



WEEKLY

Economic Commentary

November 8, 2019

The financial markets were heavily influenced by trade developments this week, this time cheered by reports that American and Chinese negotiators were hammering out a so-called phase one deal that, importantly, would include a rollback of tariffs. Not surprisingly, the news, which became more prominent on Thursday, sent stock prices to new highs as the potential removal of growth-retarding trade barriers has positive implications for the economy and, hence, profits. Also not surprisingly, bond yields moved sharply higher since a potential detente on trade suggests stronger growth, less pressure on the Fed to cut rates, and encourages investors to take on riskier assets.

But as the old refrain goes, we will believe it when we see it. Recent trade negotiations have had a nasty habit of deflating hopes - and this time may be no different. Indeed, it seems that not all White House insiders are on board with tariff rollbacks, fearing that they would undercut the administration's leverage to extract concessions from China. When news of dissent surfaced, the stock market rally faded as investors understandably put on their skeptical hats. Nonetheless, the odds that at least a limited deal will be struck have risen, if only because the trade wars are taking a heavier toll on both economies.

In the U.S., a widening trade deficit has subtracted from GDP in four of the past five quarters. To be sure, this development is not entirely a product of trade conflicts. Growth has been stronger in the U.S. than abroad, which stokes demand for imports even as exports sag due to soft foreign demand. In addition to growth discrepancies between the U.S. and its trading partners a strong dollar has also contributed to the widening trade deficit by making U.S. goods more expensive. But sagging exports to China have clearly delivered a blow to manufacturers and farmers. In the nine months through September, for example, exports of goods to China fell by \$14.5 billion, accounting for almost the entire \$15.5 billion decline in total goods exports over the period. Meanwhile, the increased tariffs and other barriers imposed by the administration on Chinese imports have taken a toll on that nation. U.S. purchases of Chinese goods have plunged by

\$53 billion over the first nine months of this year.

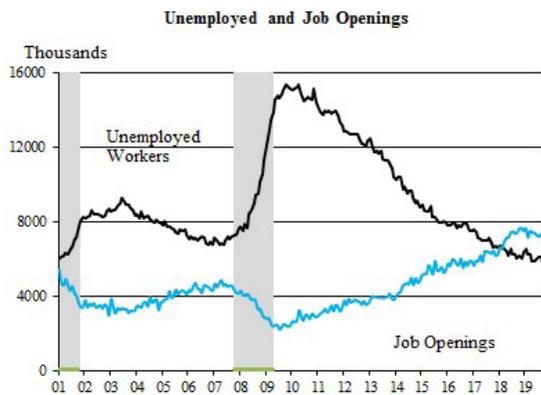
Interestingly, as wide as that dollar imbalance is - underscoring president Trump's claim that tariffs are hurting China more than the U.S. - exports to China have actually fallen more than imports from China in percentage terms, reflecting the much larger volume of goods that Americans purchase from China than that nation purchases from us. Hence, the \$53 billion decline in Chinese imports translates into a 13.4 percent drop from the \$395 billion in total goods imported from China over the first nine months of 2018. But the \$14.5 billion decline in exports to China equals a larger 15 1/2 percent decline from the relatively smaller total of \$78 billion of goods sold to China over the comparable period last year.

Importantly, it is unclear how much of the decline in imports from China is benefiting the U.S. economy. The latest Commerce Department data suggests that companies are shifting purchases of supplies and materials from China to other countries rather than to companies in the U.S. Big beneficiaries are Taiwan, Mexico, India, Vietnam and Thailand, all of which have seen their exports to the U.S. increase considerably this year. This disruption to global supply chains increases production costs for U.S. companies even as it has a chilling effect on investment plans, something that is abundantly clear in the latest GDP report. In the third quarter, investment outlays fell by 3.0 percent, the weakest result since the first quarter of 2016. This retrenchment is consistent with the downbeat sentiment among business leaders, who cite trade uncertainty as their biggest source of concern.

But unlike businesses, households remain mostly indifferent to trade developments. That's not surprising given the continuing strength in the job market that is underpinning income gains, and the persistence of low inflation, which stretches the purchasing power of worker paychecks. The latest University of Michigan survey of consumer sentiment released on Friday indicates that households remain highly upbeat, as the sentiment index increased in early November and continues to hover near the highs for the expansion.

Indeed, respondents to the survey expressed less worry over trade than they did a month ago, with only 25 percent concerned over the negative impact of tariffs. That may change if current negotiations fail and the next round of threatened levies is put into effect, covering a whole slew of consumer goods, including cell phones, laptops and apparel.

