WEEKLY
Economic Commentary

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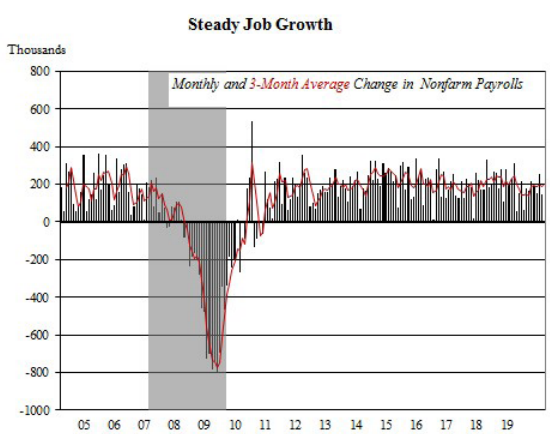
Millennium
CORPORATE CREDIT UNION

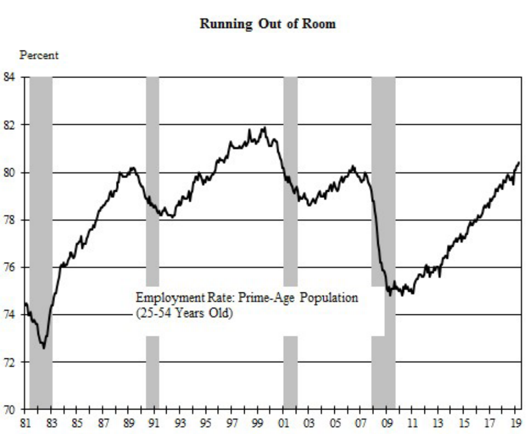
Friday's jobs report provided something for everyone but no compelling reason for anyone to change his or her opinion on the health of the U.S. economy. To the optimists, the report further confirmed that the economy's main growth engine, consumers, still has plenty of fuel to extend the record-long expansion into the new decade. But the skeptics can also point to evidence that the engine is losing steam and may require a jump-start at some point this year. For the Fed, wherein both points of view have a voice, the report provides a sense of comfort that its current policy is on the right track.

The 145 thousand jobs created in December came in slightly below the consensus expectation of a 160 thousand gain. However, the shortfall was hardly a great disappointment even with a modest 14 thousand downward revision in the job tally for October and November. The revised November increase of 256 thousand in nonfarm payrolls was clearly unsustainable, and the December slowdown brings the average gain over the past three months to a more realistic 184 thousand. Notably, it punctuates a year in which the economy generated more than 2 million jobs for an unprecedented ninth consecutive year. Nothing influences consumer behavior more than the job market, and the still healthy growth of paychecks should sustain a respectable pace of consumer spending in the early months of 2020. For sure, it is the major reason consumer confidence remains elevated, despite lackluster economic growth by past cyclical standards and myriad threats, such as trade wars and geopolitical disruptions that would ordinarily cause households to batten down the hatches.

With the unemployment rate remaining at a 50-year low of 3.5 percent last month, most job applicants should have little trouble finding work. As the government's companion report on labor market churn reveals, the number of jobs available has exceeded the number of unemployed workers for twenty consecutive months through November. That imbalance no doubt extended into December, as another 46 thousand workers were removed from the unemployment rolls during the month. What's more, workers on the margin of the labor force - involuntary part-timers and workers too discouraged to search for a job - are benefiting from the intense competition for labor. The broader unemployment rate, U-6, which includes this cohort, declined 0.2 percent to a record low of 6.7 percent in December.

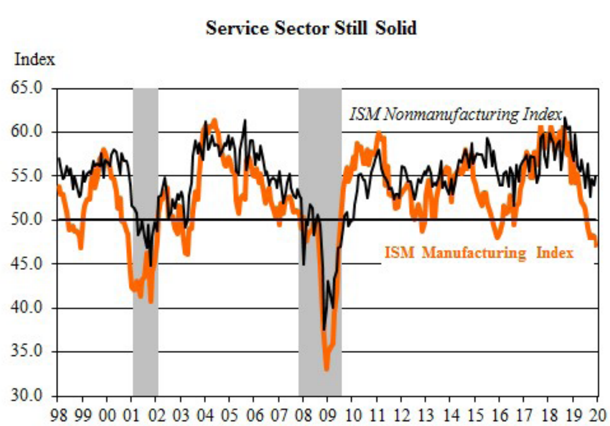
Indeed, the share of prime age workers holding jobs topped its prerecession level for the first time in the expansion. The employment-population ratio for the 25-54 age cohort increased to 80.4 percent last month, a level not seen since July 2001. Interestingly, the increase is being driven by job growth among women, reflecting diverging trends in the broader economy. Most noticeably, growth in manufacturing jobs historically dominated by men has been steadily shrinking, as the trade wars, automation and globalization have taken an increasing toll on this sector. In December, manufacturing jobs fell by 12 thousand following a 58 thousand surge in November that was juiced by the return of striking GM workers. But for all of 2019, the sector added only 4000 jobs per month, down significantly from the 22 thousand monthly average in 2019.





That trend is likely to continue going forward as the manufacturing sector continues to struggle mightily. The Institute for Supply Management reported last week that its index of manufacturing activity remains deep in recession territory, falling 0.9 points to the lowest level in ten years. Some relief should be forthcoming as the prospective signing of a phase one trade deal with China should alleviate - but not remove - one of the biggest headwinds weighing on this sector. But manufacturers still face daunting challenges that will prevent a quick recovery in this sector, including lackluster global growth, a strong dollar, tariffs that are still in place, weak capital spending and slowing domestic demand for goods that we expect in 2020. Motor vehicle sales peaked late last year and are poised to continue slipping this year.

