PROSPECT BANK
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OUTLOOKS

April 2018

ECONOMIC OUTLOOK

Summary

The Federal Reserve raised the Fed Funds Rate last month by 0.25%, taking its targeted range to 1.50% to 1.75%. This was the sixth rate increase and the Fed indicated that two more hikes are likely this year, if the economy evolves as they expect. The cumulative impact of these higher short term interest rates and larger budget deficits are beginning to effect commercial paper borrowing rates for large corporations. The incremental borrowing costs for these firms has increased about 0.25% this year, over and above the 0.25% rate hike recently implemented by the Federal Reserve.

Higher relative credit costs were a little worrisome in Q1 2018 but haven't had a material impact on the economy so far. The final revision of Q4 2017 was raised to 2.9% from 2.7% and preliminary estimates for Q1 2018 have been steady at around 2.5%. This is significant because the last four years have witnessed about a 1.0% average Q1 run rate on GDP. So, no seasonal Q1 weakness this year, combined with a full employment economy and rising real incomes translates into a solid handoff for Q2 growth prospects.

One surprising statistic this year has been the increase in the savings rate despite higher disposable income from the recently passed tax cut legislation. Consumers spent and borrowed a lot money in the fourth quarter and it seems as if we may be experiencing a little payback for that boost in economic activity.

On the surface it may look like the consumer "saved the tax cut" but history suggests (2003) that after a temporary rise in the savings rate, consumer spending picks back up once their liquidity improves and some modest debt reduction takes place.

Positives

Initial jobless claims are the lowest in over 40 years

Industrial production increased 1.1% month-over-month, 0.4% expected

Capacity utilization increased to 78.1%, the highest since 2014

Negatives

Housing starts drop 7.0% month-over-month to 1.236 million units (annualized)

Consumer confidence drops to 127.7, 131 expected

Real personal spending is flat for the month and the prior month is revised to -0.2%