



MORNING BRIEFING

September 27, 2017

Keep On Trucking

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

(1) The Fed cops. (2) What's the speed limit? (3) The 2% stall speed is the cruising speed. (4) Private-sector GDP cruising along at 3%. (5) Productivity and working-age population cruising at crawl speed. (6) Underwhelming potential. (7) Truck traffic is barreling down the highway. (8) West Coast ports reporting record activity. (9) Intermodal railcar loadings chugging along. (10) Railcar loadings of motor vehicles continue to weaken. (11) The eternal chancellor wins again. Now what?

US Economy I: On Cruise Control. Have you ever driven on a highway at 65 miles an hour, passed a cop car, and dropped your speed to 55 miles an hour because you couldn't recall seeing a speed-limit sign? In the US, the latest batch of transportation indicators show that the economy continues to cruise along the highway, as Debbie and I review in the next section. There's no sign that the economy is exceeding the speed limit. However, there is some debate about that limit.

During previous economic expansions, it was generally agreed that 3.0% was the limit for real GDP growth. If the economy ran faster than that, the engine would overheat. The Fed's cops would shoot out the tires, causing the economy to swerve out of control and wind up in a ditch.

US real GDP has been rising around 2.0% on a y/y basis since mid-2010 ([Fig. 1](#)). For a while, lots of economists warned that was too slow. They called it the "stall speed." In the past, every time that real GDP growth slowed to 2.0% on a y/y basis, the economy stalled and fell into a recession. That's what happened in all 11 recessions since 1948!

On this trip, 2.0% has turned into the speed limit, so far. Debbie and I would like to believe that the speed limit will be raised to 2.5% or even back to 3.0%. We would like to believe that the Trump administration's economic program of deregulation and tax reform will boost growth by stimulating faster productivity growth. However, while deregulation is underway, tax reform has yet to happen. There's not much the administration can do to revive the growth rate of the labor force since it is mostly determined by the growth of the working-age population, which has slowed significantly. Consider the following:

(1) *Real growth.* The economy has been performing better than suggested by real GDP if we exclude government spending, which has been mostly falling during the current expansion ([Fig. 2](#)). We know that's hard to believe, but government spending in GDP is on goods and services, not on redistributing income through entitlement programs. Since the start of the current expansion during Q2-2009, real government spending in GDP is down 6.5% ([Fig. 3](#)). Such spending rose during the previous six expansions.

Real nonfarm business output has been cruising around the good-old 3.0% growth rate since mid-2010 ([Fig. 4](#)). That still makes it the second-weakest expansion of the past seven ([Fig. 5](#)).

On a short-term basis, we monitor real GDP growth by comparing it to the y/y growth rate in the Index of Coincident Economic Indicators (CEI), which is available monthly, though with a lag of a month ([Fig.](#)

6). They are highly correlated, and often coincide. August's CEI was up 1.9% y/y, suggesting that Q3's real GDP growth rate should be close to Q2's 2.2% growth rate. The Atlanta Fed's GDP Now model is currently showing a quarterly annualized rate of 2.2% for Q3, which would make it up 2.1% y/y. By the way, also encouraging is that the Index of Leading Economic Indicators rose to another record high during August ([Fig. 7](#)).

(2) *Productivity*. Not so encouraging is nonfarm business productivity. Over the past 20 quarters (five years) through Q2-2017, the average annualized increase was just 0.6% ([Fig. 8](#)). The picture was a bit brighter over the past year, with productivity up 1.3% y/y through Q2 ([Fig. 9](#)). Combined with a 1.5% increase in hours worked, that added up to a 2.8% increase in nonfarm business output—close to the old speed limit of 3.0%.

(3) *Labor force*. Nevertheless, the underlying growth in productivity over the past five years remains depressed. The same can be said for the outlook for the growth in the labor force. The 20-quarter average annualized increase in hours worked in the nonfarm business sector was decent at 1.9% through Q2-2017 ([Fig. 10](#)). However, the 10-year growth rate in the population aged 16-64 years old dropped to 0.5% during August, the lowest on record ([Fig. 11](#)).

