FHN FINANCIAL

JANUARY 15, 2020

2019 ECONOMIC YEAR IN REVIEW

2019: Central Banks Rethink Normalization

Central banks began the year with ambitious plans for interest rate and balance sheet normalization. Those plans ran afoul of disappointing economic data and market volatility. The Fed and ECB abandoned rate hike plans in Q1 and opted for more stimulus and rate cuts by Q3. The Fed cranked its asset holdings back to $4.2t by yearend. The ECB cut overnight deposit rates from -0.4% to -0.5%, and padded stimulus with a tiered rate system and additional stimulus through open-ended QE.

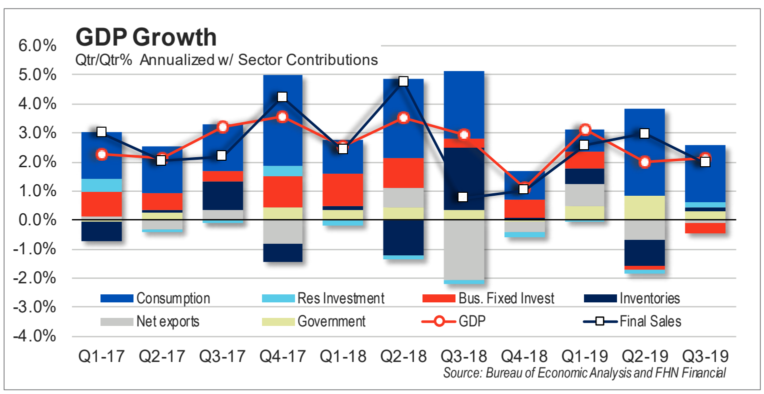
US GDP surprised on the upside, while Germany's wobbly economy barely avoided a recession in Q3. It revised Q2 GDP down from -0.1% to -0.2%, giving Q3 a technical 0.1% quarterly boost. The collapse of an imminent US-China trade deal added to market volatility, while political turmoil in Hong Kong spooked markets after its "one country, two systems" political framework was jeopardized by introduction of a criminal extradition bill. UK plans for Brexit were postponed, piling on additional uncertainty. Domestic politics had little impact on US markets prices that saw equities soar 30% and 10-year yields fall 77bp to 1.92%.

ECONOMICS

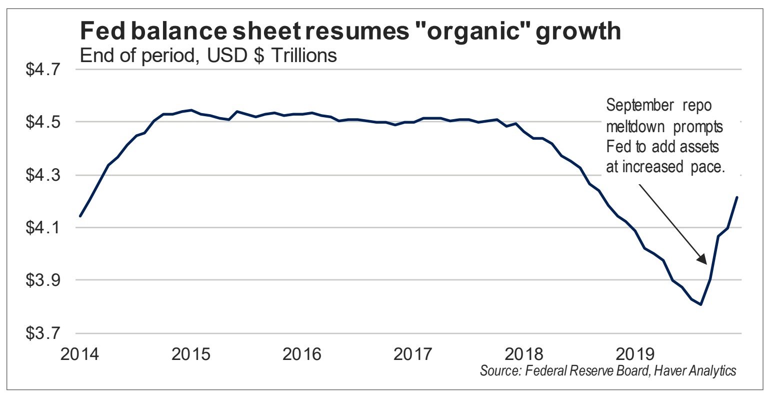
Chris Low
Chief Economist
212.418.7909
chris.low@fhnfinancial.com

