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V I E W P O I N T

THE ECONOMY

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GDP GROWTH REBOUNDS IN 2Q

The U.S. economy advanced at a 4.1% rate in 2Q18 — the first time since 2014 that the economy grew at this rate. The quarter was much stronger than the previous two, when growth averaged (a revised) 2.3%. Looking ahead, we anticipate that positive trends in several segments can keep the economy on a solid growth path for the next 3-4 quarters.

Recent Results

As we had forecast, Consumer spending bounced back in the second quarter. Personal Consumption Expenditure growth in 2Q was 4.0%, up from 0.5% in the prior quarter. Drilling deeper, spending on Durable Goods jumped 9.3% — which was expected, as Durable Goods spending declined 2% in the first quarter. Spending on Consumer Services rose a solid 3.1% and spending on Non-Durables surprised on the upside, rising 4.2%.

Capital spending dipped, although spending on Equipment and Intellectual Property Products both increased. Exports, benefiting from the global economic recovery, advanced at a 9.3% pace; this might also reflect some inventory stocking ahead of the trade wars. Elsewhere, Housing declined 1%, Government spending climbed 2.1% and Inventories rose. Offsetting growth, Imports were higher.

Pricing pressures eased a bit; ex food and energy, the price index for Personal Consumer Expenditures rose 2.0% in 2Q, down from 2.2% in 1Q.

The Argus Outlook

Since the current economic expansion began in the fourth quarter of 2009, the economy has now grown for 35 quarters in a row. In the post-World War II era, the U.S. has experienced 10 periods of economic growth; these expansions have averaged 20 quarters, or five years. The longest was 39 quarters; the shortest was five. Recently, expansions have been more durable. The six expansions since 1960 have averaged 27 months. Based on the historical record, the current expansion could certainly continue for several more quarters without breaking longevity records. And as we have frequently said, expansions don't die of old age, but rather from problems that emerge as they evolve.

Looking to the second half of 2018 and 2019, we are forecasting continued growth, as we think the positives in the economy can outweigh the negatives. For the full year in 2018, we think overall growth will average in the 3.3% range, up from the 2.5% average in 2017 and the 1.9% average in 2016. At the 3.3% pace of growth, we anticipate a total of four Federal Reserve rate hikes this year (two are already in the books). Given higher rates, we think economic growth in 2019 will cool to a 2.3% rate. These forecasts are based on our assumptions for macroeconomic factors such as the employment environment, commodity prices, the dollar and interest rates, as well as assumptions about fiscal policy.

Our estimates are slightly higher than or in line with the Federal Reserve's recently published economic projections for 2018-2020. The Fed forecasts that the central tendencies for economic growth by year are:

2018: 2.8%, with a range of 2.7%-3.0%.
2019: 2.4%, with a range of 2.2%-2.6%
2020: 2.0%, with a range of 1.8%-2.1%

The Fed's longer-run GDP forecast for the U.S. economy is 1.8%.

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Risk of Recession

We note that neither our current estimates nor the Fed's forecasts call for a recession in the U.S. through 2019. We believe that key forward-looking indicators (jobless claims, housing starts, the yield curve, and new orders from purchasing managers) are positive enough to keep the economy on a growth track over the next few quarters, despite the unpredictable impacts of the stock market, weather events, and other non-economic shocks such as geopolitical threats.

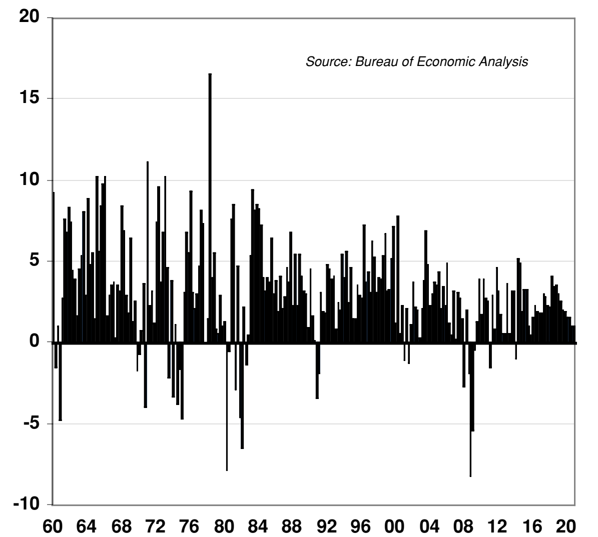
Risks to growth include volatile oil and commodity prices that could spike higher on geopolitical developments; a weaker-than-expected recovery in China; additional economic trouble in Europe; a dollar that reverses course and once again rises and limits export growth; an unexpected stumble in the housing market; a bear market in stocks; or deflationary conditions, such as those Venezuela is currently facing.

Our interest-rate forecasts now call for the Fed to hike interest rates two more times in 2018 and then two-to-three times in 2019. We expect longer-term rates to rise modestly as the Federal Reserve reduces its balance sheet, which is bloated from the days of Quantitative Easing. Our preliminary forecast for the 10-year yield in 4Q18 calls for a range of 2.75%-3.75%. Thus, within the year, the yield curve could continue to flatten — implying slower growth in 2019. By 2020, we look for the Federal Reserve to have lifted the fed funds rate to 3.0% and to have strengthened its balance sheet (assets on the balance sheet currently total \$4.28 trillion, down from the peak of \$4.5 trillion in 2015), moving into position to address any future economic slowdowns or crises.

