WEEKLY ECONOMIC COMMENTARY—WEEK OF APRIL 8, 2019

Some significant pairings caught our attention this week – President Trump and Chinese Vice Premier Liu He (striving for a trade deal); Theresa May with Jeremy Corbyn (reaching for a Brexit resolution); and Bryce Harper and Washington National fans (upset that he left for Philly money). All participants approached their get-togethers with suspicion, borne largely of mistrust, but all realized that the stakes were high. Of the three, only Harper's blast into the upper decks produced a resolution, at least for the near term. As for the others, scores have yet to be settled.

That said, Trump's meeting with China's trade envoy lifted spirits in the financial markets this week, raising hopes that it would lead to an imminent summit with Chairman Xi and set the stage for a trade pact. Nothing was settled by the end of the week, but the signals were more promising than ominous. The same could not be said for the May/Corbyn confab, which faces a more immediate deadline and could result in a chaotic and highly disruptive aftermath if Parliament can't agree on how Britain should exit the European Union by April 12. The British government is requesting another deadline extension from the EU, but the uncertainty regarding the fate of Brexit will be a dominant as well as highly disruptive issue on the global landscape until it is resolved.

Happily, things have become less chaotic on the domestic front. In recent weeks, concern has been building over the U.S. economy. A key question has been whether the nation has entered a soft patch or something more serious, pointing to a recession sooner rather than later. Some signs have been particularly ominous. The yield curve turned negative in late March – a time-honored recession signal – before reverting to a positive slope over the past week. An array of recent weak data underpinned the markets' recession fears, including a pullback in consumer spending, sagging factory orders for capital goods and persistent low inflation readings. Add to the mix some worrisome signals from the Fed, which moved further towards a dovish stance at its latest policy meeting. While the Fed's backsliding away from its earlier rate-hiking campaign was entirely expected and welcome, it also stoked concern that the central bank sees more weakness in the economy than is evident in the data.

One particularly nagging question concerned the job market. Was the tepid 20 thousand increase in February employment a sign that a critical source of economic strength was rolling over? Most believed that the abrupt slowdown in job growth that month was nothing more than an anomaly, related primarily to harsh weather conditions as well as statistical difficulties adjusting for seasonal patterns over the winter months. As it turns out, that perception was correct. The new jobs report released on Friday not only corroborated the weather effect, the payroll increase reported for March comfortably beat expectations. What's more, revisions added 13 thousand jobs to the initial February estimate, lifting the increase to a still-anemic 33 thousand for the month but making it seem more like an outlier than before.

Overall, the March report showed that the economy generated a sturdy 196 thousand new jobs during the month, topping market expectations of about a180 thousand gain. After smoothing out the data for monthly gyrations, the trend shows little loss of momentum. The three-month moving average of job growth clocks in at 180 thousand, a modest slowing from the 200 thousand average over the past twelve months. For a labor force that is presumably growing at about half that pace, the persistent ability of companies to find as many workers to fill positions is one of the more perplexing, albeit pleasing, features of the current expansion. Yet job openings continue to hover near record highs, indicating that the demand for labor is still outstripping the available supply.

The March employment report also validates the distorting impact that weather had in the February report. Among leisure and hospitality companies, which rely heavily on outdoor activity and the unfettered ability of customers to travel, payrolls swung from a 93 thousand increase in January to a 1 thousand loss in February. In March, they jumped back up, staging a 33 thousand gain. Likewise, construction jobs fell by 25 thousand in February following a 56 thousand increase in January. But more than half the February setback – the first in nearly three years and the steepest since December 2013 – was recovered in March as construction payrolls increased by 16 thousand. Importantly, the hiring strength of the two bedrock sectors driving employment growth became even more pronounced last month. Payrolls shot up by 70 thousand in the education and health services sector and by 61 thousand in the health care and social assistance sector. These increases handily exceeded the average increases of 43 thousand and 39 thousand, respectively, over the previous twelve months.

But while the headline gain in jobs last month supports the underlying strength in the labor market, a few cracks in the armor are appearing. For one, manufacturing firms, which are highly sensitive to cyclical forces and trade developments, shed workers in March for the first time in 20 months. What's more, the 6 thousand drop in payrolls followed a slim 1 thousand increase in February, suggesting a slowing trend may be gaining traction. However, other indicators of manufacturing hiring are holding up well, including the ISM index of manufacturing employment, which jumped by more than five points in March. The biggest drag on manufacturing employment seems to be coming from the auto sector, where sales are tapering off. We don't believe the revival in manufacturing activity and employment has ended, but future growth in this sector, as with the overall economy, should slow.

