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Special Economic Edition

CRF's Annual Focus on the Economy for 2020

Projections from Leading Economists

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The New Normal is Now Normal: So, What Are We Waiting For?

By: Steven C. Isberg, Ph.D.
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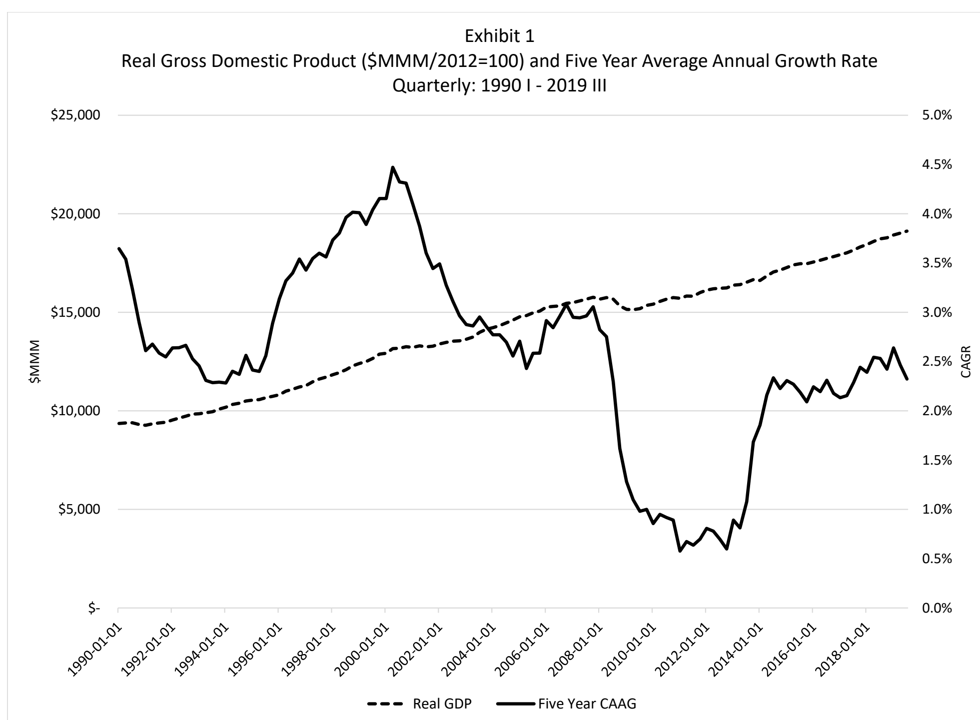
Context

The U.S. economy has experienced what may be called a long period of realignment, including major restructuring of its manufacturing industries beginning in the 1970s and the business process reengineering movement of the 1990s. Both in between and following those periods, the economy has continued to consolidate into more highly concentrated and less competitive industries; this consolidation has been fueled by interest rates which fell steadily from the early 1980s to the low levels at which they currently reside. The broadening of global trade, particularly since the opening of China in the mid-1990s has led to a persistent U.S. trade deficit. Low interest rates have also enabled borrowing by the federal government to the point where the accumulated debt level is as high, if not higher, than the GDP.

As we begin yet another year (either the end of one decade or the beginning of another, depending on how you choose to measure a decade), we find ourselves asking once again: Is this the year in which the economy will really bust out and grow? Or: Is this the year in which we will have another recession? A brief check on our current status indicates that we are still experiencing the lingering effects of recovering from the Great Recession of 2008-09. As can be seen in **Exhibit 1**, the five-year average annual growth rate in real GDP is at 2.32% but has been slightly falling for the past few quarters. We can further see from the chart that the growth started to trend up in 2017, but now seems to be taking a sharper turn down from where it peaked. Bear in mind that this is a growth rate, and that slowing growth in and of itself does not spell recession, it simply implies slower ***growth***.



Slower growth, however, is much more likely to be the character of the restructured and realigned U.S. economy. Many economists and policymakers point to the declining unemployment rate and assume that the economy is getting ready to "heat up," calling for higher interest rates to curb the inflation that would follow. Such overheating and inflation have not occurred, however, and the Federal Reserve has backed off every set of planned interest rate increases that they have initiated. The temperature is simply not that high.

Why not? The answer lies in an understanding of how the pieces of the pie are shaped as opposed to the size of the overall economic pie itself. While the aggregate measures of economic growth, such as real GDP and unemployment, would imply a healthy situation, the pie itself consists of disparately sized pieces.

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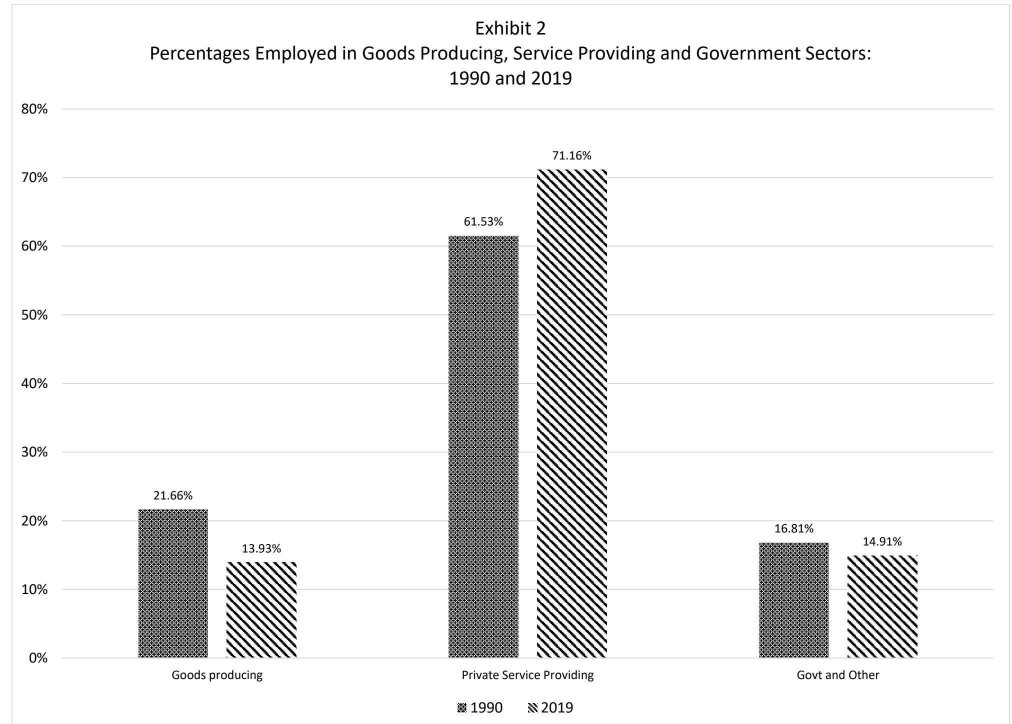
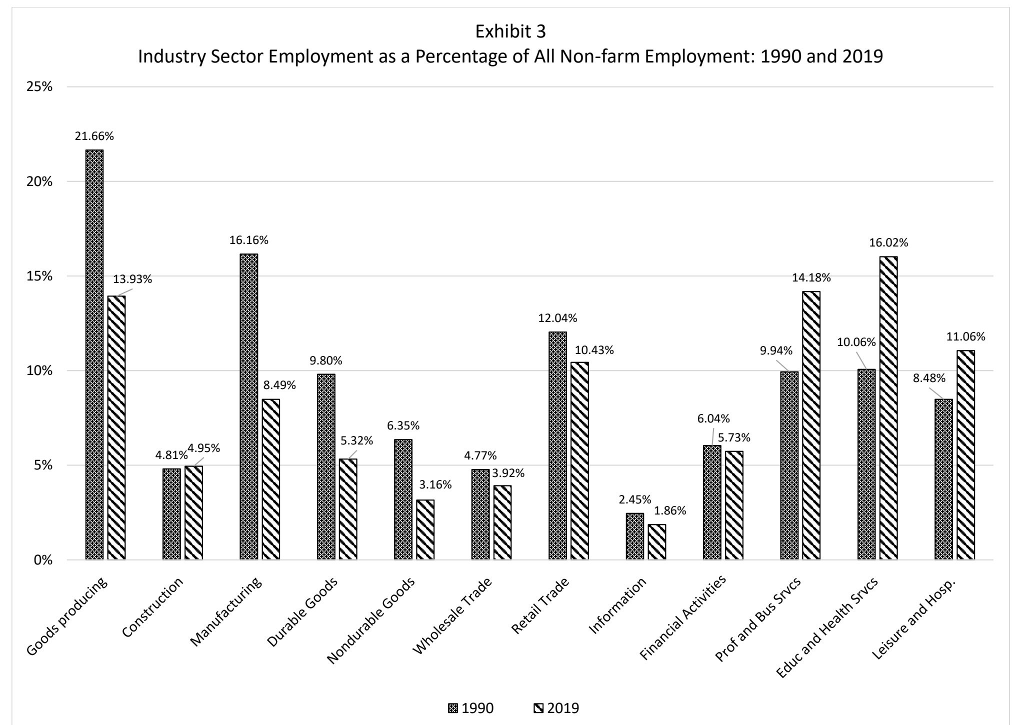
Employment Structure

By the end of the 1970s employment in the goods producing sectors of the U.S. economy had begun to fall as the manufacturing sector reorganized domestically and relocated offshore. Ever since 1990, however, the economy, and therefore employment, has continued to realign. As can be seen in **Exhibit 2**, there have been shifts out of goods producing and government employment into the now largest sector of the economy: private services providers. Deeper analysis shows how some of this shifting has panned out within two of these three categories.



Within the goods producing sector, manufacturing employment has been cut almost in half. As can be seen in **Exhibit 3**, the percentage employed in manufacturing nationally has fallen from 16.16% down to 8.41%. Even as the manufacturing sector may continue to grow, it is doubtful that it will become a major source of employment due to the increased implementation of robotics and technology to manufacturing processes.



Within the service providing sector, we further understand from Exhibit 3 that employment in the retail, wholesale, information, and financial services sub-sectors have fallen as a percentage of total employment. The biggest gains have been made in the areas of health care and private education, professional and business services, and the leisure and hospitality sub-sectors. It is important to note that the common economic narrative of the day would hold that information technology and its employees are the primary engine of growth in today's economy. Measures of employment of these types of workers, however, are muddled by the fact that they reside in virtually every sector of the economy and are therefore difficult to isolate from these statistics. The narrative further holds that compensation of these employees is leading overall growth in earnings among employees nationally.