(4) *Potential output*. It's no wonder that the Congressional Budget Office projects that real GDP growth will be below 2% through 2017 ([Fig. 12](#)). The average annualized growth in real GDP over the past 20 quarters through Q2-2017 was 2.2%, not much better than previous cyclical *lows* in this series ([Fig. 13](#)).

US Economy II: Pedal to the Metal. Despite the lackluster outlook for trend GDP growth, Debbie and I are impressed by the strength of a few recently released transportation indicators. Consider the following:

(1) *Trucking*. The ATA Truck Tonnage Index went vertical during August, jumping 7.1% m/m and 8.2% y/y to a new record high ([Fig. 14](#)). That suggests that retailers are loading up their inventories for the fall and holiday shopping seasons. Trucking serves as a barometer of the US economy, representing 70.6% of tonnage carried by all modes of domestic freight transportation, including manufactured and retail goods.

ATA's chief economist said: "Tonnage was stronger than most other economic indicators in August and more than I would have expected. However, prep work for the hurricanes and better port volumes likely gave tonnage an added boost during the month. I suspect that short-term service disruptions from when the storms made landfall, as well as the normal ebb and flow of freight, could make September weaker and tonnage will smooth out to more moderate gains, on average."

(2) *Shipping*. We track the 12-month sum of inbound shipping traffic, as well as outbound, in the Port of Los Angeles and the Port of Long Beach ([Fig. 15](#)). The inbound series rose during August, just surpassing the previous record high during February 2007, while the outbound series meandered below this cycle's highs.

(3) *Railcars*. The sum of the outbound and inbound series for West Coast port traffic was at a record high in August ([Fig. 16](#)). Not surprisingly, this sum is highly correlated with intermodal railcar loadings on a 52-week moving sum basis. If you are looking for trouble in the transportation indicators, there's some in the railcar loadings of motor vehicles, which suggest that car sales continued to weaken during September—though the hurricanes undoubtedly weighed on sales, which have been rolling over the past year ([Fig. 17](#)).

Eurozone: Ice Queen. The tried-and-true Angela Merkel once again was elected as German

Chancellor, but the 9/24 vote was disappointing. Not only did Merkel's Christian Democratic Union (CDU) lose support but the euroskeptic Alternative for Deutschland (AfD) gained seats in the German Bundestag, the national parliament of the Federal Republic of Germany. This marks the first time that a far-right-wing group has done so since 1945.

The important question for financial markets is: Could the AfD make a dent in the fate of the Eurozone? Probably not right now, because the group doesn't have quite enough support to do major damage. But the AfD's newfound voice could set the stage for future unease in the region. Further, the fractured election results could make it difficult for Merkel to form a coalition to do her job effectively. Consider the following:

(1) *Ice Mum*. In many ways, Merkel has become an icon for the stability of Germany, the largest national economy in Europe and founding member of the European Union and the Eurozone. The 63-year-old has been the effective leader of Germany's parliament since November 2005, having just been reelected for the fourth time for another four-year term as German Chancellor.

Thanks in part to Germany's lack of term limits for the role, Merkel has been dubbed the "eternal chancellor." The 9/20 *WSJ* [observed](#): "Her tenure has spanned three U.S. and four French presidents, and two Spanish, four British, six Italian, and seven Japanese prime ministers. She is the longest serving head of a major European government since her fellow German Helmut Kohl."

Although a favorite, Merkel has taken her share of mockery. She has been dubbed "The Ice Queen" for her tendency to appear cold. But she is also warmly known as "Mum," who has a love of German potato soup.

Whatever she is called, her performance has been good enough to get her reelected several times. Merkel "regularly ranks as one of Germany's most popular leaders," [reported](#) Reuters; it's thanks to her leadership, many Germans feel, that Germany didn't feel as much of the pain of the 2008 financial crisis and recent euro area turmoil as other Eurozone countries.

