Where Are We Headed?

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Resilience seems to be the theme of the national economy this past year. Other developed nations are experiencing slowing growth rates or even contractions causing global trade and manufacturing to decline. Inevitably, the global slowdown will seep into our national economy because global markets have never been as intricately linked through international trade as they are today. This means that the ongoing trade disputes and the escalation of tariffs between the U.S. and other nations will continue to raise the probability of a U.S. recession, which is technically defined as two or more consecutive quarters of declining gross domestic product (GDP). The Bloomberg survey of economists shows a 35 percent probability of recession in the next 12 months. The Guggenheim Recession Probability Model shows a 58 percent probability of recession by mid-2020 and a 77 percent chance of recession in the next 24 months. I also recently wrote about the inversion of the yield curve as a relatively good predictor of an approaching recession (http://www.uccseconomicforum.com/publications_media.shtml).

Having said this, recessions are indeed difficult to predict because of all the moving parts. Yet, it would be overly optimistic to not acknowledge the heightened risk of a contraction or at least a significant slowdown in the economy. The list of reasons is rather long: trade wars, the geopolitical instability, the vast polarization in U.S. politics, the national debt, the aging of the population and its impact on productivity, the increasing costs of abnormal weather patterns, and the limited power of monetary policy. All these factors are a drag on the economy and are, in fact, already at play.

The limited power of monetary policy is particularly troublesome and is new territory. Currently, the stock market is expecting further rate cuts and that stimulative effect is already subsumed into company valuations. This puts the Federal Reserve in a no-win situation. If the Fed does not continue decreasing interest rates, those high valuations will be adjusted downward, and the stock market will falter. This would essentially cancel out the presumably positive impact of previous interest rate cuts. In this scenario, it is the tail wagging the dog. If the Fed does continue to decrease interest rates, it loses the ability to make larger and more impactful rate cuts in the event of a full-blown recession. Complicating matters is the contentious relationship between the current administration and the Federal Reserve. Many economists are critical of the current monetary moves because they perceive that the Federal Reserve is indirectly accommodating the negative impact of the tariffs.

The question is how long will the momentum of the U.S. economy continue to override these realities?

On the upside, the resilience of the U.S. economy can most evidently be seen in two important economic drivers, employment and consumer confidence. Employment growth has been robust in the U.S., the state and in our region. In the past 12 months, employment in the U.S. has had an average monthly gain of 161,000. This is compared to an average monthly gain of 223,000 in 2018. The rate of employment growth has slowed, but it is still quite positive as of the September 2019 data. The corresponding unemployment rate in September was at a 50-year low at 3.5 percent. This indicates that businesses are confident enough in their current and short-term future growth that they believe hiring new workers is in their best interests. According to the August report from the National Federation of Independent Businesses, the small business index is still among the top 15 percent of readings dating back 45 years although the record high readings of a year ago are no longer in play. Business owners are now stating they are not as optimistic mostly because of trade uncertainty. The same surveys show a shrinking percentage of business owners who plan to hire in the near term. This indicates that the momentum in employment may soon be petering out.

There is another important dimension to the employment story beyond the low unemployment rate. Much of the overall economic momentum is also explained by increases in labor participation. In the U.S., but even more so in our state and region, many people have re-entered or newly entered the labor force. This has vast, positive impact for a few different reasons. First, the same business surveys show that company owners state their largest impediment to growth is the lack of qualified workers. If more people are entering or re-entering the labor force, some of that labor shortage is being alleviated. Second, if more people are gainfully employed, they become more active consumers in the economy creating a positive feedback loop between households and businesses. Third, the aging of the U.S. population means that we inherently have fewer workers and higher transfer payments, particularly Medicare and Social Security. We need able workers to help finance those transfer payments through income taxation.

According to the Colorado Department of Labor and Employment, our state's labor force increased by 44,242 people, or 1.4 percent, from August 2018 to August 2019. For the same period, El Paso County's labor force increased by 9,918 workers, or 2.9 percent. Our region significantly outpaced the state, which is one of the top performing states for labor participation. This has certainly been an important part of our regional economic momentum, and if we can keep local labor participation high, it will be an important part of our ongoing resilience.

My major takeaway from these positive employment trends is that even in the context of a national downturn, our state and region with its engaged and educated workforce, will not be as negatively impacted by a downturn as other portions of the nation. Our diversity of industries will also play a role in our state and regional resilience.

The other major driver of our national and local resilience has been consumer confidence. The positive sentiment and purchasing patterns of the average U.S. consumer have, of course, been tied to the robust employment trends and associated income gains. Although the U.S. has a high income gap with the top 5 percent making an average of $416,520 and the lowest quintile making $13,775 (U.S. Census Bureau), income gains during this long expansion have been broad across socio-economic groups. This has fed into the positive feedback loop between household personal expenditures and business growth. More recently, however, consumer confidence has weakened. The September index from The University of Michigan posted an almost 7 percent reduction in consumer confidence from a year ago. Waning consumer confidence and associated spending patterns are often the proverbial straw that halts economic expansions. My hope is that the robust growth we have had locally since 2014 will have cemented a stronger economic base than we have had in the past and thus, we will weather the storm well.

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