

A Downshift in the Global Economy Adds Risk

There is never a good time, but the recently ended partial federal government shutdown came at a bad time. As the global economy appeared to downshift, the shutdown put sand in the gears of the U.S. economy, and resulted in a partial economic data blackout at a critical time. The Census Bureau and the Bureau of Economic Analysis were closed through January, leaving a big gap in economic reporting. Their reopening is shedding some light on the U.S. economy, but the lighting may be inconsistent in the near term as data procedures and schedules get reassembled.

Inconsistencies in data can be seen in the January employment report from the Bureau of Labor Statistics, which was not shut down but was still impacted by the shutdown. The BLS jobs report is based on two separate surveys. The establishment survey shows employment by place of work and gives us data on employment in specific industries. The household survey shows employment by place of residence and is the source for the unemployment rate. The establishment survey showed that January payrolls increased by a very strong 304,000. December payrolls, which were previously reported as up by 312,000, were slashed to now show a gain of 222,000. Furloughed federal workers were counted as employed in the establishment survey in January because they will eventually get paid. The household survey showed a major drop of 251,000 jobs in January. Furloughed government workers were counted as not employed in the household survey. As a result, the unemployment rate increased from 3.9 percent in December, to 4.0 percent in January.

The bulk of U.S. labor-related data points to ongoing strong hiring through January. However, business and consumer confidence fell at year end 2018, and some marquis companies announced that they were beginning to lay off significant numbers of workers. We believe the hiring story is more nuanced than “full speed ahead.” We expect the blistering pace of hiring through December and January to slow down in the months ahead, reflecting more cautious behavior from U.S. businesses as U.S. and global conditions cool in early 2019.

While U.S. economic data has been inconsistent, recent data from China has been consistent in a bad way, showing slower growth in the world’s largest single economy. The Caixin Composite PMI for China for January dropped to a barely positive 50.9, with a big drag coming from the manufacturing sector. The Caixin China Manufacturing PMI dropped to a contractionary 48.3 in January. Likewise, the IHS Markit Eurozone Manufacturing PMI fell to a barely positive 50.5 in January, showing that the world’s largest trading bloc is losing momentum. Weaker economic growth is putting pressure on tax collections in Germany according to a recent Finance Ministry report. Japan, the world’s third largest economy, is also losing momentum. Global trade is clearly cooling, crimped by the U.S.-China trade war.

In addition to pressure from the U.S.-China trade war, the global economy is feeling pressure from the Federal Reserve due to higher U.S. interest rates. The Fed has responded to increased downside economic risk by emphasizing “patience” in recent announcements, speeches and press conferences. At the conclusion of the Federal Open Market Committee meeting over January 29/30, Fed Chairman Jay Powell sounded like he was in no hurry to continue raising rates. We expect the next dot plot, to be released by the Fed on March 20, to show reduced expectations for rate hikes, compared to the dot plot from December 19. In our February U.S. forecast, we have only one 25 basis point increase in the fed funds rate this year, coming at mid-year. We believe that the Fed is already very close to the top of its interest rate cycle for this expansion. Also, we expect the Fed to gradually wind down asset runoff this year, settling at a balance sheet of about \$3.5 trillion.

U.S. Economic Outlook, Summary

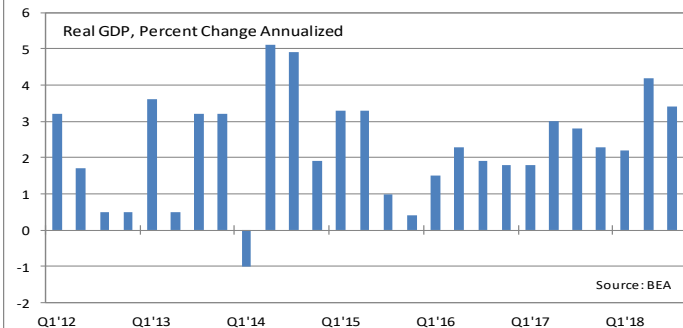
<i>a = actual f = forecast</i>	2Q'18a	3Q'18a	4Q'18f	1Q'19f	2Q'19f	3Q'19f	4Q'19f	1Q'20f	2017a	2018f	2019f
Real GDP (Percent Change Annualized)	4.2	3.4	2.5	2.5	2.3	2.3	2.2	2.1	2.2	2.9	2.6
CPI (Percent Change Year-over-Year)	2.6	2.6	2.2	1.9	1.9	1.9	2.0	2.0	2.1	2.4	1.9
Payroll Jobs (Average Monthly Diff., Ths.)	231.6	222.2	215.9	233.0	196.5	172.8	158.4	153.5	180.3	220.8	190.2
Unemployment Rate (Percent)	3.9	3.8	3.8	3.8	3.7	3.6	3.6	3.5	4.4	3.9	3.7
Federal Funds Rate (Effective)	1.74	1.92	2.22	2.39	2.42	2.63	2.63	2.63	1.00	1.83	2.52
10-Yr. Treasury Rate	2.92	2.93	3.03	2.69	2.74	3.00	3.08	3.13	2.33	2.91	2.88

