Economic Commission for Latin America and the Caribbean

ECLAC OFFICE IN WASHINGTON, D.C.

U.S. Economic Outlook

Quarterly developments

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Highlights

- The U.S. second-quarter GDP growth was revised up to a 1.4% inflation-adjusted annual rate in the third and final estimate released by the Department of Commerce on September 29, following the first quarter's 0.8% pace. Despite the upward revision, the growth rate for the first half of the year is just above 1%.

- The Federal Reserve's view implies a modest second-half pickup in growth: the economy is estimated to grow at a 1.8% rate for all of 2016.

- The Federal Reserve at its September 14-15 meeting left short-term interest rates unchanged, but said the case for a rate increase "has strengthened", signaling that a move is likely before the end of the year.

- The minutes of the meeting, released on October 12, revealed that the Fed's September's decision to hold interest rates unchanged was a "close call," with some officials wanting to move then and others preferring to wait a bit longer.

- Most market analysts expect a rate hike by December while fed funds futures show traders continuing to price in a hike with a probability of just below 70%.

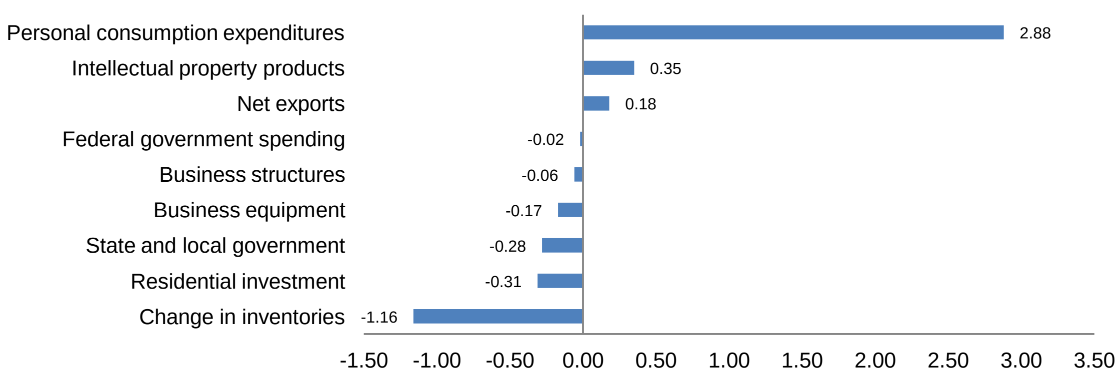
- Politics is creating uncertainty, and heightened policy uncertainty is weighing on the growth outlook.

Overview

According to the U.S. Department of Commerce's third estimate, GDP grew at a 1.4% annualized pace in the second quarter, up from a previous estimate of 1.1% and from a rate of 0.8% in first quarter. Despite the better reading, the growth rate for the first half of the year is just above 1%.

Consumer spending was the main driver of growth, contributing 2.88% to growth in the second quarter (chart 1). This was up from a 1.11% contribution in the prior quarter. Exports and nonresidential fixed investment made very minor positive contributions (0.18% and 0.12%, respectively).[1] Residential investment reduced growth by 0.31% and inventory investment reduced it by 1.16%, a possible positive for the outlook as stocks will have to be rebuilt in coming quarters. Government was a minor drag, with federal and state and local investment spending subtracting 0.02% and 0.28% from growth, respectively.

CHART 1:
CONTRIBUTIONS TO U.S. GROWTH: Q2 2016
(Percentage Points)



Source: Bureau of Economic Analysis, U.S. Department of Commerce

[1] The positive contribution from nonresidential fixed investment came mostly from investment in intellectual property products, with investment in business structures and equipment subtracting from growth.

Officials at the Federal Reserve kept the federal funds target rate unchanged at their September meeting, but appeared more divided than usual. Three regional bank presidents disagreed with the decision, the most dissents at a meeting since December 2014. Simultaneously, economic projections showed three other officials don't believe a rate increase is warranted this year. The September jobs report came amid these increasingly divergent views within the Fed. The job figures pointed to steady labor markets and were for the most part supportive of the case for a rate hike before the end of 2016, although the lack of consensus among Fed officials suggests that a December hike is not a done deal.

Nonfarm payrolls rose by a seasonally adjusted 156,000 jobs, below expectations of 172,000. Meanwhile, the unemployment rate edged higher by a 0.1 percentage point to 5%, while the labor participation rate marginally increased to 62.9% from 62.8% previously. The rise in the jobless rate suggests more people are coming off the sidelines and looking for work.

Despite conveying no sense of urgency, September's modest acceleration in inflation keeps a December rate hike on the table. The core CPI was up 2.2% on a year-ago basis, compared with the 1.9% gain in September 2015. Import prices ticked up 0.1%, while headline and core producer prices rose more than expected.

Looking Ahead

The U.S. economy grew just above 1% in the first half of the year, but a moderate pickup is expected in the second half. Recent data releases point to a moderate acceleration in economic growth in the third quarter. On average, markets project that the U.S. economy will grow at a 2.8% rate in the third quarter, and 2.2% in the fourth quarter, respectively, with forecasts made during the months of September and October (table 1). Heightened policy uncertainty has been weighing on the growth outlook and political risk has been a concern. Also weighing on growth is a weak global demand and the threat of a rise in global protectionism.

TABLE 1:
QUARTERLY MARKET FORECASTS FOR U.S. ECONOMIC GROWTH

	Q3 2016 (qoq)	Q4 2016 (qoq)	Q1 2017 (qoq)	Date of Forecast
TD Bank Financial Group	2.8%	1.9%	1.8%	Sep-16
National Association of Realtors	3.0%	1.9%	2.1%	Oct-16
Mortgage Bankers Association	3.1%	2.3%	2.0%	Sep-16
Bank of America/Merrill Lynch	3.0%	2.7%	2.1%	Oct-16
Credit Suisse	2.4%	2.5%	2.4%	Sep-16
Moody's Economy.com	3.0%	2.9%	3.2%	Oct-16
J.P. Morgan	3.0%	2.0%	2.0%	Oct-16
Wells Fargo/Wachovia	2.2%	2.3%	2.2%	Oct-16
RGE	2.5%	1.7%	1.4%	Oct-16
Forecasts average	*2.8%*	*2.2%*	*2.1%*	

Source: ECLAC, on the basis of several market sources.

Market projections for real GDP growth in 2016 (made mostly in September and October), now range from 1.5% to 1.6% (see table 2). On average, growth in 2016 is expected to expand at an annual pace of 1.6%. Market projections for real GDP growth in 2017 currently range from 1.9% to 2.9%. On average, growth in 2017 is expected to expand at an annual pace of 2.2%.

The September jobs report showed slower hiring than expected, but the U.S. labor market remains solid, with steady gains. The unemployment rate edged up as more people came off the sidelines and joined the labor force. Looking ahead, market projections for the unemployment rate in 2017 range from 4.5% to 5.0%. On average, the unemployment rate is expected to be at 4.7% in 2017.

Market projections for CPI inflation in 2016 range from 1.1% to 1.3%, reflecting the effect of declining oil prices at the beginning of the year, and for 2017 they range from 1.6% to 2.6%. On average, CPI inflation is expected to be around 1.2% in 2016, substantially higher than the 0.1% increase in 2015, and 2.2% in 2017. Albeit slowly, inflation is gradually moving up.

The Fed trimmed its GDP forecast for this year, which was expected considering the weaker than expected growth in the first half. The Fed's projections for GDP growth in 2017 and 2018 were unchanged at 2%. It expects GDP to rise 1.8% in 2019.

According to the International Monetary Fund (IMF), any further increase in U.S. interest rates "should be gradual and tied to clear signs that wages and prices are firming durably." On October 4, the IMF sharply lowered its 2016 growth forecast for the U.S. economy to 1.6% from the 2.2% it predicted in July.

Speaking at a Boston Fed conference focusing on post-crisis macroeconomic research, Fed Chair Janet Yellen speculated about the potential benefits of a "high-pressure economy" – i.e. allowing inflation to run temporarily higher than the 2% normally considered most consistent with long-term price stability – in dealing with issues such as declining labor force participation and mismatches between labor supply and employer demand. Some market participants noted that this could represent a shift toward greater tolerance of modest inflationary pressures.

Since the global crisis, job creation has been one of the most important goals of economic policymakers, but with full employment coming into view, productivity now is gaining attention, given its centrality to wage gains and overall standards of living for households. Unless productivity growth revives soon, the economy will not deliver the necessary economic growth, income, profits, tax revenues and asset returns to keep the U.S. economy buoyant.

