Financial Market Weekly

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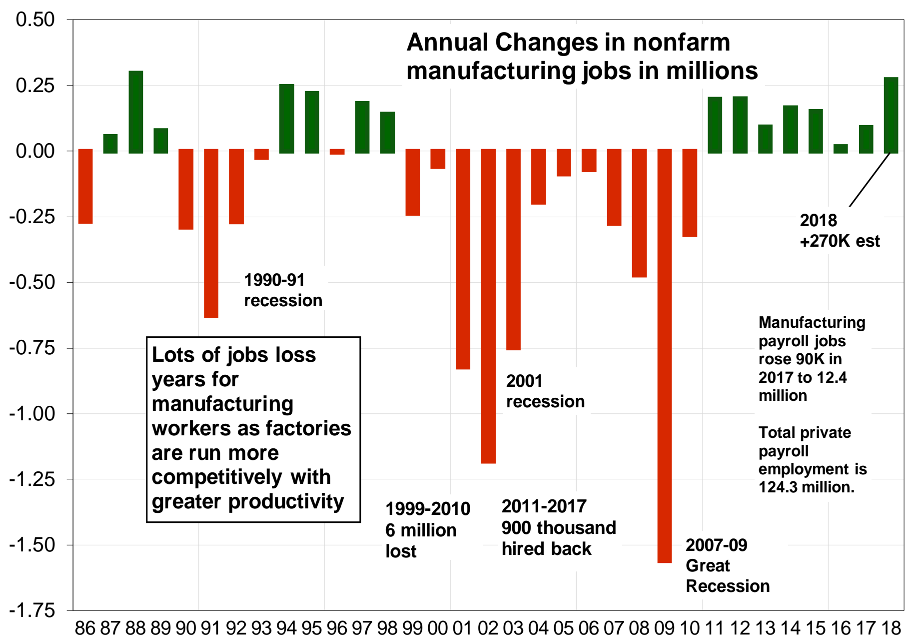
BRINGING MANUFACTURING JOBS BACK TO AMERICA REQUIRES NEW FACTORIES FIRST



Build it and they will come. Or build it and they won't come because there is no one left for any new factories to employ. Trump's economics team is negotiating hard with China as millions of jobs are at stake as US Trade Rep. Lighthizer put it in a recent statement. Maybe it could be better said as--millions of jobs were at stake… and now they are gone. Not coming back, or no evidence they will. Trump told US automakers recently that they should make more cars here, but the world has changed.

Manufacturing job losses were an issue in the presidential election, and still are in the campaign that never ends. Manufacturing losses have occurred in the last three recessions as many companies undoubtedly took advantage of the hard times to lighten the load. America's strong dollar policy in the late 90s probably hurt export sales that many manufacturers depend on, and led to shocking manufacturing losses in the short 2001 recession where GDP only fell 0.3%. (In contrast to the Great Recession where GDP fell 4.2%.) Productivity gains also helped destroy manufacturing jobs, but the recession losses are what really stands out, and the jobs losers in manufacturing were never rehired in good times after the recessions to any significant degree. All told firms fired 6 million workers from

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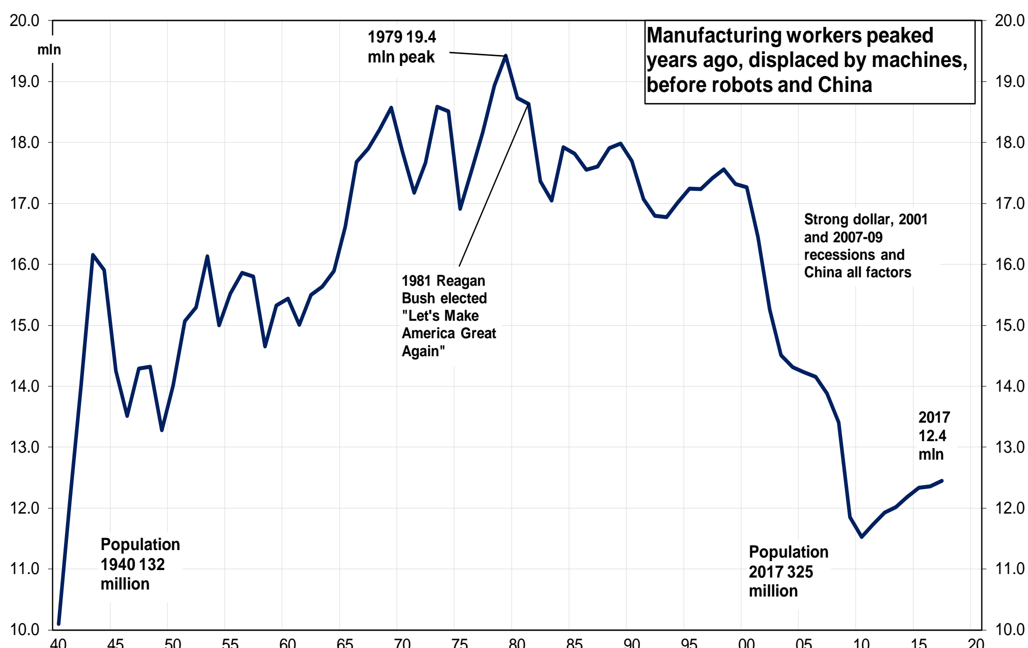
1999 to 2010, and hired back 900 thousand in manufacturing from 2011 to 2017, and maybe another 270 thousand this year in 2018 if the first four months are any guide.

