

U.S. ECONOMIC OUTLOOK, 2019 AND BEYOND

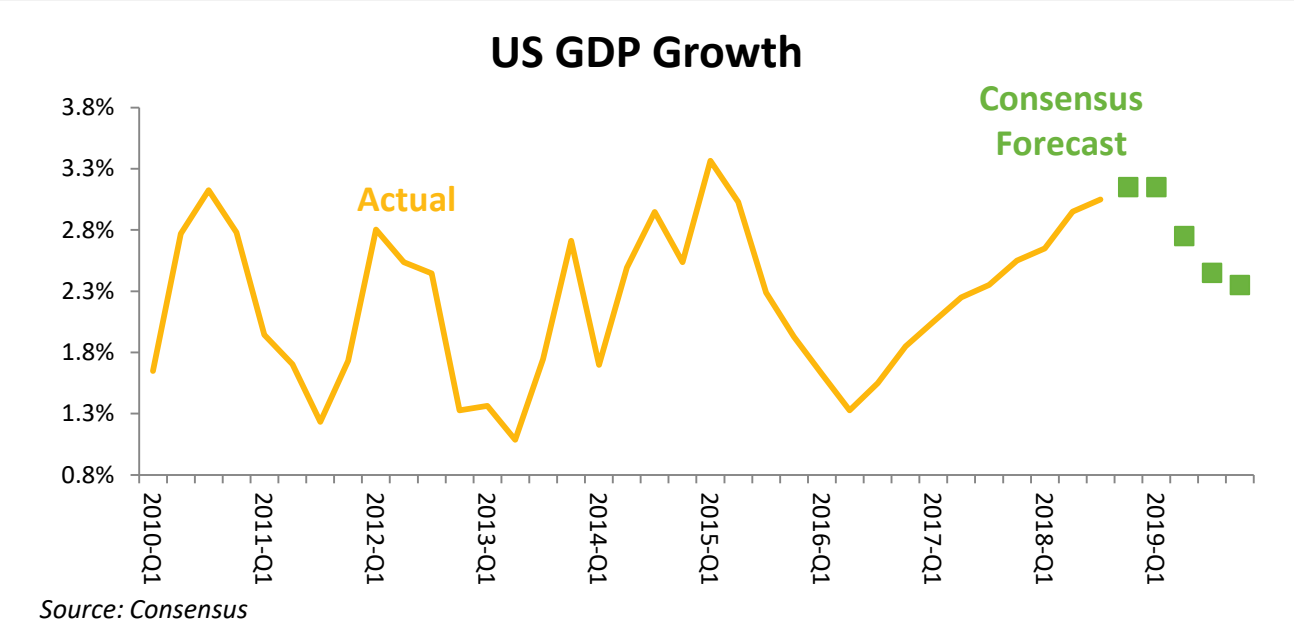
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THUMBNAIL OF THE U.S. ECONOMY

