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Economic Update
April 2017

By Andrew Kohl

Commentary

The stock market appeared to be losing steam after essentially a flat March and weakness to start the month of April. The inability to get Obamacare repealed caused many to question whether Trump and his fellow Republicans would be able to push through other major reforms that were the foundation of the Trump campaign. In addition, the risk of a potential government shutdown loomed on the horizon.

Sentiment shifted to the positive side as the Trump administration turned its focus to tax reform. Though the announced plan lacked detail, it was enough to propel the equity market forward. Equity values (as measured by the S&P 500) finished up 1% in April and remain less than 1% below their all-time high. It also appears that a government shutdown will be averted. The continuing resolution that was set to expire on April 28 was only extended one week, but major hurdles to a compromise have largely been resolved. Trump backed off his demand for immediate funding of his border wall with Mexico and agreed to continue to pay federal subsidies which help low income Americans pay for health insurance under Obamacare. Therefore, we expect the government to agree on a funding plan through the rest of its fiscal year (which ends on September 30).

We remain skeptical that major tax reform will occur in 2017. Based on the sparse information that was provided on the plan, it appears that it would add to the federal government deficit. If that is the case, it will be hard to garner the votes of the fiscal conservatives. The Trump plan is relying on potential positive growth effects from a tax cut to help negate the inflationary impact to the deficit. Economic growth rates of 4% - 5% have been bandied about. We believe that level of growth is extremely unlikely to be achieved.

Economies grow bigger when the working age population grows and/or more output is produced by the existing workforce (i.e. “productivity growth”). According to the Bureau of Labor Statistics, the labor force is expected to grow by .5% per annum over the next ten years. This is less than half the growth rate that was seen during the “high growth” period from 1994 to 2004 (the GDP growth rate averaged 3.4% during that timeframe). The story is similar for productivity growth. The negative impact of demographic trends will be hard to offset.

First quarter GDP was released this week and displayed what has become a typical seasonal pattern. Since 2010, first quarter GDP has averaged approximately 1% growth while the rest of the year has averaged 2.5% growth. Therefore, the .7% growth rate for the first quarter, while lower than expected, will be unlikely to cause alarm. We believe that consumer spending will bounce back from its weakest growth rate in seven years and our baseline expectation remains at 2% real GDP growth for 2017.

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Fixed Income Outlook
The Treasury curve flattened over the course of April. Interest rates from three years in maturity and longer fell largely due to weaker than expected economic data and in response to the minutes from the March FOMC meeting. The minutes showed that the Fed is contemplating shrinking its balance sheet in the latter part of 2017. Many believed that 2018 would be the earliest that the Fed would embark on its balance sheet strategy. The market viewed this news as an indication that the terminal fed funds for the rate cycle will be lower than previously thought.

The Fed is meeting next week, with little expectation of a rate move (the market is pricing in a 13% chance of a hike). We believe that the Fed will make a point to look through the weak first quarter GDP number and prepare the market for a potential hike in June. The market is currently pricing in a 70% chance for a hike in June and approximately a 60% chance of two more hikes (inclusive of June) for the rest of the year. This seems reasonable to us.

