

U.S. CONSUMERS FUEL STRONG SHOPPING SEASON, CAPEX ROBUST, PRICES FIRING

**U.S. durable goods orders increased 1.3% m/m (9% yr/yr) in November, as transportation orders surged 4.2%. Excluding transportation, orders stalled, declining 0.1% after four straight months of above 0.8% gains. Durable goods shipments advanced a robust 1% m/m, lifting its yr/yr gain to 7%*

**Current-dollar private consumption rose 0.6% m/m and consumption adjusted for inflation increased 0.4% m/m and rose to 2.7% yr/yr (see Chart 1)*

**The headline and core PCE deflators —the Fed's preferred measures of inflation — increased by 0.2% m/m and 0.1% m/m, respectively, lifting their yr/yr gains to 1.8% and 1.5%, slowly closing in on 2% (see Chart 2)*

Durable Goods

Core durable goods shipments (nondefense capital goods excluding aircraft), which matter for GDP, advanced by 0.3% m/m, increasing for the tenth straight month, the longest streak in the 26-year history of the series (see Chart 3). The strong industrial sector momentum since the start of the year has sustained as the headwinds that led to the deep malaise in recent years turned more favorable (dollar, global growth, oil prices) and a more pro-business government with less stringent regulations and new tax policy have unleashed business enthusiasm.

Although the lower, 21%, corporate tax rate won't take effect until 2018, the full expensing of new equipment measure in the tax bill may already be having an effect on business activity. Congressional leaders, in their initial tax proposal framework on September 27, indicated that from that date onward (for five years) it would allow full immediate expensing of equipment investment. Some businesses closely following the progress of tax negotiations may have felt satisfied enough in **Congress' progress to ramp up equipment investment in Q4.**

Continued strong optimism from businesses suggest that the robust momentum will carry through to next year. The Empire State and Philly Fed **manufacturing surveys'** six-month ahead CapEx plans remained high in Q4 (see Chart 4). We forecast a 7% increase in real business fixed investment in 2018, the best gain since 2014, and one of the primary reasons for our above-consensus 2.9% forecast for 2018 real GDP growth (see ["U.S. 2018 and 2019 growth projections revised up on tax reform"](#), December 4, 2017).

Private Consumption and PCE Deflator

Nominal personal incomes increased 0.3% m/m in November but was outpaced by the 0.6% private consumption gain, which resulted in a 0.3pp decline in the personal saving rate to 2.9%, a cycle low (see Chart 5). This signifies strong consumer confidence in finances —currently boosted by the marked acceleration in net worth — and under normal circumstances would be cause for concern and call into question the sustainability of spending. Yet, with a very low unemployment rate, robust job gains, and the individual income tax cuts in 2018, households should be able to sustain and even improve their rate of spending.

Indeed, real disposable incomes have already picked up notably over the last couple months, increasing by 1.9% yr/yr in November after rising by only 1.2% in September.

