RESEARCH SEMINAR IN QUANTITATIVE ECONOMICS
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For Release: 03/18/2019

The U.S. Economic Outlook for 2019–2020
Executive Summary: March 2019

Fiscal Stimulus Works

Real GDP grew by 2.9 percent in 2018, the strongest reading in thirteen years. Over 2019–2020, we expect GDP growth to decelerate as the temporary boost from the tax cuts and federal spending fades. Our forecast assumes de-escalation of trade tensions with China and no new tariffs on other nations.

The initial estimate of real GDP growth in the fourth quarter of 2018 showed a deceleration to a 2.6 percent seasonally adjusted annual rate, down from 4.2 percent in the second quarter and 3.4 percent in the third quarter. Investment in structures, government spending except for defense, and imports were all drags on GDP growth. The bright spots in the fourth quarter were consumer durables, intellectual property investment, investment in cars, and investment in multi-family residential structures.

With the return of divided government, gridlock and brinkmanship have also returned. They brought with them the longest federal government shutdown in U.S. history, lasting 35 days. Additionally, the lapse of federal funding delayed most government economic data, complicating assessment of the economy.

Confidence Faltering?

The shutdown and the sharp stock market sell-off at the end of 2018 appear to have broken the wave of high confidence the economy had been riding since the 2016 election. Measures of consumer and business confidence worsened in December and January. The stock market, policy uncertainty measures, and confidence indices have been improving recently, alleviating concerns of imminent recession. These recession scares may become more frequent as the economy comes off a fiscal high during 2019.

Margin Compression

Wage growth continues to improve. As of February, year-over-year average hourly earnings of employees on private nonfarm payrolls were growing at a 3.4 percent pace, the strongest reading since April 2009.

The unemployment rate temporarily jumped to 4.0 percent in January, largely due to the partial government shutdown. The unemployment rate ticked back down to 3.8 percent in February. Nonfarm payroll employment grew by just 20,000 jobs in February, but this weakness came on the heels of the 223,000 monthly average job additions in 2018 and the 311,000 jobs added in January 2019.

Driven by falling oil prices, headline CPI inflation decelerated considerably in recent months, falling to 1.5 percent year-on-year in February. Core CPI inflation retreated slightly early in 2019, registering 2.1 percent over the prior 12 months in February.

Rising wages, coupled with weak inflation and muted productivity gains, can put future business profits under pressure.

Every year since 2015, strong light vehicle sales in the fourth quarter have been followed by weakness in the next quarter, and this trend has held up so far in 2019. Light vehicle sales averaged 17.5 million units in the fourth quarter of 2018, while the January–February 2019 average was 16.6 million units. Inventories of light trucks appear to be rising. We expect inventory control to occur through production slowdowns rather than growth of incentives in the near term.

Housing on Shaky Ground

The single-family home market suffered multiple setbacks in 2018. Price appreciation eroded affordability, continuing a trend that had been ongoing for several years. Mortgage rates rose to their highest level since 2011 in the fourth quarter of 2018. Slowing sales and rising inventory shifted the housing market balance in favor of buyers, with home price appreciation slowing. The 12-month growth of the seasonally adjusted S&P CoreLogic Case-Shiller National Home Price Index has slowed from 6.5 percent appreciation in March 2018 to only 4.7 percent in December.

We expect housing market activity to be sluggish over our forecast horizon, supporting continued but slower home price appreciation.

Trillion Here, Trillion There

We expect federal government spending to ramp up during the first half of 2019, reflecting fiscal 2018–19 federal appropriations making their way into NIPA outlays and a catch-up of spending delayed by the recent partial federal shutdown. The path of spending beyond fiscal 2019 is uncertain and probably not as lavish.

On March 2, the debt ceiling reset to 22 trillion dollars; without action, sequester-level caps will return in fiscal 2020. We expect Congress to address both issues without major drama. Our forecast is for Congress to continue on its current trajectory of increasing spending and ballooning deficits over the next two years.