Fortunately, manufacturing activity has an ever-smaller footprint in the overall economy, which is increasingly driven by the demand for services. On this score, things are looking up. The same ISM survey that revealed manufacturing weakness last month followed up with a healthy report on the services side of the economy this week. The Index of non-manufacturing activity staged a solid 1.1-point increase in December, rising to the highest level since August. Simply put, the broader economy can readily survive a manufacturing slump as long as the service sectors remain healthy. That was dramatically illustrated in late 2015 and early 2016, when the ISM manufacturing index fell below the 50 threshold - which separates expansion from contraction - for five consecutive months without dragging the economy into a recession.



With the jobless rate at a 50-year low and strong anecdotal evidence of spreading labor shortages, it is reasonable to assume that workers furloughed from manufacturing jobs would have little difficulty finding positions in the service sector. But this raises the question of whether those industry switchers are able to recapture the same salary they commanded before. Traditionally, workers in the goods-producing sectors of the economy receive better pay than most service-sector workers, particularly those working in restaurants, bars, retail establishments and in health care. Indeed, the ongoing employment from goods-producing to service-producing sectors may partially explain one of the conundrums that has perplexed policy makers since the Great Recession, namely why the ever-tightening labor market has not generated stronger wage growth.

This, of course, is the issue that has animated skeptics of the job market's performance throughout the expansion. In their eyes, it is the quality as much as the quantity of jobs that matters. And while the latter has been more than adequate, the former has fallen far short. Importantly, the December jobs report provided the skeptics with more ammunition to make their case. During the month, average hourly earnings for all private sector workers inched up by a tepid 0.1 percent and slightly less for production and nonsupervisory workers. These equaled the smallest monthly increases since October 2017. What's more, for the first time since September of 2018, the annual increase in hourly earnings fell below 3.0 percent, slipping to 2.0 percent last month. So even as the unemployment rate has fallen from 3.8 percent to 3.5 percent between February and December, the annual growth rate in average hourly earnings has slowed from 3.4 percent to under 3.0 percent.

To be fair, the surprising weakness in wages last month may have reflected some unusual factors. A calendar quirk in which the payroll survey, which was taken on the 12th of the month, fell on a different week than a typical payday that falls in the 15th of the month could have depressed the wage reading. Another influence could have come from the sharp swing manufacturing jobs, as the loss of higher-paying positions dragged down the average wage growth during the month. In fact, the composition of job growth in December clearly tilted towards lower-wage industries. For example, leisure and hospitality and retail accounted for more than half of the 145 thousand increase in nonfarm payrolls during the month.

We suspect that wage growth will snap back in January as the occupational mix of job growth normalizes, although some further distortions could well occur if the problems with the beleaguered Boeing 737 Max aircraft leads to additional layoffs in manufacturing. However, one major boost to wages will come from the legislative front. At the start of this year, more than 20 states lifted their minimum wage. This trend among states has been ongoing for the past few years and has contributed importantly to the faster growth in earnings for low-wage workers than for those higher up the wage ladder.

That said, the historically low unemployment rate is not generating the type of wage pressure normally seen in past cycles. To the skeptics, this means that the economy is still not at full employment and it behooves policy makers to avoid any action that would stifle growth. With wages among non-management workers suffering the biggest setback in December, that appeal would seem to be even more urgent. No doubt, the Federal Reserve was not swayed by the December jobs report to change course. From its vantage point, the decision to stand pat following its three rate cuts last year was the right one.

We concur with that assessment, but also with the majority sentiment expressed at the last policy meeting that downside risks to the economy outweigh the upside risks. With a Boeing-depressed first quarter looming ahead, inflation still running well below the Fed's 2 percent target, lackluster capital spending and ongoing trade policy uncertainty, the economy's growth engine is likely to shift down a notch in 2020. The task of the Fed will be to guide it into a soft landing, which will likely require another burst of fuel from a rate cut around mid-year.

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

INTEREST RATES	January 10	Week Ago	Month Ago	Year Ago
3-month Treasury bill	1.54%	1.53%	1.57%	2.43%
6-month Treasury bill	1.54	1.55	1.56	2.51
3-month LIBOR	1.85	1.90	1.89	2.8
2-year Treasury note	1.58	1.53	1.61	2.55
5-year Treasury note	1.64	1.59	1.66	2.52
10-year Treasury note	1.82	1.79	1.82	2.70
30-year Treasury bond	2.28	2.25	2.26	3.04
30-year fixed mortgage rate	3.64	3.72	3.73	4.45
15-year fixed mortgage rate	3.07	3.16	3.19	3.89
5/1-year adjustable rate	3.30	3.46	3.36	3.83
STOCK MARKET				
Dow Jones Industrial Average	28823.27	28634.88	28135.28	23995.95
S&P 500	3265.35	3234.85	3168.80	2596.26
NASDAQ	9178.86	9020.77	8734.88	6971.48
Commodities				
Gold ($ per troy ounce)	1562.80	1551.50	1480.00	1287.90
Oil ($ per barrel) - Crude Futures (WTI)	59.20	62.99	59.79	51.64

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
ISM Non-manufacturing Index (December)	55.0	53.9	54.7	54.4
Nonfarm Payrolls (December) - 000s	145	256	152	189
Unemployment Rate (December) - Percent	3.5	3.5	3.6	3.6
Average Hourly Earnings (Dec.) - % change	2.9	3.1	3.1	3.1
Consumer Credit (Nov.) - $billions	12.5	19.0	8.9	15.0

Millennium Corporate Credit Union
8615 West Frazier Street
Wichita, Kansas 67212