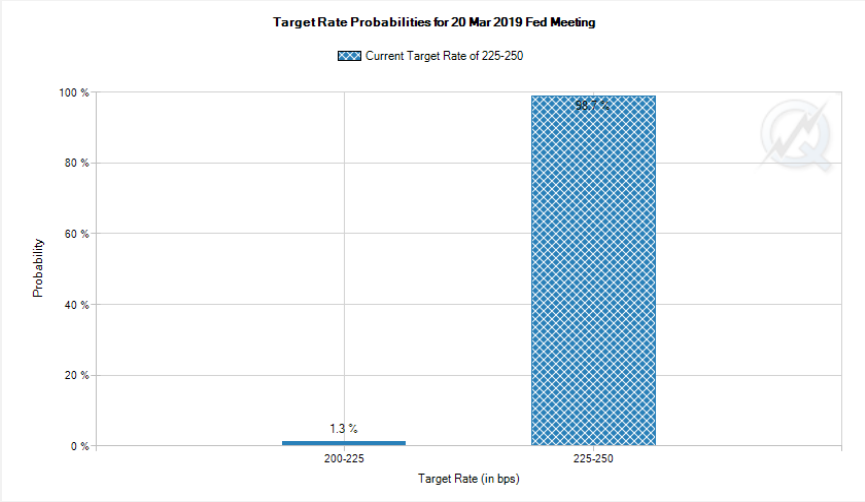


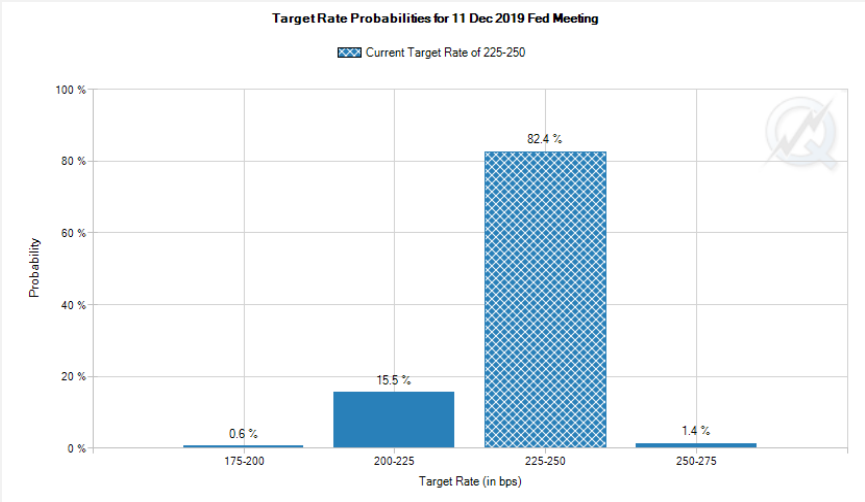
Source: Consensus

- Economic growth is expected to slow in 2019 following a sustained period of increasing economic growth over the past three years.
- Divided government in Washington means that the current tax code and budget policy will remain in place for the next two years. Trade policy continues to be a source of uncertainty.
- The fiscal stimulus from the 2017 tax cuts has mostly run its course. While a major increase in infrastructure spending would boost the economy, passing such legislation is unlikely.
- The Federal reserve is adopting a cautious policy towards interest rate increases. International central banks may lower their base lending rates amplifying the need for caution by the Fed.

INTEREST RATE OUTLOOK

- Between December 2016 and December 2018 the Feb raised the target rate ¼% eight times.
- The market assigns a negligible probability for another ¼ point hike next month and only a 1.4% probability for any increases at all in 2019.
- The Fed is mindful of the effect that a rapid series of 17 interest rate increases between 2005 and 2007 had on the economy.
- Particular concerns for Fed policy are the impacts of any further trade restrictions or a possible recession in Europe.