The manufacturing job losses feed the income inequality debate as manufacturing jobs pay more than many service economy jobs. In April 2018, production and nonsupervisory workers in durable goods manufacturing earned $21.72 an hour where restaurant and hotel workers make $13.31, and retail stores pay $15.23 an hour.



Where were the jobs lost? Most industries have lost employment over the last two decades: apparel, textiles, paper, printing, furniture, electrical equipment and appliances, were hit especially hard. Take just one year, 2009 where 1.559 million manufacturing jobs were lost, 11.6 percent off from 2008… in one year. 1.179 million was in durable goods manufacturing, representing a 13.9 percent loss for the year. The winner in losses was motor vehicles, down 211K in 2009, a decline of 24.1% to 664 thousand. Jobs in the industry have climbed back unlike many other manufacturing sectors and 952 thousand were employed in motor vehicle manufacturing in 2017.

In terms of factories themselves, there has been more construction of manufacturing facilities starting in 2015. Most of the factories have been for the chemical industry tied to cheaper energy during the fracking, game-changer miracle following the recession. But automakers (not necessarily American owned) have also added plants, and the food industry has also added more capacity to produce their products. Manufacturing production and employment is a complicated story, but it would be very difficult to change the trend at this stage. At least manufacturing and its workers do not have to contend with another recession in the next few years… we hope.

Annual Factory Construction-Value Put in Place

$billions	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
Manufacturing-Total	65.7	74.7	79.3	58.1	49.9	46.8	39.8	40.6	57.4	53.6	40.2	32.3
Chemical	31.9	34.8	36.6	22.7	15.5	10.8	7.3	7.6	10.3	12.8	13.3	8.5
Transportation equipment	8.4	11.8	12.1	7.0	5.1	3.9	3.3	2.0	3.6	4.6	3.2	2.4
Food/beverage/tobacco	7.6	6.7	6.8	6.4	4.9	4.4	4.8	4.0	3.3	4.6	3.8	4.3
Petroleum/coal	4.1	4.1	4.3	5.0	4.0	4.8	5.5	11.6	23.9	15.0	5.1	1.7
Primary metal	2.5	4.1	5.9	3.8	4.5	4.7	3.1	4.7	4.8	3.4	1.6	1.3
Computer/electronic/electrical	1.7	1.9	3.4	5.0	7.3	9.6	8.8	4.6	3.7	2.2	2.6	4.0

