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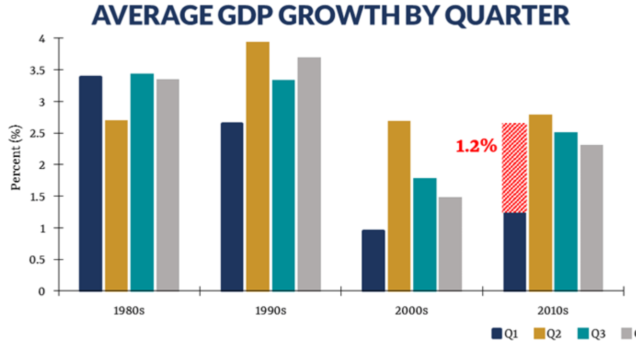
Economic Perspectives
April 2018

Should a weaker Q1 GDP report be a cause for concern?

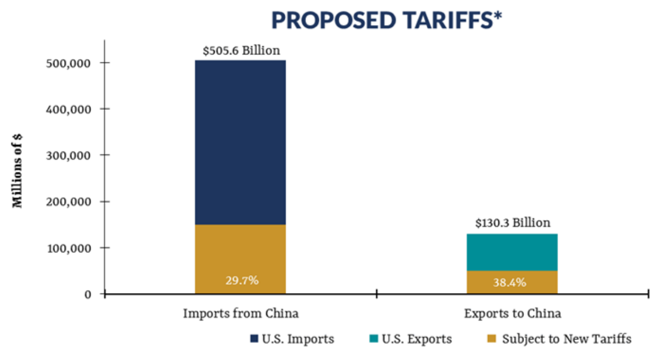


Source: PMFA, Bureau of Economic Analysis (BEA)

Since the 1990s, first quarter GDP growth has lagged growth in the subsequent three quarters by about 1.2%, on average. While the underlying cause is unclear, the consistency suggests a flaw in the Fed's seasonal adjustment calculations that negatively – and consistently - distort Q1 results. As such, investors shouldn't be surprised if the forthcoming Q1 estimate for GDP appears sluggish.

More broadly, trend growth remains solid. The effects of the new tax legislation and expected increases in capital expenditures on the horizon should be supportive of GDP in the coming quarters, and incoming economic data paints an optimistic story for continued growth. As such, we don't believe that a weak Q1 GDP report – if it occurs – should be a cause for alarm.

Are tariffs a risk to the global expansion?



***Estimates of goods that could be impacted by tariffs are as of 3/30/18**
Source: PMFA, Federal Reserve Economic Data (FRED)

The headline risk of a trade war was arguably the primary catalyst for equity market volatility in March. The Trump administration's announcement of tariffs on up to $150 billion of imported Chinese goods led to a retaliatory announcement of tariffs hitting nearly 39% of total Chinese imports of American goods.

It's unclear what the impact of these announced actions will be, but we believe that it's too early to conclude that they will ultimately represent the opening salvos of a more protracted, expansive conflict. It's possible that these announcements are intended to create a starting point for broader negotiation between the U.S. and China to address a number of lingering concerns, most notably related to China's widely acknowledged theft of corporate intellectual property.

To this point, we don't believe that these developments have fundamentally changed the outlook for the U.S. economy, which remains constructive. Nonetheless, the growing trade rift between the U.S. and China in particular is an additional risk to be monitored.

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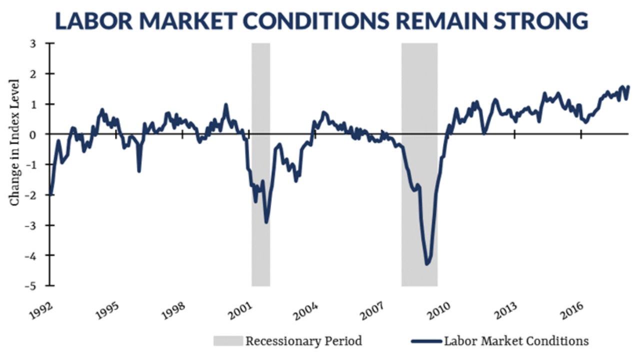
A healthy job market – for how long?



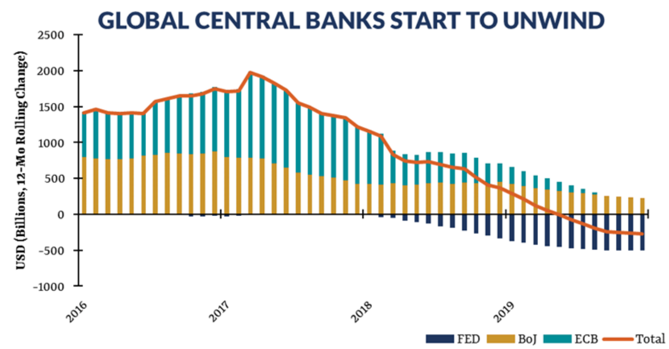
Source: PMFA, National Bureau of Economic Research, Kansas City Federal Reserve

For the past eight years, the job market has strengthened considerably, and appears to be on strong footing today. By any number of measures, the labor market is as healthy as it has been in decades. The unemployment rate remains at a 17-year low (at 4.1%), weekly jobless claims recently dipped to their lowest level since 1973, and job openings are near an all-time high.

Given these positive conditions today, it will be increasingly difficult for job creation to be maintained at its recent pace, but it should be sufficient to support continued economic expansion. Furthermore, wage growth is showing some signs of accelerating as the competition to attract and retain skilled workers is intensifying. With the rising demand and dwindling supply increasingly favoring workers, various measures of the consumer mood remain quite optimistic – ultimately supporting consumer spending growth and the broad economy.

Chart Note: The labor market conditions index monitors 24 distinct labor market indicators. The index has an average value of zero, with positive values indicating stronger labor market conditions and negative results indicative of weaker conditions.

Has the era of easy money ended?



Source: PMFA, Federal Reserve

Starting in late 2017, the Fed announced that it would begin the process of shrinking its balance sheet (quantitative tightening). Coupled with its ongoing series of short-term rate increases, the Fed's goal is to gradually normalize monetary policy. The process thus far has been gradual (and is expected to continue to be) and subject to a great deal of transparency in an attempt to avoid a negative capital market reaction.

Globally, other central banks are not as far down the normalization path as the Fed. The European Central Bank is edging that direction, and the Bank of Japan is expected to gradually trim its bond purchases over the next few years. The bias toward reduction of global central bank balance sheets could push rates higher, leading to increased borrowing costs.

Still, these decisions underscore the confidence that policymakers have in the global economy and directly address the need to normalize policy to reduce the risk of unwanted inflation or an overheating economy, and to create some "dry powder" for central banks to take action when the next economic downturn occurs.