

# Long, Inverted and Shocked

BAC Community Bank

Stockton, California

February 25, 2020

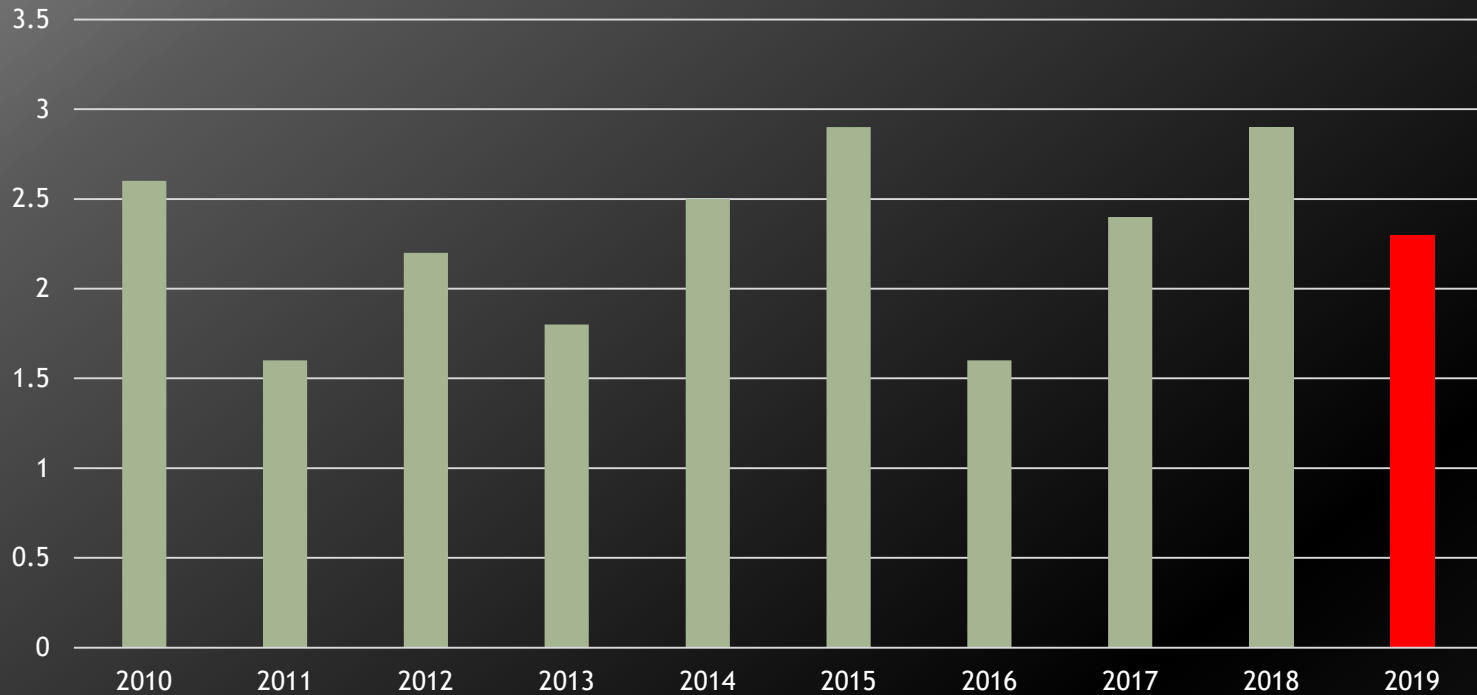
John W. Mitchell

# February, 2020

- ▶ Longest Expansion on Record
- ▶ Stocks, Bonds, Gold, Oil- All up in 2019
- ▶ Five Month Inversion in 2019 another in 2020
- ▶ Unemployment Same as it was 50 Years Ago
- ▶ Trillion Dollar Deficits on 12 Month Basis Since October
- ▶ De-escalation of Trade War on 2 Fronts-Opening Another
- ▶ Political Polarization, Excitement and Theatre
- ▶ Coronavirus/Max/Political Shocks