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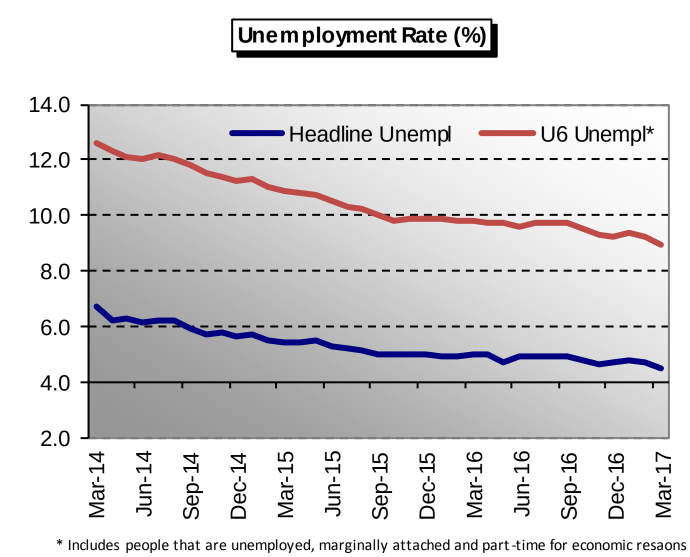
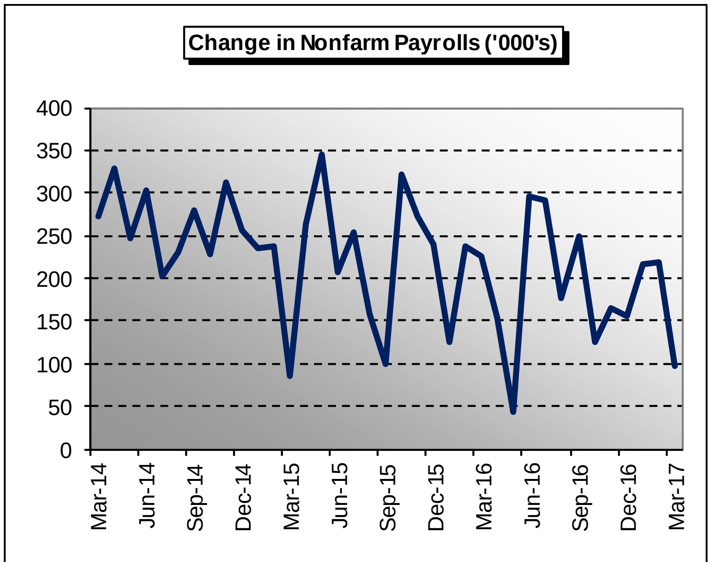
Labor Readings

(Data source: Bloomberg)



Unemployment Rate Hits Cyclical Low

The unemployment rate in March dropped to 4.5% from 4.7% the previous month. This is the lowest point thus far during the economic recovery and the rate now stands at its lowest level since May 2007. The underlying details of the Household report were positive. Both the labor force and the number of employed showed a substantial increase from the prior month.



Job Gains Disappoint

Payroll growth came in much lower than expected in March. Payrolls grew by 98,000 versus expected growth of 180,000 jobs. In addition, the prior two months were revised downwards by 38,000 jobs. Some of the decline may be weather related as a major storm hit the Northeast during the survey period. Given the large margin for error for this report, the Fed is likely to look past this relatively weak data point.

Corporate Federal Credit Union

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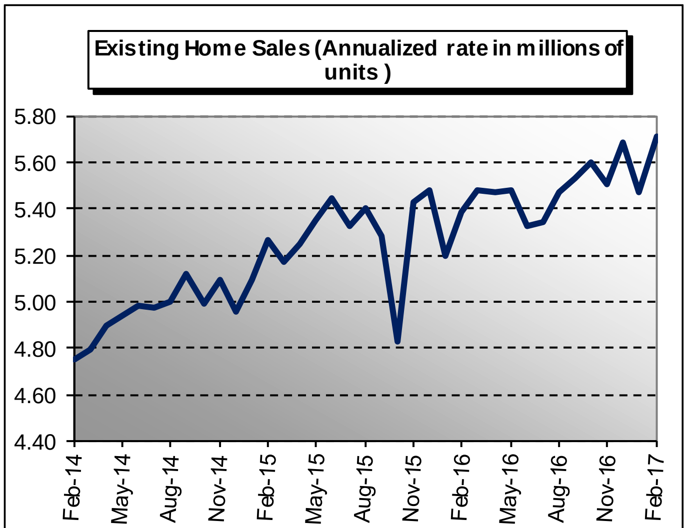
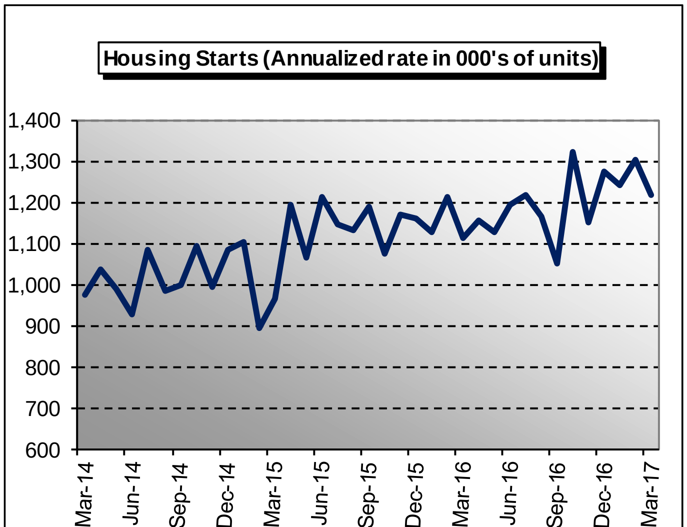
Housing Readings
(Data source: Bloomberg)