The expansion has hit seven years and has now continued for 88 months, making it the U.S. fourth-longest period of growth on record. Although it has been long, it has lacked strength, which is reflected in the low average annual pace of 2.1% since 2009. That's the slowest growth of any expansion after World War II. The length of the U.S. economic expansion is a concern, with economists now saying a recession is likely within the next four years. However, precisely because the economy has grown slowly, some think the recovery could last a long time.

TABLE 2:
ANNUAL FORECASTS FOR U.S. ECONOMIC GROWTH

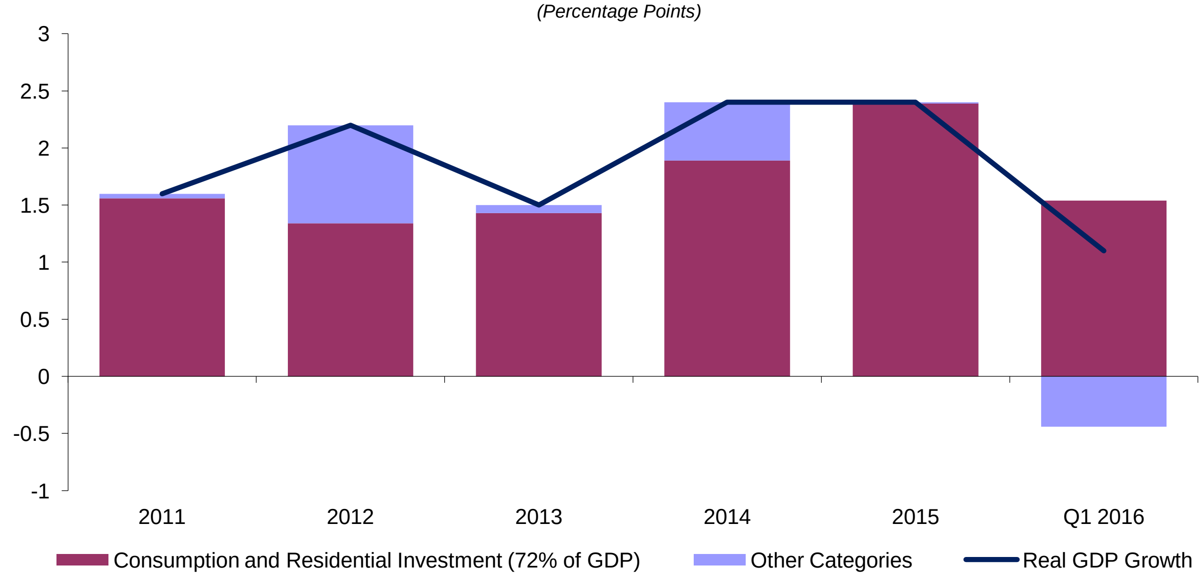
	Real GDP		CPI		Unemployment Rate		FED Funds Rate		
	(% change, y/y)	(% change, y/y)	(%)		(%)				
	2016	2017	2016	2017	2016	2017	2016	2017	Date of Forecast
A. What Government Agencies Say									
FED*	1.8%	2.0%	1.3%	1.9%	4.8%	4.6%	0.6%	1.1%	*Sep-16*
CBO	1.9%	2.4%	1.4%	2.4%	4.8%	4.5%	*na*	*na*	*Aug-16*
Administration (Office of Management and Budget)	2.6%	2.6%	1.5%	2.1%	4.7%	4.5%	*na*	*na*	*Jul-16*
B. What Markets Say									
National Bank of Canada	1.6%	2.0%	1.2%	2.0%	4.9%	5.0%	0.75%	1.25%	*Oct-16*
TD Bank Financial Group	1.5%	2.1%	1.3%	2.6%	4.9%	4.7%	0.55%	0.90%	*Sep-16*
National Association of Realtors	1.5%	2.1%	1.2%	2.3%	4.9%	4.7%	0.4%	0.8%	*Oct-16*
Mortgage Bankers Association	1.8%	2.1%	1.2%	2.1%	4.9%	4.6%	0.625%	1.625%	*Sep-16*
Bank of America/Merrill Lynch	1.6%	2.2%	1.3%	2.5%	4.9%	4.8%	0.62%	*na*	*Oct-16*
Credit Suisse	1.5%	2.3%	1.2%	2.2%	4.9%	4.6%	*na*	*na*	*Sep-16*
Moody's Economy.com	1.6%	2.9%	1.2%	2.4%	4.9%	4.8%	0.4%	0.9%	*Oct-16*
The Economist Intelligence Unit	1.6%	2.3%	1.1%	2.1%	4.8%	4.5%	*na*	*na*	*Oct-16*
JPMorgan	1.5%	2.0%	1.3%	2.5%	4.9%	4.7%	*na*	*na*	*Oct-16*
Wells Fargo/Wachovia	1.5%	2.2%	1.2%	2.2%	4.9%	4.7%	0.56%	1.00%	*Oct-16*
Roubini Global Economics	1.5%	1.9%	1.1%	1.6%	*na*	*na*	0.63%	1.13%	*Sep-16*
Market Average	***1.6%***	***2.2%***	***1.2%***	***2.2%***	***4.9%***	***4.7%***	***0.6%***	***1.1%***	
C. What International Organizations Say									
United Nations DESA (Baseline)	2.2%	2.5%	*na*	*na*	*na*	*na*	*na*	*na*	*May-16*
World Bank	1.9%	2.2%	*na*	*na*	*na*	*na*	*na*	*na*	*Jun-16*
OECD	1.8%	2.2%	1.1%	2.0%	5.0%	4.7%	1.0%	1.5%	*Jun-16*
IMF	1.6%	2.2%	0.8%	1.2%	4.9%	4.8%	*na*	*na*	*Oct-16*

Source: ECLAC on the basis of official and market sources.
Note: *FED forecast for core PCE inflation, the FED’s preferred measure.

I. Quarterly developments

U.S growth disappointed in the first half of 2016. Headwinds came from global weakness, as well as elevated inventories and a continued slowdown in energy investment. However, the core of the U.S. economy – consumption and residential investment – remained resilient in the first half of 2016 (chart 2), adding 2% to economic growth in the period, although residential investment was a negative to growth in the second quarter. The biggest subtraction from growth came from gross private domestic investment. The bulk of the decline came from inventories, but fixed investment is falling as well.

CHART 2:
CONTRIBUTIONS TO U.S. REAL GDP GROWTH
(Percentage Points)

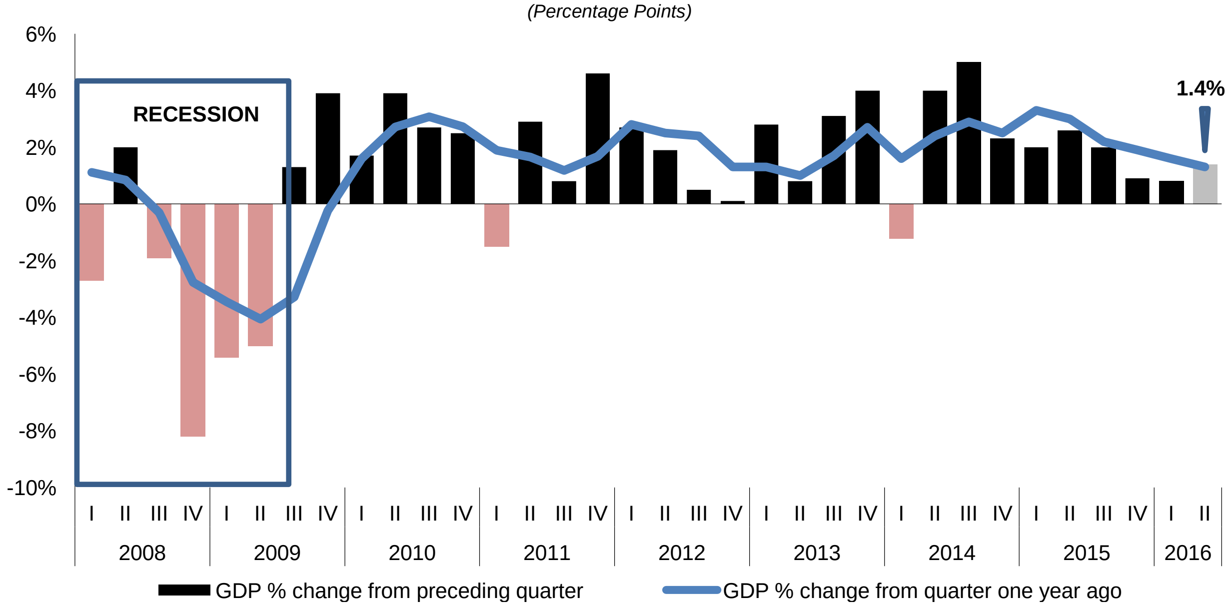


Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Department of Commerce.
Note: Contributions to growth are measured at seasonally adjusted annual rates.

