The Kiplinger Letter

FORECASTS FOR EXECUTIVES AND INVESTORS

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Dear Client: Washington, Aug. 26, 2016

SPECIAL
BUSINESS COSTS 2017

It's time to prepare your business budget for next year. To help you plan, we've pulled together fresh forecasts on GDP growth, inflation, interest rates, energy, pay and many other important business-related expenses.

The U.S. economy is in for a lackluster 2017, growing at around 2% from this year's 1.4% increase and paced largely by U.S. consumer spending on goods and services, including new homes, which will have builders busy.

Look for inflation to show more gusto. Measuring Dec. 2017 over Dec. 2016, the Consumer Price Index will climb by about 2.5%, on the heels of 1.5%, mostly because of higher energy prices. At the same time, the core inflation rate, which excludes food and energy costs, will rise 2.4%, compared with 2.3% this year.

The cost of borrowing will stay relatively cheap, with the Federal Reserve likely to pull the trigger on just one or two hikes in short-term interest rates in 2017. The 10-year Treasury note, a benchmark for home mortgages and other debt, will creep up to about 1.8% by the end of next year, after dipping to 1.4% this year.

In the uncertain global economy, U.S. Treasuries will remain a safe haven for investors, as we've noted before. U.S. securities will also attract more investors as the dollar likely strengthens further against the euro and the British pound.

Business investment will barely budge...up 3% at best, following no growth this year and a 3.5% drop in 2015. China's economy will continue to slow in 2017 and Europe's will just creep ahead, leaving plenty of slack in two large export markets. Moreover, U.S. companies must weather the effects of a higher-priced dollar that will make U.S.-produced machinery and other goods costlier in foreign markets. Plus concerns over Britain's vote to leave the European Union will weigh on spending. Note that spending by federal, state and local governments will also be flat.

Weak markets abroad spell more unexciting growth in corporate profits. Look for profits to edge up about 4% overall next year versus a flat performance this year. Slightly stronger domestic sales will help offset lower earnings abroad.

Oil markets will remain volatile, but prices are sure to trend upward as the worldwide glut of crude and refined fuels slowly shrinks, allowing demand to catch up. For the year as a whole, expect an average price for benchmark U.S. oil of $50 to $55 per barrel...moderately more than this year's $40 or so but still cheap relative to most years since the Great Recession, when oil often hit $100 per barrel.

That spells somewhat higher fuel costs. For gasoline, figure on an average for the year...nationwide, for regular unleaded...of about $2.40 per gallon. For diesel, about $2.65 per gallon. Prices will be lowest in winter, with a run-up during spring. Propane users should budget for prices 10% above what they paid this year.

Factor in a modest rise in natural gas prices...about 10% versus 2016, on average, though prices could be quite volatile during very hot or cold weather.

And a slight bump in electricity rates as a result of costlier natural gas, which generates a significant portion of U.S. power. Most users can expect a rise of 2% to 4% compared with 2016's rates. Residential users will see the biggest hikes.

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Average pay raises...3%, versus 2.5% this year, as more employers realize that they'll need to sweeten paychecks to attract and retain top-notch workers.

Benefit compensation will tick up a bit more. The cost of paid vacations, 401(k) contributions, etc., will grow 2.5% next year after increasing 2% this year.

Payroll taxes...rising. The wage base may hit $126,000, from $118,500.

For firms that pay pension premiums to Uncle Sam...a hefty 2017 increase: An 8% jump for plans paying flat rates...from $64 to $69 per plan participant. And a hike in variable rate premiums for underfunded plans, from $30 to $33 per $1,000 of unfunded vested benefits (subject to a $500-per-participant ceiling).

The cost of employer-sponsored health care will jump about 4%, on average. The hike would be higher, but employers are finding success with holding down costs in myriad ways, including the growing implementation of employee cost sharing. More companies will also offer narrower networks of providers, increase access to telemedicine and assist employees in selecting the best health plans for them.

Prescription drug costs...up about 12%, on top of an 11% increase this year, driven by soaring prices for specialty drugs for treating cancer and other diseases. Such drugs make up about 40% of all Rx drug spending. Generic drugs, up just 2%.

Trucking rates will rise 4%, and a number of regulations on truckers that are set to take effect over the next couple of years are sure to tighten capacity.

Rail rates...up 3% to 5%, as railroads try to compensate for less volume.

Ocean shipping...a skosh higher. Container capacity remains in oversupply.

Airfares will climb 3.5% on U.S. routes, on average...2.5% for global travel. But the expansion of low-cost carriers will help tamp down fares in some key markets.

Budget about 4% more for hotel costs, on average. The largest increases will be on the West Coast. But hikes will be in low single digits, or even flat, in the East.

Car rental rates...flat. The supply of cars continues to outpace demand.

Businesses may find insurance to be the biggest bargain, with many rates heading lower. Rates for commercial property insurance...down between 2% and 4%. Casualty insurance...flat or down a tick. Rates for directors and officers insurance... down 3% for commercial companies but up 2% for private firms and nonprofits. Even cyberinsurance is seeing smaller rate increases, or reductions in some areas. The biggest increases...over 8%...will be for retailers with point-of-sale systems because of their high exposure and vulnerability to cyberthieves who target them.

You can budget less for mailing catalogs, periodicals, ad brochures and more. The U.S. Postal Service won't reinstate the 4.3% increase that it lifted earlier this year. But figure on paying about 5% more for overnight parcel deliveries by UPS and FedEx.

Warehouse and office space...both up about 4%. Retail space...2.5% more.

Ad rates: Up 3% on desktops and laptops, 1% to 2% on mobile devices and 2% for TV ads. Flat for radio. Print ads...a buyer's market as rates slip further.

Tech and telecom: Look for an average 5% drop in the price of smartphones as low-cost versions from Chinese makers Huawei, Oppo and Xiaomi flood the market. Figure on paying 10% to 20% less for bandwidth as web providers battle it out for customers, though prices will vary by area. Satellite broadband costs...also down. Mobile data prices...down, too, by 10% or so. Ditto, PCs...down 5%, but prices for high-end tablets are sure to go higher. Printers and copiers...5% to 10% cheaper.

Yours very truly,

Knight Kiplinger

THE KIPLINGER WASHINGTON EDITORS

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