

## WEEKLY ECONOMIC COMMENTARY—WEEK OF APRIL 15<sup>th</sup>, 2019

Perceptions are slowly but steadily shifting again in the financial markets. Throughout most of the first quarter, recession fears escalated amid a slew of disappointing economic data, an abrupt dovish turn by the Federal Reserve and slowing global growth, paced by greater-than-expected weakness in Europe and China. Recession odds peaked with the inversion of the yield curve in March, when the 10-year Treasury yield plunged by nearly a full percentage point below its early-November peak. The stock market eluded the negativity associated with the grimmer outlook, bouncing back from a severe correction late last year – which many analysts felt was overblown – and rallying on robust earnings reports in 2018. But even here, talk of an earnings recession this year has recently gained traction and analysts have been sounding a more bearish tone.

However, the skies appear to be brightening again, mirroring some positive developments over the past several weeks. For one, the global landscape turned somewhat more favorable as China's economy is getting a lift from improving exports and trade negotiations with the U.S. seem to be progressing. What's more, the cataclysmic implications of a no-deal Brexit was avoided as the EU granted Britain another six-month extension to arrive at a solution acceptable to warring members of Parliament as well as to EU officials. For another, recent data suggest that the U.S. economy is in less dire straits than thought a month or so ago.

Indeed, contrary to the gloomy perception attributed to the Federal Reserve following the March 19-20 policy meeting, Fed officials have lately been sounding a more upbeat tone about the U.S. economy. Both Chairman Powell and, most recently, New York Fed president John Williams have lauded current conditions, stating that the economy is “in a good place.” Their comments also quelled growing expectations that the next move in rates would be down and that a cut might come sooner rather than later. That perception is also echoed in the financial markets, which are now pricing lower odds of a rate reduction than a few weeks ago. Accordingly, bond yields have moved off the floor reached in March, with the 10-year Treasury yield ending the week at 2.56 percent, up about 20 basis points over the past two weeks – and the yield curve reverted to a positive slope.

Just as the surprising weakness in the February jobs report heightened recession fears in March, the latest turning point in market perceptions comes on the heels of stronger-than-expected job growth in March, reported last week. That, along with a modest rebound in retail sales in February confirms the notion that the early-year weakness was more transitory than rooted in deteriorating fundamentals. To be sure, the economy is slowing from last year's sturdy 3.0 percent pace, with the first quarter tracking a growth rate of well under 2.0 percent. But a loss of momentum comes as no surprise, as the fiscal stimulus that boosted growth in 2018 has been steadily waning even as the global headwinds impeding growth has become fiercer. At the same time, the positive thrust from an exceptionally easy monetary policy has vanished as the Fed raised rates four times last year, lifting the federal funds rate close to a neutral level, one that neither stimulates nor restricts economic activity.

But while growth is clearly slowing, it is not heading towards the newly photographed black hole, whose gravitational pull sucks everything within its perimeter into the abyss. By all accounts, the economy is still a safe distance from that precipice and should survive long enough to set a new

record of continuous growth this July, outlasting all previous expansions. True, the economy's growth engine is not running on all cylinders; capital spending is sputtering, manufacturing activity is downshifting and small businesses are being squeezed by rising labor costs and constrained pricing power. But the bedrock strength of the economy rests with the firm job market, and the economy has never fallen into a recession without the headwind of at least several months of slowing job growth.

Even with the severe setback in February, nonfarm payrolls stood 1.7 percent higher in March than a year ago. That year-on-year growth rate extends a remarkable period of consistency. While it is a tad below the 1.9 percent pace seen in January, it is equal to the average pace over the past 3-½ years, and is actually up from the 1.4 percent pace in January 2018. Except for the 1973-74 cycle, the annual growth rate in payrolls has slowed by at least 1.0 percent before a recession hit, and usually by much more. The current pace, at 1.7 percent, is only a tad under the 2.3 percent peak reached back in 2015 when the labor force had considerably more slack than now. And, as noted, there has hardly been any slowdown over the past several years.

By all accounts, the job market is barely losing steam. Even in February, when job growth almost stalled out at 33 thousand, there were far more job openings than unemployed workers. That's starkly illustrated in the latest Job Opening and Labor Turnover Survey (the so-called Jolts report) released by the Labor Department this week. During that month, job openings did fall by a sizeable 538 thousand, but the retreat was from a record high level in January and likely reflected business concerns over the record-long government shutdown that ended in late January as well as the harsh winter weather. Even so, there were 852 thousand more job openings than unemployed workers, an imbalance that has prevailed for a record twelve consecutive months.

