Not So Fast on the Slowdown

April 13, 2018 — The markets have been focused on politics. Syria, tariffs, the Mueller investigation, elections in Europe and potential regulation of technology companies have all moved markets – and that’s just in the past two weeks. With all that, it’s natural that there has been less talk about the actual economic data in the U.S. Still, there has been a general feeling that the U.S. economy may be slowing down a bit. In the minutes released on Wednesday, Fed members mentioned they expected “softness” in first quarter GDP. Forecasts of private economists compiled by Bloomberg show GDP falling from 2.9% in Q4 of 2017 to 2.2% in Q1, which is a modest decline. There have been a few stories about potential credit problems in auto and student loans hurting consumption. It’s hard to blame people for being jittery about the economy with the volatility in the stock market, especially because some of the volatility has been on the downside.

Recent data releases do raise some questions. Are we seeing a real slowdown? Has any of the geopolitical uncertainty bled into markets? Is there any reason to expect slower growth later in the year or is the decline in GDP “transitory,” as some Fed members think?

Let’s answer the second question first. So far none of the political events have had an obvious direct effect on the economy. The tariffs, for example, have been too small, and many have not been enacted yet. This means we should see the effects of politics in sentiment numbers before they affect the activity data.

In other words, people would have to feel like things were getting bad before they stop spending or investing money.

The fall in the stock market might be one reason to think that sentiment is flagging. However, survey numbers have been telling a different story. The Conference Board Consumer Confidence Index® numbers and the University of Michigan’s consumer sentiment numbers are near their highest levels since 2000. The National Federation of Independent Business’s small business survey was lower in March, but remains near its highest level since 2004. With small businesses and consumers still comfortable, it is unlikely that any bad news in the world is currently affecting the economy.

Employment and housing numbers have been generally good as well. Not that every release has been exceptional, but the trend has definitely been positive. To the extent there is a slowdown, it is coming in some of the consumer activity numbers. Retail sales have been disappointing. Personal consumption expenditures, a broader measure of consumer spending, have also been slowing. Because consumption is such a large part of the U.S. economy, any slowdown would directly affect GDP. This slowdown in consumption, however, should not set off any alarms. The magnitude is not that large. Also, there seems to be some seasonal strangeness. In the past five years there has been a lot of volatility in retail sales numbers in the first quarter. There have been some really bad January and February numbers. Now we all know that they seasonal adjust the numbers. If they didn’t, pre- and post-Christmas retail sales would be impossible to compare. But come on, do they really adjust them in the perfect way every month? Is it even possible to do that? By the standards of the past few years, this slowdown in retail sales is modest.

Economists have not been scared into reducing their forecasts for the rest of 2018.

In fact, according to Bloomberg, consensus estimates have actually increased. Leading indicators such as manufacturing surveys have remained quite strong. The Institute for Supply Management’s Manufacturing PMI, for example, has stayed near 60, which not only indicates growth, but acceleration in that sector. There isn’t much in the data to say there is a major slowdown this year. It may be that growth is actually okay, and we can expect more of it this year.

This does not mean the U.S. economy is bulletproof and will continue along regardless of what happens in politics. Interest rates have been rising, and while they are still low, they no longer provide as much of a cushion to shocks. The potential for a trade war is probably the biggest current risk. It could increase inflation and cut investment very quickly. The events in Europe and all of the drama with privacy and
large tech firms, while problematic for individual sectors and countries, should not derail U.S. or global growth. Even the Mueller investigation, while certainly a market mover, probably will not affect economic activity in a significant way. Syria is a bit trickier. Although Syria is not a major oil producer, it could lead to disruption in oil supply if U.S.-Russia relations worsen. It is unlikely, but if the U.S. sanctioned Russian oil companies, oil prices could rally a lot more than they already have. This could choke off growth and increase inflation.

None of these fears should cause people to panic. The state of the economy is good, and they are just risks. It seems people already know that. That may be why sentiment has held up so well.

