The Economy in Focus

First Quarter 2018

March 26, 2018

Executive Summary

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In this report we discuss three important areas of the economy that have received a great deal of attention recently, namely:

- Economic Growth has given some mixed signals, but fundamentals are pointing to solid economic growth in 2018. "The Tax Cut and Jobs Act of 2017" is expected to be a catalyst as the year progresses.
- Core consumer inflation has been steady, but inflation has been broadening in the economy overall. Future interest rates will likely reflect a "normalizing" inflation and interest rate environment.
- Business Activity has been accelerating, and 2018 is expected to show the strongest overall growth since 2005. Conflicts over International trade pose a potential risk. However, if new improved trade terms result for the U.S., then U.S. export growth could benefit in the long-term.

We begin with an update on indicators of economic growth on the following page.

Indicators of Economic Growth

After solid broad-based GDP growth of 2.3% in 2017, economic growth as measured by real GDP growth likely moderated in the first quarter of 2018 to a pace in line with the 2% real GDP growth typical of the current economic expansion that began in 2009. A slower start to the year replicates the generally slow economic growth in the first quarter that has been typical in recent years. However, modest growth in the first quarter is expected to be the pause that refreshes before faster economic growth returns as the year progresses.

Real GDP growth in 2018 is forecasted to grow 2.8% for the strongest year of growth since 2005. Recent indicators such as the ISM reports on manufacturing and non-manufacturing are already pointing in that direction. (Please see the chart below.) Many consumers and businesses are beginning to obtain benefits from "The Tax Cut and Jobs Act of 2017." While tax changes were complex and will certainly depend on specific individual circumstances, reductions in personal, small business and corporate tax rates that have already begun will likely boost the overall level of disposable personal income for consumers, and raise after tax expected profits for many corporations and small businesses. The net additional stimulus to the economy is expected to be significant in 2018, in particular, but benefits should continue from tax reform in the coming years, as well.

In addition to the tax reform, potential new spending in the Federal budget in both defense and non-defense areas could lift near-term spending in the public sector as well as the private sector. Aggregate demand will likely be plentiful.

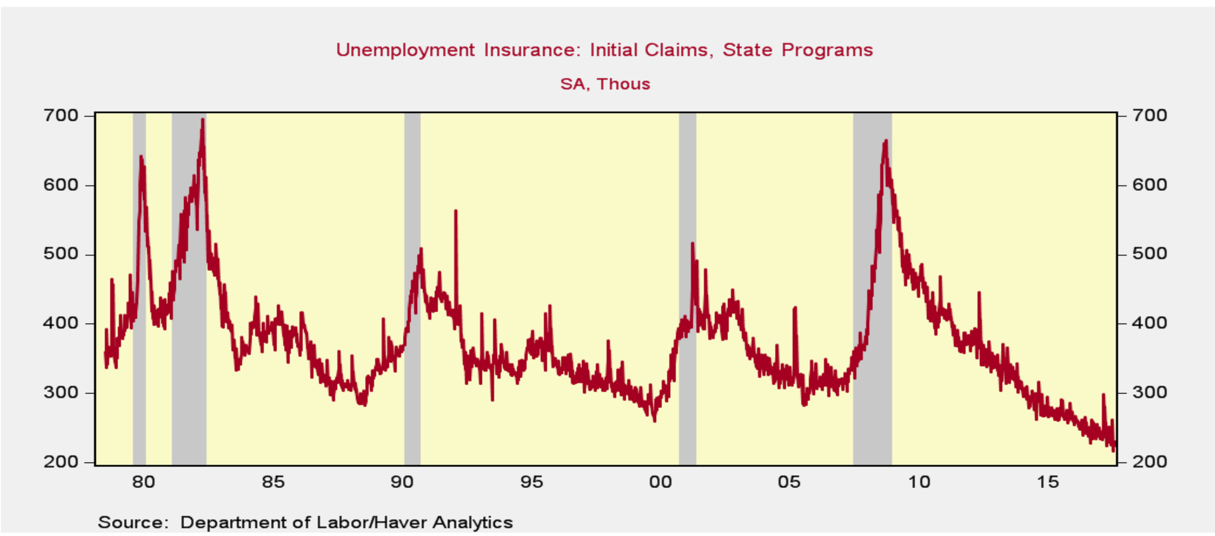
Economic Activity Volatile, but Strongest Overall since August 2005

Labor Markets Have Continued to Strengthen

Net employment grew an eye-popping 313,000 workers in February despite a historically low unemployment rate. The official unemployment rate was only 4.1% in February, remaining at its lowest rate since December 2000. How was this accomplished? **A remarkable 1.324 million new workers entered or reentered the workforce in January and February.** The labor force participation rate moved up solidly from 62.7% in January to 63.0% in February, with more increases expected in 2018 to meet rising aggregate demand in the economy. Gradually rising wages should also provide increased incentives for labor market re-entry.