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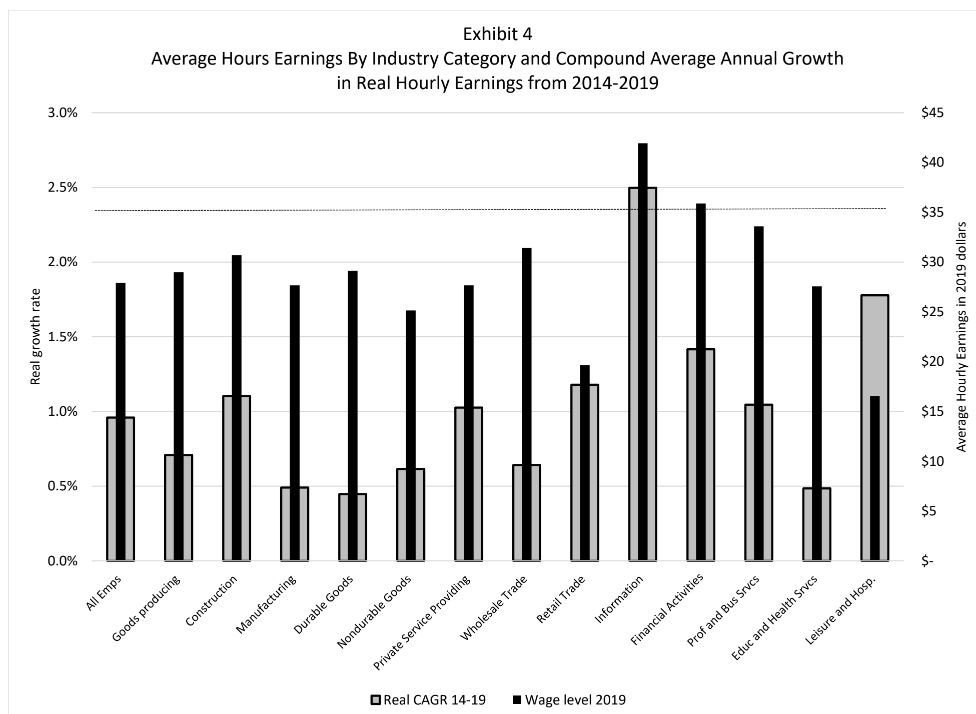
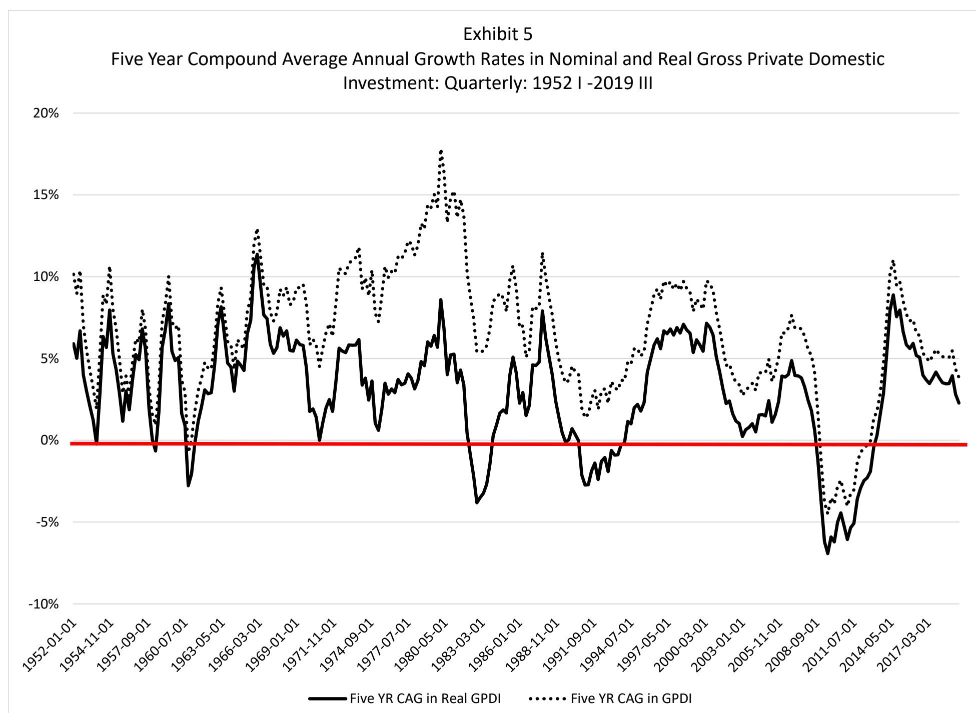
Earnings Growth



In regard to earnings growth, many economists and policymakers point to increased wage and salary growth as yet another sign of U.S. economic health. In reality, however, wage and salary growth has been very disparate across the economy. As can be seen in **Exhibit 4**, the overall average hourly compensation is currently $27.92 for all employees. Compensation within sectors, however, varies from an average of $41.94 in the information industry down to $16.53 in the leisure and hospitality sector.[1] Exhibit 4 also shows disparities in the average annual growth of hourly compensation, with information leading the way. It is very important to note here that with the exception of that particular sub-sector, growth average hourly compensation has not kept pace with the growth in real GDP, implying that the value of output is increasing faster than the incomes necessary to consume it. The average annual growth in compensation for all employees is less than one percent over the past five years. This leaves the average earner with about 8.3% less purchasing power over that five-year period. Put simply: for the average consumer, earnings growth is not keeping pace with economic growth, and hence, the average consumer is falling behind. This fact is simply not evident in the aggregate data, in which the overall economy appears to be healthy and growing. Yes: you may be employed, but you are still falling behind as your compensation has failed to keep pace.



These results explain why we now see in many, if not most of our major urban areas, the evolution of a two-class society. On one side, we have a smaller number of very well compensated professionals whose presence tends to drive up the cost of living. On the other side, what was formerly a middle class of workers, now find it harder to stay apace with increases in the cost of living in those geographical areas. In addition, there appears to be an ever-growing class of underemployed and unemployed, many of whom are unable to afford basic housing. The presence of this

1 It is interesting to note that growth in earnings in the leisure and hospitality sector has been quite high. This is most likely due to the increase in the number of minimum wage laws enacted by many state and local governments over the past five years. $15.00 per hour is a common value associated with these laws.

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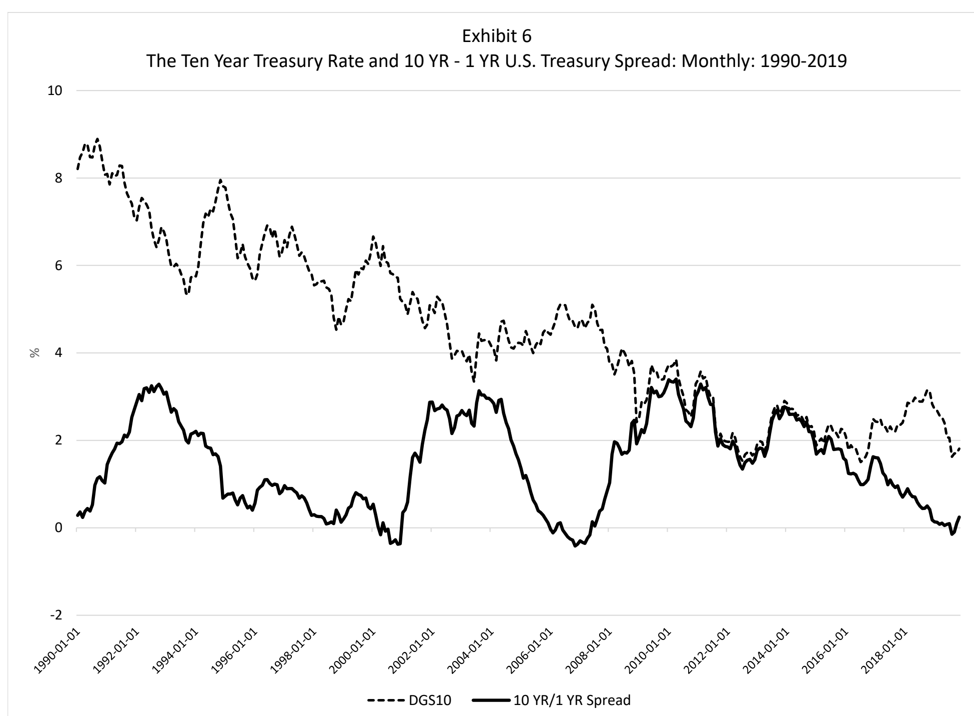
class of people is creating significant problems in cities such as Los Angeles, Portland, Oregon and Seattle, to name a few. If compensation growth disparities continue, this will put increasing recessionary pressure on the economy as people cut back on spending on a broader variety of less-necessary consumer items and/or lower volumes of the necessary items.

Private Investment Spending

Turning to the aggregates: If I have one major concern, it relates to the continuing decrease in the average annual growth in real private investment spending. As can be seen in **Exhibit 5**, the five-year compound average annual growth rates in both nominal and real private domestic investment have been steadily falling since mid-2014. It appears that the decrease was belayed somewhat by the "tax cuts" of 2018, but the declining pattern now appears to have resumed.[2] As can be clearly seen in Exhibit 5, which dates back to 1952, the recessions of the 1970s, 80s, 90s, and 2000s were all preceded by periods of declining growth in real private investment spending. We clearly appear to be headed in the same direction now.

The Yield Curve

Inversions of the yield curve are frequently associated with recessionary periods. As can be seen in **Exhibit 6**, the recessions of 2000-01 and 2008-09 were both preceded by a period in which the spread between the ten-year and one-year U.S. Treasury rates went negative. As can be further seen in Exhibit 6, the spread recently went negative, only to become slightly positive more recently. The pattern of a longer-term declining spread, however, is also consistent with the occurrences of economic slowdowns and/or recessions. This continues to be a concern, particularly as the Federal Reserve has repeatedly backed away from its attempts to increase interest rates fearing that such increases would slow things down. The U.S. is beginning to resemble the monetized economies of Europe and Asia in the sense that interest rates have been kept at very low levels, yet economic growth and inflation have yet to materialize. The primary fear in raising rates in these scenarios is the creation of deflation, which could drive the economy into a massive debt market meltdown.



Federal Debt Levels and Growth

The fact that so few are discussing the federal debt level and that even fewer seem to be worried about it should be a source of great consternation to all. As can be seen in **Exhibit 7**, the accumulated federal debt level is up over $22 trillion, at or even above the nominal GDP level! While the average annual growth rate in

2 As with most things associated with today's economy, the tax law changes led to tax cuts for some, and tax increases for others, in particular, the group of upper middle income consumers whose spending tends to keep the economy running at a faster pace because they tend to consume more than just necessity goods and services. Decreases in disposable income for this group will be significantly felt at the higher end of middle market retailing, the motor vehicle industry, and the restaurant and entertainment industries.