A. GDP Growth

The third estimate for second-quarter GDP growth, released by the U.S. Department of Commerce on 29 September 2016, was an upward revision to 1.4% from a previous 1.1% estimate, and an improvement over the 0.8% rate of the previous quarter (chart 3). Consumer spending, nonresidential investment and net exports made positive contributions to growth in the second quarter, while private inventory investment, residential fixed investment, and federal, state and local government spending subtracted from growth.

CHART 3:
U.S. REAL GDP: QUARTERLY GROWTH
(Percentage Points)



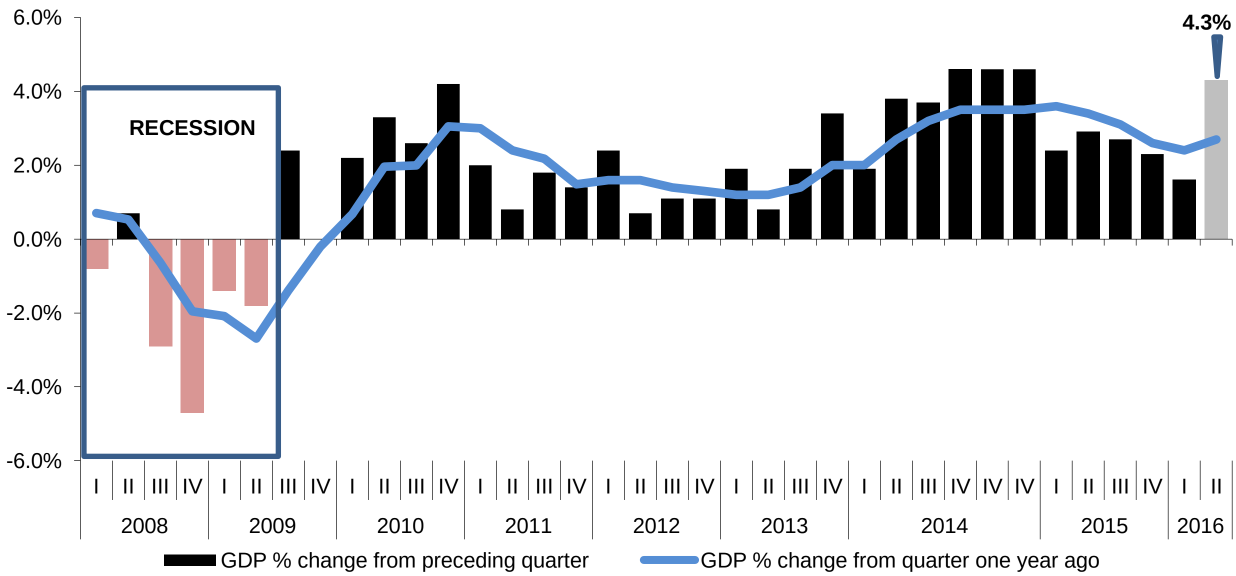
Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Department of Commerce.

The largest component of GDP, real personal consumption expenditures, grew 4.3% in the second quarter, following an increase of 1.6% in the first (chart 4). It was the largest increase since late 2014 and a main driver of growth, accounting for more than all of the quarter's gains. It added 2.88% to the second quarter expansion, the largest contribution to growth in the quarter. Stronger and higher-quality job growth in recent years, low borrowing costs and record low debt service burdens, rebounding housing prices, and lower oil prices have supported consumer spending. However, the increase in consumer spending was not enough to prevent the U.S. economy from posting its third consecutive quarter of lackluster GDP growth. Nonetheless, the fact that U.S. consumers have been able to spend without dipping into their savings is an encouraging sign. The saving rate has remained above 5% during the economic recovery and has been higher than 5.5% for more than two years.

Real residential investment declined at a 7.7% pace (subtracting 0.31% from second-quarter growth), following an increase of 7.8% in the previous quarter (chart 5). Yet, the housing sector is expected to provide a boost to the U.S. expansion in coming quarters. Homebuilding has improved, but it is still low given the demand for new housing, and the housing vacancy rate, including homes that are for sale and rent, is falling fast.

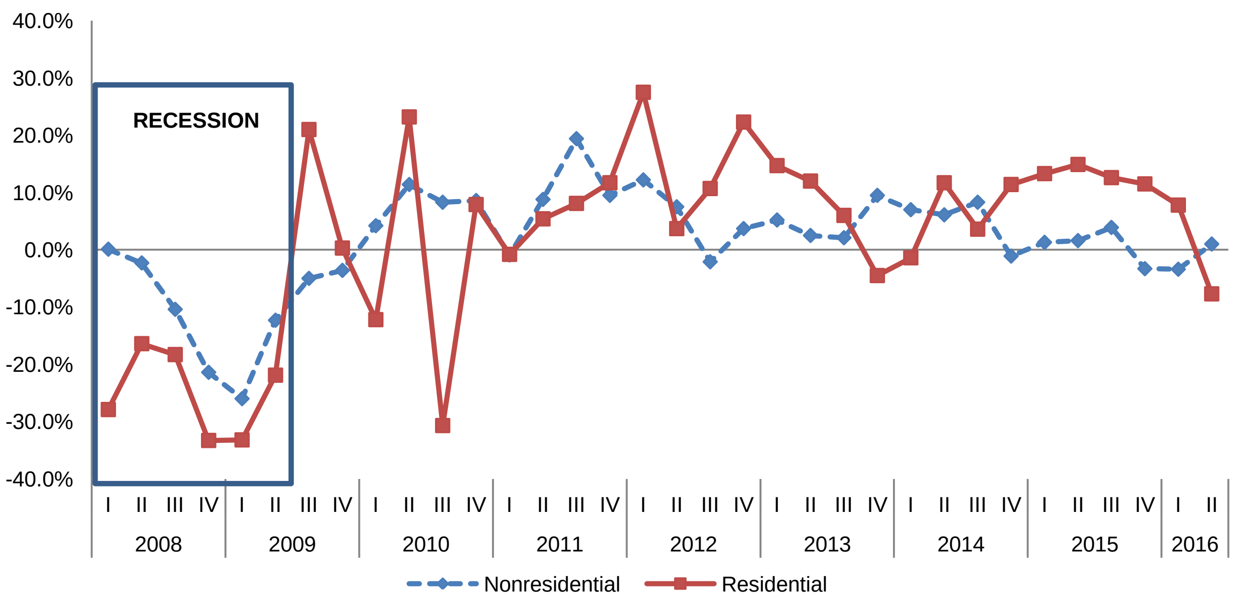
Real nonresidential fixed investment, which represents overall business spending, increased at a 1% annual rate in the second quarter following a decline of 3.4% in the previous quarter (it contributed 0.12% to second-quarter growth). Investment in equipment fell 2.9%, after declining 9.5% in the first quarter (it subtracted 0.17% from second-quarter growth). Investment in nonresidential structures declined 2.1%, after an increase of 0.1% in the previous quarter (it subtracted 0.06% from second-quarter growth). The only component making a positive contribution to growth (+0.35%) was investment in intellectual property products (including software, R&D, entertainment, literary and artistic originals), which increased 9%, following an increase of 3.7% in the first quarter. It was the fastest pace in nearly a decade.

CHART 4:
PERSONAL CONSUMPTION EXPENDITURE: QUARTERLY GROWTH
(Percentage Points)



Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Department of Commerce.

