WEEKLY ECONOMIC COMMENTARY—WEEK OF AUGUST 12th, 2019

Despite the paucity of data, the financial markets experienced one of the most tumultuous weeks in recent memory. Stock prices veered from sickening losses early in the period to exhilarating gains later on. Gold prices surged to their highest level in more than six years and bond yields plunged to pre-election lows before recovering modestly by the end of the week. When all was said and done the net changes in asset prices were not particularly startling; but the journey was breathtaking and the future looks to be just as turbulent. Simply put, volatility has returned with a vengeance, fueled by uncertainty over an array of issues that remains as intractable as ever.

Topping the list of uncertainties, of course, is the ongoing feud with China that is not only roiling the stock and bond markets but threatens to morph into an all-out currency war. Following President Trump's announcement last week of new tariffs on imports from China, the Chinese government allowed its currency to weaken against the dollar, prompting Trump to accuse China of being a currency manipulator. The latest tit-for tat in the trade dispute between the world's two largest economies stoked more fear in the financial markets, sending investors scrambling to the safety of government bonds. Early in the week the 10-year Treasury yield plunged to 1.61 percent, the lowest since the fall of 2016.

Things settled down as the week progressed as the yuan stabilized at its lower level relative to the dollar and the administration put its inflammatory rhetoric under wraps, at least for now. Stocks rebounded and bond yields clawed back some of its earlier declines, although they still wound up the week at multi-year lows. Indeed, yields on longer term Treasuries fell further below short-term rates anchored by the federal funds rate, solidifying market expectations that the Fed will lower its policy rate at the September meeting. The steeper inversion of the yield curve also heightened expectations that the U.S. economy would fall into a recession sooner rather than later, as that financial indicator has been an infallible precursor of cyclical downturns in the past.

Reflecting the gloom and doom in the financial and currency markets, many economies are showing signs of strain. Industrial output in Germany is sinking, heralding a possible recession in Europe's largest economy. The U.K. economy contracted in the second quarter and the looming prospect of Brexit less than three months away is putting a chill on business sentiment. The central banks of India, New Zealand and Thailand slashed their policy rates this week in response to the escalating trade wars that threaten to undercut their exports as well as the growth slowdown in China, a critical trading partner.

Needless to say, the Federal Reserve is deeply concerned over the negative feedback these adverse global developments could have on the U.S. economy. That concern was expressed by Fed chair Jerome Powell at the late-July FOMC meeting and press conference, in part justifying the rate cut taken at the time. The move was met with some skepticism on both sides. President Trump criticized it as being too little and too late. Others wondered if any rate reduction was actually needed. After all, the economy appeared to be doing just fine without the Fed's help. Consumers were spending vigorously, supporting a solid growth rate in the second quarter and the main driver behind consumption, the job market, was more than holding its own.

But the struggles overseas and the headline-grabbing trade wars are casting a darkening shadow over the U.S. economy. The goods-producing sectors have felt the pain for some time, as industrial output contracted in the second quarter and manufacturing surveys are steadily deteriorating. Last week the Institute for Supply Management reported that its index of manufacturing activity in July slipped to the lowest level since the energy-related slump in 2016, standing only 1.2 points above the 50 dividing line between contracting and expanding activity. This week, the ISM's survey indicated that the slowdown is spreading to the much-larger services sector. The index of non-manufacturing activity fell 1.4 points in July, slipping to the lowest level in nearly three years, albeit it retains a larger 3.7-point cushion above the 50 threshold than the manufacturing index.

The deteriorating backdrop described by the surveys is consistent with the slowing momentum we see for the broader economy in coming quarters. If trade tensions continue to escalate and Trump follows through with the 10 percent tariffs on $300 billion of additional Chinese imports beginning September 1, the economy's growth engine is likely to downshift considerably. Keep in mind that the new tariffs would apply mostly on consumer goods unlike the 25 percent tariffs already on the books for Chinese imports, which are levied primarily on industrial products. Either importers would have to absorb the higher tariffs and accept lower profits, which is unlikely, or pass them on to consumers, which would crimp demand. Importantly, the growth-dampening impact of an intensified trade war would no doubt by amplified by heightened turmoil in the financial markets.