New unemployment claims hit a multi-decade low of 220,000 in the week ending February 24 for the lowest initial claims since December 1969. Low unemployment claims indicate businesses are making efforts to retain employees under tight labor market conditions. Please also note the astounding drop in new weekly unemployment claims during the current expansion alone. The declining trend in unemployment claims points to continued economic expansion in the next year to 18 months.

Initial Claims for Unemployment Insurance at Historically Low Levels

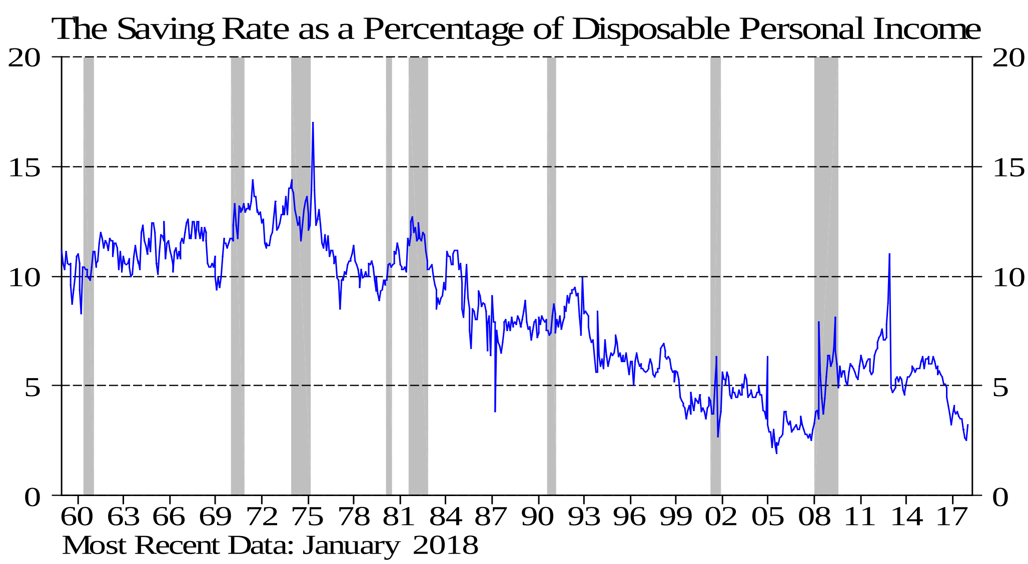


Tax Cuts will Likely Refuel Consumer Spending as the Year Progresses

Consumers spent heavily in 2017 relative to their incomes. In real terms, consumers increased consumption by 2.7% in 2017, which was equal to growth during 2016. In simple dollar terms, which is the most relevant for consumer budgets, spending grew 4.5% in 2017 for the strongest annual growth since 2011, while disposable income grew a slower 2.94%. The result was a lowered Saving Rate. (Please see the chart below.) [Although historically low, inflation cut inflation-adjusted disposable personal income growth to only 1.23% in 2017, following already slow growth of 1.39% in 2016.]

Part of the increased spending by consumers in 2017 was no doubt attributable to strong wealth gains in stock markets and steady gains in home prices. However, consumers began to feel the pinch of low saving out of current incomes in January as consumer spending showed only a modest gain of 0.2%. During February average paychecks began to reflect lower required withholdings for tax purposes. Hence, consumers should begin to see a higher saving rate in the coming months. They will likely respond with a reacceleration in consumer spending, particularly in the second half of the year after several months of higher disposable income growth and growing saving balances.

High Consumer Spending Lowers Saving Rate



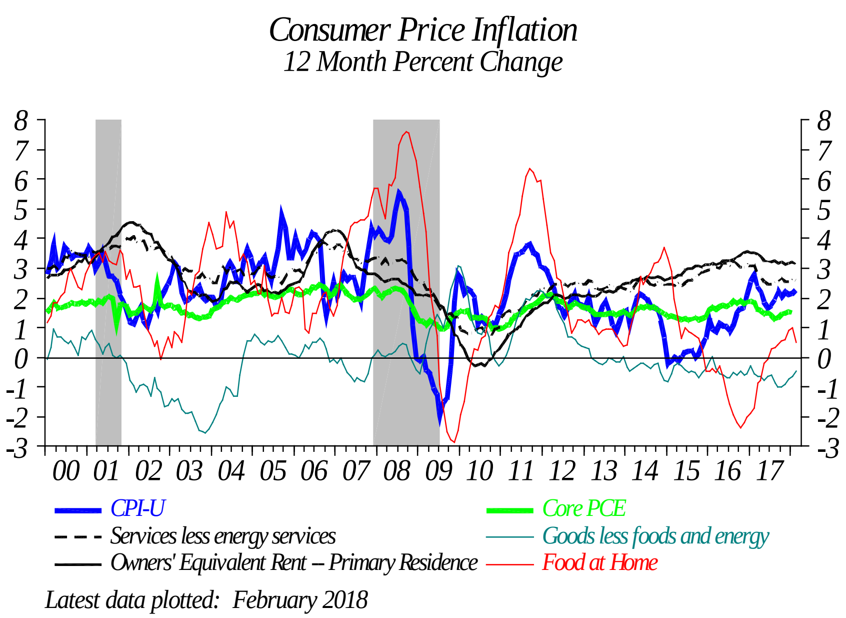
Consumer Inflation Picking Up, Official "Core Inflation" Steady for Now

