Written on 10/21/16

Corporate Federal Credit Union

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# Economic Update
## October 2016

By Andrew Kohl

### Commentary

This week brought the last of the three presidential debates to a close. Thankfully, Election Day is only a little over two weeks away. If you believe the polls, Hillary Clinton has expanded her margin over Donald Trump and it is looking increasingly likely like she will be the next President of the United States. It also appears that the Democrats are poised to take over majority control of the Senate and have an outside chance of taking over control of the House. So, what does the mean for the economy and the markets?

If Democrats were to control the presidency and Congress, they could use the reconciliation process to push through reform. The reconciliation process allows for the passage of legislation with only a simple majority, but it is only for items directly related to the federal budget. Those items include changes to tax laws and federal spending programs.

Given that the debates were largely focused on each candidate’s character (or lack thereof) rather than a discussion on policies, it is somewhat difficult to ascertain exactly what either candidate would try to accomplish in the early days of his/her presidency. Clinton’s website states that in her first 100 days, she’ll seek approval of the “biggest investment in American infrastructure in decades.” Based on Clinton’s speeches, the spending would be funded by “business tax reform.” This likely means a one-time tax (at a reduced rate to encourage action) on the repatriation of profits earned by U.S. companies from overseas. Since the main elements of the plan are directly related to the budget, it could be moved forward via the reconciliation process if Democrats were to gain full control.

Even if Clinton wins and Congress is divided, we believe that there is a decent chance that increases in infrastructure spending get enacted. A lot will depend on the skewness of the election results. President Obama has been trying to push through a similar spending/tax plan, but the Republicans have blocked it in favor of broader tax reform. A resounding victory by the Democrats may increase the willingness of Republicans to bargain.

We believe that increases in federal spending, on projects that can improve productivity, can help push the economy forward. The projects must be chosen carefully and stay within budget (admittedly, two things that the government has not historically been great at) to receive the benefit. On its current course, the budget deficit will expand in future years as the aging of the baby boomers will increase federal outlays on healthcare costs and social security. A more robust economy can help defer some of those costs.

The first estimate of third quarter GDP is due to be released next week. We look for the first 2% handle growth rate in a year. The main impetus for the improvement will be less drag from inventories, but consumer spending should also remain strong. If the labor market continues to perform at or near projections, we believe that the Fed will hike in December. After that, we expect another long pause before the next move as the Fed (and economists) continues to struggle with how this recovery has not performed as long-held economic models would have projected. A great example to this effect is Yellen’s October 14, 2016, speech on “The Elusive ‘Great’ Recovery…” given at the Boston Fed.

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### Fixed Income Outlook

Interest rates increased by 10-15 basis points across the curve since the end of September. Expectations are very low (17% chance) that the Fed will hike in November (the meeting concludes on November 2) due to the closeness to the election. The odds of a December hike are at the highest level of the year and stand at 75%. As we stated last month, December will be the last chance for the more hawkish members of the Fed to push through a hike before they roll off the committee. Next year, the Fed turns decidedly more dovish. The market seems fairly priced at these levels.