Rebecca Kooshak
Economic Analyst
212.418.7966
rebecca.kooshak@fhnfinancial.com

FHNFINANCIAL.COM
800.456.5460

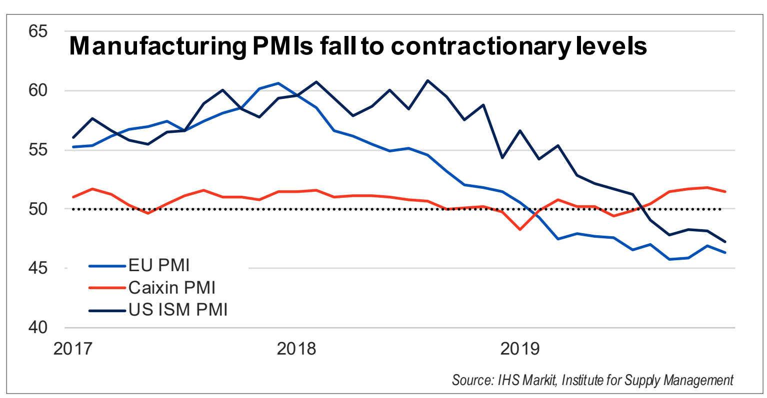


GDP growth was 3.1% in Q1, but slowed to about 2% in both Q2 and Q3. It is tracking near 2.5% in Q4, which means Q4/Q4 growth for the year was also about 2.5%. Consumer spending held up, but business investment, already weakening in 2018, detracted from growth after Q1. Net exports hurt the economy in the first half, but contributed to growth in the second. An inventory correction started in Q2, partially reversed in Q3 thanks to a colossal buildup of GM vehicles before the UAW strike, and is likely to have resumed in Q4.



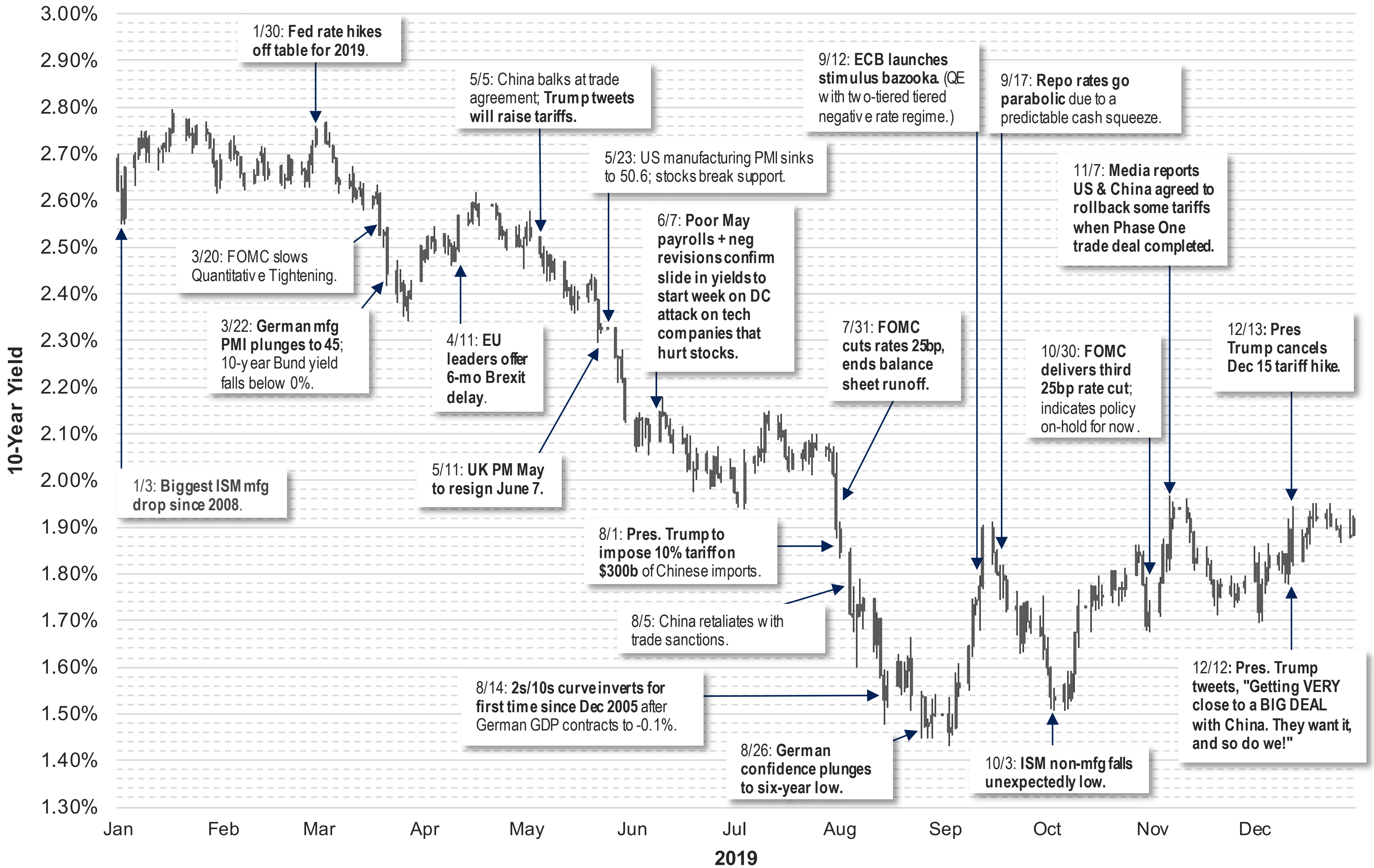
The Fed's balance sheet "normalization" program that began in October 2017 ended prematurely. But, Fed assets had already dropped from $4.5t to under $3.8t, causing liquidity strains in money markets, double-digit spikes in repo rates, and the effective fed funds rate to rise above the Fed's upper target of 2.25%. The New York Fed added roughly $200b of liquidity into the system via temporary repo operations. By yearend, the Fed's balance sheet reached $4.2t, in what Chair Powell insisted was organic balance sheet growth, not QE.

