Peter Bernstein, Vice President

2017Q1 Forecasts for the Philadelphia Federal Reserve Society of Professional Forecasters

RCF Vice President Peter Bernstein is a member of the Philadelphia Fed's Society of Professional Forecasters. Below are his 2017Q1 forecasts and analysis, as well as a look back at how his 2016 forecasts compared with actual 2016 results.

Near-Term Outlook Positive but Future Risks Appear

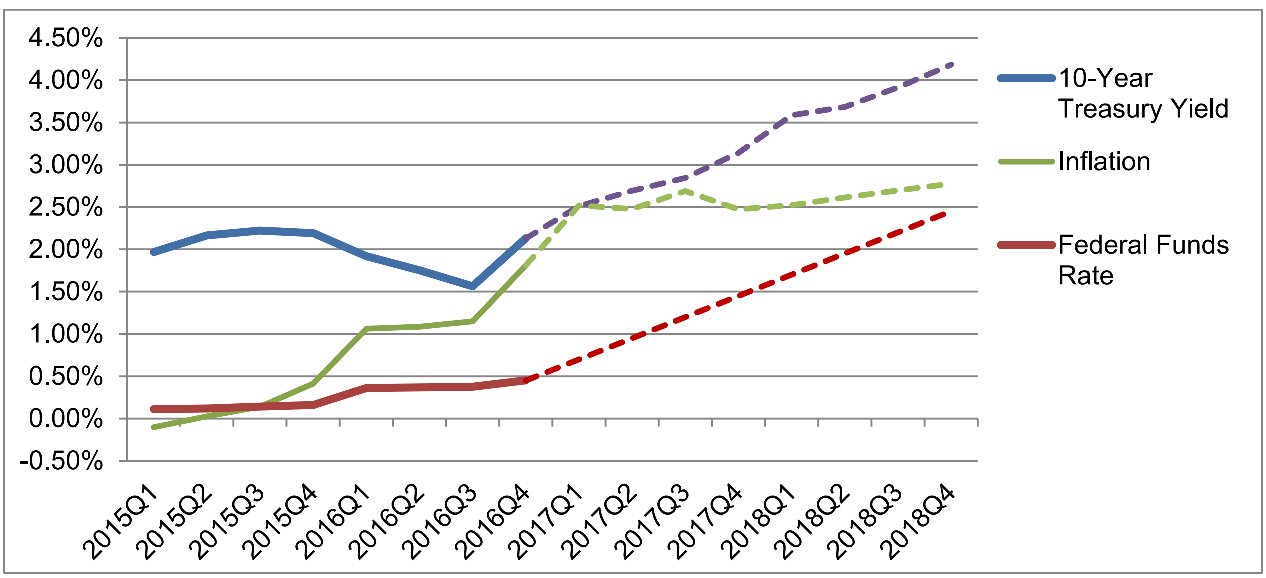
The U.S. economy grew 1.6 percent in 2016 below our forecast of 2.3 percent growth. The primary reason for weaker growth was a decline in business investment. Higher inflation also caused the real value of economic output to rise less than projected. Consumer spending grew solidly as expected, bolstered by 2.5 million additional jobs and an unemployment rate below 5.0 percent, also in line with the forecasts we made at the start of 2016. The stronger dollar hurt exports and generally slower growth limited the Fed to one rate increase last year, which resulted in lower than expected interest rates on Treasury securities. Housing starts in 2016 were exactly as projected at 1.17 million.

Looking to 2017 and 2018, we expect real GDP to increase in the 2.5-3.0 percent range. The new administration's pro-business positions on corporate taxes and regulations should boost business investment, though we don't expect to see much impact from increased infrastructure spending until 2018. Neither are we particularly optimistic about international trade, partly due to President Trump's opposition as well as continued strength in the dollar. Still, we expect the economy to add more than two million jobs over each of the next two years allowing the unemployment rate to continue its downward trend.

The biggest risk we see is higher inflation. Already, inflation has increased faster than most people realize, as shown below. Stronger growth, lower unemployment, and possible import taxes would all push prices higher, likely forcing the Federal Reserve to raise rates more aggressively. Higher interest rates might not cause much damage in the near-term as they would remain quite low by historical standards. But by 2019, the combination of more inflation and higher borrowing costs could derail what will by that time be a ten-year economic expansion.

Of course, the bond market has frequently confounded predictions of higher interest rates. And U.S. debt is likely to remain a safe haven for international investors in times of economic and political uncertainty. As such, a key question is whether future U.S. fiscal policy, which seems geared toward promoting domestic growth with little concern about the likely increase in the budget deficit or possible restrictions on global trade, will result in more or less international confidence in the American economy.

Actual and Forecasted Rates



Forecasts from 2016Q1 vs Actual 2016 Data, and Current Forecasts for 2017 and 2018

	Forecast	Actual	*Forecast*	*Forecast*
	2016	2016	*2017*	*2018*
Real GDP	*2.3%*	1.6%	*2.6%*	*2.8%*
Real Consumer Spending	*2.8%*	2.7%	*2.9%*	*2.8%*
Real Business Investment	*2.3%*	-1.6%	*5.0%*	*5.7%*
Real Government Purchases	*1.4%*	0.8%	*0.8%*	*1.8%*
Real Exports	*0.6%*	0.4%	*1.3%*	*-0.1%*
Real Imports	*3.1%*	1.1%	*3.6%*	*2.8%*
Consumer Price Inflation	*1.3%*	1.8%	*2.5%*	*2.8%*
Core Inflation (ex food and energy)	*2.1%*	2.2%	*2.3%*	*2.6%*
Unemployment Rate	*4.7%*	4.9%	*4.6%*	*4.4%*
Change in Employment (millions)	*2.47*	2.49	*2.30*	*2.00*
Housing Starts (millions)	*1.17*	1.17	*1.28*	*1.39*
10-Year Treasury Rate	*2.42%*	1.84%	*2.80%*	*3.84%*
3-Month Treasury Rate	*0.46%*	0.32%	*0.93%*	*1.66%*

All values are annual averages; historical data obtained from the Philadelphia Federal Reserve; 2016 forecast made in 2016Q1; 2017 and 2018 forecasts are from RCF Vice President Peter Bernstein's 2017Q1 submission to the Philadelphia Federal Reserve's Society of Professional Forecasters.

For additional information or questions, please contact Mr. Peter Bernstein, RCF Vice President, pbernstein@rcfecon.com.