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ECONOMIC TALKING POINTS

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Business Optimism is in Free Fall, Yet Job Openings Hit Record High. It Makes Perfect Sense!

After visiting clients the last two weeks, one sentiment emerges most often --- exasperation! Rarely have business leaders coped with so much uncertainty about the US and international economic outlook.

Here's just a small sample of the concerns they raised during our conversations

• Is there going to be a recession?
("We've got make decisions on allocating our resources? There's a lot at stake.").

• Will there be another government shutdown?
(" This is ridiculous. The last one forced us to reassess our revenue projections for the quarter. Are we going to go through that again?")

• Will there be a trade agreement between the US and China?
("Our suppliers are dealing with tremendous uncertainty. Should they raise prices or not? Restructure supply chains too? ")

• Are we about to escalate trade tensions with Europe?
("It couldn't happen at a worse time for a region that's already dealing with many other problems!")

Their worry is palpable and it is clearly infecting the decision-making process. It's also showing up some current economic releases. For example, the important Small Business Optimism Index plummeted in January for a fifth consecutive month! It now stands at its lowest level in more than two years, which means the spreading discontent is more than just the battle over a government shutdown. That has to make the Trump Administration and the GOP anxious.

A deeper look at the report put out by the National Federation of Independent Business shows that small and mid-size companies are so concerned about future conditions, an increasing number of them have chosen to cancel or postpone capital spending plans.

• The net percentage of those who believe it's a good time to expand within the next three months turned out to be the smallest since October 2016. They blamed the poor political climate as on of the main reasons for this deterioration.

• Another metric, specifically how firms viewed the outlook for general business conditions over the next half year, was in absolute free fall. The net percentage of those expecting stronger activity dropped to 6 last month, from 41 a year earlier!

• Not surprisingly, those planning to ramp up capital investments the next three to six months also remained depressed. Firms contemplating such expenditures in both the December and January surveys were the lowest in two years.

It's all another reminder that while slashing corporate taxes can help spur business activity, a lower tax burden is just one of many factors CEOs consider before launching a capital spending project. Just consider some of the issues that currently stand in the way of such investments:

--- There's the prospect of another government shutdown;
--- A worsening of trade tensions with both China and Europe;
--- New questions concerning the ratification of USMCA (NAFTA 2.0);
--- A more severe economic slowdown underway in Europe and Japan;
--- The cost of capital is rising at a time when corporate debt is at a record $9 trillion;
--- There's the dysfunctionality of government in Washington and the potential fallout from the Mueller investigation in the coming months.

All have deepened the economic uncertainty. Is it any wonder that both business and consumer confidence are now so wobbly?

Now you may well ask why, if the economic outlook is so unclear, have employers posted a record number of vacant positions in December? The BLS just reported that job opening in the final month of 2018 surged to a series high of 7.3 million --- with more than 90% of those vacancies coming from the private sector.

There are two broad explanations for these conflicting trends.

(1) The biggest increase in job openings occurred in the non-financial services industries, namely education, health care and hospitality. They are less vulnerable to swings in the business cycle or political tumult.

Let's look at hem individually.

Education:
Universities, community colleges, technical and vocational schools are filled to capacity these days as Americans seek to obtain skills that are most in demand in today's hi-tech economy. These jobs come with bigger paychecks and additional security.

Health care and leisure & hospitality:
Both sectors are hiring heavily because of demographic factors. Retiring baby boomers tend to seek out more medical services, thus the demand for more workers in the field. Baby boomers are also inclined to do more leisure travel at this stage in their lives. Hotels and restaurants therefore need to staff up, especially as new lodging facilities open up. However, with the White House cracking down on illegal immigration and even curbing those seeking legal entry into the US, the hospitality industry has had to increasingly rely on hiring American residents, a group that can be more easily tallied than immigrants.

(2) During times of great economic and political uncertainty, companies shy away from investing capital to expand capacity because the rate of return on such investments are either insufficient, unclear, or unjustifiable to shareholders. So to meet the still strong demand for goods and services, the preferred strategy is to boost output by hiring more workers.