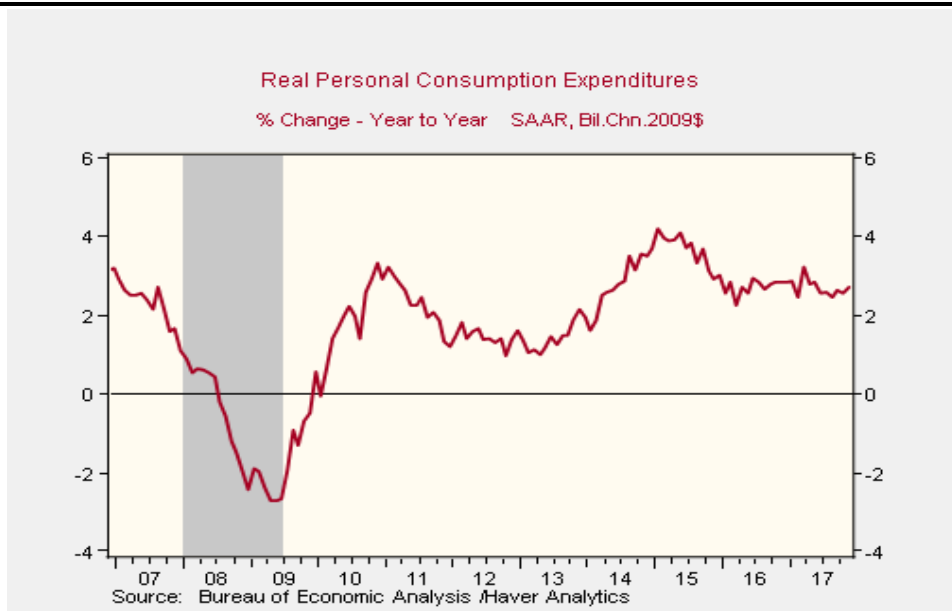
22 December 2017

(see Chart 6). Individual income tax cuts will provide even more of a boost to disposable incomes (personal income minus taxes) in the new year.

The core PCE deflator has fully escaped its earlier soft patch and is now firming. Moreover, the rolling-off of temporary idiosyncratic factors, such as the decline in cellphone service prices that weighed significantly on consumer prices in March 2017, could provide a boost to 12-month core PCE inflation in March 2018 (see Chart 7). This combined with some inflationary impact from tax reform, the lagged impact of the weaker dollar this year, and a very tight labor market all point to inflation returning to 2%.

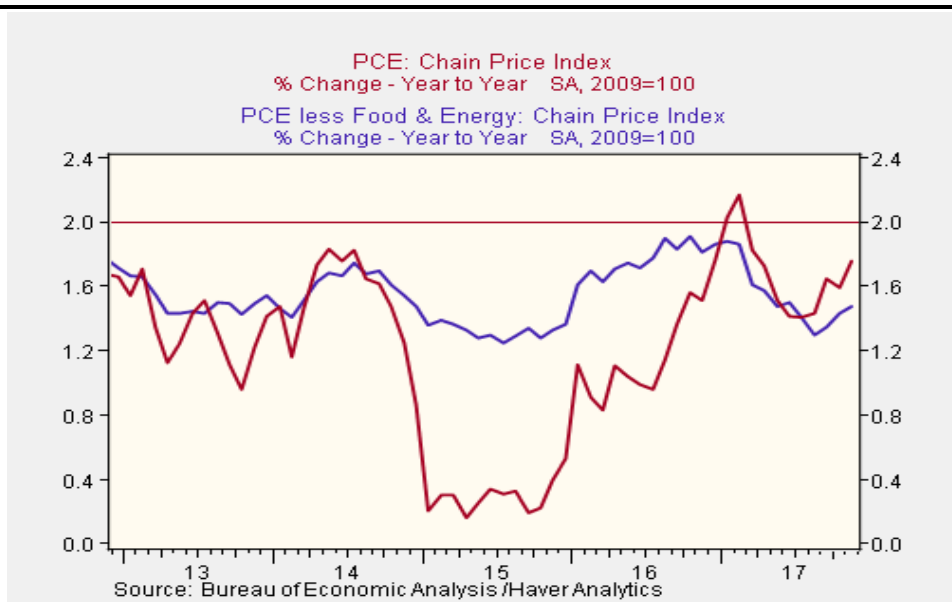
We expect a 2% yr/yr gain in core PCE in Q4 2018. As the Fed observes its preferred measure of prices climbing up to 2% throughout 2018, it will feel empowered to increase its policy rate four times.

Chart 1: Real Personal Consumption Expenditures (year-over-year, %)



