US Economic Outlook

End-Year 2018

December 2018

Table of Contents

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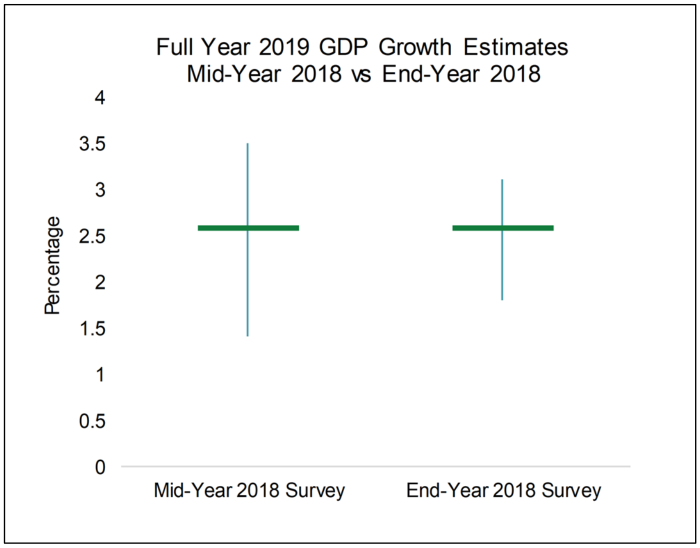
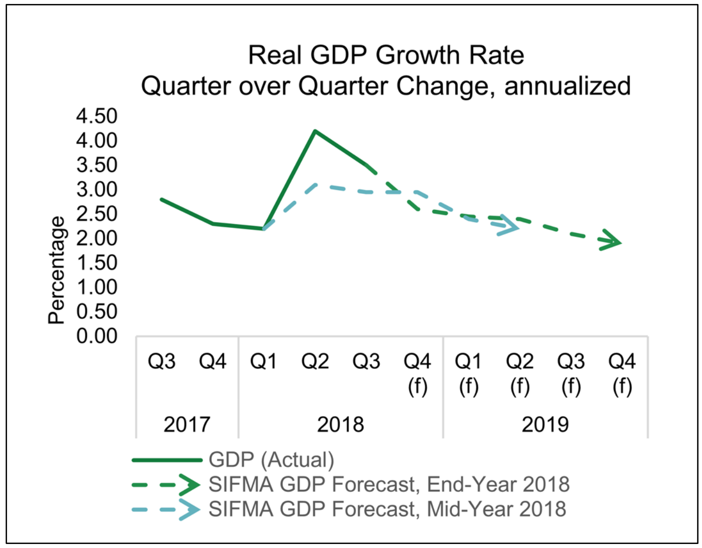
SIFMA Economic Outlook End-Year 2018

GDP Forecast Unchanged; Monetary Policy Path Remains Critical; Trade Concerns in 2019

SIFMA's Economic Advisory Roundtable[1] forecasted that the U.S. economy will grow by 2.9 percent in 2018 and by 2.6 percent in 2019, unchanged from its mid-year predictions.



Sources: SIFMA Economic Advisory Roundtable Mid-Year 2018 and End-Year 2018 Economic Outlook



*(f) Forecast

Sources: Actuals - Bureau of Economic Analysis; Forecasts - SIFMA Economic Advisory Roundtable Mid-Year 2018 and End-Year 2018 Economic Outlook

THE ECONOMY

The median end-year forecast calls for 2018 gross domestic product (GDP) to grow by 2.9 percent on a year-over-year basis and by 3.1 percent on a fourth-quarter-to-fourth-quarter basis, unchanged and slightly stronger, respectively, than the 2.9 percent year-over-year and the 2.9 percent fourth-quarter-to-fourth-quarter growth predicted in the mid-year 2018 survey.[2] Respondents expect real GDP to grow by 2.6 percent on an annualized basis in 4Q'18.[3]

