

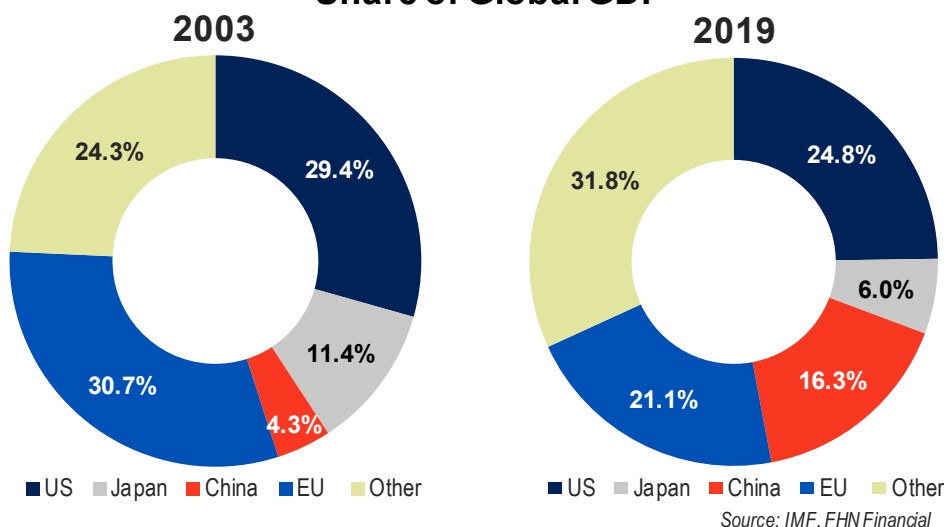
Information Overload

We published a 2020 forecast a month ago predicting stronger growth, lower inflation, and moderately lower interest rates. Since then, fourth quarter inflation was weaker than expected here and in Europe, while January growth indicators were stronger than expected in the US. The combination made us more confident in the forecast. And then the novel coronavirus emerged, threatening to cut a swath through global economic growth. Swirling information suddenly created an uncertain outlook.

This week, as more good economic news from pre-virus January broke, there was mixed news on the virus. On the good news side, doctors claim success treating some patients with certain drug cocktails. Also, the ratio of recoveries to deaths increased. There was bad news, too. Person-to-person transmission was reconfirmed in Japan. China's National Health Commission warned getting sick and recovering may not guarantee immunity against recontamination. And anecdotal reports from Wuhan suggest the virus may have infected far more people than Chinese officials are letting on.

Risk markets rallied this week and Treasuries sold off before reversing on Friday. Optimism boils down to two things. First, the possibility of a cure, even if it is months off, and second, the hope China can produce a drug cocktail that might have success treating the infection and getting it to patients faster than if it were developed in the US or Europe, with more lengthy approval processes. Also, perhaps most important from an economic standpoint, China's response to the virus has shifted. A new effort to round up and quarantine the sick is a precursor for resumed production in cities at the epicenter of the outbreak.

Share of Global GDP



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That's important because early data out of China indicates a profound economic impact already. Property sales in the first week after the New Year's holiday are near zero, likely because the holiday was extended. Rail and air travel is down 40% year-on-year, while road travel is down 25%. These figures include travel for the New Year's holiday. In South Korea, Hyundai production stopped because the company ran out of a vital wiring component from China. This is the first major indication of problems with parts production, but others are likely soon. Airbus stopped production in its China facility, which makes 10% of its most popular jet, to avoid potential contagion. Many restaurants and retail chains closed their Chinese operations, too.

Three unknowns will determine the economic impact of the virus.

