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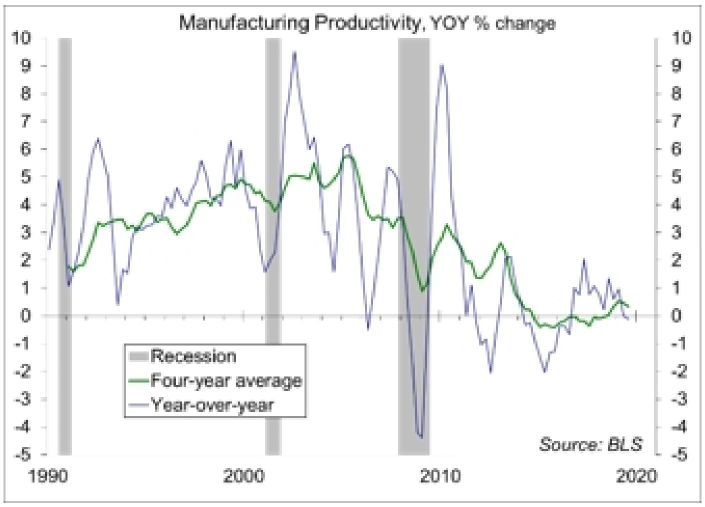
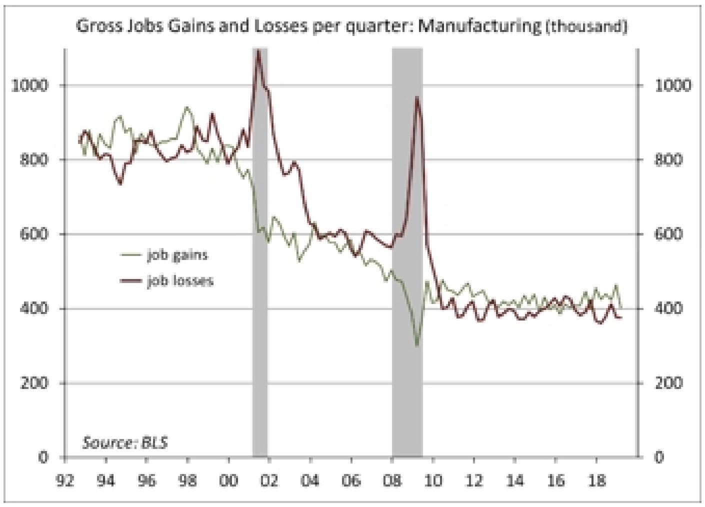
Weekly Economic Monitor -- Productivity

Productivity – Theoretically, there is no single variable more important to the economy than productivity, or output per worker. Productivity growth is how we get improved living standards over time. Faster productivity helps to offset the impact of wage growth, supporting gains in corporate profits. However, in practice, the productivity estimate is among the most troublesome of economic statistics. Productivity growth has slowed over the last week, in the U.S. and worldwide. Efforts to boost productivity growth should be a priority, as improvement would help to counter slower growth in the workforce.

Productivity weakened in the preliminary estimate for 3Q19, down at a 0.3% annual rate (+1.4% y/y). Quarterly figures are quirky and subject to large revisions. However, the underlying trend remains low (a 1.0% annual rate over the last four years). The slowdown in productivity growth is also seen outside of the U.S. and is believed to be associated with a weaker trend in capital spending (also seen outside the U.S.). The slowdown in productivity growth is more pronounced in manufacturing (-0.1% y/y and a +0.3% average over the last four years). This is in contrast to previous decades, when gains in the manufacturing sector outpaced overall productivity growth by a wide margin.





In the 1980s, the rule of thumb was that we would lose one out of ten manufacturing jobs each year, but that job would be replaced by a new job. The U.S. shed low-productivity jobs in areas like textiles and apparel, and grew jobs in higher-end industries, like technology. In the late 1990s, production of new technologies (cell phones, networking equipment, and the internet) boosted overall output per worker. By the early 2000s, these new technologies led to efficiency gains. Firms could produce more with fewer workers. Following the 2001 recession, we didn't just have a jobless recovery – we had a *job loss* recovery (we didn't begin to add jobs until nearly two years after the recession had ended).

Increased trade with China had a significant impact on manufacturing jobs since the turn of the century. However, technology also played a part. The turnover in manufacturing jobs is now about half of what it was in the 1990s. Looking ahead, advances in robotics and artificial intelligence should limit job growth in manufacturing (although there will always be some degree of flux – creation and destruction – over time).

