# Macroeconomic Outlook

## Steady as She Goes

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A strong U.S. consumer combined with a wary Fed and global stimulus should support U.S. credit markets.

Slow and steady economic growth, a cautious Fed, low interest rates, and improving oil market supply-demand fundamentals have created a favorable environment for fixed-income markets. Gross domestic product (GDP) growth was soft at 1.2 percent in the second quarter, a slight improvement from the first quarter's 0.8 percent. But the headline figures belie underlying strength. Real consumer spending rose at a 4.2 percent annualized rate, the second-strongest quarter of the current expansion. The abrupt acceleration in consumer spending appears to have caught businesses by surprise, resulting in a sharp drawdown in inventories that subtracted 1.2 percentage points from GDP growth. Inventory restocking should support growth in coming quarters. Meanwhile, the United Kingdom's Brexit referendum is unlikely to have a meaningful impact on the U.S. economy, thanks in part to the decline in interest rates and recovery in risk assets that followed. We continue to expect above-trend GDP growth of around 3 percent in the third quarter.

Our confidence in the near-term growth outlook is underpinned by stable fundamentals in the consumer sector, notwithstanding weakness in July retail sales. Labor market gains have boosted real disposable personal income, which rose at a solid rate of 2.4 percent year over year in the second quarter. Payroll gains recovered strongly to an average of 274,000 in June and July, and wage growth is trending higher (see chart, top right). Meanwhile, household debt and debt service coverage ratios are well below pre-crisis peaks, and the personal saving rate of 5.3 percent is about 2 percentage points above what we would anticipate based on its historical relationship with household net worth. We expect these factors to cushion consumer spending from shocks to income or confidence.

Despite this relatively healthy economic backdrop, we expect the Fed to delay its next rate hike until December at the earliest out of an abundance of caution. In our view, policymakers will take time to gauge the implications of Brexit, and watch for signs of firmer growth and inflation. Meanwhile, the ECB and BOJ are likely to follow the Bank of England in increasing accommodation.

Monetary policy divergence is likely to benefit the U.S. dollar in the near term, which would pose headwinds for the recovery in crude oil prices. Our research team's oil price model calls for a period of seasonal weakness in the second half of 2016 before prices rise to $55 by mid-2017 (see chart, bottom right). We see further near-term oil price declines as an opportunity to add exposure to the energy sector.

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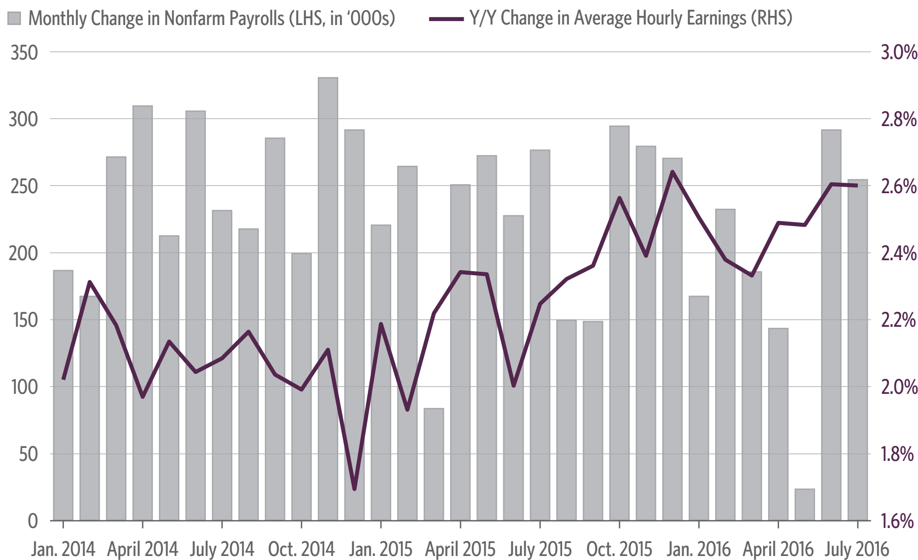
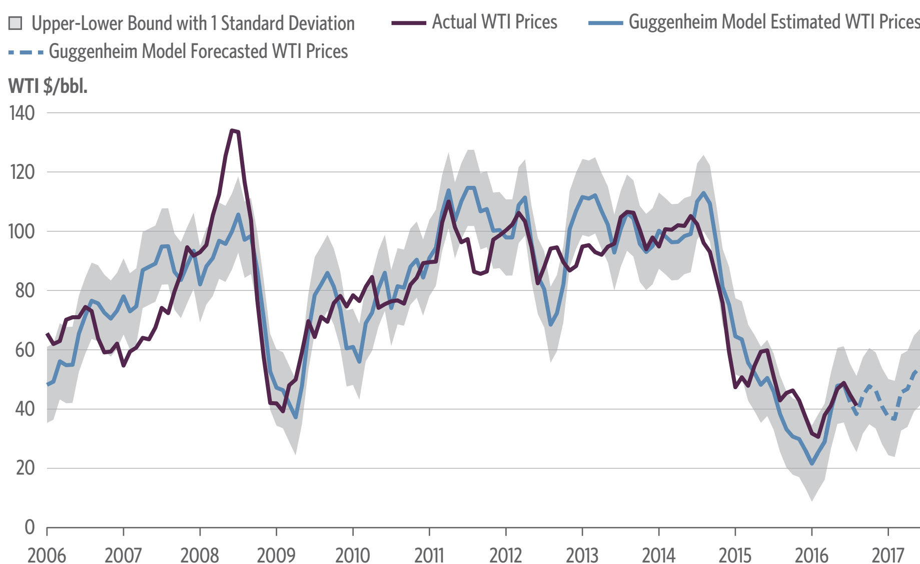
## Job Market Data Picked Up in the Second Quarter




Source: Department of Labor Statistics, Guggenheim Investments. Data as of 8.5.2016.

Solid fundamentals in the consumer sector underpin our confidence in the near-term growth outlook. Payroll gains recovered strongly to 292,000 in June and 255,000 in July, and wage growth is trending higher. Labor market gains have boosted real disposable personal income, which rose at a solid rate of 3.2 percent year over year in May despite a slowdown in hiring, and household debt and debt service coverage ratios are well below pre-crisis peaks.

## Supply-Demand Dynamics Favor Higher Oil Prices by Year End




Source: OECD, Guggenheim Investments. Data as of 6.30.2016.

Our research team's oil price model calls for a period of seasonal weakness in the second half of 2016 before prices rise to $55 by mid-2017, which should help to support credit markets into the third quarter and beyond.

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