Weekly Economic Recap & Comment

Week Ended March 1, 2019

This week's key data came in the long-delayed report on U.S. economic activity in October through December. After stripping out price changes and seasonal impacts, ***fourth-quarter gross domestic product (GDP)*** grew at an annualized rate of 2.6%, moderating from 3.4% in the third quarter and 4.2% in the second. Because of the strong growth in mid-2018, GDP in the fourth quarter was up a healthy 3.1% year-over-year, compared with an average annual increase of 2.1% over the last two decades. Most of the gain in GDP over the year came from increased personal consumption spending, although private investment and government spending also contributed. Finally, in a broad measure of inflation, the ***fourth-quarter GDP deflator*** rose at a moderate rate of 1.8%, just as it did in the previous period. We thought the data was consistent with our view that the economy retains enough momentum to keep growing in the near term, even if some sectors are softening and risks are accumulating. 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. Continuing growth should help keep domestic corporate profits on the upswing in the near term, so we are maintaining a significant exposure to equities for the time being (in our strategies that include them). The problem is that the Fed may have stopped hiking rates too late. 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 continue to gradually trim our exposure to stocks and other riskier assets, although we think we've kept enough exposure at present to take reasonable advantage of the ongoing technical recovery in stocks.

One reason for the moderation in growth last quarter was a modest softening in the consumer sector. New data showed ***December personal income*** rose strongly by a seasonally-adjusted 1.0%, after a revised 0.3% gain in November, but people apparently became more reluctant to spend in the face of the fourth-quarter correction in the stock market and the partial shutdown of the federal government. ***December personal consumption expenditures (PCE)*** fell 0.5%, essentially wiping out the revised 0.6% rise in the previous month. Compared with December 2017, personal income was up a moderate 4.3%, but PCE was up just 3.8%. The report also included the Fed's preferred gauge of inflation. Excluding the volatile food and energy components, the ***December "core" PCE deflator*** was up just 1.9%, staying slightly below the Fed's target of 2.0%.

In more recent data on the labor market, ***initial jobless claims in the week ended February 23*** rose by a seasonally-adjusted 8,000 to a level of 225,000. The four-week moving average of claims fell to 229,000, but that was still 1.9% higher than one year earlier. With initial applications for unemployment benefits apparently on the rise again, it appears that layoffs are becoming more common, even if they remain historically quite low. There's also evidence that the labor market may not be as strong as we previously thought. For instance, today's typical monthly job increases are large compared with historical experience, but they're not that impressive compared with today's bigger population. Recent job gains have been strong and consistent enough to cut unemployment to very low levels, but they haven't been strong enough to dramatically lift wage rates.

Even though the stock-market correction and government shutdown have ended, the various measures of consumer optimism are showing conflicting signs. For example, the Conference Board this week announced that its ***February consumer confidence index*** rose to a three-month high of 131.4, after a revised 121.7 in January. Similarly, the University of Michigan said its ***final February consumer sentiment index*** rose to a two-month high of 93.8. The problem is that both rebounds were driven by the respective subindexes on future expectations. The subindexes on current conditions, which we think offer a better signal of prospects in the near term, remained relatively weak.

Another reason for the slower growth last quarter was a continued fall in commercial and residential construction. In data on homebuilding, ***December housing starts*** plunged by a seasonally-adjusted 11.2%, wiping out their revised 0.4% gain in November and marking the third decline in the last four months. The annualized rate of housing starts dropped to a 28-month low of 1.078 million units. Groundbreakings fell especially sharply in the volatile multi-family sector, but single-family starts also fell, for the fourth straight month. Overall housing starts in December were down 11.9% year-over-year, while single-family starts were down 11.1%. In a somewhat better sign for future residential construction, ***December building permits*** rose 0.3%, after a revised 4.5% gain in the previous month. Still, total permits were only 0.6% higher than one year earlier, and permits for single-family homes were down 5.5% on the year.

The fourth-quarter slowdown also came in part from relatively stagnant inventory investment. In the latest data on the nation's energy sector, ***commercial crude oil inventories in the week ended February 23*** fell by 8.647 million barrels, marking their biggest weekly drop since last summer. Nevertheless, total stockpiles still stood at 445.865 million barrels, or 1.9% above their five-year moving average (an industry benchmark that suggests supply and demand are in balance). The report also said ***domestic crude oil production in the week ended February 23*** rose to yet another record high of 12.100 million barrels per day. 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 we think the data could point to a further moderation in economic growth and a continued stand-down on rate hikes by the Fed.

Fortunately, things look a bit better in manufacturing. ***December factory orders*** edged up by a seasonally-adjusted 0.1%, after revised declines of 0.5% in November and 2.1% in October. The slight rise at the end of the year came from a rebound in durable goods orders, which just offset a fall in nondurable orders. Still, the trends in late 2018 looked a bit soft from a longer perspective. Overall factory orders in December were up just 2.5% year-over-year, with durable orders up 3.6% but nondurables up just 1.4%.

Finally, in more recent data on the factory sector, the Institute for Supply Management announced that its ***February ISM manufacturing index*** fell to a seasonally-adjusted 54.2. That was only a bit lower than the 56.6 in January, but it was still the worst figure since November 2016. Importantly, the subindex on new orders also declined, to 55.5, and it's getting closer to the level that has historically signaled a recession and bear market in stocks. Those problems still aren't necessarily imminent, but the figures show the economy is losing some momentum and risks are indeed increasing.

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Upcoming U.S. Data

Date	ET	Release	For	Consensus Forecast	Prior
4-Mar	10:00	Construction Spending	Dec	NA	0.80%
4-Mar	14:00	Auto Sales	Feb	NA	4.07M
4-Mar	14:00	Truck Sales	Feb	NA	8.75M
5-Mar	10:00	ISM Non-Manufacturing Index	Feb	NA	56.7
5-Mar	10:00	New Home Sales	Dec	NA	657K
5-Mar	14:00	Treasury Budget	Jan	NA	$49.2B
6-Mar	7:00	MBA Mortgage Applications Index	2-Mar	NA	5.30%
6-Mar	8:15	ADP Employment Change	Feb	NA	213K
6-Mar	8:30	Trade Balance	Dec	NA	-$49.3B
6-Mar	10:00	Factory Orders	Jan	NA	0.10%
6-Mar	10:30	EIA Crude Oil Inventories	2-Mar	NA	-8.6M
6-Mar	14:00	Fed's Beige Book	Mar	NA	NA
7-Mar	8:30	Initial Claims	2-Mar	NA	225K
7-Mar	8:30	Continuing Claims	23-Feb	NA	1805K
7-Mar	10:30	EIA Natural Gas Inventories	2-Mar	NA	-166 bcf
7-Mar	15:00	Consumer Credit	Jan	NA	$16.6B
8-Mar	8:30	Nonfarm Payrolls	Feb	NA	304K
8-Mar	8:30	Nonfarm Private Payrolls	Feb	NA	296K
8-Mar	8:30	Avg. Hourly Earnings	Feb	NA	0.10%
8-Mar	8:30	Unemployment Rate	Feb	NA	4.00%
8-Mar	8:30	Average Workweek	Feb	NA	34.5

Source: Briefing.com

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