RCF ECONOMIC & FINANCIAL CONSULTING, INC.

Peter Bernstein, Vice President

2018Q3 Forecasts for the Philadelphia Federal Reserve Survey of Professional Forecasters

RCF Vice President Peter Bernstein is a member of the Philadelphia Fed's Survey of Professional Forecasters. Below are his 2018Q3 forecasts and analysis.

The economy grew at a 4.1 percent rate in the second quarter of 2018 and at a 3.0 percent rate for the first half of 2018. While individual quarterly growth rates can be volatile there is clearly an upward trend in growth dating back at least two years. A key contributor to faster growth has been strong business investment spending supported by recent cuts in corporate taxes and more favorable treatment of depreciation. Solid job growth has pushed the unemployment rate below 4 percent and despite growing trade tensions exports grew solidly in the first half of 2018. All in all, the economy is on solid footing and we expect the good times to continue the rest of year and into 2019.

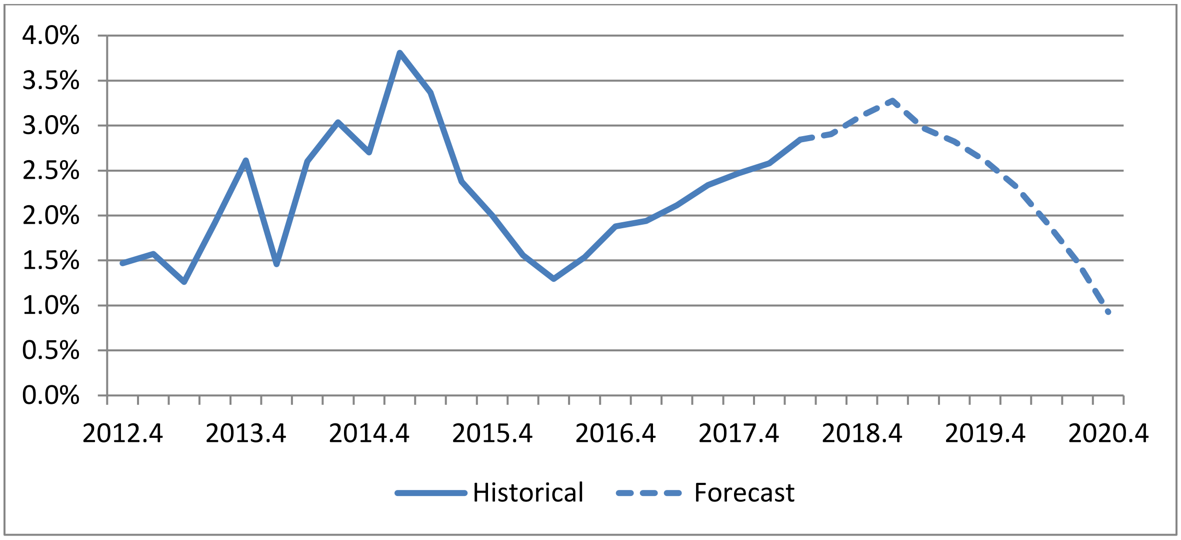
Nonetheless, there were some areas of concern which cause us to believe growth will eventually slow. The housing market seems to have stalled and housing has often been a harbinger of things to come. More important, inflation is on the rise so much so that all of the increase in worker's hourly pay has been offset by increases in prices. Only last year the Federal Reserve was troubled because inflation remained below its 2 percent target. Now all measures of inflation exceed 2 percent, and several are on their way to 3 percent. As a result, we expect the Fed to continue to raise short-term interest rates throughout 2018 and 2019.

It is 2020 when we think the economy will face its biggest struggle. By then the positive impacts of the recent tax cut will have largely dissipated while the negative effect of larger budget deficits and higher interest rates will begin to dominate. Another risk is that the global economy, which like the U.S. has been on the upswing, could falter either because of expanding trade restrictions or, more likely, currency and debt crisis affecting any number of emerging market economies. Were this to happen, U.S. interest rates would likely remain lower than our forecast but only because of a move toward the safety of U.S. debt in response to broader economic problems.

Indeed, new Fed chair Jerome Powell faces the difficult challenge of keeping inflation from accelerating further while not increasing rates too fast and too much so that it pushes the economy into recession. Adding in the unpredictable nature of current U.S. trade policy and the heavy dependence of much of the world economy on U.S. consumers and U.S. financial markets further complicates Powell's job.

The recent spurt in economic growth is similar to what happened in 2014, as shown in the chart below. The bad news is the growth slowed soon after, much as we predict it to do again. The good news is that the economy managed to avoid a recession. Repeating that pattern will likely require some deft maneuvering by the Federal Reserve.

Actual and Forecasted Growth in Real GDP vs. Year Earlier



Peter Bernstein's 2018Q3 Forecasts
Philadelphia Federal Reserve's Survey of Professional Forecasters

	2018- 1H Forecast	2018 - 1H Actual	2018 – 2H Forecast	2019 Forecast	2020 Forecast
Real GDP	3.0%	3.1%	3.1%	2.9%	1.7%
Real Consumer Spending	2.8%	2.2%	2.6%	2.3%	0.9%
Real Business Investment	6.5%	7.1%	5.7%	7.1%	4.7%
Real Government Purchases	0.9%	1.9%	1.5%	1.7%	1.6%
Real Exports	4.0%	6.4%	4.4%	3.9%	2.3%
Real Imports	4.6%	1.7%	4.1%	3.5%	2.4%
Consumer Price Inflation	2.6%	2.6%	2.6%	2.6%	2.4%
Core Inflation (ex food and energy)	2.4%	2.4%	2.5%	2.6%	2.6%
Unemployment Rate (end of period)	4.1%	3.9%	3.7%	3.7%	4.3%
Employment (monthly average change)	171,000	213,000	175,000	150,000	58,000
Housing Starts (millions at annual rate)	1.32	1.26	1.28	1.35	1.34
3-Month Treasury Rate (end of period)	1.70%	1.84%	2.11%	3.07%	2.04%
10-Year Treasury Rate (end of period)	3.05%	2.92%	3.36%	4.10%	3.68%

First-half (1H) and second-half (2H) rates expressed as an annual average, unless otherwise noted