What We Are Watching

U.S. Retail Sales (Monday)

U.S. retail sales grew rapidly late last year, but spending data has come in below economist forecasts since the start of 2018. Weakness in consumer spending has been puzzling, as fundamentals for consumption appear to remain positive. Household income growth has been strong, and sentiment surveys continue to show high levels of optimism among consumers. Retail sales data for March will have an important impact on first quarter GDP estimates, with a weak result likely forcing economists to mark down their estimates significantly. Furthermore, the data should help to clarify whether the trend in consumer spending is in fact starting to decelerate. Auto sales for March gave some cause for optimism, as consumers stepped up their purchases of cars and (especially) trucks. This may indicate that January and February represented a temporary lull in spending rather than a sign of a sustained slowdown.

China GDP, Monthly Activity Data (Tuesday)

This week, China's National Bureau of Statistics (NBS) will publish data on first quarter GDP growth along with several activity series for March, including industrial production, fixed asset investment, and retail sales. Releases covering January and February were generally positive, with unexpected strength in industrial activity and investment spending. However, economists typically take Chinese data from early in the year with a grain of salt due to volatility around the Lunar New Year holiday, which occurs at a different time each year and causes major disruptions to economic activity. Data for the first quarter as a whole should indicate whether the Chinese economy is in fact growing more quickly than expected thus far in 2018. If so, this may provide some support to domestic equity markets as well as global commodity prices.

Bank of Canada Meeting (Wednesday)

The Bank of Canada (BoC) has hiked rates three times in the last year, and the statement released following the central bank's March meeting indicated that "the economic outlook is expected to warrant higher interest rates over time." However, the BoC has been cautious about tightening too rapidly, citing uncertainties related to recent changes in mortgage lending guidelines and the renegotiation of NAFTA, which could lead to significant changes in Canada’s most important trade relationship. In recent weeks, press reports and official statements have suggested that NAFTA negotiations are making progress, perhaps lessening concerns over sudden changes to the rules governing trade with the United States. Since the BoC’s last meeting, growth and employment data has been mixed, but inflation has risen more quickly than expected. These developments could lead to a more hawkish tone from the central bank this month, and a few forecasters have called for an immediate rate hike. If the BoC raises rates or confirms that such a move is likely in the near term, it could provide a boost to the Canadian dollar and weigh on domestic fixed income markets.

AQR Capital Management, LLC | Two Greenwich Plaza | Greenwich, CT 06830 | U.S. 1
p: +1.203.742.3600 | f: +1.203.742.3100 | w: aqr.com

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1 Hungary had a parliamentary election on April 8, so it's technically correct that a European election occurred in the past two weeks. Really Italy was the big one last month, and that still hasn’t been resolved.
2 Though they said the softness was likely "transitory." Source: Federal Reserve: “Minutes of the Federal Open Market Committee Meeting 29-30 March 2019”
3 Source: Bloomberg as of 4/12/18.
4 Funny how many articles talk of volatility as if it ensures losses for longs in markets. Upside volatility is probably good for assets holders.
5 Headline, month over month, retail sales data for January and February of 2018 have missed to the downside relative to Bloomberg median consensus survey expectations and have shown deceleration. Source: Bloomberg, U.S. Census Bureau.
6 Nominal personal consumption expenditures for January and February of 2018 both saw 0.2% month over month growth, relative to an average of 0.4% month over month growth in 2017. Source: Bloomberg, Bureau of Economic Analysis.
7 If you do see a miss in a GDP release, always look first at inventories. It is really hard to predict those! It’s always inventories.
8 Those are rhetorical questions. In evaluating the long run economy, seasonal adjustments shouldn’t matter. It’s only for us macro folk who look for fast changes in trends that these types of things come into play.
9 Take that, strawman!
10 Does listing all of the geopolitical risks sound like an updated version of “We Didn’t Start the Fire?” “Syria, Presidential tweets, Elections in Italy … Mueller investigation” could easily have been a verse.

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