Louisiana Corporate Credit Union

ECONOMIC & FINANCIAL DIGEST

3500 N. Causeway, Suite 1510 • Metairie, Louisiana 70002 • (800) 421-7030 • www.lacorp.com

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Will Factory Slump Kill The Expansion?

Throughout most of the year the U.S. economy has withstood a torrent of headwinds, including escalating trade tensions with China, a severe global slowdown, geopolitical turmoil and headline-grabbing political controversy that continues to bedevil the administration. These adverse developments have taken a toll on business confidence and delivered a blow to exports and manufacturing activity, but they have not dragged down the broader economy. Although growth slowed in the second and third quarters, most believe that the long expansion, now in its eleventh year, is not about to expire.

One reason is that the fundamentals supporting continued growth remain on a solid footing. The job market is healthy, wages are increasing and households are in decent shape, having built up a significant savings buffer and keeping debt obligations well within reasonable limits relative to incomes. With confidence still elevated, consumers have the firepower and mindset to sustain spending, which is the economy's main growth driver. What's more, the Federal Reserve stands ready to lend a helping hand, lowering interest rates and poised to inject as much stimulus as necessary to keep the expansion going.

But cracks in the foundation are starting to appear, stoking fears that the fault lines could spread to the broader economy. The economic reports for September were more negative than positive, punctuated by a surprising fall in retail sales during the month. That may be a sign that consumers are succumbing to the drumbeat of adverse developments over which they have little or no control. While one month does not make a trend, the setback bears watching; consumer spending is the economy's main growth driver, accounting for about 70 percent of GDP; if it falters significantly so too will the expansion. Odds are, households are not retrenching but ratcheting down the pace of consumption in line with the gradual slowing of income and job growth expected in coming months. But if the global storms intensify and wash up on American shores, the recession threat will become more of a reality.

Downgrading Growth Prospects

In its latest World Outlook, the International Monetary Fund sliced 0.3 percent off of its April forecast of Global growth for this year, from 3.3 percent to 3.0 percent. That would be the slowest pace since the 2008-2009 global financial crisis and compares to a 3.6 percent growth in 2018. The slowdown and downward revisions were spread across most nations, with the U.S. growth rate expected to slip to 2.4 percent this year from 2.9 percent in 2018. Importantly, however, the I.M.F expects a rebound next year, with global growth accelerating to 3.4 percent, even as the U.S. slows further to 2.1 percent

From our lens, the I.M.F is being too optimistic, both in its global and, particularly, the U.S. outlook. The global rebound hinges on a strong recovery in emerging markets, many of which were in dire straits this year. While some snapback is likely, it is difficult to imagine that much of a recovery if, as the I.M.F expects, there is no improvement in the "big four" global economies – the U.S., China, Japan and the eurozone. The emerging markets are far too dependent on their larger trading partners to overcome that headwind.

Importantly, the I.M.F's forecast for the U.S. is overly optimistic. The American economy is on track to grow less than 2.4 percent this year, probably closer to 2.0 percent, and slow even further in 2020, most likely to below 2.0 percent. The weakest link in the chain is manufacturing, which is already in a recession thanks largely to the global slowdown that has weakened foreign demand for U.S. exports as well as the strong dollar, which makes American goods more expensive relative to those produced by overseas competitors. The greenback is not likely to fall and the weakness in the economies of our main trading partners is expected to persist next year. One contention of the I.M.F that has widespread agreement is its assertion that the protectionist policies and trade wars are largely responsible for the malaise afflicting the global economy.

Reduced Industrial Footprint

But while we believe the I.M.F is too optimistic about U.S. growth prospects, that doesn't mean a recession is in the offing. As noted, the manufacturing slump is the weak link dragging

I.M.F World Economic Outlook (Percent Change)

		Projections	
	2018	2019	2020
World	3.6	3.0	3.4
Advanced Economies	2.3	1.7	1.7
U.S.	2.9	2.4	2.1
Euro Area	1.9	1.2	1.4
Japan	0.8	0.9	0.5
Emerging Economies	4.5	3.9	4.6
China	6.6	6.4	5.8

down the economy. Factory output fell in the first and second quarters of the year and the ISM manufacturing index slipped to the lowest level since the recession in September. But unless the industrial weakness spreads to the much larger services sector of the economy, it should not deliver a death blow to the expansion. For one, the goods producing sector accounts for a much smaller share of economic output than it did prior to earlier postwar recessions.

Currently, for example, the gross value of goods produced in the U.S. accounts for just over 22 percent of gross domestic product. That's down from a 28 percent share just prior to the last recession and from more than 30 percent prior to each recession going back to the early 1970s, when it accounted for a 34 percent of GDP. That's not a surprising trend amid an ever-prospering advanced economy with an aging population. Such a combination generates more discretionary income to spend on things like financial services and recreational activity and has growing needs for health care services.