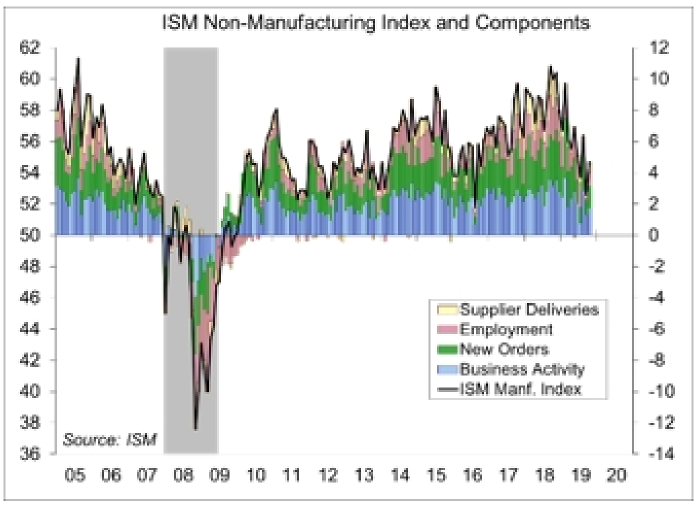
So, how do we boost productivity growth? Efforts to lift capital investment should be a priority. Academic research indicates that cuts in the corporate tax rate are more likely to show up as share buybacks and dividend increases than higher business investment – and that was reinforced by what we saw over the last year. Lowering the corporate tax rate means that the after-tax cost of business investment is greater. Government can help boost productivity growth over the long term by providing greater support for research and development, but that's not happening.

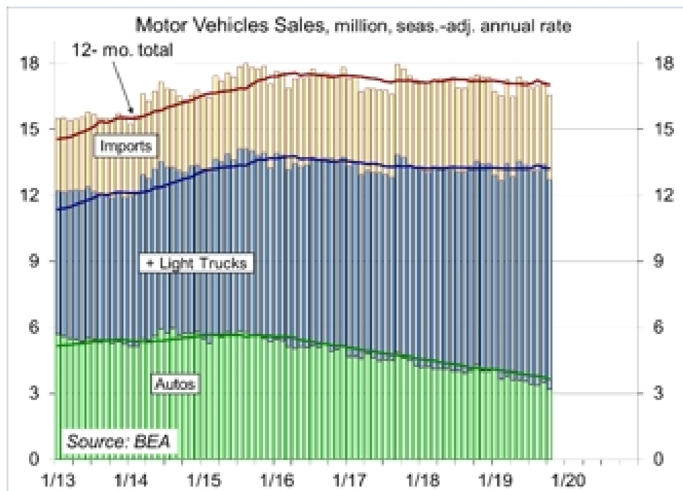
The tight labor market ought to lead to shifts in labor allocation over time. Workers will tend to move to more productive (higher-paying) endeavors over time. However, that transition is not going to be smooth and will likely be difficult for regions that are far from major population centers. The U.S. economy has always been in a state of flux, but our great success has been our ability to reinvent ourselves over time. If we fail to make needed transformations, that will be our own fault.

	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
10/11/19	1.68	1.68	1.67	1.63	1.60	1.59	1.76	2.22	1.104	1.268	108.52	1.318	8057.04	2970.27	26816.59
11/01/19	1.52	1.55	1.53	1.56	1.55	1.55	1.73	2.21	1.117	1.295	108.16	1.315	8386.40	3066.91	27347.36
11/08/19	1.56	1.58	1.58	1.68	1.70	1.75	1.94	2.42	1.102	1.278	109.20	1.322	8460.22	3093.06	27681.24

Data Recap – Once again, economic data reports were dominated by shifting perceptions in trade policy. However, this time things were flipped. It was the Chinese indicating a possible roll back of tariffs on both sides, sending the stock market higher. However, that was refuted by the White House the next day.

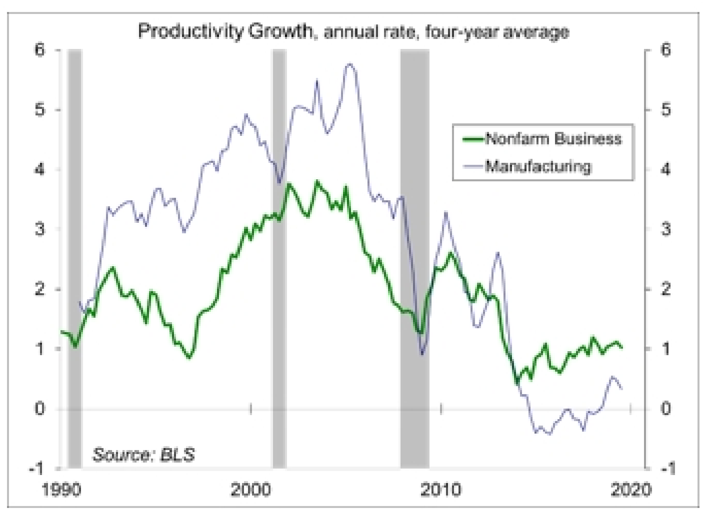
The **ISM Non-Manufacturing Index** rose to 54.7 in October, vs. 52.6 in September and 56.4 in August. Growth in business activity, new orders, and employment improved following a "soft" September report. Input price pressures were moderate. Comments from supply managers were mixed, but mostly upbeat.





