ECONOMIC COMMENTARY

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Weathering Major Economic Impact

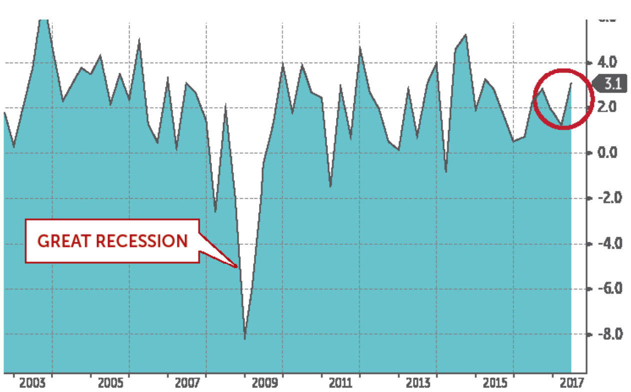
By Mel Miller, CFA® | Chief Economist

Millions of Americans, along with the economy, suffered significant losses as three major hurricanes slammed numerous states and Puerto Rico in August and September. The estimated property loss resulting from Hurricane Harvey alone, is $180 BN; damage from Hurricane Irma is projected at $50 BN; and loss from Hurricane Maria estimated at $30 BN.

The loss of property and loss of lives brought about what many thought impossible—bipartisan Congressional action. President Trump signed a bill supported by Republicans and Democrats to provide $15 BN of economic assistance to hurricane victims in Texas and Florida. However, given the projected losses and the level of devastation, a former FEMA chief predicted it would be spent within 30 days. The provision of assistance to Puerto Rico, already weathering its own economic crisis, however, has been slow.

The economic impact of these successive catastrophes had a profound impact on September's economic releases and the one-off nature of weather events makes monthly comparisons impossible. Therefore, I can only rely on July and August releases for my quarterly analysis.

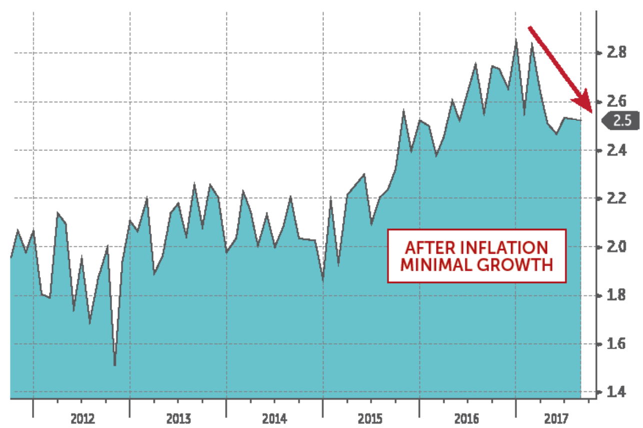
Quarterly Change in Gross Domestic Product



Second quarter GDP recovered from a dismal first quarter growth of only 1.2%, reporting a more respectable 3.1% second quarter growth. To make my third quarter GDP forecast, I examine key economic measures, starting with the all-important retail sales. I have highlighted the importance of retail sales as an indicator in previous quarterly commentaries.

"Improvement" is the best word to describe retail sales for the first two months of the quarter. The retail sales growth rate, excluding the volatile auto category, is now a respectable 3.6% annual rate.

Yearly Change in Hourly Earnings



Economists are perplexed by the fact that average annual earnings growth has slowed in 2017. Growth was increasing at an annual 2.9% at year-end, but is now only 2.5% despite declining unemployment (from 4.7% to the current 4.2%.) In addition, more and more reports highlight the lack of qualified labor. The National Federation of Independent Business (NFIB), which tracks job openings and hard to fill positions on a monthly basis, points to a near record level in its latest report; the current record was reached in June 2000. The low wage growth is also frustrating for Janet Yellen and the Federal Reserve's Open Market Committee. The Fed wants to reduce some of the economic stimulus

