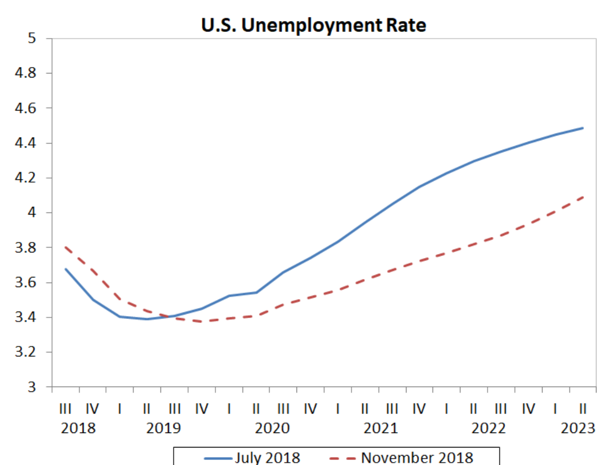
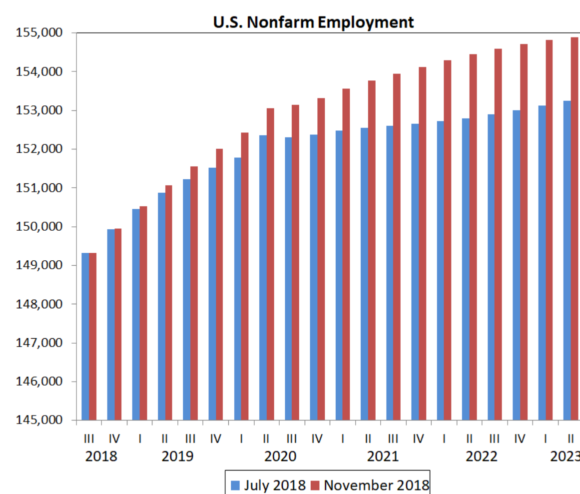
National Economic Estimating Conference
November 9, 2018

The National Economic Estimating Conference met on November 9, 2018, and adopted the IHS Markit baseline forecast. The near-term outlook is close to the last forecast adopted in July, with continued strength over the next year. The expected gains continue to be driven by the stimulus from the 2017 tax cuts and 2018 budget acts, still-accommodative monetary policy, healthy consumer balance sheets, firm growth of employment and income, gains in wealth, and high levels of both consumer and business confidence. This view of the economic environment is not expected to materially change until late 2019.

The November forecast incorporates revised historical data for personal income, resulting in higher growth rates in almost every quarter since the third quarter of 2016. Solid growth in real disposable personal income is expected to continue through the 2020 calendar year. An increase in hours worked and an acceleration in hourly compensation are driving gains in wage and salary income, aided in 2018 by the recently enacted personal income tax cuts. Further, the personal saving rate was revised upward in all but one year, mostly reflecting downward revisions to personal spending and upward revisions to personal income. In this regard, the saving rate was revised to 7.2% in the first quarter of 2018 — more than double the pre-revision number. This leaves consumers with healthier balance sheets than previously thought.



Relative to July, the November forecast also has improved growth rates in Fiscal Year 2018-19 for nonfarm jobs, real consumer spending, industrial production, and government spending. Even though the unemployment rate is slightly higher in Fiscal Year 2018-19 relative to the July forecast, the November forecast shows generally lower unemployment rates in the next five fiscal years, with a modest drift upwards beginning in 2020 based on a marked deceleration in employment. Due in large measure to the twin effects of (1) firm gains in production over recent quarters that continue through 2022 and (2) a slight upward drift in the labor force participation rate through mid-2020 as the discouraged worker effects unwind, the annual employment levels (number of non-farm jobs per year) remain above those expected in July throughout the forecast.



The November forecast also incorporates the latest information on tariffs, including those on solar panels, washing machines, steel and aluminum; a 25% tariff on $50 billon of goods from China; and a tariff of 10%, effective September 24th but rising to 25% January 1st, on another $200 billion of goods from China. The effect of the tariffs is expected to start appearing in the data for consumer prices in October, but the full effect may not be seen until the scheduled January 1st tariff increase begins and businesses make their initial decisions on the extent to which they can absorb the cost increases. The higher tariffs are expected to lead to a permanent increase in the price level, but are

unlikely to generate, by themselves, a persistent increase of inflation beyond its underlying trend. Still more tariffs have been threatened against China and other trading partners; cumulatively, these tariffs—if implemented—would mean that close to one-third of all imported goods into the US would be subject to higher tariffs. To the extent that they materialize, tariffs act like a tax increase, weakening the purchasing power of households and creating greater business uncertainty. Most of the expected slowdown in GDP growth during the 2019 calendar year is accounted for by the related deceleration in consumer spending growth, which declines from 4% in the third quarter of 2018 to 2.7% in in the fourth quarter and 2.5% in the first half of 2019.

Since the last conference, real GDP growth was a robust 4.2% in the second quarter of 2018 and 3.5% in the third quarter. Real GDP is expected to grow 2.6% in the fourth quarter of 2018, 3.1% over all of the 2018 calendar year and slow to 2.4% in the 2019 calendar year. Slowing global growth, a strong dollar, fading fiscal stimulus, tightening monetary policy, a hesitant stock market, the effects of recent tariffs, elevated energy prices, and the approach to capacity constraints point to a further slowing in the US GDP growth to 1.8% in 2020.

As a separate issue, the housing market is experiencing difficulties described as a "slump" by IHS Markit, mostly attributed to issues affecting affordability of both existing home sales and new construction. Higher interest rates, higher construction costs, and shortages of buildable lots are holding national housing starts down. Housing starts were lower than expected with 1.3 million units on an annual basis in the 2nd quarter of 2018 and 1.2 million units in the 3rd quarter. The trajectory of the Federal Funds Rate reflects more increases by the end of this calendar year and next year, turning slightly restrictive in the first half of Fiscal Year 2020-21. Similarly, conventional mortgage rates will be slightly higher than previously expected in the next three fiscal years. While little relief is expected in the short run, gains in household formation will begin to offset some of these drags by the 2nd quarter of 2020.

Lastly, the outlook for corporate profits is somewhat mixed relative to the July forecast. The levels for both book and economic corporate profits have dropped in the entire forecast horizon due to lower than expected collections in the 2nd quarter of 2018 but growth rates over the prior year have increased in Fiscal Years 2019-20 and 2020-21.