

## INDICATORS ON US OUTLOOK REMAIN STRONG

Key US economic data on the outlook continue to come in strong. Although readings on some aspects of current economic activity are mixed, and some transitory factors likely will hold down Q1 GDP growth, the outlook for stronger growth is favorable.

### Today's releases:

#### Housing Starts and Sentiment

Housing activity data have been remarkably resilient, with rising housing starts and permits and strong homebuilder sentiment. Housing starts have exceeded an annualized 1.25 million units for the last three months after averaging under 1.2 million in 2016. This may reflect in part the unseasonably warm winter in the US through the first two weeks of March which may "borrow" from the pace of residential construction in Q2.

Nevertheless, the recent strength in single family starts and permits point to a meaningful pickup in underlying housing demand, gaining support from healthy increases in employment, wages and household balance sheets (see Chart 1). There is lots of room for improvement in homeownership. The strength in housing is even more encouraging considering the surge in mortgage interest rates since November. Unlike the experience from the 2013 Taper Tantrum, household employment situations and balance sheets provide resilience.

The National Association of Home Builders (NAHB) Homebuilder sentiment has also been very strong, as its index jumping to an almost 12 year high in March, despite various supply constraints such as higher prices and shortage of labor (see Chart 2). **According to the report, "Builders are buoyed by President Trump's actions on regulatory reform, particularly his recent executive order to rescind or revise the waters of the U.S. rule that impacts permitting."**

#### Philly Fed Manufacturing Sentiment

Two key manufacturing surveys received for the first half of March – Philly Fed and Empire State – suggest that firms continue to be exceedingly optimistic about the US economy. The spike in these readings seems to reflect business optimism that the Administration and Congress will deliver on promises of corporate tax reform and deregulations that will facilitate efficiencies in the economy.

The Philly Fed manufacturing index in March fell modestly from its 33-year high in February, but its components reflected strength. The ISM-adjusted Philly Fed index which takes key subcomponent indexes into account (the headline index is just based on a single question) actually jumped by 4.6 points to 60.2, its highest reading since 2004 (see Chart 3). The six month ahead section of the report was also quite strong, with the capex plans index increasing to a 17-year high (see Chart 4).

**Although the improved confidence has not fed through to most "hard" data as yet, it appears to already be influencing business hiring decisions – private payroll growth has exceeded 200k in the last two months alone after averaging 170k in 2016 (see "[US: Solid February jobs report](#)", March 10, 2017). Our research has shown that unusually high levels of confidence are more reliable predictors of future economic activity than**

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current “hard” data (see [“US: “soft” data and “hard” outcomes”](#), March 9, 2017). Our expectations for business investment in the first half of 2017 has firmed.

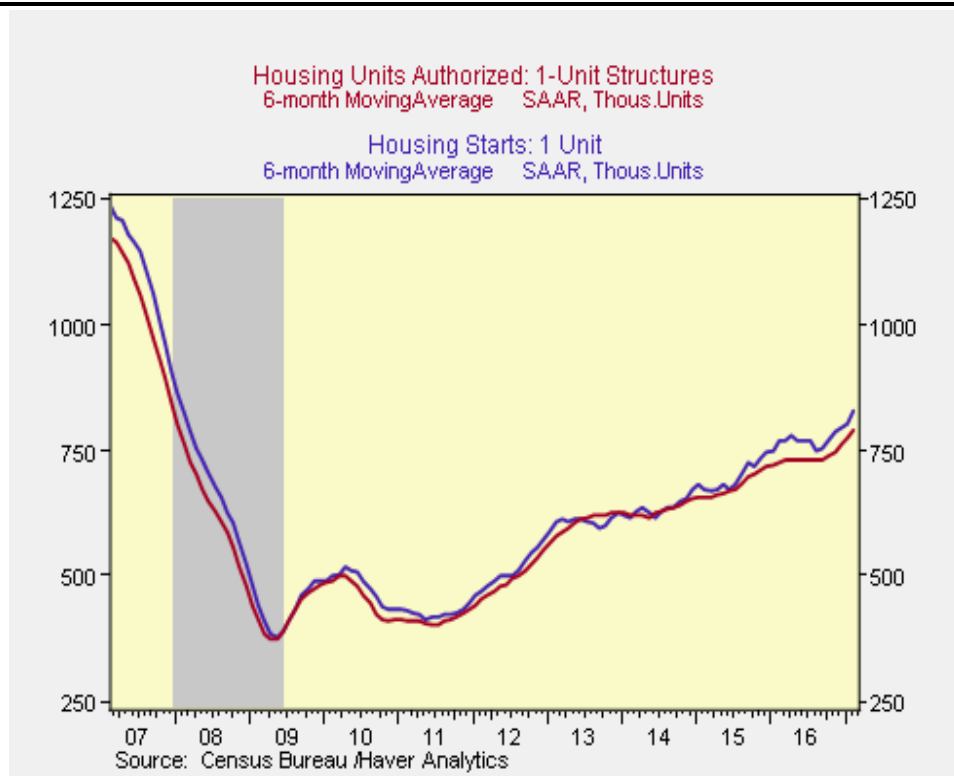
## Outlook for Near-Term Growth

Real GDP growth in Q1 is likely to be anemic, dragged down by several temporary factors. We project this quarterly weakness to be reversed with a much stronger Q2. Q1 GDP growth will be suppressed by a sizeable drag from a wider trade deficit, slower inventory building and temporarily weak real consumption. The weak real consumption will stem from two factors:

