WEEKLY
Economic Commentary

November 1, 2019

Millennium
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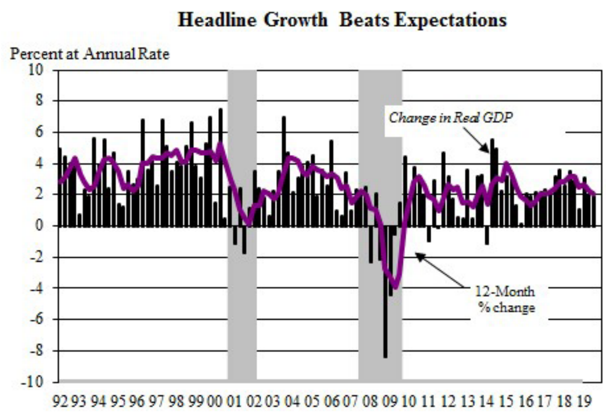
The past week was jam-packed with news on the economic, policy and political fronts, which along with ghosts and goblins of Halloween gave investors the shivers. That said, no skeletons came out of the closet and while the markets were rattled they remained mostly upbeat, thanks in part to decent earnings reports. On the economy, the third quarter's GDP report was the first to take center stage followed by the all-important monthly jobs report on Friday. While GDP was a tad stronger than expected, it did little to upend widespread perceptions that the economy is losing steam and will continue to chug along at a gradually slower pace through 2020. On policy, the Fed followed market expectations; it cut its benchmark short-term rate by another quarter of a percentage point, lowering it to a range of 1.50-1.75 percent. But its forward guidance regarding future rate changes created more confusion than clarity. As for politics, the impeachment inquiry into president Trump gained more traction and headlines, but its impact on the financial markets appears to be reaching the point of diminishing return - at least until an endgame is within sight.

The economy expanded by a 1.9 percent annual rate in the July to September period, a bit stronger than the 1.6 percent consensus forecast and only an eyelash weaker than the 2.0 percent pace registered in the second quarter. Aside from the headline overshoot, however, the underlying details came in about as expected. Simply put, consumers are propping up the economy, while the sectors exposed to global headwinds are sucking wind. Buffeted by the slowdown in global growth and the trade wars, businesses are clamping down on investment plans. Investment spending declined for the second consecutive quarter, contracting by a 3.0 percent annual rate following a 1.0 percent decline in the second quarter. Leading the way down, spending on structures plunged by 15.3 percent, weighed down by reduced outlays on oil rigs; but equipment outlays also tumbled by 3.8 percent, reflecting ongoing weakness in the troubled manufacturing sector, which is being victimized by falling exports and rising business uncertainty regarding trade policy.

However, consumers continued to resist the global



headwinds besetting businesses and did most of the heavy lifting during the third quarter. Personal consumption, which accounts for about 70 percent of GDP, increased by a solid 2.9 percent. While that's down from the unsustainable 4.6 percent increase in the second quarter, it is stronger than the 2.5 percent average increase seen throughout the decade-long expansion. Households, bolstered by solid job and income fundamentals, spent profusely on durable goods and services. Low interest rates also bolstered activity, stoking housing-related expenditures including furnishings and the like. One reason: for the first time in seven quarters residential outlays actually made a positive contribution to economic growth, increasing by a respectable 5.1 percent.

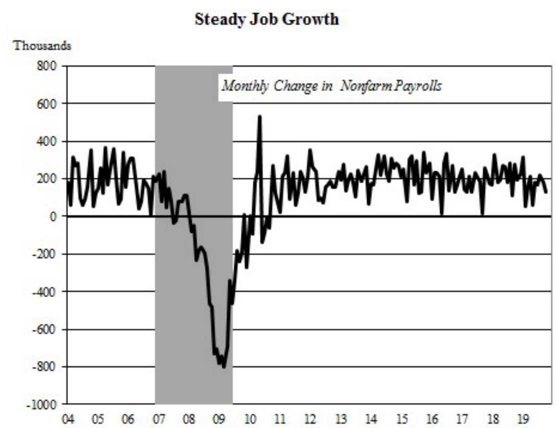
We suspect that this divergent pattern will continue to underscore the economy's performance going forward. The manufacturing sector is deriving most of its support from domestic consumption, which is still solid but slowing. Meanwhile, little relief is coming from the global headwinds; growth overseas is showing no sign of picking up, the dollar remains strong and the prospect of a limited deal with China is not vanquishing trade uncertainty. The latest ISM survey of manufacturers released on Friday confirms the sluggish state of affairs that looms ahead, as its index of overall activity in October remained below the 50 threshold that separates expansion from contraction, coming in at 48.3.

