# WEEKLY

## Economic Commentary

November 15, 2019

Millennium
CORPORATE CREDIT UNION

As the data calendar for October fills in, we are reminded of that distinguished economic philosopher, Yogi Berra, who famously opined, “When you come to a fork in the road, take it!” Increasingly, the data are portraying a bifurcated economy that can go either way - up or down. We still believe that the path ahead is upward, but the slope is getting flatter and is littered with numerous potholes. That said, the economy’s growth engine is running on more than enough cylinders to power it forward, and its chief navigator, the Federal Reserve, is poised to provide more fuel if needed.

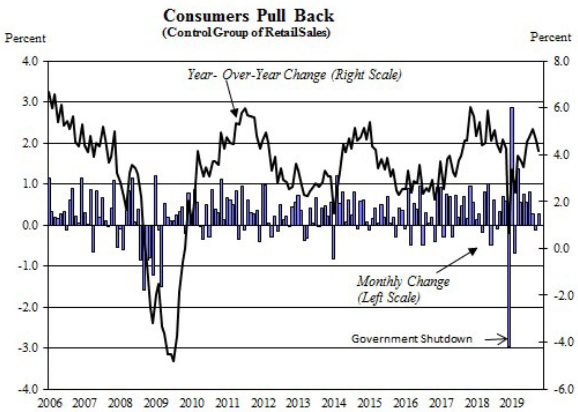
If the latest batch of reports is any indication, it may well be needed. In his remarks before Congress this week, Fed Chair Powell reiterated his contention that the economy is in a “good place” and that only a significant reassessment of the outlook would prompt the central bank to cut rates again. That perception was backed up by the comments of several other Fed officials this week. All, however, acknowledged that the economy faces a number of downside risks, including slowing global growth and trade uncertainty that are weighing heavily on business sentiment and crimping investment-spending plans. That has driven a wedge through the economy, with the industrial side tumbling into recession territory requiring heroic efforts by consumers to keep the rest of the economy afloat.

For the most part, that uneasy relationship has worked, if only because consumers have more clout in the economy’s performance, accounting for roughly 70 percent of GDP. Hence, even as business investment spending fell by a 3.0 percent annual rate in the third quarter, the economy grew by a decent 1.9 percent, thanks to a solid 2.9 percent increase in personal consumption expenditures. A similar bifurcated pattern underpinned the economy’s performance in the second quarter, when consumer spending surged to 4.3 percent. Most likely, that pattern will be repeated in the current quarter. But the heavy lifting appears to be causing some strain among households and they are on track to provide less muscle to the economy’s growth rate in the waning months of the year. That’s the clear message conveyed in Friday’s somewhat disappointing report on October retail sales.

To be sure, one month does not make a trend. What’s more, it’s still early in the quarter and the holiday spirit may yet grab households, igniting a festive shopping spree that would end the year with a flourish. But the tepid sales figures registered in October follows an even softer reading in September, so there is little sign that momentum is poised to pickup. That said, retailers in general saw some improvement last month over September. Total retail sales advanced 0.3 percent during the month, reversing the similar-sized 0.3 percent decline in September. But the reversal did little to boost momentum, as the sales gain over the past year slipped to 3.1 percent from 4.1 percent in September.

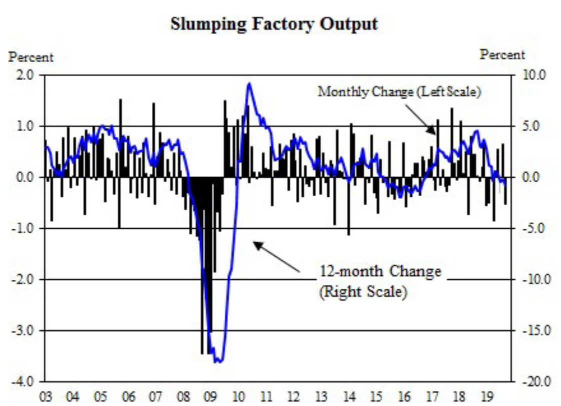
One bright spot is that the so-called control group of sales, which corresponds most closely to personal consumption in the GDP accounts, increased by 0.3 percent during the month after falling by 0.1 percent in September. But that reversal is nothing to write home about, as it equals the weakest monthly increase since February. And here too, the momentum is heading in the wrong direction, as the annual increase slipped to 4.2 percent from 4.6 percent in September and 5.1 percent in August. Nor are the details of the report encouraging. Indeed, if not for a suspicious 0.5 percent increase in auto sales, which conflicts with an earlier industry report of a decline in unit auto sales, and a 1.1 percent jump in service-station sales, reflecting an increase in gasoline prices, the picture darkens considerably. Excluding volatile auto and price-driven gasoline sales, revenues at retailers show virtually no gain for the second consecutive month. The major standout performer, as has been the case for some time, are the online vendors, whose sales jumped by 0.9 percent and continue to eat into the sales of brick-and-mortar establishments.

