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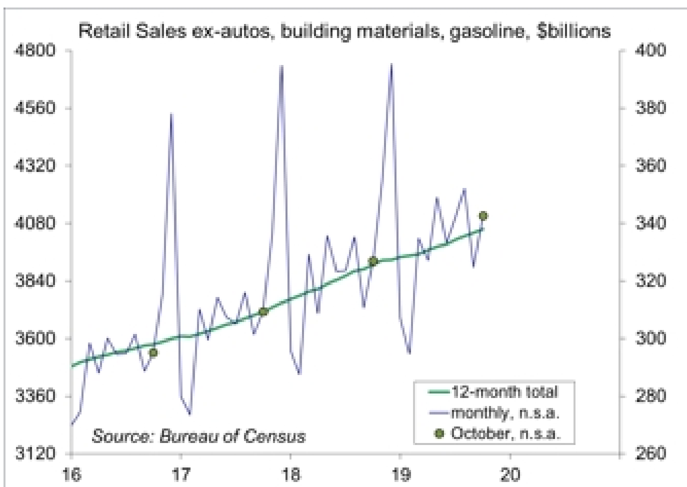
Weekly Economic Monitor -- A Downshift in Expectations for 4Q19

A Downshift in Expectations for 4Q19 – Focusing more on a possible mini trade deal with China, financial market participants have largely ignored the recent economic data reports. The figures suggest a softer growth trend in early 4Q19 and many economists have been lowering their GDP forecasts. Growth is often lumpy from quarter to quarter and the fundamentals imply a moderate economic expansion in 2020. However, as widely noted, recessions are often psychological in nature.

Core retail sales (which excluding motor vehicles, building materials, and gasoline) were reported to have risen by 0.2% in October, following no gain in September and a 0.2% rise in August. This softer trend (+0.4% over the last three months) follows strength in the spring and early summer. It's not unusual to see a few soft months following a few strong months. Although slower than in 2018, growth in nonfarm payroll has been moderately strong and wage growth has picked up. However, there is a wide range across the income scale. Those at the top are doing well and those at the bottom have seen the largest wage growth (granted, from a low base). However, there is anecdotal evidence of strain across the broad middle. More individuals are opting for longer loans when buying a new vehicle, while more are under water on their trade-in vehicle (that is, owing more than the car is worth)

Retail sales data are seasonally adjusted, but there is also likely some change underway in the seasonal pattern. Last year, holiday shopping had a lower peak in December, but a broader base for the fourth quarter (some sales apparently shifted into October). That could reflect the continued rise in online shopping and a softening in sales at brick and motor stores. Figures for the next few months could be distorted, but the trend retail sales is softer than expected into 4Q19.



Industrial production was weaker than expected in October, reflecting a drop in the output of utilities. As expected, the GM strike (now settled) had a further impact on manufacturing output. In addition, the Fed's gauge of oil and gas well drilling fell 5.1% (-15.4% in the last four months). Energy exploration is capital intensive and we should see a further negative contribution to business fixed investment in 4Q19.

Most economists forecast GDP growth by forecasting the components and adding them up. The Atlanta Fed's GDP Now model has lowered its estimate for 4Q19 to a 0.3% annual rate, mostly reflecting slower inventory growth and a wider trade deficit, but with a further decline in business structures (which includes energy exploration) and slower consumer spending growth. The New York Fed's Nowcast model is projecting a 0.4% annual rate. These models are more science than art. There is no room for subjectivity. The late Nobel Laureate Lawrence Klein applied what he called "TLC" (tender loving care) to his forecasts. Adding more variable gives you a better fit to the past, but may not help in forecasting.

At this point, we have a limited picture of the 4Q19 economy, but (at face value) the underlying trends in the GDP component data appear to be softer. A 4Q19 slowdown should be transitory, but there is a danger that negative expectations could build and become self-reinforcing. The Federal Reserve is poised to react if necessary. (M19-2827783)