The official "Core Inflation" of the economy has remained remarkably steady since the economic recovery began in July 2009, and even before that period. Core inflation is derived from price changes in consumer spending in the GDP accounts, known as the Personal Consumption Expenditures (PCE), and excludes food and energy purchases. It is "official" because it is the preferred measure of inflation by the Federal Reserve.

Some Federal Reserve policy makers have commented that inflation has actually been too low according to this measure. As can be seen in the following chart, the 12-month percent change in the index has remained in a narrow range between 1% and 2%, and has only moved outside that range slightly during short periods of time. However, the overall index averages away price volatility in many areas of spending that are important to consumers.

The most familiar measure of inflation utilized by consumers -- the Consumer Price Index for Urban consumers (CPI-U) – has been on a gradual rising trend since a recent bottom in 2015. Rising energy prices have been putting upward pressure on the overall CPI-U during the last 2 years. Outside of energy, inflation in services has generally been on an accelerating trend, with the measure of Services Less Energy Services rising 2.6% in the most recent 12-month period. In contrast, the price of goods less foods and energy has remained on a long-term declining trend, dropping another -0.5% in the last 12 months. This deflationary trend in goods is expected to continue, although shifts are possible. For example, slower Medical Care inflation from Physicians' Services has helped to contain services and core measures of consumer inflation in check so far in early 2018. In 2017 the cost of Physicians' Services declined annually for the first time in the Consumer Price Index since the beginning of the data in 1948.

Over Inflation Measures Mask Diverging Trends between Services and Goods Inflation



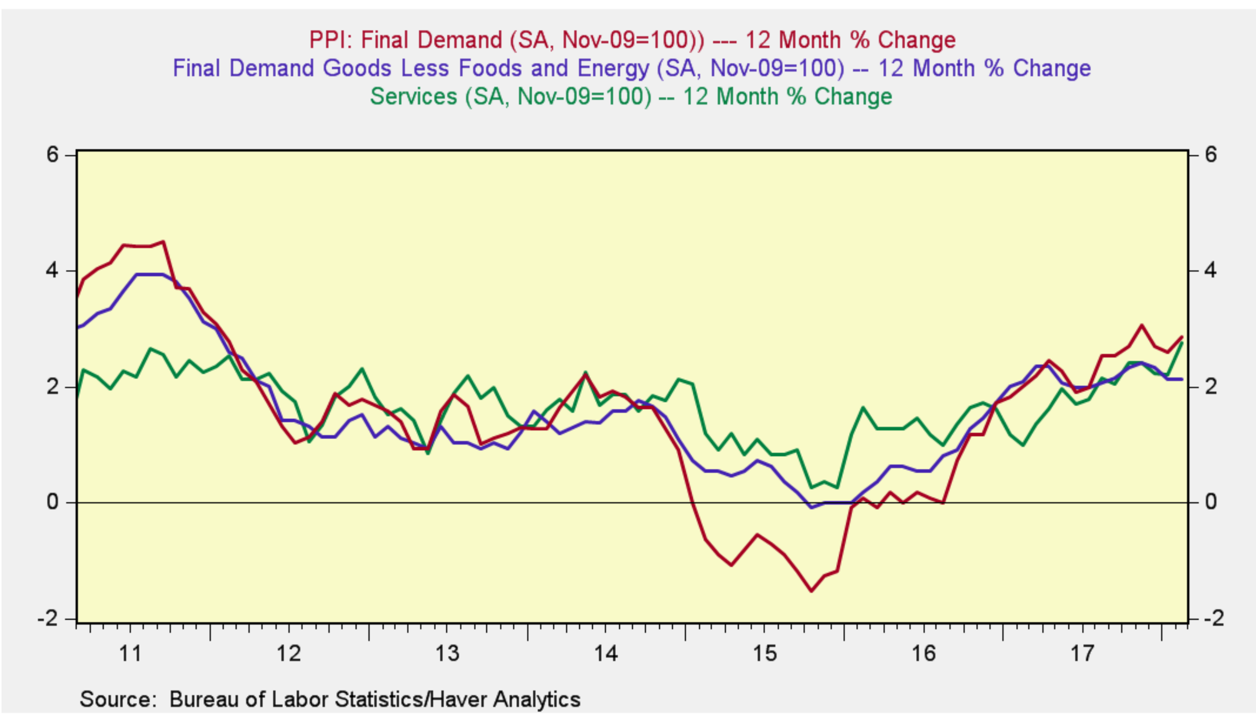
Inflation Among Producers Firming Across Sectors

