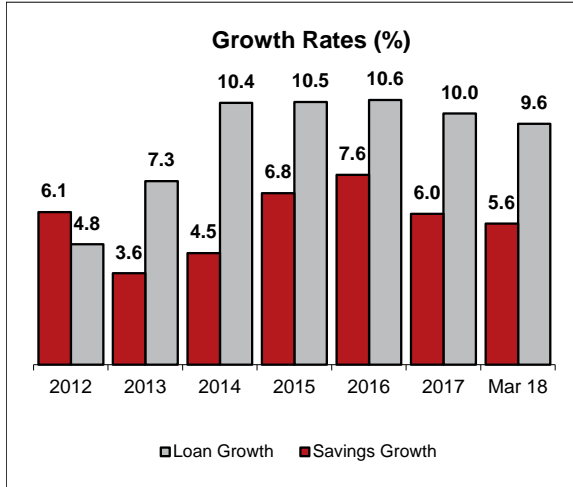


Loan Growth

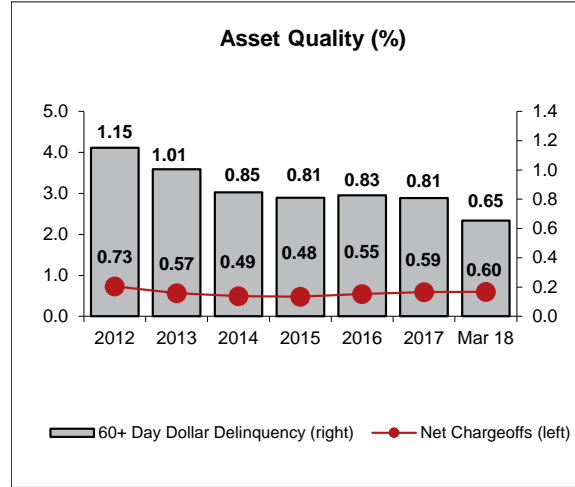


Net Interest Margin

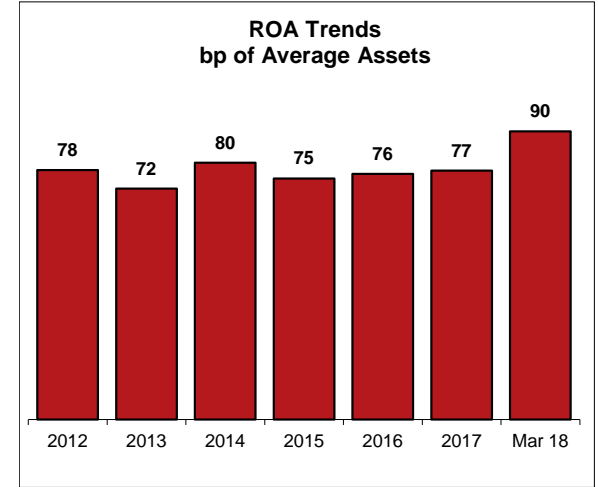
Credit Union Performance Looks Solid



Loan Growth



Credit Risk Trends



Earnings

SOURCE: U.S. Credit Union Profile, 2018:Q1

Small Business Lending Picks Up.

Main Street Leads the Way

Thomson Reuters / PayNet Small Business Lending Index (SBLI)*



*Volume of New Commercial Loans & Leases to Small Businesses, Seasonally Adjusted Index (January 2005 = 100)

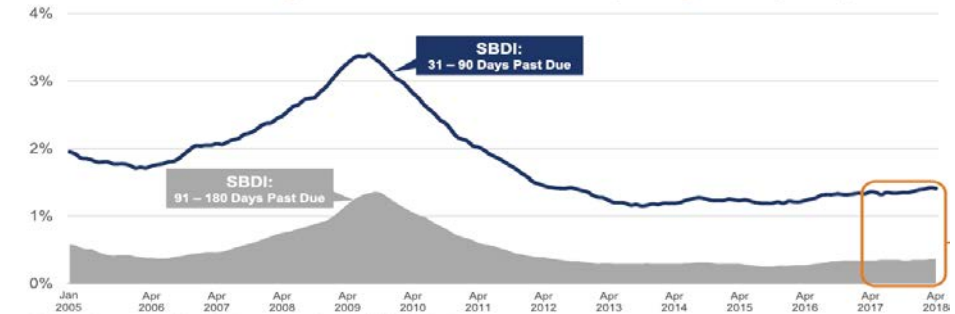
“Small businesses are benefitting from a host of tailwinds, including strong international growth and reduced regulatory and tax burdens.”

“Small business delinquencies and defaults have edged up in recent months, though this is expected at this stage of the business cycle and does not signal an imminent deteriorations in credit conditions.”