Risk of Recession Outlook

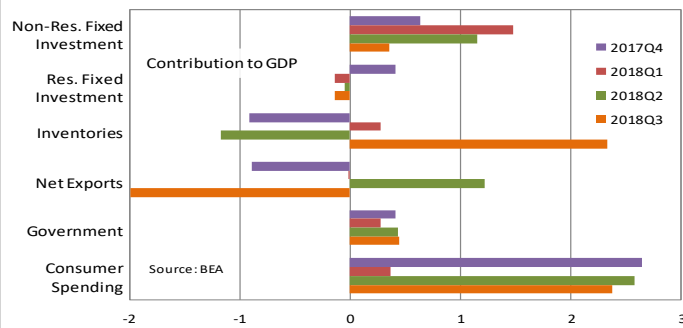
Probability of Recession (in the next)	6 months	12 months	24 months	36 months
January 2019	25%	35%	52%	60%

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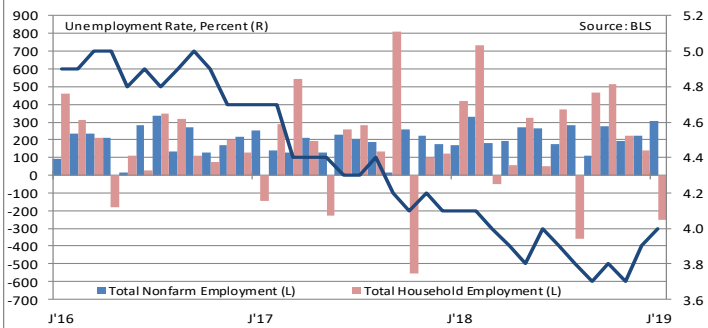
Q3 GDP 3rd Estimate at 3.4%



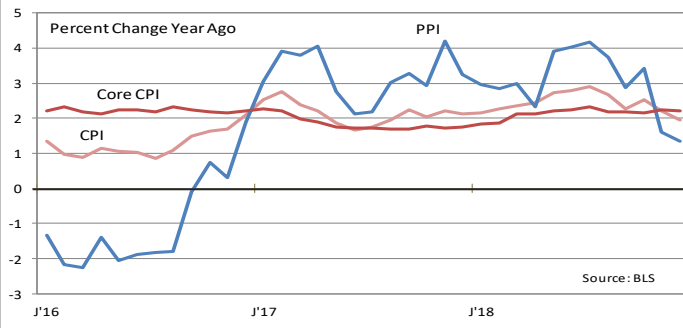
Trade Was a Drag in Q3



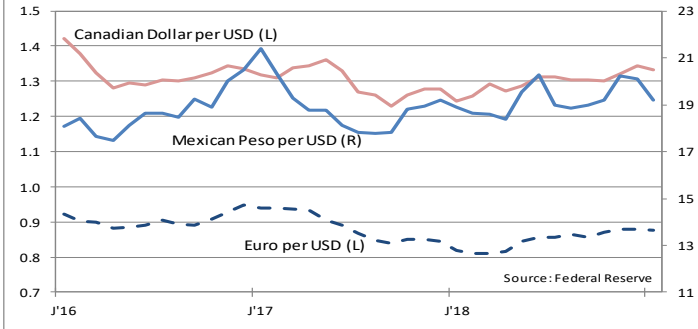
U.S. Added a Net 304,000 Jobs in January



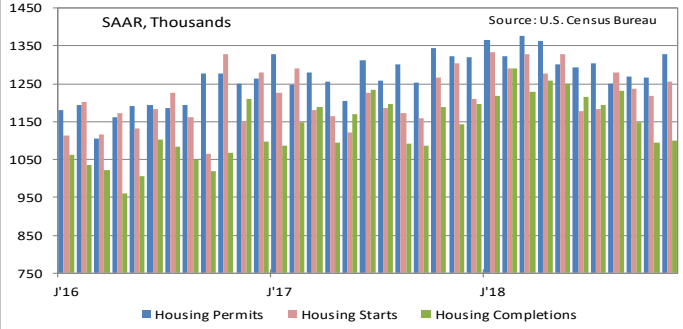
Low Oil Prices Kept December Inflation Cool