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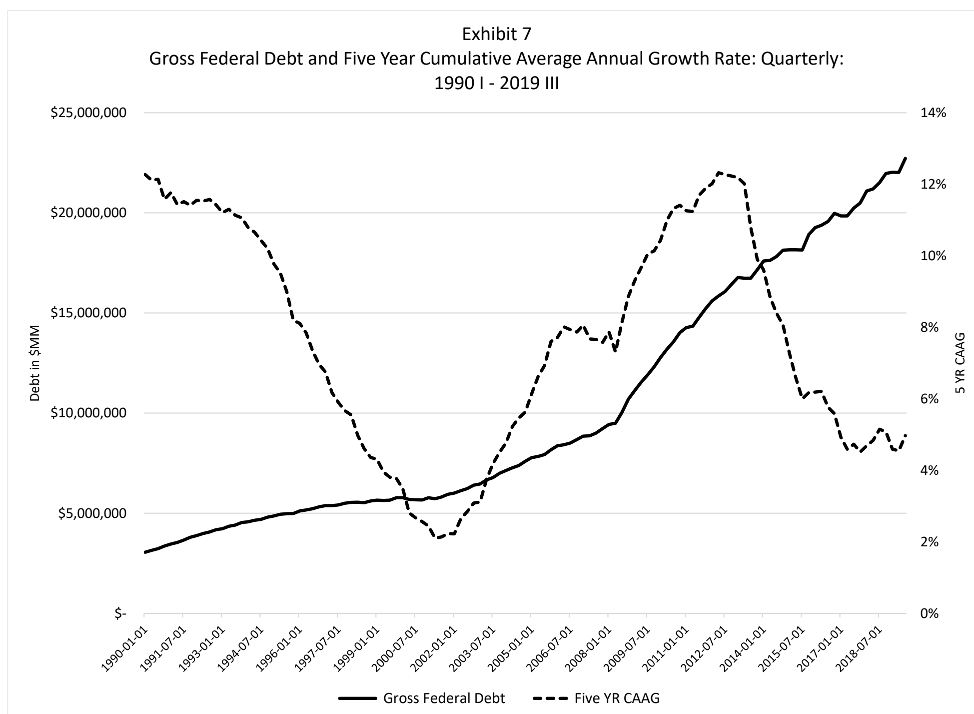
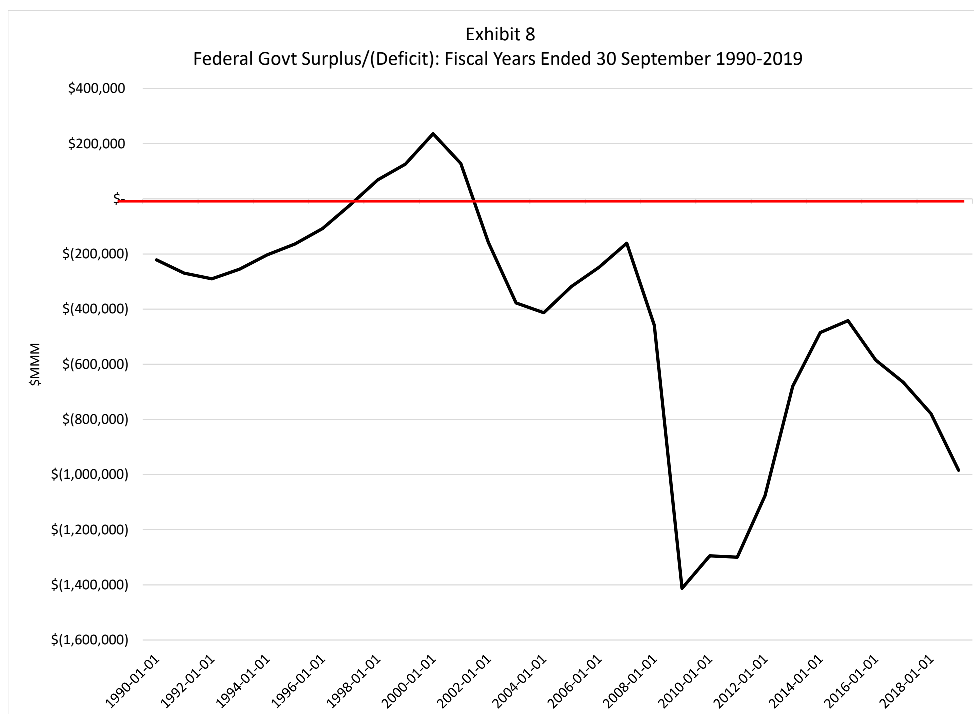
the debt has slowed down, the fact is that it continues to grow.



Of equal concern is that there is no sign that it will be getting any better. Rather: as can be seen in **Exhibit 8**, while we appeared at one point to be making progress toward reducing the annual federal budget deficit level after the meltdown of 2008, those annual deficits are once again growing. We simply cannot continue to add to the accumulated federal debt level at the rate of $1.00 trillion per year and expect it not to become a major problem.



The accumulated federal debt level is one, if not the biggest reason for the Federal Reserve's inability to increase interest rates. An interest rate increase leading to any kind of deflationary outcome could reverberate into another debt market meltdown. With hindsight we can now clearly understand that the biggest benefit of the TARP bailout and subsequent monetary expansion following the debt market collapse of 2008 was the avoidance of a deflation that could have pushed us further into depression and even greater debt market collapses. This is still a real problem that will not go away on its own. History has shown us that if there ends up being such a collapse, the burden of bearing the cost of that collapse will not be equally shared by all. Rather, it will fall disproportionately on the hardest working of the middle and upper-middle class taxpayers.

Technology to the Rescue?

Many foresee an evolving technology-savvy workforce being the source of economic salvation of the future. In this regard, it is very interesting to explore the impact of technology, in particular computers, peripherals, and software on economic growth and restructuring over the past 50 years. As can be seen in the shaded sections of **Exhibit 9**, there have been two periods of rapid expansion of investment in computers and peripherals since 1975. Both of these accompanied significant restructuring of the U.S. economy. The first was the restructuring of the manufacturing economy in the 1970s and early 80s. The second was the

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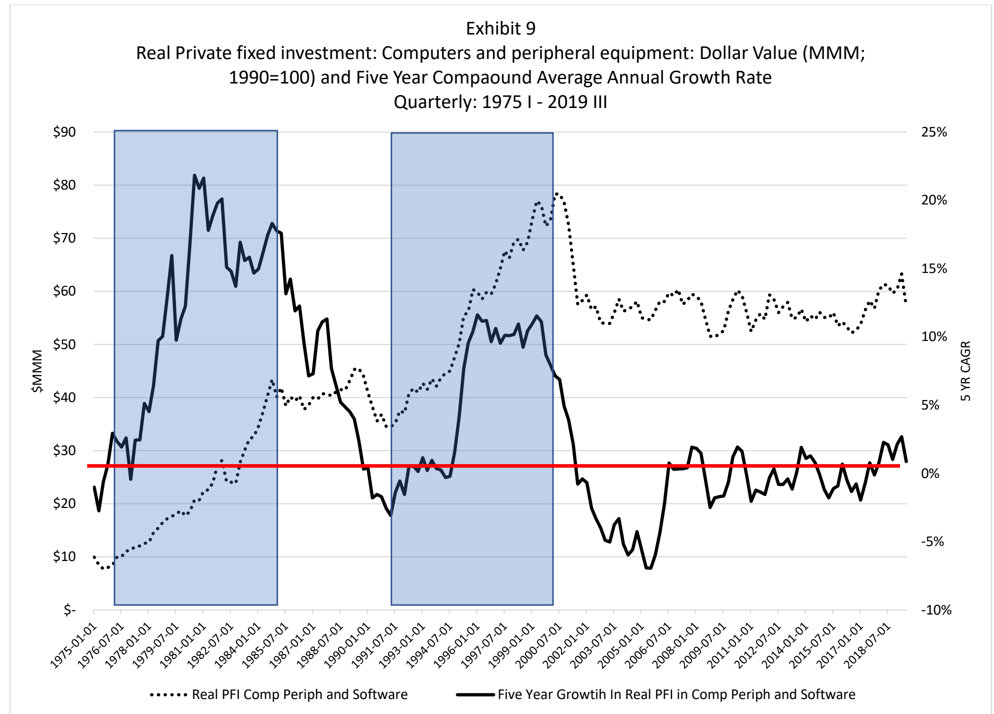
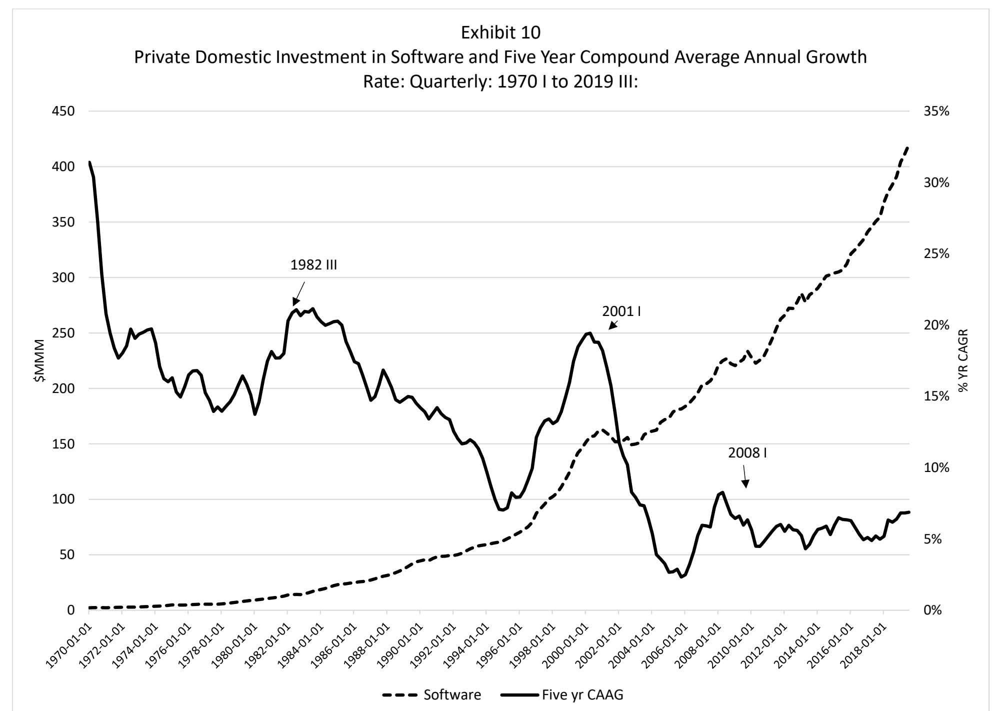
business process reengineering movement of the 1990s. Since the last of those two technology expansions, growth of investment in computer hardware has fluctuated around zero. As we have evolved past the last ten-year span of rapid technological innovation and development, much of that technology has become commoditized. As computers and peripherals take on more of the qualities consistent with their character as a commodity, they will be less of an engine of economic growth than before.



Much the same can be said for software. Three things become apparent as we consider the history of private investment in software shown in **Exhibit 10.** First, and not surprisingly, its growth rate increases along with increases in the growth of investment in computers and peripherals. Second, peaks in the growth of investment in software appear to be followed by recession, as in 1983, 2001, and 2008. Third, the rate of growth has stabilized during the recovery from the most recent recession, suggesting that software too is becoming commoditized. Even so, private investment in software continues to grow at a rate of over 5.0%. This is an indicator of the importance of automation and robotics in the current economy. The question raised by the results shown in both Exhibits 9 and 10 is: will we see any kind of major growth shift in the U.S. economy without a major period of growth of investment in technology? Such a period would have to be driven by significant innovation and changes in the nature of the technology itself. Will this happen? Can it happen in a monetized economy in which stock market pressure to generate cash flow drives companies into shorter-sighted strategic planning, research and development, and investment spending?



Prediction?

I once heard that economists forecast GDP down to the nearest billion dollars to prove that they have a sense of humor. I offer no prediction for this year's GDP growth, unemployment and interest rate levels, or many other things for that matter (even though I have an opinion of sorts). I will say that the conditions necessary for a major recession and/or debt market meltdown are omnipresent in today's global if not national economy.