Hence whereas consumers devoted 51 percent of their inflation-adjusted expenditures to services in 1971, that share has climbed to 70 percent this year. Nor is it just the demand side of the economy that is using more services relative to goods. On the supply side, the labor required to produce goods has declined even faster. For example, jobs in manufacturing have plunged from 26 percent of total nonfarm payrolls in 1970 to just 8.5 percent currently. That decline reflects the rise in labor productivity over the period and mirrors the shift in resources from goods to the services side of the economy.

Stress May Ease

Reflecting its diminished influence on the broader economy, industrial production fell for more than a year from mid-2015 through the fall of 2016 without bringing the economy to its knees. That decline – caused largely by a slump in energy-related spending following the collapse in oil prices – was only the second time in the postwar period a year-over-year decline of more than one month in industrial output didn't coincide with a recession. The only other episode when the economy stayed afloat amid a decline in production occurred just after the Korean War when the U.S. unwound its industrial defense base built up during the conflict.

Simply put, it would take a much steeper fall in goods production than in the past to send the economy into a recession. That could happen if the trade wars escalate and the global slowdown intensifies. The jury is still out on the trade front. Recent negotiations with China show some signs of promise, although on a more limited scale than President Trump had originally envisioned. As of this writing, the tariffs on Chinese imports scheduled to take place on December 15 are still on the table, which would have serious consequences for the economy if realized. What's more, tariffs on autos imported from Europe and Japan may well be imposed next month.

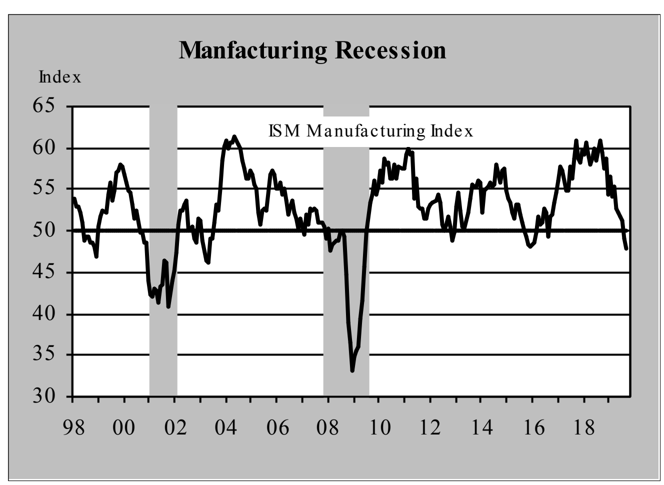
But barring an unexpected shock, such as an oil crisis or major geopolitical conflict, global growth prospects should stabilize and ease the stress on the U.S. manufacturing sector. As noted, many emerging economies are poised to recover next year, although not to the extent the I.M.F expects. Meanwhile, policymakers in Europe, Japan and China are injecting stimulus into their economies, lowering interest rates and/or stepping up asset purchases. Germany, the most fiscally conservative nation in Europe, is even considering using fiscal policy to jump-start growth and reinvigorate its lagging industrial base, which is far more important there than in the U.S.

Recession Buffers

While the manufacturing slump in the U.S. would not by itself bring on a recession, the risk is that the malaise among industrial companies could bleed into the broader economy. Some contagion is already evident, as a widening swath of business leaders are fretting over the main threat, most notably the trade wars, buffeting manufacturers. This downbeat note is showing up both in business sentiment surveys as well as plans for capital spending and hiring. Small businesses – which are mostly service providers – are reporting significant cutbacks in both areas, according to the latest survey by the National Federal of Independent Businesses.

But the downbeat note sounded by business leaders have so far not spread meaningfully to consumers, the economy's man growth engine. True, confidence has slipped from peak levels reached earlier in the year and retail sales in September came in much weaker than expected, falling for the first time in seven months. But one month does not make a trend, and the September setback could have been an outlier rather than a sign that consumers are on the verge of retrenching. Even with the latest decline, retail sales are still running at a healthy 3.8 percent above year-ago levels. What's more, households remain upbeat about the job market where job openings exceed job searchers by more than one million, wages are rising and low inflation is providing extra heft to purchasing power These pillars of support should turn gradually softer in line with slowing growth over the coming year, but they will not crash and burn, prompting consumers to zip up their wallets and purses.