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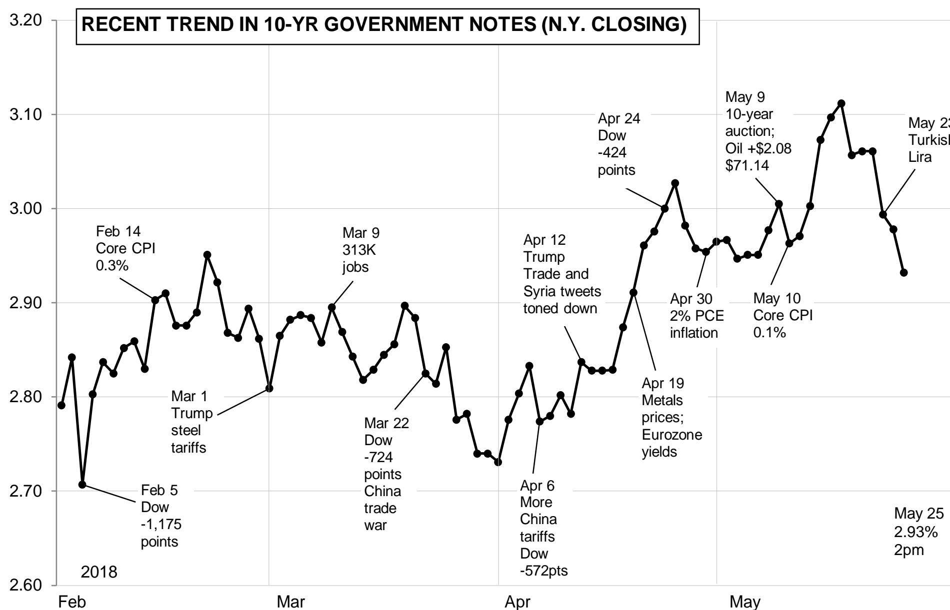
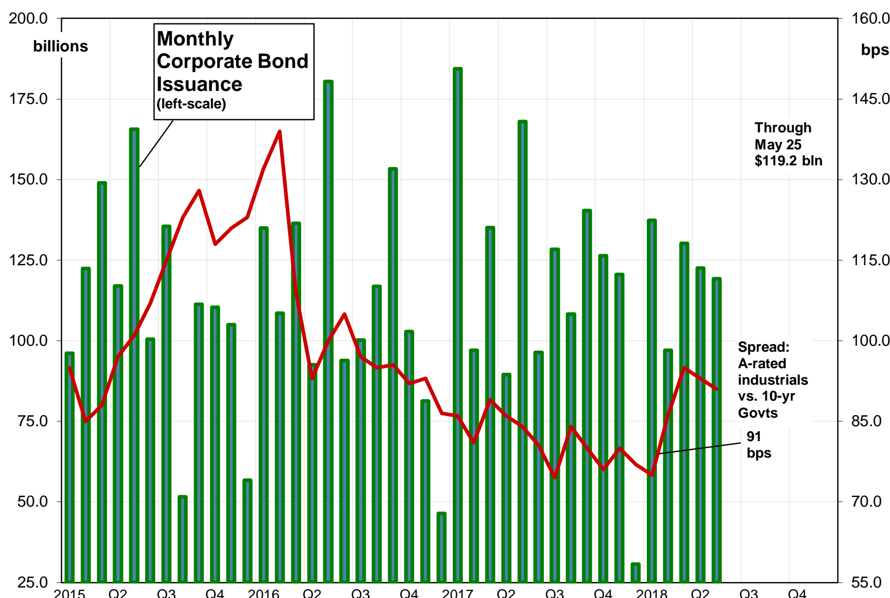
MARKETS OUTLOOK

	29-Mar 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
30-Yr Treasury	2.97	3.10	3.10	3.20	3.35	3.45	3.60	3.55	3.75	3.75	3.90	4.00
10-Yr Note	2.74	2.80	2.90	3.00	3.20	3.30	3.50	3.50	3.70	3.70	3.90	4.00
5-Yr Note	2.56	2.60	2.70	2.80	3.05	3.15	3.40	3.45	3.65	3.65	3.90	4.00
2-Yr Note	2.27	2.40	2.55	2.80	3.00	3.15	3.40	3.40	3.60	3.80	4.00	4.20
3-month Libor	2.31	2.30	2.55	2.80	3.05	3.30	3.55	3.55	3.70	3.95	3.95	4.20
Fed Funds Rate	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.25	3.50	3.75	3.75	4.00
2s/10s spread	47	40	35	20	20	15	10	10	10	(10)	(10)	(20)



It's all downhill from here. 10-yr Treasury yields closed Friday at 2.93%. We watched yields fall this week, denting the uptrend of this yield rally to put it mildly, and the decline wasn't all that understandable. Emerging market fears, the Turkish Lira, was part of it as was a misunderstanding of what the Fed is up to in the May meeting minutes. Inflation overshooting the 2% target could be helpful. Wednesday was the key day, and the bond rally continued, helped along on Friday with the $2.83 drop in crude oil to $67.88. No immediate inflation threat, no need for the Fed to go faster on rate hikes. We forgot to mention supply: the 2-year, 5-year, 7-year Treasury auctions had no impact.