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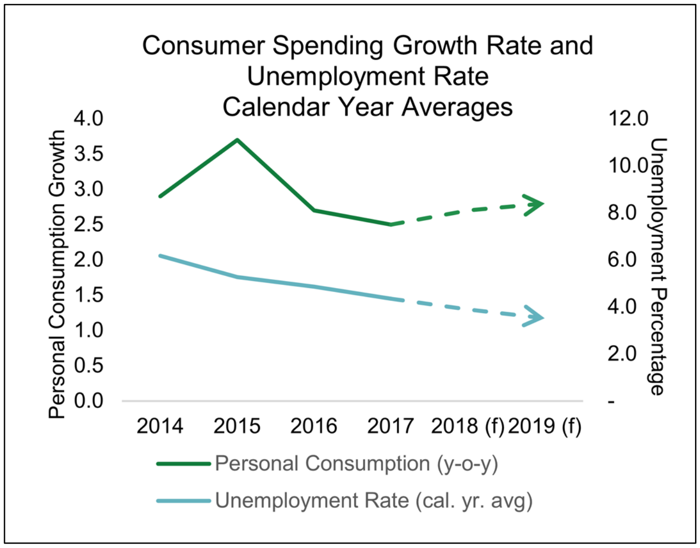
[1] The end-year 2018 survey was conducted from November 11, 2018 to December 4, 2018. The forecasts discussed in the text and appearing in the accompanying data tables and graphs are the median values of the individual member firms' submissions, unless otherwise specified.

[2] The full-year 2018 GDP growth forecasts ranged from 2.8 percent to 3.3 percent and on a fourth-quarter-to-fourth-quarter basis ranged from 2.9 percent to 3.3 percent. The full-year 2019 GDP growth forecasts ranged from 1.8 percent to 3.1 percent and on a fourth-quarter-to-fourth-quarter basis ranged from 1.7 percent to 3.4 percent.

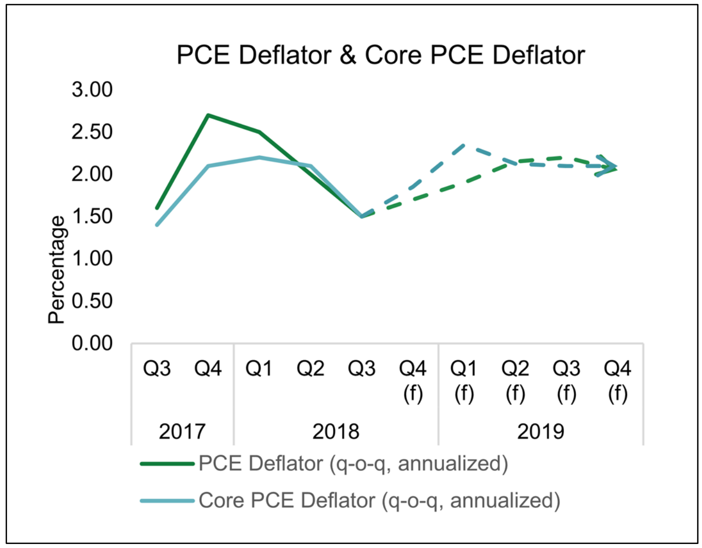
[3] Annualized GDP growth forecasts ranged from 1.8 percent to 3.1 percent in 4Q'18.

For 2019, the end-year forecast calls for GDP to grow by 2.6 percent year-over-year and by 2.2 percent on a fourth-quarter-to-fourth-quarter basis. Quarterly, real GDP is expected to grow, on an annualized basis, by 2.5 percent in 1Q'19, 2.4 percent in 2Q'19, 2.1 percent in 3Q'19, and 1.9 percent in 4Q'19.[4]



*(f) Forecast

Sources: Actuals - Bureau of Economic Analysis (personal consumption) & Bureau of Labor Statistics (unemployment); Forecasts - SIFMA Economic Advisory Roundtable End-Year 2018 Economic Outlook



*(f) Forecast

Source: Actuals - Bureau of Economic Analysis; Forecasts - SIFMA Economic Advisory Roundtable End-Year 2018 Economic Outlook

