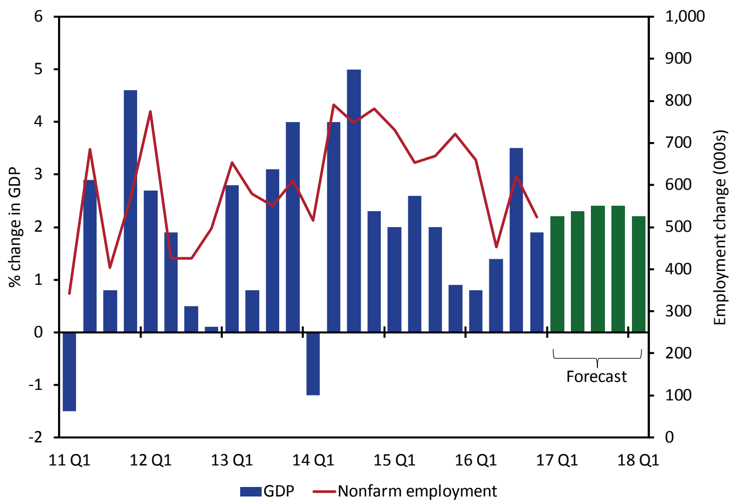
NATIONAL ECONOMY

Unlike a year ago, when concerns about China's economy and a collapse in its stock market had the U.S. economy stumbling out of the starting gates, this year started with a bang. The stock market finished 2016 in record territory and began 2017 with an initial spurt, employment growth was robust, and 2016 fourth quarter GDP growth was at 2 percent. All these positive signs prompted the Federal Reserve to raise interest rates for the second time in three months, to a range of between 0.75 and 1 percent.

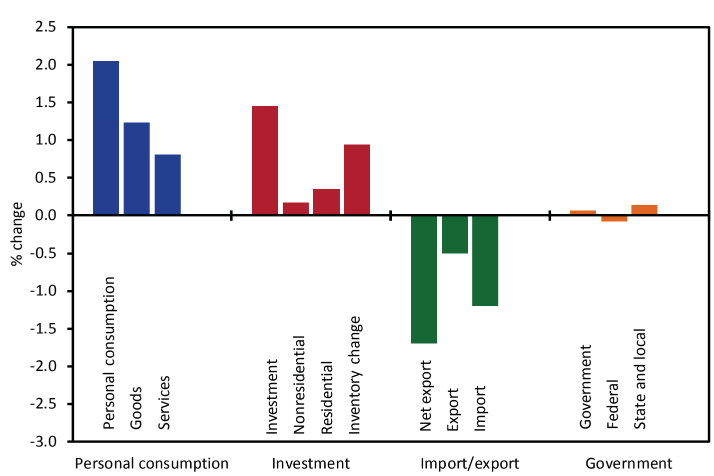
Gross Domestic Product and Nonfarm Employment



Rising estimates of GDP growth could be related to promises by the new administration for regulatory and tax reform, changes to health care, and a "border adjustment tax."

While 2017 was marked by a strong start, much of that growth was built on expectations going into 2017. Analysts saw the markets responding to hopes of further economic stimulus, this time from fiscal policy instead of monetary policy. The new administration promised a large boost in infrastructure spending, lower business taxes, and a reduction in regulations, which were enough to make markets almost giddy with enthusiasm. Consumer confidence achieved its highest level since 2000, buoyed to some extent by lower consumer debt but more by expectations of the effect of these campaign promises on the economy. Similarly, the Small Business

Major Activity Contribution to GDP Change in Current Quarter



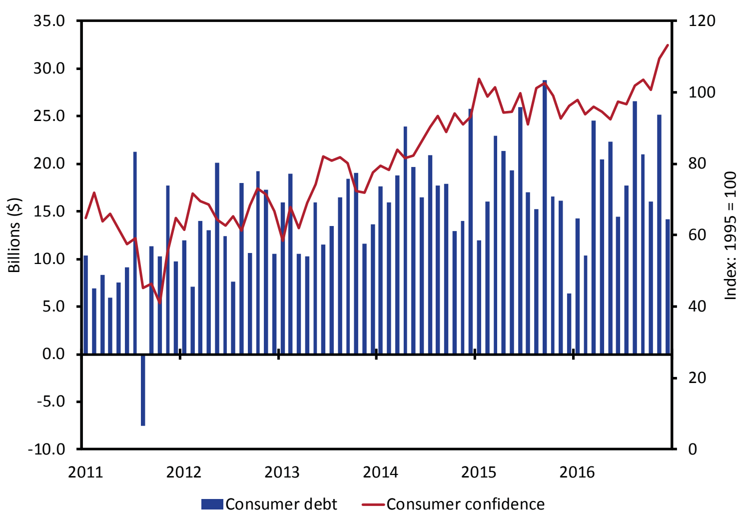
Despite high consumer spending and investment, exports created a drag on growth, as a persistently strong dollar made exporting goods and services difficult.

Survey, administered by the National Federation of Independent Business, peaked at the end of 2016, registering the highest level of optimism in the past 43 years. However, as the administration is quickly finding out, there can be a large difference between campaign promises and working with Congress to enact policy. The inability of Congress to pass the first item on the administration's agenda—health care reform—may have subdued expectations about Congress's ability to implement policy changes on other items such as tax reform and infrastructure spending.

Expectations aside, other signs would lead observers to take a more tepid view of future growth. The major components of fourth quarter GDP growth point to a fairly soft foundation for expansion. Inventory buildup was the major source of investment, instead of a needed increase in nonresidential investment to replace aging equipment and boost productivity. Total investment was completely offset by a decline in net exports because of the strong dollar. Therefore, even though the administration's promised policy initiatives were targeted at businesses, it was consumers who kept the economy going at the end of 2016.

Nonetheless, forecasters are calling for slightly higher GDP growth in 2017. The outlook for GDP growth lies within the 2.0–2.5 percent range throughout 2017, a slightly more optimistic view than previous forecasts had for the year. However, forecasters expect the economy to add jobs at a slower pace than in previous years,

Consumer Confidence and Change in Consumer Debt



Consumer confidence has soared as the risk of recession in the next six months (as calculated by Moody's Analytics) fell from 21 percent to 6 percent.

starting with around 185,000 per month in the early part of the year and ending the year at around 160,000 jobs per month. They see this slowdown in employment as being coupled with a continued decline in the unemployment rate, which they expect to end the year at around 4.5 percent. Even the risk of a recession has been revised downward, from 21 percent to 6 percent, to reflect a rosier view of the future.

The labor market shows continued strength as the economy moves into 2017. Unemployment rates are lower than at any time since the downturn began in 2007, and the labor force participation rate, while still low, is starting to creep back up. The number of long-term unemployed has steadily fallen and is back to what may be considered more normal levels, while the percentage of the labor force who are discouraged about finding a job or are working part-time because they can't find a full-time job has also diminished. Voluntary quit rates are back to prerecession levels, while separation rates (layoffs and discharges) are at their lowest since the BLS started recording labor force dynamics in 2000. So far, private-sector compensation has not budged much from the recent trend line of a 2 percent annual rate. Yet with few sources from which to hire additional qualified workers, it appears that businesses—barring an unanticipated downturn in the economy—may have to increase wages to gain the talent they need by attracting workers from other firms and drawing them out of the woodwork.