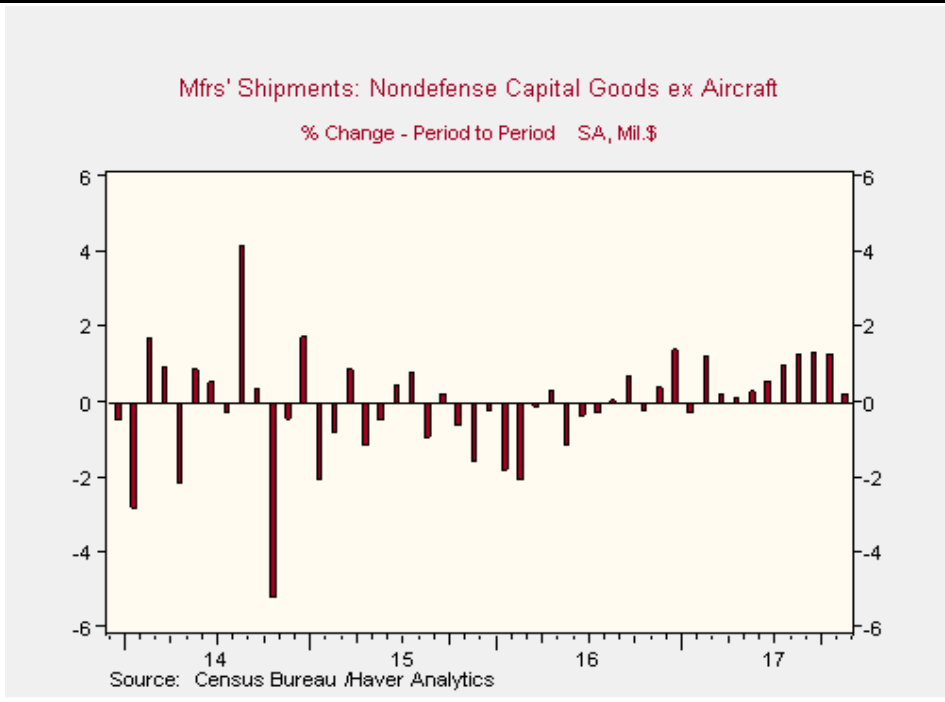
Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 2: PCE Deflator: Headline and Core (year-over-year, %)



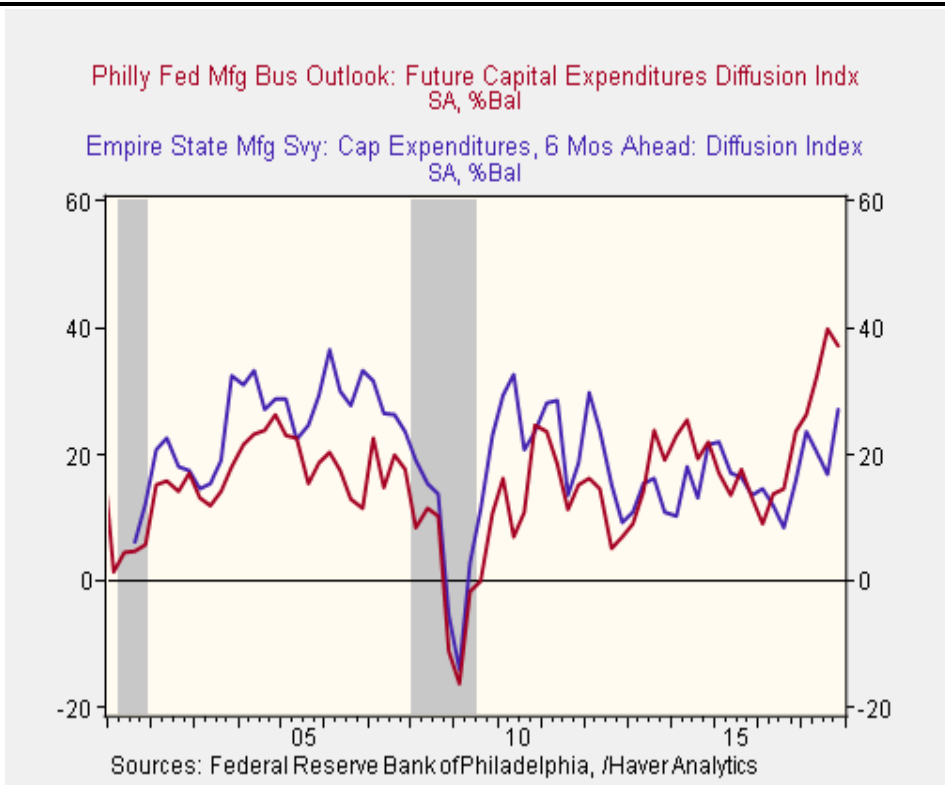
Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 3: Shipments of Nondefense Capital Goods Ex Aircraft (month-over-month, %)