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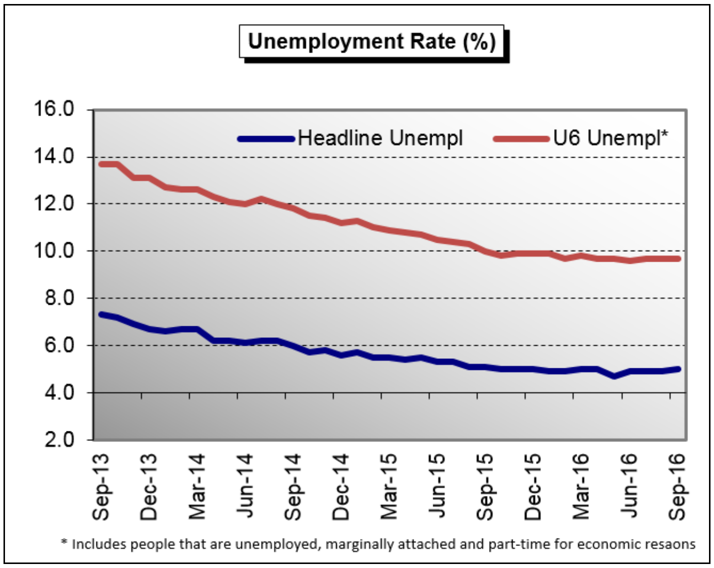
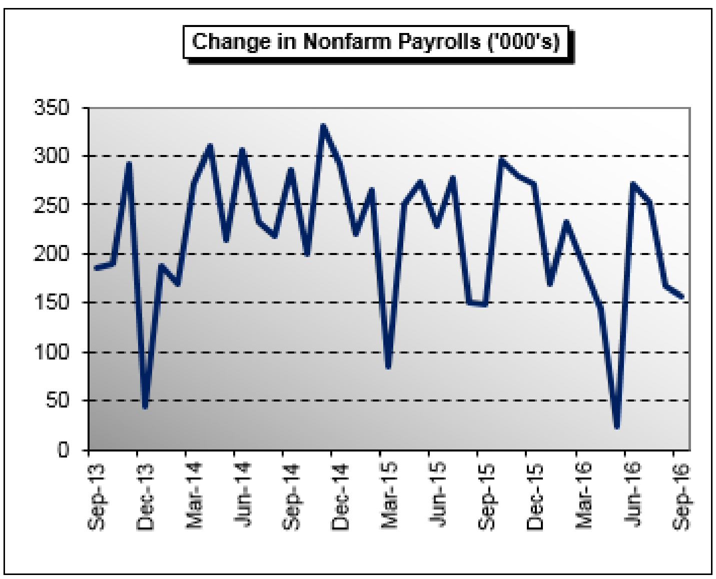
### Labor Readings

*(Data source: Bloomberg)*




### Unemployment Rate Increases to 5.0%

The unemployment rate in September increased from 4.9% to 5.0%. The increase was for "good" reasons as there was a large increase in the number of the people entering the labor force. This pushed the labor force participation rate to a six-month high. The other details of the household labor report were also relatively strong. Both wage inflation and the average hours worked per week bounced back from the weaker-than-expected data from August. This places the trend on income growth back to where it was in June and should keep consumer spending strong.




### Job Gains Come in Near Estimates

Payroll growth in September came in at 156,000 jobs versus an expected 172,000 gain. The slight miss to the downside was largely due to the biggest drop in government employment in a year. The report was likely good enough to keep the Fed in play for a hike in December, but they will get to view two more labor reports before making a decision.

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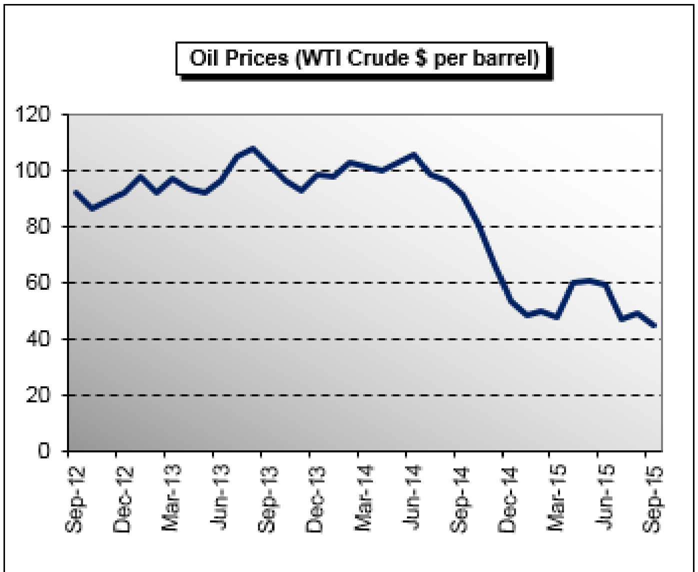
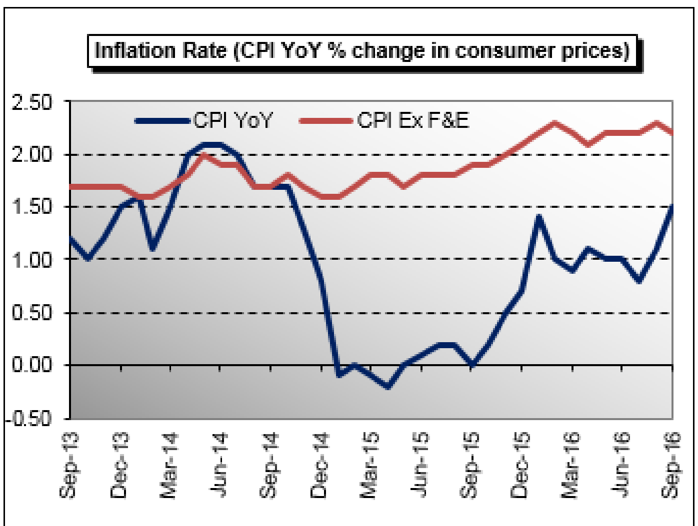
### Inflation Readings
*(Data source: Bloomberg)*