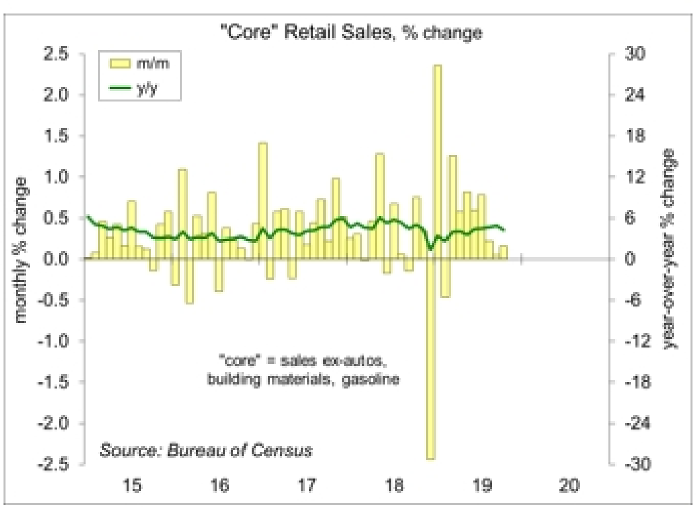
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
10/18/19	1.66	1.63	1.58	1.58	1.56	1.56	1.76	2.25	1.116	1.290	108.44	1.313	8089.54	2986.20	26770.20
11/08/19	1.55	1.58	1.58	1.68	1.70	1.74	1.94	2.43	1.102	1.279	109.14	1.322	8475.31	3093.08	27681.24
11/15/19	1.57	1.58	1.55	1.61	1.61	1.65	1.84	2.31	1.105	1.290	108.78	1.323	8531.65	3120.46	28004.89

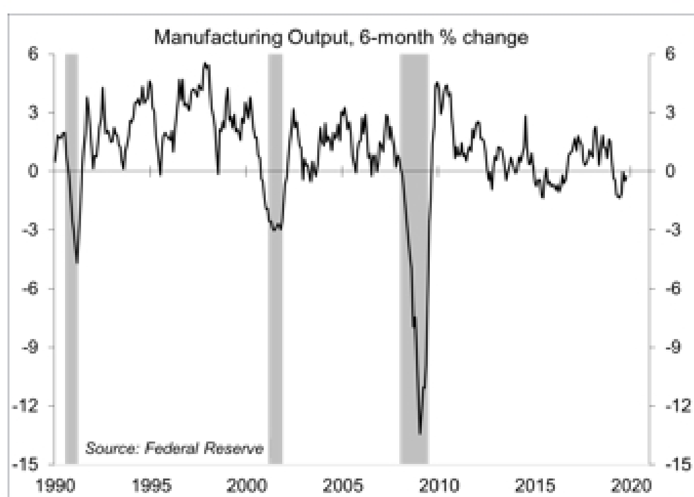
Data Recap – Fed Chair Powell repeated that the stance of monetary policy appears to be appropriate for now, while cautioning lawmakers about the federal budget deficit. As expected, seasonal adjustment amplified an increase in gasoline prices in both the CPI and PPI, but core inflation was moderate and pipeline inflation pressures continued to recede. Retail sales results for October were largely in line with expectations, but core sales for August and September were revised lower (implying a slower near-term trend in consumer spending growth). Industrial production fell further in October, reflecting the GM strike and a drop in the output of utilities (otherwise, the manufacturing output weakened modestly).

In his congressional testimony, **Fed Chair Powell** repeated that *"we see the current stance of monetary policy as likely to remain appropriate as long as incoming information about the economy remains broadly consistent with our outlook of moderate economic growth, a strong labor market, and inflation near our symmetric 2% objective."* Powell noted that *"in a downturn, it would also be important for fiscal policy to support the economy"* and *"the federal budget is on an unsustainable path."* This outlook *"could restrain fiscal policymakers' willingness or ability to support economic activity during a downturn" and "restrain private investment, reducing productivity and overall economic growth."*

The Fed's **Financial Stability Report** noted some vulnerabilities. Asset prices *"remain high in several markets relative to income streams."* However, *"risk appetite measures that account for the low level of long-term yields on U.S. Treasury securities are more aligned with historical norms for most markets."* Borrowing by businesses is *"historically high relative to GDP, with the most rapid increases in debt concentrated among the riskiest firms amid weak credit standards."* By contrast, *"household borrowing remains at a modest level relative to income, and the amount of debt owed by borrowers with credit scores below prime has remained flat."* The largest U.S. banks remain strongly capitalized, and the leverage of broker-dealers is at historically low levels. Estimates of the total amount of financial system liabilities that are most vulnerable to runs, including those issued by nonbanks, remain *"modest."* The report noted that *"stresses in Europe, such as those related to Brexit; stresses in emerging markets; and an unexpected and marked slowdown in U.S. economic growth are among the near-term risks that have the potential to interact with these vulnerabilities and pose risks to the financial system."*

