Principal Deputy Assistant Secretary Michael Faulkender Economy Statement for the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association

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Sixteen months after the passage of the Tax Cuts and Jobs Act (TCJA), the U.S. economy continues to reap significant benefits from this legislation, as well as from regulatory tailoring and other measures the Administration has undertaken to boost private investment, productivity, labor force participation, wages, and growth. The advance estimate for real GDP in the first quarter of 2019 showed economic growth increasing at an annual rate of 3.2 percent, considerably higher than market expectations. This acceleration followed growth of 3.0 percent over the four quarters of 2018 – which was the fastest pace since 2005. As of late April, the consensus of private forecasts for real GDP growth in Q1 underestimated the actual outturn by more than one-half percentage point, so it is possible that the private consensus estimate of 2.6 percent growth in the second quarter could be revised upward.

The acceleration in first-quarter growth was supported by ongoing strength in private consumption and investment, a solid build in private inventories, an increase in state and local government expenditures, and a strongly positive contribution from net exports. Consumer and business sentiment continue to hover near multi-year highs, and manufacturing and services activity remain at favorable levels. After a period of slowing, there are also signs of stabilization in the housing sector.

Tight labor markets have persisted into 2019, as evidenced by consistently higher nominal wage gains, and these conditions continue to attract workers back into the labor force. Receding inflation has boosted real wages, too. Calendar year 2018 saw an average of 223,000 jobs created per month and the first three months of 2019 have realized average monthly job growth of 180,000. For the past year, the number of job openings has topped the number of job seekers – a first for this particular measure of labor market health – and in three of the past five months, job openings have stood at an all-time high. The unemployment rate fell to 3.7 percent last

September and November, a 48-year low, and as of March 2019, the rate stood at 3.8 percent, just above that low.

GDP GROWTH

Real GDP grew at an annualized rate of 3.2 percent in 2019 Q1, matching the annualized rate over the first three quarters of 2018, and following the slight slowing of growth to 2.2 percent in last year's final quarter. Private domestic final purchases – the sum of personal consumption, business fixed investment, and residential investment – grew at an annualized rate of 2.8 percent over the four quarters through 2019 Q1, roughly in line with the 2.9 percent advance over the

four quarters through 2018 Q1. On a quarterly basis, this measure did slow to 1.3 percent in the first quarter, from 2.6 percent in the final quarter of 2018.

Real personal consumption expenditures grew 1.2 percent at an annual rate in the first quarter, following a 2.5 percent increase in 2018's fourth quarter. Outlays on consumer services drove consumption in the first quarter, rising 2.0 percent at an annual rate and accounting for nearly one-third of overall GDP growth. Spending on durable goods declined 5.3 percent in the first quarter, but nondurable goods expenditures were up 1.7 percent. On balance, real personal consumption expenditures in Q1 added 0.8 percentage point to growth.

Consistent with the investment incentives of the TCJA, business fixed investment increased 2.7 percent at an annual rate in the first quarter, following a 5.4 percent advance in the fourth quarter, and added 0.4 percentage point to overall growth. Since the end of 2016, real private nonresidential fixed investment has grown 6.2 percent at an annual rate, a markedly higher level compared to rates in the previous decade. The boost to fixed investment in intellectual property products has been especially noteworthy: in the first quarter of 2019, investment in this category grew 8.6 percent; in four of the past five quarters, this type of investment has grown at or very near a double-digit pace. Although equipment investment grew a modest 0.2 percent in the 2019 Q1, this followed an average quarterly pace of 7.7 percent over the preceding eight quarters. After declines in excess of 3 percent in 2018 Q3 and Q4, investment in structures slipped a more modest 0.8 percent in 2019 Q1. But over the eight quarters ending in 2018 Q2, investment in structures had grown by a quarterly average rate of 6.5 percent. The cycle of inventory accumulation remained positive for the third consecutive quarter, adding nearly 0.7 percentage point to real GDP growth in 2019 Q1.

Although the first quarter of 2019 marked the fifth consecutive quarter of retrenchment in residential investment, the first quarter's decline, at 2.8 percent, was more subdued. The Q1 decline in residential investment largely reflected a decrease in single family construction expenditures. However, there were signs of stabilization in home sales as well as improvements in affordability and inventories. Existing home sales, which account for 90 percent of all home sales, are over 4 percent higher on the year through March, and new home sales have grown at a healthy pace in each of the first three months of 2019, reaching their highest level in nearly 1½ years. Although total building permits declined for three consecutive months, the decrease tapered noticeably in March. Total building permits remain above total housing starts, suggesting a pickup in homebuilding in coming months. After softening at the end of last year, the NAHB's home builder confidence index has been trending upwards thus far in 2019. Inventories of existing homes for sale has started to trend up as well. House price appreciation remains relatively strong, exceeding core inflation and income growth measures, but monthly and yearly paces have been slowing more significantly of late. This development, combined with the sizeable decline in mortgage rates since last fall, has helped improve affordability.