Unit **Motor Vehicle Sales** fell to a 16.5 million seasonally adjusted annual rate in October, down from 17.1 million in September.

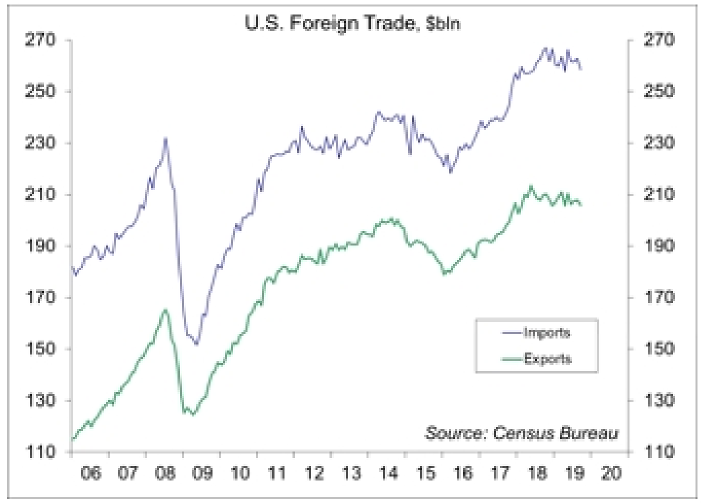
The **JOLTS** (Job Opening and Labor Turnover Survey) data for September showed a further decline in job openings (trending lower since October 2018), although the level remained very high by historical standards. Hiring and quit rates were little changed from a year ago.



Nonfarm Productivity fell at a 0.3% annual rate in the preliminary estimate for 3Q19, up 1.4% y/y. **Unit Labor Costs**, the key measure of inflation pressure from labor, rose at a 3.6% pace, +3.1% y/y. In manufacturing, productivity fell at a 0.1% annual rate, down 0.1% y/y, while unit labor costs rose at a 3.6% pace, up 4.9% y/y.

The University of Michigan's **Consumer Sentiment Index** was little changed at 95.7 in the mid-November reading, vs. 95.5 in October and 93.2 in September. Consumers remain optimistic about the job market and the impact of the impeachment inquiry is "virtually nonexistent" according to the report.

Factory Orders fell 0.6% in September (-3.5% y/y). Orders for durable goods fell 1.2% (revised from -1.1%), down 5.5% from a year ago, reflecting lower orders for civilian aircraft (-11.8% m/m, -42.2% y/y). Orders for nondefense capital goods ex-aircraft, a rough proxy for business fixed investment, fell 0.6%, following a 0.8% drop in August (-1.0% y/y). Shipments for this category fell 0.7% (+0.3% y/y), while unfilled orders fell 0.2% (-2.1%, not a good sign). (M19-2818101)



The **U.S. Trade Deficit** narrowed to $52.5 billion in the initial estimate for September, about what was assumed in the advance GDP report. Monthly figures can be choppy. Merchandise exports were down 1.4% y/y in 3Q19, while imports fell 2.2% (petroleum -22.3%, non-petroleum -0.1%).

The **Bank of England**'s Monetary Policy Committee voted 7-2 to leave the Bank Rate unchanged at 0.75%. The statement noted that "Monetary policy could respond in either direction to changes in the economic outlook in order to ensure a sustainable return of inflation to the 2% target." However, "if global growth fails to stabilise or if Brexit uncertainties remain entrenched, monetary policy may need to reinforce the expected recovery in UK GDP growth and inflation." Looking ahead, "provided these risks do not materialise and the economy recovers broadly in line with the MPC's latest projections, some modest tightening of policy, at a gradual pace and to a limited extent, may be needed to maintain inflation sustainably at the target."