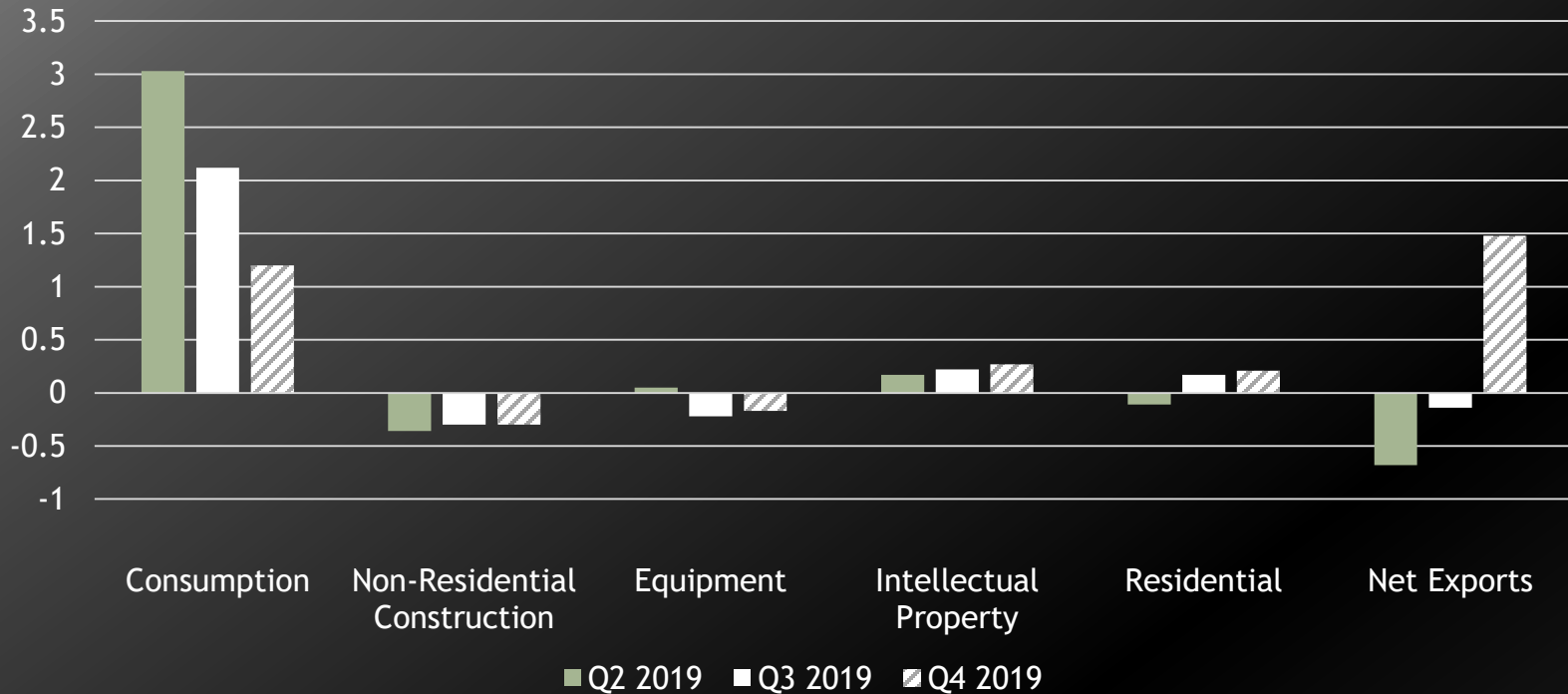
# Real GDP Growth

Source: BEA



# Percentage Point Contributions to Real GDP Growth Q2, Q3 and Q4 of 2019

Source: BEA

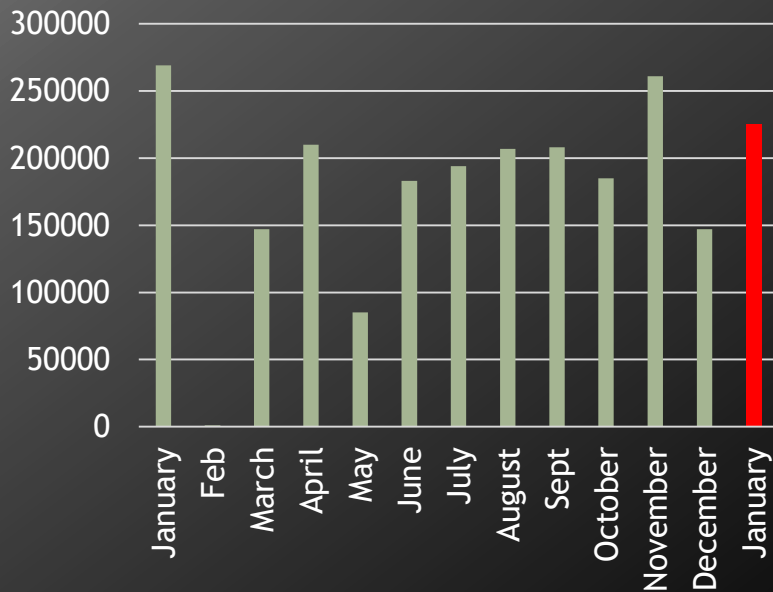


# Labor Market Snapshot

## Payroll Employment Change

2019-2020

Source: BLS

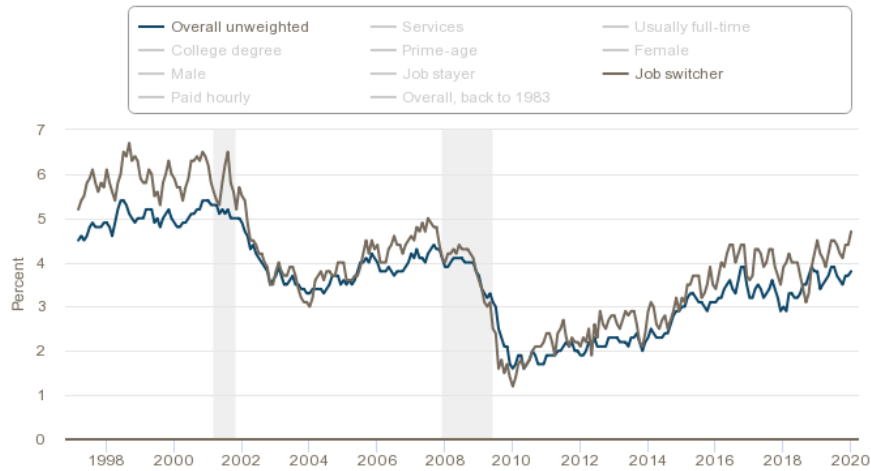


- ▶ Headline Unemployment 3.6% and U-6 down to 6.9% from 8% Last January
- ▶ Since Trough 25.5 Million Jobs
- ▶ 107 Consecutive Months of Increasing Employment
- ▶ Average Hourly Earnings up 3.1% Atlanta Fed 3.8% and 4.7% Job Switcher
- ▶ Constraint on Activity
- ▶ Implications-Census, FedEx

# Wages and Debt Service Burden

## Wage Growth Tracker

three-month moving average of median wage growth



Sources: Current Population Survey, Bureau of Labor Statistics and author's calculations

FEDERAL RESERVE BANK of ATLANTA

Exported on: Saturday, February 15, 2020

## FRED Household Debt Service Payments as a Percent of Disposable Personal Income



Shaded areas indicate U.S. recessions

Source: Board of Governors of the Federal Reserve System (US)