Producer prices declined in 2015 and much of 2016, but have accelerated gradually in unison since the second half of 2016. Unlike the CPI-U, which measures inflation in an average set of goods and services purchased solely by the average urban consumer, the Producer Price Index for Final Demand measures prices throughout the entire economy. While prices clearly dipped during the world and energy slowdowns of 2015 and the first half of 2016, prices for both services and goods have been on a rising trend since the world economy began to strengthen in the second half of 2016.

The overall Producer Price Index for Final Demand in the economy was up 2.86% in the 12 months through February, indicating prices will likely push higher at the consumer level in the coming months, as well. With economic growth expected to strengthen as the year progresses, and with plentiful liquidity and fiscal stimulus worldwide to fuel it, the gradual upward trend in inflation is forecasted to continue in 2018, bringing average inflation up in both the CPI-U and overall producer prices.

Our forecast for CPI-U inflation is 2.5% in 2018, with forecast risks tilted to the upside. Producer prices will likely go even higher.

Producer Prices Rising Broadly Again



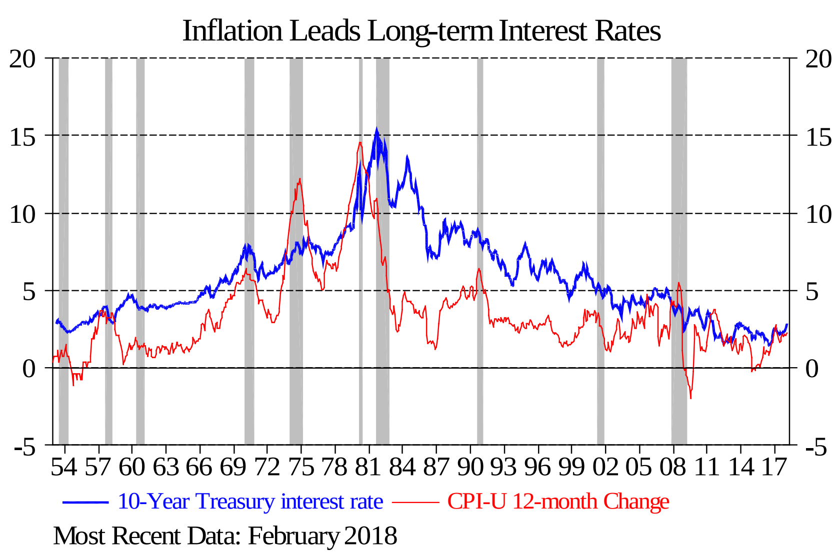
Rising Inflation Likely to put Some Upward Pressure on Interest Rates

Over long periods of time, inflation is a major determinant of long-term interest rates. This is evident in the following chart in which inflation leads the 10-year Treasury yield upwards from the late 1960s though the high-inflation 1970s. Interest rates began to recede in the early 1980s when the Federal Reserve implemented tough monetary policies to combat high inflation. Declining inflation subsequently led long-term Treasury yields gradually downwards to the present period.

In recent years, both inflation and long-term interest rates have been historically low. However, this long-term decline in long-term interest rates showed some possible signs of ending in early 2018. In addition to gradually accelerating inflation, reversals in Quantitative Easing (QE) policies that have resulted in the Federal Reserve reducing its long-term Treasury bond holdings is likely to create a gradual upward force on long-term Treasury interest rates in 2018. QE was effective in helping to suppress long-term interest rates, hence reversing those actions should help to gradually move long-term interest rates back up, as well.

Stronger expected economic growth in the U.S. and world economy, and higher federal deficits can also put upward pressures on long-term interest rates. However, foreign central banks will likely keep increases in long-term sovereign interest rates gradual. The European Central Bank (ECB) and the Bank of Japan (BOJ) continue to make asset purchases, at least through the first half of the year, keeping many long-term government yields abroad well below 1.0%. When these central banks end their bond purchasing programs, as the ECB is expected to do in the second half of the year, foreign government interest rates will likely rise relative to U.S. Treasury rates, and thereby reduce the yield advantage of buying U.S. Treasury bonds. This expected relative decline in demand for U.S. Treasury bonds underpins our forecast that the 10-year Treasury rate will break above 3.0% later in the year, and hold those gains at year-end.