This Week – Fed Chairman Powell will testify twice on Capitol Hill, although his evaluation of the economic outlook is not expected to deviate much from what he said in his post-FOMC press conference. Moreover, said testimony will be overshadowed as the impeachment inquiry enters a more public phase. The important economic data will arrive on Friday. Retail sales are expected to be mixed and industrial production should further reflect the GM strike. In the Consumer Price Index (Wednesday), a modest increase in gasoline prices will be amplified by the seasonal adjustment (which anticipates lower gasoline prices in October). Core inflation should remain moderate.

Fed rate cuts help to insure against downside risks in 2020 and moves to de-escalate trade tensions are favorable. Financial market participants have been cavalier about the impeachment inquiry, believe that it will likely be a replay of the Clinton impeachment. Recall that Clinton was impeached (meaning he was put on trial in the Senate), but the Senate voted to acquit and it came back to bite the Republicans at the polls. Much of that reflected public opinion, which could change this week amid televised hearings – or perhaps not.

This Week:					*forecast*	last	last –1	comments
Monday	11/11		Veterans Day					bond market closed
Tuesday	11/12	5:30	Fed VC Clarida Speaks					*"Mon Pol, Price Stability, and Bond Yields"*
		6:00	Small Business Optimism	Oct	***NF***	101.8	103.1	seen lower, but still relatively strong
Wednesday	11/13	8:30	**Consumer Price Index**	Oct	***+0.2%***	0.0%	+0.1%	seas. adj. adds to gasoline
			year-over-year		***+1.6%***	+1.7%	+1.7%	edging down
			ex-food & energy		***+0.1%***	+0.1%	+0.3%	modest increase in core CPI
			year-over-year		***+2.3%***	+2.4%	+2.4%	edging lower
		8:30	Real Avg. Hourly Earnings	Oct	***+0.0%***	0.0%	+0.3%	nominal earnings rose 0.2%
			year-over-year		***+1.1%***	+1.2%	+1.4%	moderate
		10:00	**Impeachment Hearing**					Taylor/Kent
		11:00	**Powell JEC Testimony**					"The Economic Outlook"
		2:00	Treasury Budget, $bln	Oct	***-133.0***	-100.5	-63.1	$33 billion higher than a year ago
Thursday	11/14	8:30	Jobless Claims, th.	11/09	***214***	211	219	still low
		8:30	**Producer Price Index**	Oct	***+0.2%***	-0.3%	+0.1%	higher gasoline prices
			ex-food & energy		***+0.1%***	-0.3%	+0.3%	mild old core
			ex-f, e, trade services		***+0.1%***	0.0%	+0.4%	mild new core
		9:10	Fed VC Clarida Speaks					*"Mon Pol Strategy, Tools, and Comm"*
		10:00	Powell House Budget Test.					*"The Economic Outlook"*
Friday	11/15	8:30	Import Prices	Oct	***NF***	+0.2%	-0.2%	does not include tariffs
			ex-food & fuels		***NF***	0.0%	0.0%	a flat trend
		8:30	**Retail Sales**	Oct	***+0.0%***	-0.3%	+0.6%	unit auto sales fell
			ex-autos		***+0.4%***	-0.1%	+0.2%	gasoline prices higher
			ex-autos, bld mat, gasoline		***+0.3%***	+0.1%	+0.3%	moderate core sales
		9:15	**Industrial Production**	Oct	***-0.3%***	-0.4%	+0.8%	expected lower
			Manufacturing Output		***-0.4%***	-0.5%	+0.6%	aggregate hours fell 0.7%
			Capacity Utilization		***77.0%***	77.5%	77.9%	not threat to the inflation outlook
		10:00	Business Inventories	Sep	***+0.1%***	-0.1%	+0.3%	assumed modestly higher in GDP est.
		10:00	Impeachment Hearing (open)					Yovanovitch
Next Week:								
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	***213***	***214***	213	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

Coming Events and Data Releases

November 26	CB Consumer Confidence (November)	December 2	ISM Manufacturing Index (November)
November 27	Real GDP (3Q19, 2nd estimate)	December 6	Employment Report (November)
November 28	Thanksgiving Holiday (markets closed)	December 11	FOMC Policy Decision

IMPORTANT INVESTOR DISCLOSURES

Index Definitions

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.

The **MSCI World All Cap Index** captures large, mid, small and micro-cap representation across 23 Developed Markets (DM) countries. With 11,732 constituents, the index is comprehensive, covering approximately 99% of the free float-adjusted market capitalization in each country.

The **MSCI EAFE (Europe, Australasia, and Far East)** is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the United States & Canada. The EAFE consists of the country indices of 21 developed nations.

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.

Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Past performance does not guarantee future results. Future investment performance cannot be guaranteed, investment yields will fluctuate with market conditions.

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