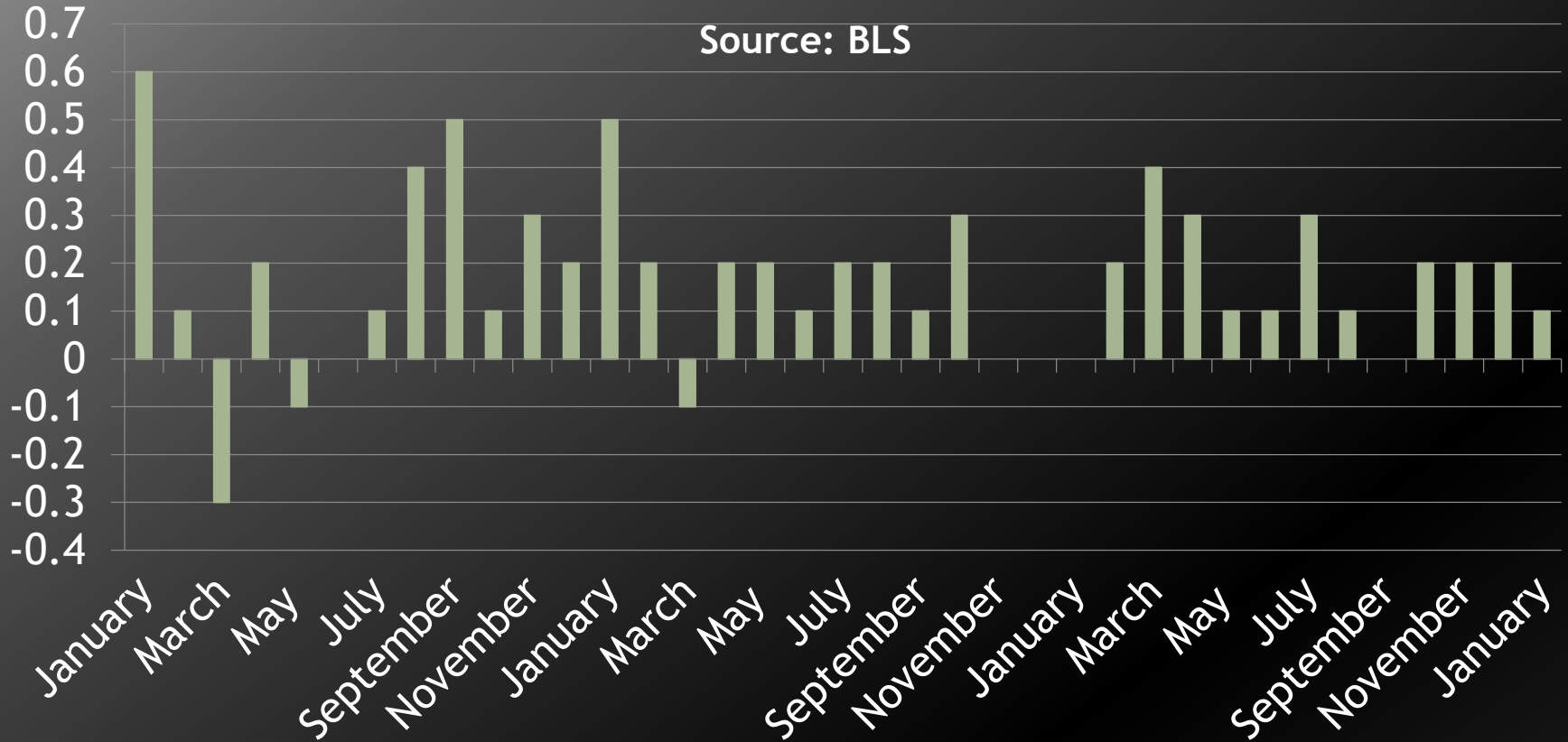
fred.stlouisfed.org

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# Monthly Change in the CPI 2017-20

Year over Year January 2.5% Total and 2.3% Core  
PCE December 1.6% and 1.6% Core