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Rising federal, corporate, and individual consumer debt levels will put increasing pressure on a potentially unstable underlying economy if the problem is not addressed. Continued widening of earnings disparities within the consumer economy will put pressure on retailers and real estate developers, which will in turn create back pressure down the entire supply chain. If such back pressure leads to diminishing earnings growth, lower employment, or some combination of the two, the economy could spin down into a recession rather quickly.

In many industries, there are few job-ready employees waiting to fill positions that will come available as the existing workforce ages out.[3] There continues to be mismatches in many of the employment markets, with shortages of job-ready employees in many technical and other skilled areas and surpluses of labor in less skilled job markets. These mismatches persist, and there are doubts that our educational infrastructure is capable of providing the training and/or skill levels that will be needed to fill those gaps. This is a huge problem that markets appear to be unable to resolve. This begs the question of whether government policymakers will need to step into the void and create a solution, and if so, how?

In the past ten years, we have shown the ability to muddle through. That kind of behavior most likely won't get us through another meltdown as easily.

3 Examples include jobs in the tool and die industries and various specialty construction and maintenance fields.

About the Author:

Steven C. Isberg *is the Chair of the Department of Accounting at Towson University. He teaches graduate and undergraduate courses in corporate finance, financial analysis and valuation, and financial economic history. As Sr Research Fellow at the Credit Research Foundation he conducts various research studies and delivers online financial analysis courses as part of the CRF Online Classroom™ program.*

He has over 25 publications in academic and professional journals and has served as a professional business consultant to a variety of firms. He frequently appears or is quoted in television, radio, and print media on financial and economic issues.

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What Awaits in 2020?
Does the Party Continue or is the Hangover Due?

By: Chris Kuehl
Managing Director
Armada Corporate Intelligence

A new year has dawned and for no apparent reason this annual event takes on all kinds of economic implications despite the fact there is not all that much that matters about going from one year to another. There are not many companies that even match their fiscal years to the calendar year these days. Nevertheless, the forecasts are coming out along with all those resolutions. In the weeks to come we will forget what we resolved to do or not do, and the forecasts will be altered.

By most measures it would appear the US is in good economic condition and the threat of a recession would seem to be quite distant. The problem is that the same can't be said for the rest of the world, and one burning question is whether the US will be infected in some way by the economic malaise that has gripped the world. Alternatively, maybe the growth in the US manages to pull the rest of the world out of the grip of this downturn.

With all the supposition regarding a recession there is actually a group whose task it is to determine when a recession has arrived, how long it lasts and when it is at an end. The National Bureau of Economic Research (NBER) is the arbiter of things recession and they have a number of data points they examine to make that determination. It is important to note that recessions don't fit neatly into a quarter by quarter box. The declaration of a formal recession comes when there are two consecutive quarters of negative growth, but that declaration doesn't tell anyone when the recession actually began. That is why NBER developed an algorithm that identifies the week the downturn began and informs even as the recession is getting underway. They look at four indicators as signals of recession and at the moment only one of them is sending any kind of warning signal.

The four include 1) real personal income less transfer payments, 2) real business sales, 3) employment and 4) industrial production. Taking these one at a time we can get a sense of what is strong and weak about the economy right now.

For the majority of the last decade there was not much growth in real personal income, but that pattern has started to shift a little. The expectation had been that wages would start to spike enough to create inflation threats due to the low rates of joblessness. This is what the Phillips Curve has predicted every time unemployment rates have fallen. This did not occur this time. The rates of unemployment hit record lows, but wage gains were not appearing and thus there was little in the way of wage inflation. This lack of wage inflation has been attributed to factors that include the retiring of better paid Boomers. Consider the fact that 10,000 Boomers reach retirement age every day – that means the economy faces the need to replace 300,000 people every month. Another issue is the fact that many companies have been hiring less qualified people that require extensive training and which will not be paid what a more experienced person would command. This has been an enormous issue for manufacturing and construction as the lack of skilled workers has compromised their ability to grow – even if there is customer demand. This situation has started to change as wages are finally catching up – the last reading showed gains of between 3.0% and 4.0%. If wages still continue to rise the consumer will maintain their level of confidence and that means a reduced threat of recession.

The category of real business sales has also been holding steady with growth rates that can be maintained. The survey of companies in the S&P 500 show a growth rate of 3.8%. This is slower than has been the case in the last couple of years, but it is still in respectable territory. The National Federation of Independent Business also reports some solid numbers with steady sales. As the holiday season has gotten underway the sales data has been getting better and that has been then case with retail activity in general. The sales data has

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been good through Back-to-School, Halloween and now the data from Black Friday and Cyber Monday have exceeded expectations. Again, this is not pointing towards a recession, but consumers can change their mood very quickly. The challenge is that business-to-business activity has not been as robust. The Federal Reserve has noted that business borrowing is down to levels not seen since the recession and it is not because banks are unwilling to lend. They are simply not getting any interest from the overall business community and that reluctance to add debt has been pronounced in the manufacturing and construction sectors. There is just not enough confidence in the performance of the economy in 2020.

The employment numbers have been very solid, to the point that there are issues that have arisen from a chronic job shortage situation. The rate of unemployment is as low as it has been in decades and that has created a situation in which there are far more jobs than there are people to fill them. If every person available to work was to be employed there would still be over 2 million jobs going unfilled. The jobs data certainly supports the notion of continued growth and puts the chances of recession at a very low probability. The fear is that productivity levels are suffering and that will create issues for many companies. It is also causing a longer-term change in the way that companies look at their employees. The lack of available skilled labor has convinced many operations to substitute technology and robotics for human resources and that creates long term employment issues for those without education and training.

The state of employment in the US deserves a very close look – it is likely to be the most critical issue in 2020. The size of the workforce has been shrinking for several years and for the most logical of reasons. The retirement surge has been anticipated for years – it is a matter of demographics as the Boomer generation ages. There are other factors contributing to the reduction in workforce. There are millions of people who are staying out of the workforce so they can care for their elderly parents and relatives as well as their small children. This has been a major reason for the reduction of women in the workforce. As the Boomers retire, they are replaced by those with less experience and appropriate skills and this contributes to the productivity gap. Another emerging issue is the creation of low paid and low skilled jobs. These have dominated as far as job growth is concerned and the availability of these jobs creates another issue. People unable to find work in the past often decided to return to school or get some kind of training as they had no other option. Now they can get a job – not a good one but a job. They don't have the same incentive to get a set of more competitive skills.

The one fly in the ointment as far as recession threat is industrial production. There are three parts to this data – manufacturing output, the energy sector and utilities. For the last several years it has been the manufacturing sector that has led the way but in the last year this sector has been floundering due to the trade wars that have erupted throughout the world. Most of the attention has been focused on the US-China confrontation but there have been disputes between the Japanese and South Koreans as well as the Brexit mess that has compromised the European Union and the UK. India and China have their issues and Brazil has been on the outs in many parts of Latin America. Even as the energy sector and utilities have been able to hold steady the manufacturing sector continues to fade and that spells potential recessionary trouble.

The US is not as dependent on exports as many other nations, but it still accounts for 15% of the GDP. In contrast the Germans depend on exports for 55% of their GDP and this is the main reason they are now in formal recession. The US exports two things – food and high value manufacturing. The trade wars have affected demand for both of these, but it has not been the trade war alone. China has been buying less of the US soybean output and part of that is related to the tariff war. The other part is the Chinese attempt to halt the spread of swine flu. They have destroyed over a third of their hog population and as a result they need far less feed.

The manufacture of vehicles is expected to continue, and this will affect everything from passenger vehicles to large trucks and even additional rail units. The Boeing mess has drastically slowed aerospace but at some point, the problems are resolved and there will be a frantic period of catch up. The slump in the energy sector has affected everything from steel demand to sector specific manufacturing and the limitations on parts and assemblies have affected many domestic producers even as they enjoy some relief from Chinese competition.

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The construction sector has been affected by the trade war as it has made many of the materials needed more expensive. If these parts and assemblies are still coming from China, the importer will be paying that tariff/tax. If the importer in the US has to develop a new supply chain, there will be additional costs and often the new source will be more expensive than China was. Domestic suppliers of these parts and assemblies have seen some demand improvements but that has been tempered by the overall slide in construction activity.

The hope in the housing market has been that millennials would start to gravitate towards that traditional home once they reached their 30s, had kids and a steady job. It turns out that this cohort remains uninterested in that home choice even as they age. Only 37% own their home and that is the lowest percentage of any of the age cohorts save the Gen-Z crowd. They want the flexibility to relocate and reject most of what goes along with ownership. That makes rental property investment far steadier and more lucrative than would have been assumed.

Commercial construction has been a bit steadier than residential as it has been driven by three areas of the economy that have been sporting better than average growth. The top of the list has been health care as there has been a persistent demand for decentralization. Health care related facilities have become ubiquitous and hospital capacity has doubled twice this decade. Right behind health care has been lodging and entertainment as hotel demand has risen alongside expansion of destinations for tourists. Retail space and office space have both been in decline but there has been expansion of warehousing and facilities for manufacturing. The growth of robotics and technology has necessitated the development of new facilities.

A big unknown going into 2020 is the cost of commodities. The prices for copper, nickel, steel, scrap and the like had been falling through most of 2019 as there had been overproduction coupled with weak demand. Now that producers have adjusted to that weak demand, they are restricting output to a significant degree and that will likely result in higher prices at some point in 2020. It will still depend on demand. If the supply still exceeds what is required, the price hikes will be subdued but the potential for shortages and bottlenecks is significant.

There are a lot of unknowns regarding 2020. The trade wars can trigger a global collapse that might drag the US down, consumers could be spooked by all the electoral negativity and cause a slowdown. At the moment recession risk is minimal and that keeps the door open for growth – albeit with strategies that are more careful than might have been the case a few years ago.

About the Author:

Chris Kuehl *is the co-founder (with Keith Prather) and Managing Director of Armada Corporate Intelligence, a company created in 1999 to provide strategy foundation, competitive intelligence, business analysis and economic forecasting for corporate clients.*

Armada's clients include YRC Worldwide, TranSystems, Spencer Fane Britt and Browne, KPMG, Hallmark International, Weitz Industrial among others.

