Louisiana Corporate Credit Union

ECONOMIC & FINANCIAL DIGEST

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Election Ends; Uncertainty Continues

With the elections behind us, the ex ante uncertainty (who will win) has been resolved. Now, the ex post uncertainty (what will the President-elect do) takes center stage. The first phase towards resolution will unfold over the next several weeks, as Mr. Trump fills out key cabinet positions and other important slots in his administration. That will give us a sense of the direction the new administration will take towards fiscal policy, foreign affairs, environmental matters and other important areas of governance that will evolve over the next four years. The next phase will transpire when the President-elect fleshes out his policy ideas with specific details. During the campaign, Trump the candidate made some extravagant promises to voters, including building a wall, repeal Obamacare, overhaul the tax code, rollback regulations, rebuild the nation's infrastructure, rip up trade pacts and restrict immigration. Trump the president now has to govern, which means that he has to translate these promises into policies that are palatable to Congress and the public without comprising his vision.

In the immediate aftermath of the election, the financial markets turned buoyant, which was as surprising as the election outcome itself. Clinton was a known quantity, whereas Trump was considered to be a disruptive force. Investors and traders tend to react adversely to the unfamiliar, shunning risky assets like stocks and bidding up safe havens, such as Treasury securities. But over the first two post-election weeks just the opposite occurred; stock prices soared to new records and bond yields spiked to the highest levels in over a year.

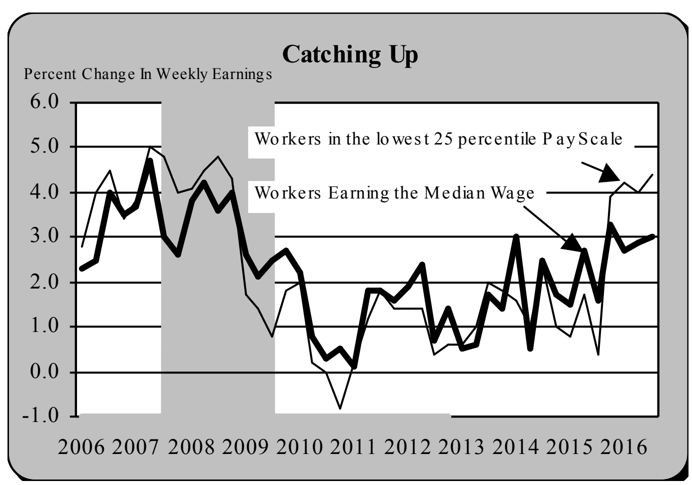
That said, the immediate reaction of the financial markets, while unexpected, is not illogical. Trump's election along with a Republican majority in Congress enhances the likelihood that a bigger dose of fiscal stimulus will be passed on Capitol Hill than otherwise, providing a jolt to economic growth. That's good for company sales and earnings, providing support for the stock market. It also increases the prospect of more inflation, a time-honored recipe for higher long-term interest rates. To be sure, there is many a slip between the cup and the lip; the President-elect may well modify his proposals on a number of issues and Congress will have a say on some of his budget-busting measures. The first 100 days in office will be an exceptionally interesting time for economists to decipher.

Signs of Strength

Even before the elections, the economy was showing signs of renewed vigor. On October 29, the government issued its GDP report, the broadest gauge of economic activity, for the third quarter. Some acceleration from the tepid 1.2 percent growth rate over the first half of the year was expected, but the surge to a 2.9 percent pace during the July-September period exceeded most optimistic forecasts. Still this surprising performance was not without its skeptics. Many scoffed that the growth surge had skimpy underpinnings, powered by a temporary burst of soybean exports made possible by a poor soy harvest in Brazil and Argentina. Indeed, growth in consumer spending – the economy's main growth driver – actually slowed to a 2.1 percent pace from 4.3 percent in the second quarter. Before the ink was dry on the report, economists widely agreed that growth would slow again in the fourth quarter, reverting back to the lackluster 2 percent average pace seen since the end of the Great Recession.

But that pessimism is defied by incoming data. Instead of retreating, the economy took a full step forward to start the fourth quarter. Most important, consumers opened their wallets and purses in October, providing retail firms with a surprisingly strong month of sales. As a result, retailers are gearing up much earlier than usual for the upcoming holiday season, scurrying to fill positions amid a tighter labor market. That is having a long-delayed positive impact for lower-paid workers.

For example, the Labor Department reported that full-time workers in the lowest 25th percentile of the wage scale – averaging $546 a week – saw their weekly earnings increase by 4.4 percent in the third quarter from a year earlier. That's the largest increase in eight years. In contrast, workers in the middle of the pay scale – averaging $827 a week – received a slimmer 3 percent pay raise over the same period. With the ever-shrinking influence of unions,



a tightening labor market is the strongest ally for lower-paid workers. Nonetheless, both the percentage and dollar gap between the lowest and median-wage earner remains notably higher than at the start of the recovery, so there is still much catching up to do.