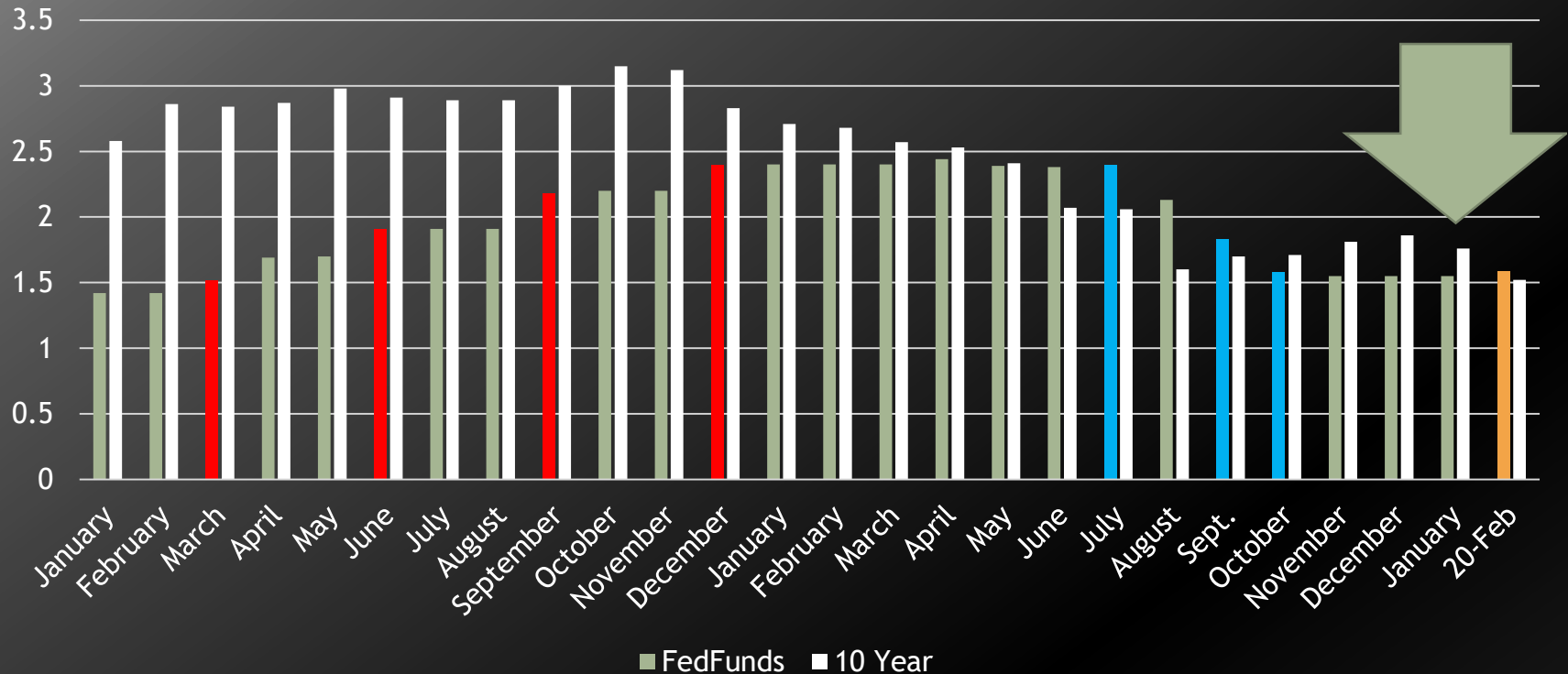
# Different World

- ▶ 49 Years Ago Price Controls (8/15/71)  
In August 1981 10 Year was 15.4%  
Now About 1.6%
- ▶ Unemployment Decline from 10% to 3.5% No Surge Inflation  
-In the 60s Unemployment went from 6.7% to 3.6% and Inflation from less than 1% to 5%
- ▶ Search for Reasons: Anchored Expectations, Changes in Labor Market, Wages Rising as in Past, Prices are Not, International Competition, Global Supply Chains, Technology Changing Prices, Comparing Prices, Is this temporary? Brookings Paper



# A Changed World Since Last Year

## Two Inversions?



# Inversions

5/15/19- 10/11/19 and in February 2020

- ▶ Inversions have Occurred Before Recessions
- ▶ Late Night Comics, Nightly News, Headlines-Recession Drumbeat Last Summer
- ▶ Idea Behind: Monetary Authority pushes up short term rates to deal with inflation, Economy expected to slow and the Fed will lower rates in the future, Rates will decline so buy longer term now driving down longer term rates-Inversion
- ▶ Is this a signal? Fed Cut in July, September and October- Rates Overseas Negative-Missing Weakness in Labor Market-Coronavirus Fears
- ▶ Raymond Devoe

# Fiscal Policy?

## A Trillion Dollar Deficit and No One Seems to Care!

- ▶ Since 2017 Series of Bills that Increased Spending, Cut Taxes and Suspended Debt Ceiling
- ▶ Deal Passed in Summer 2019 Abolished Sequester-Suspended Debt Ceiling which had been hit in March Until July 2021 and Increase Discretionary Spending by \$50 Billion in 2020
- ▶ No Serious Discussion about Deficit Reduction
- ▶ *CBO* \$984 Billion Deficit up 26% in Fiscal 2019 then Moving Above \$1 Trillion 2020-2029 -Since October of 2019-Annual Over \$1 Trillion
- ▶ Traditional View: Crowding out of Private Investment, Limits on Ability to Respond to Weakness, Inflation, Will People be willing to buy the Securities

# Modern Monetary Theory

- ▶ Look Around-Rates, Inflation, Starved Private Sector?
- ▶ MMT-Modern Monetary Theory-control economy by fiscal policy, if borrow in your own currency deficits less important-the Fed can create money-Use Spending to Manage Aggregate Demand-The Constraint is Capacity Leading to Inflation
- ▶ Assumes Fed is Complicit and That We Will Always be Able to Sell Debt
- ▶ Emerged from Small Group of Economists-Popularized by Some Politicians (Mankiw, NBER 2020)
- ▶ Cover for Green New Deal, Defense Expansion, Infrastructure
- ▶ Fiscal Policy-Driven by Politicians -Short Term Horizon (Elections!)-Long Term Policy Decisions-Fed Independence

# Trade Excitement

- ▶ Unwinding Some of Globalization for Much of Post War Period-Multilateral Institutions-GATT and WTO-Rules Based and Adjudication Mechanism
- ▶ Confronting China, Europe, NAFTA Redo, Deficit Fixation
- ▶ Phase One Deal-Export Increase(Can it happen with Coronavirus?)  
IP Protection, Dispute Resolution, Some Tariff Reduction
- ▶ European Dispute- Digital Taxes, Airbus Ruling
- ▶ Uncertainty-What will the Rules Be? WTO Adjudication Panel Defunct
- ▶ Unwinding of Supply Chains-Less China more Vietnam, India, North America
- ▶ Sanctions Rules-Nations Trying to Work Around Dollar