But households should continue to provide fuel for the economy's growth engine. Yes, personal consumption growth did slip in the third quarter, and the period ended on a soft note. In September, real consumer outlays increased by a soft 0.17 percent, the weakest since February. But that hardly dented the underlying momentum, as outlays posted a solid 2.6 percent increase over the past year. Importantly, households retain a considerable amount of spending firepower, as real disposable incomes are rising even faster, posting a 3.5 percent annual increase in September. Indeed, the 0.9 percent spread between the annual increase in incomes and outlays is the widest since February, which set the stage for the blockbuster 4.6 percent surge in personal consumption during the second quarter. What's more, households have shored up their bank accounts, as the personal savings rate increased from 8.1 percent to 8.3 percent in September.

Could households once again unleash their spending firepower as they did in the second quarter? Not likely. For one, that surge followed a tepid 1.1 percent increase in outlays in the first quarter, which was held down primarily by the record-long government shutdown. Hence, consumers entered the second quarter poised to satisfy a considerable amount of delayed purchases. No such pent-up demand currently exists as households posted a healthy 2.9 percent increase in consumption during the second quarter. And while the personal savings rate is elevated at 8.3 percent, it was at an even higher 8.8 percent back in February. Absent that extra oomph, consumer spending should align with household fundamentals going forward.

On this score, spending prospects remain favorable, largely because the job market is providing more support than expected. Friday's employment report for October provided ample evidence of this assessment. During the month, the economy generated 128 thousand net new jobs, well above the consensus estimate of a 75 thousand gain. What's more, the payroll increases for the previous two months were revised up by 95 thousand. Hence, the three-month average pace of job growth stands at 176 thousand, which is virtually spot on with the 174 average over the past twelve months. Importantly, the October increase was held down by the now-settled GM strike, which idled nearly 50 thousand workers.

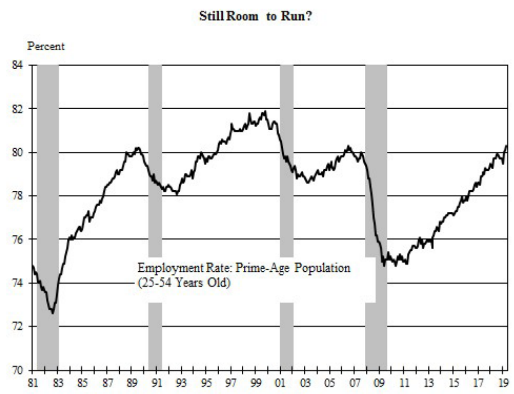
Throw them back in to the mix - they will return to the ranks of employed in the November count - and the three-month average pace of job growth stands above 190 thousand. That's an annual rate of 2.28 million; even allowing for some tapering off over the final three months of the year, the economy is on track to create at least 2 million new jobs in 2019 for the ninth consecutive year.



Simply put, the long-awaited slowdown in job growth is being put on a stretched-out timetable. Indeed, the trend is moving in the opposite direction, as the last three months have seen stronger job gains than over the previous three months and the three months before that. This is a remarkable achievement given that the economy has generated payroll increases for a record 109 consecutive months and, with the unemployment rate at a 50-year low, is supposed to be running out of available workers. Instead, the workforce is proving to be far more flexible than thought.