- 1) The acceleration in consumer prices in Q1: Growth in **Q1 control retail sales are on track to exceed Q4’s growth** in nominal terms, but the acceleration in consumer prices this quarter will hold down sales in real terms. The recent fall in oil prices point to a deceleration in consumer prices that will contribute to a bounce back in real sales in Q2.
- 2) Unusually warm winter weather: Consumption of services will be suppressed by lower use of utilities in January and February; the cold snap will reverse that temporary impact and establish a higher base for stronger consumption of services in Q2.

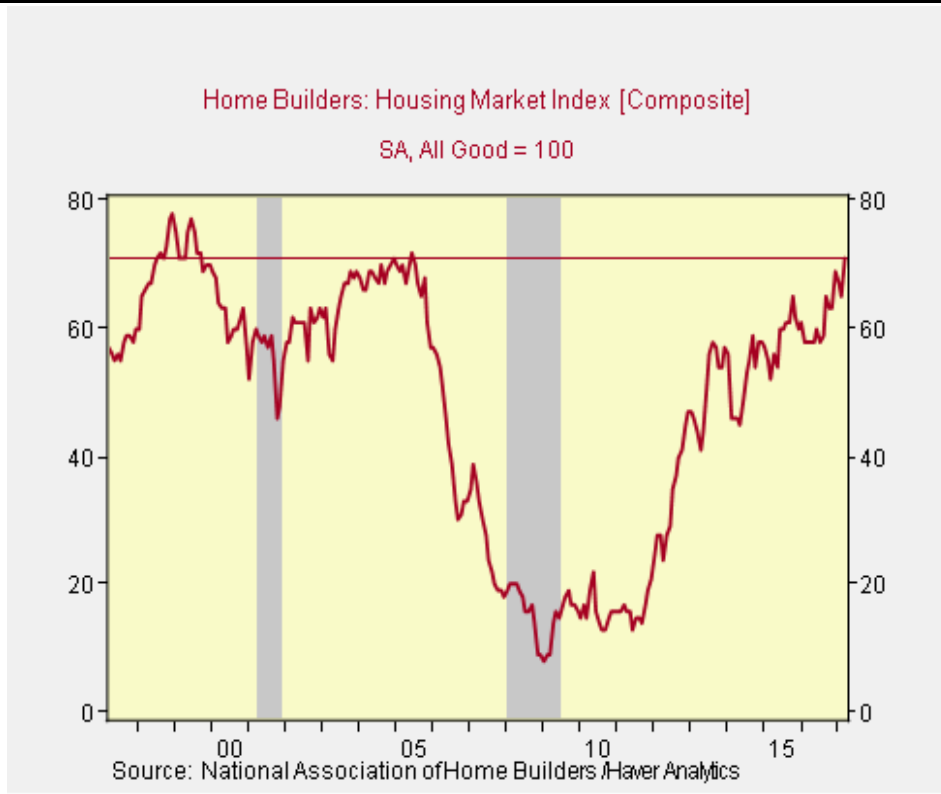
**These trends have boosted the Fed’s confidence in the economy. The usually dovish Yellen responded to a question about the weak Q1 GDP tracking estimates in her post-FOMC meeting press conference stating that “GDP is a pretty noisy indicator. If one averages through several quarters, I would describe our economy as one that has been growing around two percent per year” and directed the focus to the solid labor market performance. Given the FOMC’s change in tone, the risks are for interest rate increases to occur sooner and more frequently than currently expected.**

Chart 1: Single-family starts and building permits (six-month moving average)



