JOINT ECONOMIC COMMITTEE
RANKING DEMOCRAT CAROLYN B. MALONEY
UNITED STATES CONGRESS

The latest edition of the *Quarterly Economic Digest* (QED), updated with data from the third quarter of 2016, shows that the economy continues to expand at a moderate pace. There are bright spots—real GDP rose at an annual rate of 3.2 percent during the third quarter, average job growth exceeded 200,000 per month in the quarter, and the unemployment rate is now at its lowest level since August 2007. Inflation remains low, and real income grew at a moderate rate.

There are also areas of concern—residential investment fell in the quarter, manufacturing employment shrank, and international headwinds including slower growth in China and uncertainty surrounding the United Kingdom's vote to leave the European Union continue to constrain global growth. Low inflation and uncertain global growth prospects have led the Federal Reserve to keep holding interest rates low, but the Fed now appears poised to raise rates.

The QED is organized into 10 sections:

- **Job Growth and Openings**: Job Growth Rebounds
- **Employment:** Trend Towards Full Employment Continues, But Some Slack Remains
- **GDP Growth:** Strong Growth Despite Slowing in Consumer Spending
- **Private Investment:** Business Investment Remains Virtually Unchanged
- **Personal Income and Spending:** Consumer Spending Slows, Still Solid
- **Housing:** Mixed Signals
- **Global Economy:** Uncertainties Continue to Put a Drag on Growth
- **Financial Markets:** Strong Post-Election Reaction
- **Monetary Policy:** A Rate Hike Appears to be Imminent
- **Fiscal Policy:** State and Local Government Spending Declines; Federal Spending Rises

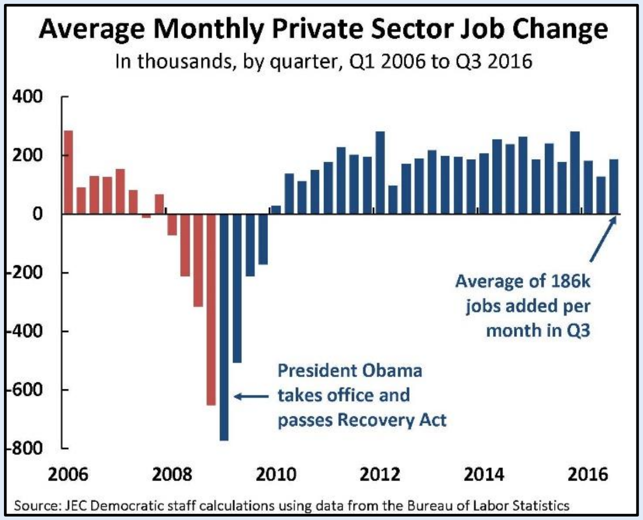
For detailed economic data for all 50 states and the District of Columbia, the Joint Economic Committee also publishes the State Economic Snapshots.

Prepared by the Democratic staff of the Joint Economic Committee

JOB GROWTH AND OPENINGS: Job Growth Rebounds

Overall job growth picked up to an average of 212,000 per month in Q3, up from 146,000 in the second quarter. Private sector job growth also picked up, from 128,000 in Q2 to 186,000 in Q3. Recent job growth has been more than sufficient to keep the unemployment rate from rising while absorbing the flows of both new workers and those returning to the labor force. With the economy fairly close to what the Fed and others consider to be maximum sustainable employment, we should expect some slowing in the rate of growth in employment during the next several years.