Retail Sales rose 0.3% in the advance estimate for October, following a 0.3% decline in September (+3.1% y/y). Ex-autos, sales rose 0.2% (+2.8% y/y). Auto dealership sales rose 0.5% (+4.5% y/y), while unit motor vehicle sales were reported lower by the various automakers. Sales of building materials and garden supplies fell 0.5% (-2.0% y/y). Gasoline sales rose 1.1% (-5.0% y/y). Core sales, which exclude motor vehicles, building materials, and gasoline, rose 0.2%, with downward revisions to August and September – implying, all else equal, a slight downward revision to 3Q19 GDP growth and lower consumer spending growth expectations for 4Q19. Department store sales edged up 0.1% (-6.9% y/y), while non-store retail sales (including internet shopping) rose 0.9% (+14.3% y/y). Sales at restaurants and bars fell 0.3% (September revised higher, +4.7% y/y).

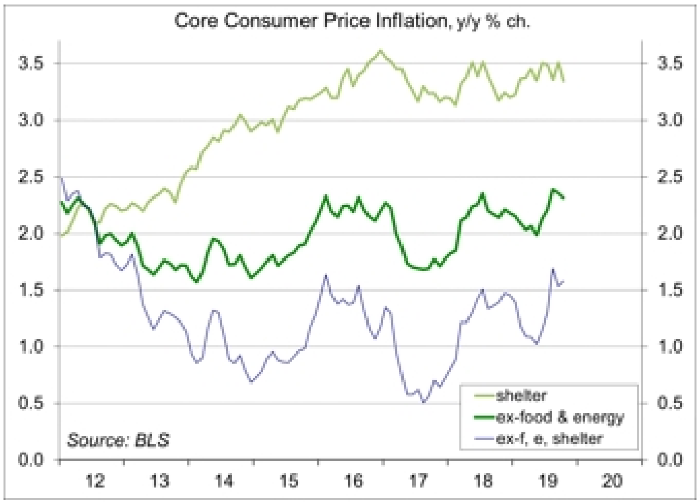


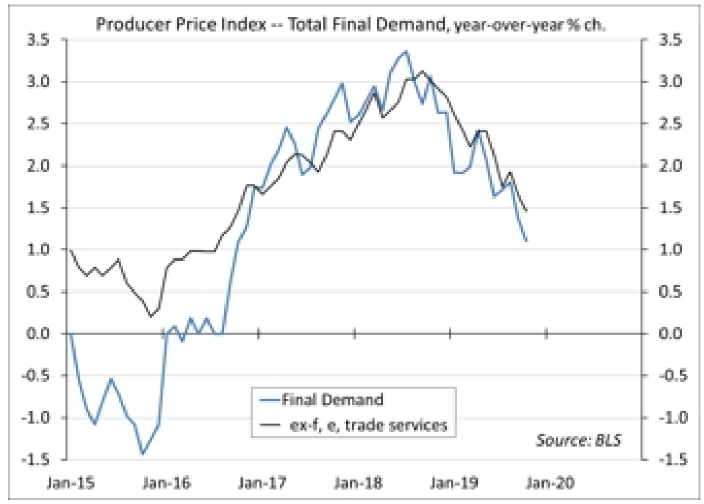


Industrial Production fell 0.8% in the initial estimate for October (-1.1% y/y), reflecting a 2.6% decline in the output of utilities (-4.1% y/y) and a further impact of the GM strike (motor vehicle production fell 7.1% following a 5.5% decline in September, -11.8% y/y). Ex-motor vehicles, manufacturing output edged down 0.1% (-0.6% y/y) – consistent with a moderate slowdown, rather than a recession. Mining output fell 0.7% (+2.7% y/y). Oil and gas well drilling fell 5.1% (-15.4% in the last four months, down 19.0% y/y), implying a further negative contribution to business fixed investment in 4Q19. Energy extraction rose 0.7% (+8.0% y/y).

The **Consumer Price Index** rose 0.4% in October (+1.8% y/y). Food rose 0.2% (+2.1% y/y), mixed over the last year (food at home up 1.0% y/y, food away from home up 3.3% y/y). Gasoline (3.9% of the overall CPI) rose 3.7% (+1.6% before seasonal adjustment, and -7.3% y/y). Ex-food & energy, the CPI rose 0.2% (+0.157% before rounding, +2.3% y/y). Bear in mind that the year-over-year change in the core PCE Price Index has been trending 0.5-0.7 percentage point below the year-over-year change in the core PCE.

