



MORNING BRIEFING

August 7, 2018

Slowing? Not So Fast!

See the [collection](#) of the individual charts linked below.

(1) Watch our first video podcast. (2) The pre-tariffs scramble to export boosted Q2 real GDP. (3) Y/y growth rates in real GDP, along with consumer and capital spending, nothing out of the ordinary. (4) Signs of weakness may be misleading. (5) Pay little attention to surprise index and NM-PMI. (6) Minimalist Millennials may be depressing demand for homes and autos. (7) Haven't run out of human workers yet, while rent-a-robot may be the next new, new thing.

New! YRI Video Podcasts. Full-time employment continues to rise to new record highs ([link](#)).

US Economy I: Slowing? Real GDP rose 4.1% (saar) during Q2 ([Fig. 1](#)). That was good, but not surprisingly good. Actually, given that taxes were cut at the end of last year, it's surprising that it wasn't better. In fact, GDP growth was temporarily boosted by exports as US exporters scrambled to beat Trump's tariffs. Exports of goods and services contributed 1.12 percentage points to Q2's real GDP growth, the most since Q4-2013 ([Fig. 2](#)).

Debbie and I like to look at the y/y growth rate of real GDP to assess whether the trend growth rate of the economy is changing ([Fig. 3](#)). It was up 2.8% y/y during Q2. That's not a new high for the current expansion, and remains in the 1.0%-3.8% range it has spanned since 2010. In other words, real GDP growth still may be fluctuating around 2.0%, as it has been doing since 2010.

Consumer spending in real GDP rose 4.0% (saar) during Q2, the best since the end of 2014. Again, on a y/y basis, the growth rate for the monthly series was 2.8% during June, just about where it has been since late 2015 ([Fig. 4](#)). Real capital spending rose solidly by 7.3% (saar) during Q2, but the 6.7% y/y growth rate was nothing out of the ordinary ([Fig. 5](#)).

Could the US economy actually be slowing already despite the fiscal stimulus provided by the tax cuts enacted at the end of last year and the fiscal spending increases passed at the start of this year? If it is, we can blame it on the Fed for raising interest rates and on the Trump administration for imposing tariffs. Both developments have also contributed to a stronger dollar, which may also start to weigh on exports and profits.

Debbie and I don't see a recession coming, but we are looking out for signs of weakness. There have been more of them recently, with the obvious exception of the all-important and booming labor market. Now consider the following:

(1) *Economic surprises downbeat.* The big surprise is that the Citigroup Economic Surprise Index (CESI) has dropped from a recent high of 84.5 on December 22, 2017 to -13.9 yesterday ([Fig. 6](#)). That doesn't jibe with the strength in real GDP, particularly during Q2. Then again, the CESI tends to be weak during Q1 and sometimes during Q2, before rebounding during the second half of the year. In any event, it is a trendless cyclical indicator, which means that after it goes down for a while, it goes up for a

while.

Notice that the CESI dropped sharply on the weaker-than-expected payroll employment gain of 157,000 during July, reported on Friday. However, it obviously didn't reflect the significant upward revisions in May (24,000 to 268,000) and June (35,000 to 248,000), as Debbie and I discussed yesterday! Nor did it capture the 389,000 jump in the household measure of employment, led by a whopping 453,000 in full-time jobs!

(2) *NM-PMI drops*. The NM-PMI fell from 59.1 during June to 55.7 last month ([Fig. 7](#)). That's the lowest since last August. The new orders component plunged from 63.2 to 57.0. We aren't alarmed, because the series is very volatile and the latest readings remain relatively high. Keep in mind that this is another trendless cyclical indicator. It was so good earlier this year that it couldn't get much better. Instead, it got a little worse, but still remains upbeat!

(3) *Residential construction flattening*. Private residential investment in real GDP fell 1.1% (saar) during Q2, and was up only 1.4% y/y ([Fig. 8](#)). The weakness has been concentrated in multi-family housing construction, which is down 4.9% y/y ([Fig. 9](#)).

Yesterday, we observed that household formation among homeowners has been increasing in recent quarters, while the number of households who rent has been falling. That should be good for single-family residential investment, though it fell 4.7% (saar) during Q2 (but was up 3.5% y/y), as rising mortgage rates may be starting to curb some enthusiasm for buying a home. That's not confirmed by mortgage applications for new purchases, which remain near recent cyclical highs ([Fig. 10](#)).

(4) *Auto sales looking topky*. The 12-month sum of US motor vehicle sales peaked at 17.7 million units during February 2016, falling to 17.3 million units last month ([Fig. 11](#)). While both domestic light truck and imported auto sales remain on uptrends, domestic car sales have crashed to the lowest since November 2010 ([Fig. 12](#)).

