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Economic Commentary

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SAn examination of the economic indicators that we routinely monitor reveals little change in the state of the economy. Most of the indicators remain positive with slight changes either up or down. The labor market added 196,000 jobs in March, unemployment and participation rates held steady, and wage growth declined slightly. The economy is acting like an economy would act if it were slowing slightly, and that is exactly what we believed would happen in 2019. The 2018 economy was mostly mid-year loaded with a weak Q1 as well as a soft Q4 (revised down to 2.2% from the estimate of 2.7%).

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Q1 of 2019 is expected to be about 2.2% as the implications of the government shutdown will be in play during the reported quarter. First quarter economic activity has historically been among the softest periods of economic growth, and 2019 may well play out in similar fashion. Much of the growth that occurred in the middle of 2018 was to some extent due to tax policy changes that provided some short-term stimulation. As trade policy became more contentious, several sectors experienced negative impacts (agriculture, auto and construction equipment) that were felt as the year unfolded. Fed policy has swung from tightening to neutral in stance, and of late, some financial publications have begun suggesting that we may see some rate decrease before Q3 of 2019. Our sense is that the data reflects more of the same, and talk of stimulation or easing by the fed is unrealistic.

The labor force is by all measures tight, and any slack in it is industry and region specific. Home sales continue to show modest growth and there are increases in both online and print advertisements for construction workers. Growth in wage rates for construction trades is outpacing national averages for wage growth by 34%. Sign-on bonuses are becoming routine in the trades and completion schedules have grown by over three months due to lack of capacity in the industry. This dynamic is particularly true in the coastal southern and western regions of the country. The logistical chain of supplies, materials, aggregates, furnishings, case goods, tools and equipment is feeling the same constraints with respect to labor, and as you can surmise, the cost of new construction is up nearly nine percent year over year.

Supply chain demand, as measured by the purchasing manager surveys (PMI), both domestic and international continue to be above the 50.0% growth measurement. International PMI surveys had been in decline until recently; however, the Chinese central bank's easing has had the desired effect and the logistical supply demand has increased accordingly, reflected in the more positive current PMI surveys.

The yield curve has become the most watched indicator of 2019. Currently, we would describe the yield curve as flat, meaning that the yield for short term bonds is essentially the same as longer maturities (7 – 10 year). Historically, when the yield curve inverts (short term rates higher than longer maturity rates), the probability of recession increases. It is important to know that the inversion needs to be significant for that probability to increase in accuracy. Currently we have a flat yield curve. Given employment, retail sales, PMI surveys and the yield curve status, the economy continues in a modest (2.2 – 2.5%) growth range.

As mentioned often during the past decade, we have recovered and experienced a very long and mature growth and expansion period. An economy growing in the two percent range is fragile and subject to geopolitical as well as domestic political impact. Brexit, and now simultaneously Venezuela, have opportunity to change the calculus. During the mass Syrian migration created by the self destruction of Syrian dictatorship, we in this country stood comfortably afar from the European Union's struggle to deal with the asylum seekers leaving war torn Syria. It has been nearly three years since the infamous Brexit vote, and as of this writing, there is no visible solution in place to Britain's exit from the European Union. In aggregate, the European Union, inclusive of Great Britain, is a huge trading partner of the United States. Any negative impact by a botched exit will translate into negative demand for goods and services globally. For the past decade, the global recession impacted many countries with small and or emerging economies. Political destabilization within many of these economies translated into dictatorships, constant erosion of political will, infrastructure deterioration, power supply interruption, education system neglect, and increases in organized crime to fill power voids. Three Central American countries, each with troubled pasts, have deteriorated into troubled third-world status. Guatemala, Honduras and Nicaragua now represent the Americas' "Syrian" refugee problem, and one we cannot view from afar. Destabilization in these countries causes people to flee the chaos just as millions fled the chaos in Syria. The European Union's failure to deal effectively with the migration flow led to significant conflict among trading partners and ultimately the Brexit vote to leave the EU. The answer in the EU was not necessarily to solve the humanitarian crisis with refugee camps, but rather to solve the humanitarian crisis in Syria itself. If we ignore the chaos in Central America, we will accelerate the problem at our border, and in doing so, increase the challenge of equitable solutions.

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The president's victory lap after the release of Attorney General Barr's summary of the Mueller report didn't last very long. The President tripped over the line in the sand that Senate Majority Leader McConnell had drawn and perhaps forgot to tell him. Given the results of the mid-term elections, Senate leader McConnell had no appetite for revisiting "repeal and replace" of the Affordable Health Care Act. The president's urging of the Justice Department to pursue appellate court rulings to find the act unconstitutional gave the Democrat-controlled house the weapon they were seeking to frame themselves as the party of health care and the Republicans as the party that didn't care. The message sent to the president was that the senate had no appetite for the battle, the polling wasn't in their favor and without an alternate plan the president's position was a gift to the opposition. Surprisingly, the president accepted the somewhat blunt rebuke from the Senate leadership and retreated to the position that the Republican Party plan would be rolled out directly after the 2020 election.

The Muller report is out. Republicans want to move on and Democrats remain focused on the revelations they hope to pry out of the details. Polling suggests that the core of the base in each party wants to use the report for whatever gain they think is there and the remainder is weary of the entire focus. It seems accurate that the base of the Democratic Party is frustrated that more people aren't focused on the report, and the base of the Republican Party is frustrated that anyone would focus on it. These are polar opposites which explain the base of each party. The silly season is quickly approaching. As we get into the late summer, the substantial number of Democratic hopefuls will shrink as their ability to raise funds deteriorates. Traditional Democratic Party operatives hope that there is not an independent candidate that surfaces with enough financial backing to gather 5 – 7% of the vote. Republicans, of course, hope a third party candidate emerges. Their challenge is a president who has done everything to solidify his base and literally nothing to expand it. The president has earned the tightest band of approval ratings of any president. If you are a part of his base that loyalty is rewarding. If you want him re-elected, the lack of growth in his approval rating is a problem. Things can always play out differently, but no president with a 43% approval rating has been elected to a second term. The opening scene is set, truth will be the victim, and voters' intellect will be insulted regularly by both sides of the aisle.