Importantly, a key recession buffer is firmly in place, namely a central bank that is highly tuned in to the global risks facing the economy. Unlike the late stages of previous expansions, the Federal Reserve has already made two interest rate cuts to insulate the economy from the global headwinds, and a third is highly likely at the end of October. These "insurance cuts" represent a marked departure from past policies, wherein the Fed usually didn't start cutting rates until after the recession began reflecting a persistent inability to foresee that a downturn was coming. Not in recent history have policymakers been so worried about recession risks amid an economy that continues to grow and an unemployment rate at a half-century low. While their proactive approach may turn out to be unnecessary, being prepared is the best defense against possible adversity.



KEY ECONOMIC AND FINANCIAL INDICATORS

*FINANCIAL INDICATORS**

								12-Month Range	
	September	August	July	June	May	April	March	High	Low
Prime Rate	5.15	5.25	5.50	5.50	5.50	5.50	5.50	5.50	5.15
3-Month Treasury Bill Rate	1.89	1.95	2.10	2.17	2.35	2.38	2.40	2.40	1.89
5-Year Treasury Note Rate	1.57	1.49	1.83	1.83	2.19	2.33	2.37	3.00	1.49
10-Year Treasury Note Rate	1.70	1.63	2.06	2.07	2.40	2.53	2.57	3.15	1.63
30-Year Treasury Bond Rate	2.16	2.12	2.57	2.57	2.82	2.94	2.98	3.36	2.12
Tax-Exempt Bond Yield	2.78	3.09	3.45	3.50	3.57	3.82	3.96	4.32	2.78
Corporate Bond Yield (AAA)	3.03	2.98	3.29	3.42	3.67	3.69	3.77	4.22	2.98
Conventional 30-Year Mortgage Rate	3.61	3.62	3.77	3.80	4.07	4.14	4.27	4.87	3.61
Dow Jones Industrial average	26900	26058	27089	26160	25745	26402	25723	27089	23806
S&P 500 Index	2982	2898	2996	2890	2855	2904	2804	2996	2567
Dividend Yield (S&P)	1.98	2.00	1.96	1.96	2.10	1.95	2.01	2.22	1.95
P/E Ratio (S&P)	19.6	19.2	19.4	19.2	18.0	19.3	18.7	19.6	16.6
Dollar Exchange Rate (vs. Major Currencies)	92.7	92.3	91.7	91.6	92.6	92.3	91.9	92.7	90.8

** Monthly Averages*

ECONOMIC INDICATORS

								12-Month Range	
	September	August	July	June	May	April	March	High	Low
Housing Starts (In Thousands)	1256	1386	1204	1233	1264	1270	1199	1386	1142
New Home Sales (Thousands of Units)		713	666	729	598	656	693	729	557
New Home Prices (Thousands of Dollars)		328	305	306	313	339	311	339	305
Retail Sales (% Change Year Ago)	4.1	4.1	3.4	3.5	3.0	3.8	3.8	4.8	1.4
Industrial Production (% Change Year Ago)	-0.1	0.4	0.4	1.1	1.8	0.7	2.3	4.1	-0.1
Operating Rate (% of Capacity)	77.5	77.8	77.8	77.7	78.4	78.5	79.0	79.6	77.5
Inventory Sales Ratio (Months)		1.40	1.40	1.40	1.40	1.39	1.38	1.40	1.34
Real Gross Domestic Product (Annual % Change)				2.0			3.1	3.1	2.2
Unemployment Rate (Percent)	3.5	3.7	3.7	3.7	3.6	3.6	3.8	4.0	3.5
Payroll Employment (Change in Thousands)	136	168	166	178	62	216	153	312	56
Hourly Earnings (% Change Year Ago)	2.9	3.2	3.3	3.2	3.1	3.2	3.2	3.4	2.9
Personal Income (% Change Year Ago)		4.6	4.6	4.9	4.9	4.9	4.7	5.4	4.5
Savings Rate (Percent of Disposable Income)		7.1	7.8	8.1	8.0	8.1	8.4	8.8	7.1
Consumer Credit (Change in Blns. Of Dollars)		17.9	23.0	13.3	17.1	16.6	10.0	23.0	10.0
Consumer Prices (% Change Year Ago)	1.7	1.7	1.8	1.6	1.8	2.0	1.9	2.5	1.5
CPI Less Food & Energy (% Change Year Ago)	2.4	2.4	2.2	2.0	2.0	2.1	2.0	2.4	2.0
Wholesale Prices (% Change Year Ago)	1.4	1.8	1.7	1.7	1.8	2.2	2.2	3.2	1.4

Louisiana Corporate Credit Union

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Second Quarter 2019 – By the Numbers

$4.27 billion	Total credit union issuance outstandings.
1,472	Number of credit unions that have issuance agreements in place, prepared to issue share certs, should the need arise.
$195 million	Total outstandings for SimpliCD's largest share certificate issuer.
411	Number of credit unions that currently have share certificate issuance balances through SimpliCD.

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