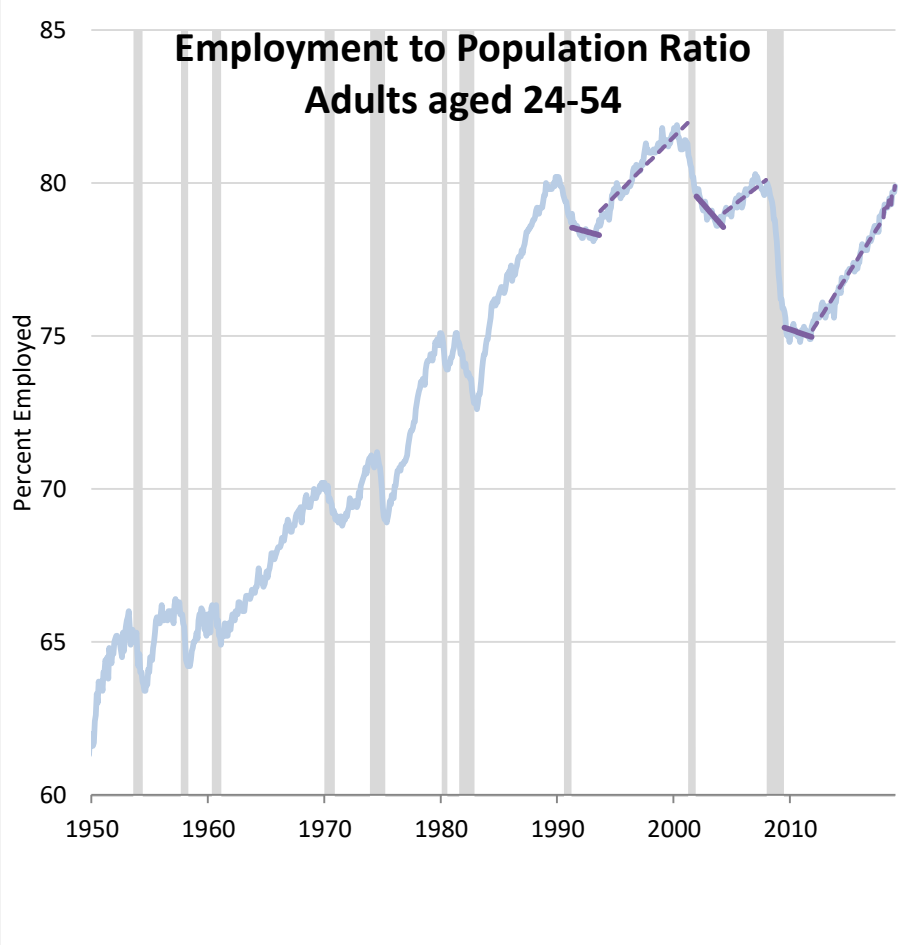


Source: CME Group
http://www.cmegroup.com/trading/interest-rates/countdown-to-fomc.html

STRESS #1: THE JOB MARKET IS TIGHT

The labor force is at recent peaks

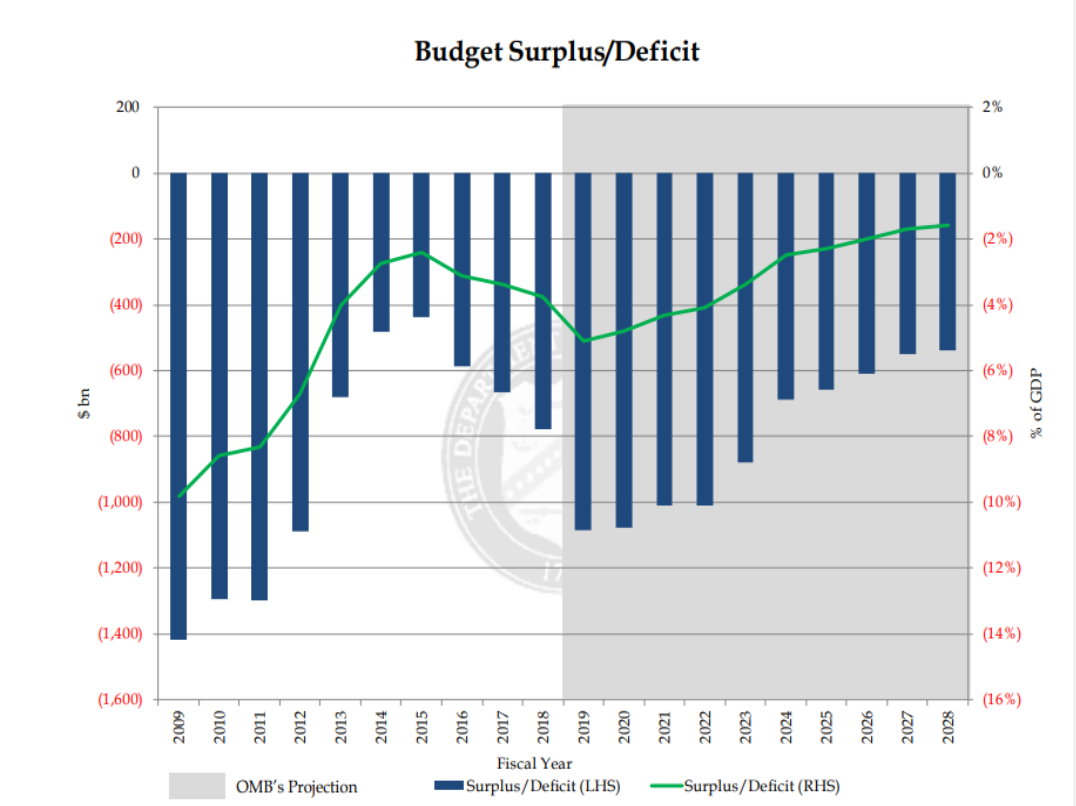
- We look at the employment to population ratio for workers aged 24-54 which is less affected by younger adults delaying work or older adults retiring.
- The current percentage of working adults is finally almost as high as it was in 2008.
- The decline in the labor force from the Financial Crisis no longer appears to be permanent.
- A tighter labor market means more wage inflation which under normal conditions would pressure the Fed to raise rates.