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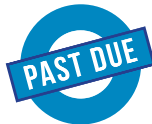

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2019 Was a Good Year and Provided a Good Hand-off to 2020

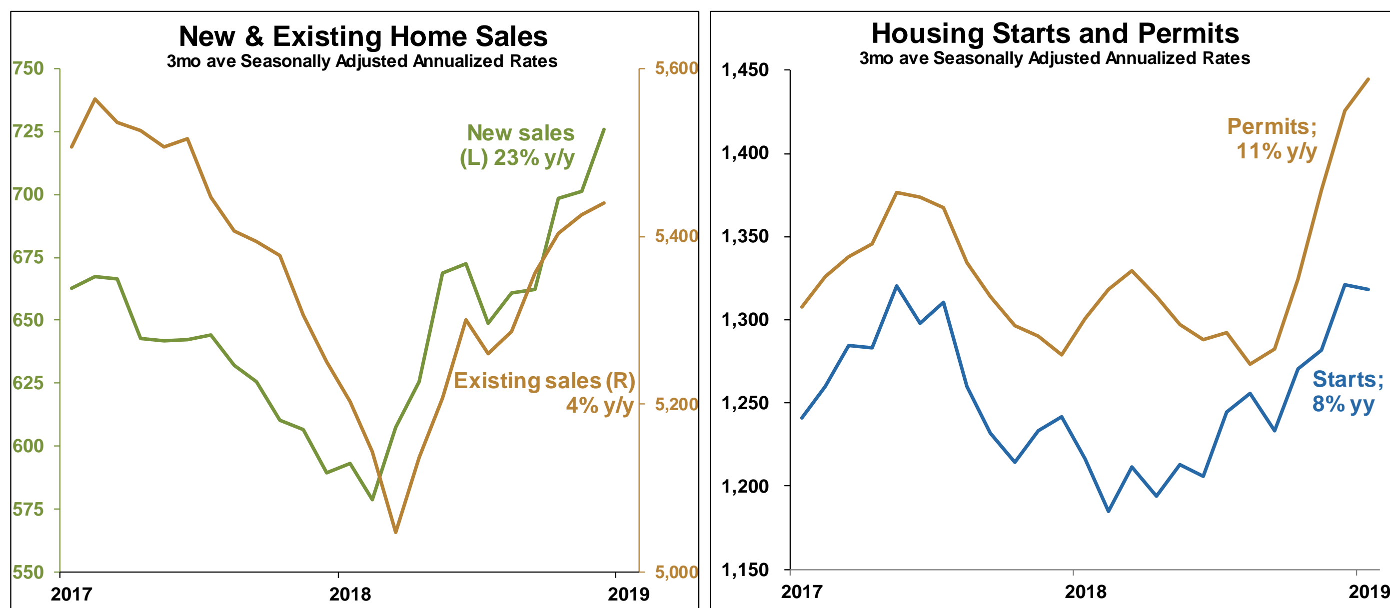
By: Dan North
Economist
Euler Hermes

Despite some bumps along the way, 2019 was a solid year all around for the economy, for business, for the consumer, and for the financial markets. For 2020 however, while we expect positive growth, it will be markedly slower. We may even experience a quarter of flat or negative growth, but the odds of a recession are waning.

One of the major supports for the economy for the entire recovery has been somewhat overlooked because it has become the "new normal", and that is low interest rates and low inflation. It's hard to imagine now in a world of stable 2% inflation, but in 1974 inflation was running at 12% y/y and in 1984 it reached 15%. Mortgage rates, which are now less than 4%, reached an unthinkable 19% in 1981. It's also hard to overstate the beneficial effects to consumers and to businesses of low and stable inflation and interest rates, even if savers and lenders are somewhat less well off. And the best news is that low inflation and interest are likely to continue on and support the 2020 economy.

It's also hard to overstate the importance of the services sector which comprises about 80% of the economy. Historically services have not only grown faster, but have also been more stable than the goods sector, offering a solid foundation for growth. That was certainly the case in 2019, and again, given its stability, we expect that to be the case in 2020 as well.

The housing market, which was a drag for part of 2019, has seen a sharp rebound over the past few months. Sales, starts, and permits have all taken a leg up, largely due to lower mortgage rates which declined throughout 2019.



Source: National Association of Realtors, Census, Allianz Research

The Federal Reserve also initiated a series of three cuts to short term interest rates in July of 2019 after economic data suggested a slowing economy, and the yield curve had inverted. Since it can take from six months to a year for monetary policy actions to have full effect on the economy, so those cuts will help

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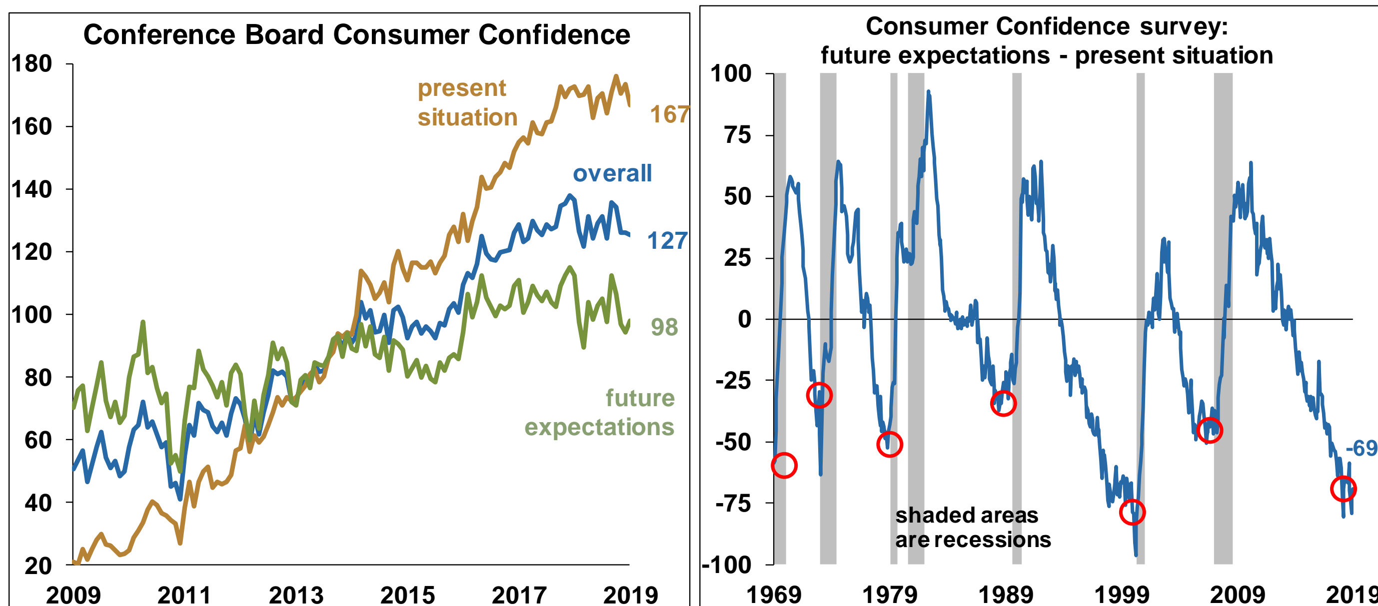
support the economy in 2020. But they may not be enough to counteract the headwinds of slowing global growth, trade tensions, and fading fiscal stimulus.

There is no question that the economy was in fine shape at the end of 2019, and many indicators demonstrate currently robust conditions. But the key word is "currently". Some of the same indicators are also giving us concerns about the future, including interest rates, consumer behavior, and the labor market.

There are still significant risks for 2020

Interest rates are currently low and are a positive for the economy, as mentioned above. But the behavior of the interest rate yield curve earlier in 2019 gives us a warning for 2020. The curve inverted in May, meaning the 10-year yield was lower than the 3-month yield, and it stayed inverted for five months. Over the past 50 years, an inverted yield curve has been a perfect predictor of the past seven recessions. Typically, there is a three to five quarter lag between when the curve inverts and when a recession starts, and if that pattern were to hold true, it would put a slowdown somewhere in the first half of 2020. And the fact that the curve has now gone positive is not an argument against its predictive powers because in five of the past seven recessions, that has been the pattern – the curve inverts, then goes positive, and then the recession comes. Note that we are using the term "slowdown" instead of recession. One reason we are hedging our bets is that, because of the unconventional monetary policy over the last decade, where we are coming off a 0% Fed Funds rate, historical patterns may not hold up perfectly.

Similarly, the Conference Board's Consumer Confidence Index is currently at a very high level historically which is typically a sign of strength for consumption. But the index has fallen for four consecutive months, and five of the past six. More importantly, two components of the survey, present situation and future expectations, are diverging sharply. The difference between the two is shown as the blue line in the right-hand chart, and when that line gets very negative, it means people are much more concerned about the future than they are of the present, and they are usually right – a recession usually follows.



Source: The Conference Board, NBER, Allianz Research

And it would appear that consumers' actual behavior is being guided by expectations for the future, because total consumption is not only running below average, it's trending down as well. On top of concerns about the future, another weight on consumption is that growth in real, after-tax, disposable income is also stalling. That downshift can be explained in part by the fact that the effects of last year's tax cuts, a form of fiscal stimulus, are now drying up. Since there is no tax cut this year, growth in taxes is returning to previous levels, leading to a decline in after-tax income growth.

