BLOG POST

Last Country Standing

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Notwithstanding the dire predictions about the demise of the U.S. economy from pundits and politicians, the data suggests economic expansion in the U.S. is likely to continue for the immediate future. The U.S. has enjoyed continuous growth in its economy since March of 2009, making this expansion the longest in post-war history. It is the rest of the world that appears to be headed toward economic contraction, or recession.

Concern was sparked in August when the yield curve inverted with the yield on the 2-year Treasury above the 10-year Treasury; a reliable predictor of recession over the last 50 years. While reliable indictors should not be ignored, they are not as important as the actual economic data from each country or region.

For example, Consumer Confidence remains near all-time high levels after a brief drop in the June reading. The Unemployment Rate is hovering around 3.7% — near a 50-year low for those without work. The National Federation of Independent Businesses (NFIB) data suggests the outlook for business remains optimistic. Citizens Bank just released their Business Conditions Index of corporate and public data with a reading of 61.2, down just slightly from the highs recorded in the first quarter of 2019. Even with the Trade War with China, corporations showed strong revenue growth, productivity gains and plans to add new jobs.

The rest of the world, sadly, is not faring so well. The Purchasing Managers Index (PMI) in the UK, Germany, Italy and Japan all suggest their manufacturing sectors are in contraction. Nowhere is that more troublesome than in Germany, where the PMI reading has fallen from 63 in January 2018 to just 43 in August 2019. Most analysts agree that Germany is already in a recession and very likely to drag the balance of Europe with it.

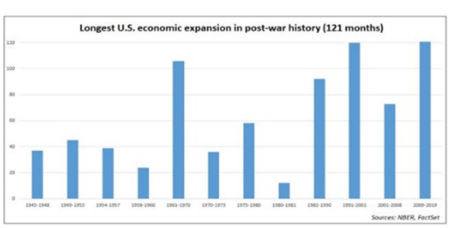
Asia is equally struggling with exports from Japan, a critical part of their economy, falling for 3 consecutive quarters. The slowdown in China has been well-documented with growth estimated below 5% for the first time in decades. The protests in Hong Kong are disrupting the global economy and could tilt much of the world into recession.

Politicians have seized on global economic turmoil, often caused by tweets emanating from the White House, to suggest the U.S. economy is in dire shape. If they make the economy the centerpiece of their campaign, however, they may live to regret that strategy. The volatile but prescient GDPNow published by the Atlanta Fed indicates that 3rd quarter GDP is trending higher and forecasts growth of 2.2%. The current economic data is too strong today to suggest that a contraction or recession is imminent.

There are significant risks that are worth noting and watching. Exports to China represent just .2% of U.S. GDP, so the Trade War with China simply will not result in a recession here. My biggest concern is that the U.S. will experience a contraction in corporate credit and lending that has the potential to lead to a recession. The inverted yield curve is a profit squeeze on banks as the margins on bank loans contract. As banks become less willing to lend, credit necessary for businesses to grow becomes scarce even though rates are at very low levels.

Wages are growing at the fastest pace in almost two decades, making consumers resilient to claims of economic doom. Housing has slowed dramatically at the high end of the market, but remains robust in most markets at median price levels. Business confidence is weak and companies that rely on exports are facing high levels of uncertainty, but history suggests weak business investment is not enough to tilt the U.S. economy into contraction.

Strong consumer spending plus higher government expenditures less weak business investment (capex) equals slow growth, not a recession. Even the flashing red light of the inverted yield curve does not suggest a recession before the 2020 election is complete. Over the last 50 years, the average time between the yield curve inverting and the start of a recession is 18 months. Also interesting is that the stock market has gained, on average, 15% from inversion to recession. It makes sense to be vigilant from a risk-management standpoint but likely too early to be in panic mode.



Strong Consumer Spending +
Higher Government Expenditures –
Business Investment = Slow Growth