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ECONOMIC TALKING POINTS

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March's Disappointing Payroll Report: The Economic Winds May Be Shifting

If there's one overriding takeaway from March's weak jobs report it is that the economy is now entering a treacherous phase.

After nearly ten years of fairly steady growth, this White House has suddenly thrown a massive wrench into what had been a smoothly operating economic machine. The threat of a trade war between the two largest economies on the planet has now quickly devolved into a dangerous contest of who can demonstrate more testosterone when it comes to national interest, President Trump or China's Xi Jinping, who has just been coronated as president for life.

Perhaps it is premature, or too much of a leap, to view the disappointing 103,000 increase in March payrolls as the result of rising nervousness among employers over trade tensions. Yet last month also saw a fairly significant slowdown in new orders in both the manufacturing and service sectors, according to the ISM survey. Moreover, global financial markets have reacted uniformly negatively to the prospect of a trans-Pacific economic "fight club."

And these early metrics are just the very first signs that trouble may be looming ahead. In the last four weeks we saw an alarming escalation in the blazingly stupid tit-for-tat threats to impose more punitive tariffs on key products that China and the U.S. purchase from each other.

How should we view this going forward? To begin with, it's important to make a distinction between (a) the rhetoric calling for tariffs, (b) an announcement detailing which goods will be subject to higher import tariffs, and (c) the actual implementation or enactment of such tariffs. For the moment, the Trump Administration has only given the green light to post additional tariffs on solar

panels, washing machines, steel and aluminum, though even here numerous countries have been exempt from some of these trade barriers.

The danger here is the rhetoric keeps getting hotter and the list of products that will be subject to higher tariffs grows larger by the day. If you then overlay these disruptions with a business cycle that is already long in the tooth, plus rising short term rates and swelling levels of debt among households, businesses and the federal government, the pressures bearing down on this economic expansion raises serious questions whether we are provoking a recession.

I have raised the prospect of a downturn in the next 12 to 18 months to 65% --- if no agreement on trade is reached with China, and is followed by a wave of retaliatory tariffs!

Having said that, we still expect cooler heads will prevail and avoid such folly. President Trump is now battling a trade conflict on two fronts, one with China and the other involving NAFTA. A failure with either will not just pummel the economy and financial markets, it pretty much guarantees that Republicans will lose one or both houses of Congress.

Should Democrats regain control of the House, and polls suggest such a transition is highly probable, the Trump Administration knows this would raise all sorts of ominous questions. For example, would that doom the President's entire economic agenda the rest of his term? Will the Democrats roll back the tax cuts? Could Trump face impeachment hearings? Will it shorten the longevity of the Trump administration?

Our predominant scenario is that all this Strum and Drang on tariffs and retaliation will result in a new trade deal between China and the US by May. The U.S., after all, does have certain legitimate gripes against China when it comes to the theft of intellectual property, the production of numerous counterfeit goods, and the forced transfer of technology. Indeed, these complaints are shared by many other countries that trade with China. (Frankly, we view the threat to go after China for dumping of steel and aluminum far less compelling and certainly not one that warrants an all out trade war.)

The Trump Administration, I believe, quietly recognizes that launching a full-scale trade war against China would be economic and political suicide for the GOP. We also foresee a deal being struck with Canada and Mexico before summer. If not, Mexico's leading candidate for the presidency, Andres Manuel Lopez Obrador, will likely be victorious in the July election. The U.S. would then have to negotiate with a socialist whose popularity stems mostly from his popular anti-Trump speeches.

In my view, March's soft payrolls report and the declines in factory and service activity reflect an economy that is struggling with the uncertainty over future trade policies. Private sector hiring of 102,000 in March was the lowest in six months. There were also downward revisions the previous two months with 50,000 fewer jobs formed than first published for January and February. And while the average monthly increase in payrolls the first quarter was still a respectable 202,000 a month, the question that looms large now is how trade talks will impact hiring in the second quarter.

That's why I noted at the start that this economy is at a treacherous point in the business cycle. It had a nice marathon run since June of 2009, but economic and political headwinds are increasing. The tax cuts many believed would add fresh firepower to business investments may in the end yield little if CEOs and consumers become increasingly alarmed about the path of US trade policy and the potential impact that could have on an aging expansion.

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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	2.3	2.6	2.1
Eurozone	-4.1	1.7	1.4	-0.9	-0.3	1.2	1.6	1.7	2.5	2.4	1.7
United Kingdom	-5.2	1.7	0.7	0.3	1.8	2.9	2.2	1.9	1.8	1.0	1.4
Japan	-5.4	4.6	-0.4	1.6	1.5	-0.1	1.1	1.0	1.6	1.7	0.9
Canada	-2.8	3.1	3.1	1.7	2.2	2.5	0.9	1.4	3.0	2.6	2.5
India	6.3	8.4	8.6	6.7	4.9	7.4	7.9	7.1	6.6	7.4	7.3
China	9.2	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.9	6.6	6.3
Brazil	-0.3	7.5	2.7	0.9	2.3	0.1	-3.5	-3.5	1.0	2.3	2.6
Mexico	-4.7	5.2	4.0	3.9	1.4	2.3	2.7	2.9	2.1	2.0	2.5
Australia	1.2	2.8	2.6	3.6	2.4	2.6	2.5	2.4	2.4	2.7	3.0
Russia	-7.9	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.5	2.1	2.0
World	-1.9	4.2	3.0	2.6	2.9	3.0	2.7	2.4	3.2	3.4	3.2

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	2.9	1.8	3.3	2.7	2.6	1.9	2.2	2.0	2.4
Personal Consumption Expenditures:												
PCE %	1.9	3.3	2.2	4.0	1.9	2.4	2.7	3.0	2.2	2.1	2.3	2.7
Inflation, end of period, year-over-year:												
CPI %	2.4	1.6	2.2	2.1	2.2	2.2	2.3	2.3	2.4	2.4	2.5	2.7
Unemployment Rate (end of period):												
%	4.5	4.4	4.2	4.1	4.1	3.8	3.7	3.9	4.2	4.4	4.4	4.5
Non-farm Payrolls, monthly avg. thousand:												
	166	187	128	204	202	190	160	160	150	145	140	140
Treasury 10-yr Note Yield % (end of period):												
	2.39	2.30	2.33	2.41	2.74	2.98	3.05	3.05	3.35	3.25	3.10	3.10
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