WEALTH MANAGEMENT
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Proactive Investment Management & Financial Planning

Weekly Economic Recap & Comment
Week Ended February 15, 2019

U.S. economic activity is clearly still expanding, but this week we saw more evidence that the growth rate is moderating from its rapid pace in mid-2018, and downside risks are accumulating. For example, ***December retail sales*** unexpectedly dropped by a seasonally-adjusted 1.2%, wiping out their revised gains of 0.1% in November and 1.0% in October. Receipts at automobile dealerships rose in December, but sales declined in most other types of retail establishments. ***December retail sales excluding autos*** plunged 1.8%, for their biggest monthly decline in ten years. Overall retail sales in December were up a meager 1.4% from one year earlier, and sales ex-autos were up just 1.1%. Some of the year-end weakness may have come from temporary issues, such as the fourth-quarter stock market correction, the partial shutdown of the federal government, and a bout of frigid weather, but some of it probably also reflects the softening we're seeing in other economic sectors. Since continuing growth should help keep domestic corporate profits on the upswing in the near term, we are maintaining a significant exposure to equities (in our strategies that include them). Near-term prospects are also supported by the recent slowdown in inflation and the Federal Reserve's decision to stop or slow its campaign of interest-rate hikes. The problem is that the Fed's move to take its foot off the brakes may not have been as perfectly timed as we all hope. With the economy much less dynamic than in decades past, there's a chance that the inflation and rate hikes to date may have already done their damage, and growth could now slow substantially further. Besides, foreign demand is still weakening, which will hurt both exporters and those U.S. firms that produce and sell abroad. There are also yellow flags in the government policy environment, such as risky posturing in national security and international trade disputes, and political risks are increasing as investigators make more progress in their examination of high-level scandals. Because of those risks, we have begun to modestly trim our exposure to stocks and other riskier assets, though we think we've kept enough exposure to enjoy the benefits of the ongoing technical recovery in stocks.

Today's continuing economic growth stems mostly from the healthy labor market. Job creation isn't necessarily robust, but it has been strong and consistent enough to cut unemployment to very low levels and modestly lift wage rates. Layoffs have also fallen to very low levels, but recent reports suggest that may now be changing. In the latest data, ***initial jobless claims in the week ended February 9*** rose by a seasonally-adjusted 4,000 to a level of 239,000. More worrisome, the four-week moving average of claims rose to 231,750, reaching its highest level in more than a year. With initial applications for unemployment benefits on the rise again, it appears that layoffs are becoming more common, even if they remain historically low.

Fortunately, while the stock-market correction and federal government shutdown seemed to be weighing especially heavy on consumer optimism late last year, it appears the end of those problems has produced a bit of a rebound. The University of Michigan this week said its ***preliminary February consumer sentiment index*** rose to 95.5 from 91.2 in January. However, it's still too early to know if optimism can rebound all the way back to the high levels seen earlier in 2018. The February reading on the sentiment index was still well below the December figure of 98.3, and it was still much weaker than the cycle high of 101.4 last March.

The week's data on the business sector also showed more softening. ***January industrial production*** dropped by a seasonally-adjusted 0.6%, reversing most of its revised increases of 0.1% in December and 0.6% in November. The decline in January stemmed entirely from plunge in manufacturing output. Overall industrial production in January was still up a decent 3.7% on the year, driven in part by a 15.2% jump in mining output, but manufacturing production was only up 2.9% and utility output was down 4.9%. The report also showed ***January industrial capacity utilization*** dropped sharply to a six-month low of 75.8%. That's important because lower usage rates discourage price hikes. In other words, softer production and lower capacity utilization rates will probably help hold down inflation and discourage the Fed from hiking interest rates further.