Inflation Leads Long-Term Interest Rates

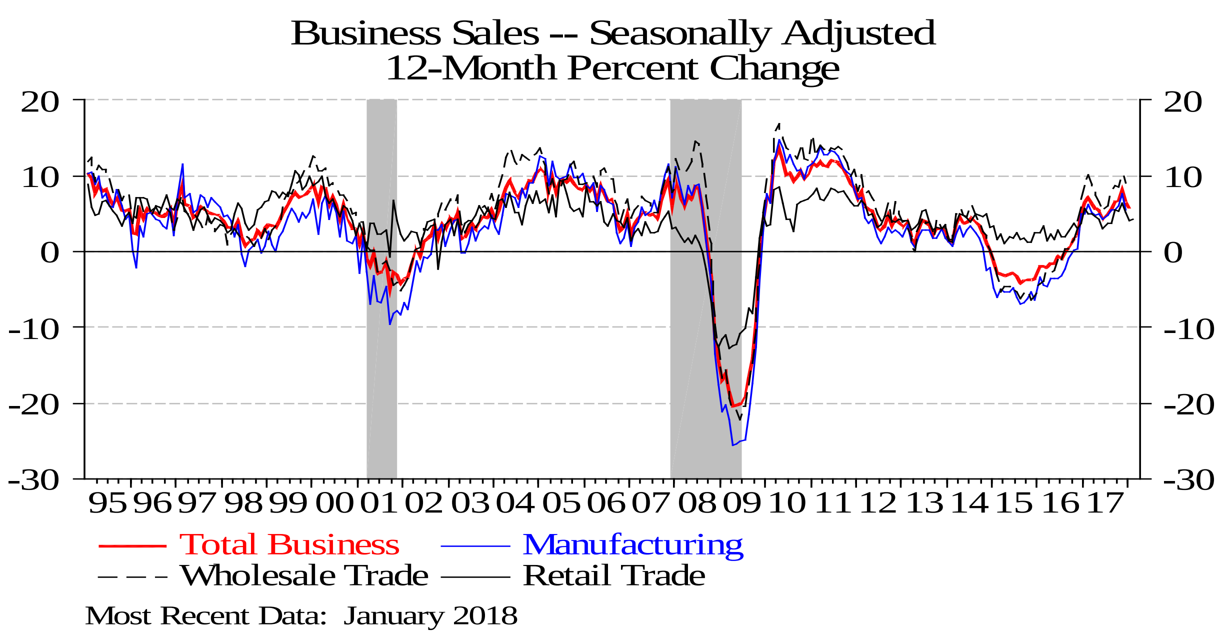


Business Keeps on Humming

Business sales cooled a bit in January from December, although the unusually severe winter weather may have had something to do with it. Compared to January 2017, overall business sales were up a solid 5.7% with all major sectors contributing to annual gains. (Please see the following chart.) Sales growth in Manufacturing, Wholesale Trade and Retail Trade contributed to broad-based annual increases in cash flows and earnings in the private sector.

As evident in the chart, business sales slumped annually from January 2015 through August 2016. Although the economy was not in a technical recession, Business Sales were clearly in a downturn that had recession type qualities. Resurgence in the overall world economy and the beginnings of recovery in the energy sector in late 2016 provided initial catalysts for the recovery in total U.S. business activity that extends to this day. High business confidence was a likely contributing factor to growth in the last year, as well. The forecast is for continued strong sales that could reach double digit annual growth as the year progresses.

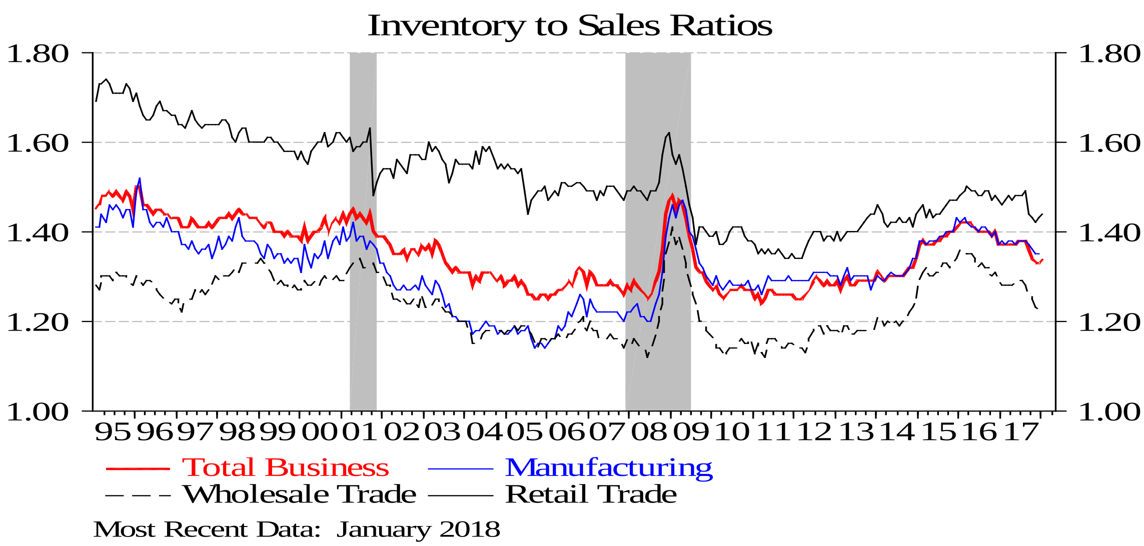
Business Sales Expected to Continue Accelerating Trend