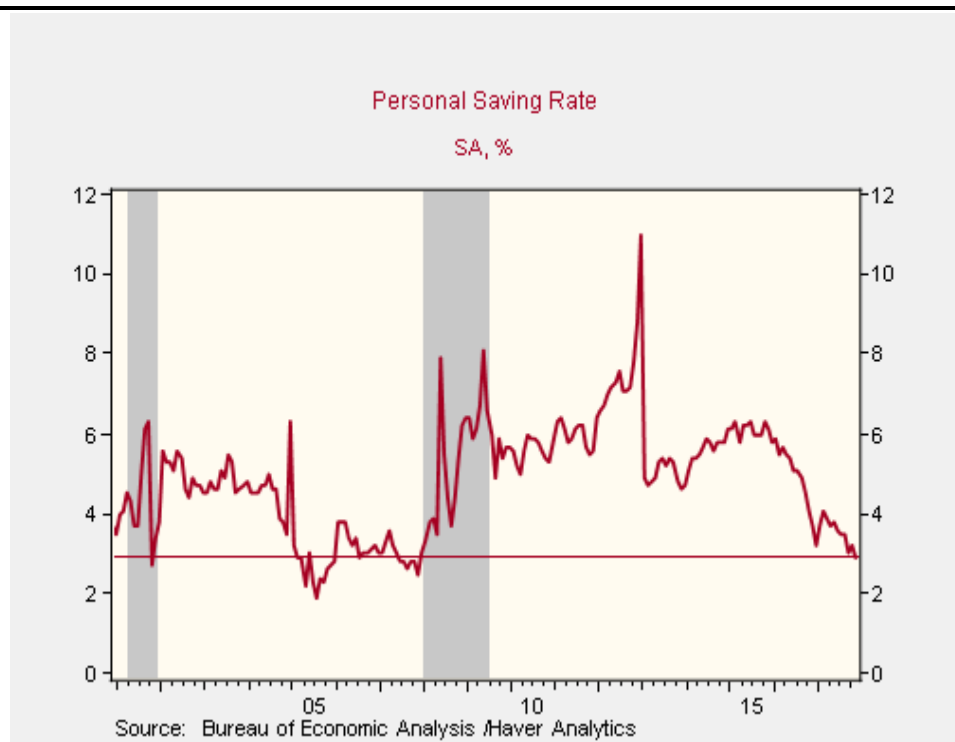
Source: Monthly data. Source: Census Bureau and Haver Analytics

