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ECONOMIC TALKING POINTS

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A weak jobs report, declining manufacturing activity an escalation in the trade war: How much more can an aging business cycle take?

During the first half of the year, the economy showed initial signs of an air leak. But as we enter the second half of 2019, evidence has started to mount that it is losing altitude at an even faster rate.

No, the US is not about to free-fall into recession. But it is abundantly clear from the last several job reports, their downward revisions on payrolls, along with the latest surveys from corporate purchasing managers, that economic activity is rapidly decelerating. (ISM manufacturing activity has been sliding for four straight months.)

At the heart of this deterioration is the festering trade war with China. It has been damaging to the economy and endangering the current US business cycle.

Let's start with the most important report card on the economy – job creation. We had a slew of data points in the July employment release that should concern the White House.

- **The 3-month average increase in private payrolls has dropped to 136,000 in July, from 224,000 a year ago.**

• Average weekly hours worked in the private sector has been declining all year. It fell to 34.3 hours last month, the fewest in more than two years.

• Average overtime hours in manufacturing has dropped to 3.2 in July from 3.5 a year ago.

• While the unemployment rate held at 3.7% last month, looming uncertainties over trade have made CEOs reticent about ramping up capital spending and slowed new hiring. Jobless rates are creeping higher for Hispanics, Asians, teenagers and women.

These are disturbing trends since it is the consumer that kept the economy out of any danger up to now. Now their spending may soon be in jeopardy. The new 10% tariff President Trump announced on $300 billion of Chinese imports will zero in on popular consumer products --- toys, cell, phones, clothing and consumer electronics. These new import duties will take effect September 1st, just as retailers are gearing up for the holiday shopping season. If they are passed on in the form of higher prices, it could force consumers to scale back shopping. If they do retrench, this business cycle is effectively over!

Evidently the truce that followed the June G20 meeting between Trump and Xi Jinping lasted barely a month, not an encouraging sign. Now that the White House has raised the stakes again, China will undoubtedly announce how they are going to retaliate. And so has gone this vicious punitive cycle between the two largest economies in the world.

The economic outlook thus becomes murkier by the day. The futures market sees a near 100% chance of another rate cut by the Federal Reserve in September. But as we have said in our previous report, the heavy foot on the neck of the economy now is <u>not tight monetary policy</u>. How could it be when the real fed funds rate is just half a percentage point?

What's weighing heavily on the economy are nonstop rounds of tariffs against China, followed by their retaliation against the US. It's also the scatter-shot approach with which the White House has used tariffs to carry it's domestic economic and foreign policies, regardless of the cost. It's also the manifest goal of the Trump administration to reverse globalization and pursue protectionism, despite decades of unassailable evidence that the former promotes economic growth, while the latter hampers it. And finally it is the erratic implementation of tariffs without regard to how it disrupts decades of carefully crafted relationships US firms have with suppliers all over the world.

These are poorly conceived actions, which the Federal Reserve cannot rectify. Slashing interest rates to stimulate the economy in this environment is like filling a car's gas tank for long drive when it's disabled with multiple flat tires. Simply put, we have reached the limits of what low interest rates can do in this situation.

So while this long economic cycle still has legs, those legs are tiring under the chronic strain of flawed trade policies. We see it in the July jobs report and from depressing US and foreign stats on manufacturing.

The next downturn will not be triggered by high interest rates, nor some exogenous shock that drives up oil prices --- but because if acts of human folly, self-injurious trade policies that will engulf the entire world economy. We have therefore raised the odds of recession next year from 35% to 50%.