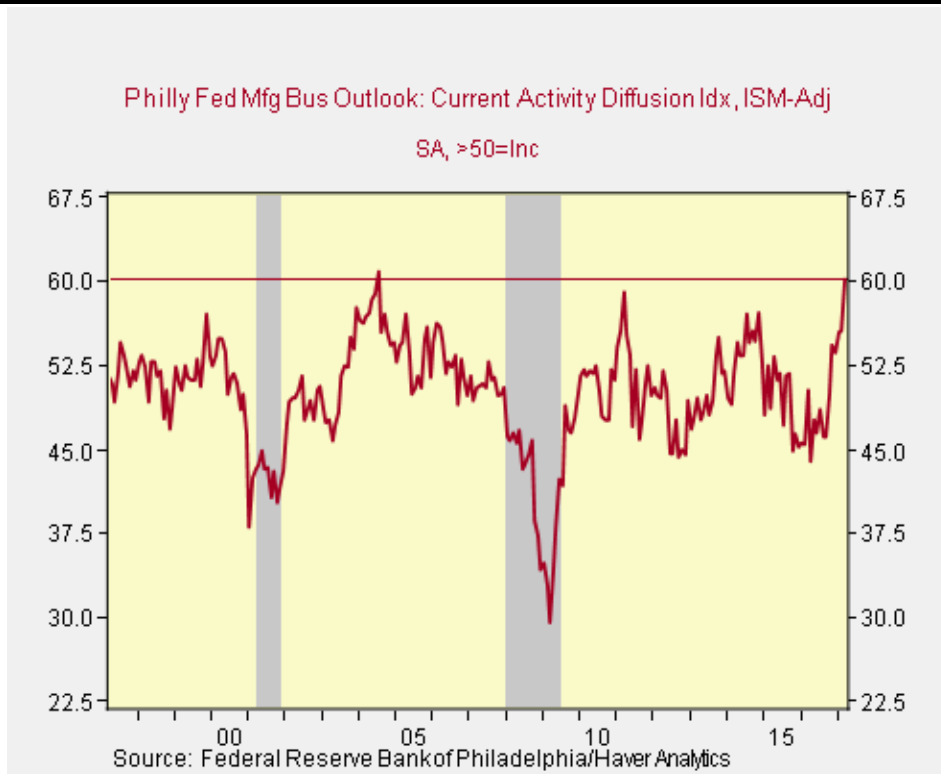
Source: Monthly data. Source: Census Bureau and Haver Analytics

Chart 2: National Association of Home Builders housing market index



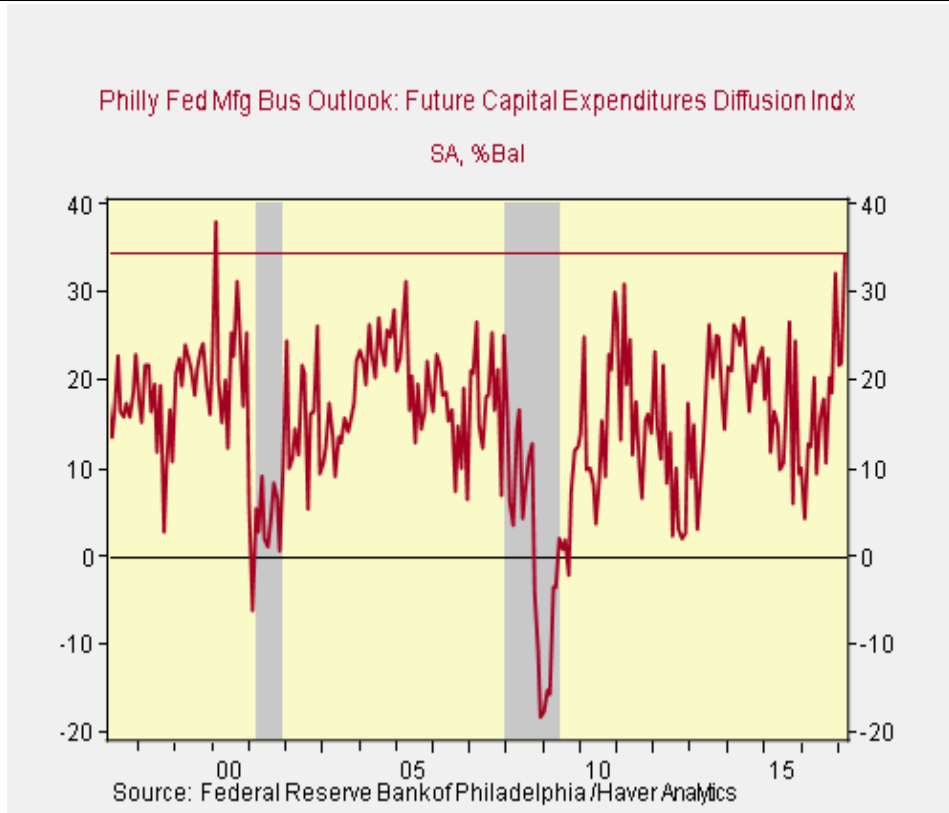
Source: Monthly data. Source: National Association of Home Builders and Haver Analytics

Chart 3: Philly Fed manufacturing current activity ISM-adjusted diffusion index



Source: Monthly data. Source: Federal Reserve Bank of Philadelphia and Haver Analytics

Chart 4: Philly Fed manufacturing future capital expenditures diffusion index



Source: Monthly data. Source: Federal Reserve Bank of Philadelphia and Haver Analytics

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