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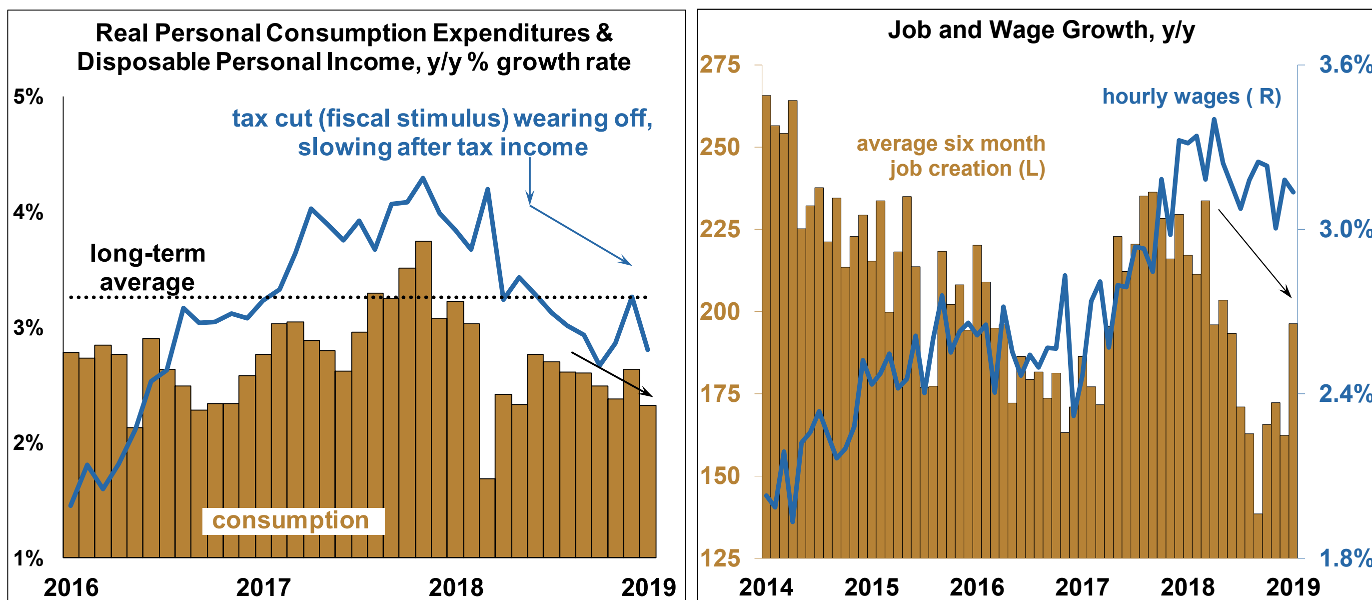
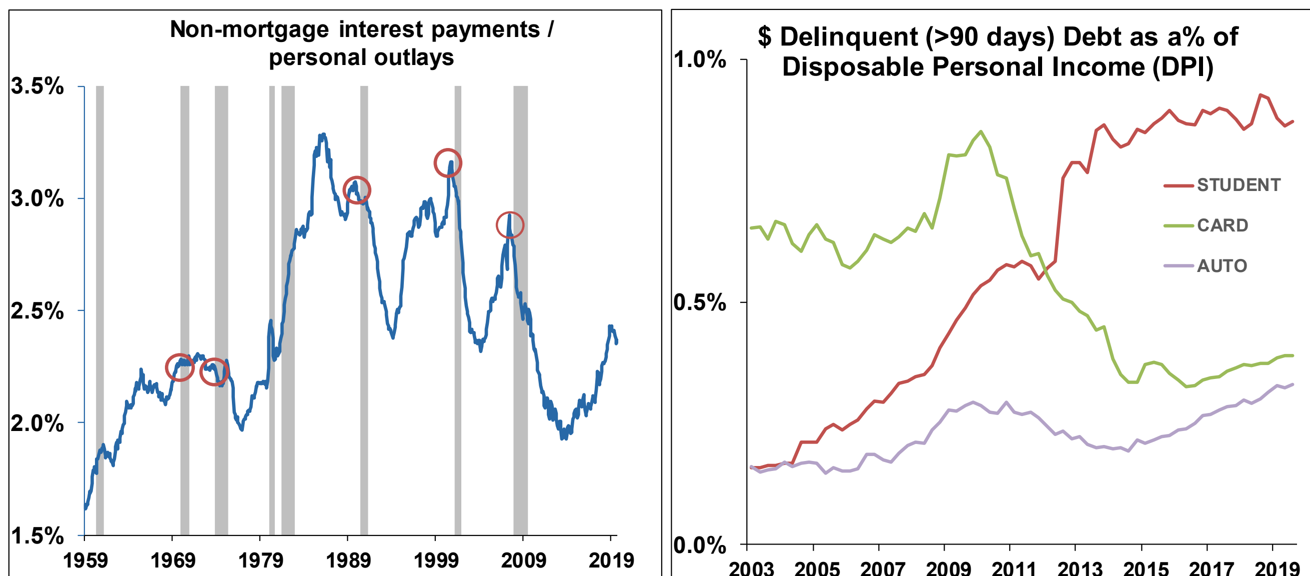
Another weight on income is growth in hourly wages, which is now running at a decent 3.1% y/y but is down from 3.4% in February. In turn, that slowing wage growth is due in part to the deceleration in job creation from 1.9% y/y at the beginning of 2019 to 1.5% currently. A decline in job growth has historically been associated with a recession, and in all 11 of the previous recessions over the past 70 years, job growth was actually faster than it is now. There are some other less visible signs of decay in the labor market as well. Job openings have fallen 4.7% over the past year, effectively breaking a 10-year upward trend. Weekly jobless claims are up 11% since April, and recently jumped the most in over two years. Finally, the number of job quitters has fallen 4.3% over the past two months, indicating less confidence among workers that they will be able to find a new job easily.



Source: BEA, BLS, Allianz Research

The consumer is also facing an additional burden from interest payments. Despite the Fed cutting interest rates over the past six months, credit card rates remain sky-high at an average annual rate of 17%. In addition, the amount of outstanding student debt has soared. The combination has resulted in rising levels of interest payments as a percent of all personal outlays. In fact, in January that percentage reached the highest level since the recession, and although that percentage has turned down slightly since then, it follows previous patterns which suggest an imminent slowdown. When consumers have to pay more interest on their debts, it leaves less money available to spend on other goods and services to support the economy. In addition, consumer delinquencies on such debt are on the rise, surely a drag on the consumer.



Source: BEA, NBER, FRBNY, Allianz Research

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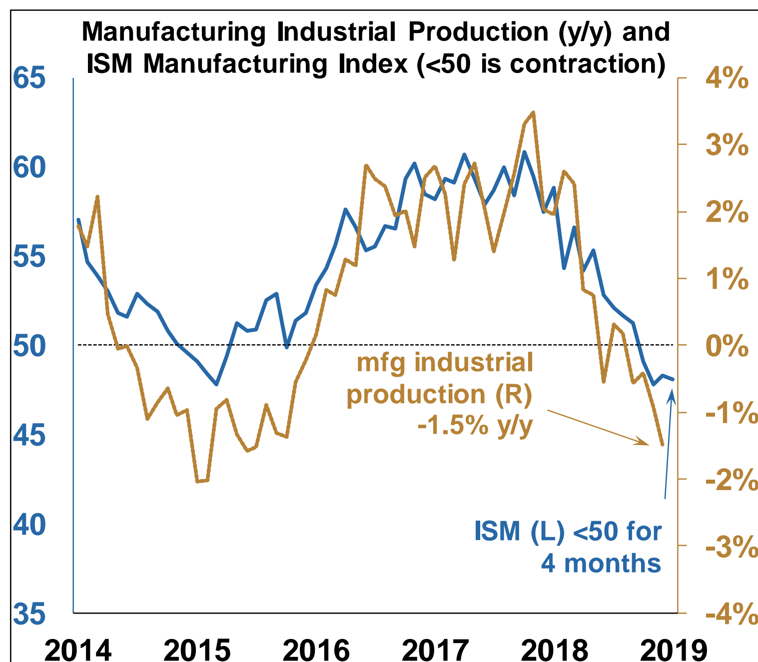
The trade situation has created a great deal of uncertainty and has caused business investment to fall in Q2 and Q3. In addition, total merchandise exports have declined 0.6% in the past 12 months compared to the previous 12 months. As a result, manufacturing has been suffering. The ISM manufacturing index has been under the 50 level signaling contraction for four consecutive months, manufacturing industrial production is down 0.8% y/y with 13 of 19 sub-industries in contraction, core orders for durable goods are down 0.8% y/y, and shipments of those orders, which are a part of the GDP calculation, are only running at 0.4% y/y. Perhaps more importantly for the future, manufactured goods have to be shipped, and shipping indicators, which lead the economy, are all in decay. Freight hauled by trucks, carried by rail, or moved in and out of our ports by ship are all in sharp decline. All of this manufacturing and shipping data could turn more positive relatively quickly if trade negotiations with China were to be finalized immediately, but that seems unlikely. As of this writing we are on the brink of a phase one trade deal which would offer some relief on tariffs, but it is only a limited agreement, and it's possible that the Chinese may drag out any more agreements on trade until after the November 2020 election. At the moment, we estimate that we are losing a bit less than 1% of GDP growth over two years due to this trade "feud". However, if we enter into a trade "war" where we put tariffs on all Chinese goods, and put tariffs on $200B of auto imports, and suffer retaliatory tariffs, we would be losing closer to 2% over two years. And in a world of 2%-ish growth, that's a lot.



Source: ISM, Fed, Allianz Research

Enjoy the current strength, but expect a slowdown in 2020

So, the list of worrisome indicators is significant, but again, many of those same indicators show good business conditions at the moment. Consumer confidence is high overall, but consumer concerns over the future are significant. Overall consumption and personal income are both positive but slowing. Job creation is strong, but is decelerating, and several other indicators in the labor market confirm this emerging weakness. Personal interest payments as a percent of total outlays have risen sharply, constraining spending on everything else. Trade uncertainty is driving down investment, manufacturing, and transportation. As a result, our overall scenario is one of positive, but sluggish, GDP growth of 1.6% for all of 2020. And it is possible that we may see a quarter of near zero, or perhaps even negative growth in the first half of 2020, however the chances of a full-blown recession are waning.

Our scenario is a bit less rosy than the consensus, and we suspect that this is because of the nature of our business. We insure our clients against the possibility that the businesses they sell to won't pay them back, or can't pay them back due to bankruptcy, and the incidence of those events has been soaring. Perhaps

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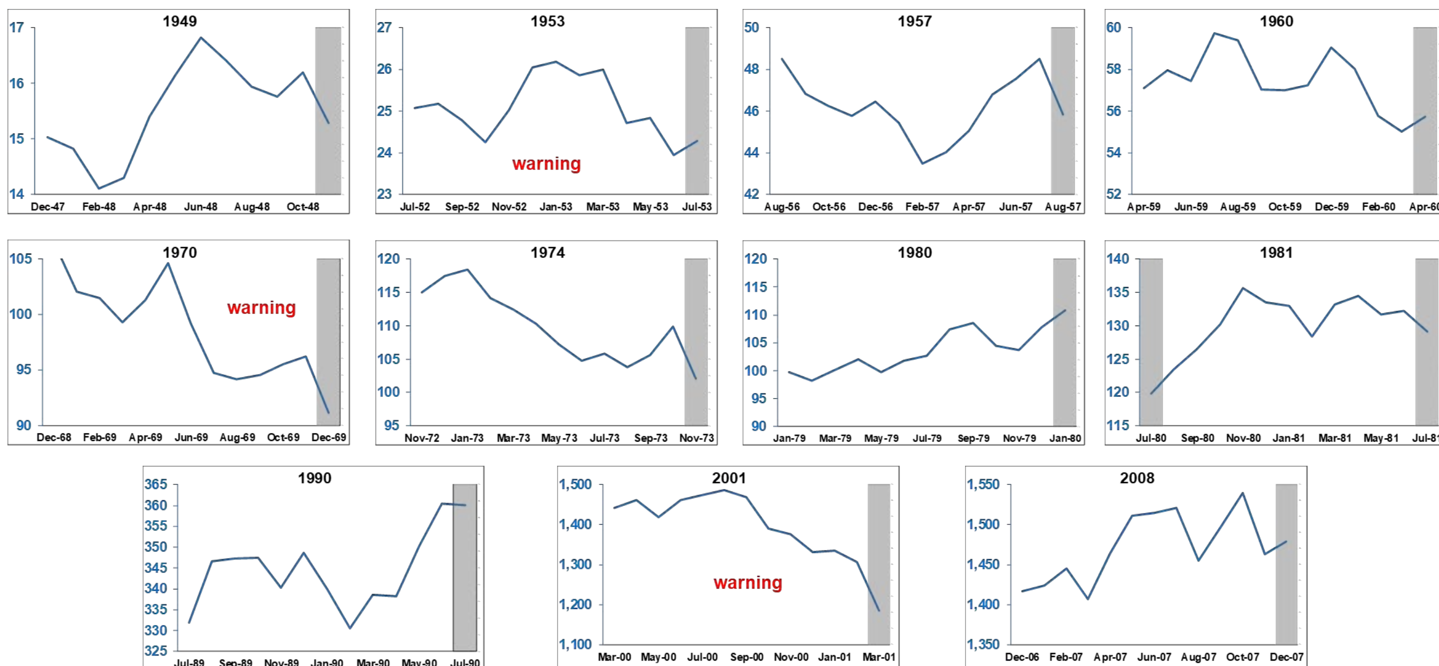
more importantly, we know that increase is a strong leading indicator of the economy. Other analysts may be more focused on the steadily rising stock market which tends to create euphoria and an exaggerated sense of security about the economy. But historically the stock market is usually rising just before a recession. In fact, the S&P 500, shown in the charts below as the blue line, has only given a substantive warning about an impending downturn in just three of the past 11 recessions (shown as the gray columns) going back 70 years. So enjoy the rising stock market now and the currently strong economic conditions. But be aware that there will likely be a marked downshift in 2020.