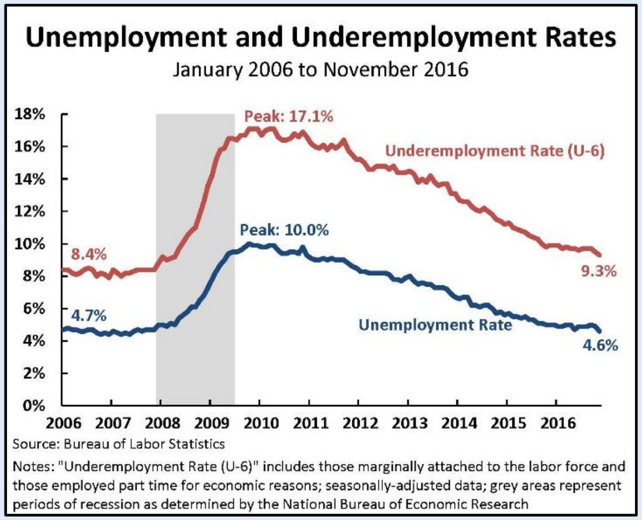
- ***Manufacturing employment remains a weak spot.*** Employment in manufacturing declined by an average of 7,000 jobs per month in the third quarter. Overall, manufacturing has recovered less than a third of the roughly 2.6 million jobs lost between 2006 and 2010. The current level is about 5 million (29 percent) below where it was in 2000.
- ***Job openings edge lower:*** The Job Openings and Labor Turnover Survey (JOLTS) reports 5.5 million job openings at the end of September. The number of job openings remains substantially higher than in the years immediately preceding the recession. On average, there were 1.4 unemployed workers and 2.8 underemployed workers for every job opening in the third quarter, little changed from Q2 but down from the peak of the recession in 2009 when there were monthly highs of 6.6 unemployed and 11.7 underemployed workers per job opening.



EMPLOYMENT: Trend Towards Full Employment Continues, But Some Slack Remains

The unemployment rate averaged 4.9 percent in the third quarter, unchanged from the previous quarter's average. This is considered to be very close to full employment. In November, the unemployment rate fell to 4.6 percent, its lowest level since 2007.

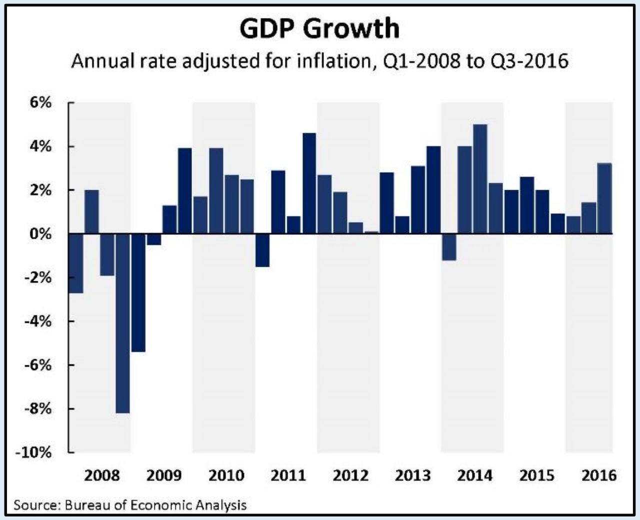
- ***Initial claims for unemployment insurance remained very low:*** Initial claims for unemployment compensation continued to edge down in Q3 to an average of 259,000 per week. This indicates that very few people are currently losing jobs, and implies a minimal risk of imminent recession.
- ***Labor force participation rose:*** The share of adults that are in the labor force (those employed or looking for work) rose 0.1 point to 62.8 percent in Q3. The participation rate for people ages 25 to 54 (sometimes termed "prime working-age") rose 0.2 points to 81.3 percent, its highest level since 2012, more than offsetting the ongoing effects of the aging population. Although the participation rate has increased since late 2015, the longer-term decline (beyond what can be explained by aging) remains a concern.
- ***Part-time work is still elevated:*** The number of people employed part-time who would have preferred a full-time job averaged about 6.0 million in Q3, little changed from the previous quarter. Involuntary part-time employment has fallen by about a third from its peak of around 9 million in 2010. Nonetheless, it remains significantly elevated compared with its pre-recession level (an average of 4.3 million between 2005 and 2007).



