Comment on Q4 GDP

Lower than Expected Growth Should Not Dim 2018 Optimism

The U.S. Bureau of Economic Analysis today reported 2.6 percent annualized growth in real Gross Domestic Product for the final quarter of 2017. While this figure broke a run of two quarters of above 3.0 percent growth, the fact that a 2.6 percent reading can be considered “below expectations” illustrates the current strength of the economy. A gross domestic purchases figure of 3.6 percent growth in the fourth quarter better captures current conditions as the GDP number was suppressed by a slowdown in inventory build due to higher demand, which will encourage firms to increase 2018 activity. The global economic upturn provides an upside for the U.S. economy and is likely to strengthen even further in 2018. Continued gains in US business confidence, culminating with the recent tax legislation, will help keep the economy on track for near 3 percent growth this year.

A robust holiday season set the pace for consumer spending in the fourth quarter, with durable goods recording especially strong growth. Labor markets are continuing to tighten which supports brighter consumer sentiment. Spending growth can accelerate slightly in 2018 despite very low savings rates, thanks to both higher disposable incomes due to tax cuts and the possibility that a shortage of available workers could cause an acceleration in wage growth. The Federal Reserve will be watching carefully to see if inflation firms, as it did in the fourth quarter, possibly necessitating faster interest rate tightening. A weaker dollar provides another source of inflation risk, especially with oil prices rising and imports growing rapidly this quarter in line with increased spending on investment goods.

Burgeoning capital spending could force the Fed’s hand as well. Investment in capital equipment has been accelerating during the past three quarters. In 2018, nonresidential structures may also enjoy improved momentum due to higher oil prices which could bring drillers back to the field and especially favorable tax treatment under the new law, thanks to long depreciation periods. Residential structures also showed a pickup after flagging in the previous two quarters, possibly fueled in part by increased demand resulting from Hurricanes Harvey and Irma.

The US economy is well positioned for a strong year in 2018. Looking ahead, constraints on labor and capital resources will start to pull growth back towards its long-term 2 percent trend with recession risks rising the longer the current pace of growth continues.

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