3Q18 Economic Summary

While US economic data continued to exceed expectations during the third quarter of 2018, trade policy and political discord remained at the forefront of the news cycle. Markets bounced around as investors vacillated between concern over trade tensions and jubilance over robust US economic growth. By the end of September, economic enthusiasm won out. The stock market ended the quarter near record highs, and Treasury yields were up across the curve.

After a booming 4.2% second quarter GDP print, the positive economic momentum continued into the third quarter. Labor market conditions remained firm with job gains averaging 190,000 per month during the quarter. The unemployment rate dropped to a 48-year low of 3.7% in September as hiring outpaced labor-force growth. Job openings are at a record high as employers are finding it harder and harder to fill open positions. In fact, there are currently more job openings than there are unemployed Americans. Competition for workers pushed wages up during the quarter. Higher incomes fueled consumer confidence, which jumped to an 18-year high in September. As confidence increased, so did consumers' appetites to spend. Personal consumption was solid during the quarter as Americans purchased a range of products, including clothing, autos, electronics, furniture and appliances. Business investment was also up during the quarter as higher profits and lower corporate taxes gave companies confidence to invest for the future. The uptick in business and consumer spending was evident in the continued expansion in the manufacturing and services sectors, both of which appear to be shrugging off tariff skirmishes. The one area not quite firing on all cylinders is the housing market. Despite solid demand, residential investment has been hampered by low inventory levels, escalated asking prices, and rising borrowing costs, all of which are limiting the sector's contribution to growth. Inflation picked up during the quarter but remains well contained, hovering around the Fed's 2% target. Fed officials have said they are comfortable with annual inflation exceeding their target a bit because inflation has been below target for so long. Overall, it appears that it was another strong quarter for the US economy, and indications are that the expansion will continue into the fourth quarter.

While the US economy continued to hum along, global growth remained subdued during the third quarter. The International Monetary Fund (IMF) recently cut its global growth forecast, citing escalating trade tensions between the US and its trading partners. Thus far there has been little evidence that trade policy has impacted the US expansion, but other countries are showing signs that trade disruptions are starting to take a toll. Emerging market economies saw the largest downward revisions in their growth forecasts from the IMF, particularly Argentina, Brazil, Mexico, Iran and Turkey. The IMF said these economies were showing "signs of lower investment and manufacturing, coupled with weaker trade growth."

Although trade tensions between the US and China continued to escalate, some advances were made on the trade front during the quarter. In July, the US and the European Commission agreed to work toward the elimination of tariffs and subsidies that hamper trade. At the end of September, the US, Mexico and Canada agreed to a revamped NAFTA agreement, and the US and Japan agreed to start new trade talks. Markets were encouraged by these developments but remained frustrated by the lack of progress with China.

Even though trade has been a primary focus for markets, the ongoing rancor has not swayed the Fed's quest to normalize monetary policy. As expected, the Fed raised rates by 25 basis points to a new target range of 2.00-2.25% at the September FOMC meeting. The dot plot forecast continued to show one more hike this year and three hikes in 2019. The FOMC statement was little changed with one exception. The Fed removed the language in the statement describing the stance of monetary policy as "accommodative." Although the FOMC had already broadcast that the change in language was coming, the market took the removal of "accommodative" as a dovish signal. Chairman Powell tried to dispel this notion at the post-meeting press conference, stating "This change does not signal any change in the likely path of policy. We still expect, as our statement says, further gradual increases in the target range for the fed funds rate."

Overall, it appears that the US economy has the stamina to keep the nearly decade-old expansion going. The labor market remains strong, consumption is solid, and inflation remains in check. For now, trade remains the primary wildcard. Although the realignment of trade policy has had minimal impact on the US thus far, markets do not like the uncertainty, and volatility is likely to increase with each new salvo thrown. However, we expect the Fed to continue to take a wait and see approach in evaluating the impact of trade disputes. Barring any spillover to US economic data, the Fed is likely to continue to gradually remove accommodation.