Real Average Hourly Earnings fell 0.2% (+1.2% y/y), down 0.2% for production workers (+1.9% y/y).





The **Producer Price Index** rose 0.4% in October, vs. -0.3% in September (+1.1% y/y). Wholesale gasoline prices rose 7.3% (+2.8% before seasonal adjustment, -16.3% y/y). Food rose 1.3% (+3.2% y/y). Trade services (which measure changes in margins received by wholesalers and retailers) rose 0.8% (+2.2% y/y). Transportation and warehousing services rose 0.3% (+0.5% y/y). Ex-food, energy, and trade services, the PPI 0.1% (+1.5% y/y). Ex-food & energy, the price index for unprocessed intermediate goods fell 6.4% y/y, while the index for processed intermediate goods fell 2.4% y/y). The PPI figures do not include tariffs, but tariffs may be passed through to prices of finished goods.

Import Prices fell 0.5% in October (-3.0% y/y), reflecting a 3.7% decline in petroleum prices (-14.7% y/y). Ex-food & fuels, import prices fell 0.2% (-1.3% y/y). There remained no inflation in the prices of imported finished goods. These figures do not include tariffs.

Jobless Claims rose to 225,000 in the week ending November 9, vs. 211,000 in the previous week, but the weekly figures tend to be erratic during this time of year and the four-week average (at 217,000) remained low.

Treasury reported a $133 billion **Federal Budget Deficit** for October, the first month of FY20, up from $100.5 billion in October 2018.

Business Inventories were essentially unchanged in September (+3.7% y/y). Business sales fell 0.2% (+0.5% y/y). The inventory-to-sales ratio rose from 1.36 in September 2018 to 1.40 in September 2019. That likely reflects stockpiling ahead of tariff increases (most of the increase was in manufacturing and wholesale trade).

The Index of **Small Business Optimism** edged up to 102.4 in October, vs. 101.8 in September and 103.1 in August (the index peaked at 108.8 in August 2018). The general business outlook edged up. The earnings trend weakened. Hiring plans were moderate. Capital spending plans remained moderately strong.

This Week – The economic calendar thins out. The FOMC minutes (from the October 29-30 policy meeting) are expected to show that officials were split on the appropriate course of monetary policy, but there should be a general consensus that no further cuts are likely for the time being. Depending on the rounding, the Index of Leading Economic indicators should post a third consecutive monthly decline. Despite ongoing impeachment hearings, the House is expected to vote on a Continuing Resolution to fund the government beyond the November 21 deadline.

October is a transitional month for housing. Residential construction activity is likely to have been mixed, with volatility in the multi-family sector and moderate strength in single-family activity.

Together, the ISM new orders index and the factory workweek will subtract 0.20 from the October LEI. While the stock market has improved recently, the S&P 500 average for October was slightly lower than in September. Three consecutive monthly declines in the LEI is widely viewed as a signal of a pending recession (the last time was October-December 2007), but the pace of decline has not been steep and we ought to see a rebound in November.

