3Q19 Economic Summary

During the third quarter, the US economy broke the record for the longest US expansion in history. However, concerns over trade and slowing global growth overshadowed positive US economic data. Markets fluctuated with every new trade headline and calls for easier monetary policy increased. Trade tensions between the US and China escalated in August, causing equity markets to plunge and bonds to rally across the curve. Trade fears eased in September after it was announced that trade negotiations would resume in October; however, other global risk factors including protests in Hong Kong, attacks on Saudi oil facilities, continued Brexit uncertainty, and impeachment rhetoric in the US, kept markets on edge.

Overall, US data was solid during the third quarter; however, some signs of slowing economic momentum began to emerge. US manufacturers appeared to be bearing the brunt of the trade war. The US purchasing managers index from the Institute of Supply Management contracted in September for the second month in a row as exports fell and economic anxiety contributed to wider caution in hiring and investment. Firms retreated to the sidelines as trade and supply chain concerns led to a reevaluation of capital spending plans. The services sector continued to expand but at a more moderate pace, which could indicate that weakness from manufacturing is starting to spill over into the broader economy. However, labor market conditions remained favorable as the US added an average of 157,000 jobs per month during the quarter and the unemployment rate dropped to a 50-year low of 3.5% in September. Data on consumer spending remained positive, but sentiment began to wane in September as the overwhelming number of negative headlines relating to trade and political wrangling began to take their toll. Activity in the housing market picked up as low mortgage rates and the solid labor market supported sales and prompted an acceleration in construction activity. Overall, third quarter US GDP growth is expected to be solid but a bit slower than last quarter.

Global growth also took a step down during the third quarter as the fallout from the trade war was felt by economies around the world. China's GDP fell to 6%, its lowest level in nearly three decades, as trade tensions with the US continued to weigh on business sentiment and investment. European economies also continued to sputter, particularly those reliant on manufacturing, like Germany, Italy, France and Spain. Uncertainty over Brexit did not help the situation as fears that Britain will leave the union without an agreement stymied trade and business investment. Japan's growth also slowed as exports weakened significantly, affecting factory output. The IMF recently trimmed its 2019 global growth forecast to 3.0%, the slowest pace in a decade, and warned that trade and geopolitical tensions had created a precarious global economic situation. Gita Gopinath, the IMF's chief economist, advised that until tensions ease, central banks should continue to increase accommodation, but she recognized that monetary ammunition is limited and may need to be coupled with fiscal stimulus to effectively boost growth.

The Federal Reserve did its part to help offset the impact of trade policy on US growth. The Fed cut rates by 25 basis points at both the July and September FOMC meetings, resulting in a target fed funds range of 1.75-2.00%. Balance sheet reduction was also ended in August, a month early than planned. Committee members acknowledged the solid US economic data but cited the slowdown in global growth and trade uncertainty as reasons for the cuts. Not everyone was on board with the rate moves. Boston Fed President Eric Rosengren and Kansas City Fed President Esther George dissented at both meetings, preferring to leave rates unchanged. St Louis Fed President James Bullard also dissented at the September meeting but for different reasons. He favored a larger 50 basis point cut to provide insurance against a slowing economy and further declines in inflation expectations. While the September dot plot forecast no further rate cuts in 2019 and 2020, Fed Chair Powell made it clear in his post-meeting press conference that the Committee was open to further cuts if needed to sustain the economic expansion. He stated that monetary policy is not on a preset course, but the Committee is willing to act based on the data and evolving risk picture.

While Fed members may be divided on the appropriate course of action, market participants appear more certain. Currently, futures markets are pricing in an almost 90% chance of another 25 basis point ease at the October 30 FOMC meeting. Although the US economy remains in a good place and trade tensions have de-escalated recently, the Fed has yet to disappoint markets and is likely to take another "insurance" cut at the upcoming meeting.