The S&P 500 12 Months Before the Last 11 Recessions



Source: Standard & Poor's, NBER, Allianz Research

About the Author:

***Dan North** is an Economist with Euler Hermes, North America. Mr. North has been with Euler Hermes North America since 1996. He has appeared on CNBC, Fox Business News, France 24, and Bloomberg Radio and Television. He has been quoted by Barron's, Business Week, Paris Le Monde, Tokyo Nikkei, the New York Times and the Wall Street Journal. After having predicted the 2008/2009 recession and its implications accurately, he was ranked 4th on Bloomberg's list of the 65 top economic forecasters in 2010.*

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Economic Outlook Symposium: Summary of 2019 Results and 2020 Forecasts

**By: William A. Strauss, Senior Economist and Economic Advisor
and and Kelley Sarussi, Research Assistant
Federal Reserve Bank of Chicago**

According to participants in the Chicago Fed's annual Economic Outlook Symposium (EOS), the U.S. economy is forecasted to expand at a pace in 2020 near the long-term average, with inflation ticking up and the unemployment rate remaining low.

The Federal Reserve Bank of Chicago held its 33rd annual Economic Outlook Symposium on December 13, 2019. More than 140 economists and analysts from business, academia, and government attended the conference. This *Chicago Fed Letter* reviews the forecasts for 2019 from the previous EOS, and then analyzes the forecasts for 2020 (see below) and summarizes the presentations from the most recent EOS.

	2018	2019	2020
	(Actual)	(Forecast)	(Forecast)
Real gross domestic product[a]	2.5	2.2	1.7
Real personal consumption expenditures[a]	2.6	2.7	2.0
Real business fixed investment[a]	5.9	0.5	1.8
Real residential investment[a]	-4.4	0.7	1.0
Change in private inventories[b]	93.0	53.0	48.1
Net exports of goods and services[b]	-983.0	-999.0	-1,002.6
Real government consumption expenditures and gross investment[a]	1.5	2.8	1.7
Industrial production[a]	4.0	-0.7	0.9
Car and light truck sales (millions of units)	17.2	16.9	16.6
Housing starts (millions of units)	1.25	1.26	1.28
Unemployment rate[c]	3.8	3.6	3.7
Consumer Price Index[a]	2.2	1.9	2.0
One-year Treasury rate (constant maturity)[c]	2.67	1.63	1.69
Ten-year Treasury rate (constant maturity)[c]	3.0.	1.78	1.95
J. P. Morgan trade-weighted dollar index[a]	4.3	1.5	2.7
Oil price (dollars per barrel of West Texas Intermediate)[c]	58.97	55.90	56.52
[a]Percent change, fourth quarter over fourth quarter.			
[b]Billions of chained (2012) dollars in the fourth quarter at a seasonally adjusted annual rate.			
[c]Fourth quarter average.			
Note: These values reflect forecasts made in November 2019.			
Sources: Actual data from authors' calculations and Haver Analytics; median forecasts from Economic Outlook Symposium participants.			

In the third quarter of 2019, the U.S. economy entered the 11th year of its expansion, making this the longest expansion in U.S. history. While the nation's real gross domestic product (GDP) is at its highest level ever, the rate of economic growth since the end of the Great Recession in mid-2009 has been quite restrained. During

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the 41 quarters following the second quarter of 2009, the annualized rate of real GDP growth was 2.3%—somewhat above what is considered the long-term rate of growth for the U.S. economy.

The economy expanded by 2.5% in 2018—a bit higher than the current expansion's average. However, the economy was challenged by a significant drop in the stock market as the year came to a close. The Standard & Poor's (S&P) 500 stock market index fell dramatically between September 21 and December 24, 2018, losing 19.8% of its value. This led to concerns by some about a potential recession in 2019. Yet, back in 1966, Nobel Prize-winning economist Paul Samuelson wrote that "Wall Street indexes predicted nine of the last five recessions," indicating that declines in the stock market are not necessarily reliable signals for imminent economic downturns.[1] The negative signals of late 2018 also turned out to be incorrect, and the market began rising again in late December. By the end of April 2019, the S&P 500 had recovered the entire drop in its value.

The annualized rate of real GDP growth was 2.7% in the first quarter of 2019 and then, in part challenged by increased tariffs and threats of additional future tariffs, it decelerated to 2.3% in the second quarter and 2.1% in the third quarter. The moderation in economic growth in 2019 was largely due to slowing business investment.

Real business fixed investment, which had expanded at a strong 5.9% pace in 2018, grew at a very weak annualized rate of 0.2% over the first three quarters of 2019. After registering a growth rate of –4.4% in 2018, real residential investment grew at an annualized rate of just 0.3% during the first three quarters in 2019. Moreover, the annualized rate of housing starts was 1.26 million units for the first 10 months of 2019—down 0.7% compared with the same period in 2018.

In contrast, consumer spending expanded at a solid pace in 2019: Real personal consumption expenditures grew at an annualized rate of 2.9% during the first three quarters of 2019—above the 2.6% rate recorded in 2018. The pace of light vehicle sales (car and light truck sales) was 16.9 million units in the first 11 months of 2019—1.4% lower than the comparable selling rate in 2018.

After averaging $67.19 during the first ten months of 2018, West Texas Intermediate oil prices moved down sharply in the final two months of that year. The average price of oil fell from $70.60 per barrel in October 2018 to $49.14 per barrel in December 2018. In 2019, oil prices did move above $50 per barrel, averaging $56.73 per barrel during the first 11 months.

With relatively lower oil prices, more consumers continued to purchase larger, less fuel-efficient vehicles than in the year before: Sales of light trucks (including sport utility vehicles) were up 2.7% during the first 11 months of 2019 compared with the same period of a year earlier, while sales of passenger cars were down 10.6%. This shift in consumer demand (which continued a trend from the past couple of years) led to a record-setting share for light trucks of 71.9% of overall light vehicle sales during the first 11 months of 2019.

Industrial production had an annualized growth rate of –2.1% over the first 10 months of 2019—in stark contrast with its growth rate of 3.8% in 2018. The deterioration in industrial production was largely due to weakening business investment.

On an annualized basis, growth in real government spending was 3.1% over the first three quarters of 2019—well above its average annual rate of 1.2% over the past 20 years.

Against this backdrop, the U.S. economy continued to increase employment in 2019: 2.20 million jobs were added between November 2018 and November 2019. Moreover, the unemployment rate stood at 3.5% in November 2019—below most economists' estimates of the natural rate of unemployment (i.e., the rate that would prevail in an economy making full use of its productive resources).

1 Paul Samuelson, 1966, "Science and stocks," Newsweek, September 19, p. 92.

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Inflation, as measured by the Consumer Price Index (CPI), decreased from a 2.2% reading in 2018 to a year-over-year rate of 2.0% in November 2019.

Results versus forecasts

According to the consensus forecast (defined as the median forecast) from the most recent EOS, the growth rate of real GDP in the fourth quarter of 2019 relative to the fourth quarter of 2018 is estimated to be 2.2%—somewhat lower than the 2.4% rate predicted at the previous EOS. (For the remaining comparisons of GDP components, annual values are calculated based on the consensus estimates for the fourth quarter of 2019 from the most recent EOS.) Growth in real business fixed investment was quite a bit weaker than forecasted; growth in real personal consumption expenditures was a little stronger than expected; and growth in real residential investment came in much weaker than predicted. The unemployment rate is anticipated to average 3.6% in the fourth quarter of 2019—0.1 percentage points lower than the value forecasted for the final quarter of 2019. Inflation, as measured by the CPI, is now expected to be 1.9% in 2019—0.4 percentage points below the previously predicted rate of 2.3% for the year. West Texas intermediate oil's price in the fourth quarter of 2019 is expected to average $55.90 per barrel—well below its predicted average price of $68.75 per barrel. Light vehicle sales are predicted to come in at 16.9 million units for 2019—above the 16.8 million units forecasted. The annualized rate of housing starts was 1.26 million units for the first 10 months of 2019; so, total housing starts in 2019 are expected to come in somewhat below the 1.28 million units previously predicted. The one-year Treasury rate is expected to go down to 1.63% in the fourth quarter of 2019—well below the 3.26% forecasted. The ten-year Treasury rate is anticipated to decrease to 1.78% by the end of 2019—also well below the predicted rate of 3.55%.

Economic outlook for 2020

The EOS consensus forecast for 2020 is for the pace of economic growth to be close to the long-term average. In 2020, the growth rate of real GDP is expected to be 1.7%—lower than the projected 2.2% rate for 2019. The quarterly pattern reveals a fairly steady performance throughout 2020 (close to the annual pace) for real GDP growth. The unemployment rate is expected to remain relatively steady at a very low 3.7% for each quarter through the end of 2020.

Inflation, as measured by the CPI, is predicted to tick up from an estimated 1.9% in 2019 to 2.0% in 2020, according to the EOS consensus forecast. Oil prices are projected to edge higher throughout 2020. Real personal consumption expenditures are forecasted to expand at a pace of 2.0% in 2020—somewhat slower than in 2019. Light vehicle sales are expected to fall to 16.6 million units in 2020. The pace of real business fixed investment growth—which has averaged 3.0% over the past 20 years—is anticipated to improve to a still modest 1.8% in 2020. Industrial production is forecasted to grow by 0.9% next year—below its long-run average rate of growth.

The housing sector is predicted to improve modestly and continue its extremely slow march toward normalization in 2020. The growth rate of real residential investment is forecasted to move up to 1.0% in 2020 from 0.7% in 2019. And housing starts are anticipated to edge up to 1.28 million units in 2020—nearly in line with the 20-year annual average of roughly 1.27 million starts.

The one-year Treasury rate is expected to edge up to 1.69% in 2020, and the ten-year Treasury rate is forecasted to increase to 1.95%. The trade-weighted U.S. dollar is predicted to rise 2.7% in 2020, and the nation's trade deficit (i.e., net exports of goods and services) is anticipated to increase to a little over $1 trillion by the final quarter of 2020.

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Conclusion

In 2019, the U.S. economy expanded at a pace just above the long-term average. The economy is forecasted to grow at a slower pace in 2020 than in 2019, though still near its long-run trend, according to EOS participants. Business investment and the housing sector are projected to improve in 2020. The unemployment rate is expected to stay low, at 3.7%, through the end of 2020, and inflation is predicted to move up slightly to 2.0%.

About the Author:

William Strauss *is the Senior Economist and Economic Advisor in the Economic Research Department at the Federal Reserve Bank of Chicago. His chief responsibilities include analyzing the current performance of both the Midwest economy and the manufacturing sector for use in monetary policy.*

He produces the monthly Chicago Fed Midwest Manufacturing Index and organizes the Bank's Economic Outlook Symposium and Automotive Outlook Symposium. In addition, he conducts several economic workshops and industrial roundtables throughout the year.

His research papers include analysis of the manufacturing sector, the automotive sector, the Midwest regional economy, the trade-weighted dollar, business cycles, and Federal Reserve payments operations.

Mr. Strauss has been interviewed on numerous television and radio shows and quoted in the major business magazines and newspapers. He has also provided testimony concerning manufacturing issues to the U.S. Senate.