This Week:					*forecast*	last	last –1	comments
Monday	11/18	10:00	Homebuilder Sentiment	Nov	***70***	71	68	still strong, but mortgage rates are up
Tuesday	11/19	8:30	Building Permits, mln	Oct	***1.400***	1.391	1.425	volatility in multi-family activity
			% change		***+0.6***	-2.4	+8.2	general strength in single-family
			Housing Starts		***1.300***	1.256	1.386	choppy, but trend seen higher
			% change		***+3.5***	-9.4	+15.1	watch for revisions
Wednesday	11/20	2:00	**FOMC Minutes**					few new clues to peruse
Thursday	11/21	8:30	Jobless Claims, th.	11/16	***216***	225	211	holiday adjustment adds uncertainty
		10:00	Leading Econ Indicators	Oct	***-0.2%***	-0.1%	-0.2%	three declines in a row
		10:00	Existing Home Sales, mln	Oct	***5.42***	5.38	5.50	seen little changed
			% change		***+0.7***	-2.2	+1.5	seen a bit higher
Friday	11/22	10:00	UM Consumer Sentiment	Nov	***94.8***	95.5	93.2	95.7 at mid-month
Next Week:								
Monday	11/25	8:30	Chi Fed Nat Activity Index	Oct	***NF***	-0.45	+0.15	uneven, but a weak trend
			three-month average		***NF***	-0.24	-0.06	consistent with below-trend growth
Tuesday	11/26	8:30	Advance Econ Indicators	Oct				inventories and merchandise trade
		10:00	New Home Sales, th.	Oct	***690***	701	706	these data are erratic
			% change		***-1.6***	-0.7	+6.2	but the trend has improved
		10:00	**CB Consumer Confidence**	Nov	***125.5***	125.9	126.3	seen little changed (revisions?)
Wednesday	11/27	8:30	Jobless Claims, th.	11/23	***218***	***216***	225	noisy during this time of year
		8:30	Real GDP (2nd estimate)	3Q19	***+1.8%***	+2.0%	+3.1%	+1.9% in the advance estimate
			Priv Dom Final Purchases		***+1.9%***	+3.3%	+1.6%	+2.0% in the advance estimate
		8:30	**Durable Goods Orders**	Oct	***-0.8%***	-1.2%	+0.2%	more problems at Boeing
			ex-transportation		***-0.2%***	-0.4%	+0.1%	soft otherwise
			nondef cap gds ex-aircraft		***-0.4%***	-0.6%	-0.8%	a weak trend
		9:45	Chicago Business Barometer	Nov	***47.2***	43.2	47.1	likely to remain in contraction
		10:00	Personal Income	Oct	***+0.3%***	+0.3%	+0.5%	aggregate weekly payrolls up 0.3%
			Personal Spending		***+0.2%***	+0.2%	+0.2%	a lackluster short-term trend
			PCE Price Index ex-f&e		***+0.1%***	+0.0%	+0.1%	the core CPI rose 0.157%
			year-over-year		***+1.6%***	+1.7%	+1.8%	slightly lower
		10:00	Pending Home Sales Index	Oct	***NF***	+1.5%	+1.4%	may moderate
		2:00	**Fed Beige Book**					still mixed
Thursday	11/28		Thanksgiving Holiday					markets closed
Friday	11/29		No significant data					markets close early

Coming Events and Data Releases

December 2	ISM Manufacturing Index (November)	December 11	FOMC Policy Decision
December 4	ISM Non-Manufacturing Index (November)	December 13	Retail Sales (November)
December 6	Employment Report (November)	December 17	Industrial Production (November)

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The **S&P 500** is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market.

The **Dow Jones Industrial Average (DJIA)** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.

The **NASDAQ Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market.

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The **MSCI Emerging Markets Index** is designed to measure equity market performance in 23 emerging market countries. The index's three largest industries are materials, energy, and banks.

The **Russell 2000** index is an index measuring the performance of approximately 2,000 smallest-cap American companies in the Russell 3000 Index, which is made up of 3,000 of the largest U.S. stocks.

The **NYSE Alerian MLP** is the leading gauge of energy infrastructure Master Limited Partnerships (MLPs). The capped, float-adjusted, capitalization-weighted index, whose constituents earn the majority of their cash flow from midstream activities involving energy commodities, is disseminated real-time on a price-return basis (AMZ) and on a total-return basis (AMZX).

The **Barclays Intermediate Government/Credit Bond** index measures the performance of U.S. Dollar denominated U.S. Treasuries, government-related and investment grade U.S. corporate securities that have a remaining maturity of greater than one year and less than ten years.

The **Euro Stoxx 50 Index** is a market capitalization weighted stock index of 50 large, blue-chip European companies operating within Eurozone nations. Components are selected from the Euro STOXX Index which includes large-, mid- and small-cap stocks in the Eurozone.

The **China CSI 300** is a capitalization-weighted stock market index designed to replicate the performance of top 300 stocks traded in the Shanghai and Shenzhen stock exchanges. It had a sub-indexes CSI 100 Index and CSI 200 Index.

The **S&P 500 Futures** is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The **DJIA Futures** is a stock market index futures contract traded on the Chicago Mercantile Exchange`s Globex electronic trading platform. Dow

Futures is based off the Dow 30 stock index.

The **Nasdaq 100 Futures** is a modified capitalization-weighted index of the 100 largest and most active non-financial domestic and international companies listed on the NASDAQ.

Europe: DAX (Deutscher Aktienindex (German stock index)) is a blue chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange.

Asia: Nikkei is short for Japan's Nikkei 225 Stock Average, the leading and most-respected index of Japanese stocks. It is a price-weighted index composed of Japan's top 225 blue-chip companies traded on the Tokyo Stock Exchange.

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