2Q18 Economic Summary

Volatility continued in the second quarter of 2018. Markets fluctuated as enthusiasm over solid US economic data was offset by rising tensions over trade policy. Treasury yields backed up during the first part of the quarter, with the 10-year Treasury topping 3% for the first time since 2014. However, as tariff tiffs escalated and various geopolitical developments spooked markets, the safe-haven trade came back in favor and tempered the rise in Treasury yields by quarter-end.

After a slow start to the year, it appears that US economic growth rebounded during the second quarter. While trade war rhetoric had markets on edge, thus far there is little, if any, evidence of tariff-related weakness in the economy. Labor market conditions remained favorable as job gains averaged 211,000 per month during the quarter. After falling to an 18-year low of 3.8% in May, the unemployment rate rose to 4.0% in June as the strong job market lured more workers off the sidelines and into the labor force. Although job vacancies exceeded the number of unemployed during the quarter, wage pressures remained muted. While wages are not accelerating at the pace expected given the tight labor market, they are still increasing and consumers are spending their higher after-tax incomes. Personal consumption, which hit a lull at the start of the year, picked up in the second quarter as consumers spent their hard-earned cash on goods and services. Business investment also accelerated during the quarter thanks to higher profits and lower corporate taxes. Housing demand remained solid, but tight inventory levels and elevated asking prices continued to limit the sector's contribution to growth. Overall, it appears that the first quarter slowdown is behind us, and the US economy is on track to report robust second quarter GDP growth.

While the US economic expansion picked up steam, global growth remained lackluster. GDP growth in the Eurozone is expected to have increased marginally in the second quarter, with inflation moving closer to the European Central Bank's (ECB) 2% objective. At its June policy meeting, the ECB announced it would end quantitative easing in December 2018, but rates were forecasted to remain unchanged at least through the summer of 2019 as Mario Draghi acknowledged that the first quarter soft patch in growth may last longer than expected. Japan is also expected to see a moderate pickup in growth after experiencing a contraction during the first quarter. At its June policy meeting, the Bank of Japan opted to leave interest rates and its asset purchase program unchanged as it remains cautious about the country's modest growth and stubbornly low inflation levels. China's GDP growth is expected to have moderated in the second quarter due to slowing credit expansion and weaker domestic demand. The slowdown comes at a time when the tit-for-tat tariff spat with the US is escalating, which could harm China's export machine and put further pressure on the world's second largest economy.

As expected, the Federal Reserve raised rates by 25 basis points at the June 13 FOMC meeting, resulting in a target range for the fed funds rate of 1.75%-2.00%. The dot-plot projections revealed that the Fed expects to hike rates two more times this year, boosting the total number of expected hikes in 2018 from three to four. At the post-meeting press conference, Chairman Powell acknowledged that the US economy is in good shape. Growth and labor markets are strong, and inflation is close to target. While uncertainty surrounding trade policy was discussed as a potential risk to growth, Powell said that economic data showed no evidence that fears of a trade war are damping activity. In discussing the future course of monetary policy, Committee members agreed that "with the economy already very strong and inflation expected to run at 2% on a sustained basis over the medium term" it would likely be appropriate to continue gradually raising rates. Officials said that if the current course continues, the fed funds rate could be above what they consider "neutral" by next year. In light of this expectation, Committee members approved the removal of forward guidance which stated that the fed funds rate would likely remain "below levels that are expected to prevail in the longer run." One other surprise to come out of the June meeting was that the Fed will begin holding press conferences after every meeting starting in January 2019. Currently press conferences are held after every other meeting. Although the Fed has stated that every meeting is live, market consensus is that they will only raise rates at meetings which are followed by a press conference. Scheduling press conferences after every meeting, therefore, gives the Fed a little more optionality on the timing of rate hikes. Committee members did a good job telegraphing their more hawkish lean prior to the meeting, so markets took the shift in forecast and guidance in stride. Markets are currently pricing in that the next 25 basis point hike will come at the September meeting.

All said, it appears that the US economy is on target for continued strong growth in the second half of the year. The primary wildcard is trade policy. Thus far, the robust US economy appears impervious to the tariff spat. However, if trade tensions continue to escalate and unsettle the global economy, sentiment and spending in the US could falter.