1Q19 Economic Summary

After a tumultuous end to the year, financial markets recovered nicely during the first quarter of 2019. Although many of the headwinds that plagued investor sentiment in the fourth quarter remained – including no trade deal with China, no resolution on Brexit and a continued slowdown in global growth – markets took solace in the Fed's decision to take a pause in policy firming as they assess how these headwinds are impacting the US economy. Equity markets rebounded and Treasuries continued to rally as investors adjusted their outlooks to reflect a Fed on hold.

Lending credence to the Fed's decision to take a pause, US economic data came in somewhat mixed during the first quarter. Consumers cut back on spending at the start of the year as the lingering impact of the government shutdown and the year-end equity market sell-off weighed on consumer sentiment. By the end of the quarter, however, retail sales had bounced back as these transitory factors abated. Businesses were also feeling a bit of the blues as weaker global demand weighed on corporate America and resulted in a pullback in fixed investment. The pace of expansion in US manufacturing and services also slowed during the quarter. Even the labor market showed a blip of weakness in February when non-farm payrolls rose only 33,000 for the month. However, this stall proved to be an anomaly as both January and March payrolls came in higher than expected. Overall, the labor market remained the stalwart for the US economic expansion as job gains averaged 180,000 per month during the quarter, and the unemployment rate continued to hover around a five-decade low at 3.8%. The housing sector also proved to be a bright spot for the economy. Home sales rebounded from last year's slump as improvements in housing affordability, including a drop in mortgage rates and slower home price appreciation, brought more buyers to the market. Overall, it appears that US economic growth got off to a slow start in 2019. However, first quarter soft patches have been the norm over the past few years. The recovery in equity markets combined with ongoing wage growth should reenergize consumer confidence and be supportive of a pick-up in economic activity in the second quarter.

The US was not alone in battling slower first quarter growth. The IMF recently downgraded its global growth forecast for 2019 citing a convergence of factors that affected major economies in the latter half of last year and that will continue to impact growth through the first half of 2019. These factors include ongoing US-China trade tensions, China's effort to reign in shadow banking, weakened consumer and business confidence in Europe, disruptions in the German auto sector, Brexit uncertainty and tightening financial conditions in emerging markets. To combat weaker growth, central banks across the globe have shifted to a more accommodative stance, and some governments have instituted fiscal stimulus. While the results of these policy responses may take some time to materialize, the IMF predicts that global growth will eventually pick up in the second half of the year.

The US Federal Reserve certainly did its part to help ease financial conditions. After raising rates in December and forecasting two additional hikes in 2019, the Fed did a full dovish U-turn during the first quarter. They began to lay the groundwork for the policy shift at the January meeting when they removed language referencing further rate hikes from the FOMC statement. Instead the statement read "In light of global economic and financial developments and muted inflation pressures, the Committee will be patient as it determines what future adjustments to the target range for the fed funds rate may be appropriate." January's dovish pivot turned into a full dovish about face in March. As expected, the Fed left rates unchanged at the March FOMC meeting, but the big surprise was the shift in the dot plot forecast. The Fed's median estimate for rate hikes in 2019 dropped from two to none. They are now forecasting just one hike to occur next year and none in 2021. The Fed also announced new guidance on balance sheet reduction. They plan to taper the runoff of Treasuries beginning in May and will completely end the reduction in September, which was earlier than consensus estimates of year-end. At the post-meeting press conference, Chairman Powell said that the economy is "in a good place" and economic fundamentals are still very strong, but growth appears to be slowing due to trade disputes, economic slowdowns in Europe and China, and fading fiscal stimulus. As a result, the Fed lowered its GDP forecast to 2.1% for 2019, down from the 2.3% it forecast in December. Powell went on to say that the data are not currently sending a signal that the Fed needs to move in one direction or another. "It may be some time before the outlook for jobs and inflation call clearly for a change in policy."

While the Fed reiterated its pledge to remain patient and assess the data, the dovish surprise in the dot plot pushed Treasury yields lower as markets began to price in not just a Fed on hold but one prepping for an ease. Fed members came out in force to reign in investor expectations. They reiterated that despite the slowdown, economic fundamentals remain sound, and that it was premature to contemplate a rate cut. The minutes to the March meeting went on to show that while a majority of participants expected to leave rates unchanged for the remainder of the year, some left room for the possibility of a rate hike before year-end if economic conditions improve.

Time will tell if the first quarter slowdown in growth was just a speed bump or a harbinger of economic woes to come. Until employment and inflation data point definitively in either direction, expect the Fed to remain on the sidelines.

Any opinions herein, including forecasts, reflect our judgment as of this date and are subject to change.

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