Weekly Economic Recap & Comment

Week Ended December 14, 2018

Increased consumer spending remains the main source of current U.S. economic growth, so we paid close attention this week to the latest report on retail activity. ***November retail sales*** rose by a seasonally-adjusted 0.2%, decelerating from their 1.1% jump in October. ***November retail sales excluding autos*** also rose 0.2%, after their gain of 1.0% in the previous month. Despite those slowdowns, however, the longer-term trends remained positive. Total sales in November were up a healthy 4.9% from the same month one year earlier, and sales ex-autos were up an even stronger 5.7%. Those increases were much bigger than the rise in consumer prices over the period, so it seems clear that the actual volume of sales is still rising nicely. In sum, the report was consistent with our view that the economy continues to grow well. That should create more profit growth and an eventual rebound in stock prices, so we are maintaining a significant exposure to equities for the time being (in our strategies that include them). The problem is that demand has been rising faster than supply in a wide range of industries, putting upward pressure on prices and interest rates. We still think broad, long-standing factors such as population aging and new technologies will ultimately limit how bad inflation will get. Recent data suggest inflation could already be cooling. All the same, excess demand has created a risk that the Federal Reserve might hike interest rates too far, or that rising costs could cut into corporate profits and short-circuit the economic expansion, compounding the slowdown in growth overseas. There are also yellow flags in the government policy environment, such as risky posturing in national security and international trade disputes, and we sense that political risks are increasing as investigators make more progress in their examination of high-level scandals. We responded to those risks by modestly cutting our exposure to stocks and other volatile assets in August, which helped protect our portfolios in the recent market correction. If the data keeps coming in like it has been, we expect to further cut risk in the coming months.

The rise in consumer spending mostly reflects the strong labor market. In the latest report, ***initial jobless claims in the week ended December 8*** dropped sharply by a seasonally-adjusted 27,000 to just 206,000, after several months of nearly constant increases. The four-week moving average of claims fell more modestly, to 224,750, but that still helped allay concerns that the trend in first-time applications for unemployment benefits might be signaling a rise in layoffs. If the figures remain well behaved in the coming weeks, it would suggest that labor demand remains strong and that consumer spending will probably keep rising at a good pace.

The main reason we think the Fed will keep hiking interest rates is that current rates still seem "too low" for today's economic growth, based on historical relationships. However, against a backdrop of reduced economic dynamism since the Great Recession, some figures suggest the policymakers have already hiked rates far enough, or even too far. For example, the ***November consumer price index (CPI)*** came in unchanged, after a 0.3% rise in October and a 0.1% gain in September. The flat performance came mostly from a big drop in energy prices. Excluding the volatile food and energy components, the ***November "core" CPI*** rose a modest 0.2%, as it did in the previous month and in many recent months. In November, both the overall CPI and the core CPI were up a just 2.2% year-over-year, only slightly above the Fed's target of 2.0%.

Similar trends were evident at the producer level. The ***November producer price index (PPI)*** rose only slightly by a seasonally-adjusted 0.1%, falling short of its 0.6% gain in October and its average monthly increase of 0.2% over the last year. Excluding the food and energy components, the ***November "core" PPI*** was up 0.3%, after a 0.5% rise in the previous month. The overall PPI in November was up 2.5% year-over-year, and the core PPI was up 2.7%. Business-to-business prices are still rising relatively fast, but the annual gains have slowed markedly since early summer.

There is one area where price trends look especially good. ***November import prices*** declined by a seasonally-adjusted 1.6%, easily reversing their 0.5% rise in October and marking their third decrease in the last five months. Most of the drop came from falling energy prices, but ***November nonfuel import prices*** also fell, by 0.3%. Overall import prices in November were up just 0.7% from one year earlier, and nonfuel import prices were up a mere 1.8%. We think import prices will generally continue to help hold down inflation as long as global oil prices remain under wraps, the dollar stays strong, and foreign economic growth continues to soften.

Other production-sector data also touch on the inflation issue. For instance, ***November industrial production*** jumped by a seasonally-adjusted 0.6%, erasing its revised 0.2% fall in October. Overall output in November was up 3.8% year-over-year, led by a 13.2% surge in mining production and a 4.7% rise in utility output, while manufacturing production was up a more modest 1.8%. ***November industrial capacity utilization*** rose to 78.5%, tying its highest level of the last four years and rising further above its 20-year average of 77.3%. However, factory utilization fell back to a four-month low of 75.7%, which could discourage further price hikes.

In other inflation-related data from the business sector, ***October business inventories*** rose by a seasonally-adjusted 0.6%, after revised increases of 0.5% in both September and August. In contrast with recent trends, the rise in inventories was bigger than the rise in sales. The ***October business inventory-to-sales ratio*** therefore rose to a six-month high of 1.35. We think the threat of inventories getting out of hand could further reduce the incentive for firms to hike prices.

In data on stockpiles specifically in the energy sector, ***commercial crude oil inventories in the week ended December 8*** fell by 1.208 million barrels, for their second straight weekly decline. However, total stockpiles, at 441,954 million barrels, still stood 2.1% above their five-year moving average (an industry benchmark that suggests supply and demand are in balance). While the report said ***domestic crude oil production in the week ended December 8*** fell slightly to 11.600 million barrels per day, that was still close to a record high. Considering the continued U.S. economic growth, rising usage around the world, and reduced exports from big producers (such as Iran and Venezuela), we still think inventories may remain in check and support global prices, so we are maintaining our exposure to broad commodity funds in our more aggressive portfolios for now. However, if U.S. production and stockpiles start rising again, oil prices could soften further and we may need to change tack.

Patrick Fearon, CFA
Chief Investment Officer

Upcoming U.S. Data

Date	ET	Release	For	Consensus Forecast	Prior
17-Dec	8:30	Empire Manufacturing	Dec	NA	23.3
17-Dec	10:00	NAHB Housing Market Index	Dec	NA	60
17-Dec	16:00	Net Long-Term TIC Flows	Oct	NA	$30.8B
18-Dec	8:30	Building Permits	Nov	NA	1263K
18-Dec	8:30	Housing Starts	Nov	NA	1228K
19-Dec	7:00	MBA Mortgage Purchase Index	15-Dec	NA	1.60%
19-Dec	8:30	Current Account Balance	Q3	NA	-$101.5B
19-Dec	10:00	Existing Home Sales	Nov	NA	5.22M
19-Dec	10:30	Crude Inventories	15-Dec	NA	NA
19-Dec	14:00	FOMC Rate Decision	Dec	NA	2.13%
20-Dec	8:30	Continuing Claims	8-Dec	NA	1661K
20-Dec	8:30	Initial Claims	15-Dec	NA	206K
20-Dec	8:30	Philadelphia Fed	Dec	NA	12.9
20-Dec	10:00	Leading Indicators	Nov	NA	NA
20-Dec	10:30	Natural Gas Inventories	15-Dec	NA	-77 bcf
21-Dec	8:30	Durable Goods –ex transportation	Nov	NA	0.10%
21-Dec	8:30	Durable Orders	Nov	NA	-4.40%
21-Dec	8:30	GDP - Third Estimate	Q3	NA	NA
21-Dec	8:30	GDP Deflator - Third Estimate	Q3	NA	NA
21-Dec	8:30	PCE Prices	Nov	NA	NA
21-Dec	8:30	PCE Prices - Core	Nov	NA	NA
21-Dec	8:30	Personal Income	Nov	NA	NA
21-Dec	8:30	Personal Spending	Nov	NA	NA

Source: Briefing.com

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