1. **How bad is it in China?** This is a hard question to answer. Healthcare workers are overwhelmed. They have turned away people who may be sick but are not critical. Doctors do not have enough test kits. Rumors on Chinese online media, some more credible, like the ones citing people turned away from over-crowded hospitals, and some less credible, like the ones citing mortuary workers handling far more bodies than reported to have died, suggest the disease is worse than official data suggest. [The New York Times](#) confirmed that sentiment with reports from overwhelmed hospitals in Wuhan. *The Times* also cites a WHO warning the virus is likely spreading unreported in other parts of Asia.
2. **How will Chinese production be affected?** Hubei is a small part of China's economy relative to Guangdong, the SARS epicenter. But there are now almost 1,000 cases in Guangdong. The shift in China's approach to the virus late this week, calling on medical workers to go door to door and remove anyone suffering from the virus, appears to be part of an effort to get it under control more quickly and get the economy going again.
3. **Can the disease be contained primarily in China?** There are 86 cases in Japan and more than 20 in Singapore, Thailand, Hong Kong, and South Korea. These countries claim the disease is well-contained. Almost all patients brought it from China and have been isolated from the population.

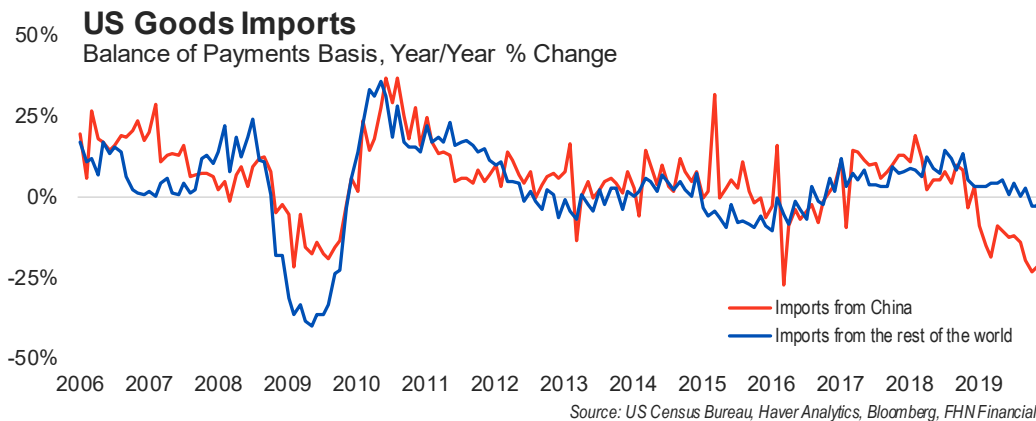
China accounts for 16% of global GDP, almost four times its GDP share in 2003 when the SARS epidemic struck. SARS did not affect as many people and still it knocked Chinese growth down six percentage points in the first quarter. Most economists' China growth forecasts are based on the SARS experience. Those forecasting 4.5% year-on-year Chinese growth in Q1 — by far the most common forecast — are assuming growth will slow by six percentage points, to zero. (The average of 6% in the last three quarters of last year and no growth in the first quarter of this year yields a 4.5% year-on-year forecast.) Those expecting a smaller impact point to Hubei's smaller manufacturing footprint than Guangdong's. A few forecasts predicting 3.5% year-on-year growth have popped up recently, suggesting some think Chinese output will decline outright in the first quarter.

Note, too, that while comparisons to SARS are apt in the sense that SARS was terrifying and caused widespread behavioral changes, including people avoiding crowds, the new corona virus is quite different. Accounts of the SARS epidemic are chilling. One infected person traveling from China to Hong Kong infected 16 people in his hotel. Those people

brought the disease to Canada, Singapore, Taiwan, and Vietnam. In each case, each of these people infected dozens of hospital workers, most of whom died. The SARS mortality rate was 9.6%, and it was higher still in the beginning, when doctors struggled to treat it. The Wuhan virus mortality rate is likely about 2%, though it is too early to tell for sure. *The New York Times* notes it is over 4% in Wuhan and as low as 1.2% outside Wuhan, suggesting it is higher in places where caregivers are overwhelmed.