GDP GROWTH: Strong Growth Despite Slowing in Consumer Spending

Real GDP rose at an annual rate of 3.2 percent in Q3, based on the preliminary (second) estimate. This was up from 1.4 percent in the second quarter. Although the growth of consumer spending slowed, jumps in exports and in inventory investment boosted GDP growth. Business investment was little changed, and residential investment declined.

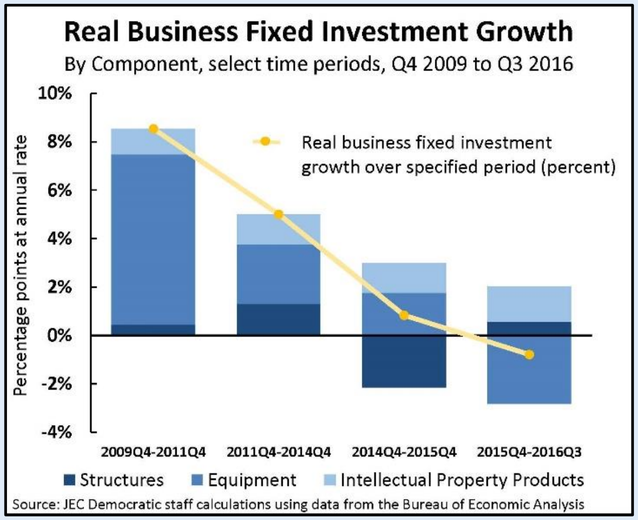
- ***Consumption growth slowed:*** Consumer spending rose at an annual rate of 2.8 percent in Q3, down from 4.3 percent in the second quarter but close to its average growth rate in the past several years.
- ***Investment rose:*** Business fixed investment edged up at a 0.1 percent annual rate in the third quarter. Inventories, which had been a significant drag on growth during the previous 5 quarters, contributed a positive 0.5 points to GDP growth in the third quarter. However, real residential investment fell at a 4.4 percent annual rate in the third quarter.
- ***Government spending was slightly higher:*** Government consumption expenditures and gross investment rose at a 0.2 percent annual rate in Q3. State and local government spending fell at a 1.1 percent annual rate, while total federal spending rose at a 2.5 percent rate.
- ***Net exports contributed significantly to growth:*** Real net exports rose by $37.5 billion, adding 0.9 percentage point to real GDP growth. Led by a one-time surge in exports of soybeans, exports rose at a 10.1 percent annual rate from the previous quarter. Imports rose at a 2.1 percent rate, with services accounting for most of the increase.



PRIVATE INVESTMENT: Business Investment Remains Virtually Unchanged

Business (nonresidential) fixed investment rose marginally at a 0.1 percent annual rate in Q3, down from a 1.0 percent increase in the second quarter.

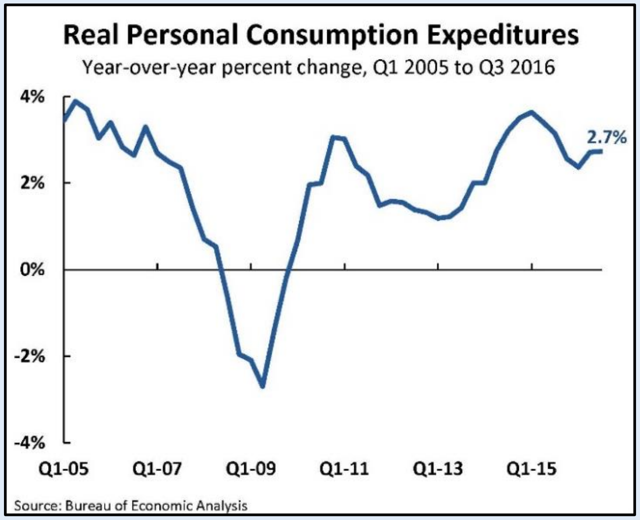
- ***Investment in structures rose:*** Structures investment rose at a 10.1 percent annual rate in Q3, as the rate of decline in investment in oil drilling and mining structures slowed, while the commercial/ health care and manufacturing categories showed considerable strength.
- ***Investment in equipment fell by 4.8 percent:*** Investment in equipment has declined for 4 consecutive quarters. Weak foreign demand and falling oil prices have weighed on equipment investment, which is the largest component of business fixed investment.
- ***Investment in intellectual property products rose at a 1.0 percent rate*:** Investment in software continued to grow rapidly, but spending on research and development declined at a 5.4 percent rate in the third quarter after rising 17 percent in Q2.
- ***Inventory investment rose by $17 billion:*** The increase in inventories added 0.5 percentage point to GDP growth in Q3, as businesses chose to rebuild inventories rather than draw them down as they had been doing during the previous 5 quarters.