The Fed is not likely to wait for the full impact to play out before pulling the rate trigger again. If the global environment continues to deteriorate and trade tensions remain in the forefront by the September policy meeting, it will look to take out more insurance against the adverse feedback on the U.S. economy and lower rates by another quarter-point. Some believe that a half-point reduction will be necessary. However, that would be hard to justify unless the job market suffers a severe setback, something that is surely not indicated by recent monthly jobs reports, including last week's solid reading for July. As much as anything, the steady employment gains that are sustaining a respectable pace of wage growth are also elevating household confidence. The Conference Board's index of consumer confidence surged to an eight-month high in July.

To be sure, as noted in last week's commentary the monthly changes in payrolls have been very lumpy this year, so July's solid increase could well be followed by a weak reading for August, the last report before the September policy meeting. Such an outcome would no doubt be linked to global and trade developments, putting more pressure on the Fed to lower rates, particularly since Chair Powell has explicitly lauded the steady employment gains for bringing long disenfranchised workers back to the labor force. But there are few signs yet that the tightening labor market, which is giving those workers more job opportunities, is ready to roll over.

In its latest Jobs Openings and Labor Turnover Survey, the so-called JOLTS report, the Labor Department continues to reveal far more job openings than there are job searchers. In June, job listings exceeded the number of unemployed workers for a record sixteenth consecutive month, this time by 1.37 million. This imbalance is luring back workers and keeping the labor force participation rate significantly higher than would otherwise occur due to demographic forces, including the ongoing wave of retiring baby boomers. It is also providing long-delayed benefits to lower-paid workers, whose wages are increasing faster than their higher-earning colleagues.

That said, the pace of job growth is trending lower this year. While the slowdown primarily reflects growing labor supply shortages, there are signs that the demand for workers is also starting to ebb. Job openings fell in June and are almost 400 thousand lower than at the start of the year. Hiring activity also slipped last month, and the frenetic pace of job-hopping – a barometer of worker confidence in the job market – is starting to cool. The number of workers voluntarily quitting their jobs fell for the second consecutive month in June, the first back-to-back setback in 1-1/2 years.

The cooling off in the pace of voluntary quits raises some intriguing questions. Is it because workers are becoming less confident in finding a new position and are opting to stay put? Or are job stayers being rewarded with stronger pay raises, diminishing the lure of switching jobs? The Atlanta Federal Reserve Bank tracks wage growth between these two groups and, as can be seen in the chart, the gap between job stayers and job hoppers has narrowed significantly this year – averaging about 0.6 percent compared to 1.1 percent in 2018. Indeed, the incentive to switch jobs has not gotten any stronger since late 2016, whereas wage increases for job stayers have accelerated markedly.

The struggle to retain workers is consistent with other metrics, such as the historically low number of workers filing for unemployment benefits and the steady decline in layoffs. We suspect that that an early sign of a weakening job market can be gleaned from the trend in layoffs and discharges, which would be more indicative of demand for labor than the monthly data on payrolls. If there is any sign of weakness, it is not showing up in claims for jobless benefits, which fell to a four-month low in the first week of August.

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FINANCIAL INDICATORS

INTEREST RATES	Aug 9	Week Ago	Month Ago	Year Ago
3-month Treasury bill	2.00	2.06	2.15	2.05
6-month Treasury bill	2.00	2.01	2.08	2.23
3-month LIBOR	2.18	2.29	2.30	2.34
2-year Treasury note	1.64	1.71	1.85	2.61
5-year Treasury note	1.57	1.66	1.86	2.75
10-year Treasury note	1.75	1.84	2.11	2.87
30-year Treasury bond	2.26	2.38	2.64	3.03
30-year fixed mortgage rate	3.60	3.75	3.75	4.59
15-year fixed mortgage rate	3.05	3.20	3.22	4.05
5/1-year adjustable rate	3.36	3.46	3.46	3.90

STOCK MARKET				
Dow Jones Industrial Index	26,287.44	26,485.01	27,332.03	25,313.14
S&P 500	2,918.65	2,932.05	3,013.77	2,833.38
NASDAQ	7,959.14	8,004.07	8,244.14	2,839.11

COMMODITIES				
Gold ($ per troy ounce)	1,509.50	1,453.50	1,416.80	1,219.20
Oil ($ per barrel) - Crude Futures (WTI)	54.32	55.20	60.24	67.79

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
ISM Non-manufacturing Index (July)	54	55	57	56
Consumer Credit (June) - $Blns.	15	18	18	15
Producer Price Index (July) - % change	0.2	0.1	0.1	0.2