CHART 5:
GROSS PRIVATE DOMESTIC INVESTMENT: QUARTERLY GROWTH
(Percentage Points)



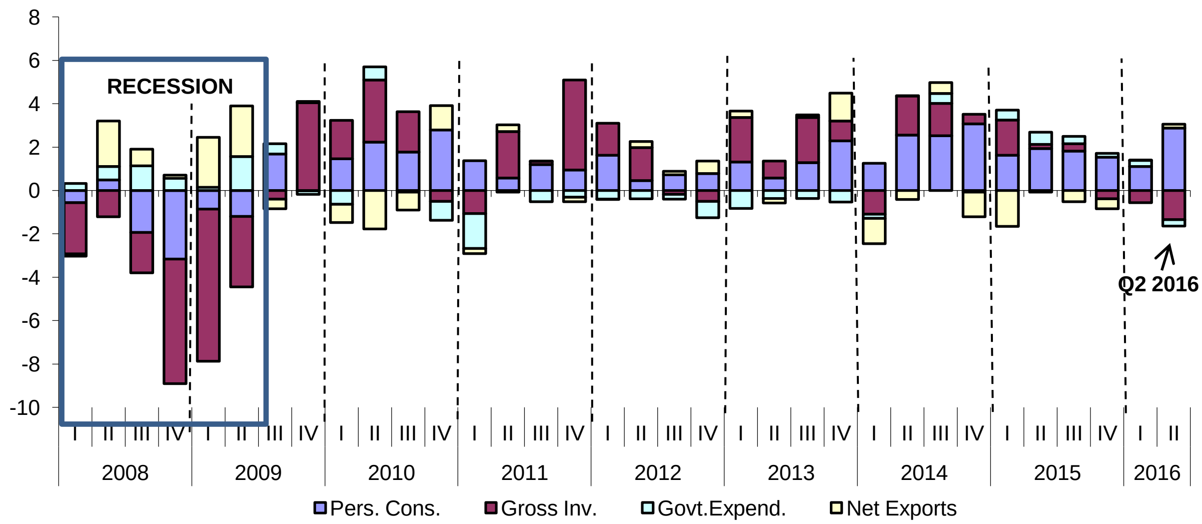
Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Department of Commerce.

The change in private inventories subtracted 1.16% from the second quarter change in real GDP, after subtracting 0.41% from growth in the previous quarter, which could be a positive for future growth as inventories will need to be rebuilt. Overall, gross private domestic investment declined at a 7.9% annual rate in the second quarter, subtracting 1.34% from second-quarter GDP growth (with -0.18% due to business fixed investment – 0.12% from nonresidential and -0.31% from residential – and -1.16% due to inventories). Real final sales – GDP excluding the change in inventories – expanded at a much healthier 2.6% pace, up from the 1.2% pace in the previous quarter.

Total government consumption was a negative to growth in the second quarter. Overall, government spending declined by 1.7% and subtracted 0.30% from growth. State and local government spending decreased 2.5%, and federal outlays declined 0.4% (national defense spending fell 3.2%, while nondefense spending increased 3.8%).

Finally, net exports added 0.18% to growth in the second quarter. Exports increased 1.8% and imports 0.2%, as the dollar stabilized against major currencies and global conditions improved (chart 6).

CHART 6:
CONTRIBUTIONS TO REAL GDP GROWTH
(Percentage Points)



Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Department of Commerce.
Note: Contributions to growth are measured at seasonally adjusted annual rates.

For the first half of the year, the growth rate of just above 1% is a sharp slowdown from the expansion's 2.1% average annual rate, which itself is the weakest of any period of growth since 1949. Weak capital expenditures by U.S. businesses weighed on growth, but investment in intellectual property products grew at the fastest pace in nearly a decade, suggesting businesses still have a positive longer-term outlook for the U.S economy, even if the strong dollar and uncertainty surrounding the U.S. election have delayed some capital investments. Recent data suggest that current economic activity has increased, with forecasts pointing to moderately faster growth in the third quarter.

B. Industrial production

U.S. industrial production rose at an annual rate of 1.8% in the third quarter of 2016, the first quarterly increase since the third quarter of 2015. Manufacturing production rose at a 0.9% rate in the third quarter. Manufacturing has been hurt by business efforts to reduce an inventory overhang, which has resulted in fewer orders being placed with factories. However, there are signs of stability, as the dollar's rally appears to be slowing and oil prices steadily rise. Still, strong gains in the near-term are unlikely.

Capacity utilization increased to 75.5% in the third quarter, from 75.2% in the second. The increase in capacity utilization is consistent with a gradual increase in inflation, such as that forecast by the Federal Reserve's FOMC.

TABLE 3:
U.S INDUSTRIAL PRODUCTION

	Total Industrial Production		Capacity Utilization Rate
	Index 2012=100	Percentage Change From Previous Period	Total Industry (%)
2015	**105.2**	**0.3**	**76.7**
2016 Q1	**104.1**	**-1.7**	**75.4**
January	104.5	0.5	75.7
February	104.4	-0.2	75.6
March	103.4	-0.9	74.9
2016 Q2	**103.9**	**-0.8**	**75.2**
April	103.80	0.4	75.2
May	103.7	-0.2	75.1
June	104.2	0.5	75.4
2016 Q3	**104.4**	**1.8**	**75.5**
July	104.7	0.5	75.8
August	104.2	-0.5	75.3
September	104.2	0.1	75.4

Source: U.S. Federal Reserve, Industrial Production and Capacity Utilization
Note: Quarterly changes are at annual rates. Annual changes are calculated from annual averages.

The Institute for Supply Management's index of manufacturing activity advanced to 51.5 in September from 49.4 in August, adding weight to the possibility of a Fed rate hike this year. A reading above 50 indicates that factory activity is expanding while a reading below 50 signals contraction. The details of the report were seen as especially encouraging, as the New Orders component jumped to 55.1 from the August reading of 49.1. Markit's Manufacturing PMI was also revised up a fraction, to 51.5, pointing to continued growth in the sector. Some believe the worst effects of cheap oil, a strong dollar and weak demand overseas have passed, though there is still little sign factories are revving up.

C. Labor market

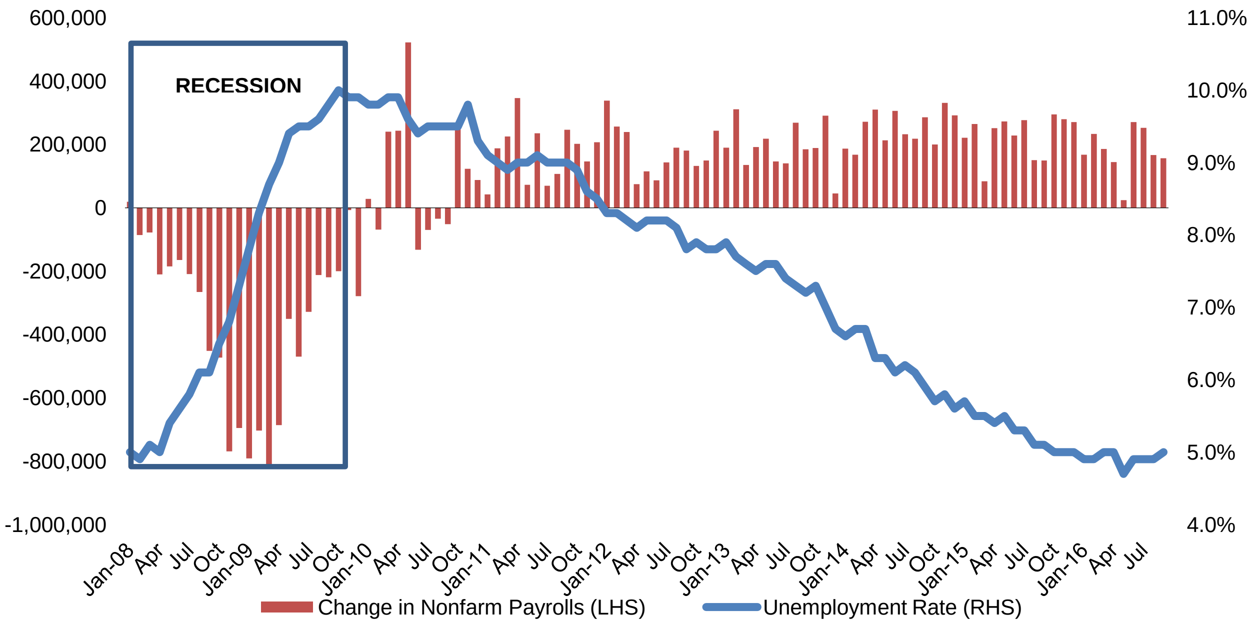
The U.S. economy added 156,000 jobs in September, keeping labor markets steady as the presidential campaign enters its final stretch and the Federal Reserve grapples with whether to raise interest rates this year. Gains in July and August were collectively revised down by 7,000.

The September jobs report confirms the moderation in the labor market expansion compared to the past two years. The average gains for 2016 year-to-date are 178,000 payroll jobs a month, down from the better than 200,000 pace in 2014 and 2015, but still healthy given the longevity of the recovery and the overall unemployment rate.