PERSONAL INCOME AND SPENDING: Consumer Spending Slows, Still Solid

The growth of consumer spending, which accounts for about two-thirds of GDP, slowed to a still healthy 2.8 percent rate in Q3, compared with 4.3 percent in the second quarter.

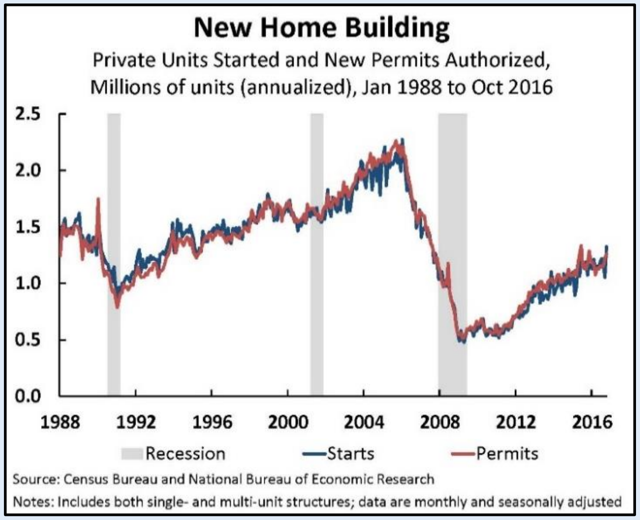
- ***Slower growth in consumer spending:*** Spending on consumer durables (“big ticket” items such as autos and furniture) rose at an 11.6 percent annual rate in Q3, its second consecutive quarter of rapid growth. However, real spending on nondurable goods declined at a 0.6 percent rate, and the growth of spending on services – by far the largest category of spending – slowed from 3.0 to 2.5 percent.
- ***Real income growth has been solid:*** Real disposable personal income rose at a 2.7 percent annual rate in Q3, slightly below the 2.9 percent growth rate in the second quarter (which was revised significantly higher from what had earlier been reported).
- ***Other key drivers of consumer spending remain supportive:*** Reductions in the amount of household debt and low interest rates have together reduced households’ debt burden, helping to boost consumer spending. Higher stock and house prices have also contributed. The Conference Board’s measure of consumer confidence picked up in Q3, while The University of Michigan index of consumer sentiment was little changed; both indicators remain at levels consistent with ongoing expansion.



HOUSING: Mixed Signals

Residential investment fell in the third quarter and housing starts were slightly lower. Existing home sales were somewhat lower, but sales of new homes rose. House prices continued to advance at a modest pace.