We also think it is important to point out that the Federal Reserve currently forecasts its next rate cut in 2021. And why does the Fed cut interest rates? To stimulate an economy in recession. Indeed, as 2020-2021 approach, we may start calling for a conclusion to the current economic expansion.

John Eade
President, Argus Research

GDP TRENDS & OUTLOOK (% CHANGE)

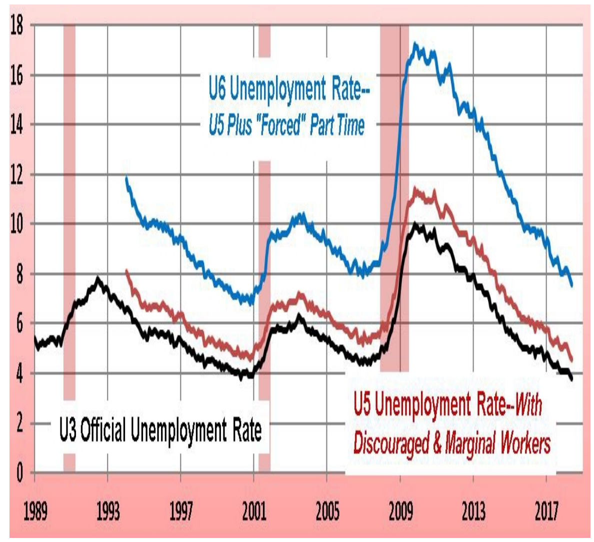


The U.S. economy advanced at a 4.1% rate in 2Q18 — the first time since 2014 that the economy grew at this rate. In the past two quarters, growth averaged (a revised) 2.3%. We anticipate positive trends in several segments can keep the economy on a solid growth path.

LEADING INDICATORS

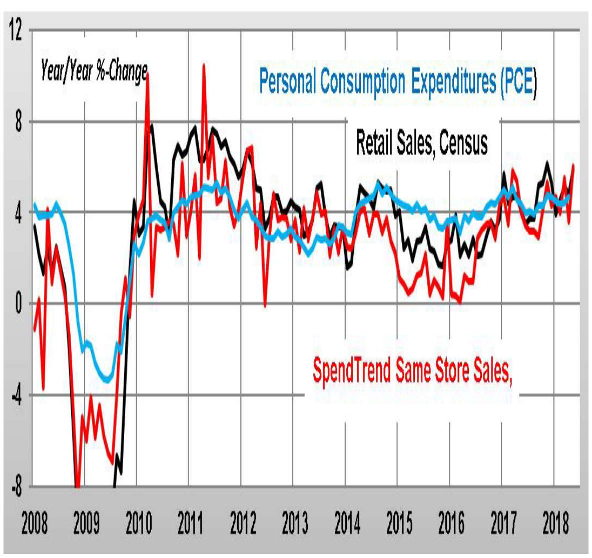
The Conference Board's Leading Economic Indicators points to stronger economic growth ahead. The semi-annual momentum of the LEI rose to just under 8% in February and March, the strongest reading since the initial recovery from the 2007-09 recession.

BROADER UNEMPLOYMENT RATES



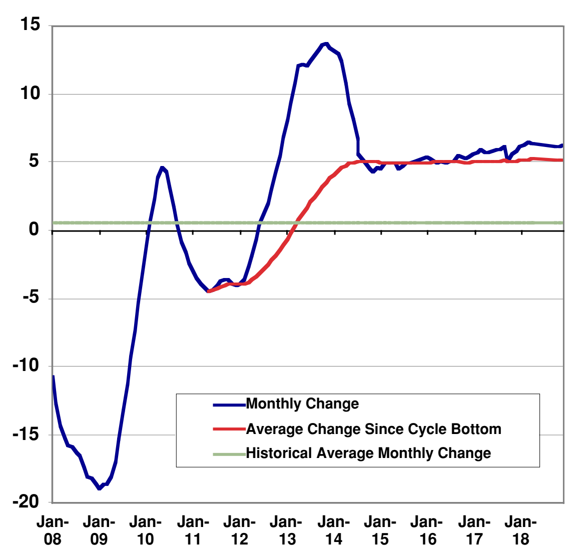
The strength of the labor market is confirmed by all of the broader measures of unemployment, which have fallen to the lowest jobless rates since 2000 or 2001.

ANNUAL CONSUMER SPENDING



The Census comprehensive Retail Sales tally started the year slowly, due to adverse weather in January/February, but then advanced at a surprisingly strong pace in the past four months.

S&P CASE/SHILLER NATIONAL HOME PRICE INDEX (%)



The S&P/Case-Shiller National Home Price Index recently showed that prices gained an impressive 6.4% year-over-year through May. Looking into the second half of 2018 and 2019, we expect price hikes to settle in the 5.0%-5.5% range.