Strong Finish

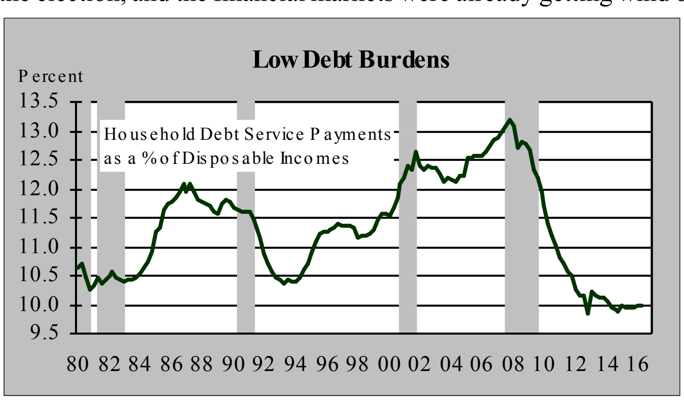
With the strong showing in October, consumer spending is poised to rebound from the tepid growth rate in the third quarter. Indeed, the October spending strength is all the more impressive given the high degree of anxiety generated by the bitterly fought presidential campaign. Now that this source of stress is behind us, there is no compelling reason to think that consumers will go into hibernation. Jobs are still being created at a plentiful clip, spurring faster wage growth, and household balance sheets are getting a boost from appreciating property and stock prices. Personal consumption expenditures may not rebound all the way back to the 4.3 percent growth rate of the second quarter, but something closer to 3 percent looks to be a reasonable prospect at this juncture.

If that's the case, the economy's performance in the fourth quarter may come close to, if not surpass, that of the third. Indeed, economists have been marking up their growth outlook for the period, a far cry from their downbeat assessment prior to the election. The Federal Reserve Bank of Atlanta's GDPNow forecasting model, which is continuously updated following key data releases during the course of the quarter, revised up its fourth-quarter growth projection to 3.6 percent on November 16 from 2.3 percent at the start of the month. The strong retail sales report contributed to the upward revision. But consumers are not the only part of the economy showing vigor.

After dragging down growth during the second and third quarters, the housing recovery that began in 2011 is getting a second wind. Responding to lean inventories, strong sales and rising home prices, homebuilders cranked up construction activity in October. Housing starts surged to the highest level in nearly a decade and building permits for future construction continued to expand. The recent spike in bond yields is pushing up mortgage rates, which may drive some prospective homebuyers to the sidelines. But even with the backup, mortgage rates remain near historic lows. What's more, the incomes generated by the improving job market should provide households with the wherewithal to handle higher debt-servicing charges. As it is, the debt-servicing burden of households continues to hover near all-time lows.

Are Markets Overreacting?

To be sure, all this positive momentum got underway before the election, and the financial markets were already getting wind of it. By late October, bond yields had increased by about half-percent from their mid-year lows, and the dollar was up by over 5 percent. But in the three weeks following the election, these trends escalated dramatically; bond yields surged by another half-percent, the dollar spiked to a 13-year high and the S&P 500 stock index hit an all-time record on November 21 for the third consecutive day. Clearly, the financial markets are pricing in much stronger growth and inflation prospects than was the case prior to the election.



While there may be some justification for that more upbeat sentiment, it is just as likely that the markets are overreacting to the election results. No doubt, the door is open for more fiscal stimulus, something that has been missing from the economy's growth engine since Congress enacted the 2011 Budget Control Act. Keep in mind though that the stimulus, even if implemented quickly after the inauguration, would not have a meaningful impact on the economy until late in 2017. Meanwhile, the tightening of financial conditions that has already taken place could put a near-term dent on growth. Not only will higher interest rates discourage some borrowing, the dollar's strength puts another weight on the manufacturing sector, which already faces weak global demand for its products. A stronger dollar makes goods more expensive on the global market, further undercutting foreign sales.

Keep in mind also that Trump the candidate strongly espoused several growth-dampening proposals during the campaign. While some of them would require congressional approval, others could be implemented quite soon. For example, President Trump would have the executive power to pull out of trade agreements and impose tariffs on our trading partners. Such protectionist measures would no doubt spark a tit-for-tat reaction, curbing exports as well as imports.

The Unknowns

There is a mountain of information about "Candidate" Trump, who has received more media exposure than any presidential aspirant in modern times. But very little is known about President Trump, the political stance he will adopt and the specific policies that will be implemented. In the immediate post-election climate, the financial markets are thriving on expectations the economy will receive a positive jolt from lower taxes, increased infrastructure spending and reduced regulation, all major themes the president-elect espoused during the campaign.

