CenterState
CORRESPONDENT DIVISION

Market Update

Economic News

July 3, 2019

With the market staring at an early close today (2pm ET), and the Fourth of July holiday tomorrow one could be excused for thinking it will be an inconsequential session but with the ADP Employment Change Report out this morning it gives us a tell on the more consequential June Jobs report due on Friday. The ADP reported 102,000 new private sector jobs which missed the 140,000 expectation but was better than May's soft 41,000 print. Recall that last month's ADP report preceded a disappointing May jobs report with only 75 thousand jobs, the second lowest of the year. The Friday jobs report is expecting 164,000 new jobs but with today's ADP miss that may be in question. The correlation between the two reports, however, has been low of late so last month's near-hit may be hard to repeat in back-to-back months. Meanwhile, Treasuries are continuing the rally from yesterday as concerns over slowing global growth and still-present trade war angst provide a strong bid for Treasuries. The 10-year is currently yielding 1.96% after moving 5bps lower yesterday. With the ADP report in hand, and the June ISM Non-Manufacturing Report due later this morning, investors are scanning the domestic numbers looking for hints of oncoming weakness and the Friday jobs report will be a big piece of that puzzle.

While the resumption of trade talks between the U.S. and China may have seemed like a trade war truce was in place, the news that the U.S. was considering adding another $4 billion in E.U. goods to be taxed in response to European aircraft subsidies only reinforced the notion that the issue will be an ongoing "uncertainty" for investors and central banks alike. For those keeping score at home, the running tally of E.U. goods subject to potential tariffs has reached $25 billion. While that's not an economy-shattering total, it does illustrate that the topic will never likely recede too far from the spotlight. When you're willing to use trade tariffs against grievances as disparate as immigration it shows it can be utilized in a host of situations and that will keep it on the table as a potential source of uncertainty.

While we await the early close today, and the July Fourth celebrations tomorrow, those unlucky enough not to have a four-day weekend (like us) will be back at it on Friday for the June jobs report in what promises to be a lightly attended session. While we are onboard with a 25bps rate cut at the July 31 FOMC meeting, one thing that could upset that calculus would be an extremely strong or weak report. Given the ADP numbers released today a strong report is less likely to be in the cards.

While a 50bps cut has been advanced in some quarters, and frankly we were swayed by some of the arguments to get ahead of the curve and to unequivocally state that the Fed was on the case, when St. Louis Fed President James Bullard discounted the notion it gave us some pause. When you don't have the most dovish voting member of the FOMC on board for a 50bps cut who else is there to advance the case?

We believe the Fed cuts 25bps this month and another in September, and even a solid jobs report is not likely to sway them from that course. When you look around the globe and the increasing signs of slowing, particularly in the manufacturing sector, and the aforementioned trade uncertainties, and the docile inflation picture it gives the Fed plenty of excuses to cut. Now, if the jobs report comes in exceedingly weak then the murmurs for a 50bps cut this month will start to grow louder. Look to Bullard as the canary-in-the-coal-mine for that shift. If he starts to hedge his comments on a larger cut the shift in outlook may be on.

The consternation for investors in the U.S. is that the economy still seems to be operating on all cylinders. Sure, there's been some hits to confidence but the recent retail sales and personal income/spending numbers were good. The consumer, despite a recent decline in confidence, seems to still be spending at a healthy pace. That being said, there are some soft spots that will keep the Fed leaning towards a rate cut later this month.

The Atlanta Fed's GDPNow model is calling for a 1.47% second quarter GDP as inventory run-off and slower net exports drag on the modest rebound expected in consumer spending. Recent housing activity numbers have been tepid which wasn't expected when mortgage rates dropped to yearly lows. The latest car sales have been lukewarm too. While those interest-rate sensitive sectors slowed last year in the face of quarterly Fed rate hikes, the thinking was that the "patient pause" with rate hikes, combined with the strong rally in market rates, would revive both sectors and that hasn't been the case. At least not yet.

Thus, the jobs report this Friday and the ISM Non-Manufacturing Survey later this morning will give us a broad look at economic activity in June. The ISM Manufacturing Survey from Monday, while better than expected at 51.7 versus 52.1 in May, is still slipping closer to the 50 dividing line that separates an expanding sector versus one in contraction. The ISM Non-Manufacturing Survey later this morning is expected to have a better showing with a 56.0 reading forecast versus 56.9 in May. The bottom line to all this is the economy is still moving forward but the momentum definitely is slowing.

Citigroup Economic Surprise Index

We haven't dragged out the Citigroup Economic Surprise Index in awhile so we felt it was overdue. The index measures data surprises relative to market expectations with positive surprises adding to the index and negative surprises subtracting. As shown, the index has been in negative territory for most of this year with the most recent results approaching YTD lows. What's interesting regarding the index is that as results miss expectations one would expect forecasts to be lowered. So far, however, expectations are still coming in too optimistic versus realized results. It's another sign that economic momentum is softening and another sign the Fed will likely be easing later this month.

Agency Indications— FNMA/FHLMC Callable

Maturity (yrs)	2 Year	3 Year	4 Year	5 Year	10 Year	15 Year
0.25	2.22	2.28	2.35	2.43	2.72	2.95
0.50	2.12	2.17	2.24	2.32	2.64	2.88
1.00	1.95	2.02	2.11	2.18	2.54	2.79
2.00	-	1.77	1.87	1.96	2.42	2.61
3.00	-	-	-	-	2.29	2.52
4.00	-	-	-	-	2.18	2.46
5.00	-	-	-	-	2.09	2.40
10.00	-	-	-	-	-	NA