1Q17 Economic Summary

The post-election optimism that took hold of markets at the end of last year continued through most of the first quarter of 2017. While the ascent in equities was pretty one directional, bond markets were a bit more volatile. Short-end rates rose, but longer-term rates ended the quarter about where they started as US economic data came in softer than expected. In addition, as political reality set in, expectations for the timing of fiscal stimulus were pushed back, thus taking some of the pressure off the long-end of the curve.

President Trump hit the ground running after his inauguration, signing numerous executive actions during his initial days in office. However, when it came to repealing and replacing the Affordable Care Act, the President learned that it's much easier to wield a pen than it is to spur Congress into action. The House of Representatives pulled their vote on a revised healthcare plan after Republicans were unable to garner enough support within their own party to get a bill passed. While healthcare reform was not a major focus for financial markets, the political failure raised concerns about the Trump administration's ability to bring Republican leaders together on key pro-growth legislation. If the President is unable to make progress on getting his tax reform and infrastructure spending plans through both houses of Congress, market euphoria is likely to fade.

While the President was learning to navigate the Congressional waters, the US economy hit a bit of a soft patch. Labor market data was somewhat mixed during the quarter. The non-farm payroll report showed that after solid job gains in January and February, hiring dropped off in March. While some of the slowdown was weather related, there was a noticeable pullback in service sector jobs. Despite the reported decline in hiring, other employment measures remained strong. The unemployment rate dropped to 4.5% in March, labor force participation remained steady, and wages continued to tick up. Favorable labor market conditions combined with rising stock prices contributed to a surge in consumer confidence during the quarter. Unfortunately, this optimism did not translate into stronger consumption. Business sentiment was also on the rise, but the corresponding uptick in investment has been slow to emerge. Housing demand remained strong during the quarter in spite of rising home prices and higher mortgage costs. However, a scarcity of existing home inventory continues to limit the sector's growth potential. Overall, lackluster first quarter growth is nothing new for the US. It has been a trend for the last few years, so hopefully we will see the economy pick up steam in the second quarter.

Given the somewhat tepid first quarter data, most economists believed that the Federal Reserve would remain on the sidelines until mid-year. However, hawkish comments from a bevy of Fed officials in the two weeks leading up to the March meeting dispelled that notion and put a rate hike firmly on the table. By the time the Fed raised rates by 25 basis points on March 15th, the move was fully priced in and markets took the hike in stride. While acknowledging the slower pace of first quarter growth, the Fed cited strong labor market conditions and an increase in inflation as reasons for the hike. Committee members also stated that global economic risks had diminished. The Fed left their 2017-2019 median forecast for interest rates unchanged, indicating that they still expect to raise rates just two more times this year. Investors were wary that the Committee's forecast would signal a more hawkish tone, so when the Fed reconfirmed their expectations for only a gradual removal of accommodation, fixed income markets rallied.

Focus now turns to the second quarter. While most expect a rebound in growth, consumers will need to start putting their newfound confidence into action in order to kick start the economy into high gear. Post-election euphoria is not lost yet, but enthusiasm will begin to wane if no definitive policy actions are taken. Clarity is needed because nothing kills confidence quicker than uncertainty.