Acting Assistant Secretary Diana Furchtgott-Roth Economy Statement for the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association

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The U.S. economy grew 3.5 percent in the third quarter, according to last week's advance estimate. This pace confirmed the economy's strong growth in the wake of the Administration's tax reforms, deregulatory measures, and other business-friendly policies. Real GDP is forecast to grow 3.2 percent in 2018, which would be the first calendar year of growth above 3 percent since 2005.

Further accelerations in private consumption and a strong build in private inventory were the main drivers of solid economic performance in the third quarter, followed by a larger positive contribution from government spending. Private non-residential fixed investment made a small positive contribution in the third quarter, although residential investment continued to decline, and net exports also subtracted from growth. Altogether, private domestic final purchases (the sum of consumption, business fixed investment, and residential investment) advanced by 3.1 percent in the third quarter, following 4.3 percent growth in the second quarter.

In the second quarter, for the first time in history, the number of job openings climbed above the number of job seekers, and this configuration, considered indicative of a tight labor market, has continued in the third quarter. In fact, the average monthly pace of job creation continues to exceed that of 2017. The unemployment rate fell to a 49-year low of 3.7 percent in September, and growth of nominal wages and personal income continues to trend higher, with progress also apparent in real wage gains. Measures of consumer and business sentiment remain at, or very near, multi-year highs. Private forecasters are predicting solid growth in the fourth quarter as well as for the year as a whole.

GDP GROWTH

According to the advance estimate of real GDP, which was released last Friday, the U.S. economy grew at an annual rate of 3.5 percent in the third quarter, a strong pace if slower than the second quarter's 4.1 percent surge. Private domestic final purchases – the sum of personal consumption, business fixed investment, and residential investment – grew in the third quarter at an annual rate of 3.1 percent, following a 4.3 percent rise in the second quarter. This measure of private demand has held above 3 percent in all but two of the last seven quarters. Over the past four quarters, private domestic final purchases have grown by 3.4 percent at an annual rate, well above the 2.7 percent average seen over the previous two years.

Growth in real personal consumption expenditures accelerated further in the third quarter, growing at an annual rate of 4.0 percent, the fastest quarterly pace in four years, after an already-strong 3.8 percent advance in the second quarter. Outlays on consumer durables drove consumption, rising 6.9 percent at an annual rate, extending the momentum of the second quarter's 8.6 percent advance. Spending on nondurables was up 5.2 percent in the third quarter, accelerating from the 4.0 percent reading in the previous quarter. Consumption of services also accelerated in the third quarter, to a 3.2 percent annual rate, after growing 3.0 percent in the second quarter. On balance, real personal consumption expenditures added 2.7 percentage points to growth in the third quarter – the largest contribution from this component in nearly four years.

Business fixed investment increased 0.8 percent at an annual rate in the third quarter, after increasing 8.7 percent in the second quarter, and added 0.1 percentage point to overall growth. Since the start of 2017, real private nonresidential fixed investment has grown at a quarterly average of 6.6 percent, marking a return to the healthy pace seen in the early years of the recovery. Fixed investment in intellectual property products continued to grow at a healthy, if slower, pace, rising 7.9 percent in the third quarter after a 10.5 percent increase in the second quarter. Investment in this category has grown at an average annual rate of nearly 11 percent per quarter over the past three quarters, the fastest three-quarter clip in such investment seen in 12 years. Although investment in structures declined 7.9 percent in the third quarter after growing at double-digit paces in each of the previous two quarters, the level of investment in structures remains almost 8 percent above its level at the start of 2017. Outlays for equipment grew just 0.4 percent in the third quarter, softening after growing an average annual rate of nearly 9 percent in each of the previous six quarters. As expected, the cycle of inventory accumulation turned strongly positive in the third quarter, adding 2.1 percentage points to real GDP growth.

Residential investment retrenched for the third consecutive quarter, declining 4.0 percent at an annual rate and subtracting 0.2 percentage point from growth, after making an essentially flat contribution in the previous quarter. Signs of slowing in the housing sector persist, against a backdrop of low inventories and rising mortgage rates. Existing home sales, which account for 90 percent of all home sales, have declined in each of the past six months, including a 3.4 percent drop in September, and these sales were 4.1 percent lower over the past year through September. New home sales have fallen in five of the past six months, and as of September, were 13.2 percent lower than a year ago. Total housing starts declined 5.3 percent in September, reflecting a 0.9 percent decrease in the single-family sector but also a 15.2 percent decrease in the volatile multi-family component. Although building permits fell below total starts in August, which may suggest the possibility of weaker housing activity in coming months, permits did rise back above starts in September. Homebuilder confidence remains elevated, and in October, stood only six points below the 18-year high reached in December 2017, with current as well as forward-looking components of the survey strengthening. House price appreciation remains relatively strong, exceeding core inflation and income measures, although the pace has slowed relative to a year ago, likely due to notably higher mortgage rates in recent months.