China's yuan plunged in August, breaking the 7-to-1 USD benchmark after President Trump announced the US would impose a 10% tariff on an additional $300b of Chinese goods. The devaluation prompted Treasury to label China a currency manipulator. The label caused more of a stir in the media than in financial markets.

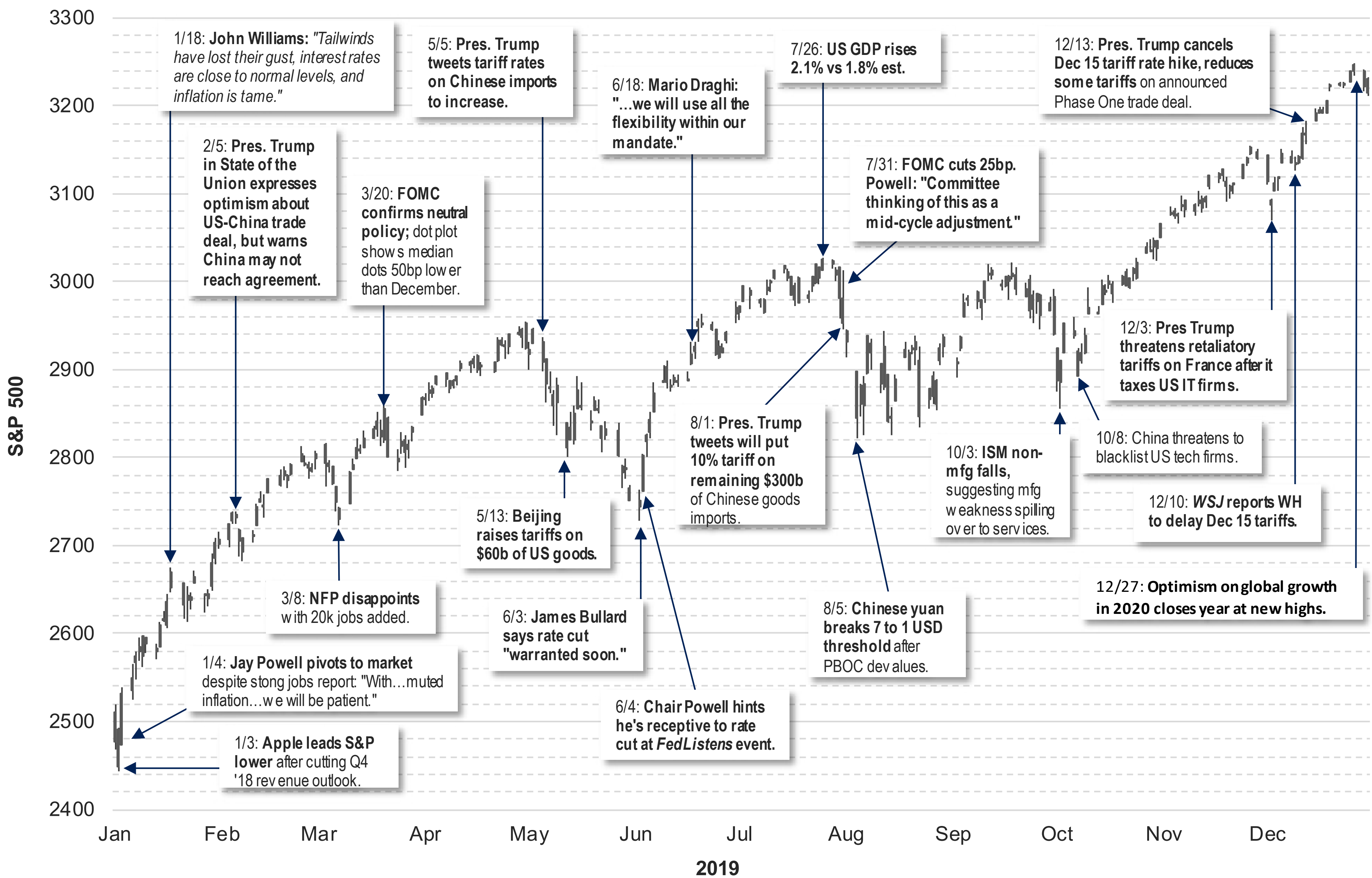


In January, US manufacturing PMI fell to a two-year low when new orders plunged 11 points, surprising markets. A deeper contraction in Germany's already dismal manufacturing sector also surprised, as German PMI fell to 44.7 in Q1. Investors piled into 10-year bunds and US Treasuries. In the 2H, China's manufacturing PMI rose