The September's job creation was below both the consensus forecast and the annual average, but some economists attribute that to a surprising 11,000 drop in government payrolls. The three-month moving average of 192,000 in September exceeds the second quarter average of 146,000 and is more than enough to keep up with growth in the working-age population.

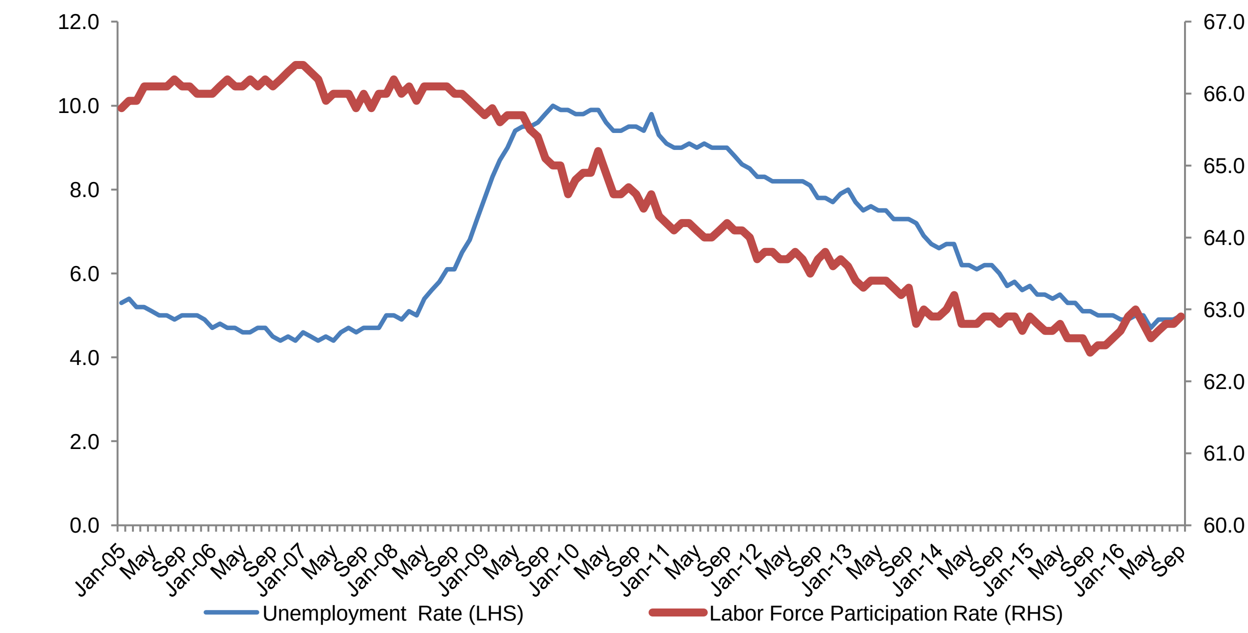
The unemployment rate edged up to 5% in September from 4.9% in August (chart 7). But the rise occurred because the overall pool of workers, both the employed and unemployed, grew. The labor force increased by 3 million workers over the past year, the biggest gain since 2000. The labor-force participation rate – the share of the overall population in the labor force – stood at 62.9% in September. It remains historically low, but grew a tenth of a percentage point from August and by half a point over the past year, as people are drawn off the sidelines and into the labor force amid strengthened job prospects (chart 8).

CHART 7:
THE U.S. LABOR MARKET
(Average Monthly Job Growth (left axis); Percentage Points (right axis))



Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics.

CHART 8:
U.S. UNEMPLOYMENT RATE AND LABOR FORCE PARTICIPATION
(Percentage Points)



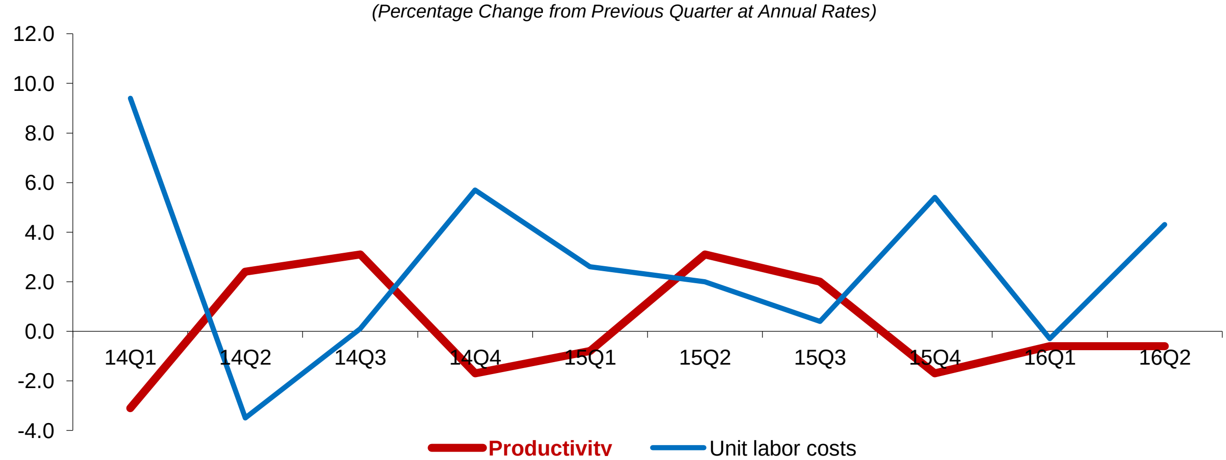
Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics.

Average hourly earnings moved higher by 0.2% from August, bringing the wage gain over the last 12 months to 2.6%, a decent gain, but still well below the rates of more than 3% before the financial crisis. According to Moody's, although the long expansion and a tight labor market would suggest stronger wage growth than is currently the case, the data may be affected by an ongoing generational shift in the labor market where highly compensated baby boomers are exiting the workforce to be replaced by younger workers, who receive lower compensation.

Trend productivity growth is running well below 1%, which has negative implications for wages and potential GDP gains. [2] Nonfarm productivity fell 0.6% at an annual rate in the second quarter of 2016. This is the third consecutive quarterly decline in productivity. In addition to slowing total factor productivity, analysts attribute the weakness in productivity to persistent weakness in business investment. Productivity was down 0.4% on a year-ago basis, its first drop since the third quarter of 2011. Even year-over-year growth in productivity has been volatile. One of the biggest puzzles right now regarding the U.S. economy is whether the weakness in productivity growth is structural or cyclical.[3]

On a year-ago basis, unit labor costs were up 2.6%. Growth in unit labor costs has averaged 1.7% over the past five years. The gap between growth in unit labor costs and productivity growth has steadily widened over the past year or so (chart 9), an unfavorable development for corporate profits and margins.

CHART 9:
U.S. NONFARM BUSINESS SECTOR: PRODUCTIVITY VS UNIT LABOR COSTS
(Percentage Change from Previous Quarter at Annual Rates)



Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics.

TABLE 4:
U.S. PRODUCTIVITY AND COSTS
Revised first quarter 2016 annual averages
(Seasonally adjusted annual rates)

Sector	Productivity	Output	Hours	Hourly compensation	Real hourly compensation	Unit labor costs
			Percent change from preceding quarter			
Nonfarm business	-0.6	1.1	1.7	3.7	1.1	4.3
Business	-0.8	1.2	2.0	3.3	0.7	4.1
Manufacturing	-0.4	-0.8	-0.4	6.3	3.7	6.7
Durable	2.4	0.7	-1.8	5.5	2.9	3.0
Nondurable	-4.4	-2.6	1.9	8.0	5.4	13.0

Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics.

[2] Productivity grew at an annual average of 2.2% since World War II but has expanded just 0.6% over the last five years.
[3] Among the possible reasons for depressed productivity growth are measurement issues, labor mismatching, weak business formation, regulation, low labor costs, aging population, and the availability of credit.

