Monthly Market Commentary

Recent economic news was mixed, with strong U.S. auto sales and decent employment growth, but also with negative first-quarter GDP growth. The European Central Bank made headlines by lowering its key interest rates and announcing measures designed to ensure price stability and to support lending.

GDP: The U.S. economy contracted in the first quarter, after all. As many economists anticipated, first-quarter GDP growth was reduced from a 0.1% growth to a 1.0% decline. Although many categories shifted, it was inventories that really moved the needle. However, inventories are notoriously volatile, especially difficult to measure and to seasonally adjust. Wide swings in the data more likely represent measurement errors and timing issues and not necessarily things happening in the real economy. Given the solid growth rates in employment and consumption, the first quarter would have shown some modest growth if it weren't for the inventory subtraction.

Employment: The economy added 217,000 total jobs in May compared with the 12-month average of 194,000 jobs. Private sector jobs grew about 2.05% year over year, and the nonfarm payrolls, which add government to the mix, grew 1.72%. Both of those numbers are consistent with GDP growth in the 2.0%–2.5% range.

Total employment finally made a new all-time high and recaptured every job lost during the recession. It only took just under six and a half years, the longest recapture period in the post-World War II era. And that politely ignores the fact that the population is quite a bit greater than it was over six years ago. The performance has been very uneven, too, with many, many industries still operating below peak levels.

European Central Bank: Sagging economic growth and falling inflation finally forced the ECB to take decisive action to head off a Japan-like bout of deflation. Myriad rates were cut, negative interest rates were implemented for bank reserves, and new low-cost lending programs were rolled out. By putting a negative rate on deposits, the central bank hopes to force banks to lend more cash, which might generate more economic activity. All of this should stimulate the European economy and depress the euro, which would aid European exports. Equity markets around the world reacted well to this news. In general, easy money policies tend to help emerging markets, and the potential for a stronger export market in Europe provided a double dose of good news.

Housing Prices: Home price growth generally peaked last October and November, with the broader FHFA index down quite significantly and the CoreLogic data showing almost no change. Home affordability has slipped, mostly because of higher prices, but also because of higher mortgage rates. Less affordability means fewer transactions and less housing-related economic activity. The economy needs to work out a balance, with some level of price appreciation that keeps both investors and consumers in the market, but without so much price appreciation that no one can afford a home.

Consumption and Personal Income: Consumption growth, adjusted for inflation, dropped 0.3% in April, which was below expectations and is quite disconcerting taken in isolation. Incomes continued their nice upward slope, which should provide fuel for consumer spending in the months ahead.

Trade Deficit: The news on the trade front was not good, although monthly data can be highly volatile. The trade deficit for April was $47.2 billion, its highest level in the past two years and higher than the upwardly revised $44.2 billion for March. The widening deficit was a combination of a 0.2% decline in exports and a 1.1% surge in imports. Unfortunately, this data indicates further downward potential in the first-quarter GDP estimate and even more pressure on the second-quarter report.