In other soft data, ***November business inventories*** fell by a seasonally-adjusted 0.1%, erasing part of their 0.6% rise in October. Importantly, however, business sales fell even more, continuing a recent pattern. The ***November business inventory-to-sales ratio*** remained at 1.35, but that is elevated compared with the ratio of 1.33 as recently as last June and readings below 1.30 before the last recession. Excess stockpiles

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discourage firms from hiking prices, so if the inventory ratio continues to rebound, we think inflation pressures will ease further and the Fed will be even more likely to refrain from further rate hikes.

We think most of the rise in inventories last autumn came from softening demand, but surging oil production probably also played a part. In the latest data, ***commercial crude oil inventories in the week ended February 9*** rose by 3.633 million barrels, marking their fourth straight weekly increase and lifting total stockpiles to a 15-month high of 450.840 million barrels. Inventories now stand a significant 3.2% above their five-year moving average (an industry benchmark that suggests supply and demand are in balance). The report said ***domestic crude oil production in the week ended February 9*** remained at a record high of 11.900 million barrels per day for the fifth straight week. In spite of continued U.S. economic growth, rising usage around the world, and reduced exports from big producers (such as Iran and Venezuela), the figures suggest excess inventories and high U.S. production could keep weighing on energy prices. Besides helping to hold down inflation, weak energy prices could also discourage new drilling and oil field development, so the data point to a further moderation in economic growth and a continued stand-down on rate hikes by the Fed.

Several reports specifically on inflation also pointed to stable Fed interest rates. After stripping out seasonal impacts, the ***January consumer price index (CPI)*** came in unchanged for the third straight month, compared with the typical increase of 0.2% through most of 2017 and 2018. Excluding the volatile food and energy components, the ***January "core" CPI*** was up 0.2%, remaining in line with recent history. The total CPI in January was up just 1.6% year-over-year, and the core CPI was up just 2.2%. Both those figures were significantly weaker than the elevated levels recorded last summer. Taken together, we think they're consistent with the Fed's target inflation rate of 2.0%.

Similar trends were visible in business-to-business prices. The ***January producer price index (PPI)*** fell by a seasonally adjusted 0.1% for the second straight month. The ***January "core" PPI*** rose 0.3%, but that came after a flat performance in December. The overall PPI in January was up 2.0% on the year, while the core PPI was up 2.6%. As recently as last July, the total PPI was up 3.4% on the year, while the core PPI was up 2.8%.

Finally, the week also included some data on prices in international trade. ***January import prices*** fell 0.5%, marking their third straight monthly decline. Some of the fall came from weaker energy prices, but that wasn't the whole story. ***January import prices excluding fuels*** fell 0.2%, after being flat in December and falling 0.3% in November. Overall import prices in January were down 1.7% year-over-yar, while nonfuel import prices were down 0.2%. We suspect the decline in import prices comes in large part from weakening demand overseas and the strong dollar. In any case, we think the trend will help hold down overall inflation and further discourage the Fed from hiking interest rates further.

Patrick Fearon, CFA
Lead Portfolio Manager

Upcoming U.S. Data

				Consensus	
Date	**ET**	**Release**	**For**	**Forecast**	**Prior**
19-Feb	10:00	NAHB Housing Market Index	Feb	NA	58
20-Feb	7:00	MBA Mortgage Applications Index	16-Feb	NA	-3.70%
20-Feb	14:00	FOMC Minutes	Jan	NA	NA
21-Feb	8:30	Durable Orders	Dec	NA	0.80%
21-Feb	8:30	Durable Goods ex-transportation	Dec	NA	-0.30%
21-Feb	8:30	Initial Claims	16-Feb	NA	239K
21-Feb	8:30	Continuing Claims	9-Feb	NA	1773K
21-Feb	8:30	Philadelphia Fed Index	Feb	NA	17
21-Feb	10:00	Existing Home Sales	Jan	NA	4.99M
21-Feb	10:00	Leading Indicators	Jan	NA	-0.10%
21-Feb	10:30	EIA Natural Gas Inventories	16-Feb	NA	-78 bcf
21-Feb	11:00	EIA Crude Oil Inventories	16-Feb	NA	+3.6M

Source: Briefing.com

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