

Eszylfie Taylor Economic Update November 2018

THE MONTH IN BRIEF

October certainly lived up to its reputation for volatility. The S&P 500 suffered its second correction of the year as investors wondered if they were seeing early signs of the peak of the current business cycle, absorbing news of moderating corporate earnings, while also considering the potential impact of higher interest rates and tariffs. Real estate indicators, for the most part, left much to be desired; labor, manufacturing, and consumer spending and confidence indicators were in better shape.

DOMESTIC ECONOMIC HEALTH

Housing aside, the domestic economic data arriving in October ranged from middling to excellent. The Institute for Supply Management presented its latest manufacturing purchasing manager index; the September reading was 59.8, down from the previous mark of 61.3, but still superb. ISM's non-manufacturing PMI reached an all-time peak of 61.6, rising 3.1 points from its August level.

In a notable miss, the Department of Labor's September employment report showed U.S. non-farm payrolls adding 134,000 net new hires. Economists surveyed by Bloomberg projected the gain at 185,000, and some wondered if Hurricane Florence might have affected the total. Headline unemployment fell 0.2%, however, to a remarkably low 3.7%. The jobless rate had not been that low since the end of the 1960s. The U-6 unemployment rate, which counts both the unemployed and underemployed, ticked south 0.1% to 7.4%. Another bright spot: the upward revision of the previous two months of hiring totals. The July jobs gain was 18,000 to 165,000; the August gain was upgraded from 201,000 to 270,000.

The major reports in the following week covered retail sales and consumer prices, and they posed some question marks. Why had retail sales improved just 0.1% in August and September, in a presumably prospering economy? Turning to another closely watched indicator, the annualized rate of consumer inflation fell from 2.7% in August to 2.3% in September. (Core consumer inflation remained at a 2.2% yearly pace.) Seasonal fluctuations in fuel and energy costs may not be enough to explain the variance. Annualized wholesale inflation also declined in September, weakening 0.2% to 2.6%. Speaking of business, data on September industrial and manufacturing production showed a monthly gain of 0.3% for the first of those two sectors and 0.2% for the second.

The month's first important consumer confidence index, the gauge overseen by the University of Michigan, fell 1.1 points in its preliminary edition and another 0.4 points in its final October reading, ending the month at 98.6. On October 30, the Conference Board's consumer confidence index displayed another noteworthy reading: 137.9, which surpassed its (revised) 135.3 mark in September.

As the month stretched on, the federal government provided its initial estimate of third quarter economic expansion, and it was solid: 3.5%. That followed a 4.2% pace of growth in Q2. The six months ending in September represented the best back-to-back quarters for the economy since 2014. Additionally, overall hard goods orders rose 0.8% in September (though they were down 0.6% minus defense industry orders).

Personal income and personal spending data for September appeared as October wound down, and one indicator impressed more than the other. While personal spending grew 0.4%, wages were up only 0.2%.

Wages improved 2.9% year-over-year through September, as the Department of Labor's Employment Cost Index pointed out on Halloween. This was the largest annualized wage gain seen in a decade.

GLOBAL ECONOMIC HEALTH

Last month, China's National Bureau of Statistics reported Q3 economic expansion of 1.6%, leaving the nation's projected 2018 GDP at 6.5%. The Chinese economy last grew that slowly in Q1 2009. China's official growth target for the year is 6.5%, but its GDP was running at a 6.7% annual pace when the second quarter ended, prior to the direct impact of tariffs. The International Monetary Fund believes the U.S. tariffs on the P.R.C. will also affect the region's other economies: in the first half of October, it cut

its 2018 GDP estimate for Malaysia by 0.6%, and lowered its GDP projections for Indonesia, the Philippines, and India by 0.1%-0.2%.

Economic deceleration was also a rising concern in Europe. The European Central Bank projects 2018 eurozone growth of 2.0%, down from 2.5% in 2017. (The bank still intends to conclude its bond-buying campaign in December.) Germany's Chamber of Industry and Commerce now estimates that nation's GDP at just 1.8% for 2018, quite a reduction from its previous 2.7% projection. Meanwhile, Italy's newest proposed budget, which flagrantly disregarded E.U. rules, was chided by E.U. officials who warned of fines for the country if it was not modified. As for the Brexit, much was still unresolved. The possibility of a "blind Brexit" – a Brexit in which the United Kingdom exits the E.U. without any formal future trading agreement established with E.U. nations – was still on the table. In late October, word came that eurozone growth in the third quarter was 0.2%, half that seen a quarter earlier.

WORLD MARKETS

Brazilian investors were feeling exceptionally bullish last month. That nation's main stock index gained 10.19% for October. No other major index even came close to that kind of performance. In fact, several benchmarks corrected: Mexico lost 11.23%; Argentina, 11.87%; Hong Kong, 10.11%; Japan 225, 10.51%; South Korea, 12.90%; Taiwan, 10.39%.

Other marquee indices avoided month-long corrections, but still fell sharply like ours. MSCI's World index stumbled 7.42% and its Emerging Markets index lost 8.78%. The most prominent European benchmarks all retreated 5% or more on the month. In the Asia-Pacific region, the Shanghai Composite absorbed a 7.75% October loss; Australia's All Ordinaries dropped 5.72%. In India, the Sensex lost 4.93%, while the Nifty 50 fell 4.98%. To our north, the TSX Composite ceded 6.51% last month.

COMMODITIES MARKETS

Light sweet crude and unleaded gasoline relinquished considerable ground in October. Oil ended the month at \$65.02, falling 11.62%; gasoline shed 16.82%. October also saw natural gas add 9.00%, while heating oil lost 4.41%. In soft commodities, double-digit gains came for coffee (10.20%) and sugar (32.82%). Cocoa futures climbed 7.79%; cotton futures, 2.83%; corn futures, 2.03%. Soybeans retreated 0.83% and, wheat, 1.62%.

Gold posted an October gain of 2.38%, settling at \$1,218.20 on the COMEX on Halloween. Silver lost 1.82% for the month, ending October at \$14.28. Copper lost 4.56% for the month; platinum rose 2.91%.
The greenback grew stronger in October: the U.S. Dollar Index advanced 2.08%.

REAL ESTATE

Sometimes, the real estate sector transmits the first hint that a business cycle is weakening when home sales and starts begin to taper off. The jury is out on whether this is currently happening or whether the housing market is simply seeing a temporary slump. The latest indicators were not encouraging.

The National Association of Realtors announced a 3.4% retreat for resales in September and projected a 1.6% decline in existing home sales for 2018. A Census Bureau report showed the rate of new home buying weakening 5.5% in the ninth month of the year. As for residential construction activity, further Census Bureau data had housing starts down 5.3% for September, building permits down 0.6%.

Home loan interest rates climbed significantly between Freddie Mac's September 27 and October 25 Primary Mortgage Market Surveys. The mean rate for the 30-year FRM rose from 4.72% to 4.86%. Similar moves occurred for the 5/1-year ARM (3.97% to 4.14%) and the refiner's favorite, the 15-year FRM (4.16% to 4.29%). As rates rose, real estate analysts also noted the slimming 12-month advance made by the 20-city S&P CoreLogic Case-Shiller home price index with the annualized price gain was 5.8% for August, the smallest in a year.