# Job Growth Update December 2019 Data

## Year over Year Change - 44 States Up

Source: BLS, ASU

▶ Utah 1	▶ Kansas 18	▶ North Dakota 35
▶ Arizona 2	▶ Arkansas 19	▶ Ohio 36
▶ Idaho 3	▶ South Carolina 20	▶ Pennsylvania 37
▶ Texas 4	▶ Delaware 21	▶ Mississippi 38
▶ Washington 5	▶ Maryland 22	▶ Michigan 39
▶ Florida 6	▶ Massachusetts 23	▶ Louisiana 40
▶ Alabama 7	▶ Kentucky 24	▶ Wisconsin 41
▶ Colorado 8	▶ South Dakota 25	▶ Connecticut 42
▶ North Carolina 9	▶ New York 26	▶ Minnesota 43
▶ Oregon 10	▶ Maine 27	▶ Indiana 44
▶ Nevada 11	▶ Montana 28	▶ Alaska 45
▶ <b>California 12</b>	▶ New Jersey 29	▶ Iowa 46
▶ New Mexico 13	▶ Hawaii 30	▶ Oklahoma 47
▶ Rhode Island 14	▶ New Hampshire 31	▶ Vermont 48
▶ Tennessee 15	▶ Illinois 32	▶ West Virginia 49
▶ Nebraska 16	▶ Missouri 33	▶ Wyoming 50
▶ Georgia 17	▶ Kentucky 34	

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# California

	Population 18-19	Personal Income Q3	Residential Permits 2019	FHFA House Price Index Q3 PO	Un Rate December
California	0.1%	3.6%	-3.1%	4.1%	3.9%
US	0.5%	3.8%	3.1%	4.9%	3.5%

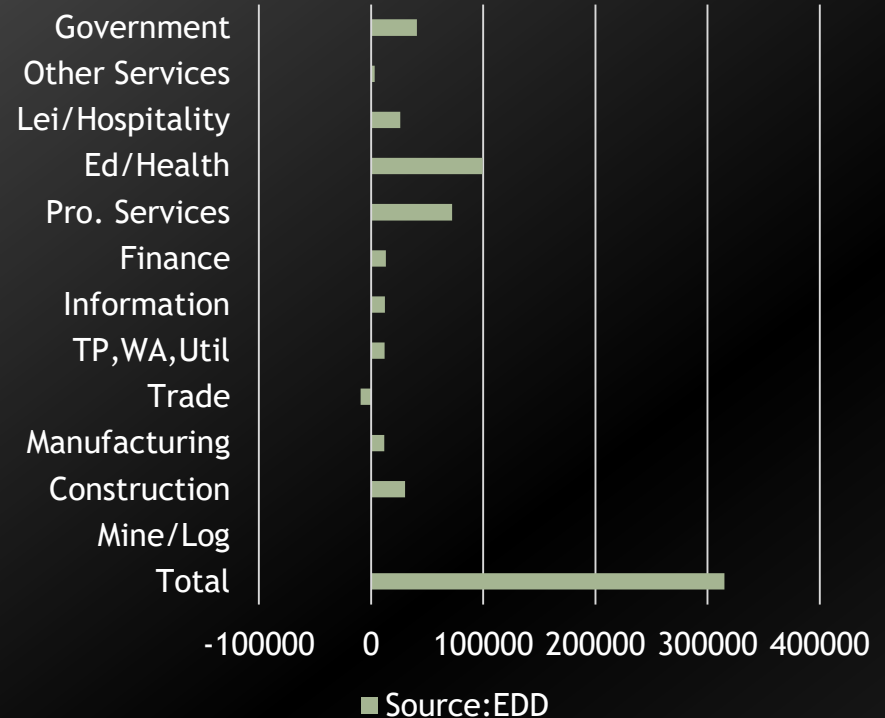
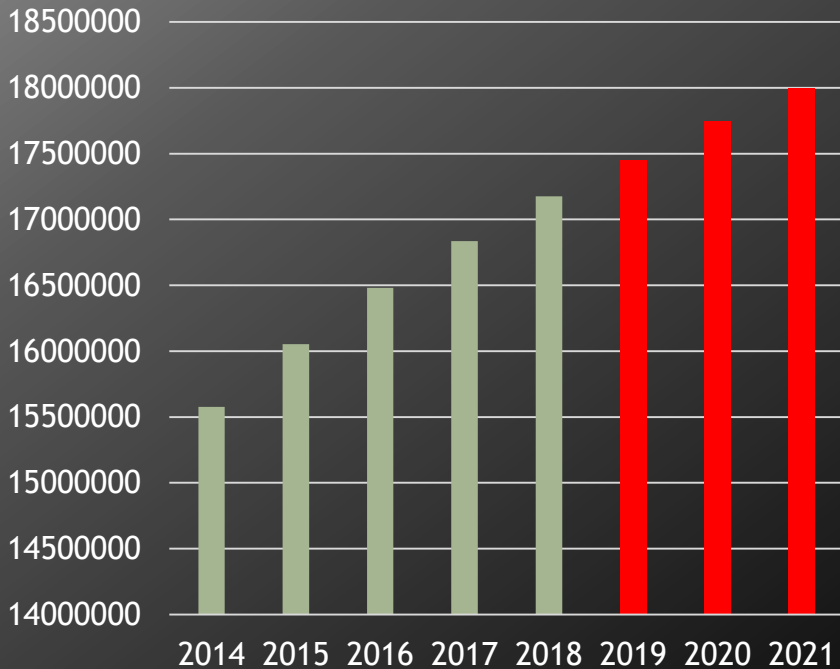
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# Annual Average Wage and Salary Employment