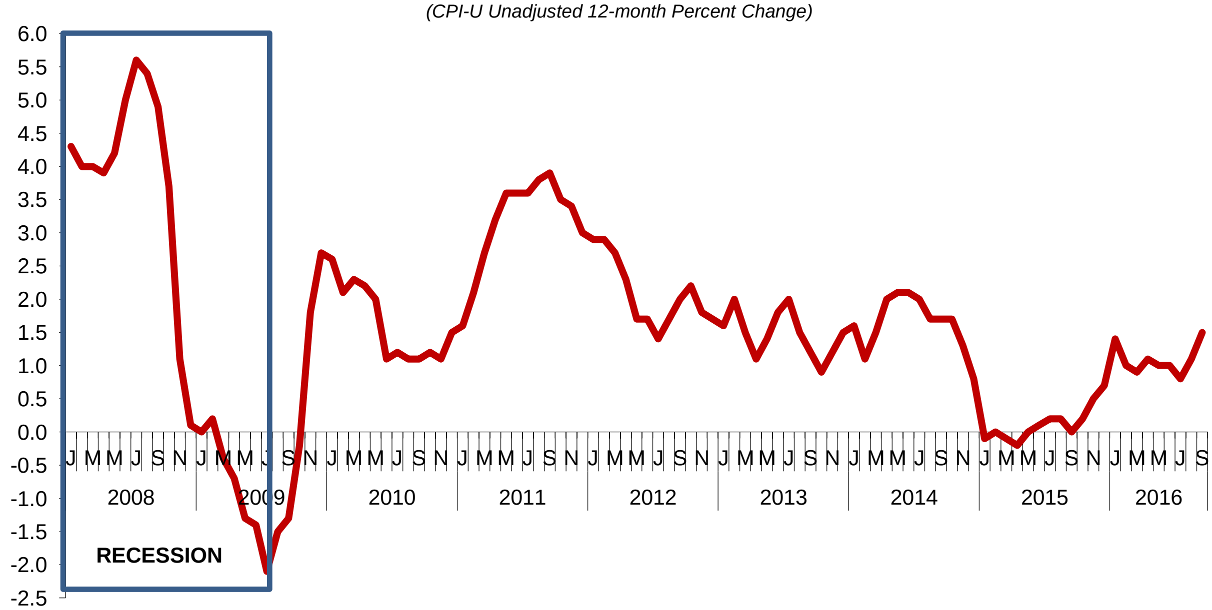
D. Inflation

U.S. consumer prices increased steadily in September, a sign of slowly building inflation. The Consumer Price Index for All Urban Consumers (CPI-U) increased 0.3% from a month earlier. Consumer prices have grown in six of the past seven months. Higher oil prices are driving the latest growth. Over the last 12 months, the all items index rose 1.5% before seasonal adjustment (chart 10). This is a sluggish pace historically but still the biggest gain in any 12-month period since October 2014.

Increases in the shelter and gasoline indexes were the main causes of the rise in the all items index. The gasoline index rose 5.8% in September and accounted for more than half of the all items increase. The shelter index increased 0.4%, its largest increase since May.

The energy index increased 2.9%, its largest advance since April. Along with the gasoline index, other energy component indexes also rose. The index for food, in contrast, was unchanged for the third consecutive month, as the food at home index continued to decline.

CHART 10:
U.S. DOMESTIC PRICES: MONTHLY EVOLUTION
(CPI-U Unadjusted 12-month Percent Change)

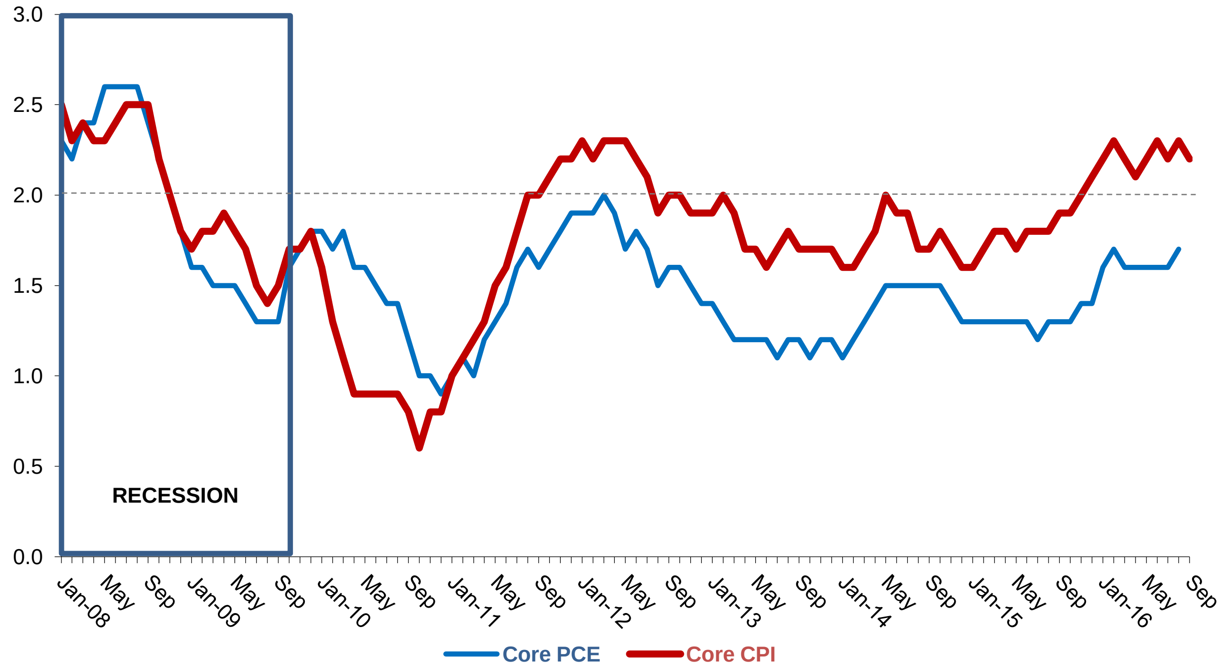


Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics.

Excluding food and energy, the CPI rose 0.1% in September following a 0.3% gain in August. The core CPI had risen by an average of 0.2% in the prior three months. The core CPI was up 2.2% on the year, marking the tenth consecutive month that annual core inflation matched or exceeded 2%. The 12-month increase has stayed in the narrow range of 2.1% to 2.3% since December 2015. The firming in core prices has largely reflected the swift rise in the cost of shelter, especially rent. Shelter prices rose 3.4% in September from a year earlier.

The most closely watched measure by the Federal Reserve – the Personal Consumption Expenditure (PCE) core price index– increased at an annualized 1.8% in the second quarter. In August, the latest data available, the core PCE advanced at 1.7%, lower than the Federal Reserve's threshold of 2%. August marked the 52th consecutive month in which prices have fallen short of the Fed's 2% annual target (chart 11).

CHART 11:
U.S. CORE CONSUMER PRICE INDICES
(Year-over-year Percentage Change)



Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics (BLS), Department of Labor and the Bureau of Economic Analysis (BEA), U.S. Department of Commerce.

PCE, which is published by the U.S. Commerce Department's Bureau of Economic Analysis, is derived from retail-sales data collected in business surveys, and in this data, medical care tends to carry the greatest weight. The CPI, on the other hand, is derived from consumer purchases reported in household surveys. Typically, consumers report spending more on shelter than anything else, giving that category more weight in the CPI. Since shelter costs have been rising, the core CPI has been increasing faster than the core PCE.

