

## **2016Q3 Forecasts for the Philadelphia Federal Reserve Society of Professional Forecasters**

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RCF Vice-President Peter Bernstein is a member of the Philadelphia Fed's Society of Professional Forecasters. Below are his 2016Q3 forecasts and analysis, as well as a look at his 2016Q2 forecasts and recent historical data.

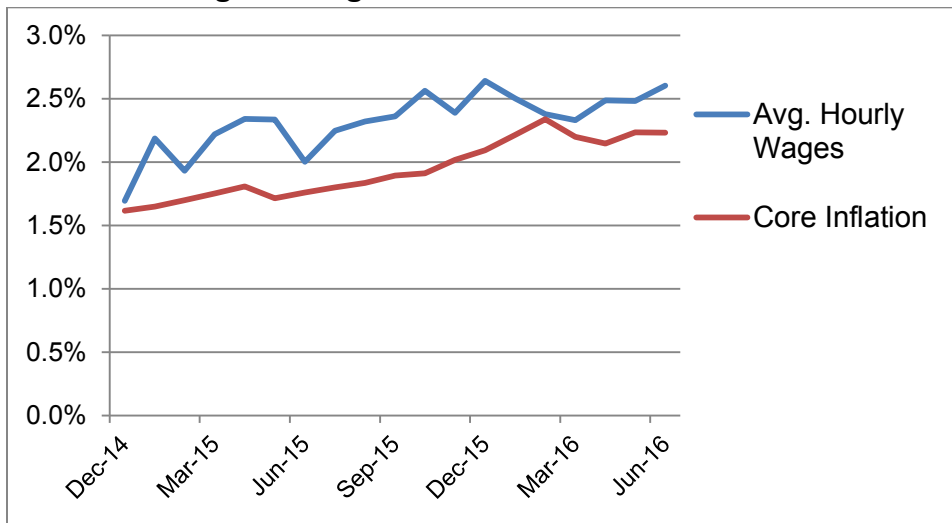
### **Consumer Spending Keeps Economy Growing**

Real GDP grew at only about a 1.0 percent annual rate through the first-half of 2016, even less than the modest 2.0 percent growth that has been typical of the past few years. The weaker growth was due to a decline in business investment spending. Business investment spending fell in part because of a temporary reduction in inventories, but mainly because of a slowdown in the manufacturing sector due to a sluggish global economy, a strong dollar, and continued weakness in U.S. oil production.

Consumer spending on the other hand was particularly strong, especially in the second quarter of 2016 when it rose at a 4.2 percent annual rate. Solid job growth (1.1 million jobs added in the first-half of 2016) and modestly rising wages (up 2.6 percent vs. last year) have been the key. But with this increase in wages and consumer spending, there has been a notable uptick in inflation. In fact, the increase in inflation explains much of the smaller increase in real GDP.

In the near-term, higher inflation might actually be a good sign because it indicates that consumers are willing and able to pay higher prices. But eventually, higher inflation could put the Fed in a quandary. Rising prices might force the Fed to increase interest rates even at a time when slow growth and an uncertain international situation argue against a rate hike. For now, we expect the Fed to hold off on any rate increase until December.

## Percent Change in Wages and Prices



Note: Core Inflation excludes food and energy prices  
Source: U.S. Department of Labor, Bureau of Labor Statistics

Looking ahead, we expect the economy to strengthen in the second-half of the year, with real GDP projected to increase at close to a 3.0 percent rate over the next two quarters. Longer-term we think 2.5 percent growth is reasonable. The risk to the economy is that the Fed will be forced to raise rates more rapidly than their current intention. Indeed, our thinking is that a marked slowdown would not be unlikely in 2019.

We expect unemployment to remain below 5.0 percent, but doubt that the measured rate will fall too much more. One key reason is that improvements in the job market have caused the labor force to increase and as this continues there will be a rough balance between new workers and new jobs. Still, that will be a good short-term sign for the economy overall, and should support further increases in wages and consumer spending.

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### Details:

U.S. Business Indicators							
	Actual	Forecast	Actual	Forecast	Forecast	Forecast	Forecast
	2016:Q1	2016:Q2	2016:Q2	2016:Q3	2016:Q4	2017	2018
Nominal GDP (billions)	\$18,282	\$18,432	\$18,438	\$18,253	\$18,466	\$19,493	\$20,454
Civilian Unemployment Rate (%)	4.9	4.9	4.9	4.8	4.7	4.7	4.9
Change in Payroll Employment (thousands)	659	625	459	600	575	2140	1431
Housing Starts (millions)	1.151	1.200	1.160	1.171	1.276	1.345	1.488
Fed Funds Rate	0.36	0.38	0.36	0.38	0.63	1.34	2.63
T-Bill Rate, 3-month	0.29	0.29	0.26	0.23	0.43	1.02	2.11
AAA Corp Bond Yield	3.93	3.79	3.59	3.53	3.71	4.10	5.13
BAA Corp Bond Yield	5.31	5.14	4.67	4.61	4.79	5.18	6.21
Treasury Bond Rate, 10-year	1.92	1.88	1.75	1.82	2.10	2.74	4.02

Note: Values are quarterly and annual averages

Actual data obtained from Philadelphia Federal Reserve Bank

Real GDP and Its Components							
	Actual	Forecast	Actual	Forecast	Forecast	Forecast	Forecast
Chain-weighted (2009\$)	2016:Q1	2016:Q2	2016:Q2	2016:Q3	2016:Q4	2017	2018
Real GDP	0.8%	2.1%	1.2%	2.8%	3.1%	2.6%	2.4%
Real Consumer Spending	1.6%	3.3%	4.2%	2.8%	2.9%	3.0%	2.7%
Real Fixed Business Investment	-1.1%	0.0%	-3.1%	0.2%	1.0%	1.9%	4.2%
Real Government Purchases	1.6%	-3.5%	-0.9%	0.9%	0.6%	0.5%	0.5%
Real Exports of Goods & Services	-0.7%	1.2%	1.4%	1.6%	3.7%	3.7%	2.9%
Real Imports of Goods & Services	-0.6%	2.8%	-0.4%	3.7%	3.7%	3.6%	3.6%

Note: Quarterly values are expressed at annual rates

Actual data obtained from Philadelphia Federal Reserve Bank

CPI and PCE Inflation					
	Forecast	Actual	Forecast	Forecast	Forecast
	2016 - YTD	2016 - YTD	2016	2017	2018
CPI Inflation Rate	0.7	1.1	1.8	2.5	2.6
Core CPI Inflation Rate	2.3	2.2	2.4	2.5	2.6

Note: Actual inflation is for the 12-month period ending 2016Q2, percent changes are compared to prior year

Actual data obtained from Philadelphia Federal Reserve Bank