Employment is expected to continue improving on a slightly stronger basis than expected in the mid-year outlook. Survey respondents now predict the unemployment rate will average 3.9 percent in 2018 (unchanged from the mid-year survey), improving to 3.5 percent in 2019 (versus 3.6 percent in the mid-year survey).[5] Expectations for job growth were also slightly stronger, with employers expected to add 2.4 million workers to payrolls in 2018[6] (from 2.2 million expected mid-year) and to add 2.0 million in 2019 (up from 1.8 million).[7] Expectations for personal consumption strengthened since the mid-year survey, rising from 2.5 percent in mid-year to 2.7 percent for full-year 2018 and from 2.3 percent to 2.8 percent for 2019.[8]

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[4] On a quarterly basis, 1.1 percent to 3.0 percent in 1Q'19, 1.8 percent to 4.0 percent in 2Q'19, 1.0 percent to 3.5 percent in 3Q'19, and 1.1 percent to 3.4 percent in 4Q'19.
[5] The full-year 2018 average unemployment rate forecast ranged from 3.6 percent to 3.9 percent and for 2019 ranged from 3.2 percent to 3.8 percent.
[6] The full-year 2018 non-farm payroll employment growth forecasts ranged from 1.7 million jobs to 2.8 million jobs.
[7] The full-year 2019 non-farm payroll employment growth forecasts ranged from 1.4 million jobs to 2.6 million jobs.
[8] Personal consumption growth forecasts ranged from 2.6 percent to 2.8 percent in 2018, and 2.2 percent to 3.0 percent in 2019.

Estimates for business capital investment also strengthened from the previous survey, rising from 6.0 percent to 6.8 percent for 2018 and from 4.2 percent to 4.3 percent for 2019.[9] The outlook for state and local government spending strengthened slightly from the mid-year survey from 1.0 percent to 1.1 percent growth in 2018 and more notably from 0.9 percent to 1.7 percent growth for 2019.[10]

The forecast for 2018 “headline” inflation, measured by the personal consumption expenditures (PCE) chain price index, fell slightly from 2.2 percent in the mid-year survey to 2.1 percent in the end-year survey. For 2019, the forecast PCE chain price index remain unchanged at 1.9 percent.[11] The projection for the core PCE chain price index, which excludes food and energy prices, was unchanged from the mid-year survey, with 1.9 percent expected for full-year 2018 and 2.0 percent for full-year 2019.[12]

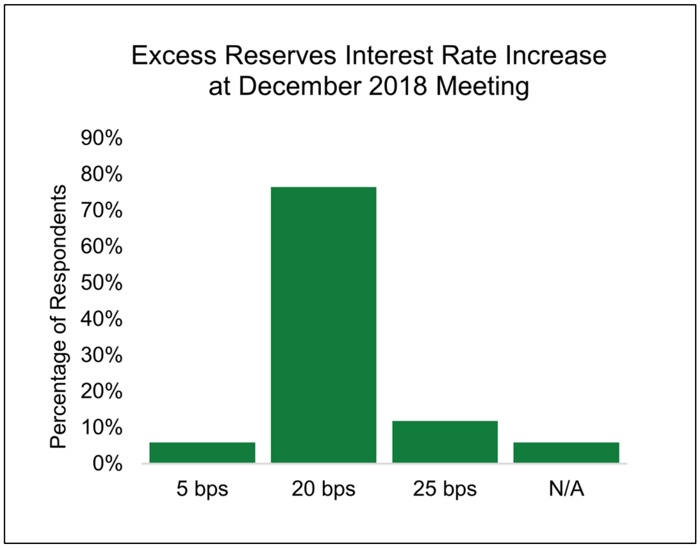
Economic slack/unemployment continued to be the dominant factor cited in the core inflation outlooks, followed by inflation expectations. Several respondents, however, voiced their concerns with the passthroughs of tariffs, which ranked as another top concern in their inflation outlooks.