modestly, largely due to domestic demand. Foreign firms that struggled to find alternate supply chains outside China also added to demand.

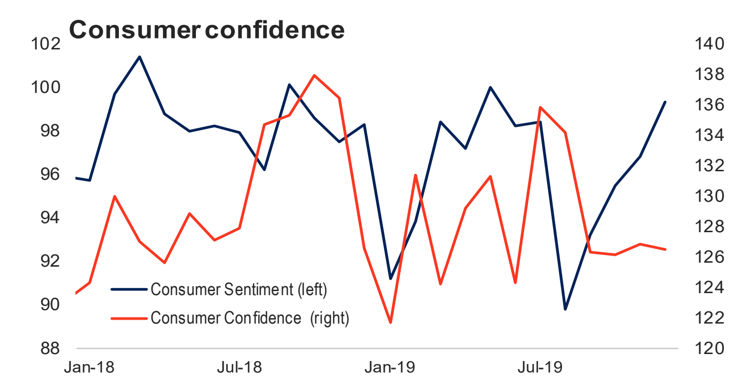
Market-Moving Events: 10-Year Treasury



Market-Moving Events: S&P 500

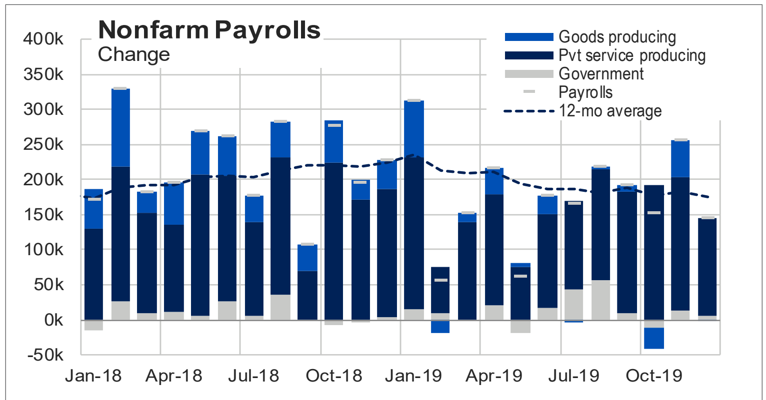


Data Watch: Key Economic Indicators



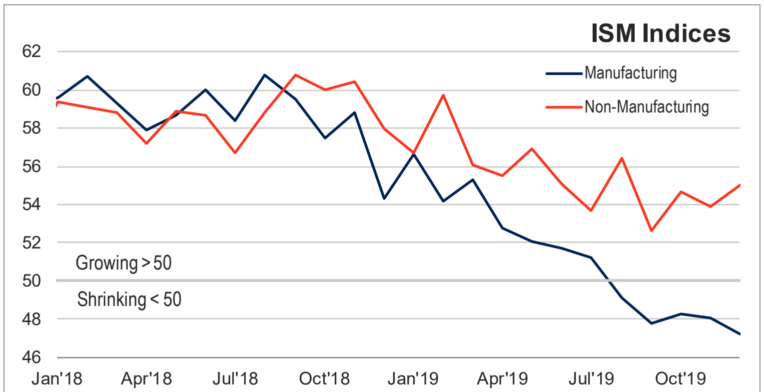
Source: The Conference Board, University of Michigan, Haver Analytics

Consumer confidence edged higher in 2019, from 124.3 to 126.5. Consumers were largely optimistic about labor market prospects. Sentiment rose from 91.2 to 99.3 with gains driven by upper income households reporting record gains in household wealth.