The slowdown in consumer spending casts a dark cloud over the outlook, but we do not believe it foreshadows a major retrenchment. Some giveback from the torrid pace of consumption over the spring and summer months is not unusual, and households may just have taken a breather in September and October. For sure, there has not been a meaningful deterioration in underlying fundamentals that would




warrant a sustained pullback. Although there has been some slowing in job growth, as expected, the labor market has held up much better than most thought possible, given the advanced stage of the business cycle and the historically low unemployment rate. And while wage growth peaked earlier in the year, it remains anchored at a sturdy 3.0 percent pace, which is comfortably ahead of inflation.

Importantly, wages have been growing faster among lower-paid workers than those higher up the income ladder. That divergence can be seen both in nominal and real dollars. In October, real hourly earnings of nonmanagement workers increased 1.9 percent from a year earlier compared to 1.2 percent for all private sector workers, the widest discrepancy in nearly 10 years. This is more than a statistical footnote because lower wage-earning workers spend a higher fraction



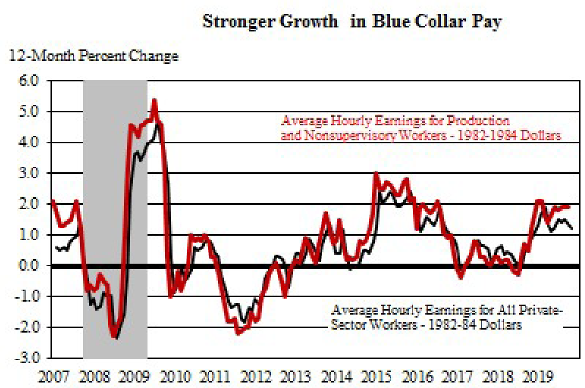

of their incomes than their upper-income colleagues. Simply put, wage growth, although slower than earlier in the year, is delivering a bigger bang for the buck because more of it is flowing to households with a higher propensity to spend.

The stronger wage growth among bluecollar workers is a direct product of an ever-tightening labor market that forces companies to compete in a shrinking pool of available workers. In past cycles, the Fed would have started to tighten the credit screws, fearing that the labor-cost increases spurred by a growing scarcity of workers would stoke an inflation outbreak. That's clearly not the mindset of today's Federal Reserve. Indeed, a key takeaway from Powell's congressional testimony this week was his openness to explore how low the unemployment rate can fall in a stable inflation environment. That's understandable in light of the experience throughout the current expansion. Despite an unemployment rate that currently rests at a half-century low, inflation has steadfastly remained below the Fed's 2 percent target and shows little sign of piercing that threshold anytime soon.

Hence, while some view the Fed's signal to put the rate-cutting cycle on pause at its October 29-30 policy meeting as a hawkish move, we see it more as a bridge leading to another reduction some time over the first half of next year. No doubt, recession fears that escalated over the summer months have faded and the job market has continued to deliver sturdy payroll gains. As well, some encouraging news on the trade front has bolstered perceptions that the expansion has legs to continue. The financial markets have more than accepted this upgraded outlook. Stock prices have set new record highs and bond yields have increased by a significant 30 basis points from their early-October lows.

But the underwhelming spending behavior of consumers over the past two months should be a warning that the road ahead may be bumpier than thought. Again, we do not expect a full-fledged retrenchment, as consumer fundamentals remain firmly intact. But households are shoring up savings and reducing credit-card borrowings, signs that they are preparing for adversity and less inclined to spend as aggressively as they had in the second and third quarters. While consumers have resisted the downward pull that has weighed on business sentiment, their patience may be wearing thin if fears that the cutbacks in investment spending will lead to less hiring and more layoffs in coming months starts to grow.