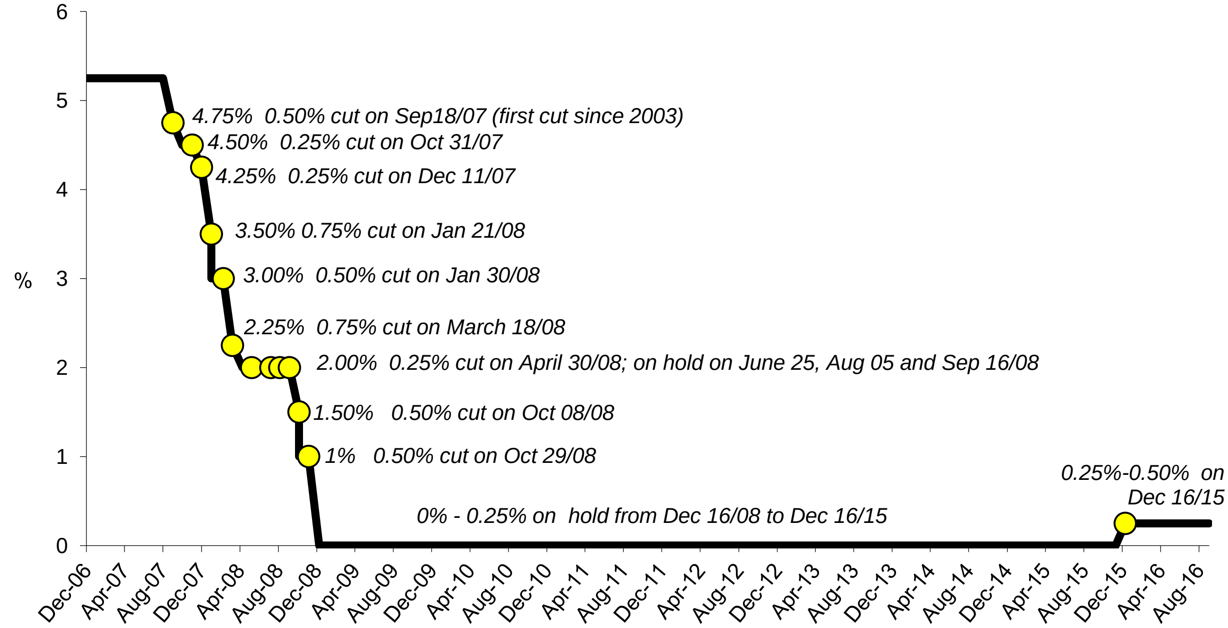
However, more recently the core CPI has been running ahead of the core PCE more than normal. Year-over-year growth in the core CPI is 0.6% above the core PCE compared with the 0.3% average since 2000. Healthcare costs are one reason for the divergence between core CPI and core PCE. The core PCE for healthcare is more comprehensive and has been more affected than the Core CPI by policy changes over the past few years, including sequestration and the Affordable Care Act.[4] Thus if the Fed's preferred measure of inflation were the core CPI, the argument for higher interest rates would be stronger.

E. Monetary policy

The Federal Open Market Committee (FOMC) remained on hold following its two-day meeting on September 20-21 (chart 12). The minutes of the meeting, released on October 12, revealed that the Fed's decision to hold interest rates unchanged was a "close call," with some officials wanting to move then and others preferring to wait a bit longer. Officials at the Federal Reserve appeared more divided than usual. Three regional bank presidents disagreed with the decision, the most dissents at a meeting since December 2014. Simultaneously, economic projections showed three other officials don't believe a rate increase is warranted this year.

[4] See Moody's Analytics, *Daily Economic Roundup*, October 13, 2016.

CHART 12:
U.S. FEDERAL FUNDS TARGET RATE
(Percentage)



Source: ECLAC, on the basis of data from the U.S. Federal Reserve.

The minutes of the meeting revealed diverging views as to how soon to raise rates, underscoring the sense of a committee that is divided over how to respond to complex signals about the health of the U.S. economy. Some policymakers thought a move could be merited relatively soon and officials largely agreed that the case for a rise in short-term rates had strengthened in the weeks leading up to the September meeting, with a number of policymakers seeking to signal that a move could happen soon if the economy stayed on track.

Data since the September meeting have suggested a steady picture of the U.S. economy. The September employment report showed wages rising while more workers are coming off the sidelines. Consumer confidence hit a post-recession high in September, manufacturing seems to be strengthening, although it is far from revving up, and inflation is gradually increasing.

Meanwhile, expectations of U.S. economic growth keep getting downgraded. On October 4, the IMF sharply lowered its 2016 growth forecast for the U.S. economy to 1.6% from the 2.2% it predicted in July. According to the International Monetary Fund (IMF), any further increase in U.S. interest rates "should be gradual and tied to clear signs that wages and prices are firming durably." Still, the minutes show the Fed officials didn't see any major threats to the U.S. economy. Most said the risks to the outlook were balanced.

The FOMC is scheduled to meet twice more before the end of the year, in November and December. Markets place odds for a December move at about 67%, the highest odds in advance of a meeting since last November.

F. Financial conditions

Financial markets provide a risk channel from global developments to the U.S. economy. A prolonged slump in global risk appetite, which drives equity markets lower and increases risk aversion, could lead U.S. firms to cut back investment and hiring plans. U.S. equity market's exposure to global growth is greater than the exposure of U.S.-based factories. Around 40% of S&P 500 revenues come from outside the United States. Volatility in financial markets may spark greater risk aversion and lead to slower Fed rate normalization.

Stock markets did not perform well in the first quarter of 2016, but improved in the second and third quarters, with the Dow Jones Industrial Average, the S&P 500, and NASDAQ gaining 4.13%, 5.04%, and 4.24%, respectively from January to September. There were losses in the first two months of 2016, with credit and equity investors deeply concerned about the risk of further slowdown in China's GDP and the possibility of further devaluation of its currency, and about signs that the U.S. growth could be slowing while interest rates were set to increase.

However, monetary easing by major central banks, a firming of commodity prices, and increasing confidence that the U.S. Federal Reserve was not planning to raise interest rates before the end of the year, powered U.S. stocks higher since then. From March to September 2016, the Dow Jones Industrial Average, the S&P 500, and NASDAQ gained 12.07%, 13.30% and 17.72%, respectively.

TABLE 5:
U.S. STOCK PRICES AND TREASURY SECURITY YIELDS

STOCK PRICES				U.S. TREASURY SECURITY YIELDS			
	Monthly Stock Prices				Monthly Yields		
	Dow Jones	S&P 500	Nasdaq		3-year	10-year	30-year
2015				**2015**			
January	17,542.26	2,028.18	4,673.70	January	0.90	1.88	2.46
February	17,945.41	2,082.20	4,854.26	February	0.99	1.98	2.57
March	17,931.75	2,079.99	4,938.01	March	1.02	2.04	2.63
April	17,970.51	2,094.86	4,985.95	April	0.87	1.94	2.59
May	18,124.71	2,111.94	5,029.94	May	0.98	2.20	2.96
June	17,927.22	2,099.28	5,073.04	June	1.07	2.36	3.11
July	17,795.02	2,094.14	5,082.14	July	1.03	2.32	3.07
August	17,061.59	2,039.87	4,934.62	August	1.03	2.17	2.86
September	16,339.95	1,944.40	4,748.00	September	1.01	2.17	2.95
October	17,182.28	2,024.81	4,879.04	October	0.93	2.07	2.89
November	17,723.77	2,080.62	5,082.51	November	1.20	2.26	3.03
December	17,542.86	2,054.08	5,040.54	December	1.28	2.24	2.97
2016				**2016**			
January	16,305.25	1,918.60	4,610.71	January	1.14	2.09	2.86
February	16,299.90	1,904.42	4,463.21	February	0.90	1.78	2.62
March	17,302.14	2,021.95	4,754.48	March	1.04	1.89	2.68
April	17,844.37	2,075.54	4,892.17	April	0.92	1.81	2.62
May	17,692.32	2,065.55	4,788.24	May	0.97	1.81	2.63
June	17,754.87	2,083.89	4,856.23	June	0.86	1.64	2.45
July	18,341.18	2,148.90	5,023.99	July	0.79	1.50	2.23
August	18,495.19	2,177.48	5,217.04	August	0.85	1.56	2.26
September	18,267.40	2,157.69	5,254.15	September	0.90	1.63	2.35

Source: Economic Indicators, U.S. Government

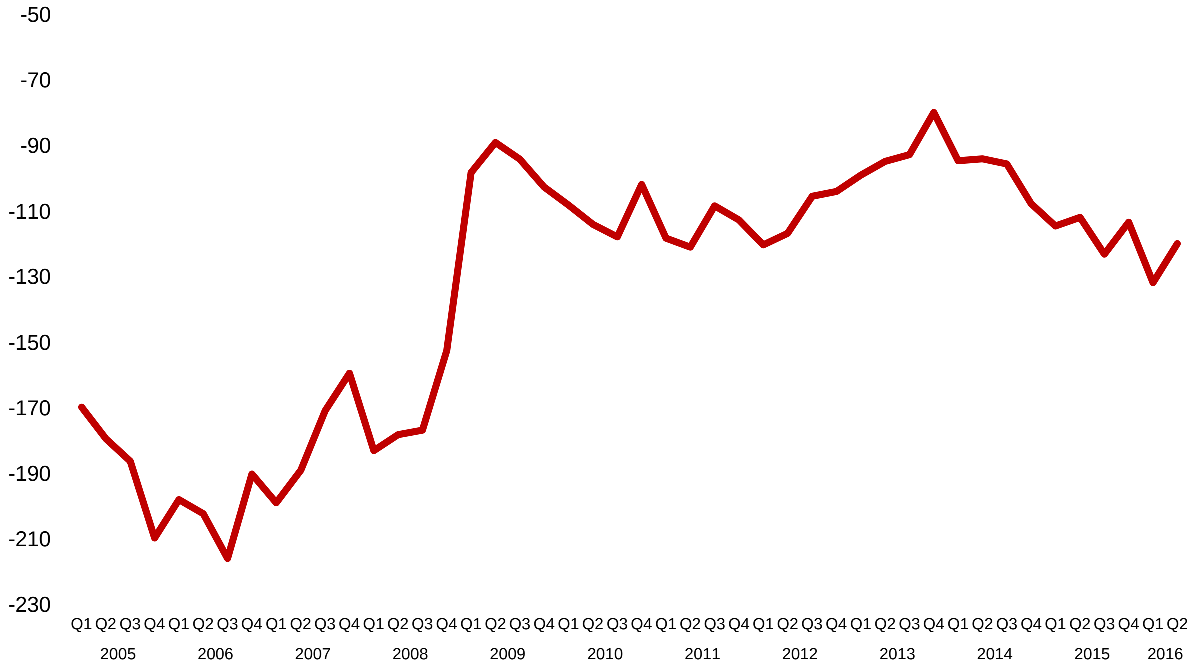
U.S equity prices have been supported for the past three decades by an acceleration of global trade and freer flow of capital. The S&P 500 is up nearly ninefold since October 1986, according to FactSet, a supplier of market data and economic information to the investment management and banking industries. But now concerns that globalization may have reached its peak are increasing.