MONETARY POLICY

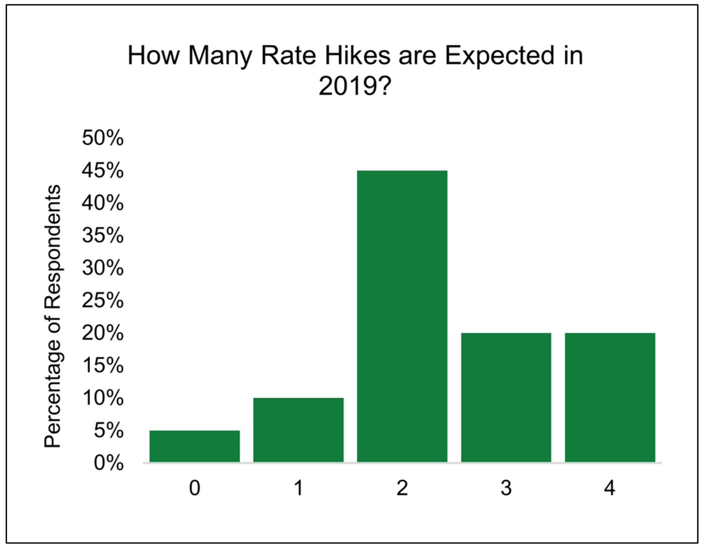
All but one of the respondents expect the Federal Open Market Committee (FOMC) will raise its target rate range by 25 basis points (bps) at the December 18-19, 2018 meeting from the current 2.00-2.25 percent range to 2.25-2.50 percent . For 2019, respondents continued to be divided in their predictions for rate hikes: the most oft-cited prediction was two rate hikes (45 percent), followed by three or four hikes (32 percent), one rate hike (10 percent) and no hike (5 percent).

Survey respondents considered indicators of inflationary pressure and expectations to be the most important factor in the FOMC’s decision to raise rates in 2019, followed by labor market conditions.

[9] The full-year 2018 business fixed investment forecasts ranged from 6.6 percent to 7.0 percent and for 2019 ranged from 2.6 percent to 6.0 percent.
[10] The full-year 2018 real state and local government spending forecasts ranged from 0.9 percent to 1.9 percent and for 2019 ranged from 1.2 percent to 3.4 percent.
[11] The full-year 2018 PCE deflator forecasts ranged from 1.7 percent to 2.1 percent and for 2019 from 1.6 percent to 2.5 percent.
[12] The full-year 2018 core PCE deflator forecasts ranged from 1.8 percent to 2.0 percent and for 2019 from 1.5 percent to 2.2 percent.



Source: SIFMA Economic Advisory Roundtable End-Year 2018 Economic Outlook



Source: SIFMA Economic Advisory Roundtable End-Year 2018 Economic Outlook

In the November FOMC meeting, Chairman Jerome Powell observed “the upward trend in the effective federal funds rate (EFFR) relative to the interest on excess reserves (IOER) rate . . . and suggested it might be appropriate to implement another technical adjustment in the IOER rate relative to the top of the target range for the federal funds rate fairly soon.”[13] Survey respondents, with only one dissenter, expect the Federal Reserve to raise the interest rate it pays on excess reserves at the December 2018 meeting. The median expectation was for the excess reserve rate to be increased by 20 bps.[14]

Respondents’ commentary reflected their concerns for the trajectory of monetary policy, with several offering caution to the Fed’s next steps. Comment highlights include: “The [Federal Reserve] should pause or stop once it becomes clear inflation is falling;” “[t]he balance sheet reduction program may need recalibration in 2019;” and that “the risks [are] tilted to the downside.”

