



# WEEKLY

Economic Commentary

November 22, 2019

Since it was a light week of data, the Fed has a brief respite before new evidence that either supports or contradicts its perception that the economy is in a “good place” comes into focus. For sure, early evidence is not very promising. Following a handful of reports for October, the forecasting community has steadily downgraded growth estimates for the fourth quarter. The Atlanta Fed’s GDPNow model is tracking a growth rate of 0.4 percent, down from 1.5 percent at the beginning of the month. We are not as pessimistic, but still see the economy growing at a not-so-hot 1.2 percent pace during the period.

That’s clearly not what the Fed had in mind when the policy setting committee met on October 29–30. Although it lowered its policy rate by another quarter point as expected Fed officials signaled that it was moving to the sidelines for the foreseeable future as it monitors how the economy responds to the three rate cuts put into effect this year. The details of that meeting, contained in the minutes released this week, confirmed that intention as well as Chair Powell’s post-meeting comments that it would require a “material reassessment” of the outlook for the Fed to cut rates again.

It’s still too early to tell if the economy’s growth engine will downshift as abruptly as some of the tracking models indicate. The Fed took encouragement from the still-solid labor market, the reversion to a more normal upward sloping yield curve and tentative signs of progress on the trade front. And since policy changes affect the economy with a considerable lag, it’s understandable that policymakers would prefer to wait-and-see if the previous rounds of rate cuts stokes an acceleration of the growth engine. Still, the slowdown underway has to amplify the concerns over downside risks facing the economy that were expressed at the meeting. Not only would a growth rate of less than 1 percent in the U.S. be a worrisome development, but recent data also suggest that the Fed’s fears about weak global growth are being realized. A purchasing managers report for early November released on Friday reveals that the eurozone is stuck in the mud, on track to barely eke out a small gain in the fourth quarter. News out of the U.K. and Japan are

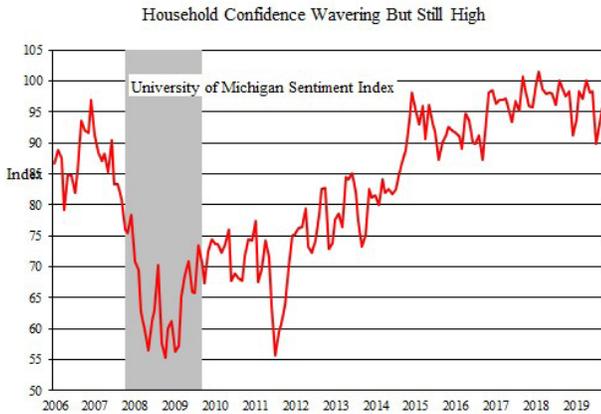
just as grim, if not more so.

The persistent weakness overseas indicates that the beleaguered manufacturing sector will receive little support from exports. Not only does languishing global growth suppress foreign demand for U.S. goods, but the strong dollar also makes those goods more expensive to foreign customers, further damaging export prospects. Meanwhile, the abundance of oil is dampening fracking activity in the U.S., curbing energy-related investment spending even as a broad swath of businesses are putting investment plans on hold due to trade uncertainty. Simply put, the forces that have driven manufacturing into recession territory remain very much intact, although they do not seem to be getting worse. At best, industrial activity is bottoming out, easing fears that it will drag down the broader economy.

While the fourth quarter is starting off on a downbeat note, there are positive signs suggesting that the final months of the year will not turn out to be as bad as the early data indicate. As always, the economy’s performance hinges largely on how consumers behave. Unfortunately, the early batch of weak data includes disappointing spending reports, as evidenced by retail sales for September and October. The jury is still out as to whether consumers merely took a breather following robust spending in the second and third quarters or are on the verge of a sustained pullback in spending behavior. From our lens, consumer outlays will provide less muscle to economic growth in the fourth quarter than they did over the spring and summer months. But the pullback will be less severe than portrayed in some of the more pessimistic forecasts.

In contrast to business leaders who are dismayed by ongoing trade uncertainty, households retain a relatively upbeat mindset. The latest University of Michigan index of consumer sentiment increased 1.3 points in November and hovers well within the upper range of the expansion, now in its eleventh year. The resilient attitude of households suggests that they are not overly bothered by trade conflicts or the ongoing impeachment inquiry and are driven more by job and income prospects. Both are still on the positive side of the ledger, which should sustain the positive attitude of households and support

modest spending increases going forward.

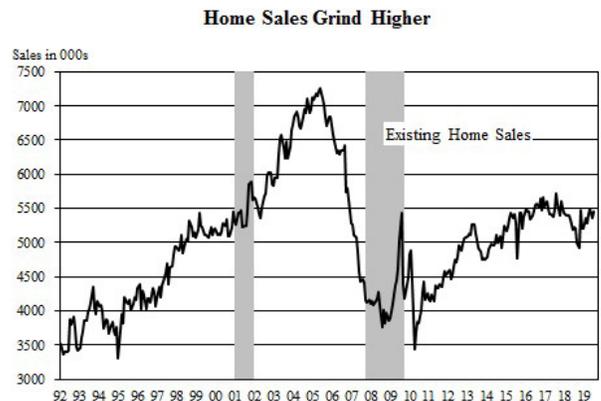


Of course, that could change if the external shocks buffeting businesses gain traction. Consumers have not suffered the consequences of the trade wars or the tariffs to any meaningful extent. The abrupt slowdown in global trade, sagging exports and weak investment spending has not translated into more layoffs and significant reductions in hiring. Nor have the higher tariffs, which are crimping profit margins, resulted in steeper price increases to consumers. In fact, inflation expectations remain well anchored according to the University of Michigan survey, holding steady at a low 2.5 percent over the next twelve months, down from 2.9 percent as recently as May.