SOURCE: PayNet/Thomson Reuters (June 2018)

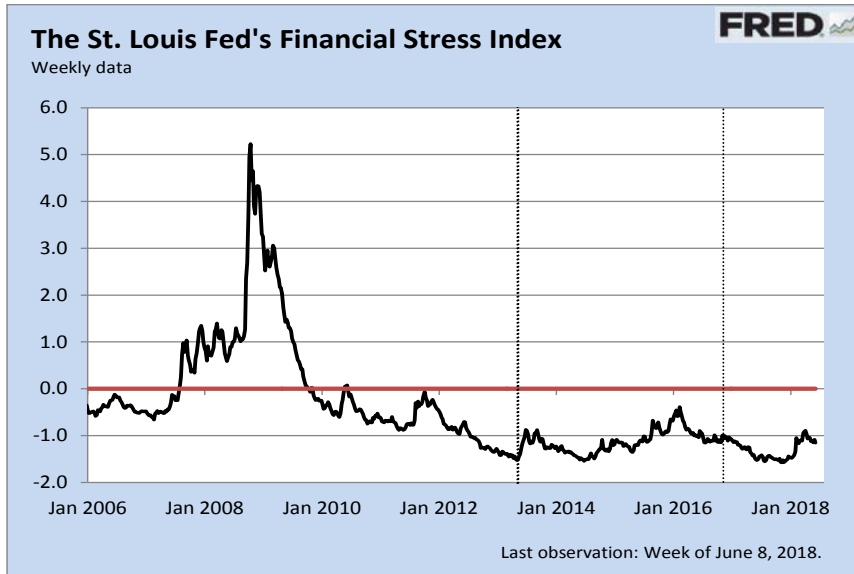
Financial Health Stabilizes

Thomson Reuters / PayNet Small Business Delinquency Index (SBDI)*

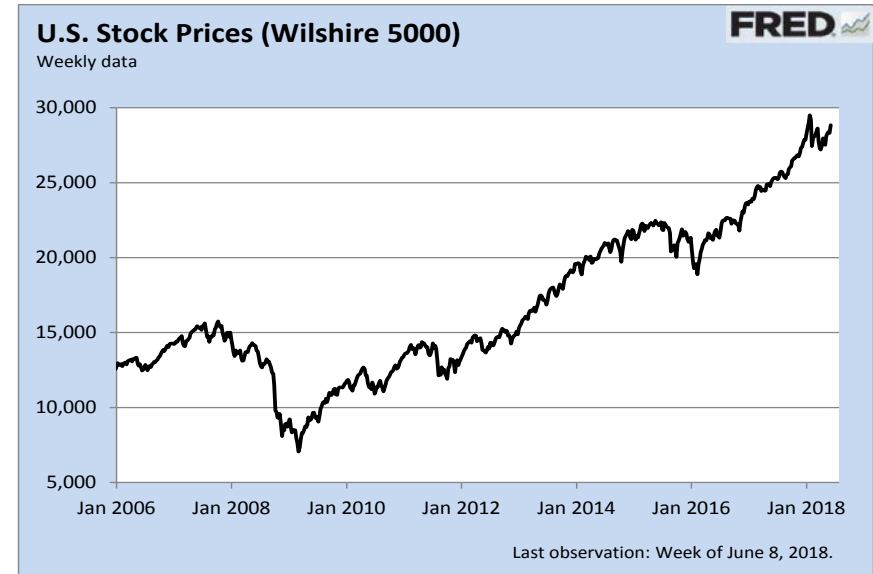


*Delinquent Percentage of Small Business Loans, Seasonally Adjusted Index.

Financial Market Conditions Remain Supportive of Growth



St. Louis Fed Financial Stress Index



Stock (Equity) Prices

Why You Should be Optimistic . . .

- Cuts in marginal tax rates, coupled with increases in household wealth, should keep consumer spending and housing construction growing at healthy rates.
- Deregulation and tax law changes will encourage firms to boost capital spending, hiring, and repatriate foreign profits.
- All else equal, these developments will tend to raise productivity, real wages, and economic growth.
- Unless inflation ramps up, the FOMC will be patient in withdrawing monetary stimulus.

And Why You Might Worry.

- Productivity growth, the key ingredient to rising living standards, remains lethargic.
- Fiscal stimulus could produce faster-than-expected real GDP growth (a good thing!). But this could raise inflation expectations.
- Larger-than-expected budget deficits could also cause a spike in inflation expectations and thus interest rates.
- International trade disruptions could roil markets, raise business uncertainty, and lead to lower growth.

Kliesen's Forecast

- Projected averages, 2018 to 2020:
 - Real GDP growth: 2.5% to 3.0%
 - Unemployment rate: 3.5% to 4.25%
 - Headline inflation: 2% (some upside risk)
- Punchline: Policy changes will boost economic growth. Inflation fears have crept into the market, so the Fed will need to remain vigilant.

QUESTIONS?