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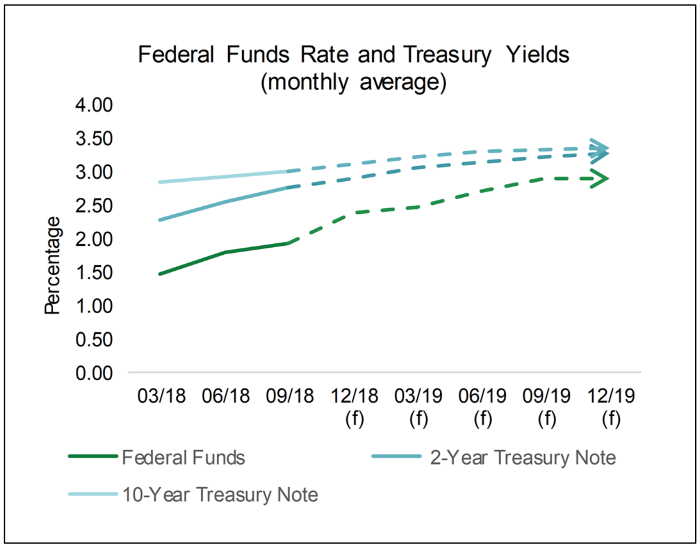
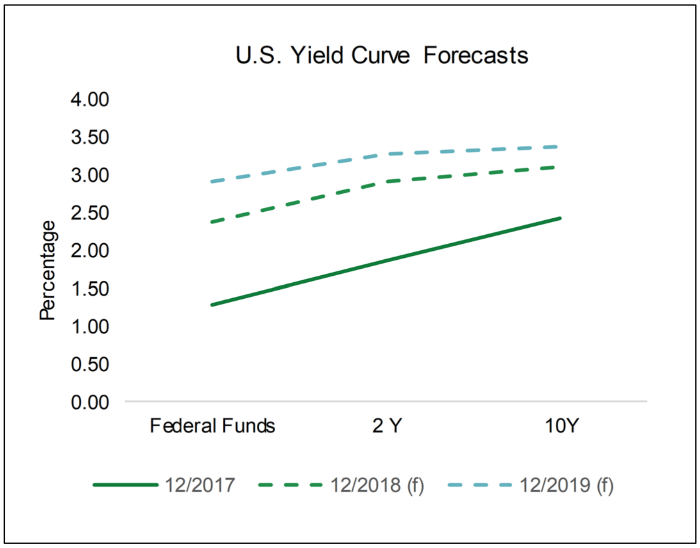
[13] Minutes of the Federal Open Market Committee, November 7-8 2018 (https://www.federalreserve.gov/monetarypolicy/files/fomcminutes20181108.pdf).

[14] Of those that agreed that the rate paid on excess reserves would be increased at the December 2018 meeting, the forecasts ranged from 5 basis points to 25 basis points.

INTEREST RATES





*(f) Forecast

Actuals and forecasts are averages for the month specified.

Source: Actuals - Federal Reserve, U.S. Treasury; Forecasts - SIFMA Economic Advisory Roundtable End-Year 2018 Economic Outlook

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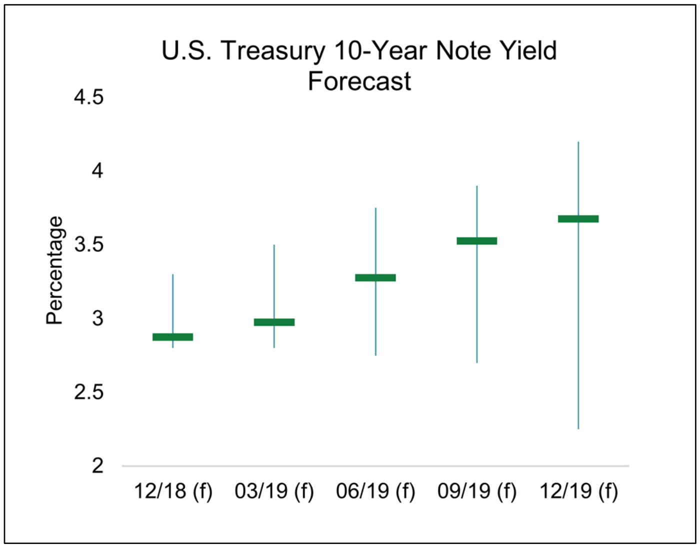
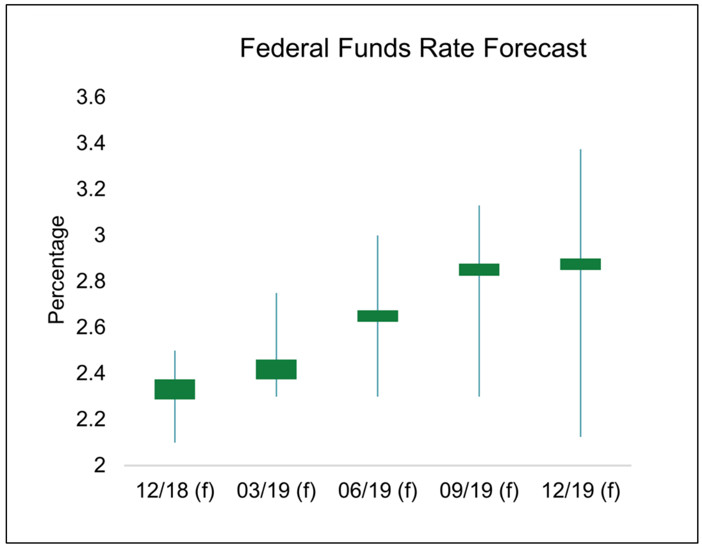
Source: Actuals: Federal Reserve, U.S. Treasury; Forecasts: SIFMA Economic Advisory Roundtable End-Year 2018 Economic Outlook