Total government spending rose 3.3 percent at an annual rate in the third quarter, accelerating from a 2.5 percent pace in the previous quarter. After making an essentially neutral contribution to growth in most of 2016 and 2017, government spending has added to growth in each of the past four quarters, including a 0.6 percentage point contribution in the third quarter. Federal outlays grew 3.3 percent in the third quarter, after a 3.6 percent rise in the previous quarter, while state and local government spending growth stepped up to a 3.2 percent rate in the third quarter – the fastest pace in more than two years.

The U.S. trade deficit widened in the third quarter, as import growth accelerated to an annual rate of 9.1 percent, and export growth slowed to a decline of 3.5 percent annual rate. One reason for the widening of the deficit is that the U.S. economy is growing faster than the economies of the rest of the world, so U.S. domestic demand for imports is stronger. As a result, net exports subtracted 1.8 percentage points from growth in the third quarter, after adding 1.2 percentage points to growth in the second quarter.

LABOR MARKETS AND WAGES

Through the end of the third quarter of 2018, monthly job growth averaged 208,000, well above the 182,000 monthly average for 2017. The unemployment rate fell to a 49-year low of 3.7 percent in September. Meanwhile the most comprehensive measure of labor market slack, which includes those marginally attached to the labor force and those working part-time for economic reasons, continued to trend lower in the third quarter, despite an uptick in September: the U-6 unemployment rate edged up to 7.5 percent, but was still 1.6 percentage points below the pre-recession average of 9.1 percent. The employment report for October will be released this Friday.

Although the pace of nominal wage growth remains above year-ago levels, it has leveled off in the past several months. Even so, gains have been sufficient to bring about a more solid increase in real wages. Nominal average hourly earnings for private-sector production and nonsupervisory employees rose 2.7 percent over the year ending in September, a bit higher than the 2.6 percent, 12-month pace through September 2017. But real average hourly earnings advanced 0.4 percent, the fastest rate in over a year, picking up from 0.2 percent pace over the 12 months through September 2017, and also much higher than the negative or flat readings in the vast majority of months since then. Growth of wages and salaries for private industry workers has also consolidated at a higher rate; this measure of compensation grew 2.9 percent over the twelve months through June 2018, accelerating from the 2.6 percent pace over the previous twelve months. Using the Personal Consumption Expenditures (PCE) price index, the index of most interest to the Federal Reserve, real average hourly earnings grew at 0.7 percent over the past year. Data for the Employment Cost Index for the third quarter will be released this Wednesday.

PRICES

Price inflation has slowed in recent months, although it continues to accelerate on a year over year basis, based on several measures. Over the 12 months through September 2018, the consumer price index (CPI) for all items rose 2.3 percent, slowing from the 2.9 percent, 12-month readings seen this past June and July, but still faster than the 2.2 percent pace over the year through September 2017. Energy price inflation recently slowed markedly from the double-digit paces registered over the summer, and food price inflation, though higher over the past two years, has stabilized. Excluding food and energy, the CPI increased 2.2 percent over the year through September 2018, above the pace of 1.7 percent through September 2017.

The PCE price index has also accelerated at both the headline and the core levels. The index rose 2.0 percent over the 12 months through September, above the 1.8 percent observed a year earlier. Similarly, core PCE price inflation picked up to 2.0 percent over the year through September 2018, well above the 1.5 percent pace observed a year earlier.

CONCLUSION

Against a backdrop of tax reform, deregulation, and other incentives to boost investment, incomes, and labor force participation, headline real GDP growth remained strong in the third quarter, rising by 3.5 percent, propelled by a further acceleration in private consumption and solid gains in government spending and private inventories. Although some components of private investment declined in the latest quarter, third quarter trends attest to the underlying strength of private domestic demand in the economy and the likelihood of future growth benefits from this investment. With various measures of consumer and business confidence at or near record highs and the labor market very close to full employment, the underpinnings of sustainably rapid growth for the foreseeable future remain in place.