In October, for example, the labor force expanded by 325 thousand, lifting the share of the adult population that is either looking for a job or holding one to 63.3 percent. That's the highest labor force participation rate since August 2013. Not all of the job seekers entering the workforce found a position right away, which accounted for the slight uptick in the unemployment rate from a near 50-year low of 3.5 percent to 3.6 percent. But that's an increase driven by positive factors, as the strong job market is luring workers off the sidelines. One little-known figure captures that trend: the number of workers not in the labor force who say they want a job now has fallen by 569 thousand, or more than 10 percent of the total, since mid-year alone.

Emboldened by brightened job prospects, those workers have reentered the labor force, and most have landed positions. Nor are these just armchair retirees returning to work. The employment-population ratio for prime age workers, the 25-54 year cohort, jumped to 80.3 percent last month, matching the highest share going back to March 2001. Critically important is that the vibrant job market is benefiting all segments of the population, including the less educated and minority groups. The unemployment rate among African Americans fell to an all-time low of 5.4 percent in October. As recently as February, it stood at 7.0 percent.



So, the question is, is this as good as it gets? Most likely yes. While the steep climb in the employment/population ratio suggests that there is more capacity in the labor force than thought, the upper limit is not far off. Indeed, the list of companies reporting worker shortages continues to grow. But there are still nearly 5 million workers not in the labor force that want a job; given the opportunity, such as company retraining programs and affordable child-care services, they could still be drawn into the labor market. It's unlikely that the unemployment rate is as low as it can go without stoking wage inflation. Most likely, it can drift closer to 3.0 percent from the current 3.6 percent. Wage pressures are clearly not an imminent inflation threat. In October, average hourly earnings increased by a mild 0.2 percent, bringing the annual increase back to 3.0 percent from the previous month's 2.9 percent. That is hardly an acceleration and well below the nearby peak of 3.4 percent seen in February.

With wage and price inflation well under control, the surprising resilience of the job market should not prod the Fed to change course, However, it does validate the hawkish interpretation that many have attributed to the rate cut at this week's policy meeting. Heading into the meeting, there was a fair amount of expectation that the Fed would follow up the expected rate cut this week with another as soon as December. However, the policy statement put the kibosh on that expectation. Instead, it signaled that policy would be put on hold until a clearer picture of how economic developments unfold in coming months comes into view. We expect that the modest growth slowdown now underway will continue into next year and spur additional rate cuts, but probably not until March. The stronger-than-expected jobs report this week gives more credibility to the Fed's decision to wait-and-see before pulling the rate trigger again.

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

INTEREST RATES	November 1	Week Ago	Month Ago	Year Ago
3-month Treasury bill	1.52%	1.67%	1.71%	2.32%
6-month Treasury bill	1.54	1.66	1.65	2.51
3-month LIBOR	1.90	1.94	2.04	2.58
2-year Treasury note	1.56	1.63	1.40	2.92
5-year Treasury note	1.54	1.63	1.35	3.04
10-year Treasury note	1.72	1.80	1.53	3.21
30-year Treasury bond	2.19	2.29	2.02	3.45
30-year fixed mortgage rate	3.78	3.75	3.65	4.83
15-year fixed mortgage rate	3.19	3.18	3.14	4.23
5/1-year adjustable rate	3.43	3.40	3.38	4.04
STOCK MARKET				
Dow Jones Industrial Average	27347.36	26958.06	26573.72	25270.83
S&P 500	3066.91	3022.55	2952.01	2723.06
NASDAQ	8386.40	8243.12	7982.47	7356.99
Commodities				
Gold ($ per troy ounce)	1516.20	1507.30	1510.10	1234.60
Oil ($ per barrel) - Crude Futures (WTI)	56.09	56.62	52.95	62.86

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
Nonfarm Payrolls (October) - 000s	128	180	219	155
Unemployment Rate (October) - Percent	3.6	3.5	3.7	3.6
Average Hourly Earnings (October) - % Chg.	3.0	3.0	3.2	3.1
Real GDP (Q3) - % change, SAAR	1.9	2.1	3.1	2.4
Personal Income (September) - % change	0.3	0.5	0.1	0.3
Personal Expenditures (Sept.) - % change	0.2	0.2	0.5	0.4
ISM Manufacturing Index (October)	48.3	47.8	49.4	50.0

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