CORPORATE BONDS: VODAFONE, MICROCHIP TECH, EQUIFAX, UNUM



Corporate offerings were $21.5 billion in the May 25 week versus $34.0 billion in the May 18 week. On Wednesday, Harris Corp. priced a $850 million 4.4% 10-yr (m-w +25bp) at 140 bps (Baa3/BBB-). The international communications equipment company will use the proceeds to redeem 4.4% notes due in 2020, and 5.55% notes due in 2021. Corporate bonds (10-yr Industrials rated A2) were 91 bps above 10-yr Treasuries this week versus 91 bps last Friday.

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FEDERAL RESERVE POLICY

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	23-May	16-May	9-May	2-May	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2387.010	2386.966	2395.528	2395.460	479.782
Federal agency debt securities	4.391	4.391	4.391	4.391	0.000
Mortgage-backed securities	1744.179	1745.514	1744.972	1744.972	0.000
Primary credit (Discount Window)	0.028	0.009	0.000	0.160	23.455
Term auction credit (TAF auctions)	0.000	0.000	0.000	0.000	150.000
Asset-backed TALF	0.000	0.000	0.000	0.000	
Maiden Lane (Bear)	1.713	1.712	1.715	1.714	29.287
Maiden Lane II (AIG)	0.000	0.000	0.000	0.000	0.000
Maiden Lane III (AIG)	0.000	0.000	0.000	0.000	0.000
Central bank liquidity swaps	0.082	0.080	0.080	0.117	62.000
Federal Reserve Assets	4384.9	4385.2	4405.8	4403.6	961.7
3-month Libor %	2.33	2.33	2.36	2.36	2.82
Factors draining reserves					
Currency in circulation	1656.691	1653.732	1649.163	1646.124	834.477
Term Deposit Facility	3.686	0.000	0.000	0.000	0.000
Reverse repurchases w/others	2.966	2.545	2.720	6.520	0.000
Reserve Balances (Net Liquidity)	2040.545	2022.661	2046.775	1991.823	24.964
Treasuries within 15 days	28.479	28.479	26.228	26.228	14.955
Treasuries 16 to 90 days	84.951	61.882	90.360	90.359	31.549
Treasuries 91 days to 1 year	306.288	329.356	290.879	290.878	69.272
Treasuries over 1-yr to 5 years	1052.018	1052.008	1068.428	1068.418	170.807
Treasuries over 5-yrs to 10 years	296.104	290.054	304.602	304.579	91.863
Treasuries over 10-years	619.195	625.189	615.031	614.998	101.337

**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08

The Fed meets June 12-13 to consider its monetary policy. The committee hasn't voted, but the market has, and for a long time now too; the market odds of a 25 bps rate hike to 2.0% are 86%. There was some discussion in the May 1-2 Fed meeting minutes released on Wednesday (always three weeks after they met) about needing to change the language in the press statement as the Fed funds rate keeps moving up closer to neutral. That isn't so bad, but we are worrying more that the bar to additional rate hikes once they get to neutral is going to be a lot higher than it is for rate hikes right now. In other words, they don't want to raise rates above neutral, some of the participants, and possibly slow the economy… unless the inflation fires are raging out of control. The first issue is how many more rate hikes from 1.75% do they do before they hit neutral. Incoming New York Fed President Williams seems to think neutral is "around 2.5%." Not great for the higher rates story. He has his Laubach-Williams model that says real neutral rates are "around 0.5%" currently, which means the neutral Fed funds rate is basically the same as the rate of inflation. Williams' comments are interesting because only one participant said in March that the longer run (normal/neutral) Fed funds rate was 2.5%.