Inventory Levels Coming Down to Healthy Levels

One undesirable consequence of the business mid-cycle slowdown of 2015- 2016 was a significant build in excess inventories across the economy. This created an excess supply of goods that put sustained downward pressures on the prices of many commodities and goods. As evident in the following charts, the Inventory-to-Sales ratios rose sharply in Manufacturing, Wholesale Trade and Retail Trade during the slowdown. With the resurgence of sales that gained momentum in 2017, those key ratios have come back down towards healthier levels.

Leaner inventories will mean businesses need to step up production in the coming months in order to meet the anticipated continuation of strong demand. The 1.24% burst in manufacturing output in February is the likely beginning.



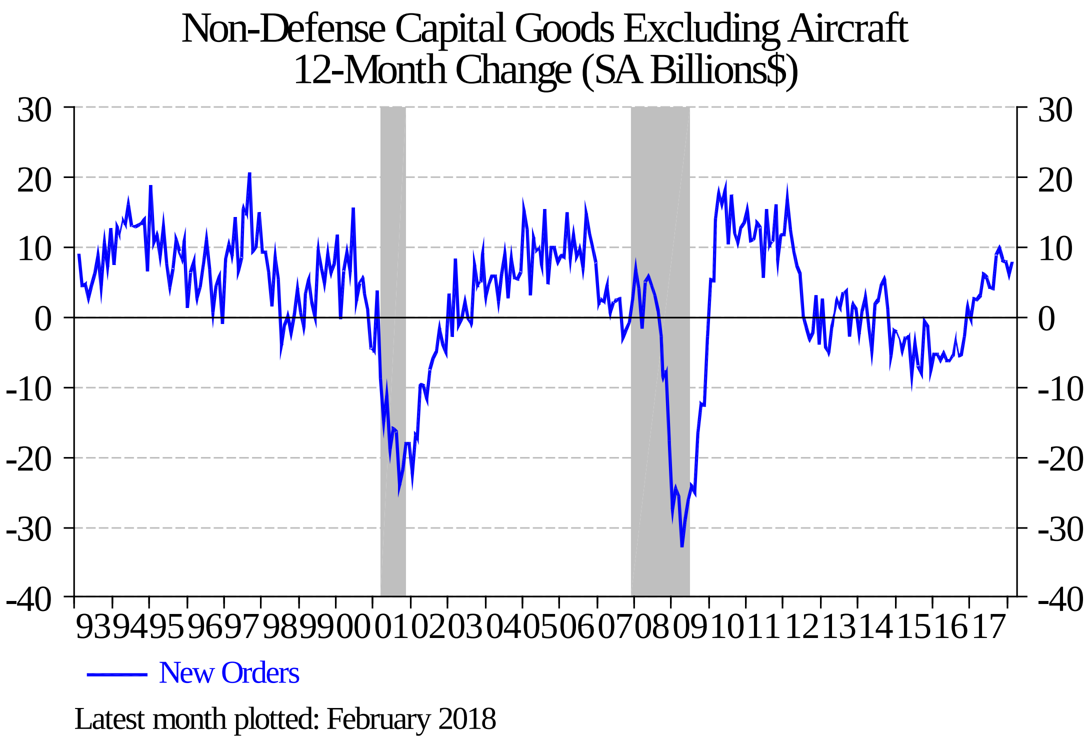
Business Investment Expected to Strengthen

No other objective of recent tax reform received as much emphasis as incentives for increased investment in the United States. "The Tax Cut and Jobs Act of 2017" featured significant cuts in corporate and small business taxes, bonus depreciation for capital investment, incentives for repatriation of profits, the creation of a territorial tax-based system, maintenance of previous investment incentives and the creation of other measures designed to spur domestic investment.

The rate reduction in the corporate tax rate from 35% to 21% alone makes the U.S. significantly more competitive internationally. It increases the average net present value of domestic capital investment and simultaneously reduces the risks of taking on more investment.

Overall, the tax reform positively addresses generally weak capital investment in the U.S. during recent years, as evident in the following chart on new orders for capital goods excluding aircraft. New orders began to grow in 2017, but more business investment will be needed in order to increase productivity, long-term GDP growth, and potentially real wages of workers. Capital investment could also make the U.S. even more competitive in the goods and services it exports to the world economy. (Please see the following discussion.)

Our forecast is for an acceleration in capital investment during 2018, with investment likely to remain strong into 2019.