Source: FRED

STRESS #2: U.S. TREASURY BORROWING WILL RISE

- There are many near simultaneous demands for debt funding from both the private and public sectors.
- The chart ignores the Fed's reduction of the QE assets it acquired. The Feb's portfolio is down over $500B from a peak of $4.5Tr.
- Large budget deficits put pressure on the Feb to keep money tight in order to offset the inflationary effects of deficit spending.



Source: U.S. Treasury, Q3 2017

STRESS #3: DECLINING WORLD TRADE



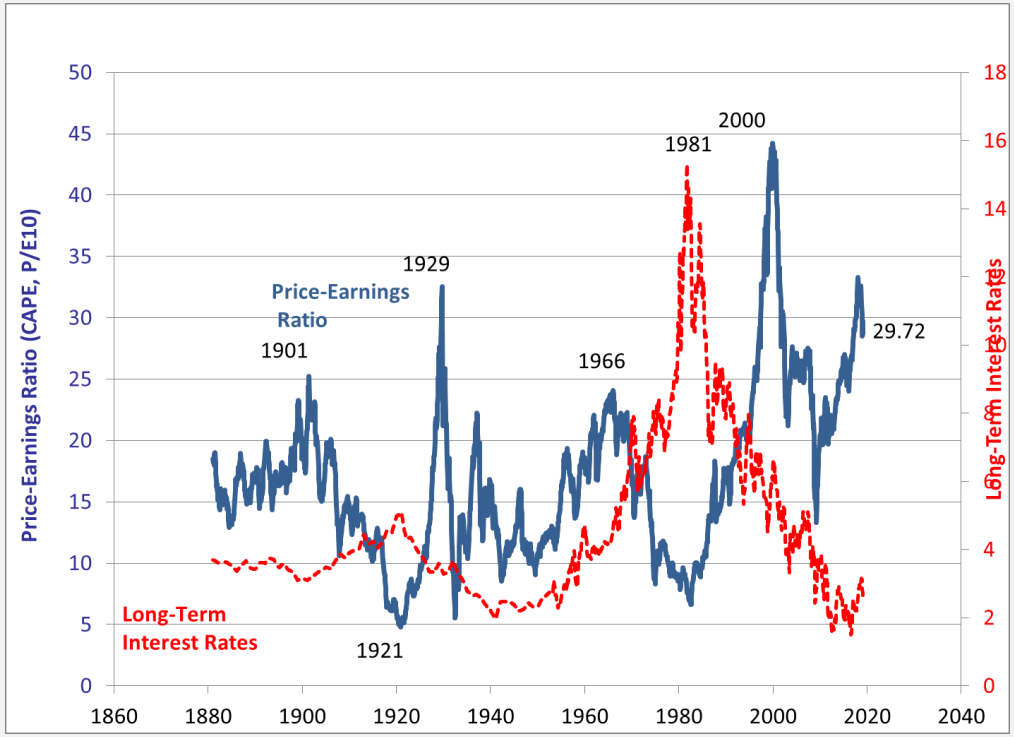
- The declining outlook for world trade is one of the factors behind the slowdown in GDP forecasts.
- The negative outlook for trade also contributes to the Fed's caution in further increasing interest rates