### Oil Prices Climb on OPEC Cuts
Oil prices have climbed 13% since OPEC reached an agreement on September 28 to manage supplies. If oil prices remain at these levels, headline inflation rates will continue to move higher. September month-end marks the first year-over-year increase in oil prices in over two years.




### Headline Inflation Rate Pushes Higher
The headline inflation rate rose to its fastest monthly pace in five months. This helped to push the year-over-year increase to its highest level in almost two years. The general price increase was mainly driven by higher housing and energy prices. The core inflation measure (which excludes food and energy prices) came in slightly below estimates and has remained in a tight range for all of 2016.

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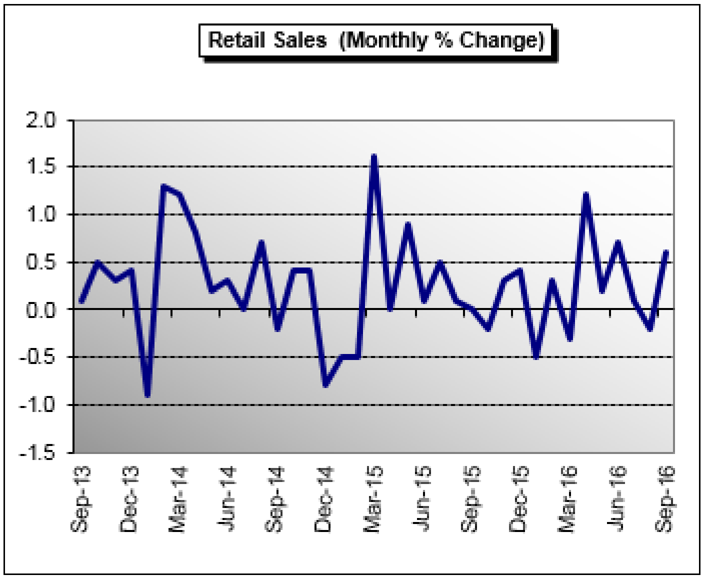
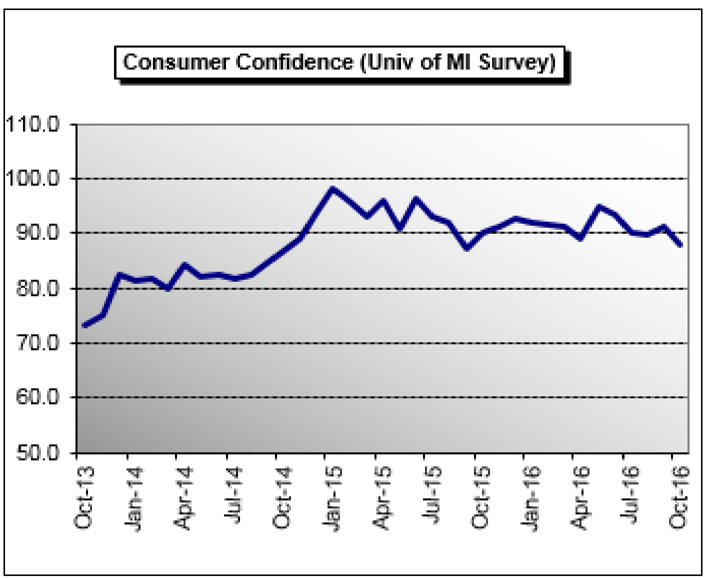
### Consumer Readings
*(Data source: Bloomberg)*




### Retail Sales Meet Estimates
Retail sales in September met the consensus estimate and reached the highest level in three months. The gain in sales was broad-based as ten of the thirteen major sales categories showed gains. The largest gains came from auto dealers, restaurants, and gas stations.




### Consumer Confidence Falls
Consumer confidence fell to a one-year low according to the preliminary reading of the October consumer confidence survey conducted by the University of Michigan. The measure of expectations six months from now hit its lowest level in two years. The survey may be getting dragged down by the negativity surrounding the upcoming presidential election.