The International Economy is Accelerating

The international economy is now growing at its fastest pace since the robust period prior to the Great Recession according to the latest Sentix Global reading. The largest advanced economies are leading the global growth surge, although many emerging economies are also performing well.

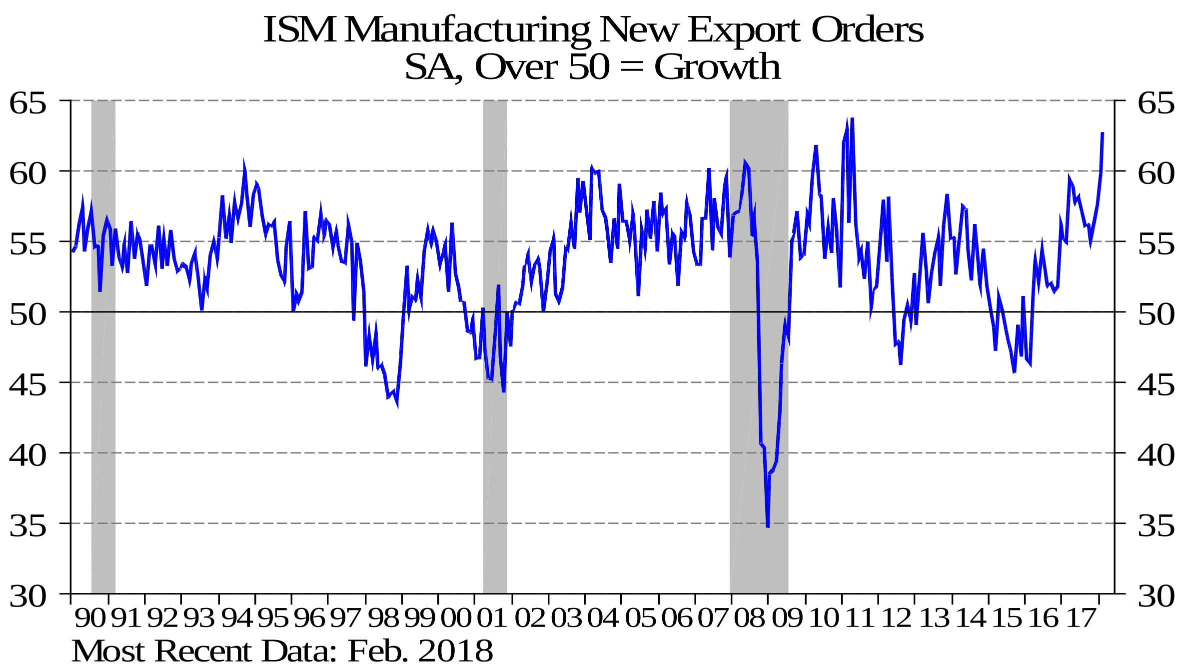
- Real GDP in the European Union (EU 28) grew 2.5% in 2017, actually outpacing 2.25% growth in the U.S. last year.
- Japan grew a more modest 1.7% in 2017, but that was Japan's strongest growth since 2013.
- China has experienced relatively slow growth compared to past years, but the overall level of real growth remains in the 6-7% range. The manufacturing purchasing managers' index in China has been weak recently, but consumer confidence in China recently reached its highest levels since the second half of 1993.

Emerging market economies generally are benefitting from strong economic growth in the advanced economies as growth in the large economies keeps the demand for emerging market products and services at relatively high levels.

Global Growth Strongest since May 2006

Exports Expanding

The world economy is growing impressively, and so are U.S. exports to the world. The most recent ISM reports on manufacturing indicate the strongest new orders of manufactured goods for export since April 2011, during the V-like acceleration of exports in the early stages of the economic recovery. Non-manufacturing exports are also on a strong upward trend. Imports for non-manufacturers was relatively flat in early 2018, but manufacturing imports have been on a rising trend as manufacturing markets have become increasingly intertwined internationally.



