Economic highlights from the week ending on April 26, 2019

Today’s GDP report is a head-scratcher but does help to confirm our view that a near-term recession is unlikely. First quarter GDP grew at an annualized pace of 3.2%, well ahead of the 2.3% consensus estimate. Despite the government shutdown and ongoing global trade disputes, GDP growth accelerated in the first quarter from 2.2% in the fourth quarter. Net exports and state and local government spending advanced in the first quarter, while consumer spending and business investment moderated. Residential investment contracted in the quarter. The consensus estimate for current quarter GDP growth is 2.5%. Overall, the consensus view calls for GDP growth of about 2.4% this year versus 2.9% last year, which is consistent with modest economic growth.

Last week’s report on business inventories indicated inventories were up more than twice as much as sales on a year-over-year basis, which suggests the inventory build that contributed to first quarter GDP growth may be unfavorable unless demand accelerates. In our view, the consumer remains in good shape given the strength of the labor market and there is reason to believe that consumer spending could firm in the current quarter. Notably, last week’s retail sales report was much stronger than expected, with sales up 1.6% in March following a decline of 0.2% in February. Though higher energy prices contributed to the gain, retail sales excluding autos and gas were also much stronger than expected, up 0.9% in March following a 0.7% decline in February. Furthermore, consumer sentiment ticked higher in the latest survey, which points to healthy consumer spending trends in the current quarter.

Today’s remarkably better than expected GDP report follows a string of other better than expected economic data. Most notably, first quarter corporate earnings have largely surprised to the upside. So far, nearly half of the companies in the S&P 500 have reported first quarter results. More than half of those have posted better than expected sales and nearly 80% have reported better than expected earnings. What’s more, both aggregate sales and earnings are trending up slightly year-over-year, despite fears of an “earnings recession” in the quarter. Thus far, 70% of the companies that have reported first quarter results have posted year-over-year earnings growth.

Despite a string of reassuring economic data in past few weeks, the market-implied probability of a fed funds rate cut by year-end (based on fed funds futures prices) is more than 60%. The market-implied probability of a rate cut by January 2020 is more than 70%. In our view, the hurdle rate for either a rate cut or a rate hike by year-end is high. Fed policymakers have signaled a willingness to allow inflation to run above-target before another rate hike would be necessary, and we believe domestic economic data would have to weaken significantly to prompt a rate cut. Although energy prices are up meaningfully year-to-date, oil prices are still lower year-over-year, and inflationary
pressures in general remain modest. We believe the Fed is likely to remain on the
sidelines at least until the end of this year. The Federal Open Market Committee is
scheduled to meet next week, and we expect monetary policy to remain unchanged.
There will be a press conference next week but no update to the Fed’s summary of
economic projections.

Next Week

Personal Income & Outlays, S&P Case-Shiller HPI, Consumer
Confidence, Pending Home Sales, ISM Manufacturing, Construction
Spending, FOMC Meeting, Productivity & Costs, Factory Orders,
International Trade, ISM Non-Manufacturing, Employment