

Macroeconomic Outlook

Expansion Continues Despite Weak Q1



Brian Smedley
Head of Macroeconomic and
Investment Research



Maria Giraldo, CFA
Vice President

U.S. economic growth was below trend in the first quarter, but early signs point to a rebound in the second quarter.

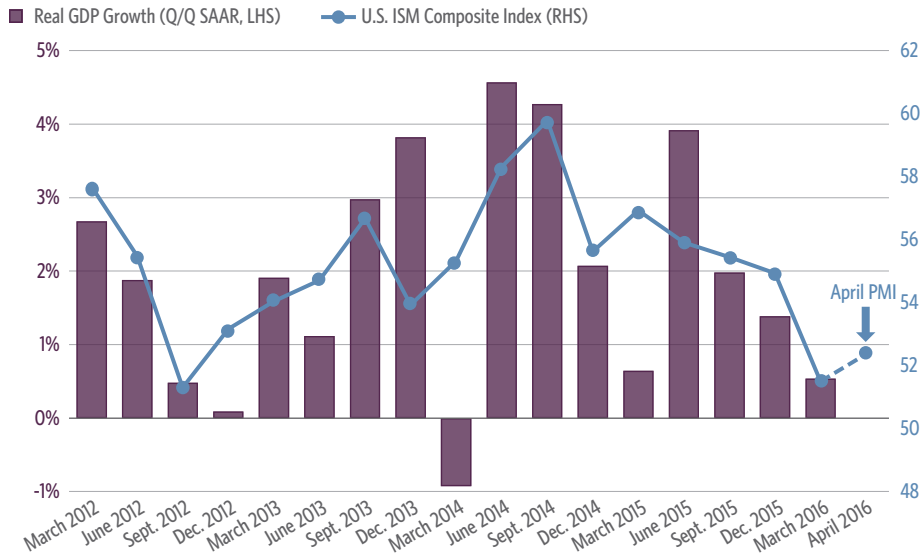
The initial estimate of real gross domestic product (GDP) growth in the first quarter was 0.5 percent, well below the average real GDP growth rate of 2.1 percent seen over the last five years. Net exports and an ongoing inventory adjustment shaved a combined 0.7 percent off growth, but we see the drag from these components as transitory. We also attribute part of the weakness to “residual seasonality,” a statistical quirk that biases GDP growth downward in the winter months while boosting growth in the second and third quarters.

We anticipate that growth will be closer to trend in Q2, thanks in part to the easing of financial conditions since February. High-frequency indicators of economic activity support our forecast, with the Markit U.S. Composite PMI recovering to 52.4 in April from 50.0 in February (see chart, top right). While payroll growth has downshifted from an average monthly rate of 282,000 in Q4 of 2015 to 200,000 in the three months through April, we see this as a more sustainable pace of net job creation. We forecast further slowdown in payroll growth over the next few months, with rising labor productivity bridging the gap between faster GDP growth and slower job gains.

We expect the Fed will raise rates once in 2016 as policymakers will be watching Chinese growth, the “Brexit” vote in June, and the U.S. presidential election in November. Fed officials have given greater weight to global economic developments in their policy framework, which in practice means that the FOMC has become less tolerant of financial market turbulence and more tolerant of inflation at the margin. We see this dovish shift as benefiting U.S. credit markets and inflation-sensitive assets, such as Treasury Inflation-Protected Securities (TIPS).

A more accommodative Fed outlook has pushed interest rates lower and weakened the U.S. dollar, which depreciated by 6.3 percent on a trade-weighted basis between mid-January and the end of April. Oil prices have benefited from dollar weakness. Our research team’s oil model indicates that WTI oil prices will average \$40-\$45 per barrel for the remainder of 2016 (see chart, bottom right). In sum, solid but unspectacular economic growth, a cautious Fed, and improving oil market supply-demand fundamentals underpin our positive outlook for the U.S. economy, which should continue to support a historically low default environment for credit.

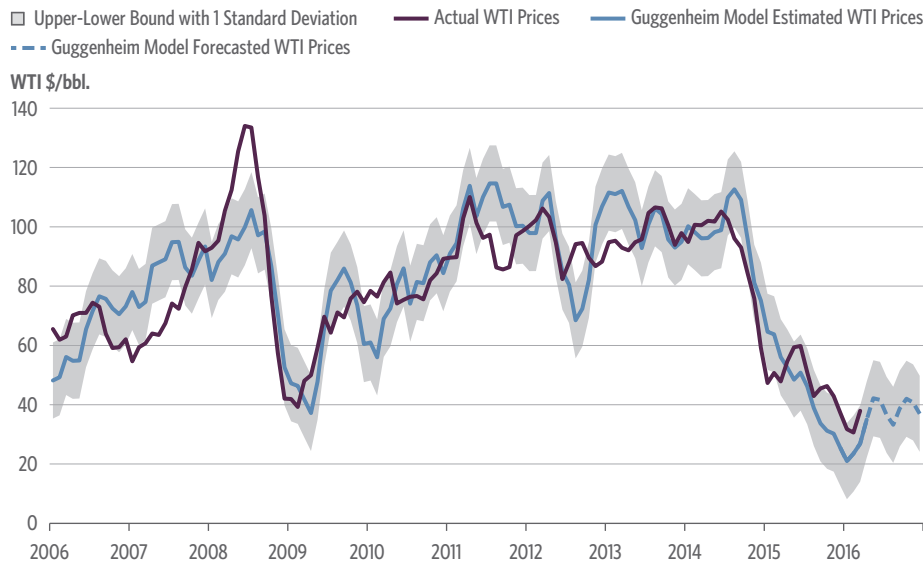
U.S. GDP Growth Is Gaining Momentum



Source: Guggenheim Investments, Bureau of Economic Analysis, Markit, Haver Analytics. Data as of 5.4.16.

We anticipate that growth will recover in the second quarter, thanks in part to the substantial easing of financial conditions since February. High-frequency indicators of economic activity support our forecast, with the Markit U.S. Composite PMI recovering to 52.4 in April from 50.0 in February.

Oil Prices Should Stabilize Later this Year



Source: Guggenheim Investments, Bloomberg, Haver, EIA. Data as of 3.31.2016.

Near-term price volatility is likely, and another negative shock is possible, but oil prices should start to stabilize as supply/demand comes into balance. Our model indicates that oil prices will average \$40-\$45 per barrel for the remainder of 2016.

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