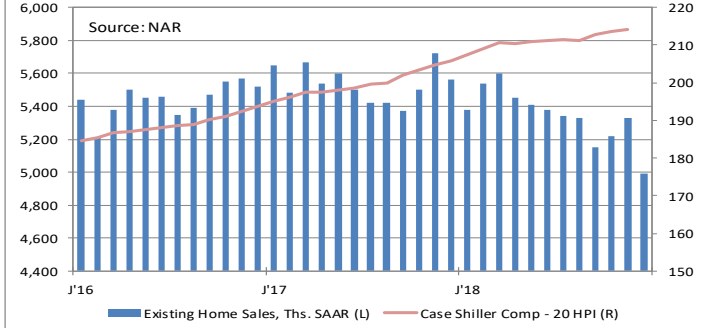
US Dollar Remains Strong through Jan.



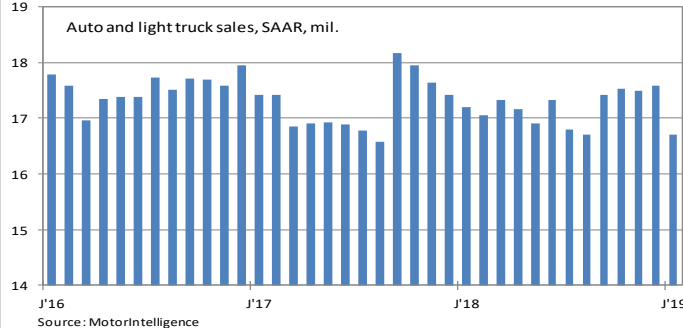
Housing Starts Ticked Up in November



Existing Home Sales Declined in December



Auto Sales Fell Off in January



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	2Q'18a	3Q'18a	4Q'18f	1Q'19f	2Q'19f	3Q'19f	4Q'19f	1Q'20f	2017a	2018f	2019f
Output											
Nominal GDP (Billions \$)	20412	20658	20876	21103	21327	21551	21777	21996	19485	20497	21440
Percent Change Annualized	7.6	4.9	4.3	4.4	4.3	4.3	4.3	4.1	4.2	5.2	4.6
Real GDP (Chained 2012 Billions \$)	18512	18665	18782	18899	19009	19116	19222	19321	18051	18571	19062
Percent Change Annualized	4.2	3.4	2.5	2.5	2.3	2.3	2.2	2.1	2.2	2.9	2.6
Pers. Consumption Expenditures	12842	12953	13056	13134	13199	13269	13337	13398	12559	12893	13235
Percent Change Annualized	3.8	3.5	3.2	2.4	2.0	2.1	2.1	1.8	2.5	2.7	2.6
Nonresidential Fixed Investment	2710	2727	2746	2773	2804	2836	2866	2895	2538	2709	2820
Percent Change Annualized	8.7	2.5	2.9	3.9	4.6	4.6	4.4	4.0	5.3	6.7	4.1
Residential Investment	613	608	617	616	619	622	624	626	611	613	620
Percent Change Annualized	-1.3	-3.6	6.1	-0.5	2.0	1.6	1.5	1.4	3.3	0.4	1.1
Change in Private Inventories	-37	90	50	50	55	55	55	56	23	33	54
Net Exports	-841	-950	-931	-931	-939	-948	-953	-955	-859	-906	-942
Government Expenditures	3172	3192	3200	3212	3225	3237	3246	3255	3130	3179	3230
Percent Change Annualized	2.5	2.6	1.0	1.6	1.6	1.4	1.2	1.1	-0.1	1.6	1.6
Industrial Prod. Index (2007=100)	107.3	108.5	109.6	110.5	111.3	111.9	112.6	113.1	103.7	107.8	111.6
Percent Change Annualized	5.2	4.7	3.8	3.5	2.7	2.5	2.2	1.9	1.6	4.0	3.5
Capacity Utilization (Percent)	77.8	78.3	78.6	79.1	79.5	79.8	80.2	80.6	76.1	78.0	79.6
Prices											
CPI (1982-84=100)	250.5	251.7	252.8	254.1	255.4	256.6	257.9	259.2	245.1	251.1	256.0
Percent Change Annualized	1.7	2.0	1.8	2.0	2.0	2.0	2.0	2.0	2.1	2.4	1.9
PCE Price Index (2012=100)	108.1	108.5	108.8	109.4	109.9	110.4	111.0	111.5	106.1	108.2	110.2
Percent Change Annualized	2.0	1.6	1.3	2.0	1.9	2.0	2.0	2.0	1.8	2.0	1.8
GDP Price Index (2012=100)	110.2	110.7	111.1	111.7	112.2	112.8	113.3	113.9	107.9	110.3	112.5
Percent Change Annualized	3.0	1.8	1.7	1.9	2.0	2.0	2.0	2.0	1.9	2.2	2.0
PPI, Final Demand (Nov. 2009=100)	116.0	116.5	117.2	117.9	118.4	119.0	119.6	120.2	113.0	116.2	118.7