Fed Individual Forecasts				
Fed funds rate by year-end				Longer
Votes	2018 End	2019 End	2020 End	run
1	1.625	1.625	1.625	2.250
2	1.625	2.125	2.625	2.500
3	2.125	2.625	2.625	2.625
4	2.125	2.750	3.125	2.750
5	2.125	2.875	3.250	2.750
6	2.125	2.875	3.375	2.750
7	2.125	2.875	3.375	2.750
8	2.125	2.875	3.375	3.000
9	2.375	2.875	3.375	3.000
10	2.375	3.125	3.375	3.000
11	2.375	3.125	3.500	3.000
12	2.375	3.375	3.625	3.000
13	2.375	3.375	3.625	3.250
14	2.375	3.375	4.125	3.500
15	2.625	3.875	4.875	
Median	2.125	2.875	3.375	2.875
Meeting	Mar 2018	Mar 2018	Mar 2018	Mar 2018

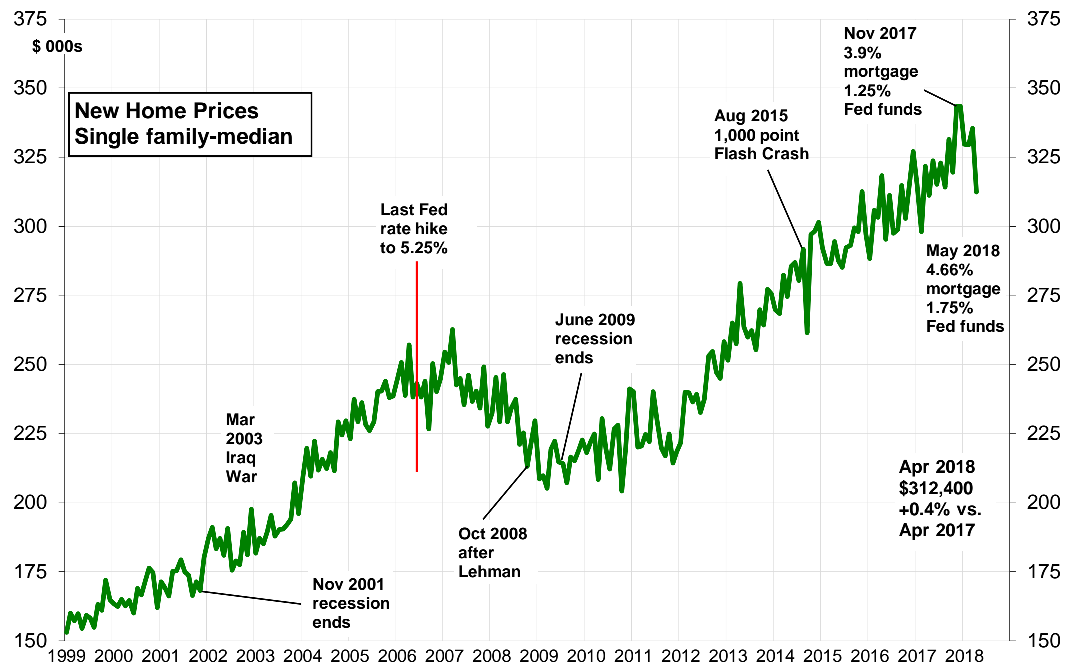
Regardless, those of us looking for higher bond yields should be concerned that a couple of Fed officials said this week that the bar to raising rates above normal levels is high. Dallas Fed President Kaplan said that after 3 or 4 more moves "we're going to be at neutral" (2.5-2.75 percent.) Right now, he's not prepared to go above neutral, although it would depend on the economy then whether it made sense for monetary policy to become restrictive. Philadelphia Fed President Harker said they were getting closer to neutral, which is 2.75-3.0 percent in his view. He said he would be comfortable with the Fed funds rate just sitting there in neutral. So, prompted by a CNBC question, he agreed that the rate hikes could be done by the end of 2019. "If we can hit neutral and stay around there… then I'd be comfortable with that. I wouldn't want to just go far over neutral and then have to put the brakes on." Not sure we understood all that about putting the brakes on, but suffice it to say, the bar to raising interest rates above neutral looks rather high at this point in time, which puts our 3.5% 2019 and 4% 2020 bond yield forecast in some peril unless there is a $2 trillion Federal budget deficit with auctions every week.

OTHER ECONOMIC NEWS THIS WEEK

Big News Coming Soon for New Home Sales (Wednesday)

You have waited long enough. Here it is. Breaking economy news. April New Home sales fell 1.5% from a lower revised level to 662 thousand. They were 579 thousand in November 2016 when the President was elected. There were over 1.2 million new homes built in 2005 before the housing bubble popped its cork. Homebuilders are saying they aren't seeing the demand so they aren't going to build them at that rate again. Orders aren't up as much as they had hoped. Maybe higher mortgage rates are starting to have an impact as much as homebuilders don't want to admit it. Tax law changes that limit deductions for state and local taxes might be adding to homebuyers' effective costs of buying a new home as well, as much as homebuilders don't want to admit it. Whistling in the dark it is called. They do like building multifamily structures, who doesn't, multifamily construction is higher than it was in the housing bubble years over a decade ago.