# California Job Growth Year to December 1.8%

Source: EDD, WBC





## Region

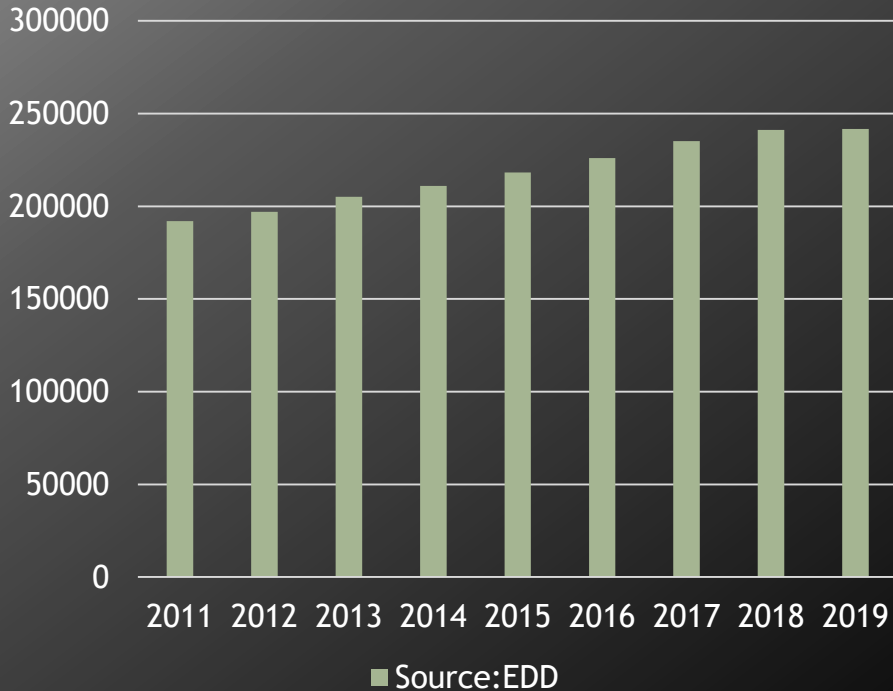
	Dec. YoY Job Change	%	Un Rate December
Modesto	2,900	1.6	5.6
Oakland	18,900	1.6	2.6
Sacramento	11,900	1.2	3.2
San Francisco	29,000	2.5	1.8
Stockton	1,400	0.6	5.7

## California

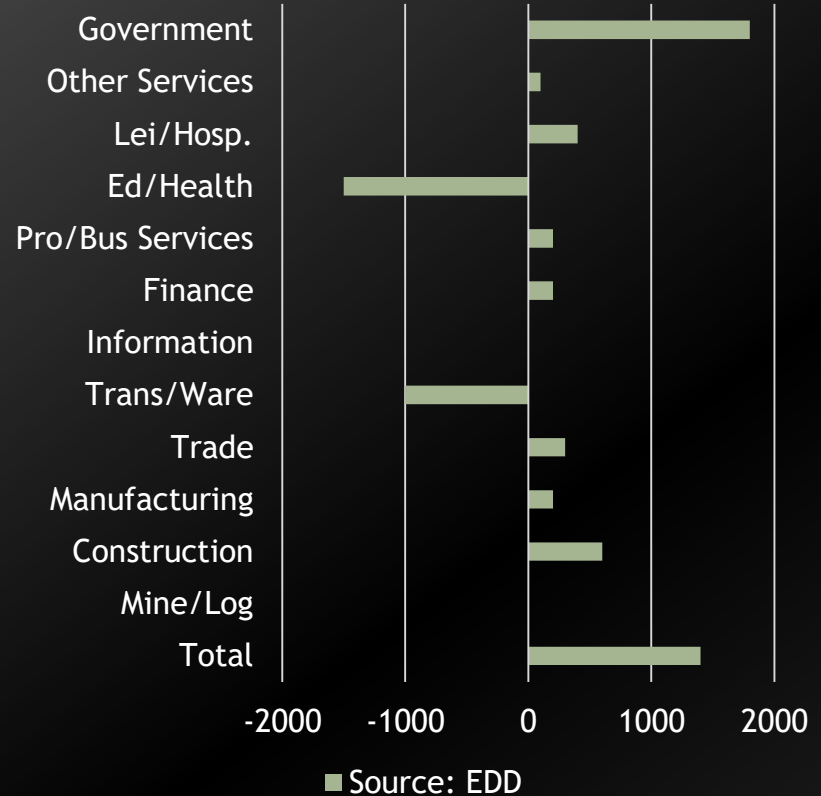
- ▶ Unemployment Rate down from 11.2% Recession Peak to 3.9%
- ▶ All 11 Sectors Grew over the Year to December
- ▶ Highest Weekly Earnings in Information, Finance, Professional and Business Services, and Construction