With revenue growth expected to lag behind expenditure growth, the federal deficit will exceed a trillion dollars in fiscal 2019–2020. The deficit will widen from 4.6 percent of GDP in 2018 to 5.4 percent of GDP in 2020.

The Fed Humbled

The stock market dived while financial volatility shot up in December after an interest rate hike and hawkish guidance from the Federal Reserve. In particular, markets were spooked by the idea of an "autopilot" unwinding of the Fed's balance sheet. By early January the Fed reversed course, with Chairman Powell reassuring markets that the Fed would be flexible with the policy tools at its disposal.

Inflation remains close to the Fed's 2 percent target, while the labor market tightens somewhat further. As a result, we currently project one 25-basis-point fed funds rate range increase in December 2019, followed by one more in 2020.

The 2019–2020 Outlook

Calendar-year growth slows to 2.4 percent in 2019 and only 1.8 percent in 2020, as the fiscal boost from lower taxes and higher federal spending wanes.

As the economy slows, so do light vehicle sales. The all-time high of 2016's 17.5 million units is now a distant memory. Total light vehicle sales fall from 17.2 million units in 2018 to 16.8–16.9 million units in 2019–2020.

Total housing starts barely improve in 2019–2020. Single-family home starts stay flat in 2019 and increase only 20,000 units in 2020. We expect multi-family home starts to edge down between 2018 and 2020.

Employment and Inflation

Average monthly nonfarm payroll job gains decelerate from about 207,000 job additions per month in 2019q1 to 143,000 in 2019q4 and to 109,000 at the end of 2020. The unemployment rate continues to decline, falling from 3.9 percent in 2019q1 to 3.6 percent at the end of 2019. It stays at that level until the end of 2020.

In 2019, core CPI inflation remains about flat with 2018's 2.1 percent pace and then ticks up to 2.2 percent in 2020. Driven by lower energy prices, headline CPI inflation decelerates to 1.7 percent in 2019. A mild rise in energy prices helps inflation to rise to 2.0 percent in 2020.

	Actual		RSQE Forecast	
	2017	2018	2019	2020
GDP (billions of current $)	19485.4	20500.6	21389.5	22266.4
Real GDP (billions of 2012 $)	18050.7	18571.3	19007.7	19358.5
% change: year-over-year	2.2	2.9	2.4	1.8
% change: 4th-qtr-to-4th-qtr	2.5	3.1	2.0	1.6
Nonfarm payroll employment (millions)	146.6	149.1	151.5	153.2
Civilian unemployment rate (%)	4.4	3.9	3.7	3.6
Capacity utilization, total industry (%)	76.1	78.0	78.2	78.1
Inflation (private nonfarm GDP deflator, % change)	1.9	2.3	1.9	2.2
Inflation (CPI-U, % change)	2.1	2.4	1.7	2.0
Inflation (core CPI, % change)	1.8	2.1	2.1	2.2
Light vehicle sales (millions)	17.1	17.2	16.9	16.8
Private housing starts (thousands)	1208.2	1240.5	1238.7	1252.5
3-month Treasury bill rate (%)	0.9	1.9	2.4	2.6
10-year Treasury note rate (%)	2.3	2.9	2.8	3.1
Conventional mortgage rate (%)	4.0	4.5	4.6	4.9
Real disposable income (billions of chained 2012 $)	13949.3	14350.0	14718.8	15105.2
% change	2.6	2.9	2.6	2.6
Corporate profits after tax (billions of current $)	1831.2	1950.3	2028.3	2175.5
Value of U.S. $ (FRB broad index), % appreciation	-0.3	0.7	3.1	-0.0
Current account balance (NIPA basis, billions of current $)	-472.5	-502.9	-553.2	-538.7
Federal surplus (FY, NIPA basis, billions of current $)	-664.1	-931.9	-1103.7	-1201.2