Indeed, the support from consumers is becoming ever more critical as the industrial slump shows no sign of ending. In October, the nation's factories, mines and utilities slashed output for the second consecutive month. The 0.8 percent contraction lowered total production below its year-earlier level for the first time since November 2016. Importantly manufacturing, which accounts for more than 80 percent of total output, remained in the doldrums, as production slid by 0.5 percent during the month. To be fair, the UAW strike played a big role in last month's weakness, as automakers assembled 1.3 million fewer vehicles than in September, a whopping 12.5 percent decline.




With the strike over, auto assemblies are ramping up again, which should give production a belated boost in November. But the woes of the beleaguered manufacturing sector are far from over. Even stripping out the effect of the strike-related slump in auto output manufacturing production slipped by 0.1 percent last month. Importantly, the weakness was widespread among sectors that are most vulnerable to adverse trade developments and sagging investment spending. Business equipment output contracted by 0.6 percent following a 1.1 percent decline in September; that was the steepest back-to-back decline since the energy-related collapse in November/December 2015.

As Powell noted, trade uncertainty and weak global growth are the biggest downside risks facing the economy. We don't see a significant improvement in either area as the calendar page turns to 2020. Nor do we expect inflation to hit the 2 percent target in the foreseeable future, given the limited pricing power of corporations and cooling domestic as well as foreign demands. Hence, another rate cut will likely be needed to prevent the gradual slowing in economic activity, held up by a steadily less supportive consumer, from morphing into a recession in 2020.

# KEY FINANCIAL & ECONOMIC INDICATORS

## FINANCIAL INDICATORS

| INTEREST RATES | November 15 | Week Ago | Month Ago | Year Ago |
|---|---|---|---|---|
| 3-month Treasury bill | 1.57% | 1.56% | 1.67% | 2.35% |
| 6-month Treasury bill | 1.58 | 1.57 | 1.63 | 2.52 |
| 3-month LIBOR | 1.90 | 1.90 | 1.97 | 2.60 |
| 2-year Treasury note | 1.61 | 1.67 | 1.58 | 2.81 |
| 5-year Treasury note | 1.66 | 1.75 | 1.56 | 2.88 |
| 10-year Treasury note | 1.84 | 1.94 | 1.75 | 3.07 |
| 30-year Treasury bond | 2.31 | 2.43 | 2.25 | 3.32 |
| | | | | |
| 30-year fixed mortgage rate | 3.75 | 3.69 | 3.69 | 4.96 |
| 15-year fixed mortgage rate | 3.20 | 3.13 | 3.15 | 4.36 |
| 5/1-year adjustable rate | 3.44 | 3.39 | 3.35 | 4.14 |
| | | | | |
| **STOCK MARKET** | | | | |
| Dow Jones Industrial Average | 28004.89 | 27681.24 | 26770.20 | 25413.22 |
| S&P 500 | 3120.46 | 3093.08 | 2986.20 | 2736.27 |
| NASDAQ | 8540.93 | 8475.31 | 8089.54 | 7247.87 |
| | | | | |
| **Commodities** | | | | |
| Gold ($ per troy ounce) | 1467.60 | 1459.20 | 1493.90 | 1222.00 |
| Oil ($ per barrel) - Crude Futures (WTI) | 57.83 | 57.38 | 53.71 | 56.83 |

## ECONOMIC INDICATORS

| | Latest Month/Quarter | Previous Month/Quarter | Two-Months/ Quarters Ago | Average-Past 6 Months or Quarters |
|---|---|---|---|---|
| Consumer Price Index (October) - % change | 0.4 | 0.0 | 0.1 | 0.2 |
| Core CPI (October) - % change | 0.2 | 0.1 | 0.3 | 0.2 |
| Producer Price Index (October) - % change | 0.4 | -0.3 | 0.1 | 0.1 |
| Retail Sales (October) - % change | 0.3 | -0.3 | 0.6 | 0.4 |
| Industrial Production (October) - % change | -0.8 | -0.3 | 0.7 | -0.1 |

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