Global trade this year will grow at the slowest pace since 2007, according to the World Trade Organization, just as protectionist policies are on the rise and efforts to liberalize trade have stalled. The International Monetary Fund recently warned that anti-trade trends such as increases in tariffs could cause long-term damage to the world economy, which could spill over to corporate profits. Global stock-index provider MSCI estimates that if policies such as trade protectionism and government deficit spending increase significantly in the developed world in the next two years, U.S. equities would shed more than 17%.

G. External sector

The U.S. current account deficit, the broadest measure of net exports to the rest of the world because it includes income payments and government transfers in addition to foreign trade, narrowed from a revised US$ 131.8 billion in the first quarter of 2016 (2.9% of GDP) to US$ 119.9 billion in the second (2.6% of GDP). The second quarter's decline in the current account balance is positive for economic growth. The deficit in the goods balance remains stubbornly entrenched, however, as the strong dollar remains a weight on exports and robust domestic consumption fuels imports. According to Moody's, rising fuel prices are boosting both exports and imports by similar degrees.

CHART 13:
U.S. BALANCE ON CURRENT ACCOUNT
(Quarters, Seasonally Adjusted, US$ Billion))

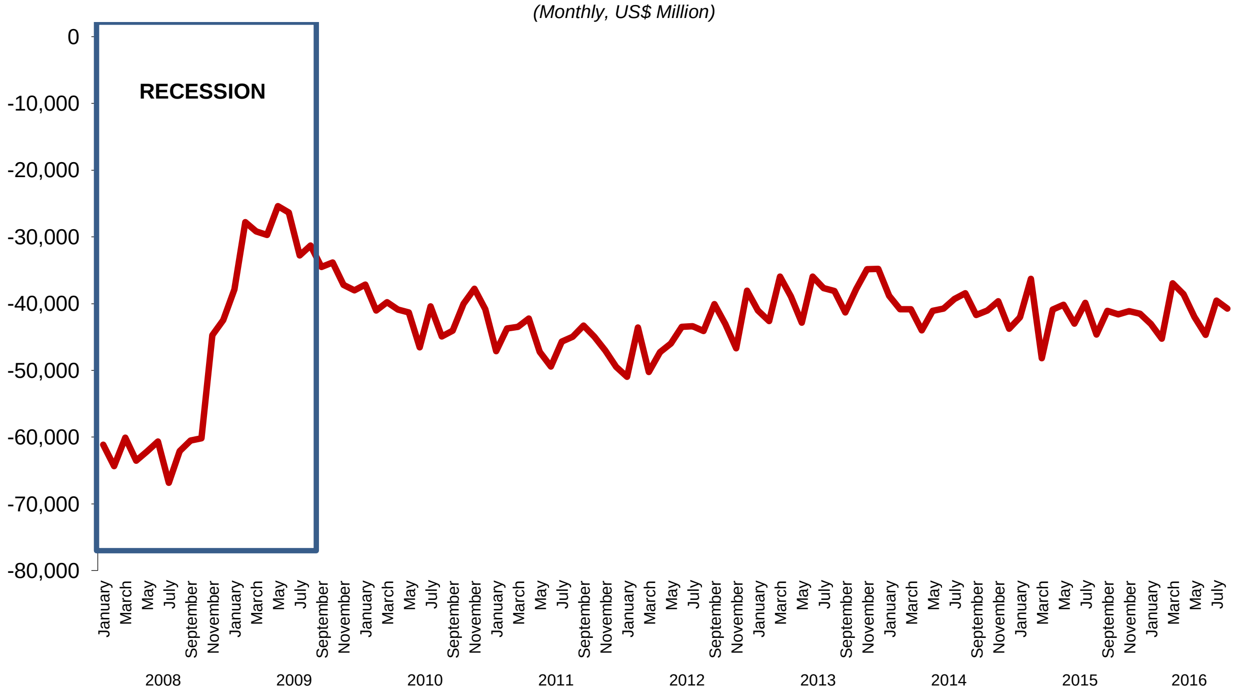


Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Commerce Department.

The trade gap increased 3% from July to a seasonally adjusted US$ 47.7 billion in August, the latest data available, according to the Commerce Department. The U.S. trade deficit remained relatively low for a second straight month. Although the deficit increased from the previous month, it was still well below trend (chart 14). The details were positive, with increases in both exports and imports. Exports of goods and services rose 0.8%, while imports climbed 1.2%. Export gains over the past two months have been largely driven by higher exports of soybeans. Excluding food, feed and beverages, exports are still up relative to the past six months, but gains are much smaller. Trade will likely provide a welcome boost to GDP this quarter.

The U.S. accumulated a trade deficit of US$ 330.7 billion in the first eight months of 2016, compared with a deficit of US$ 335.1 billion in the same period a year earlier.

CHART 14:
U.S. BALANCE ON GOODS AND SERVICES TRADE
(Monthly, US$ Million)



Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Commerce Department.

II. Recent trends and emerging market economies

The low rate backdrop of developed markets, including the U.S., makes emerging markets' yield story attractive. While the U.S. concluded its quantitative easing (QE) operations in 2014, the Bank of Japan, the Bank of England (especially after the vote for Brexit) and the European Central Bank are still expanding, pushing the collective balance sheets of G4 central banks to more than US$ 13 trillion. According to estimates by Citi, the collective balance sheets of central banks is now equal to about 40% of global GDP, a move that is shrinking the universe of securities available for investment, according to its credit strategists, and making emerging market assets more attractive.

Emerging markets have arguably benefited from central bank policy in developed economies driving yields lower. The JPMorgan global diversified composite index covering emerging market bonds was up almost 15% this year at the end of September. Hence the close attention being paid to the U.S. dollar and Federal Reserve policy intentions, given the large exposure of emerging market currencies and economies to debt denominated in the reserve currency.

According to market analysts, nothing gets the emerging market investor base more exercised than the health of the U.S. economy and the direction of interest rates, thus the biggest risk to emerging markets is further deterioration in U.S. data, which could increase global growth risk. Perversely, emerging market currencies could also weaken if the U.S. economy strengthens. Emerging market currencies have been helped by a revival in the price of oil from below US$ 30 a barrel in January and frequent bouts of caution from the U.S. central bank, which has kept the dollar at bay. Barclays expects the dollar to rise around 5% over the next 12 months, however, because of monetary policy normalization.

Withdrawals from emerging market funds invested in local currency bonds climbed to US$ 727 million in the week of October 19 according to EPFR, a provider of fund flow and asset allocation data to financial institutions around the world, which was the largest outflow since the third week of the year when concerns about Chinese growth rattled markets. As conviction rises that both rates and the dollar will rise by year-end as the Fed debates lifting interest rates, outflows from emerging market funds may continue. Since the lows reached in July, yields on developed market sovereign bonds have been rising (see table 4 on page 20), offsetting some of the attractiveness of high-yielding emerging market debt.

Another concern is whether the increase in emerging market debt that has taken place, especially in the corporate sector, may become a threat to emerging market economies. In June, the Bank for International Settlements warned that the world faced a "risky trinity" of high debt, low productivity growth and dwindling firepower at the world's big central banks.

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