Melissa and I suspect that the Millennials may be causing home and auto sales to top out. They are mostly minimalists. Many are single and city dwellers, renting apartments, which are no longer in short supply after the multifamily housing boom of the last few years. They don't have much use for a car, let alone a light truck. Instead, they rely on Uber and Lyft or rent bicycles.

US Economy II: Not So Fast! The bottom line on all the above is that the US economy isn't as weak as it seems according to the recent signs of slowing. On the other hand, it isn't as strong as supply-siders had hoped it would be in response to their tax cut, but the jury may still be out on that score.

Meanwhile, the labor market indicators show an economy that continues to create plenty of jobs. The risk may be that we run out of able-bodied men and women to keep the economy growing, but that hasn't happened yet, and may not happen at all. Consider the following:

(1) *Plenty of people filling jobs*. Here are the ytd and monthly average employment gains over the past seven months through July for the following three surveys: payrolls (1.50 million, 215,000 per month), household (1.94 million, 278,000), and ADP (1.45 million, 207,000). Here are the monthly averages for the past three months through July: payrolls (224,000), household (261,000), and ADP (199,000). These numbers suggest that while it may be taking longer to fill job openings, there are still plenty of people to fill the jobs.

(2) *Payrolls rising in construction and trucking industries*. Notwithstanding lots of anecdotal evidence that construction workers and truck drivers are hard to find, the payroll survey shows that both job

series are still rising. Construction employment is up 170,000 ytd through July ([Fig. 13](#)). Employment in the truck transportation industry is up 20,600 over the same period ([Fig. 14](#)). Furthermore, wage inflation in the industry remained subdued at 2.7% y/y during June ([Fig. 15](#)).

(3) *Rent a robot.* An 8/4 NBC News [report](#) explained how a Michigan factory facing a labor shortage as a result of booming demand for its seat belt parts rented two robots from [Hirebotics](#). The company pays each of the robots \$15 an hour when they are working. The robots are 30% more productive than their human colleagues.

No wonder wage inflation remains subdued despite the tight labor market. More of us humans may face competition from robots that are paid less, and are more productive, than us!

CALENDARS

US. Tues: Job Openings 6.650m, Consumer Credit \$16.0b. **Wed:** MBA Mortgage Applications, EIA Petroleum Status Report, Barkin. (*Wall Street Journal* estimates)

Global. Tues: Germany Industrial Production -0.5%*m/m*/3.0%*y/y*, Germany Trade Balance €20.8b, Japan Leading & Coincident Indexes 105.3/116.2, RBA Cash Rate Target 1.50%. **Wed:** Japan Machine Orders -0.8%*m/m*/10.0%*y/y*, China Trade Balance \$39.05b, China Exports & Imports 10.0%/17.0% *y/y*. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings rose to record highs for all three of these indexes last week. Forward earnings activity has been relatively strong in the past 12 months: LargeCap's forward earnings has risen in 51 of the past 53 weeks, MidCap's in 50 of those weeks, and SmallCap's in 46. Earnings momentum remains healthy, as the yearly change in forward earnings is up from six-year lows in early 2016 and should remain strong in 2018. In the latest week, the rate of change in LargeCap's forward earnings rose to a seven-year high of 22.5% *y/y* from 22.3%, which compares to a six-year low of -1.8% in October 2015; MidCap's fell to 22.4% from 23.7%, which compares to a seven-year high of 24.0% in early June and a six-year low of -1.3% in December 2015; and SmallCap's rose *w/w* to an eight-year high of 33.2% from 32.2%, which compares to a six-year low of 0.3% in December 2015. Here are the latest consensus earnings growth rates for 2018 and 2019: LargeCap 22.8% and 10.3%, MidCap 20.7% and 12.3%, and SmallCap 30.4% and 15.2%.

S&P 500/400/600 Valuation ([link](#)): Forward P/E ratios were mostly steady last week at levels that are not much above their recent post-election lows. LargeCap's weekly forward P/E was steady at 16.5, which is up from a post-election low of 16.0 in late March and down from 18.6 on January 26—the highest since May 2002. That compares to the post-Lehman-meltdown P/E of 9.3 in October 2008, but is well below the tech-bubble record high of 25.7 in July 1999. MidCap's forward P/E rose to 16.6 from 16.4, which compares to a 25-month low of 16.1 in early April. MidCap's P/E is down from a 15-year high of 19.2 in February 2017 and compares to the record high of 20.6 in January 2002; however, it is up from a three-year low of 15.0 in January 2016. MidCap's P/E had mostly been at or below LargeCap's P/E from August to March for the first time since 2009. SmallCap's P/E was steady at 17.5, which compares to a post-election low of 17.0 in mid-March. That's well below its 51-week high of 20.2 in December (which wasn't much below the 15-year high of 20.5 in December 2016, when Energy's earnings were depressed), but is comfortably above its three-year low of 15.5 in February 2016. Looking at daily forward price/sales (P/S) ratios, they were all higher *w/w* for the three indexes, but remain at levels well below January highs: LargeCap's P/S of 2.07 is down from a record high of 2.19 on January 26; MidCap's 1.33 compares to its record high of 1.40, also on January 26; and SmallCap's

1.03 is down from 1.05 then, which compares to its record high of 1.17 in November 2013, when Energy revenues were depressed.