The trade war may have helped insulate the US

Last year, quite a few American companies quietly re-sourced parts production to factories outside of China, according to *The Wall Street Journal*, to avoid tariffs on Chinese-made goods. Most declined to discuss specifics with the reporter for fear of angering their Chinese customers. But they are confident they can keep production going even if Chinese suppliers are forced to close for months. As the below chart demonstrates, imports from China fell 26.8% last year, more than at any time during the global financial crisis and Great Recession.



Imports from the rest of the world rose 4.6%, though they were down year-on-year in October and November, and even in December, they grew quite a bit less than in early 2018. The general slowdown in imports likely reflects the 2018 tax reform, which made domestic production more attractive. It also reflects slower economic growth. But the divergence between imports from China and imports from the rest of the world reflects the effect of Chinese tariffs. We are buying a lot less from China than we did a year ago.

January and beyond

Early January data offered a clear picture of improvement in the US but confusion in Europe.

In the US:

- The ISMs rebounded, finally breaking from their 2019 declining trends. The manufacturing index rose from 47.8 to 50.9. The non-manufacturing index rose from 54.9 to 55.5.
- Nonfarm payroll employment rose 225k. The labor-force participation rate rose to a six-and-a-half year high of 63.4%.
- Fourth quarter GDP growth was decent.
- Home sales boomed in December, thanks in part to unusually clement weather.
- Fourth quarter core PCE inflation rose just 1.3%.

In Europe:

- The ISMs were mixed, but improved overall.
- ZEW investor sentiment, usually a reliable economic indicator, shows marked improvement in the outlook for Germany and the Eurozone as a whole.
- Eurozone core inflation unexpectedly fell to 1.1%.
- German industrial output plunged 3.1% in December, bad enough to threaten a fourth quarter GDP drop, which would be the second in three quarters.

Beyond January, there's little doubt the Wuhan virus will hurt global growth in Q1. Growth should rebound in Q2. Lost in the focus on the virus, Boeing's decision to curtail 737-Max production until the FAA approves the plane for flight again will cut into first half US GDP by as much as 0.8%. The net result is likely to be downside growth surprises for the next few months at least and lower inflation for the year as a whole. If there's one thing we have learned in the last ten years, after all, even temporary economic setbacks leave lasting inflation weakness in their wake.

– Chris Low, Chief Economist

The Week Ahead

This Week's Numbers		CONSENSUS				
		PRIOR	HIGH	LOW	MEDIAN	FHN
Tuesday, February 11	NFIB Small Business Optimism - Jan	102.7	104.8	102.0	103.5	104.0
	JOLTS Job Openings - Dec	6800	7428	6700	6925	6750
Wednesday, February 12	Monthly Budget Statement - Jan	-\$13.3b	\$15.0b	\$6.2b	\$11.5b	\$11.5b
Thursday, February 13	CPI MoM - Jan	0.2%	0.2%	-0.1%	0.2%	0.2%
	CPI Ex Food and Energy MoM - Jan	0.1%	0.3%	0.1%	0.2%	0.2%
	CPI YoY - Jan	2.3%	2.5%	2.2%	2.4%	2.3%
Friday, February 14	CPI Ex Food and Energy YoY - Jan	2.3%	2.4%	2.0%	2.2%	2.2%
	Import Price Index MoM - Jan	0.3%	0.5%	-0.6%	-0.2%	-0.3%
	Import Price Index ex Petroleum MoM - Jan	0.2%	0.0%	-0.1%	-0.1%	-0.2%
	Import Price Index YoY - Jan	0.5%	0.2%	-0.2%	0.1%	0.0%
	Export Price Index MoM - Jan	-0.2%	0.2%	-0.2%	-0.1%	-0.2%
	Export Price Index YoY - Jan	-0.7%	--	--	--	-0.8%
	Retail Sales Advance MoM - Jan	0.3%	0.6%	0.0%	0.3%	0.4%
	Retail Sales Ex Auto MoM - Jan	0.7%	0.4%	0.1%	0.3%	0.4%
	Retail Sales Ex Auto and Gas - Jan	0.5%	0.4%	0.2%	0.3%	0.4%
	Retail Sales Control Group - Jan	0.5%	0.3%	0.2%	0.3%	0.3%
	Industrial Production MoM - Jan	-0.3%	0.1%	-1.5%	-0.2%	-0.5%
	Capacity Utilization - Jan	77.0%	77.2%	76.0%	76.9%	76.6%
	Manufacturing (SIC) Production - Jan	0.2%	0.2%	-0.8%	-0.1%	-0.5%
	Business Inventories - Dec	-0.2%	0.3%	0.1%	0.1%	0.1%
	U. of Mich. Sentiment - Feb P	99.8	100.5	95.8	99.0	98.8