The decline in home sales was all out in the West, which may reflect some of the tax law changes in one of the most expensive markets in the country. New home sales in the West were 176 thousand in April which is less than the pace seen in November and December last year as the tax cut legislation made its way through Congress.



Net, net, new home sales are not in the driver's seat when it comes to generating economic growth like they were a decade ago. But new home sales are not showing signs of headlong retreat either, so we know that higher interest rates have not really begun to bite yet and slow sales activity in a worrisome way.

New home sales of 662 thousand are generating enough heat to drive consumer purchases of appliances, carpeting, furniture, a new car in the driveway perhaps, all the things that will keep the economy growing for another year and get closer and closer to breaking the record of the ten year expansion during the Clinton years in the 90s. New home sales are an early warning sign for the economy that tend to lead in forecasting a downturn in economy. Homebuyers are not getting cold feet yet and their steady purchases will keep the Fed on course to raise interest rates at a gradual pace. We are watching new home sales like a hawk to tell us the Fed has raised interest rates too high, but so far so good. Stay tuned. Story developing.

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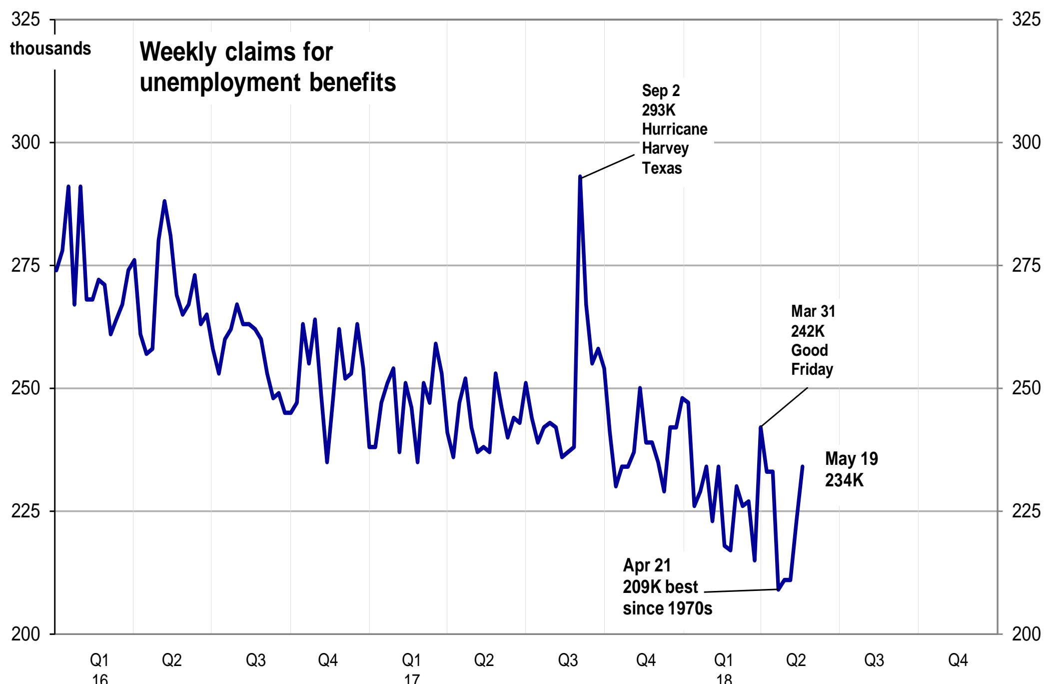
One of Bernanke's timeliest indicators is flashing a caution light... maybe (Thursday)

Breaking economy news. Weekly jobless claims have risen the last two weeks and are now at 234 thousand in the May 19 week which is the highest level since late March this year.



