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Rising Recession Risk Confirmed

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More Sour Data

With more data in bearing on Friday's Labor Market Report, Tuesday's ADP (135,000 vs. the DE forecast of a very low 115,000; Consensus at 140,000) and ADP downward revisions last month, to 97,000 from 157,000, and then today a disappointing ISM Services (52.6 vs. DE 54.0 and Consensus 55.0) and in the ISM Services Employment component (50.4 from 53.1), *the DE estimate for Nonfarm Payrolls in September (release tomorrow) is down to a range of 75,000-to-100,000.*

This forecast was downgraded Tuesday to 100,000 on the very, very sour ISM Manufacturing data that made for a *Recession call on U.S. Manufacturing* and moreso on the ADP yesterday and ISM Services reading today.

This does not necessarily mean Recession for the whole economy, however, as the Manufacturing Sector these days is very small relative to the overall economy.

The momentum for the labor market and track on the economy does look negative. The DE Q3 track for real GDP prior to this coming Friday's Labor Market Report is down to 2.1%, annualized, compared with 2.7% previously. And, the risk is that it could be sub-2%.

The DE forecast on other dimensions of the Labor Market Report is 3.8% for the unemployment rate, downgraded Tuesday from a previous 3.7%, and 0.3% for Average Hourly Earnings (AHE), or 3.3% yoy.

DE View Had Been Weak But Now Weaker

Prior to the data this week, the DE Nonfarm Payrolls estimate had been a very weak 126,000 (Consensus, 140,000). So, even before Tuesday and yesterday, the DE forward look at the September labor market was for weakness—*now, it is even weaker*. Financial markets had *not* anticipated the surprisingly weak ISM Purchasing Managers' report Tuesday, although DE had, nor yesterday's ADP weakness, nor today's ISM Services result.

The result is clearcut Recession in U.S. Manufacturing with further downside risk going forward on weak global economies and trade confrontations. *Recession odds for the overall economy must now be assessed at 15%, up from 10%!*

The rising Recession risk and its level of 15% is notable and significant. The weakness in the labor market is notable and significant. The macro risk Scenario "Recession" (odds now 15%) has as a major channel a weakening labor market, such as may be happening now, then less disposable income, diminished consumer confidence, less consumption, then a Recession that would occur in 2020, maybe as soon as the first or second quarter. If that actually were to happen*, an Equity Bear Market could occur as early as this quarter.*

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The Cause? Of Recessions?

A proximate cause for a weakening and weak labor market would be diminishing company sales and earnings growth, then cutbacks in hiring and jobs, in outlays generally, setting off the sequence of events that could bring damage to aggregate consumption and a Recession.

It is this process that is the downside risk and depressing the Equity market and lifting the Fixed Income market. 1-out-of-11 post-WWII economic downturns have occurred in this manner. 8-out-of-10 have been from high, rising and embedded inflation, tight and tightening monetary policy, and interruptions in credit availability. Two were from the bursting of asset price bubbles and the derivative effects.

In the current episode, non-U.S. economic weakness is the catalyst for the kind of downturn that would emanate from a declining Business Sector, which includes Manufacturing. The collection of the economies of China, Germany and Japan, ranked 2, 4 and 3 in relative size in the Global Economy, with weakness being through trade in exports and imports made worse by the uncertainty of the U.S. and China trade conflict; rising tariffs (a tax); the *prospect* of derivative damage to jobs, income and spending; further weakness in export-driven economies like Germany and China; then less growth in U.S. and Global companies' sales and earnings, less hiring, less income and less consumption spending—that is the process and the problem.

The Fixes?

Reversal of this risk will take macro policy stimulus, already very much in-place on ultra-easy monetary policy in the U.S.—lowering interest rates and perhaps another round of QE—*before* real GDP turns negative.

But, with some major Global Economies in a kind of modern-day "Liquidity Trap," lowering interest rates given long lags before any stimulus impacts, similarly so for QE and bank lending channels compromised, *it is hard to see any easy reversal of the downward momentum on growth*.

Fiscal stimulus likely will be required, existing in the U.S.; not in Japan where a consumption tax has just been raised, although not by much; in process in France where tax reductions have been proposed and likely will be legislated; perhaps in Germany where spending stimulus is being considered; certainly in India where a major reduction in corporate taxes has occurred; and in China, where both monetary and fiscal stimulus, the latter through tax reductions and increased spending, is in process.

All of this is promising but *in the dynamic economic and financial systems of the U.S. and the world, could be occurring too late*.

One lesson from the late 1980s preemptive easing by the Federal Reserve is that reductions in interest rates before the negative print for real GDP in 1990 did not stop that negative print for real GDP from occurring, with the business sector as the proximate cause in the sequence of effects that led to the Recession. The Recession was *mitigated* by the preemptive easier monetary policy from mid-1989 forward, but not prevented.

Markets—Bad Stocks Depending on What Priced; Positive Fixed Income; Temporarily Negative Dollar

The Equity Market remains in a Correction mode, almost having exited the Correction that began in early August, but not yet—with "marks" a minor correction of 5% down from the

previous peak of 3026 and S&P500, at 2880; a standard correction of 10% with a 2725 mark; and a near Bear Equity Market level of 2450 on a 20% Correction.

Helpful would be further easier monetary policy of size, and sooner, but more importantly emerging fiscal stimulus other than the U.S., where it is already there; a pattern of data, including tomorrow indications that the U.S. labor market remains solid; signs of improved or less worsening economic activity in China, Germany, France and Europe; and progress in the forthcoming trade talks between the U.S. and China in Washington.

Now, markets will wait for the next Employment Report, foreshadowed by DE as weak.

To repeat, Nonfarm Payrolls are estimated at 75,000-to-100,000; the Unemployment Rate at 3.8% (from 3.7%) underpinned by weakness in persons finding work and in the labor force, and wage inflation stable to slightly higher, at 3.3% yoy.