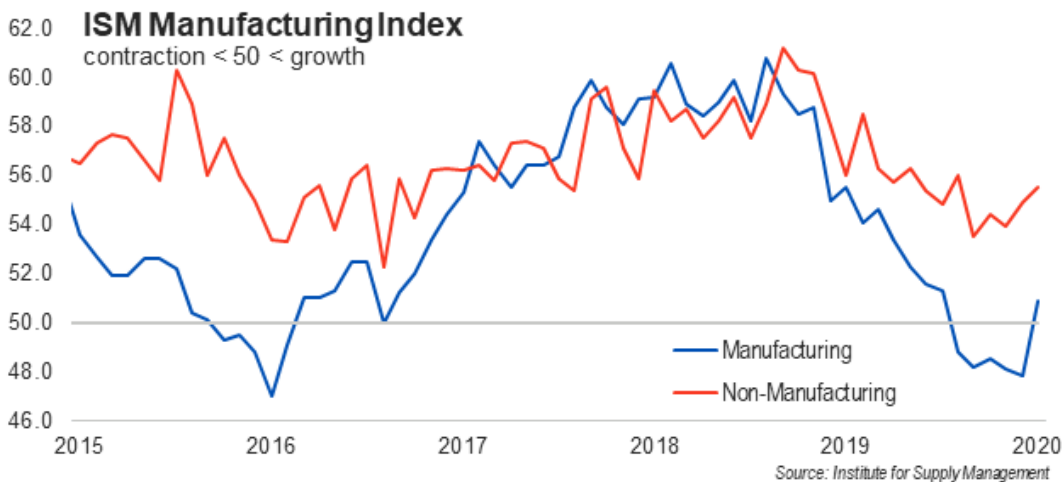
Review

This week, President Trump's impeachment trial ended in acquittal, as expected, the ISM's were stronger, and employment blew past expectations.

- **Nonfarm payrolls added 225k jobs in January, hourly earnings are pacing a 3.1% y/y rate and the household survey** showed a slight tick higher in unemployment, from 3.496% to 3.579%. The biggest payroll gains were in construction (+44k), health care (+36k), and transportation and warehousing (+28k). Manufacturing shed the most jobs in the goods-producing industry (-12k), while retail trade lost 8.3k jobs on the services-producing side.
- **January's ISM manufacturing rose from 47.8* to 50.9**, beating consensus of 48.4. Production and new orders lifted the headline number driven by the \$32.9b manufacturing increase expected this year from the China Phase One trade deal and the USMCA. Computer and electronics grew substantially, though tariffs are weighing on supplies and profit margins.
 - Production rose 9.5 points, from 44.8* to 54.3
 - New orders rose 4.4 points, from 47.6* to 52.0
 - Employment rose 1.4 points, from 45.2* to 46.6
 - Order backlogs rose 2.4 points, from 43.3 to 45.7

The new export orders sub-index exploded 6.0 points, from 47.3 to 53.3, ultimately supporting demand. Overall, it's a beautiful report, marking the PMI's return to expansion for the first time since July 2019.

*December's readings reflect revised seasonal adjustments.



