

ECONOMIC OUTLOOK

- ◆ Economic data continue to surprise to the upside. The Institute for Supply Management (ISM) reported economic activity in the manufacturing sector expanded in August while the overall economy grew for the 112th consecutive month. The August survey reported business conditions surged to a 14-year high with the index rising to 61.3% from 58.1% in July. Readings over 50 indicate the economy is growing. We expect third quarter and full year real U.S. GDP growth of approximately 3%.
- ◆ Inflation measures edge higher. The headline Personal Consumption Expenditures (PCE) Index rose 0.1% in July and 2.3% year-over-year. The core PCE Index, which excludes volatile food and energy components, climbed 0.2% for a 2.0% year-over-year increase, which was in-line with expectations and the Federal Reserve's inflation target. The core PCE index is the Federal Reserve's preferred inflation measure. Consumers still came out ahead as personal income rose 0.3% over the prior month while spending gained 0.2%. We expect similar moderate inflation gains in the months ahead.
- ◆ The yield curve continues to flatten. The Federal Open Market Committee (FOMC) has telegraphed two short-term interest rate hikes before year-end. As short-term rates rise, the spread between the 10-year and 2-year Treasury note have narrowed from 0.50 percentage point at the start of the year to around 0.20 point today. Long-dated rates have remained anchored under 3.0%, which may signal investors lack confidence in sustainable economic growth. An inverted yield curve has often, though not always, signaled a recession. We expect 10-year Treasury yields to move higher when core inflation trends sustainably rise over the Fed's 2.0% inflation target.
- ◆ Consumers are poised to spend. The Conference Board's Consumer Confidence Index surged in August to a 17-year high. Survey respondents viewed the economic outlook favorably including an expectation for improving wages. An improvement in the Personal Savings Rate to more than 6% in each of the past few months supports the ability of consumers to spend going forward. The Personal Savings Rate calculates the ratio of personal saving to disposable income. Low unemployment and higher wages should support consumer spending during the second busiest retail sales period of the year, back-to-school shopping.
- ◆ Small businesses are optimistic. The Small Business Optimism Index recently rose to within one-tenth of a percent of the all-time high recorded in 1983. The Index is a monthly survey reported by the National Federation of Independent Businesses (NFIB). Owners reported record job creation plans and job openings. Higher nominal sales over the past three months contributed to the optimism. According to the Small Business Association, since 1995 businesses employing under 500 employees have generated 64% of new jobs and paid 44% of the total U.S. private payroll. We expect low unemployment trends will continue.

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