Existing Homes Sales Beat Estimates
Sales of existing homes were greater than expected in March. Sales increased by 4.4% from the prior month and reached the highest level in over ten years. Tight supply continues to boost housing prices, but housing affordability measures have improved lately with the decrease in mortgage rates.



Housing Starts Decline
New home construction in March was weaker than expected. Housing starts fell by 6.8% on a month-over-month basis. Despite the decline, housing starts have increased by over 9% since the same time last year. Builder sentiment remains near decade high levels and lower mortgage rates are providing a boost. Greater than expected building permit applications for the month indicate that housing starts will bounce back up.

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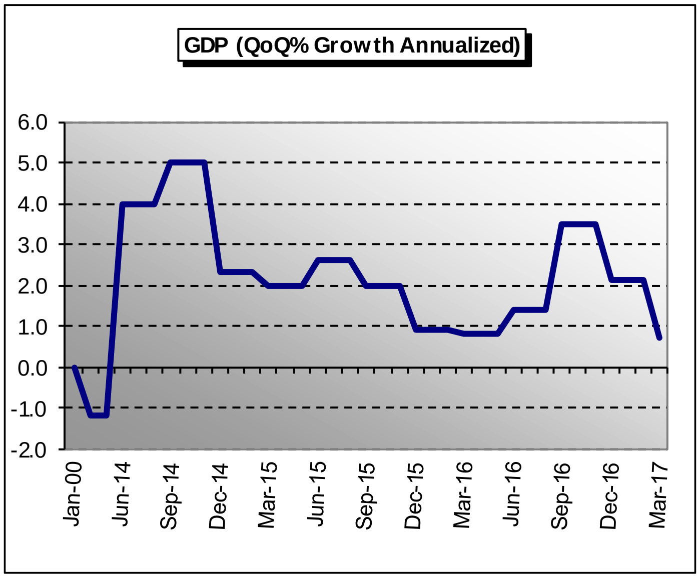
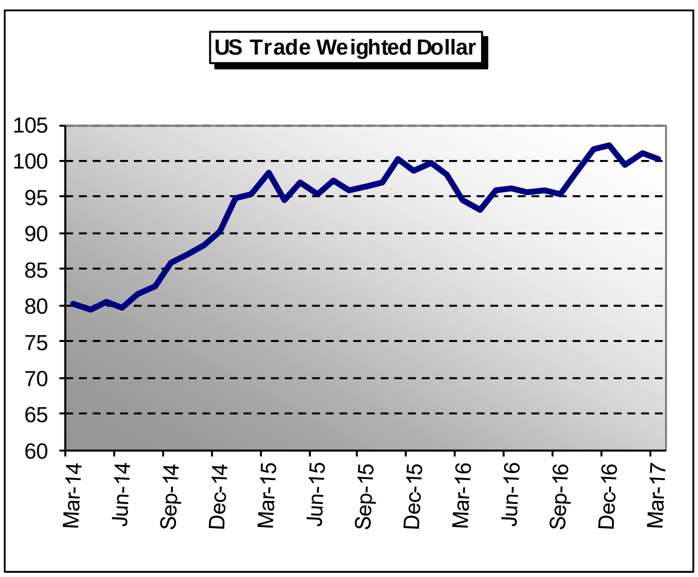
Economic Growth Readings
(Data source: Bloomberg)



1st Quarter GDP Shows Weakness
As has been typical over the last several years, first quarter GDP came in below expectations. GDP grew by .7% versus an expectation of 1.0% growth. This was the weakest growth rate in three years. The slowdown from the fourth quarter's 2.1% pace was mainly due to weaker consumer and government spending.



Dollar Declines after Initial Trump Bounce
The U.S. dollar is almost back down to the level before Trump was elected. The dollar rose by over 5% after the Trump election, but has fallen 4% since year-end. The decline is due to better than expected economic performance from foreign economies and lowering expectations for rate hikes in the U.S.