With support from all sides, Merkel is moderately conservative. She stands staunchly behind her core principle, an integrated Europe, for which she is the chief proponent. On other views, Merkel has flip-flopped on more than one occasion. But her tendency to do so is a secret to her success, [observed](#) the 9/20 *WSJ* article, which says Germans view that as a sign of strength.

For investors, the benefit of Merkel's reelection is that, as she said four years ago in self-promotion, "You know me." Maybe so. But the problem now is that we don't know how she will perform in a freshly fractured Bundestag.

(2) *Polar bears*. Merkel's CDU is now vulnerable to other parties. During 2013, the CDU combined with its sister party the CSU achieved nearly 42% of the vote, but their support fell to 33% this time around, highlighted a 9/25 *FT* [article](#) titled "Angela Merkel has passed the zenith of her power." Both Merkel's CDU and the second majority party, the Social Democratic Party (SPD), have fallen in favor. During this election, the CDU and the SPD lost about 65 and 40 seats, respectively, according to projected results [posted](#) in the 9/24 *WSJ*.

Recently, the Chancellor has been criticized for her highly liberal immigration policies, specifically relating to the Syrian refugee crisis. As a result, Merkel admitted at a press conference following the election that she felt responsible for the increased political polarization in Germany, according to a 9/25 *FT* [article](#).

(3) *Right turn.* Merkel's moves to the left might have paved the way for the AfD to enter Germany's political scene from the far right. For a party to gain seats in the German parliament, at least 5% of the vote is needed, [according](#) to CNBC. Official preliminary results of the election showed that the AfD party gained nearly 13% of the vote and around 90 seats, flooring its political trajectory up from zero seats at the last election. Supporters are largely male, mostly living in rural areas, mostly employed in blue-collar jobs, and tend to earn less, according to a voter profile [chart](#) in the 9/25 *WSJ*.

The AfD is now the third-largest party in the Bundestag. Its victory "will have no immediate effect on policy per se," but it will "alter the political tone. In a nutshell: things are about to get a lot nastier," [observed](#) *Deutsche Welle*, a German publication. Exemplifying the AfD's point of view at a press conference in Berlin, Alice Weidel, one of the party's two top candidates, said: "Germany has become a safe haven for criminals and terrorists from all over the world," reported a 9/19 *FT* [article](#). Her right-hand man, Alexander Gauland, added: "Islam does not belong to Germany."

Infighting could hurt the AfD's prospects for making a difference in the long term. Just after the election, one of the AfD politicians elected told reporters that she would refuse to sit in the party's group in parliament alongside the party's extremists. German Foreign Minister Sigmar Gabriel has gone so far as to [equate](#) some in the AfD with Nazis.

(4) *Uncharted path.* In contrast, Gabriel, the former chairman of the SPD, has [described](#) Merkel as "always fair, always resilient." Merkel's next test of resiliency will be to form a coalition to govern, which could take months. "But she has no option for a center-right majority, and her current coalition partner, the Social Democratic Party, has announced it would go into opposition. The only coalition possible for Ms. Merkel appears to be an untested alliance with the pro-business Free Democrats, or FDP, and left-leaning Greens," explained a 9/24 *WSJ* [article](#).

Such a coalition would be difficult to manage, as she would have to "chart a path between the demands of her increasingly restless party, the misgivings of the FDP on such issues as surveillance, and the liberal views of the Greens."

CALENDARS

US. Wed: Durable Goods Orders, Total, Ex Autos, and Core Capital Goods 1.5%/0.4%/0.3%, Pending Home Sales -0.1%, MBA Mortgage Applications, EIA Petroleum Status Report, Kashkari. **Thurs:** GDP, PCE, and GDP Deflator 3.1%/3.3%/1.0%, Corporate Profits, Jobless Claims 275k, Merchandise Trade Balance Advance Estimate -\$65.7b, Kansas City Fed Manufacturing Index, Weekly Consumer Comfort Index, EIA Natural Gas Report. (Bloomberg estimates)