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U.S. Macro Outlook: Two Economies

How Americans perceive the economy's performance and prospects varies significantly according to whether they are Republican or Democrat.

By: Mark Zandi
Chief Economist
Moody's Analytics

Overview

- Democrats and Republicans believe they are living in different economies.
- In reality the economy has performed much the same in the three years of the Trump administration as it did in the final three years of the Obama administration.
- Meanwhile, the differences in economic policy between Trump and any of his potential Democratic rivals are stark.
- Perceptions about the economy are so tied up in peoples' political identities that uncertainty over the 2020 election outcome may have an outsize impact on consumer and business behavior.

U.S. real GDP growth has been slowing for more than a year and is ending 2019 at just below the economy's 2% growth potential. Job gains have moderated commensurately and, after accounting for upcoming benchmark revisions to the employment data, are averaging close to an estimated 150,000 per month. Unemployment is low and stable near 3.5% but will begin to rise if GDP growth does not pick up soon.

Strong cross-currents are buffeting the economy's growth. Consumers, particularly middle-income households, are the principal tailwind. Home sales and housing construction also have revived as mortgage rates have fallen firmly below 4%. And budget deals between the Trump administration and Congress green-lighted a sizable increase in deficit-financed federal government spending.

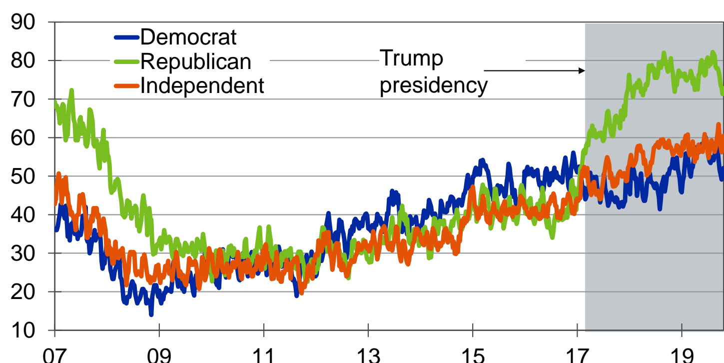
Flat business investment is the principal headwind, since businesses remain cautious given the uncertainty created by various geopolitical threats, including the Trump administration's trade war with China. The recent truce in that war will not quell business concerns about how the conflict will play out after next year's presidential election. The nation's trade deficit has also widened as the trade war upended global growth and lifted the value of the U.S. dollar, weakening demand for U.S.-made goods and services.

Perception gap

How Americans perceive the economy's performance and prospects varies considerably across income, education, gender and, most significantly, whether they are Republican or Democrat. Republicans believe the economy could not be much better. According to Bloomberg's weekly survey of consumers, Republicans are about twice as upbeat about the economy as they were just prior to President Trump's election three years ago. In contrast, Democrats' view of the economy has not changed appreciably since the election.

Living in Different Economies

Consumer comfort index by political party affiliation



Sources: Bloomberg, Moody's Analytics

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This gap in perceptions about the economy has widened substantially and is currently about as wide as it has been since the end of the Bush administration when the financial crisis was unfolding. Independent voters' feelings about the economy are a bit more upbeat than the Democrats', but they are still meaningfully more dour than the Republicans'.

A daily Morning Consult survey of consumers confirms that Democrats and Republicans believe they are living in different economies. Those who voted for Trump in the 2016 election are more than 50% more upbeat about their own financial situation and broad business conditions than those who voted for Secretary of State Hillary Clinton. Consistent with this is the similar difference in perceptions between those who watch Fox News regularly and those that prefer MSNBC.

Trump vs. Obama

The reality is that the economy has performed much the same in the three years of the Trump administration as it did during the final three years of the Obama administration. There is almost no difference in GDP growth, which was just above the economy's potential growth under both presidents, or in real after-tax income growth.

Trump vs. Obama

Economic performance in first 3 yrs of Trump administration vs. final 3 yrs of Obama administration

	Obama	Trump
Real GDP, avg annual growth, %	2.5	2.6
Consumer Price Index, %	3.2	6.3
Employment, avg monthly change, ths	220	191
Unemployment rate, change, ppt	-2.2	-1.1
Real disposable income per capita, %	7.8	8
Household net worth, avg annual growth, %	5.2	5.8
Wilshire 5000, %	19.7	38.9
CoreLogic House Price Index, %	15	12.6
Fixed mortgage rate, avg, %	3.9	4.4
Trade deficit, % of GDP	-2.8	-3
Fixed investment, avg annual growth, %	2.9	4.1
Federal budget deficit, avg annual, $ bil	599.6	893

Sources: BEA, BLS, Census Bureau, Wilshire, SoreLogic, Treasury, Moody's Analytics

Employment growth was somewhat stronger, and unemployment fell more under Obama than Trump, but this may be in part because there was still some slack in the labor market a few years ago.

The stock market has done much better under Trump, with the Wilshire 5000 index, which includes all publicly traded stocks, up almost 40% since his election. During the last three years of the Obama administration stock prices also rose solidly, but only by 20%. Explaining much of this difference is the large tax cut Trump gave corporations, lowering their top marginal tax rate from 35% to 21%. Of course, this and Trump's personal income tax cuts were deficit financed; the average annual budget deficit under Trump has been $275 billion larger than under Obama.

Despite the rally in stock prices under Trump, household net worth increased by about as much under Obama. This goes to the stronger house price gains experienced under Obama, which may also reflect in part the Trump tax law changes that scaled back tax preferences for homeownership and have weighed on house price appreciation. Household debt has also increased more under Trump than Obama.

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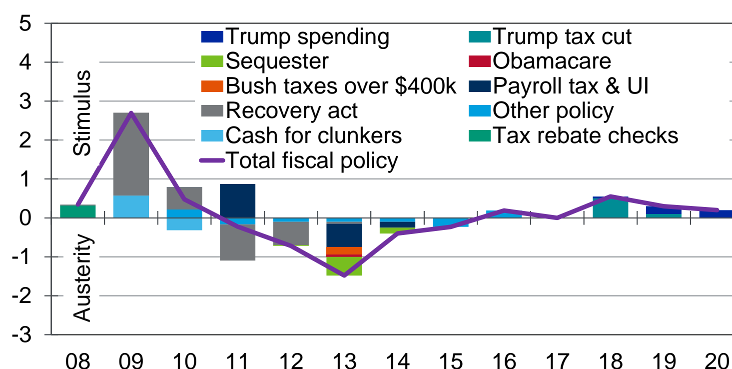
The performance of other economic statistics is mixed. Inflation and interest rates were lower during Obama's last three years, but business investment wasn't as strong—a collapse in oil prices undermined energy investment under Obama, and higher oil prices lifted such investment under Trump. Despite Trump's focus on reducing the U.S. trade deficit, it has widened somewhat under his tenure.

Trump's fiscal stimulus

Trump's economic policies in their totality have been largely a wash on the economy's performance, at least so far. There were no meaningful changes to economic policy in the first year of the president's term. However, since then there have been substantial changes to tax and spending policies, international trade and foreign immigration policies, and regulation of the environment, financial system, healthcare and labor market.

Trump's tax and spending policies have been the most sweeping, and to date have lifted GDP and jobs. Based on simulations of our structural econometric model of the U.S. economy, Trump's fiscal policies have added 0.75 percentage point to real GDP (0.6 percentage point from tax cuts and 0.15 percentage point from spending) and increased employment by 580,000 jobs as of the third quarter.



The tax cuts and spending have been financed by increased Treasury borrowing and have thus acted like classic fiscal stimulus.

The stimulus will continue through much of 2020 fueled by further increases in deficit-financed government spending and adding an additional 0.2 percentage point to real GDP. But the economic benefit of the stimulus will quickly fade after that and eventually dissipate because of ill effects of the government's higher debt load.

Trump's anti-globalization policies

Trump's trade and immigration policies have been decidedly negative for the economy. Based on our model, the U.S. trade war with China and other trading partners has reduced real GDP by 0.4 percentage point and cost 340,000 jobs as of the third quarter. Higher tariffs act like a tax increase that is paid for by U.S. businesses and consumers, and the capricious process for setting the tariffs has hurt business sentiment and thus investment and hiring.

The Trump administration's stiff implementation of immigration law has substantially slowed net immigration into the U.S. and is also weighing on the economy. Real GDP has been reduced by an estimated 0.3 percentage point and employment by 220,000 jobs as of the third quarter. Less immigration weighs on consumer spending and housing because there are fewer people and households. Longer run, having fewer immigrants reduces the growth in the labor force and labor productivity growth and thus the economy's growth potential.

It is difficult to connect the dots between the Trump administration's lighter regulatory stance and the macroeconomy. Businesses often put regulation near the top of their list of irritants, but there are few regulations that matter broadly across the economy.

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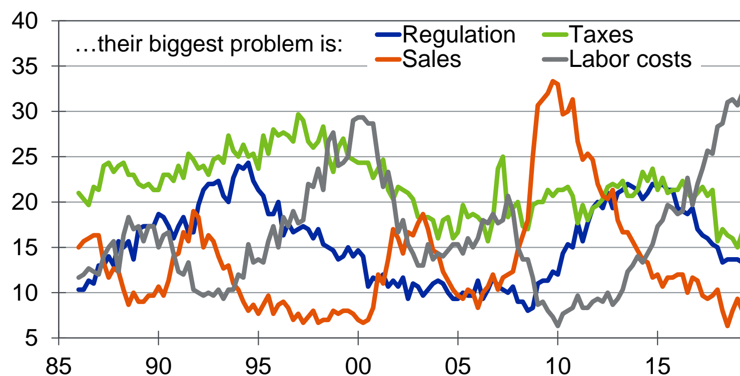
The administration has focused on reducing regulations for the fossil fuel industry, which has benefited from an easing in environmental rules and easier permitting for development. Smaller financial institutions have also enjoyed a reprieve from various compliance requirements. But it is difficult to see the impact on these industries, at least compared with other buffeting forces. It is even more difficult to see any broader economic impacts.



Election uncertainty

If Trump is re-elected, he is likely to double down on his current economic policies. This means more deficit-financed tax cuts and government spending increases, renewed trade tensions with China and other nations, and tougher immigration policies. However, if a Democrat is elected, economic policy will be flipped on its head. At a minimum, the Trump tax cuts for higher-income and wealthy households will expire as they are set to do under current law in the next presidential term. Foreign immigrants will be welcomed with open arms, and while a Democratic president will take a hard stance in trade negotiations with China, the tariff wars are unlikely to continue.

The differences in economic policy between Trump and any of his potential Democratic rivals are so stark, and perceptions about the economy are so tied up in peoples' political identities, that uncertainty over the election's outcome may have an outsize impact on consumer and business behavior. Historically, elections have had no discernible impact on the economy. Voters weren't so polarized, and the candidates' policy views were similar enough that voters didn't feel compelled to change anything they were doing. That may not be true in 2020.

About the Author:
Mark M. Zandi *is Chief Economist of Moody's Analytics, where he directs economic research. Moody's Analytics, a subsidiary of Moody's Corp., is a leading provider of economic research, data and analytical tools.*
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