The economy expanded at a 1.5% annualized rate in the 3rd quarter, below the long-run natural rate of 2.5%, due to a dramatic slowdown in inventory accumulation. Consumer spending, fixed investment spending and state and local government spending were the main drivers of growth. Real output rose 2% year over year. Final sales added 3.0 percentage points and the change in inventories subtracted 1.5 percentage points. Economic growth should come in at 2.8% in 2016 and 2017. The economy is operating with a -2.0% "output gap" but is rapidly approaching its potential level of output. The Federal Reserve will therefore begin increasing the fed funds interest rate later in 2015.
The labor market added 142,000 jobs in September, below the 150,000 target. Average hourly earnings fell 1 cent to $25.09, but is up 2.2% during the last year. The unemployment rate remained at 5.1% in September, which corresponds to 7.9 million unemployed workers. The labor force fell by 350,000 (-236,000 employed + -114,000 unemployed).

The underemployment rate fell to 10.0% or 15.8 million (7.9 mil. unemployed, 6.0 mil. involuntarily part time, 1.9 mil. marginally attached). Continued employment gains will increase household incomes, wage growth, household formations, confidence and desire to borrow and spend. Expect loan growth to remain strong in 2016.
Headline inflation fell -0.2% in September and 0% during the last 12 months while core inflation rose 0.2% in August and 1.9% during the last year, both below the Federal Reserve’s target of 2%. There are 5 factors keeping inflation low: the negative output gap leads to idle capacity, the unemployment rate above the natural unemployment rate keeps wage growth slow, a rising value of the dollar keeps import prices low, the “commodity super cycle” keeps commodity prices low, and low oil prices.

The **10-year Treasury interest rate** fell in September to 2.17% because of falling inflation expectations (1.52%) more than offsetting rising real interest rates (0.65%) due to a sell-off of safe Treasury bonds.
The Federal Reserve will raise **short-term interest rates** by 1.25 percentage points per year for 3 years starting in December 2015. The Fed believes the **neutral fed funds rate** is 3.5%. Interest rates will “normalize” in 2018 at levels below previous plateaus due to lower **real interest rates** and lower **expected inflation**. It appears the Fed will raise the Fed funds interest rate later this year but hold off ending its reinvestment program until 2017. By maintaining the current size of the Fed’s balance sheet and thereby depressing the term premium on long-term bonds, long-term interest rates will be slow to adjust upwards. This will cause a flattening of the yield curve over the next two years, which typically leads to downward pressure on credit union net interest margins.
U.S. vehicle sales reached a recovery high of 18.2 million unit seasonally-adjusted annualized basis in September, up from 17.8 million units in August. Sales were up 10% year over year. Low gasoline prices are driving light truck sales. Consumer fundamentals remain favorable to drive auto sales into the future.

Existing home sales rose 4.7% in September, rising to a 5.55 million annual rate, and rose 8.8% from September 2014. Home inventories remain tight (2.21 million) leading to home prices rising 6.1% year over year.
The U.S. dollar rose 13% over the last year due to expectations of rising U.S. interest rates and global geopolitical stress. This has reduced the cost of imports to U.S. residents but raised the cost of exports from the point of view of foreign buyers. This will worsen the trade deficit and slow economic growth.

The price of a barrel of oil averaged $45.46 in September 2015, down from $93.20 one year ago, a 51% decline. This will slow energy investment but boost consumer spending. Oil Economics: $P_{\text{oil}} = $10 => $P_{\text{Gas}} = $0.25 => ↓ growth 0.3%-0.5% over next two years
Household balance sheets have improved over the last year due to rising stock prices and home prices.

Stock prices are 4.5% higher in October than one year earlier, creating a positive wealth effect.

Home prices rose 5.4% over the last year, due to rising home demand colliding with a lack of housing inventory for sale.
Personal income rose 0.1% in September and 4.1% year over year, due to rising rental and stock and bond income. Wage income growth came in at 0.0%. Nominal spending rose 0.2% in September (led by durable good spending) and 2.9% year over year. The outlook for spending is positive because of the recent rise in discretionary items (recreational goods, furniture and appliances, and vehicles sales). Lower gas prices are freeing up cash for other purposes. Consumers had chose to save the gas windfall and/or pay down debt. Now they are starting to spend the gas windfall. Household balance sheets improved over the last year as home prices rose 5% and debt burdens fell. This will boost spending from the “wealth effect” and from additional access to credit. The lowest debt burdens & payments in 35 years is freeing up income for additional spending. A surge in household formations will lift spending in the next couple of years.
Consumer credit rose $16.0 billion in August, a deceleration from $18.9 billion in July. Consumer credit rose 6.1% over the last year (revolving rose 3.9% and nonrevolving rose 7.9%). Big ticket items (auto and student loans) continue to be the major driver of consumer credit. Rising consumer confidence is a sign consumers are more willing to take on debt via credit cards.

The household debt service ratio (mortgage and consumer debt payments (interest and principal) required to remain current on that debt as a percent of disposable personal income) rose to 10.06% in the second quarter from the record low of 10.01% in the fourth quarter of 2014 but below the record high of 13.22% in Q4 2007. Low debt payments freed up disposable income for additional consumption or savings.
The saving rate (savings / disposable personal income) fell to 4.6% in August from 4.7% in July. Savings should decline as households begin spending some of their gasoline savings windfall. In this environment of modest savings, spending gains will be highly dependent on income growth and consumers preferences for additional savings.

Consumer Confidence Index rose to 103 in September due to optimism about the labor market and falling gas prices. Consumer Sentiment Index fell to 87.2 in September due to falling stock prices and therefore worries about retirement. Improving GDP growth will boost consumer confidence and also the demand for credit.
During the **first quarter of 2015**, the real annual purchasing power of **financial assets** are the highest in U.S. history at $5.22 per dollar of disposable income (5.22 years worth of disposable income), up 24% from the cyclical low of 4.22 set back in the first quarter 2009. Rising stock prices were the major contributing factor. The real annual purchasing power of **non-financial assets** rose to $2.24 per dollar of disposable income (2.24 years worth of disposable income), up 14% since the cyclical low of 1.96 set in the third quarter of 2011, due mainly to rising home prices. Non-financial assets as a percent of disposable income is down 24% from the record high of 2.96 set back in the fourth quarter of 2005.
During the first quarter of 2015, households’ debt burden ratio (debt-to-disposable-income) fell to 1.02, from 1.29 in the fourth quarter of 2007. Financial institutions writing off and households paying off mortgage debt were the major contributing factors for the decline. The deleveraging phase of the business cycle has come to an end. If growth in debt equals the growth rate of disposable income over the next few years the debt burden ratio will remain around 100% which is what economists believe is sustainable in the long run.

The real annual purchasing power of household net worth rose to $6.39 per dollar of disposable income (or 6.39 years worth of disposable income), slightly below the 6.51 record set back in the fourth quarter of 2006.