- ***Real residential investment fell:*** Real residential investment fell at a 4.4 percent annual rate in the third quarter, after falling at a 7.7 percent rate in Q2. Residential investment had risen 13.1 percent in 2015 and by an average of 8.6 percent during the previous 4 years. Nonetheless, its current level is almost a third below its peak during the housing bubble.
- ***Housing starts dipped:*** Housing starts fell 1.2 percent in the third quarter. At about 1.15 million units per year, housing starts remain well below not only the 2.1 million units per year average at the height of last decade’s bubble but also the pre-bubble long-run average of about 1.5 million. Single-family starts were virtually unchanged in the third quarter. Starts in the more volatile multifamily category were lower, plunging in September (but fully recovering in October).
- ***Home sales were mixed:*** New home sales rose 4 percent in the third quarter, and 21 percent year-over-year. The much larger category of existing home sales fell 2.1 percent in the third quarter, with the number of sales held down due to a limited supply of homes for sale.
- ***House prices continued to rise:*** All of the major house price indexes (the FHFA Purchase Only Index, the S & P Case Shiller U.S. National and 20-city Indexes, and the CoreLogic Home Price Index) were up between 5 and slightly more than 6 percent compared with a year earlier.



GLOBAL ECONOMY: Uncertainties Continue to Put a Drag on Growth

The global economy continued to grow at a moderate pace in Q3. Uncertainty surrounding Brexit and the future of the European Union and ongoing concerns about the long-term health of China's economy continue to restrain global growth. Oil prices were flat in Q3, but now appear likely to be rise.

- ***Uncertainty in UK and Europe:*** Thus far, the British economy has weathered the storm triggered by the June 23 vote to leave the European Union. A sharp decline in the British pound has boosted exports and restrained imports in the United Kingdom, and accommodative monetary policy and easing of restrictive fiscal policy have helped to prop up the UK economy. However, ongoing uncertainty about the terms of Brexit are likely to weigh particularly on investment, causing growth to slow. In the Eurozone, preliminary estimates show that real GDP in Q3 grew at about a 1.6 percent rate, roughly in line with recent growth rates and suggesting limited fallout thus far from Brexit. However, Italy's prime minister is resigning after voters rejected proposed constitutional reforms, and upcoming elections in France, Germany and the Netherlands are further amplifying uncertainty over the future of the European Union.
- ***China's outlook is uncertain:*** GDP growth in China has slowed over the past several years from a double digit average over more than a decade to a 6.7 percent year-over-year growth rate in Q3. Although stimulus from infrastructure spending and from accommodative monetary policy have kept growth from slowing further, weak private investment and falling exports have raised concerns about whether the current growth rate is sustainable.
- ***Oil prices are set to rise:*** The price of Brent crude oil averaged $46 per barrel during Q3, unchanged from Q2 and well below its level in recent years. At a just-concluded meeting, however, OPEC members agreed to limit oil production; in response the price of oil has risen above $50 per barrel. If the production cuts are sustained (which is far from a sure thing, especially if the latest price increase induces non-OPEC producers to boost production), oil prices are likely to remain above recent levels in the coming months.

IMF October 2016 World Economic Outlook Projections

Real GDP Growth in Percent Change (Q4 over Q4)

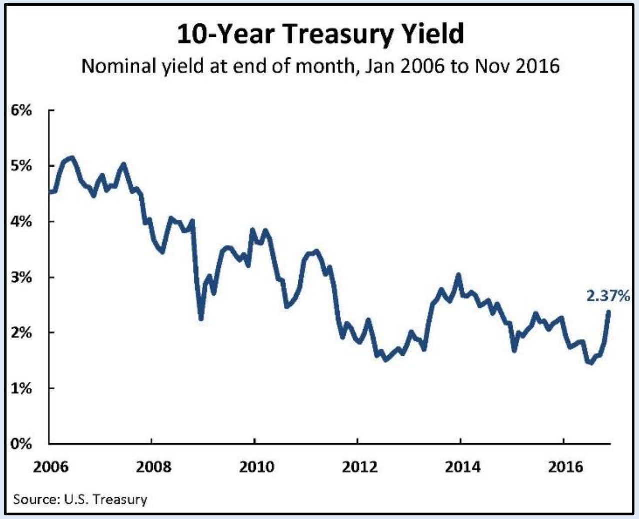
	Actual 2015 GDP	2016	2017
World	3.1	3.1	3.5
Advanced Economies	1.8	1.7	1.8
United States	1.9	2.0	1.9
Euro Area	2.0	1.6	1.6
UK	1.8	1.4	0.8
Japan	0.8	0.8	0.8
Canada	0.3	1.5	1.9
Emerging Markets	4.2	4.3	5.0
Brazil	-5.9	-1.2	1.1
Mexico	2.4	1.8	2.4
China	6.9	6.4	6.1