S&P 500 Sectors Quarterly Earnings Outlook ([link](#)): With Q2 results being released at a faster pace, analysts are digesting the news and adjusting future expectations. The S&P 500's Q3-2018 EPS forecast fell 12 cents w/w to \$40.84. That's down 0.5% since the end of Q2, but up 8.2% ytd and 8.9% since the passage of the TCJA. The \$40.84 estimate represents a forecasted pro forma earnings gain for Q3-2018 of 22.7%, down from 22.9% a week earlier and up from 22.1% at the end of Q1. That compares to Q2-2018's blended 23.5%, Q1-2018's 26.6% (which is the strongest since Q4-2010), Q4-2017's 14.8%, Q3-2017's 8.5%, Q2-2017's 12.3%, and Q1-2017's 15.3%. Since the end of Q2, Q3-2018 estimates are higher for four sectors, down for six, and steady for one. The Q3 forecast has risen for Consumer Discretionary (up 0.9%), Telecom (0.3), Utilities (0.2), and Health Care (0.1). Real Estate is the biggest decliner, with its Q3-2018 forecast down 2.4% since the end of Q2, followed by Consumer Staples (-0.9), Energy (-0.8), Materials (-0.4), Financials (-0.1), and Industrials (-0.1). The S&P 500's Q3-2018 forecasted earnings gain of 22.7% y/y would be its ninth straight gain after four declines. All 11 sectors are expected to record positive y/y earnings growth in Q3-2018, but eight are expected to rise at a double- or triple-digit percentage rate compared to nine during Q2. However, just three are expected to beat the S&P 500's forecasted y/y earnings gain of 22.7% compared to four during Q2. That compares to all 11 sectors rising y/y during Q1-2018, when ten rose at a double-digit pace and four outpaced the S&P 500. Analysts expect Energy to report another large profit jump in Q3 relative to very low earnings a year ago, with the pace slowing from Q2. The latest forecasted Q3-2018 earnings growth rates vs their blended Q2-2018 growth rates: Energy (98.4% in Q3-2018 vs 123.7% in Q2-2018), Financials (45.0, 25.2), Materials (31.6, 32.3), S&P 500 (22.7, 23.5), Telecom (22.4, 16.3), Industrials (17.7, 19.8), Consumer Discretionary (18.4, 20.1), Tech (16.9, 25.4), Health Care (11.5, 17.8), Consumer Staples (8.2, 13.0), Utilities (5.7, 7.0), and Real Estate (4.4, 2.8). On an ex-Energy basis, analysts expect S&P 500 earnings to rise 19.8% y/y in Q3, up from a blended 20.4% in Q2; that compares to 24.5% in Q1-2018, 12.7% in Q4-2017, and 6.1% in Q3-2017 (which was the slowest growth since ex-Energy earnings rose just 2.2% in Q2-2016).

S&P 500 Q2 Earnings Season Monitor ([link](#)): With Q2 results in hand for over 81% of the S&P 500 companies, we find a higher percentage of companies reporting positive surprises than at the same point during the Q1 earnings season but a lower overall percentage surprise. Year-over-year growth rate metrics for the Q2 reporters to date are close to Q1's historically high levels. More specifically, of the 412 companies in the S&P 500 that have reported through mid-day Monday, 80% exceeded industry analysts' earnings estimates by an average of 5.2%; they have averaged a y/y earnings gain of 26.0%. At the same point during the Q1-2018 reporting period, a similar percentage of companies (80%) in the S&P 500 had beaten consensus earnings estimates by a higher 7.1%, and earnings were up a lower 24.8% y/y. On the revenue side, 73% of companies beat their Q2 sales estimates so far, with results coming in 1.7% above forecast and 10.2% higher than a year earlier. At this point in the Q1 season, a higher 76% of reporting companies had exceeded revenue forecasts by a lower 1.1%, and sales had risen by a lower 8.1% y/y. Q2 earnings results are higher y/y for 84% of companies, vs a higher 86% at the same point in Q1, and Q2 revenues are higher y/y for 87% vs 87% also a quarter ago. These results are very encouraging, particularly the percentage of companies growing revenues y/y and their Q2 surprise. Q2-2018 should mark the eighth straight quarter of positive y/y earnings growth and among the highest growth since Q4-2010. The strong results are mostly due to lower tax rates and improved business conditions.