The majority of respondents (73 percent) expect the Treasury yield curve (Fed funds-to-10-year Treasury yield spread) to flatten in the first half of 2019, with the balance evenly split between the curve steepening and remaining the same. U.S. economic conditions, inflation and inflationary expectations, and FOMC policy remain the dominant factors cited impacting Treasury yields, followed by credit market risk and global economic conditions.

The median forecasts for 10-year Treasury rates were 3.10 percent for December 2018, rising to 3.34 by December 2019.[15]

[15] For reference, the yield on the 10-year U.S. Treasury was 2.91 percent on survey's closing day (December 4). The 10-year Treasury yield forecasts ranged from 2.80percent to 3.30 percent for December 2018; from 2.80 percent to 3.50 percent in March 2019; from 2.75 percent to 3.75 percent for June 2019; from 2.70 percent to 3.90 percent in September 2019, and from 2.25 percent to 4.20 percent in December 2019.





*(f) Forecast

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Slightly more than half (57 percent) of the respondents expect the TED (Treasury bill less LIBOR) spread to remain unchanged in the first half of 2019; 29 percent expected the spread to widen with the balance expecting it to narrow.

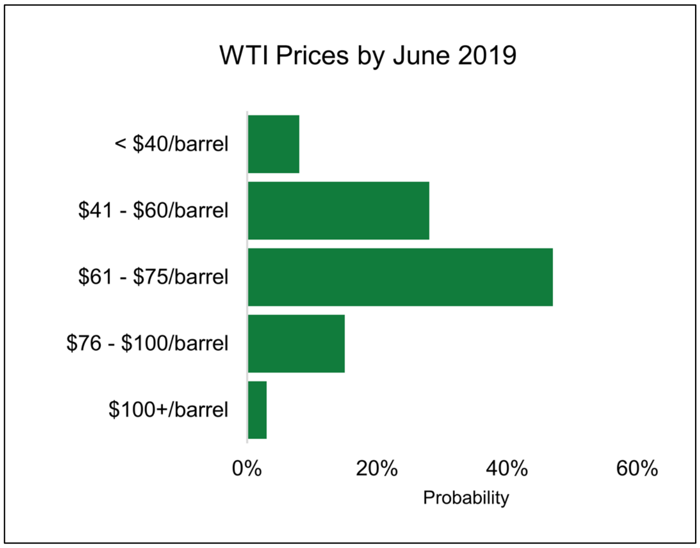
Nearly two-thirds of survey respondents expect investment-grade spreads to widen in the first half of 2019; 29 percent expect spreads to remain unchanged and one dissenter expected spreads to narrow. The forecast for high yield spreads were similar: two-thirds of respondents expected spreads to widen by mid-year 2019, 21 percent expected spreads to remain the same, and the balance to narrow.