Global. Wed: Eurozone M3 4.7% y/y, Japan Small Business Confidence 49.4, Poloz. **Thurs:** Eurozone Economic Confidence 112, Germany CPI 0.1%/m/m/1.8%/y/y, Germany Gfk Consumer Confidence 11, UK Gfk Consumer Confidence -11, Japan CPI Headline, Core, and Core-Core 0.6%/0.7%/0.2% y/y, Japan Industrial Production 1.8%/m/m/5.2%/y/y, Japan Retail Trade -0.8%/m/m/2.4%/y/y, Japan Jobless Rate 2.8%, BOJ Summary of Opinions at September Meeting, Carney. (DailyFX estimates)

US ECONOMIC INDICATORS

Consumer Confidence ([link](#)): Consumer confidence slipped slightly in September as Hurricanes Harvey and Irma caused a considerable decline in confidence in both Texas and Florida. According to the Conference Board, "Despite the slight downtick in confidence, consumers' assessment of current conditions remains quite favorable and their expectations for the short-term suggest the economy will continue expanding at its current pace." The Consumer Confidence Index fell for the first time in three

months to 119.8 this month, holding near March's 16-year high of 124.9. The present situation component fell for only the second time this year, edging down to 146.1 from a cyclical high of 148.4 in August. The expectations component edged up from 101.7 to 102.2; it peaked at 112.3 in March. Consumers' view of the current job market remains near 16-year highs, with those saying jobs plentiful (to 32.6% from 34.4%) slipping slightly from August's cyclical high and those saying jobs hard to get (18.1 from 18.4) sinking to a new cyclical low. As for the six-month job outlook, the percentage expecting more jobs (19.5%) continued to surpass those expecting fewer jobs (13.5), with the spread improving to 6.0ppts after narrowing steadily from 11.1ppts in March to 3.6ppts in August.

New Home Sales ([link](#)): August new home sales fell to an eight-month low as “information on the sales status at the end of August was collected for only 65 percent of cases in Texas and Florida counties” affected by the hurricanes, according to the Commerce Department. Sales fell for the second month, by 3.4% m/m and 8.8% over the period, to a low for this year of 560,000 units (saar)—after jumping five of the prior six months by 12.0%. (These sales are tabulated when contracts are signed, making new home sales a timelier barometer of the residential market than existing home sales.) In August, there were 284,000 new homes on the market—the most since May 2009—but still roughly half of the peak recorded during the housing boom. The months' supply of homes climbed to 6.1, the most since July 2014. The hurricanes also impacted homebuilders' confidence for September, falling 3 points to 64, back at its low for the year. “The recent hurricanes have intensified our members' concerns about the availability of labor and the cost of building materials,” said NAHB Chairman Granger MacDonald. “Once the rebuilding process is underway, I expect builder confidence will return to the high levels we saw this spring.”

Regional M-PMIs ([link](#)): Four Fed districts have now reported on manufacturing activity for this month—New York, Philadelphia, Dallas, and Richmond—and they show growth in the sector accelerated for the second month at a robust pace. We average the composite, orders, and employment measures as data become available. The composite index rebounded from 15.0 in July to 22.1 this month, moving back toward February's cyclical high of 26.4. The New York (to 24.4 from 25.2) gauge held near August's cyclical high, while Philadelphia's (23.8 from 18.9), Dallas' (21.3 from 17.0), and Richmond's (19 from 14) all accelerated at healthy clips. The new orders gauge expanded markedly for the second month from 12.4 in July to 23.3 this month as bookings in the New York (24.9 from 20.6), Philadelphia (29.5 from 20.4), Dallas (18.6 from 14.3), and Richmond (20 from 17) districts accelerated sharply—with New York's and Dallas' at new cyclical highs. The employment measure edged higher for the second month to 12.1 after slowing steadily from April's cyclical high of 13.2 to 9.0 in July. New York (10.6 from 6.2) manufacturers added to payrolls at a faster pace for the second month, while Philadelphia's (6.6 from 10.1) hired at a slower rate for the fifth month; Richmond's (15 from 17) held around recent highs. Meanwhile, the hiring pace at factories in the Dallas (16.3 from 11.2) area was the best since April 2014.

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