But barring a shock from another failed attempt to strike a trade deal - which would no doubt send tremors through the financial markets - households should continue to feel positive about the job market, where job openings still exceed the number of job searchers by a considerable margin. In September, that gap stood at a formidable 1.3 million, marking a record 19th consecutive month of more listings than unemployed workers. As much as anything, the large number of unfilled jobs fuels the debate over whether the recent slowing in job growth reflects a worker shortage or a softening in demand for labor consistent with a cooling economy.



Most likely, some combination of the two is unfolding, but the demand for workers is clearly softening. Job openings, while still high relative to job searchers, are gradually coming down; in September, companies posted about a half million fewer openings than at the start of the year and the lowest number since March 2018. Meanwhile, workers are showing signs of becoming less confident about moving to a new job. Voluntary quits fell for the second consecutive month and for the fourth time in the last five months. One possible reason: layoffs jumped to the highest level since May 2012 in September. That may be an aberration

related to the GM strike, but is something that bears watching.

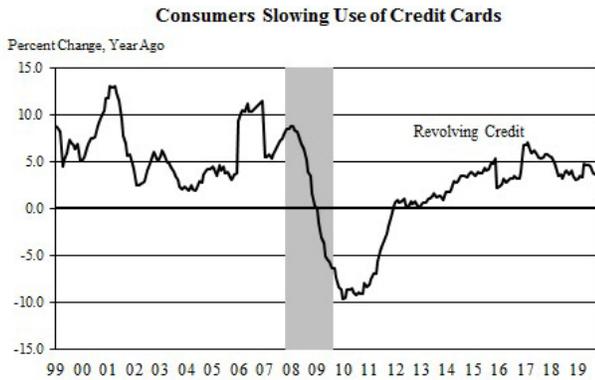
Still Taut, But Peaking, Job Market



What also bears watching is how long households can remain upbeat while businesses retain a gloomy outlook. So far, personal consumption has more than offset the pullback in investment spending and continues to be the economy's main growth driver. But if households begin to worry that the retrenchment in investment outlays will lead to less hiring and more unemployment, their confidence will surely wither and impact future consumption. Based on the latest confidence measures, that worry has not yet seeped into the mindset of households. Still, there is some indication of growing consumer caution.

For one, real consumer spending took a step back in September, posting the weakest gain since February. For another, households are borrowing less, particularly with credit cards. For the first time since the spring of 2018, revolving credit - mostly credit-card borrowing - contracted for two consecutive months, falling by \$1.1 billion in September following a \$2.2 billion drop in August. It's unclear, however, how much of the slow-down in credit-card use reflects growing household caution over taking on new debt or the more restrictive consumer lending policies being implemented by banks, as detailed in the latest survey of bank lending officers.

The good news is that even as households pulled back borrowing and spending in September, they continued to see their incomes increase and bank balances grow, as the personal savings rate rose to



a seven-month high of 8.3 percent. Hence, with confidence still elevated they have both the inclination and wherewithal to sustain spending in coming months. We suspect that consumers will continue to keep the expansion going, albeit provide less thrust than in second and third quarters when personal consumption increased by a robust 4.6 percent and 2.9 percent, respectively. If debt financing is becoming less of an option for whatever reason - either tighter lending standards or an aversion to borrowing - households will have to rely on income and savings to finance purchases, and both are poised to slow in line with a gradual cooling of job growth.

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

	November 8	Week Ago	Month Ago	Year Ago
INTEREST RATES				
3-month Treasury bill	1.56%	1.52%	1.68%	2.35%
6-month Treasury bill	1.57	1.54	1.68	2.52
3-month LIBOR	1.90	1.90	1.99	2.61
2-year Treasury note	1.67	1.56	1.59	2.94
5-year Treasury note	1.75	1.54	1.56	3.04
10-year Treasury note	1.94	1.72	1.73	3.18
30-year Treasury bond	2.43	2.19	2.20	3.39
30-year fixed mortgage rate	3.69	3.78	3.57	4.94
15-year fixed mortgage rate	3.13	3.19	3.05	4.33
5/1-year adjustable rate	3.39	3.43	3.35	4.14
STOCK MARKET				
Dow Jones Industrial Average	27681.24	27347.36	26816.59	26037
S&P 500	3093.08	3066.91	2970.27	2785.21
NASDAQ	8475.31	8386.40	8057.04	7406.9
Commodities				
Gold (\$ per troy ounce)	1459.20	1516.20	1492.42	1210.20
Oil (\$ per barrel) - Crude Futures (WTI)	57.38	56.09	54.86	59.82

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
ISM Non-manufacturing Index (October)	54.7	52.6	56.4	54.9
Job Openings (millions) - September	7.024	7.301	7.174	7.251
Hires (millions) - September	5.934	5.884	5.978	5.877
Voluntary Quits (millions) - September	3.498	3.601	3.668	3.540

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