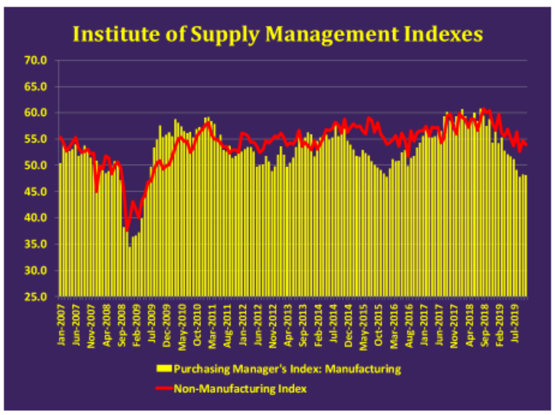
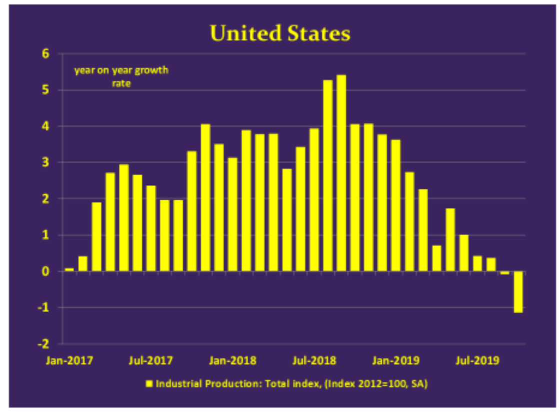
Dan Hamilton
December 7, 2019

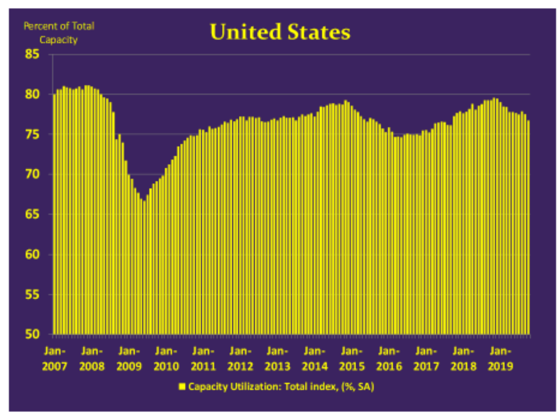
Monthly indicators of the business sectors continue to indicate a slowing of activity. Recent readings of the Institute for Supply Management's (ISM) measures for manufacturing and services indicate that the economy is weakening.



The ISM's measures of manufacturing as well as services activity have mostly been declining for a year now. The indicator of manufacturing is at its lowest level since the Great Recession, and, as of November 2019, registered a value of 48.1 percent, a drop from October and indicating a contraction of the sector.

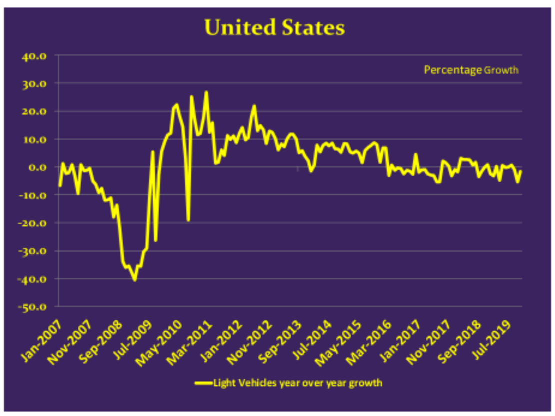
The readings of the Board of Governors' industrial production indicator show that manufacturing activity has been declining for many of the past 12 months. The October 2019 data indicate a negative annual growth rate for the first time since November of 2016.