GLOBAL ECONOMIC INDICATORS

Global Composite PMIs ([link](#)): Global economic activity in July eased for the first time in four months. The JP Morgan Global Composite Output Index (C-PMI) fell to 53.7 last month, after climbing the prior

three months from 53.3 in March to 54.2 in June—which wasn't far from February's 3.5-year high of 54.8. The NM-PMI slipped to a three-month low of 54.0 after advancing steadily from 53.2 in March to 54.6 in June. Meanwhile, the M-PMI fell for the sixth time this year, sinking from 54.5 in December to a 12-month low of 52.7 in July. Of the 13 countries for which C-PMI data are compiled, only Germany (to 55.0 from 54.8) and India (54.1 from 53.3) saw faster rates of expansion last month, while Brazil's (50.4 from 47.0) stopped contracting. C-PMIs for the US (55.7 from 56.2) and UK (53.6 from 55.2) showed growth slowed to three-month lows, while those for the Eurozone (54.3 from 54.9), China (52.3 from 53.0), and Japan (51.8 from 52.1) eased to two-month lows. Within the Eurozone, Ireland's C-PMI (56.8, 4-month low), topped the leader board, followed by those of Germany (55.0, 4-month high), France (54.4, 2-month low), Italy (53.0, 2-month low), and Spain (52.7 (56-month low). Meanwhile Russia's C-PMI (51.7 from 52.0) slowed to a 26-month low, while Australia's (52.3 from 52.9) was the weakest in its 27-month series history.

Global Non-Manufacturing PMIs ([link](#)): The global service sector in July eased after accelerating the prior three months. The JP Morgan's NM-PMI fell to 54.0 last month after climbing from 53.2 in March to 54.6 in June, which was the second-highest rate of the past three years—February's 54.8 being the highest. Growth rose across all of the economies covered by the July survey, though the only countries to outperform the relative global average—in order of strength—were: Ireland (to 57.4 from 59.5), the US (56.0 from 56.5), France (54.9 from 55.9), Germany (54.1 from 54.5), and India (54.2 from 52.6). India was one of only three nations to show an acceleration last month, the other two being Russia (52.8 from 52.3) and Brazil (50.4 from 47.0), with the latter returning to expansion.

US Non-Manufacturing PMI ([link](#)): Both the ISM and IHS Markit measures showed growth in the service sector eased last month, though both also remained at elevated levels. ISM's NM-PMI slipped to 55.7 from 59.1 in June—near January's 59.9—which was the fastest rate since August 2005. Three of the four components of the NM-PMI slowed last month, business activity (56.5 from 63.9), new orders (57.0 from 63.2), and supplier deliveries (53.0 from 55.4), while employment (56.1 from 53.6) posted its best performance since March. IHS Markit's NM-PMI fell for the second month since reaching a three-year high of 56.8 in May, slipping to 56.0 last month. According to the report, "US service providers experienced strong growth conditions at the start of the third quarter, with business activity rising at only a slightly softer pace than in June. Strong domestic demand helped to support another improvement in new order levels and a solid expansion of payroll numbers in July. However, business expectations across the service economy edged down to a six-month low. Survey respondents cited concerns about rising costs and trade frictions, alongside difficulties sustaining the tempo of new business growth seen in the second quarter of 2018."

Germany Manufacturing Orders ([link](#)): Factory orders contracted eight times as fast as forecast in June. The economy ministry acknowledged that "uncertainty from trade policy played a role," as demand from non-Eurozone countries led the slide. June billings fell for the fifth time in six months, by -4.0% m/m (vs -0.5% consensus estimate) and -7.3% ytd. Foreign orders (-4.7%) posted the biggest decline since August 2015 in June, led by a -5.9% drop in orders from outside the Eurozone; billings from within the Eurozone slumped -2.7%. Year-to-date, the former is down -8.6%, the latter by -8.8%. Domestic orders also weakened, slumping -2.9% m/m and -5.1% ytd. Here's a monthly and ytd performance list by market group: Capital goods was the weakest, led by sharp losses in foreign orders from both inside (-3.4% m/m, -14.9% y/y) and outside (-6.4, -8.9) the Eurozone, with domestic (-3.8, -7.1) billings also contracting. The decline in intermediate goods orders was also a sea of red, led by a sharp drop in foreign orders from outside (-5.2, -7.9) the Eurozone—though both orders from within (-2.0, -2.2) the Eurozone, as well as domestic (-0.9, -3.9) orders, fell on a monthly and ytd basis. Meanwhile, consumer goods orders fell across the board in June, driven by a -7.4% drop in domestic orders, followed by declines of -3.6% and -1.3%, respectively, in foreign billings from outside and inside the

Eurozone. However, only orders from outside (-9.4) the Eurozone are down ytd; foreign billings from inside (7.1) the Eurozone and domestic (7.6) orders rose.

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