STRESS #4: EUROPE & CHINA

- The declining outlook for world trade is also one of the factors behind the slowdown in GDP forecasts in both the EU and China.
- Brexit in the EU and the slower than expected increase in consumerism in China are also having negative impacts on the outlook for growth.
- A slowing pace in global economic activity in major economies outside the U.S. is another reason for caution by the Federal Reserve.

VALUATION – WHERE ARE WE?

- Economic growth will have to exceed current forecasts if valuations are to be reduced by higher earnings.
- The inflation rate will have to remain historically low for long term interest rates to remain at current levels.
- The current value of the CAPE is 29.72 down from a peak of 33.41 in January 2018. The decline in the CAPE is partly due to the market decline and partly due to earnings growth.

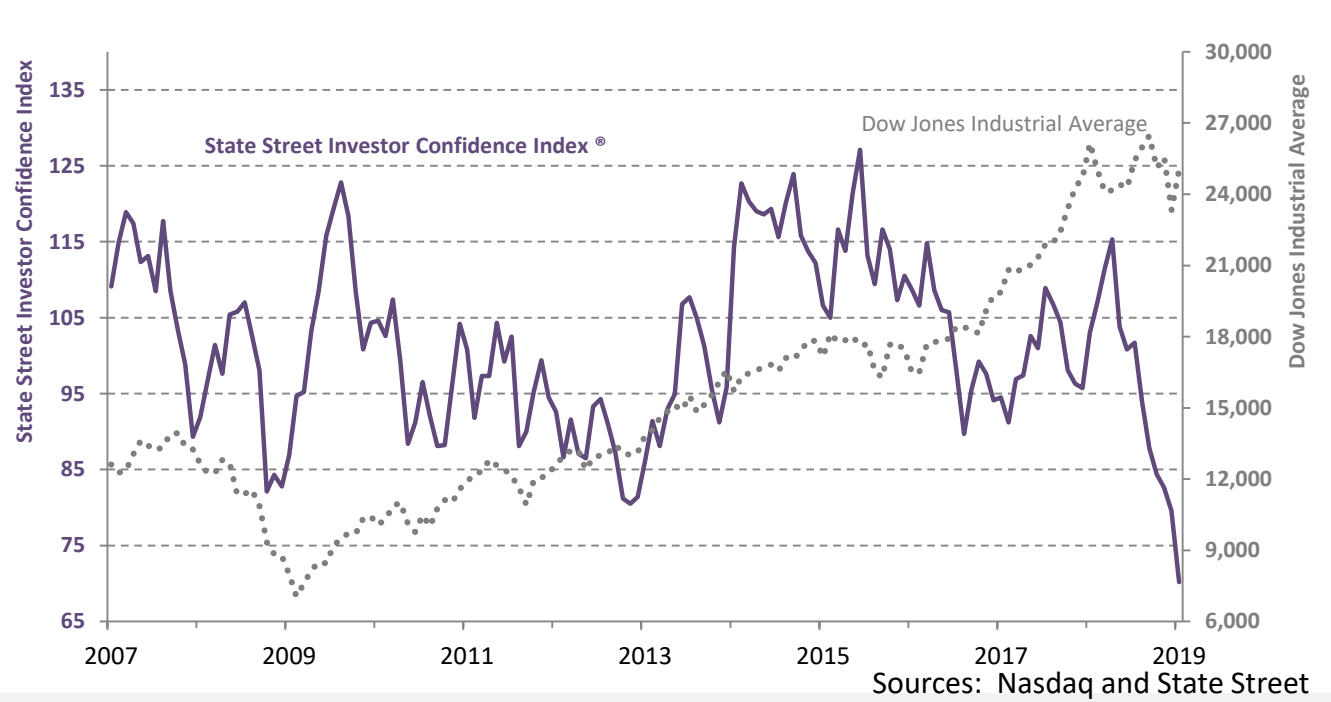


Source: Robert Shiller, http://www.econ.yale.edu/~shiller/data.htm

CAPE = cyclically adjusted price-to-earnings ratio