Source: IMF Overview of the World Economic Outlook Projections

FINANCIAL MARKETS: Strong Post-election Reaction

Financial markets conditions improved modestly in the third quarter. Stock prices and bond yields jumped following the U.S. presidential election.

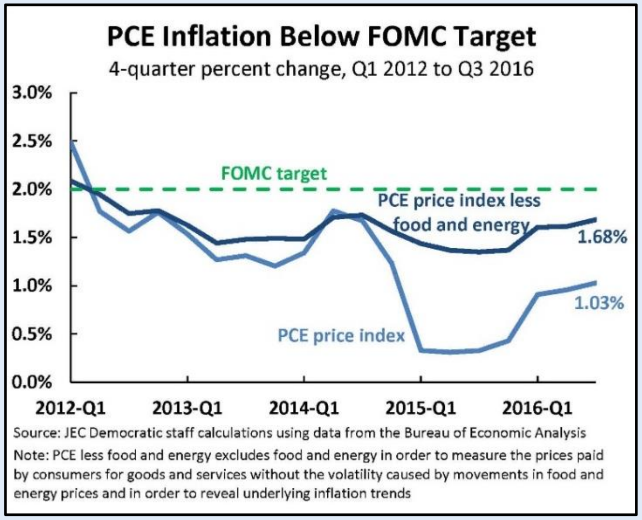
- ***The stock market advanced*****:** The S&P 500 rose about three percent in Q3, leaving it up about 6 percent since the beginning of the year. After losing ground in October, the stock market rose sharply following the U.S. election, reaching record heights. By the end of November, stock prices were up about 1½ percent from the end of the third quarter and about 7½ percent year-to-date.
- ***The U.S. bond market experienced large post-election losses:*** Yields on US Treasury securities were stable at very low rates throughout the third quarter. The yield on the 10-year Treasury averaged 1.56 percent in the third quarter, its lowest quarterly average ever recorded; by Election Day it had edged up to 1.88 percent. At the end of November that yield stood at 2.37 percent, with more than half of the increase occurring in the two days immediately following the election.
- ***The dollar exchange rate was little changed in Q3:*** The exchange rate as measured against a broad index of currencies was virtually unchanged in the third quarter. Since the U.S. election, however, it has appreciated about 4 percent, as expectations of a pending increase in U.S. interest rates have firmed. The appreciation has been especially pronounced against the Mexican peso, reflecting concerns about the impact of potential actions on trade and immigration under the incoming administration.



MONETARY POLICY: A Rate Hike Appears to be Imminent

The Federal Reserve has continued to hold interest rates low as it awaits further evidence of progress toward meeting its employment and inflation objectives. However, it has signaled a high probability of a quarter point rate hike at its next meeting, to be held December 13-14.