But another disturbing sign on the jobs front is the continued cutback in hiring among retail firms. Retail payrolls fell by 12 thousand in March following a 20 thousand drop in February, marking the fifth decline out of the last eight months. To be sure, the retail workforce has been steadily shrinking for some time, reflecting a huge loss of sales to less labor-intensive competitors, most notably online venders dominated by Amazon. The March level of retail employment, at 15.8 million, is the lowest in more than three years, going back to February 2016. The concern is that retailers may also be cutting staff in response to soft consumer spending, and that would have worrisome implications for the broader economy.

Not coincidentally, retail sales have been sluggish in recent months. Yes, they increased strongly in January, but that only recouped a fraction of the astonishing plunge in December. What's more, there was no follow-through to the January rebound, as sales slipped by 0.2 percent in February. That yielded a negative 0.4 percent growth rate over the last three months, which is the weakest three-month stretch in four years. The so-called control group of sales, which feeds into personal consumption in the GDP accounts, has been similarly weak. Since household spending accounts for about 70 percent of GDP, the recent weakness is consistent with our tracking model that shows a marked slowdown in GDP growth in the first quarter.

From our lens, however, the setback in consumer spending reflects a temporary breather by households that have been battered by a number of headwinds in recent months, including the government shutdown, harsh weather conditions, uncertainty over trade and policy decisions and the lingering effects of a stock market meltdown at the end of last year. For the most part, the fundamentals supporting consumer spending remain firm, highlighted by the sustained strength in the job market and improving income prospects. With this support firmly in place, consumer confidence remains elevated, setting the stage for a modest rebound in spending over the summer months.

Just how muscular of a rebound is in the cards, of course, will depend on how confident households feel about job and income prospects. The strength in payrolls last month is clearly a positive input, as is the low unemployment rate, which remained at 3.8 percent in March. But not all elements of the latest jobs report portrayed unambiguous strength. Average hourly earnings only ticked up by 0.1 percent, following a promising 0.4 percent gain in February. That lowered the annual increase to 3.2 percent from a cycle high of 3.4 percent. However, for rank and file workers, the increases have recently been more consistent and stronger. Average hourly earnings for workers in non-management positions increase by 0.3 percent for the second consecutive month, yielding a yearly pay raise of 3.3 percent. It was the fifth consecutive month that mid-level workers saw their annual pay rise faster than their upper echelon wage earners, the longest stretch of outperformance since 2014.

That said, there is no sign that wage growth is poised to accelerate and pose either an inflation threat or a severe squeeze on profit margins. If anything, the Federal Reserve can breathe a sigh of relief that wage growth remains on solid ground, as it helps arrest the recent downward movement in household inflationary expectations. And while rising labor costs are seen as a growing problem among smaller firms, the corporate sector is having little problem keeping up with wage increases. According to Commerce Department data, unit profits from current production hit an all-time high of 12.6 percent in the fourth quarter. These are not the ingredients that suggest the economy is heading for troubled waters.

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FINANCIAL INDICATORS

INTEREST RATES	April 5	Week Ago	Month Ago	Year Ago
3-month Treasury bill	2.42%	2.40%	2.45%	1.71%
6-month Treasury bill	2.46	2.44	2.52	1.89
3-month LIBOR	2.59	2.59	2.60	2.33
2-year Treasury note	2.33	2.26	2.46	2.27
5-year Treasury note	2.30	2.23	2.43	2.59
10-year Treasury note	2.49	2.41	2.63	2.78
30-year Treasury bond	2.90	2.82	3.01	3.02
30-year fixed mortgage rate	4.08	4.06	4.41	4.4
15-year fixed mortgage rate	3.56	3.57	3.83	3.87
5/1-year adjustable rate	3.66	3.75	3.87	3.62
STOCK MARKET				
Dow Jones Industrial Index	26,425	25,929	25,450	23,933
S&P 500	2,893	2,834	2,743	2,604
NASDAQ	7,939	7,729	7,408	6,915
COMMODITIES				
Gold ($ per troy ounce)	1,296	1,297	1,295	1,337
Oil ($ per barrel) - Crude Futures (WTI)	63	60	56	62

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Nonfarm Payrolls (March) - 000s	196	33	312	207
Unemployment Rate (March) - Percent	3.8	3.8	4.0	3.8
Average Hourly Earnings (March) - % chg	0.1	0.4	0.1	0.2
Retail Sales (February) - % change	0.2	-1.6	0.0	0.1
ISM Manufacturing Index (March)	56.6	54.2	55.3	56.1
ISM Non-Manufacturing Index (March)	56.7	59.7	56.1	58.6