Percent Change Annualized	3.2	1.7	2.4	2.2	2.0	2.0	2.0	1.9	1.8	2.2	2.1
Crude Oil, WTI (\$/barrel)	68.0	69.7	59.4	54.0	55.0	60.0	60.0	60.0	50.8	65.0	57.3
Labor Markets											
Payroll Jobs (Average Monthly Diff., Ths.)	231.6	222.2	215.9	233.0	196.5	172.8	158.4	153.5	180.3	220.8	190.2
Unemployment Rate (Percent)	3.9	3.8	3.8	3.8	3.7	3.6	3.6	3.5	4.4	3.9	3.7
Average Weekly Hours	34.5	34.5	34.5	34.5	34.5	34.5	34.5	34.5	34.4	34.5	34.5
Population (Millions)	327.2	327.7	328.3	328.9	329.5	330.1	330.7	331.3	325.4	327.5	329.8
Percent Change Annualized	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.6	0.6	0.7
Personal Income											
Average Hourly Earnings (\$)	26.98	27.21	27.44	27.65	27.87	28.11	28.36	28.60	26.31	27.10	28.00
Percent Change Annualized	3.2	3.5	3.3	3.1	3.3	3.5	3.6	3.5	2.6	3.0	3.3
Real Disp. Income (2012 Billions \$)	14282	14365	14506	14605	14703	14804	14901	14996	13949	14343	14753
Percent Change Annualized	1.8	2.4	4.0	2.7	2.7	2.8	2.7	2.6	2.6	2.8	2.9
Personal Saving Rate (Percent)	6.6	6.3	6.0	5.9	5.8	5.8	5.8	5.8	6.7	6.5	5.8
Housing											
Housing Starts (Ths., Ann. Rate)	1261	1234	1226	1236	1240	1240	1243	1244	1208	1259	1240
Exst. SF Home Sales (Ths., Ann Rate)	4797	4690	4593	4614	4603	4601	4597	4596	4910	4746	4604
New SF Home Sales (Ths., Ann Rate)	633	607	605	610	611	610	610	610	616	625	610
Case/Shiller HPI (Jan. 2000=100)	201.9	203.7	206.2	208.6	211.0	213.4	215.9	218.5	191.6	202.9	212.2
Year/Year Percent Change	6.4	5.7	5.1	4.5	4.5	4.8	4.7	4.7	5.8	5.9	4.6
Consumer											
Household Economic Stress Index	0.2	0.7	0.9	1.2	1.1	0.8	0.9	0.8	0.7	0.4	1.0
Auto Sales (Millions)	17.1	17.0	17.5	17.1	16.8	16.5	16.2	16.0	17.2	17.2	16.6
Interest Rates (Percent)											
Federal Funds Rate (Effective)	1.74	1.92	2.22	2.39	2.42	2.63	2.63	2.63	1.00	1.83	2.52
Prime Rate	4.80	5.01	5.28	5.49	5.52	5.73	5.73	5.73	4.10	4.90	5.62
1-Month LIBOR	1.97	2.11	2.35	2.51	2.56	2.77	2.77	2.77	1.11	2.02	2.65
3-Month LIBOR	2.34	2.34	2.63	2.76	2.81	3.04	3.05	3.06	1.26	2.31	2.91
1-Yr. Treasury Rate	2.25	2.47	2.67	2.59	2.65	2.88	2.91	2.92	1.20	2.33	2.76
5-Yr. Treasury Rate	2.77	2.81	2.88	2.54	2.62	2.92	2.99	3.04	1.91	2.75	2.77
10-Yr. Treasury Rate	2.92	2.93	3.03	2.69	2.74	3.00	3.08	3.13	2.33	2.91	2.88
30-Yr. Fixed Rate Mortgage	4.54	4.57	4.78	4.53	4.66	4.94	4.99	5.01	3.99	4.54	4.78

a = actual f = forecast

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