Weekly Economic Recap & Comment
Week Ended June 14, 2019

This week provided several key reports on inflation. Most important, the ***May consumer price index (CPI)*** rose only tepidly by a seasonally-adjusted 0.1%, after rising 0.3% in April and 0.4% in March. The slowdown stemmed in part from sliding oil prices, but inflation looks weak even after adjusting for volatile categories like that. Excluding food and energy, the ***May "core" CPI*** rose just 0.1% for the fourth straight month! The overall CPI in May was up 1.8% from a year earlier, compared with annual gains of almost 3.0% in mid-2018. The core CPI in May was up 2.0% on the year, compared with its recent annual gains of around 2.4%. Overall, we still think the U.S. economy is growing and retains significant momentum, mostly because of the healthy labor market and increased consumer spending. The problem is that some other sectors are facing strengthening headwinds, and as they slow, they're threatening to overwhelm the consumer sector and drive inflation even lower. We believe continued overall growth should help keep domestic corporate profits on an uptrend for now, so we are maintaining a meaningful exposure to equities for the time being (in our strategies that include them). What we worry about is that the Federal Reserve's recent pause on interest-rate hikes may have come too late. With the economy much less dynamic than in decades past, the inflation and rate hikes through 2018 may have already done their damage, and growth could now slow further, especially if the Fed is slow to start cutting interest rates. Besides, a continued weakening in foreign demand could 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 the administration's risky posturing in national security and international trade disputes. Because of those threats, we've been gradually cutting our exposure to stocks and other riskier assets since last summer. Those adjustments helped cushion our portfolios from the recent market turbulence. Going forward, I believe they've also left the portfolios in a good position for the transition period after I leave my position as portfolio manager, as we announced earlier.

Importantly, other data this week also pointed to cooling inflation pressure farther up the production chain. The ***May producer price index (PPI)*** rose weakly by a seasonally-adjusted 0.1%, slowing from its increases of 0.2% in April and 0.6% in March. Excluding the volatile food and energy components, the ***May "core" PPI*** rose 0.2%, accelerating from a 0.1% gain in April but remaining weaker than its 0.3% rise in March. The overall May PPI was up 1.8% on the year, and the core PPI was up 2.3%. As with the CPI, those annual gains were both much smaller than the ones seen last year at this time.

The week's final inflation report touched on international trade. ***May import prices*** fell by a seasonally-adjusted 0.3%, after rising 0.1% in April, 0.6% in March, and a full 1.0% in February. As with the CPI and PPI, the downshift in import prices came in part from falling oil prices, but that wasn't the whole story. Reflecting factors like the strong dollar and faltering demand overseas, the data showed ***May nonfuel import prices*** also declined 0.3%, after falling 0.1% in April and 0.2% in March. Overall import prices in May were down 1.5% on the year, while nonfuel import prices were down 1.4%. As lower import costs work their way through the economy, we think domestic prices will remain under pressure.

Other reports this week also pointed to further inflation declines. For example, ***May industrial production*** rose modestly by a seasonally-adjusted 0.4%, but that was only the second rise in the last five months, and it basically just reversed the revised 0.4% decline in April. Compared with May 2018, overall output was up just 1.9%, as a 10.2% jump in mining production was largely offset by a weak 0.6% gain in manufacturing output and a 0.9% drop in utility production. Of utmost importance for inflation, ***May industrial capacity utilization*** rose only a bit to 78.1%. That's still slightly above the average rate over the last two decades, but it's far lower than the usage rates in mid-2018. We think lower usage rates will discourage firms from hiking prices.

Even the week's inventory data pointed to faltering price pressures. ***April business inventories*** jumped by a seasonally-adjusted 0.5%, continuing their recent trend of rising even when business sales were falling. The ***April business inventory-to-sales ratio*** therefore rose back to its recent high of 1.39. The inventory ratio remains much higher than the 1.28 or so that we think would make firms more comfortable. As it is, we think excess stockpiles will now encourage more promotions, putting further downward pressure on inflation.

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In data specific to the energy sector, ***commercial crude oil inventories in the week ended June 8*** rose by 2.206 million barrels, notching their 9th rise in the last 12 weeks and reaching a 23-month high of 485.470 million barrels. Stockpiles remained extraordinarily bloated at 9.4% 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 June 8*** fell back to 12.3 million barrels per day, but that was only slightly below the record high in the previous week. In spite of continued demand growth and reduced exports from some big producers (such as Iran and Venezuela), we are worried that historically high inventories and strong U.S. output could keep supplies too high and result in further price declines. We therefore continue to avoid commodity funds in most of our strategies at present.

Happily, the week also included some good news on the still healthy consumer sector. ***May retail sales*** rose by a seasonally-adjusted 0.5%, accelerating from an upwardly revised gain of 0.3% in April. These figures are sometimes skewed by the volatility in auto sales, but not this time. ***May retail sales excluding autos*** were also up 0.5%, matching their gain in the previous month. Overall retail sales in May were up a moderate 3.5% year-over-year. Sales ex-autos were up 3.4%.

In a positive sign for future retail activity, other data showed ***initial jobless claims in the week ended June 8*** rose only modestly by a seasonally-adjusted 3,000, reaching a level of 222,000. The four-week moving average of claims rose to 217,750, but both measures remain historically quite low. With initial applications for unemployment benefits this low, it appears that layoffs remain quite limited.

All the same, a final data point this week showed that while continued job creation and limited layoffs are still buoying consumer spirits, optimism has pulled back a bit. The University of Michigan announced that its ***preliminary June consumer sentiment index*** fell back to 97.9 from final readings of 100.0 in May and 97.2 in April. Although the index remains historically high, it is no longer rising as it was a year ago, perhaps because of the headwinds, slowing activity, and increasing risks in the non-consumer sectors of the economy that we mentioned above. In fact, the key subindex on consumers' view of current conditions is now significantly lower than its highs in early 2018. We think that underlines the risk that slowing growth in some parts of the economy could eventually lead to decreased consumer demand and a pullback in overall activity.

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Upcoming U.S. Data

Date	ET	Release	For	Consensus Forecast	Prior
17-Jun	8:30	Empire State Manufacturing	Jun	NA	10.1
17-Jun	10:00	NAHB Housing Market Index	Jun	NA	66
17-Jun	16:00	Net Long-Term TIC Flows	Apr	NA	$51.9B
18-Jun	8:30	Building Permits	May	NA	1269K
18-Jun	8:30	Housing Starts	May	NA	1139K
19-Jun	7:00	MBA Mortgage Index	15-Jun	NA	26.80%
19-Jun	10:30	EIA Crude Oil Inventories	15-Jun	NA	+2.2M
19-Jun	14:00	FOMC Rate Decision	Jun	NA	2.38%
20-Jun	8:30	Initial Claims	15-Jun	NA	222K
20-Jun	8:30	Continuing Claims	8-Jun	NA	1695K
20-Jun	8:30	Current Account Balance	Q1	NA	-$134.4B
20-Jun	8:30	Philadelphia Fed Index	Jun	NA	8.5
20-Jun	10:00	Leading Indicators	May	NA	0.40%
20-Jun	10:30	EIA Natural Gas Inventories	15-Jun	NA	+102 bcf
21-Jun	10:00	Existing Home Sales	May	NA	5.19M

Source: Briefing.com