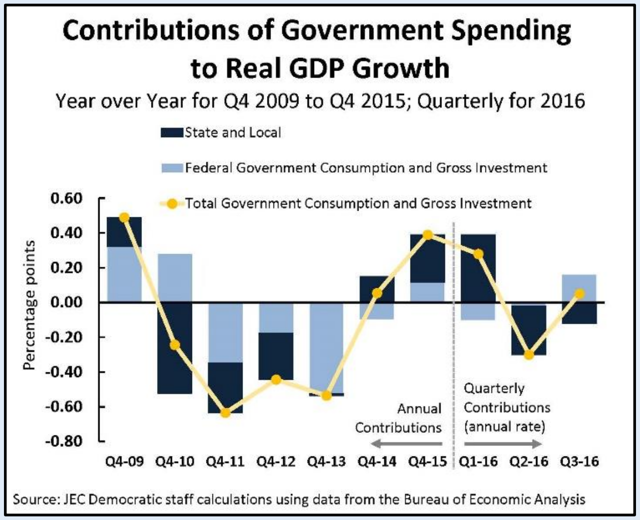
- ***There have been no rate hikes so far in 2016:*** In December 2015 the Fed increased the federal funds rate by ¼ point to a range of ¼ to ½ percent, the first rate increase since 2006. After hinting that more increases may be imminent, the Fed has declined to further raise rates so far this year.
- ***The FOMC is Signaling an Imminent Rate Hike:*** Minutes of the September meeting suggest that the decision not to raise rates was a close call, with below-target inflation the most decisive factor. At the November meeting, uncertainty surrounding the upcoming election and potential reaction in financial markets was an additional reason for restraint. However, mostly strong recent data releases and the stock market's upbeat reaction to the election suggest that a December rate hike remains on track. In her November 17 testimony before the Joint Economic Committee, Fed Chair Yellen said that an increase could become appropriate "relatively soon."
- ***Core inflation measures still running low:*** Low inflation over the past year has been due mostly to falling prices of energy and imported goods. Energy prices were slightly higher in the third quarter, but core measures (those excluding food and energy) continued to run low. In October the core PCE index rose just 0.1 percent.



FISCAL POLICY: State and Local Government Spending Declines; Federal Spending Rises

Overall government spending (combined federal, state and local) rose slightly in Q3. Federal spending rose, but spending by state and local governments was slightly lower.

- ***Overall government spending rose modestly:*** Real government spending and investment rose at a 0.2 percent seasonally-adjusted annual rate in the third quarter, and is little changed so far this year. This is a significant drop from the 2.2 percent growth experienced in 2015. The increase in government spending in Q3 added less than 0.1 percentage point to real GDP growth.
- ***Federal spending was higher:*** Real federal spending rose at a 2.5 percent annual rate in the third quarter. Nondefense spending rose by 3.0 percent, and defense spending rose by 2.1 percent.
- ***State and local spending edged lower:*** Real state and local government spending declined at a 1.1 percent annual rate in Q3. State and local spending had risen by 2.5 percent in 2015, and at an average annual rate of 0.5 percent in the first half of 2016.



SUGGESTED READINGS

- Ana Swanson, "How China May Have Cost Clinton the Election?" *Washington Post* (12/1/2016)
- Greg Ip, "The Latest, Greatest Threat to the Euro: Populism," *The Wall Street Journal* (11/30/2016)
- Nayla Razzouk, Angelina Rascouet and Golnar Motevalli, "OPEC Confounds Skeptics, Agrees to First Oil Cuts in 8 Years," *Bloomberg* (11/30/2016)
- Adam Samson and Jessica Dye, "Data show Trump to inherit strengthening US recovery," *Financial Times* (11/29/2016)
- Min Zeng, "Wall Street is Betting $2.1 Trillion that U.S. Rates Will Rise," *The Wall Street Journal* (11/22/2016)
- Mohamed A. El-Erian, "A Primer on the Dollar's Surge," *Bloomberg* (11/17/2016)
- Anna Louie Sussman, "Job Gains at Startups Are Way Down and That's a Bad Sign," *The Wall Street Journal* (11/9/2016)
- Ben Casselman, "The Economic Challenges Facing the Next President," *FiveThirtyEight* (11/7/2016)
- Neil Irwin, "These Jobs Numbers Show an Economy That is Basically Healthy," *The New York Times* (11/4/2016)
- Binyamin Appelbaum, "A Little-Noticed Fact About Trade: It's No Longer Rising," *The New York Times* (10/30/2016)
- Josh Zumbrun, "What 'Expansions Don't Die of Old Age' Really Means," *The Wall Street Journal* (10/28/2016)