Risks to Growth: Private Sector Investment and Trade on the Upside; Trade, Monetary Tightening and Global Slowdown on the Downside

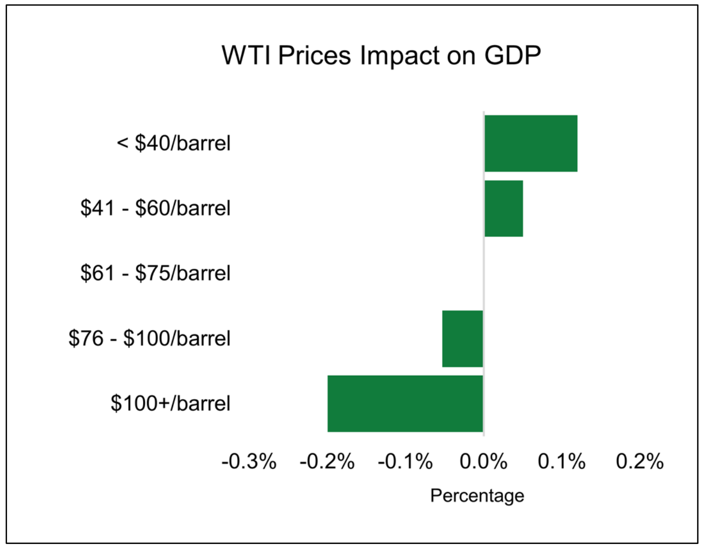
Respondents ranked trade policy as the single most important variable in their U.S. economic growth forecasts for the first half of 2019 – for better or worse. Better than forecast private sector investment, and, to a lesser extent, consumer spending, infrastructure spending and tax reform could also result in higher than expected economic growth.

On the downside, following the risk of higher than expected tariffs/lack of resolution of trade disagreements, respondents most frequently cited the risk of overly aggressive tightening by the Federal Reserve. To a much lesser extent, fading fiscal stimulus, commodities prices, inflation and global slowdown were also noted as risks for lower than expected growth.

Oil Prices



Source: SIFMA Economic Advisory Roundtable End-Year 2018 Economic Outlook Survey



Source: SIFMA Economic Advisory Roundtable End-Year 2018 Economic Outlook Survey

Asked to forecast the price of West Texas Intermediate (WTI) crude oil at the end of June 2019, respondents expected the most likely scenario for prices to be between $60 and $75.[16] Respondents estimated that the most likely scenario (prices remaining between $60 and $75) would have no impact on economic growth, and prices in adjacent bands having little impact (plus or minus 5 bps of annual GDP growth).

Respondents forecasted that WTI would settle at an equilibrium price of $65.00 per barrel three years from now, assuming continued moderate global growth, unchanged from the mid-year 2018 projection.[17]

Tax Policy

Three quarters of respondents estimate the 2017 tax reform positively impacted full year 2018 GDP growth by more than 25 basis points, while one quarter estimate the impact to be in the 0 to 25 bps range. A majority (57 percent) of respondents believe tax reform has increased the long-term potential growth rate of the economy. Of that group, two-thirds believe the impact is up to 25 bps, 22 percent 25 to 50 bps, and 11 percent an impact greater than 50 bps.

United States-Mexico-Canada Agreement (USMCA)/Trade Policy

Asked about what impact the USMCA would have on GDP growth once enacted, the majority (60 percent) saw no impact, a third expected a positive impact of up to 25 bps, and one dissenter expected a negative impact of up to 25 bps. One

[16] For reference, WTI was $53 per barrel on survey's closing day (December 4).
[17] The range of current forecasts for the equilibrium oil price in three years was $55 per barrel to $80 per barrel.

respondent noted that they were “still concerned about the outlook for USMCA, and its passage through Congress. . . We have long asserted that [it’s] as important, if not more so, than the U.S./China [trade issue].”