Adding to payrolls is simply more defensible than enacting a costly cap ex project when future business conditions are so opaque. Those hired can be kept on payroll, or if necessary re-assigned in the event of a significant economic slowdown, or ultimately laid off in the event of a recession.

That flexibility helps explain how during periods of economic uncertainty and falling business confidence, the demand for workers can still be surprisingly strong. These two trends can remain in effect until the some of the economic fog lifts – and that may not happen for another few months.

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Economic & Geopolitical Events That Can Disrupt U.S. GDP Growth

Projections are for 2019 and 2020

PROBABILITY (%)	U.S.
60	White House extends the truce and delays lifting tariffs to 25% on Chinese imports
55	Economy slows 2nd half 2019. Fed cuts rates in 2020
20	Yield curve inverts (3-month bill to 10-year Treasury note)
25	US companies significantly ramp up capital expenditures in 2019
45	U.S. economic recession to begin by 2020
	FOREIGN
70	Venezuela's Maduro regime collapses in 2019; new government takes over
85	China boosts official spending and extends credit to fend off economic downturn
45	U.S. - Chinese military clash in the South China Sea and over Taiwan
50	Saudi monarchy in turmoil in 2019. Oil prices climb sharply
55	Major clashes erupt between Israel & Lebanon's Hezbollah
65	UK decides to postpone Brexit by March, followed by a second referendum on leaving the EU
35	US and China reach a comprehensive accord on trade in 2019. Trade tensions fade

Key Economic Forecasts

- Actual
- Forecast

United States

	I 2018	II 2018	III 2018	IV 2018	I 2019	II 2019	III 2019	IV 2019	I 2020	II 2020	III 2020	IV 2020
Real Gross Domestic Product (GDP):												
%	2.2	4.2	3.4	2.6	2.1	2.6	2.2	2.1	1.8	1.8	1.3	1.5
Personal Consumption Expenditures:												
PCE %	0.5	3.8	3.5	2.8	1.6	2.3	2.0	2.2	1.2	2.0	1.1	1.6
Inflation, end of period, year-over-year:												
CPI %	2.4	2.9	2.3	1.9	2.2	2.5	2.5	2.7	2.5	2.4	2.4	2.1
Unemployment Rate (end of period):												
%	4.1	4.0	3.7	3.9	3.7	3.6	3.7	3.9	3.9	4.1	4.2	4.4
Non-farm Payrolls, monthly avg. thousand:												
	218	211	190	230	201	189	170	140	140	120	95	110
Treasury 10-yr Note Yield % (end of period):												
	2.74	2.85	3.06	2.76	2.85	2.95	3.00	3.15	3.25	3.40	3.30	3.15
Federal funds rate % (end of period):												
	1.63	1.88	2.13	2.38	2.63	2.63	2.63	2.63	2.38	2.38	2.13	2.13

GDP Growth - Global Economy

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
US	2.6	1.6	2.2	1.8	2.5	2.9	1.6	2.2	3.1	2.4	1.5
Eurozone	1.7	1.4	-0.9	-0.3	1.2	1.6	1.7	2.5	1.8	1.8	1.7
United Kingdom	1.7	0.7	0.3	1.8	2.9	2.2	1.9	1.8	1.3	1.2	1.4
Japan	4.6	-0.4	1.6	1.5	-0.1	1.1	1.0	1.6	1.1	0.9	0.7
Canada	3.1	3.1	1.7	2.2	2.5	0.9	1.4	3.0	2.2	2.3	2.1
India	8.4	8.6	6.7	4.9	7.4	7.9	7.1	8.2	7.2	7.0	7.2
China	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.6	6.3	6.0
Brazil	7.5	2.7	0.9	2.3	0.1	-3.5	-3.5	1.4	2.3	2.2	2.4
Mexico	5.2	4.0	3.9	1.4	2.3	2.7	2.9	2.1	2.0	1.9	1.6
Australia	2.8	2.6	3.6	2.4	2.6	2.5	2.4	2.4	3.0	2.8	2.9
Russia	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.6	2.3	2.0	1.9
World	4.2	3.0	2.6	2.9	3.0	2.8	2.6	3.3	3.1	2.8	2.7