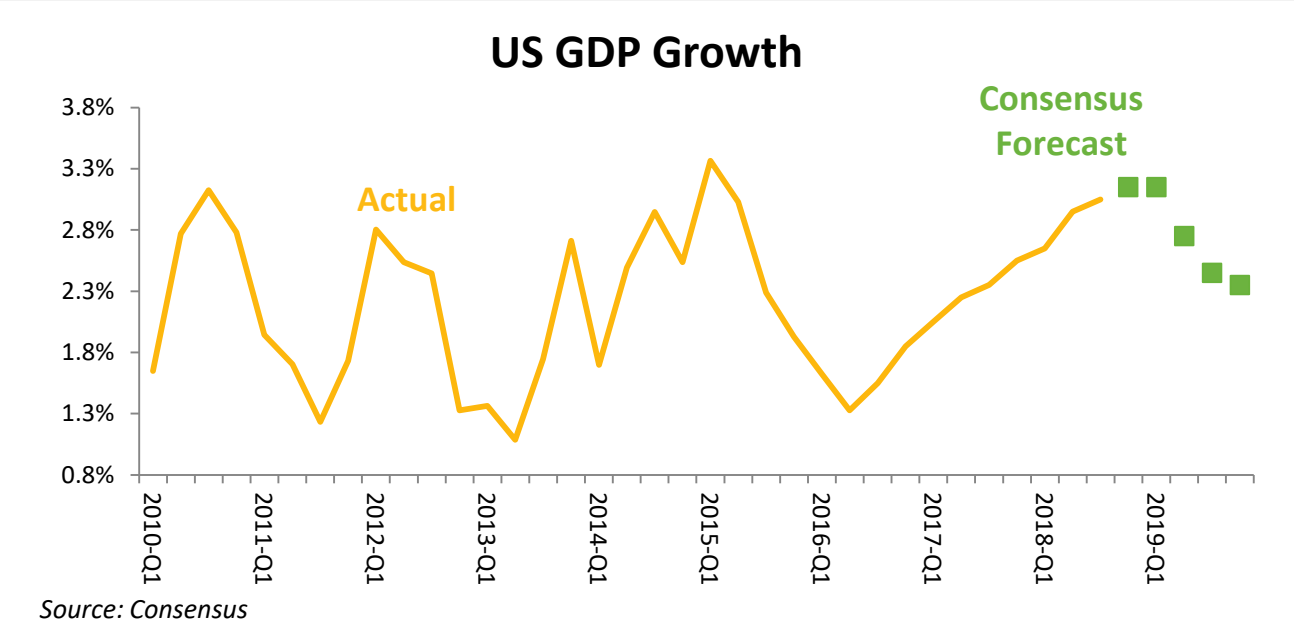
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INVESTOR CONFIDENCE



- The State Street Investor Confidence Index® measures the willingness of investors to allocate funds to risky assets based on actual trades.
- The Investor Confidence Index® has fallen rapidly since Q1 2018.
- The government shutdown is affecting the statistics and a rebound is expected over the next few months if no additional shutdowns occur.
- Even with a rebound, investor confidence remains relatively weak.

CONCLUSION



Source: Consensus

- The rate of economic growth in the U.S. is likely to slow over the next year although a recession is unlikely.
- After almost 10 years of positive economic growth since the financial crisis, most measures of economic activity are exceeding their pre-crisis levels.
- No central banker wants to be responsible for triggering the next recession. Consequently, major global central banks are likely to remain cautious.

QUESTIONS?

Thank you

