4Q16 Economic Summary

The US presidential election took center stage during the quarter. With polls unanimously pointing to a decisive Clinton victory, the US had a very Brexitesque moment when Donald Trump was named the 45th President of the United States. Even more surprising than the election result was the market reaction to Trump's victory. Equity markets initially plummeted on the news, and Treasuries rallied overnight. However, as investors began to analyze the implications of a Trump victory combined with a Republican-controlled Congress, markets quickly reversed course. Focus shifted to the potential acceleration in growth from Trump's infrastructure spending and lower tax agenda. Equity markets surged to all-time highs, and Treasury yields backed up sharply in anticipation of higher inflation.

While markets were digesting the impact of Trumponomics, the US economy continued to chug along. Labor market conditions remained favorable, as the US added an average of 163,000 jobs per month during the fourth quarter, and the unemployment rate ended the year at 4.7%. With the country close to full employment, employers had to start paying up to retain workers. In December, average hourly earnings jumped 2.9% from the prior year, marking the largest increase in wages since June 2009. Higher paychecks resulted in a boost in consumer spending in December, particularly on big ticket items like autos. Home sales also increased as buyers scrambled to lock in low mortgage rates prior to an anticipated rise in borrowing costs. Business investment remained soft but picked up toward the end of the year as sentiment improved and companies began to prepare for an increase in consumer demand. Overall, 2016 turned out to be a decent year for the US economy, but optimism is high that Trump's proposed spending, tax, and regulatory policies will result in stronger growth going forward.

While enthusiasm over Trump's expansionary fiscal policies have increased growth expectations for the US, concerns over an expected rise in protectionism have hampered the outlook for global growth. Talk of import tariffs and abandoning or restructuring free trade agreements drove foreign currencies down during the quarter, particularly in emerging markets. While an increase in protectionist trade policies could further stunt already lackluster growth abroad, there is hope that the talk is more bark than bite, and that the rest of the world will also benefit from a resurgence in US economic growth.

After the election, fed funds futures began pricing in a 100% chance of a rate hike by year-end, so the Fed's decision to raise rates by 25 basis points at the December meeting came as no surprise to investors. The primary uncertainty heading into the meeting was how the potential for fiscal stimulus would affect the Fed's projections for rate hikes in 2017. Committee members acknowledged that uncertainty regarding fiscal and other economic policies had increased, but agreed that it was too early to tell how policy changes would alter the economic outlook. They did, however, boost the median forecast for hikes in 2017-2019 by a quarter of a point each year. The Committee felt that a slightly firmer path for rates was appropriate given the continued improvement in labor market conditions and increased confidence that inflation was moving toward their 2% objective. They reiterated that monetary policy remains data dependent and will adjust to the evolving outlook for the US economy.

While the Fed is taking a wait-and-see approach to Trump's fiscal proposals, enthusiasm over the pro-growth agenda has awakened the animal spirits in consumers and businesses alike. Only time will tell what parts of the President's agenda will make it through the legislative process, but optimism is high that the US is on the right track for many years of strong growth. Hopefully the US economy will give us lots of good things to tweet about in 2017.