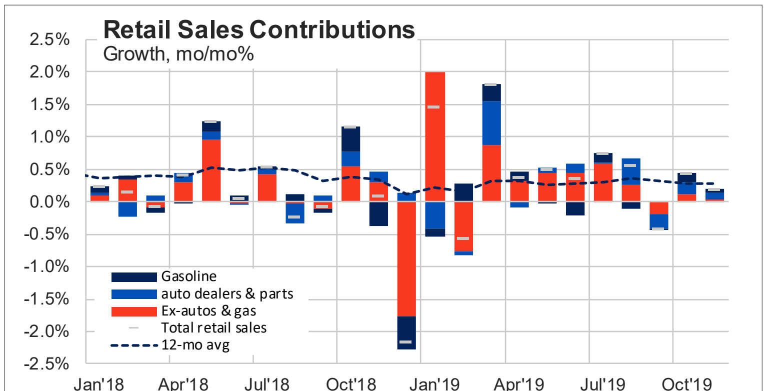
Source: Bureau of Labor Statistics and FHN Financial

Job gains slowed during the year, but were faster than the Fed expected. Gains averaged 176k versus 223k in 2018. Goods producing jobs fell from a 12-month average of 53k to 15k with, mining and logging losing jobs and manufacturing gaining 4k. Health care and leisure & hospitality services drove the year's gains.



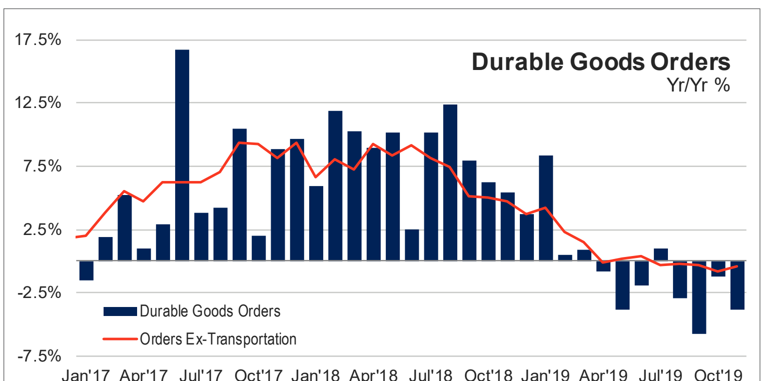
Source: Institute for Supply Management and FHN Financial

ISM indices fell from last year's cycle highs due in part to the Fed's four rate hikes in 2018. Manufacturing PMI weakened over the year to contract in Q3 after trade and tariff tensions escalated. September's deeper manufacturing contraction spilled over to services, unnerving investors and prompting talk of recession.



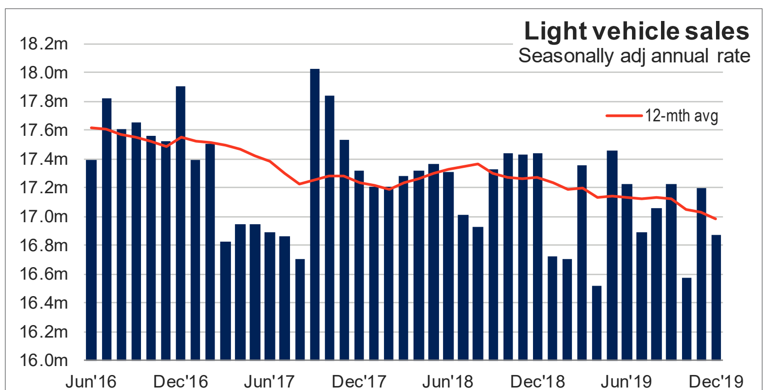
Source: Bureau of the Census and FHN Financial

Retail sales were weak in Q1, rising only 0.3%. Sales rebounded in Q2 and Q3, rising 1.9% and 1.4%, respectively on a quarterly basis. Excluding autos and gas, retail sales were driven by online, office supply and gifts, and grocery store sales. Department store sales fell for five straight quarters losing ground to online sales.



Source: U.S. Census Bureau and FHN Financial

Durable goods orders were weak throughout much of the year. November's orders fell 3.7% y/y as GM and Boeing drove weakness in transportation equipment. Fabricated metal, primary metals, and machinery were flat to outright weak. Electric equipment rose throughout the year.



Source: Autodata Corporation and FHN Financial

Total light vehicle sales fell 1.7% in 2019, from 17.3m annualized in 2018 to 17.0m. Car sales fell 10.3% over the year, while truck/SUV sales rose 2.2%. (SUVs and light trucks account for 72% of market share.) The average transaction price rose from $37,260 in 2018 to $38,377, and average APRs fell from 5.9% in 2018 to 5.4% at year end.