- **January's ISM non-manufacturing nudged higher, from 54.9* to 55.5.** Production rose 3.9 points to 60.9 and new orders rose 0.9 points to 56.2. But, employment's 1.7 point drop, from 54.8* to 53.1 is concerning. The coronavirus didn't make its way into the survey, aside from one mention by the health care and social assistance industry, which said it was carefully watching the virus' impact on medical supplies and surgical masks. (*As with the manufacturing index, seasonal factors are revised in January, resulting in significant revisions to all 2019 values.)
- **Caixin's China Services PMI fell from 52.5 to 51.8 in January.** Business confidence rose to a 16-month high due to new territory expansions and the closing of the phase one trade deal. New orders softened over the month, as new export orders rose, suggesting domestic demand decreased in spite of average price cuts aimed at growing sales. Input costs rose, due to higher staff, operating, and fuel costs.

The Atlanta Fed's Q1 GDPNow is tracking 2.7% growth, unchanged from last week, while the NY Fed revised its Nowcast from 1.55% to 1.67%, driven by goods and services imports.

Next week, Chair Powell delivers the semi-annual [Monetary Policy Report](#) to the House, Tuesday, and the Senate on Wednesday. Also next week, the Senate Banking Committee will hold hearings for two nominees to the Federal Reserve Board of Governors, Judy Shelton and Christopher Waller.

Preview

Note: ★ = High Impact Event

All times Eastern

Saturday, Feb 8

- **Ireland:** Ireland holds general elections with Sinn Fein leading, according to a recent poll. No party is likely to hold a majority, meaning the party with the most seats will be expected to build a coalition. The emergence of Sinn Fein is part of a global rise in populism against the political establishment.

Monday, February 10

- 4:00am – Italy:
 - Industrial Production – Dec (Last: 0.1% m/m)
 - Industrial Production – Dec (Last: -0.6% y/y)
- 8:15am – Canada: Housing Starts – Jan (Last: 197.3k)
- 8:30am – Canada: Building Permits – Dec (Last: -2.4% m/m)
- ★ 1:45pm – US: San Francisco Fed President Mary Daly speaks in Ireland. (FOMC voter in 2021)
- ★ 3:15pm – US: Philadelphia Fed President Patrick Harker speaks about economic outlook. (FOMC voter)

Tuesday, February 11

- ★ 4:30am – UK:
 - GDP – Q4 P (Last: 0.4% q/q)
 - GDP – Q4 P (Last: 1.1% y/y)
 - Industrial Production – Dec (Last: -1.2% m/m)
 - Industrial Production – Dec (Last: -1.6% y/y)
 - Manufacturing Production – Dec (Last: -1.7% m/m)
 - Manufacturing Production – Dec (Last: -2.0% y/y)
 - Trade Balance – Dec (Last: £4.031b)
- ★ 6:00am – US: NFIB Small Business Optimism – Jan (Last: 102.7)
- ★ 6:00am – US: San Francisco Fed President Mary Daly speaks in Ireland. (FOMC voter in 2021)
- ★ 10:00am – US:
 - Chair Powell gives Humphrey-Hawkins testimony before the House Financial Services Committee.
 - JOLTS Job Openings – Dec (Last: 6800)
- ★ 1:30pm – US: Saint Louis Fed President James Bullard discusses monetary policy and the economic outlook. (FOMC voter in 2022)
- ★ 2:15pm – US: Minneapolis Fed Governor Neel Kashkari speaks. (FOMC voter)

Wednesday, February 12

- Ireland: San Francisco Fed President Mary Daly and ECB chief economist Philip Lane speak at the European Financial Forum in Dublin.
- Brussels: NATO defense ministers meet for two days. Secretary General Jens Stoltenberg holds a press conference the day before the meeting.
- Argentina: An IMF technical mission visits for talks with the government following a record \$56b credit line that has been on hold due to economic uncertainty.
- OPEC releases monthly oil market report, which includes demand forecasts and January production estimates.
- 1:00am – Japan: Machine Tool Orders – Jan P (Last: -33.5%)
- ★ 5:00am – EU:
 - GDP – Q4 P (Last: 0.1% q/q)
 - GDP – Q4 P (Last: 1.0% y/y)

