Comerica Economic Alert

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2017Q1 GDP, March Employment Cost Index

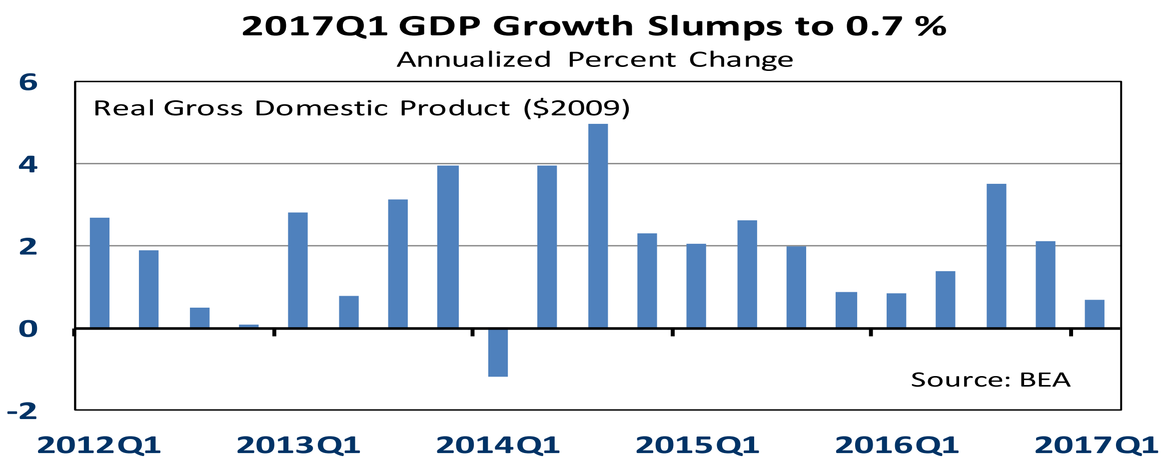
First Quarter GDP was Weak, as Expected. We Look for Stronger Growth Later….if…

- Real Gross Domestic Product for 2017Q1 increased at a weak 0.7 percent annualized rate.
- Worker Compensation increased by 0.8 percent in March as labor markets tightened.

The first estimate of first quarter 2017 real GDP came in about as expected, with a weak 0.7 percent annualized growth rate. Several factors were in play and not all of the results were bad. Personal consumption expenditures, the lion's share of GDP, increased at a very low 0.3 percent annualized rate. That kind of drag is hard for the other components of GDP to overcome. Consumer spending on durable goods declined at a 2.5 percent annualized rate, consistent with the drop in unit auto sales, from the robust average 18.1 million unit sales pace of the fourth quarter of last year, to an average 17.3 million unit rate for the first quarter of this year. Also, warmer-than-normal weather reduced the demand for home heating, and so consumer spending on services increased at only a 0.4 percent annualized rate in Q1. The good news in the GDP report came from business fixed investment which increased at a strong 9.4 percent annual rate, boosted by the ramp up in oil drilling activity. Residential fixed investment was also strong, increasing at a 13.7 percent annualized rate, with ongoing gains in the single-family housing market. Despite a negative read from the advance trade indicators, international trade was actually a small net positive for GDP in Q1. Inventories were weaker than expected, pulling 0.9 percent out of Q1 real GDP growth. Both federal and state/local government spending were also weak, declining in total at a 1.7 percent annualized rate. A soft Q1 was expected, and that's what we got. We continue to expect better performance for the current quarter and through the end of this year. However, there is a growing question mark over Washington D.C. We need to see some real progress on the Trump Administration's fiscal agenda in order to justify positive economic expectations for the second half of this year. The failure of meaningful tax reform and infrastructure initiatives could result in a negative and consequential reset of business and consumer expectations and confidence.

The Employment Cost index for March showed a 0.8 percent month-over-month increase in compensation for civilian workers. This was stronger than expected, and it continues an increasing trend visible since early 2013. Tight labor market conditions, evidence by the low 4.5 percent unemployment rate, are driving wages up. The Federal Reserve will factor this into their expectations for interest rate increases this year. We look for the Fed to keep the fed funds rate steady at their upcoming Federal Open Market Committee meeting next week, over May2/3. The odds of a June 14 interest rate hike are increasing. According to the fed funds futures market, the cumulative implied odds of a June 14 fed funds rate hike are now up to about 71 percent, which indicates a strong market expectation.

Market Reaction: Equity markets were mixed at the open. The 10-year Treasury bond yield is up to 2.29 percent. NYMEX crude oil is up to $49.52/barrel. Natural gas futures are up to $3.28/mmbtu.



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