However, should the attention-getting “phase 1” trade deal between China and the U.S. break down, household patience could wear thin. That’s because the next stage of tariff increases, scheduled to take place on December 15, would hit consumer wallets more directly than previous increases, which were mostly absorbed by businesses. The pending 15% levies would be imposed on laptops, cellphones, tablets and other consumer goods totaling \$160 billion. If a phase 1 deal is not consummated by December 15, these tariffs could very well take effect unless president Trump believes enough progress in negotiations has been made to justify a suspension. Some encouraging comments by Chinese leaders on Friday buoyed the prospects of a limited deal - and sparked a rally in the stock market - but Congress may have thrown a wrench in the negotiations by passing a bill in support of the Hong Kong demonstrators.

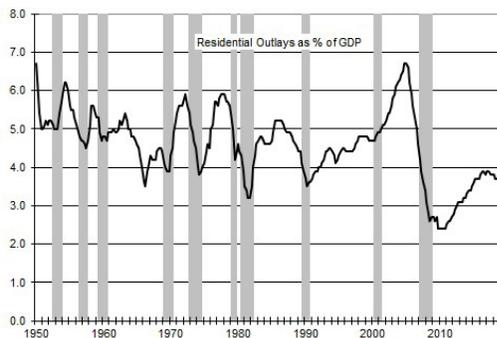
One bright spot among recent economic reports is the housing market, which is providing atypical oomph to the economy so late in the expansion. Residential outlays made a positive contribution to GDP in the third quarter for the first time in nearly two years. Ordinarily, home sales and construction activity weakens as the expansion matures, reflecting the time-honored tightening of monetary policy that occurs at this point of the economic cycle. Not so this time, as the Fed’s rate reductions this year combined with trade-related recession fears, tame inflation and sluggish global growth has lowered mortgage rates and made home buying more affordable to households.

Hence, unlike several indicators for October that have lowered fourth-quarter growth prospects, the housing data have been mostly upbeat. The National Association of Realtors reported this week that home resales rose by a sturdy 1.9 percent during the month to a 5.460 million annual rate, the highest since February. If not for the limited number of homes on the market, sales would most likely have been even stronger. Inventories fell for the fifth consecutive month compared to year-earlier levels, and would last for only 3.9 months on the market at the current sales pace, a historically low inventory/sales ratio. One factor keeping inventories down is demographics: the population is aging and older homeowners are less willing to move than younger counterparts. But the problem is broader, as the Census Bureau just reported that mobility rates among households are the lowest on record.



Homebuilders could alleviate the problem, and they are making some progress. Housing starts are grinding higher, with the total rising 3.8 percent to a 1.34 million annual rate in October. Most impressive is that the recent strength has been driven by single-family construction. Starts of one-family homes have increased for five consecutive months, the longest stretch of consecutive gains in more than a dozen years. What's more, single-family building permits are at the highest level since August 2007, signaling more construction gains going forward. But it would be a mistake to overstate the significance of this brighter outlook given the diminished footprint of the housing sector in the overall economy.

**Smaller Housing Share**



To be sure, the advance in residential construction is good news for the economy and certainly for construction workers. The bad news, however, is that the industry does not carry the same weight as it did in earlier business cycles. In the third quarter, for example, residential outlays accounted for 3.7 percent of GDP, more than a full percentage point less than the share in the late stages of previous post-war expansions. Hence, whatever positive contribution to growth homebuilding provides in coming quarters, it will not be enough to offset an investment spending bust and the likely drag from slower consumer spending. We suspect that at some point early next year, the Fed will need to reassess the outlook and provide another interest rate cut to jump-start the economy's growth engine.

# KEY FINANCIAL & ECONOMIC INDICATORS

## FINANCIAL INDICATORS

	November 22	Week Ago	Month Ago	Year Ago
<b>INTEREST RATES</b>				
3-month Treasury bill	1.58%	1.57%	1.67%	2.41%
6-month Treasury bill	1.59	1.58	1.66	2.53
3-month LIBOR	1.91	1.90	1.94	2.69
2-year Treasury note	1.63	1.61	1.63	2.82
5-year Treasury note	1.63	1.66	1.63	2.87
10-year Treasury note	1.77	1.84	1.80	3.04
30-year Treasury bond	2.22	2.31	2.29	3.31
30-year fixed mortgage rate	3.66	3.75	3.75	4.81
15-year fixed mortgage rate	3.15	3.20	3.18	4.24
5/1-year adjustable rate	3.39	3.44	3.40	4.09
<b>STOCK MARKET</b>				
Dow Jones Industrial Average	27875.62	28004.89	26958.06	24285.95
S&P 500	3110.29	3120.46	3022.55	2632.56
NASDAQ	8519.88	8540.93	8243.12	6938.98
<b>Commodities</b>				
Gold (\$ per troy ounce)	1462.40	1467.60	1507.30	1223.40
Oil (\$ per barrel) - Crude Futures (WTI)	57.95	57.83	56.62	50.39

## ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
Housing Starts (October) - 000s	1314	1266	1375	1276
Building Permits (October) - 000s	1461	1391	1425	1354
Existing Home Sales (October)	5460	5360	5500	5398

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