It's unclear if the rebound in job growth in March, with nonfarm payrolls rising by 196 thousand, closed some of the gap between the supply and demand for workers, or if the rebound was accompanied by a corresponding increase in job openings. In either case, the job market continues to cruise along at top speed and generate pay raises in excess of 3 percent. That, in turn, provides the fuel for households to keep on spending at a healthy pace. It also keeps confidence elevated, providing consumers with an incentive to open their wallets and purses. The latest University of Michigan consumer sentiment index did slip in early April, ticking down to 96.9 from 98.4 in March due primarily to a fall in expectations. But the reading is not far off the cycle high and still depicts an upbeat mind-set by historical yardsticks. Importantly, assessments of current conditions actually rose by nearly a point, which is a more reliable indicator of near-term spending intentions.

The one fly in the ointment is that household inflation expectations continues to weaken, a surprising development in light of the recent rebound in gas prices. In fact, long-term inflation expectations – i.e., five-years out – fell from 2.5 percent to 2.3 percent, equaling the lowest rate going back to 1979. This downward move mirrors the path of actual inflation, which is also trending lower. In March, the annual increase in the core consumer price index, which excludes volatile food and energy prices, fell to 2.0 percent from 2.1 percent in February and 2.2 percent in January. Significantly, if not for the 3.4 percent increase in shelter prices – which account for 40 percent of the core CPI – core inflation would be increasing at a much slower 1.1 percent.

The good news for households is that lower inflation boosts their purchasing power, enabling paychecks to go a longer way. The bad news is that lower inflation and particularly inflation

expectations, is a disincentive to accelerate spending in advance of future price gains. After all, if wages are increasing faster than inflation, households will get an even bigger bang for the buck by waiting to make a purchase. The risk is that if inflation expectations continue to fall, households might delay spending in anticipation of lower prices down the road. That, in turn, could set in motion the vicious deflationary cycle ending in a pernicious recession that gives Fed officials nightmares.

From our lens, the inflation backdrop is not nearly as dire. Just as sturdy job growth should support consumption, it should also keep upward pressure on wages and, hence, labor costs. While business pricing power is constrained by global competitive and other forces, they have shown an increasing ability to pass on some of these costs to consumers, which should keep inflation hovering near the 2 percent target set by the Fed. That said, the stubborn persistence of low inflation continues to be the main influence keeping the Fed on the sidelines, and is likely to remain a restraining force even if the economy shows more strength than expected in coming months.

---

**HEADQUARTERS**

2188 SW Park Place Suite 100  
Portland, OR 97205 | Office: 503-248-9973

**CALIFORNIA OFFICE**

2010 Main Street, Suite 320  
Irvine, CA 92614 | Office: 949-529-5289

## FINANCIAL INDICATORS

INTEREST RATES	April 12	Week Ago	Month	
			Ago	Year Ago
3-month Treasury bill	2.44	2.42	2.45	1.75
6-month Treasury bill	2.46	2.46	2.52	1.95
3-month LIBOR	2.60	2.59	2.60	2.35
2-year Treasury note	2.40	2.33	2.40	2.36
5-year Treasury note	2.38	2.30	2.40	2.67
10-year Treasury note	2.56	2.49	2.59	2.82
30-year Treasury bond	2.98	2.90	3.01	3.03
30-year fixed mortgage rate	4.12	4.08	4.31	4.42
15-year fixed mortgage rate	3.60	3.56	3.76	3.87
5/1-year adjustable rate	3.80	3.66	3.84	3.61

### STOCK MARKET

Dow Jones Industrial Index	26,412	26,425	25,848	24,360
S&P 500	2,907	2,893	2,822	2,656
NASDAQ	7,984	7,939	7,689	7,107

### COMMODITIES

Gold (\$ per troy ounce)	1,294	1,296	1,302	1,347
Oil (\$ per barrel) - Crude Futures (WTI)	64	63	58	67

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two- Months/ Qtrs Ago	Average-
				Past Six Months or Quarters
Consumer Price Index (March) - % change	0	0	0	0
Core CPI (March) - % change	0.1	0.1	0.2	0.2
Producer Price Index (March) - % change	0.6	0.1	-0.1	0.2

DISCLAIMER: This communication has been prepared by Government Portfolio Advisors LLC solely for informational purposes for institutional clients. Sources for this commentary include Bloomberg and Stone McCarthy Research Associates. It is not an offer, recommendation or solicitation to buy or sell, nor is it an official confirmation of terms. It is based on information generally available to the public from sources believed to be reliable. No representation is made that it is accurate or complete or that any returns indicated will be achieved. Changes to assumptions may have a material impact on any returns detailed. Past performance is not indicative of future returns. Price and availability are subject to change without notice. Additional information is available upon request.