Economic Outlook

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ECONOMIC OUTLOOK

- The U.S. economy grew 3.1% in the first quarter of 2019, according to the second estimate released by the Bureau of Economic Analysis. This was ahead of expectations and the best start to a year since the first quarter of 2015. We expect growth for all of 2019 to be between 2.0-3.0%.

- The U.S. labor market continues to display impressive strength. Unemployment remains at a fifty-year low of 3.6%. There are now 1.2 job openings for every job seeker, and that ratio has been in record high territory for over a year. The tight labor market is driving wage gains in excess of inflation, as average hourly earnings rose 3.1% year-over-year for all workers in May.

- The trade war between China and the U.S. grinds on. As of this writing, the U.S. has applied 25% tariffs on $250 billion of Chinese goods sold in the U.S. while China has enacted tariffs ranging from 10% to 25% on $110 billion of American exports to China. On June 28th and 29th, President Trump and Chinese President Xi Jinping met at the G-20 summit in Osaka Japan. They agreed to restart trade talks, and the U.S. changed its stance on Huawei, allowing U.S. tech companies to resume sales to the Chinese telecom giant. However, Mr. Trump has vowed to slap tariffs on the remaining $300M of Chinese imports if negotiations stall. We continue to view a protracted trade war as the greatest threat to the current economic expansion.

- The yield curve is currently inverted. The yield on the ten-year treasury is 2.00%, below the three and six-month T-bill yields of 2.12% and 2.11%. An inverted yield curve can be a recessionary signal, and bears believe that the low ten-year rate presages an economic slowdown related to the trade war. A more bullish interpretation is that the 10-year yield is low because of purchases by foreigners seeking yield. A 2.0% interest rate is attractive compared to the negative rates available in the Eurozone and Japan.

- The Fed voted to keep the federal funds rate in a range of 2.25%-2.50% at its June meeting. The post-meeting statement removed language from prior statements suggesting that the Fed would take a “patient” approach to interest rate adjustments. Based on this language change, the futures market is now pricing in a 100% chance of a July rate cut. The Fed’s preferred measure of inflation (Core PCE) is currently at 1.6%. We believe the Fed would contemplate a rate cut as long as Core PCE inflation is less than its 2.0% target.