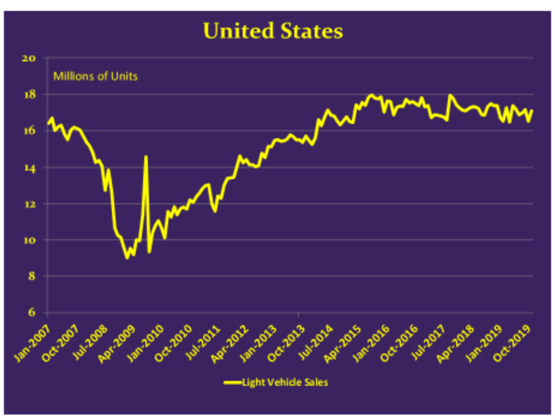




Capacity utilization has been falling for most of the past 12 months. This is against the backdrop of already low levels. CERF has previously pointed out that the post Great Recession history of capacity utilization has been uninspiring at best. This is to say, capacity utilization is falling from what is already an extremely low level for an expansion phase of the business cycle.

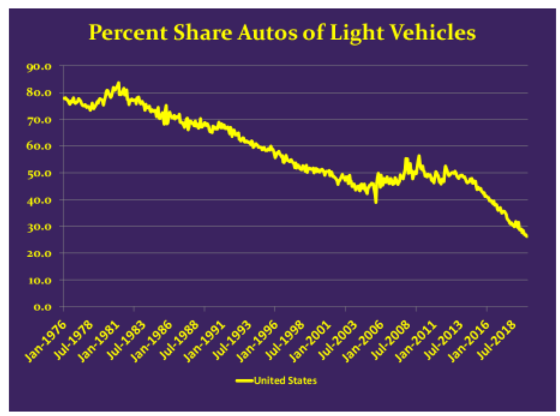
Light vehicle sales have contracted for 30 of the most recent 45 months compared with the same month one year prior. This underscores that auto sector activity at rates of 17.4 or 17.5 million units per year like we experienced during 2015 and 2016 have not been happening in more recent years. With most of this year's sales data on the books, it is clear that 2019's unit sales will not reach the 17 million mark.

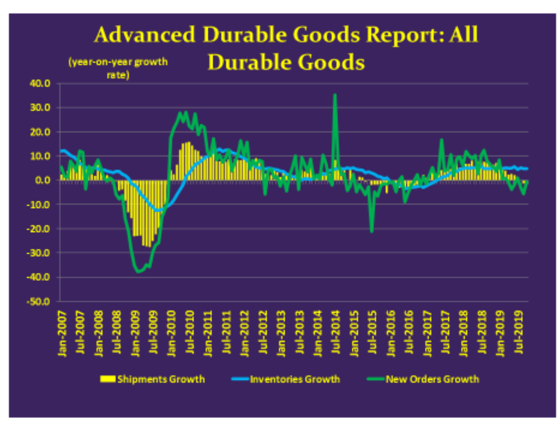




A factor driving the decline of vehicle sales is the decline of autos relative to light truck/SUV sales. Auto sales are in a secular decline that began in February of 2012, when the auto share was 53 percent, and has eroded to an industry-changing 26 percent in the latest reading.

While this might not impact overall auto industry revenues, the market has been forced to adapt to the lower unit volume, and this dynamic is not over. While consumers prefer light trucks or SUVs, these are more expensive than autos on average. Auto-sector activity that is unit dependent rather than value dependent will contract for the time being.

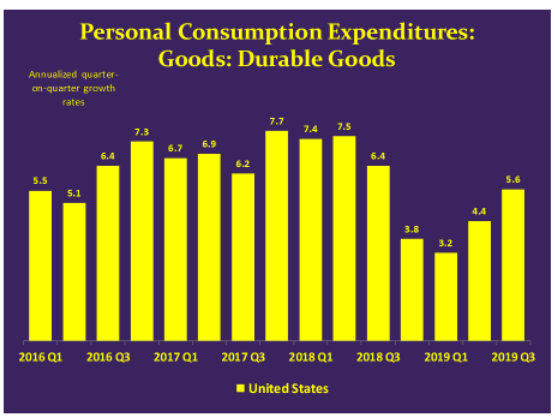




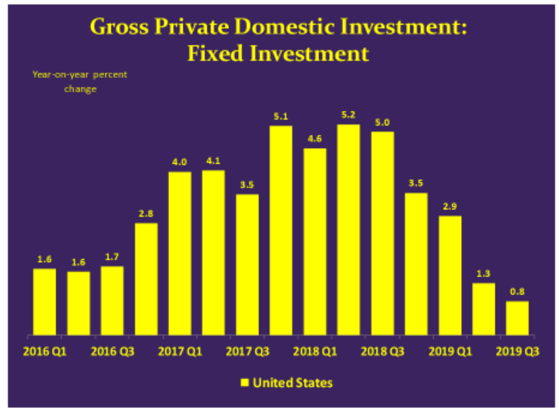
Shipments and new orders for Durables goods are declining, and have been in decline for just under two years now. Unsurprisingly, inventories are not declining.