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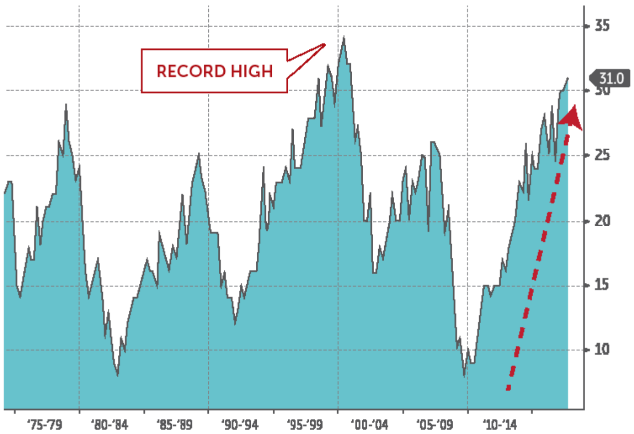
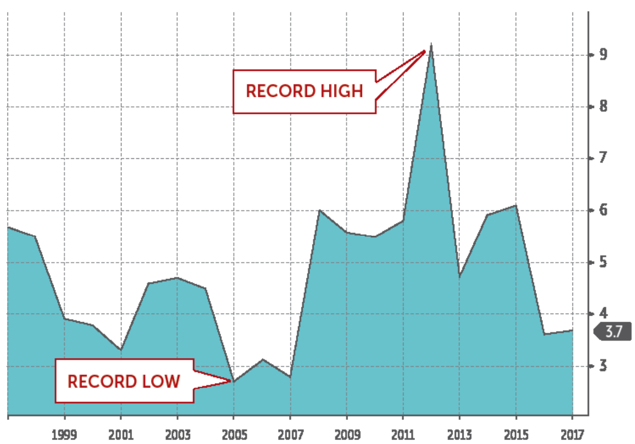
NFIB Hard to Fill Jobs Index



provided over the years by raising rates but the lack of wage growth and general lack of inflation has stymied their efforts. The odds are the Fed will raise rates in December.

Personal Savings Rate



The gap between earnings growth and retail sales growth can create a problem for the import consumer sector and thus the economy in general. Another indicator I monitor is the U.S. Personal Savings Rate to gain insight into the consumers' financial strength. In short, the consumer is getting squeezed. The savings rate rose during and after the Great Recession to a cyclical high of 9.2% at the end of 2012. Since then the rate has declined to the current 3.6%, approaching the all-time low annual rate of 2.2% recorded in 2005.

Last quarter, I discussed how uncertainty and partisanship ruled the economy. Alongside the hurricane relief bill, there was a slight crack in the wall of partisanship as President Trump joined with congressional Democratic leaders to reach an agreement to raise the federal debt ceiling for three months (as opposed to the Republican plan seeking an 18-month extension to delay the battle until after the midterm elections.)

Maybe this small crack is sufficient justification for the NFIB Optimism Survey to remain at near record high. The small business community continues to be buoyed by the dismantling of regulations by various federal agencies. Any repeal and replacement of Obamacare looks to be off the table for the remainder of the year, however, the business community does not seem concerned. In addition, the prospect of tax reform with a reduced corporate tax rate helps to keep optimism elevated even though the chances of meaningful tax reform, in my opinion, are low.

As I mentioned last quarter, consumer confidence rebounded tremendously since the end of the "Great Recession" and remains elevated. Since the same is true for business confidence, one has to wonder, "Is this as good as it gets?" Low inflation (under 2%), low unemployment (4.2%), and rising wages sounds like the "perfect" economic scenario and could be the best we are going to see. The stock market certainly seems content with the current economy.

So, what is my third quarter GDP prediction? Based on my analysis, another 3% growth quarter was a distinct possibility prior to the hurricanes. Prior hurricane disasters provide insight into the economic impact that this quarter's hurricanes may bring: Negative impact to the economy is in store through the remainder of 2017 and into the first quarter of 2018. Following six months of negative impact, a positive impact from rebuilding efforts should neutralize the situation. As a result, I am expecting a reduction in GDP of approximately 1% this quarter, resulting in a 2% GDP increase for the third.

Our hearts and prayers go out to the victims.

Mel Miller, CFA® is Chief Economist and a member of the First Affirmative Investment Committee. He monitors economic conditions and market movements, and keeps the firm and its network advisors current on economic issues.

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Source of graphic data: Bloomberg

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