



Economic Commentary

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The Government shutdown caused the delay in several data reports normally released in the last two weeks of January. There are some important releases that were available and at least two of those releases are among the three that provide somewhat dependable forecasts of recessionary probabilities. As a reminder, those data points are employment, retail spending and the yield curve.

Employment Report

The January report revealed that non-farm payrolls increased by 304,000, which exceeded the median expectation of 165,000. So as not to get too excited about the near doubling of the forecast, you should know that the increase was nearly offset by the adjustment downward of November and December estimates. Still, the three-month average of payroll additions was 234,000, which is well ahead of the number to stabilize employment. If that is the case, then why the tick up in the unemployment rate? For the third consecutive month, the labor participation rate rose, resting at nearly 62%. As more people seek employment, the pool of labor grows, and it requires more jobs to be added to keep the unemployment rate constant. The difference between the previous unemployment rate of 3.9% and the current reported 4.0% is inconsequential. Average hourly earnings rose at a level to keep the twelve-month average above 3.1%, while the employment cost index increase was slightly lower at 2.9%. Many analysts both inside and outside of the Fed look to labor and wage reports as leading indicators of future inflation pressure.

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Few would say that there is much slack in labor force availability, yet the current reports fail to indicate wage pressure beyond the current GDP growth rate or inflation indicators.

Retail Sales

The commerce department was impacted by the Government shutdown, and so the latest retail sales data will be released later this month. There are few anecdotal examples of trends in growth or declines in retail sales and thus we will await the data releases to reflect further.

Yield Curve

As described in multiple previous writings, analysts view an inverted yield curve (where longer term treasury bond rates yield less than those bonds of shorter duration) as a sign of future economic trouble, mainly recession. While yield curves can flatten for multiple other reasons in the short term (mainly significant geopolitical trauma) sustained flattening of the yield curve is almost always associated with early stage recessionary cycles. As of today's writing

the yields on treasuries are as follows:

5 yr. = 2.54%, 10 yr. = 2.62%, 20 yr. = 2.72%, 30 yr. = 2.89%.

Is the curve normal? Well, from a historical perspective we haven't seen a normal yield curve in ten years; however, it is definitely not inverted.

ISM Manufacturing Index

There were many months over the past decade that we yearned to see ISM data above 50%, indicating likely growth in GDP. For the past 36 months we have grown accustomed

to seeing ISM readings in the mid to upper 50s. January's index rose to 56.6% vs. December's 54.4%. Index readings above 50% reflect positive growth demand of raw materials and component parts for production of goods.

Consumer Confidence Surveys

The Consumer Confidence Index declined for the month of January while the Consumer Sentiment Index increased slightly. Both indexes measure different components of confidence and, while it doesn't occur with regularity, they sometimes do reflect different short term results. The consistency in both surveys was centered around future expectations. Given the government shutdown focus in the media, it isn't surprising to witness some deterioration in optimism. I have been asked often in the past few weeks about the economic impact of the shutdown. One way to look at it would be to reference our total GDP forecasted for 2019 to be about \$20.4 trillion. The Congressional Budget Office estimated the shutdown cost at \$4.0 billion. The growth rate of GDP in real dollars for 2019 is estimated to be about one trillion dollars and thus the impact cost is about 4 tenths of one percent. Most of the shutdown costs were related to payroll and the resulting consumer spending. Indications are that furloughed workers, and those who worked without pay, would receive payment by the end of February — thus the total impact is likely to be negligible.

Those impacted directly would argue, as would suppliers, contractors and subcontractors whose wage and income recovery is very much doubtful. While the harm to the overall economy is quite small, the impact and stress toll on hundreds of thousands of workers is very real.

Budget / Deficit

The current fiscal year is forecasted to add \$900 billion to the deficit, which is equivalent to 4.2% of GDP according to

the Congressional Budget Office. That release last week by the CBO was met by "crickets" on the part of both parties which seem to have lost their appetite to discuss the issue. The "silly" season of a Presidential election will be upon us soon. Both parties, and the candidates representing each, will fill the sound bites available with promises of a better future. I wonder how many of them will have this topic in their list of brighter futures.

Federal Reserve

Optics are always difficult to craft in real time. Fed Chairman Powell got his first taste of that when the president used his bully pulpit to threaten the Fed chair's tenure if the Fed continued to raise interest rates. Those of us that study Fed policy, meetings and summary meeting notes, noticed the difference in the chair's tone in the January post-meeting notes as opposed to those after the December 17 meeting. What changed in the thirty days between meetings to cause the tone change? Markets tanked after the December summary which was interpreted as conviction to the rate hike plan in place confirmed by a 25 basis point rate hike. What were the changes in our economy that the Fed governors saw that softened their stance on future 2019 rate hikes? Our view is that it wasn't our data that caused concern but rather the inflection potential of Brexit on Europe's GDP as well as deteriorating manufacturing data from China. Hav-

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ing recently traveled to the UK, I can report that Brexit is as messy as ever and a reasonable solution to that crisis is multiple times more difficult than the negotiations between the president and Speaker Pelosi on "The Wall." The issues of trade and immigration impact every component of daily life in the Euro Zone. The Fed is right to be concerned because the problem will not just be "over there" but will have impacts here as well. ☑