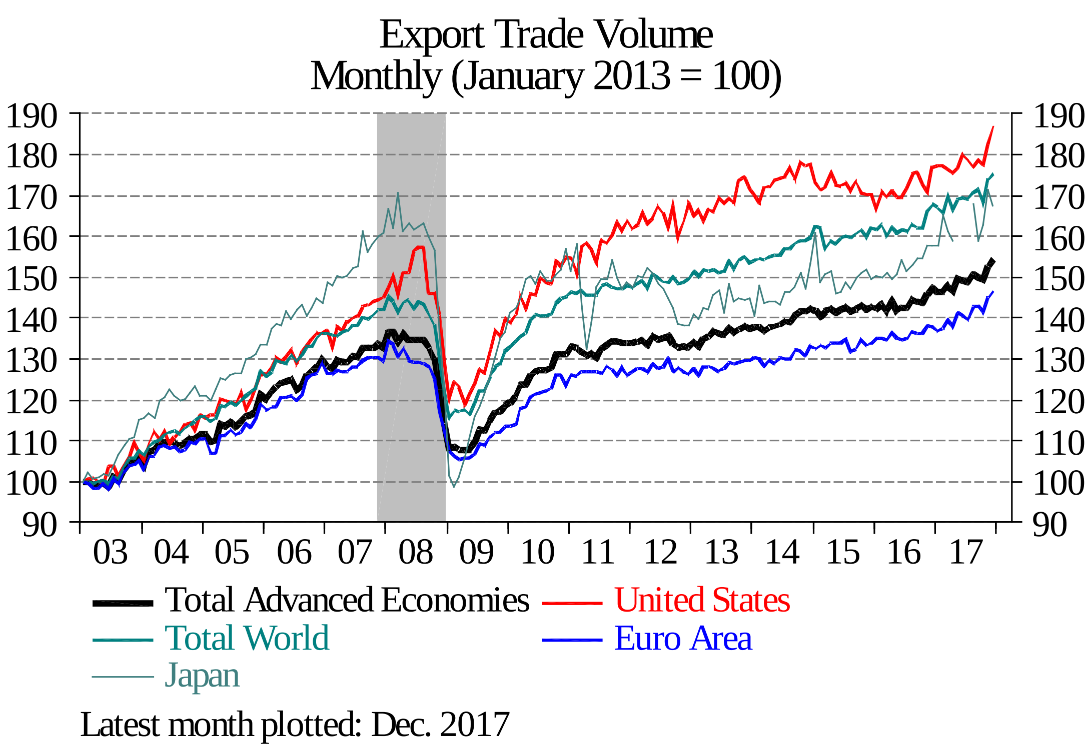
The U.S. – Advanced Economy Export Growth Leader

With the focus on imports and the trade deficit, less attention has been given to the enormously successful performance of the U.S. economy in expanding exports in the last 15 years. Over time, the United States has had strong export growth, outpacing not only the Total Advanced Economies, but also the Total World trade growth.

With January 2003 as the starting point, the following chart below shows the percent change over time in exports for the Total Advanced Economies (154% of January 2003 levels,) the Total World economy (175.5%) and the United States (187.1%). U.S. exports come from all sectors in the economy and include agricultural products, raw materials, fabricated materials, chemicals, services, consumer goods, pharmaceuticals, vehicles and parts, machinery and aeronautics, among others. In the coming years, liquefied natural gas (LNG) could also become a large export if the required infrastructure is built.

Of course, in a worst case scenario in which foreign countries significantly raise tariffs on U.S. exports, the positive trend in U.S. export growth could be endangered. However, if new trade agreements are made that reduce protectionist measures abroad such as foreign tariffs on U.S. goods, then export growth to the world economy could accelerate even further.

U.S. Export Growth Has Been Strong



Summary Table

Key Economic Indicators
March 29, 2018

	2015	2016	2017	2018*
Real GDP Annual Growth Rates 2009 Chained Prices				
Consumption	3.6%	2.7%	2.75%	2.8%
Private Fixed Investment	5.1%	-1.6%	3.3%	6.5%
Exports	0.4%	-0.3%	3.4%	4.0%
Imports	5.0%	1.3%	4.0%	5.0%
Government	1.4%	0.8%	0.1%	0.3%
Total Real GDP	2.9%	1.5%	2.3%	2.8%
Nominal GDP Current dollars	4.0%	2.8%	4.1%	4.9%
Consumer Price Index Annual growth For urban consumers (CPI-U)	0.1%	1.3%	2.1%	2.5%
Federal Funds Rate Target Year-end range	0.25% to 0.50%	0.50% to 0.75%	1.25% to 1.50%	2.00% to 2.25%
10-year Treasury Note Year-end interest rate yield	2.27%	2.45%	2.40%	3.15%
National Income Corporate Profits Average annual growth rate	-1.1%	-2.1%	5.0% estimate	6.0%
Net New Average Monthly Non-farm Payrolls Thousands	226K	195K	182K	150K
Unemployment Rate Annual average	5.3%	4.9%	4.4%	3.8%

Data Sources: Haver Analytics, Factset Inc., and other sources noted in text.

*Forecasts: Huntington Investment Management of the Private Bank, Division of Huntington National Bank

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International investing involves special risks including currency risk, increased volatility of foreign securities, political risks, and differences in auditing and other financial standards. Prices of emerging markets securities can be significantly more volatile than the prices of securities in developed countries and currency risk and political risks are accentuated in emerging markets.

Bonds are affected by a number of risks, including fluctuations in interest rates, credit risks, and prepayment risk. In general, as prevailing interest rates rise, fixed income securities prices will fall. Bonds face credit risk if a decline in an issuer's credit rating or credit worthiness, causes a bond's price to decline.