In a certain world, that scenario would have a reasonably good chance of playing out. Traditionally, elections have reduced political and policy uncertainties. But in this case, an unusually elevated degree of uncertainty remains. How much of Trump's proposed tax and spending plan – which is estimated to balloon the public debt by more than $5 trillion over the next decade – will be accepted by Congress? While Republicans control the House and Senate as well as the White House, they are still the party of fiscal orthodoxy. Hence, the process of cobbling together a fiscal policy will involve some serious horse-trading on Capitol Hill early next year. If it turns into a headline-grabbing acrimonious debate, it could undercut household and business confidence and erase the goodwill now prevailing in the financial markets. The theatrics seen during the campaign may be the opening chapter of what's to come.

KEY ECONOMIC AND FINANCIAL INDICATORS

*FINANCIAL INDICATORS**

								12-Month Range	
	October	September	August	July	June	May	April	High	Low
Prime Rate	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.25
3-Month Treasury Bill Rate	0.33	0.29	0.30	0.30	0.27	0.27	0.23	0.33	0.02
5-Year Treasury Note Rate	1.27	1.18	1.13	1.07	1.17	1.30	1.26	1.70	1.07
10-Year Treasury Note Rate	1.76	1.63	1.56	1.50	1.64	1.81	1.81	2.26	1.50
30-Year Treasury Bond Rate	2.50	2.35	2.26	2.23	2.45	2.63	2.62	3.03	2.23
Tax-Exempt Bond Yield	3.27	2.93	2.85	2.83	3.20	3.29	3.30	3.68	2.83
Corporate Bond Yield (AAA)	2.56	2.48	2.34	2.30	2.43	2.51	2.43	2.82	2.30
Conventional 30-Year Mortgage Rate	3.47	3.46	3.44	3.44	3.57	3.60	3.61	3.96	3.44
Dow Jones Industrial average	18185	18267	18495	18341	17755	17692	17844	18495	16300
S&P 500 Index	2143	2158	2177	2149	2084	2067	2076	2177	1918
Dividend Yield (S&P)	2.17	2.12	2.11	2.11	2.17	2.16	2.18	2.31	2.11
P/E Ratio (S&P)	19.9	20.4	20.4	20.4	19.8	19.5	19.2	20.4	17.6
Dollar Exchange Rate (vs. Major Currencies)	91.9	90.1	89.8	90.9	89.7	89.8	89.4	95.3	89.4

** Monthly Averages*

ECONOMIC INDICATORS

								12-Month Range	
	October	September	August	July	June	May	April	High	Low
Housing Starts (In Thousands)	1323	1054	1164	1218	1195	1128	1155	1323	1054
New Home Sales (Thousands of Units)		593	575	629	579	566	570	629	478
New Home Prices (Thousands of Dollars)		314	294	296	322	296	321	322	291
Retail Sales (% Change Year Ago)	4.2	3.3	2.4	2.3	2.8	2.2	3.0	4.2	1.6
Industrial Production (% Change Year Ago)	-0.9	-1.0	-1.1	-0.8	-0.6	-1.3	-1.4	-0.5	-2.3
Operating Rate (% of Capacity)	75.4	75.4	75.6	75.7	75.4	75.1	75.2	76.3	74.9
Inventory Sales Ratio (Months)		1.39	1.39	1.39	1.39	1.40	1.40	1.41	1.38
Real Gross Domestic Product (Annual % Change)		2.9			1.4			2.9	0.8
Unemployment Rate (Percent)	4.9	5.0	4.9	4.9	4.9	4.7	5.0	5.0	4.7
Payroll Employment (Change in Thousands)	161	191	176	252	271	24	144	295	24
Hourly Earnings (% Change Year Ago)	2.8	2.7	2.5	2.7	2.6	2.5	2.5	2.8	2.3
Personal Income (% Change Year Ago)		3.2	3.1	3.2	3.1	3.1	3.4	4.0	3.1
Savings Rate (Percent of Disposable Income)		5.7	5.8	5.6	5.5	5.7	5.8	6.2	5.5
Consumer Credit (Change in Mil. Of Dollars)		19292	216751	17651.0	14413	22577	205291	216751	6561
Consumer Prices (% Change Year Ago)	1.6	1.5	1.1	0.8	1.0	1.0	1.1	1.6	0.2
CPI Less Food & Energy (% Change Year Ago)	2.1	2.2	2.3	2.2	2.3	2.2	2.1	2.3	1.9
Wholesale Prices (% Change Year Ago)	0.8	0.7	0.0	-0.2	0.3	-0.1	0.0	0.8	-1.6