As documented in the nearby *Housing Markets* essay, sales and construction activities are very low for an economic expansion.

Switching to the latest quarterly GDP accounts data, we are happy to see that the decline in durables consumption growth that we noticed last quarter has reversed course and strengthened to 5.4 percent in the latest estimates for quarter 3.

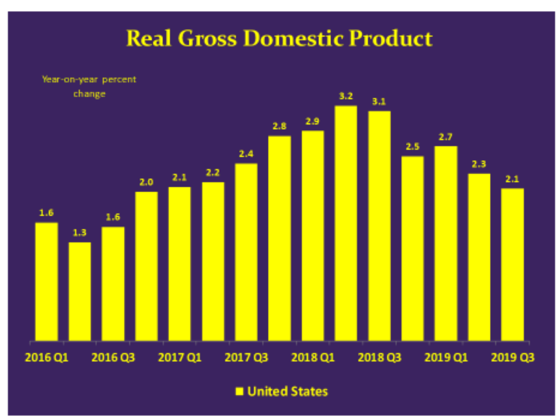


In contrast to consumer durables, the indicator of growth in fixed investment shows continued deterioration. The latest measure of quarter 3 shows a notably slow growth rate of 0.8 percent. This is well within the confidence interval of zero growth.



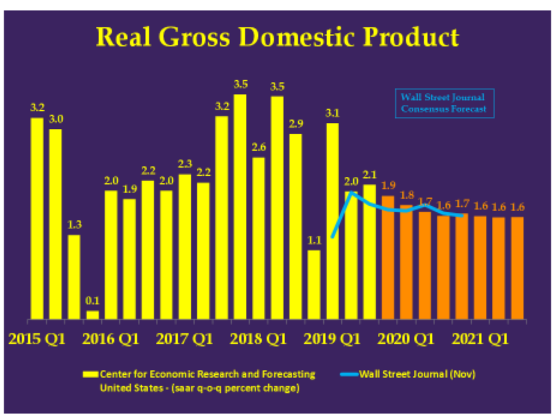
The previous two slides use year-on-year growth rate calculations rather than the annualized quarter-on-quarter calculation. The year-on-year calculation is less volatile and is mathematically linked to the growth rates obtained using annual data.

Using year-on-year growth rates for GDP growth, we see that since 2018 quarter 2, GDP growth has declined every quarter except one, which was 2018 quarter 4.



The current economic situation is one where high-multiplier activities are either in decline or at low activity levels relative to post-war history. Manufactured products, automotive vehicles, and structures are all high-multiplier activities, meaning that the production of these items also requires the production of a large quantity of inputs. This is of benefit to the economy, as just one expanding industry will generate additional economic activity in various other industries, expanding overall economic activity and growth.

The CERF 2019 Q4 forecast calls for slow growth for the next eight quarters. This is driven by subdued growth in the various industries mentioned so far. A reasonable question is why these industries are slow.



We believe that growth-harming policies are an important part of the story. Other analysts will mention changes to demographics and consumer tastes, but we believe that markets adapt more quickly than ever to changes of this kind.

The growth-harming policies include the trade war, monetary policy, and major regulatory acts, such as Sarbanes-Oxley and the Affordable Care Act. These policies show no sign of relenting.

While the initially estimated November jobs number was pretty good, we note that it was boosted in part by the end of the auto strike. The implied year-on-year growth rate of that number was 1.5 percent, which is 20 basis points lower than the average of the monthly growth rates during the past five years.

I do actually hope that the economy ultimately grows at a rate that exceeds our forecast.