Total government spending rose 2.4 percent at an annual rate in the first quarter, reversing from a 0.4 percent decline in the fourth quarter. Government spending made an essentially neutral contribution to growth in 2016 and 2017, but with recent accelerations, government spending has

added 0.3 percentage points on average to GDP growth in each of the past five quarters. Federal outlays were flat in the first quarter, after rising 1.1 percent in the final quarter of 2018. State and local government spending has been growing more consistently since the end of 2017, and in the first quarter of 2019, accelerated to 3.9 percent, the fastest pace in three years, mainly reflecting more investment in infrastructure.

The U.S. trade deficit narrowed sharply in the first quarter of 2019, as import growth turned negative, declining 3.7 percent, while export growth more than doubled to 3.7 percent. Rather than posing a drag on growth, as in the previous two quarters, net exports added over a full percentage point to real GDP growth in 2019 Q1, making the largest contribution of any component.

LABOR MARKETS AND WAGES

The employment report for March showed that the headline unemployment rate, at 3.8 percent, stands only a tick above the 48-year low reached last fall. Perhaps more significantly, the most comprehensive measure of labor market slack, which includes those marginally attached to the labor force as well as those working part-time for economic reasons, stands at 7.3 percent, the lowest level since March 2001 (and 1.8 percentage points below the pre-recession average of 9.1 percent). The TCJA has drawn workers back into the labor force, and in numbers that have more than offset the downward pressure from the aging population. The overall labor force participation rate (LFPR) stood at 63.0 percent in March, just under the five-year high reached in January and February. The LFPR for prime-age workers stood near a nine-year high in March. Payroll job creation has averaged 180,000 per month thus far in 2019, following the average monthly job growth of 223,000 during 2018. The 2019 average reflects the anomalous gain of just 33,000 in February, likely related to bad weather and the partial government shutdown; gains in January and March of this year averaged almost 240,000. The employment report for April will be released this Friday, May 3.

The pace of nominal wage growth for private-sector production and nonsupervisory workers resumed an accelerating trend towards the end of 2018 and into 2019. Nominal wages grew 3.3 percent over the year ending in March 2019, just below the 3.5 percent rates posted in February 2019 and December 2018, which were the fastest paces since February 2009. The acceleration in wage gains has been more durable, too: in March, for the first time since early 2009, year-over-year growth in this measure of nominal wages held above 3 percent for the eighth consecutive month. Slower inflation combined with faster nominal wage growth has boosted real wage gains as well. After rising by 2.2 percent over the 12 months through February 2019, the fastest pace since December 2015, real wages for private-sector production and nonsupervisory workers grew by 1.6 percent over the year through March 2019, still far above the 0.2 percent, year-earlier rise. Another measure of wage and salary growth, the Employment Cost Index, showed that private wages and salaries grew by 3.1 percent year-over-year in the third and fourth quarters last year, the fastest pace since March 2008. Data for the Employment Cost Index for the first quarter will be released this Tuesday, April 30.

PRICES

Consumer price inflation has been slowing at the headline level for nearly one year, and core inflation (which excludes the volatile food and energy component) has recently started to decelerate as well. Over the 12 months through March 2019, the Consumer Price Index (CPI) for all items rose 1.9 percent, slowing from 2.4 percent a year earlier. Energy price inflation has been slowing significantly since last summer; over the year through March 2019, energy prices declined 0.4 percent, compared to a 7.0 percent year-earlier advance. On the other hand, food price inflation has been accelerating in 2019, and reached 2.1 percent over the 12 months through March, much faster than the 12-month rate of 1.3 percent through March 2018. Excluding food and energy, core CPI was by 2.0 percent over the year through March, slowing slightly from 2.1 percent over the year through March 2018.

Headline inflation, as measured by the Personal Consumption Expenditures (PCE) Price Index (the measure in which the Federal's Reserve's 2 percent inflation target is expressed), dipped below the target to 1.8 percent over the year through December 2018. The 12-month headline PCE inflation rate slowed further to 1.3 percent over the 12-months through February 2019, the slowest 12-month reading since September 2016, before edging up to 1.5 percent over the year through March 2019. Core PCE inflation rose 1.6 percent over the year through March 2019, decelerating from the 2.0 percent pace over the year-earlier period.

CONCLUSION

Last year, the economy grew at its strongest pace in 13 years, and in this year's first quarter, growth accelerated. The economy continues to respond, vigorously and rapidly, to the benefits of the TCJA's reforms as well as to regulatory tailoring and other growth-boosting measures. Real GDP grew 3.2 percent in 2019 Q1, and drivers of growth were broad-based and led by a sizeable contribution from net exports. Even the decline in residential investment, the only component to subtract from growth in Q1, tapered noticeably in the first quarter, and the housing sector is showing some signs of steadying after last year's more extensive, though temporary, slowing. The unemployment rate remains just above a 48-year low, jobs are plentiful, and key labor force participation rates stand near multi-year highs, as do measures of consumer and business sentiment. Nominal wages are growing smartly and as inflation slows, this has helped underpin real wage growth. Near-term risk factors include slowing global growth, although to date, this has not had a deleterious effect on U.S. economic performance. Private forecasters predict real GDP growth of 2.1 percent in 2019 on a Q4 over Q4 basis, but in 2017, 2018, and the first quarter of 2019, the economy's growth consistently outpaced private as well as government predictions, and by wide margins. According to the President's FY 2020 Budget, the Administration is predicting growth nearing 3 percent for the next few years, based on the investment and productivity improvements incentivized by the TCJA.