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ECONOMIC TALKING POINTS

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Multiple Government Shutdowns This Time Could Spell Trouble For Stocks and the Economy

Morning brief:

The starter's pistol went off this weekend for the midterm election. With the government shut down now in its third day, the battles lines have been drawn. Whether it's the budget, DACA, health care or financing the Wall, what the shutdown has crystallized is how ferociously unbridgeable these policy differences are.

Now, it may be we'll get some tenuous accord this week to keep the government functioning for a few more days or weeks, but both parties are likely to remain fully ensconced in their ideological trenches, especially on the topic of immigration.

Complicating matters further are multiple power struggles that will shape the funding debate: We have Republicans versus Democrats, conservative Republicans versus moderate Republicans, liberal Democrats versus more center-oriented Democrats, Republicans and Democrats versus the White House, and most remarkable of all, White House policy makers are even feuding among themselves. The political swamp has now fully devoured the nation's capital.

So what's next?

The overriding question is how will all this impact the financial markets and the economy? Will investor euphoria shortly peak out and finally bend the stock market's curve down? Could one of the longest economic expansions in history itself be in its final months?

Here's our take. A shutdown lasting a week or two will certainly unnerve investors and CEOs, but it is unlikely to do serious long term damage to the stock market or put the brakes on economic activity.

But a prolonged series of shutdowns will (not "may") change everything! If the brawl over the budget continues well into the first quarter, then it sets in motion a series of events that could take the steam out of the stock market, dramatically slow economic growth, and effectively neutralize all the benefits of the recently passed tax cuts.

Here's why.

1. Episodic government shutdowns that stretch into March will run up against another major risk to the economy, the failure to reach an agreement on NAFTA. If those trade talks go nowhere by March, Trump has threatened to give the required 6-month notice to withdraw from the 24-year old agreement. The combination of budgetary paralysis in the US and the possible termination of a trading relationship that by most measures has been a resounding success would cause investor, consumer and CEO sentiment to shift from one of confidence to increasing agitation and disgust.

2. Should stock market investors finally call in their chips between now and March, it would pose a serious threat to the economy. A sharp downturn in equity values would reduce household wealth at a time when consumers are already carrying a record amount of debt ($12.96 trillion) and showing the lowest savings rate in a decade (2.9%). A reversal in household net worth might be manageable when interest rates were historically low, but it could be problematic now that we're in a rising rate environment. A government shutdown will make matters even worse since Americans relying on a tax refund may have to wait longer than usual to receive those checks.

3. Business leaders face an additional set of questions. Could a period of intermittent government shutdowns, plus the possible termination of NAFTA and an impotent GOP so infuriate voters that Republicans would suffer a bloodbath in the November elections? And if Republicans do end up losing one or both houses of Congress, then that would alter the legislative dynamics on Capital Hill. The entire Trump economic agenda may be in jeopardy. With Washington in full paralysis mode, consumer spending in retreat, and the cost of capital rising (as a result of lower stock prices and rising interest rates) how likely is it that businesses will forge ahead with major new capital spending projects. It's not likely at all!

Given all the uncertainties, expect the hurdle rate to green light such business expenditures to climb. After all, why would companies add more capacity when the economic outlook suddenly looks dimmer and with the probability of a less business-friendly Congress after the midterm elections?

The bottom line:

This business cycle has had a remarkable run. But let's be clear. This economic expansion is now entering treacherous waters. The government shutdown, NAFTA, the multiple investigations in Washington that threatens the legitimacy if not longevity of the Trump Administration, and the myriad of geopolitical hazards ahead --- could with surprising speed shut down all support that has propelled both the stock market and economy.

For investors and corporate decision makers, it means the yellow warning light is no longer just flashing; it has changed to remain solidly lit.

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United States

	I 2017	II 2017	III 2017	IV 2017	I 2018	II 2018	III 2018	IV 2018	I 2019	II 2019	III 2019	IV 2019
Real Gross Domestic Product (GDP):												
%	1.2	3.1	3.2	2.8	2.4	3.2	3.0	2.5	1.9	2.5	2.6	2.8
Personal Consumption Expenditures:												
PCE %	1.9	3.3	2.2	3.4	2.4	2.8	2.6	2.4	2.2	3.1	2.9	2.7
Inflation, end of period, year-over-year:												
CPI %	2.4	1.6	2.2	2.1	2.1	2.0	2.2	2.3	2.4	2.4	2.5	2.7
Unemployment Rate (end of period):												
%	4.5	4.4	4.2	4.1	4.2	3.7	3.7	3.9	4.2	4.4	4.4	4.5
Non-farm Payrolls, monthly avg. thousand:												
	166	187	128	204	190	185	160	160	150	145	140	140
Treasury 10-yr Note Yield % (end of period):												
	2.39	2.30	2.33	2.41	2.58	2.55	2.85	3.10	3.35	3.38	3.40	3.40
Federal funds rate % (end of period):												
	0.88	1.13	1.13	1.38	1.63	1.63	1.88	2.13	2.38	2.63	2.63	2.63

GDP Growth - Global Economy

Country	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
US	-2.8	2.5	1.6	2.2	1.7	2.6	2.9	1.5	2.5	2.8	2.4
Eurozone	-4.1	1.7	1.4	-0.9	-0.3	1.2	1.6	1.7	2.3	2.4	1.7
United Kingdom	-5.2	1.7	0.7	0.3	1.8	2.9	2.2	1.8	1.4	1.0	1.4
Japan	-5.4	4.6	-0.4	1.6	1.5	-0.1	1.1	1.0	1.6	1.9	0.9
Canada	-2.8	3.1	3.1	1.7	2.2	2.5	0.9	1.4	3.2	2.7	2.5
India	6.3	8.4	8.6	6.7	4.9	7.4	7.9	7.1	6.8	7.5	7.5
China	9.2	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.3	6.2
Brazil	-0.3	7.5	2.7	0.9	2.3	0.1	-3.8	-3.6	0.9	2.3	2.8
Mexico	-4.7	5.2	4.0	3.9	1.4	2.3	2.7	2.0	2.1	2.0	2.5
Australia	1.2	2.8	2.6	3.6	2.4	2.6	2.4	2.4	2.7	2.8	3.0
Russia	-7.9	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.4	2.1	2.0
World	-1.9	4.2	3.0	2.6	2.9	3.0	2.7	2.4	3.5	3.7	3.9