It's too early to say definitively and weekly jobless claims are notoriously volatile week to week, but one does wonder if the tough talk on trade is injecting an air of caution into the outlook where companies' plans for expansion and the employment that goes with it are being put on hold until the uncertainty gets resolved. The supply chain for American companies is long and extends around the world so if global trade patterns are going to see a major upheaval, then it pays to err on the side of caution. America first policies of the Trump administration is a game changer that disrupts the way US companies have done business globally the last two decades. Time will tell if the trade war slows the economy more than the historic tax cuts boost economic growth. Protectionist policies helped bring about the Great Depression, and it will be a miracle if the US economy dodges a bullet a second time around. At the very least those increasing odds of recession in 2020, forecast by many economists, are looking more real by the moment.

Durable goods: business capex bounces back from deeper in the hole (Wednesday)

Breaking economy news. Durable goods orders for April. Total durable goods orders fell 1.3% to $248.5 billion. But business capex, nondefense capital goods orders ex-aircraft rose 1.0% in April to $67.3 billion after downward revisions in February and March of about 1%. These orders were $60.6 billion in November 2016 when Trump was elected, so are 11.1% higher. Business sentiment has improved under Trump and the biggest corporate tax cuts in history, but the recovery in capital spending on equipment mirrors the movement in crude oil prices, crashing in 2015 and into 2016 and riding the wave back in 2017.

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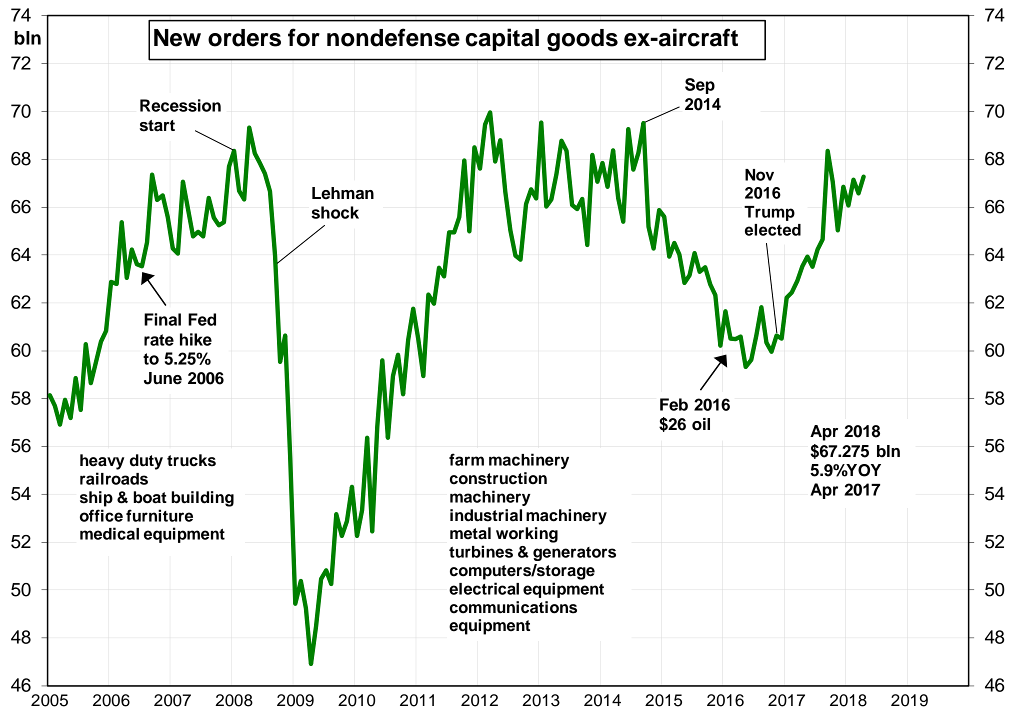
Orders are strong on a year-to-year basis, with primary metals and fabricated metal products up 15.2 and 11.7 percent, respectively. The only weakness is in orders for computers and related products which are down 13.6% from prior year levels.

Net, net, business capital spending on key industrial equipment rose back in April to start the second quarter on a positive note. Businesses are spending some of their tax cuts on the purchase of key equipment that makes economic growth more sustainable and is consistent with GDP growth that is nearer to the Trump economics team forecasts of 3%.



Business investment spending is solid enough to keep the Federal Reserve on the gradual path of interest rate hikes, where order books are full, but not enough to strain capacity and lead to more inflation. The economy is firing on all cylinders this quarter with both consumers and business investment adding to the mix on economic growth. Stay tuned. Story developing. Some of the corporate tax cuts monies are being deployed for equipment orders to generate some heat for economic growth, but whether the economy reaches 3 percent on a sustained basis remains an open question.

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