While most respondents (67 percent) agreed that tariffs have negatively impacted fourth quarter 2018 GDP by up to 25 bps, the balance saw no impact. Respondents were more measured on the impact of tariffs on the PCE deflator, with 47 percent estimating a rise of 10 bps, 47 percent seeing no change and one dissenter seeing a decline of 10 bps.

Looking forward to 2019, two-thirds of respondents expect 25 percent tariffs on Chinese goods, which they expect will lower 2019 GDP growth by up to 25 bps and raise prices by 10 bps or more (as measured by the PCE deflator). The remaining third expect a resolution on trade policy in 2019, and with such agreements in place, an up to 25 bps boost to GDP and little to no impact on inflation.

Regulatory Policy

Respondents ranked prudential capital, liquidity and leverage regulation as the most likely targets of reform in 2019, followed by the Volcker Rule, then derivatives.

Respondents, however, were divided over the impact such regulatory reform would have on their economic growth forecasts, with 15 percent expecting a positive impact of more than 25 bps, 38 percent seeing a positive impact of up to 25 bps, 40 percent of respondents seeing no impact, and one dissenter seeing a negative impact of up to 25 basis points. One respondent noted that “significant financial regulatory reform impact is going to take time to be reflected in economic growth, so the impact on the performance in the year the reform takes effect will be limited if there is any material effect at all.”

SIFMA Economic Advisory Roundtable Forecast

	2018	2019
Real GDP	2.9	2.6
Real GDP (4Q – 4Q)	3.1	2.2
CPI	2.4	2.1
CPI (4Q – 4Q)	2.3	2.3
Core CPI	2.1	2.3
Core CPI (4Q – 4Q)	2.2	2.4
PCE deflator	2.1	1.9
PCE deflator (4Q – 4Q)	1.9	2.1
Core PCE deflator	1.9	2.0
Core PCE deflator (4Q – 4Q)	1.9	2.1
Personal Consumption	2.7	2.8
Nonresidential Fixed Investment	6.8	4.3
Housing Starts (millions)	1.3	1.3
Real State & Local Government Spending	1.1	1.7
Current Account Deficit ($ billions)	(480.0)	(530.7)
New Home Sales (millions of units)	0.6	0.7
Existing Home Sales (millions of units)	5.4	5.4
Nonfarm Payroll Employment (change in millions)	2.4	2.0
Unemployment Rate (calendar year average)	3.9	3.5
Federal Budget (FY, $ billions)	(779.0)	(1,000.0)

Quarter-to-Quarter % Changes in Annual Rates

	2018				2019			
	1	II	III	IV	I	II	III	IV
Real GDP	2.2	4.2	3.5	2.6	2.5	2.4	2.1	1.9
CPI	3.5	1.7	2.0	2.0	2.3	2.4	2.4	2.4
Core CPI	3.0	1.8	2.0	2.1	2.5	2.4	2.3	2.3
PCE deflator	2.5	2.0	1.5	1.7	1.9	2.2	2.2	2.0
Core PCE deflator	2.2	2.1	1.6	1.8	2.4	2.1	2.1	2.1
Personal Consumption	0.5	3.8	4.0	3.1	2.6	2.4	2.2	2.1
Nonresidential Fixed Investment	11.5	8.7	2.5	4.7	4.3	4.3	3.4	3.1

Interest Rates (monthly average %)

	Dec. ‘18	Mar. ‘19	Jun. ‘19	Sep. ‘19	Dec. ‘19
Fed Funds	2.38	2.46	2.68	2.88	2.90
2 Year Treasury Note	2.90	3.03	3.10	3.21	3.25
10 Year Treasury Note	3.10	3.20	3.28	3.30	3.34
30 Year Fixed-Rate Home Mortgages	4.86	4.91	5.00	5.04	5.10

Exchange Rates (monthly average)

	Dec. ‘18	Mar. ‘19	Jun. ‘19	Sep. ‘19	Dec. ‘19
Yen/Dollar	113.0	113.2	111.8	110.0	109.0
Dollar/Euro	1.15	1.16	1.19	1.21	1.22
Dollar/GBP	1.30	1.34	1.35	1.39	1.41

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