Chart 4: Philly Fed and Empire State Manufacturing Future CapEx Indexes



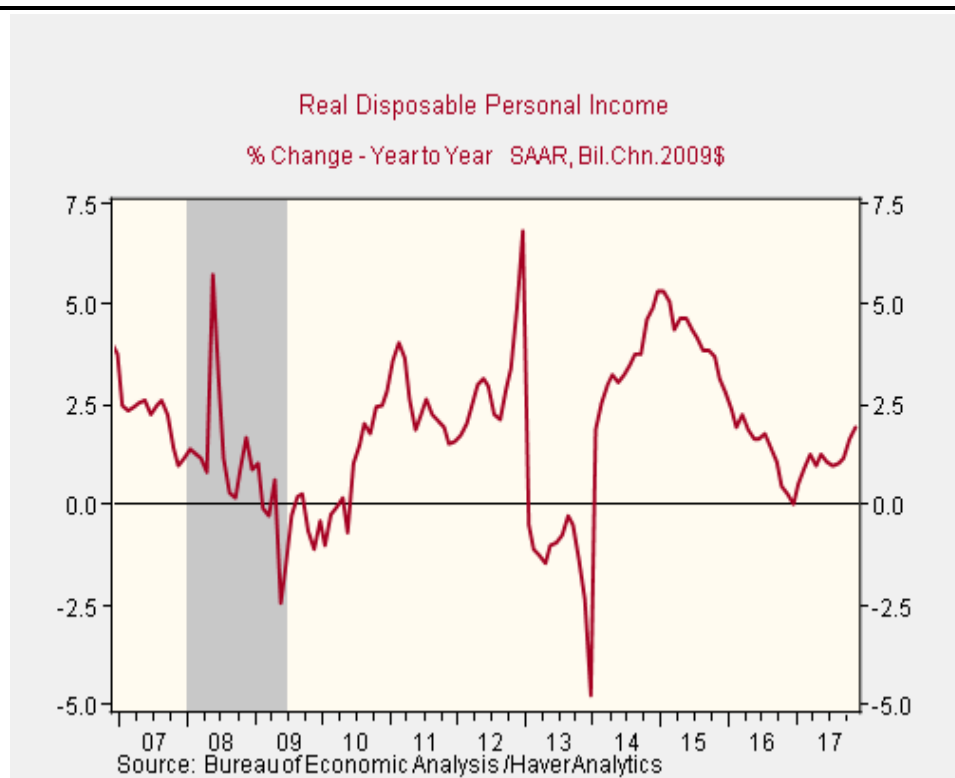
Source: Quarterly data. Source: Federal Reserve Banks of Philadelphia and New York and Haver Analytics

Chart 5: Personal Saving Rate



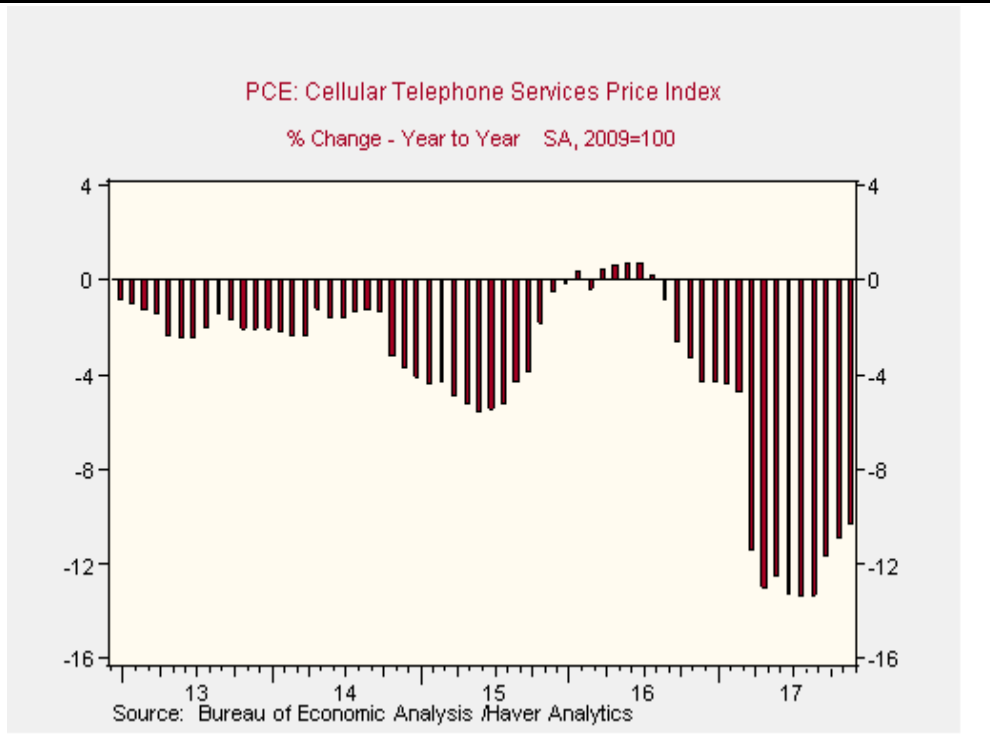
Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 6: Real Disposable Personal Income (year-over-year, %)



Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 7: Cellular Telephone Services Prices (year-over-year, %)



Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

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