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	I 2021	II 2021	III 2021	IV 2021
Real Gross Domestic Product (GDP):																
%	2.2	4.2	3.4	2.2	3.1	2.1	1.9	2.0	1.3	2.0	1.8	2.0	2.2	2.4	2.5	2.5
Personal Consumption Expenditures:																
PCE %	0.5	3.8	3.5	1.4	1.1	4.3	1.3	1.9	1.2	1.9	1.7	2.0	2.0	2.7	2.8	3.1
Inflation, end of period, year-over-year:																
CPI %	2.4	2.9	2.3	1.9	1.9	1.6	2.1	2.3	2.2	2.0	2.0	2.2	2.5	2.7	2.7	3.7
Unemployment Rate (end of period):																
%	4.1	4.0	3.7	3.9	3.8	3.7	3.6	3.5	3.8	3.9	4.0	4.2	4.1	4.0	4.0	3.9
Non-farm Payrolls, monthly avg. thousand:																
	228	243	189	233	174	171	165	155	125	115	105	100	115	125	155	165
Treasury 10-yr Note Yield % (end of period):																
	2.74	2.85	3.06	2.76	2.42	2.00	2.30	2.20	2.15	2.35	2.45	2.85	3.20	3.50	4.10	4.40
Federal funds rate % (end of period):																
	1.63	1.88	2.13	2.38	2.38	2.38	2.13	1.88	1.88	1.88	1.88	1.88	2.13	2.38	2.63	2.63

GDP Growth - Global Economy

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
US	2.6	1.6	2.2	1.8	2.5	2.9	1.6	2.2	2.9	2.2	1.8	2.4
Eurozone	1.7	1.4	-0.9	-0.3	1.2	1.6	1.7	2.5	1.9	1.3	1.4	1.8
United Kingdom	1.7	0.7	0.3	1.8	2.9	2.2	1.9	1.8	1.4	1.4	0.8	1.6
Japan	4.6	-0.4	1.6	1.5	-0.1	1.1	1.0	1.9	0.8	0.5	0.4	1.1
Canada	3.1	3.1	1.7	2.2	2.5	0.9	1.4	3.0	1.9	1.5	1.3	2.2
India	8.4	8.6	6.7	4.9	7.4	8.0	8.1	7.2	6.8	6.8	6.5	7.3
China	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.6	6.2	5.9	6.5
Brazil	7.5	2.7	0.9	2.3	0.1	-3.5	-3.5	1.4	1.1	1.2	1.2	1.7
Mexico	5.2	4.0	3.9	1.4	2.3	2.7	2.9	2.1	2.0	1.3	0.9	2.1
Australia	2.8	2.6	3.6	2.4	2.6	2.5	2.4	2.4	2.7	2.0	1.8	2.6
Russia	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.6	2.5	2.0	1.8	2.4
World	4.2	3.0	2.6	2.9	3.0	2.8	2.6	3.3	3.2	3.0	2.7	3.3

Economic & Geopolitical Risks to Monitor

Projections are for 2019 and 2020

PROBABILITY	U.S.
HIGH	China to stall on trade talks until after US presidential election.
HIGH	Higher tariffs on Chinese imports slows US economy. Trump pressures the Fed to cut rates further.
Moderate	Fed expected to reduce rates twice in 2nd half of 2019, each 25 basis points. No cuts seen in 2020.
HIGH	10 Yr. Treasury yield rebounds sharply in 2020 as investor appetite for US federal debt decreases.
HIGH	U.S. firms slow CAP EX in 2019 given global economic slowdown, trade tensions and record corp. debt.
Moderate	U.S. economy suffers a recession by end of 2020.
	FOREIGN
HIGH	Venezuela's Maduro regime collapses in 2019; new elections are planned.
HIGH	China successfully arrests economic slowdown by using selective stimulus.
Moderate	Risk of military confrontation in South China Sea escalates as US increases naval presence.
HIGH	Terrorist attempts to sabotage Saudi oil infrastructure increases in 2019. Oil prices climb.
HIGH	Iran counters U.S. sanctions by taking actions that raise tensions in the Middle East.
HIGH	Boris Johnson's willingness to accept a no-deal BREXIT will depress UK economy and pound.
Moderate	Global demand for US WTI oil rises as conflict in the Persian Gulf disrupts shipments of crude.

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