# Stockton Lodi MSA

## Annual Average Employment 2011-2019

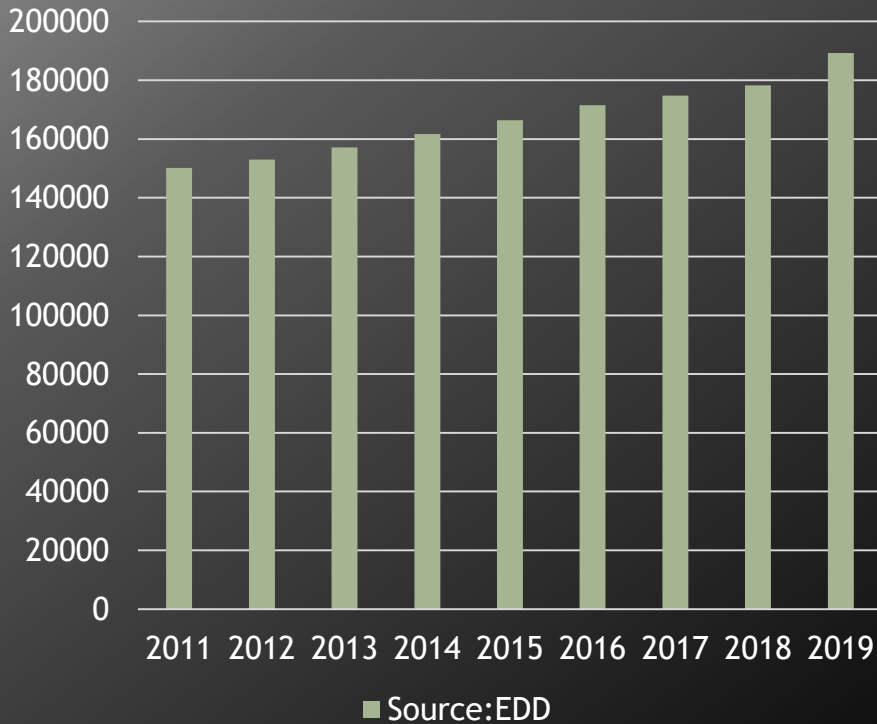


## Year to December

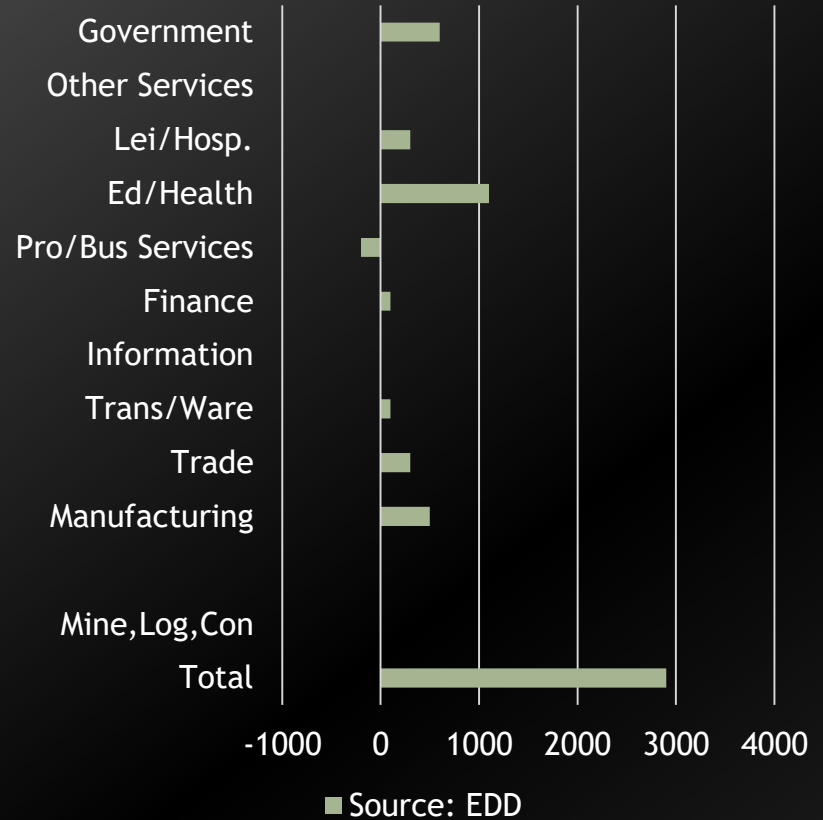


# Modesto MSA

## Annual Average Employment 2011-2019

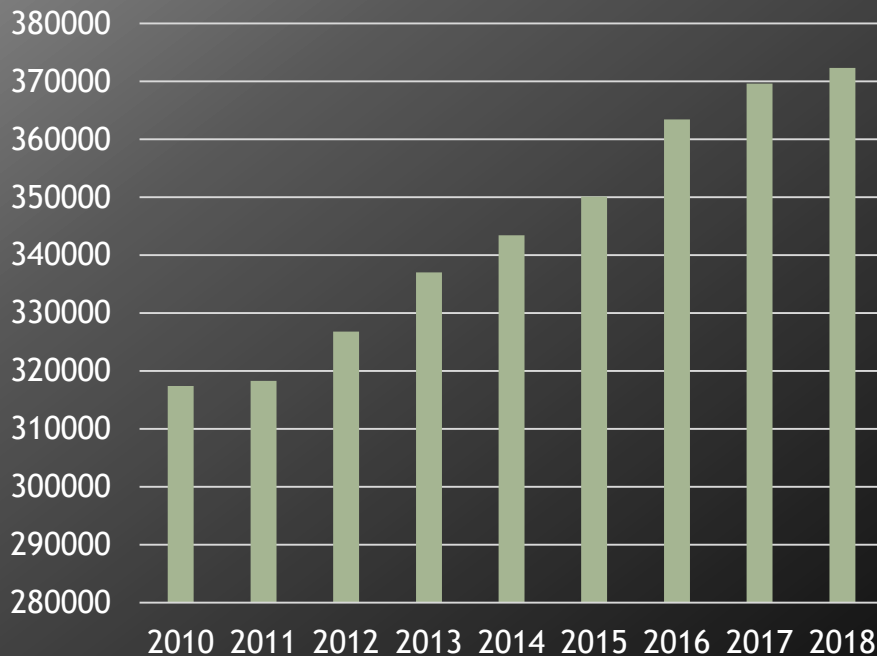


## Year to December



# Contra Costa

## Annual Average Employment 2010-2018



■ Source: EDD

- ▶ Oakland Metro Division Annual Average Employment up 23.2% 2010-2019
- ▶ Year to December-Job Growth in Professional and Business Services, Education and Health, Leisure/Hospitality, Construction, Trade/TP/Utilities, Government