- Industrial Production – Dec (Last: 0.2% m/m)
- Industrial Production – Dec (Last: -1.5% y/y)
- Trade Balance – Dec (Last: €19.2b)
- 8:30am – US: Philadelphia Fed President Patrick Harker discusses the economic outlook. (FOMC voter)
- ★ 10:00am – US: Chair Powell gives Humphrey-Hawkins testimony before the Senate Banking Committee.
- 2:00pm – US: Treasury Budget Statement – Jan (Last: -\$13.3b)
- 6:50pm – Japan:
 - PPI – Jan (Last: 0.1% m/m; Con: 0.0% y/y)
 - PPI – Jan (Last: 0.9% y/y; Con: 1.5% y/y)

Thursday, February 13

- Mexico: Mexico's central bank is expected to cut interest rates by 25bp, for the fifth straight meeting, to 7%.
- 1:30am – France: Unemployment Rate – Q4 (Last: 8.6%)
- ★ 8:30am – US:
 - CPI – Jan (Last: 0.2% m/m; Con: 0.2% m/m)
 - CPI – Jan (Last: 2.3% y/y; Con: 2.5% y/y)
 - Core CPI – Jan (Last: 0.1% m/m; Con: 0.2% m/m)
 - Core CPI – Jan (Last: 2.3% y/y; Con: 2.2% y/y)
 - Real Avg Hourly Earnings – Jan (Last: 0.6% y/y)
- ★ 10:00am – US: Senate Panel holds hearing for Fed nominees Christopher Waller and Judy Shelton.
- 11:30am – Japan: Tertiary Industry Index – Dec (Last: 1.3% m/m; Con: 0.3% m/m)

Friday, February 14

- ★ US: Deadline for money managers to file Form 13F with the SEC
- ★ 2:00am – Germany:
 - GDP – Q4 P (Last: 0.1% q/q)
 - GDP – Q4 P (Last: 1.0% NSA y/y)
 - GDP – Q4 P (Last: 0.5% WDA y/y)
- 4:00am – Italy: Trade Balance – Dec (Last: €4.872b)
- ★ 8:30am – US:
 - Retail Sales Advance – Jan (Last: 0.3% m/m; Con: 0.3% m/m)
 - Retail Sales Ex Autos – Jan (Last: 0.7% m/m; Con: 0.4% m/m)
 - Retail Sales Ex Autos and Gas – Jan (Last: 0.5% m/m)
 - Retail Sales Control Group – Jan (Last: 0.5%)
 - Import Price Index – Jan (Last: 0.3% m/m; Con: -0.2% m/m)
 - Import Price Index Ex Petroleum – Jan (Last: 0.2% m/m)
 - Import Price Index – Jan (Last: 0.5% y/y)
 - Export Price Index – Jan (Last: -0.2% m/m; Con: 0.0% m/m)
 - Export Price Index – Jan (Last: -0.7% y/y)

- 9:00am – Canada: Existing Home Sales – Jan (Last: -0.9% m/m)
- 9:15am – US:
 - Industrial Production – Jan (Last: -0.3% m/m; Con: -0.3% m/m)
 - Manufacturing Production – Jan (Last: 0.2% m/m; Con: 0.0% m/m)
 - Capacity Utilization – Jan (Last: 77.0%; Con: 76.8%)
- ★ 10:00am – US:
 - UMichigan Consumer Sentiment – Feb P (Last: 99.8; Con: 99.0)
 - Business Inventories – Dec (Last: -0.2% m/m; Con: 0.1% m/m)
- 11:45am – US: Cleveland Fed President Loretta Mester discusses payment modernization. (FOMC voter in 2022)

– Rebecca Kooshak, Economic Analyst

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