# Regional Price Parities

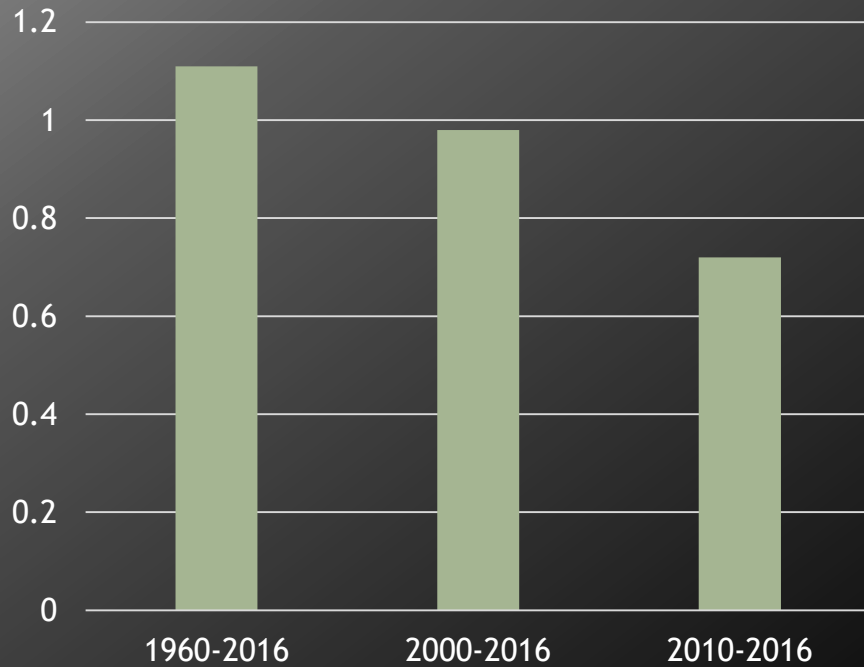
## 2017 MSAs

### US=100

	Total	Rent
Modesto	98.1	99.4
Sacramento	102	119.1
San Francisco	128	195
San Jose	130.9	218.4
Stockton	99.5	105.5
Source: BEA		

# Housing

## Housing Starts Per Household



■ Source: ECONorthwest

## Crosswinds

- ▶ Tighter Lending
- ▶ Affordability-Rentership Communities
- ▶ Capacity
- ▶ Policy-NIMBY, Land Use Controls, Permit Fees
- ▶ YIMBY
- ▶ Rising Income
- ▶ Household Formation-Out Running Production
- ▶ Generational Behavior
- ▶ New Tax System
- ▶ Traditional Response Thwarted
- ▶ Policy Focus-State of State Speech

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# Housing

	Dec. Median CAR	% Change	FHFA Q3	% Change Sales Dec.	CAR Affordability
Modesto	\$330,000	8.2%	4.06%	4%	48
Stockton	\$385,000	2.7%	2.07%	12.8%	45
Contra Costa	\$614,000	3.2%	0.9% (OAK)	10.9%	39
San Francisco	\$1,460,000	6.1%	-1.9%	-3.1%	18

# Observations

- ▶ Case for Place Based Policies-Convergence has Become Divergence
- ▶ Brookings-A crisis of regional imbalance:90% of Innovation Sector growth in 5 Metro Areas: Boston, San Francisco, San Jose, Seattle and San Diego- Leading to “spiraling real estate costs, traffic gridlock, and increasingly uncompetitive wage and salary costs.”
- ▶ How to facilitate spread?
- ▶ Sustainable Groundwater Management Act-Implications



# Outlook

- ▶ 2020 GDP Growth Slowing to 2% in 2020
- ▶ Inflation also about 2%
- ▶ Rates will *Depend on Data-Three Rate Cuts in 2019-Done Until Performance Changes*
- ▶ Bottom Line is Slower, But Still Up- Risks Downside
- ▶ Consensus has California seeing 1.7% Employment Growth in 2020 to 1.4% in 2021

# New Territory

- ▶ Trade Conflict -Constitutes Upside and Downside Risk
- ▶ Coronavirus-Not SARS Redo-China Much More Important
- ▶ Surging Deficit in the 11<sup>th</sup> Year of Expansion
- ▶ Trillions in Negative Yielding Debt-
- ▶ Are Trying a MMT Experiment?

- ▶ Net Worth Changes-Financial Assets and Low Rates, Net Worth in 2010 \$62.5 Trillion and in Q3 2019 \$113.8 Trillion-Up \$574 Billion in Q3- Households and Non-Profits-Double Digit Equity and Bond Market Changes
- ▶ Are We to Live In A World of Slower Growth, Low Rates and Low Inflation? Japan?
- ▶ What will our options be at the next downturn? Forward Guidance, QE Again? Monetary Policy -FED, Fiscal Policy Congress- Lags?

# Reflections/Considerations/Worries

- ▶ Forgetting the Basics-Freedom, Property Rights, Rule of Law, Sensible Regulation
- ▶ Social Mobility has Declined part of the reason seeing attention on inequality and opportunity. How do we enhance?
- ▶ Aging Population, Falling Numbers of Young People
- ▶ Creative Destruction is Ongoing-New Ways of Doing Things, New Products, the Destruction of Old Jobs and the Creation of New with Different Skill Sets-Age Old Issues
- ▶ First Fed Conference on Climate Change Implications for Monetary Policy and Financial System

# *Endgame*

## *(Looking for Things that will Reduce Spending)*

- ▶ Trade Issues-Next Chapter?
- ▶ Major Market Decline?
- ▶ Some of the Things that Preceded Other Recessions Do not Seem to be There
- ▶ Manufacturing Weakness PMI - Freight Volumes-Slowing in Consumer Spending
- ▶ Will the Stirring in Housing Persist-strength in Year 12?
- ▶ Quelling of Animal Spirits?
- ▶ Geo-Political Shock— Brexit, Megxit, Threats to Upend the Tax System, Medical System, Polarization, Coronavirus, Some Black Swans We Are Missing
- ▶ What Policies Are Beyond January of 2021?

# *Questions?*