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Economic Outlook Symposium: Summary of 2018 results and 2019 forecasts

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According to participants in the Chicago Fed's annual Economic Outlook Symposium (EOS), the U.S. economy is forecasted to grow at a pace somewhat above average in 2019, with inflation ticking down and the unemployment rate remaining low.

The Federal Reserve Bank of Chicago held its 32nd annual Economic Outlook Symposium on November 30, 2018. More than 125 economists and analysts from business, academia, and government attended the conference. This *Chicago Fed Letter* reviews the forecasts for 2018 from the previous EOS, and then analyzes the forecasts for 2019 (see figure 1) and summarizes the presentations from the most recent EOS.

Some materials presented at the latest EOS are available online, https://www.chicagofed.org/events/2018/economic-outlook-symposium.

The U.S. economy entered the tenth year of its expansion in the third quarter of 2018, already having become the second-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 the 37 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 2017—a bit higher than the current expansion's average. Then, in part boosted by economic stimulus offered by the federal tax reform passed in December 2017 (the Tax Cuts and Jobs Act), the economy's growth accelerated to an annualized rate of 3.2% during the first three quarters of 2018.

The strength in economic growth in 2018 was broad-based. Consumer spending expanded at a solid pace in 2018: Real personal consumption expenditures grew at an annualized pace of 2.6% during the first three quarters of 2018—nearly the same growth rate recorded in 2017. The pace of light vehicle sales (car and light truck sales) was 17.2 million units in 2018—0.5% higher than the selling rate in 2017.

Energy prices increased sharply during the first ten months of 2018. Specifically, the average price of West Texas Intermediate oil rose from $57.90 per barrel in December 2017 to $70.76 per barrel in October 2018. Oil prices then collapsed in November, partly because of the rising global supply of oil and partly because of slowing economic growth around the world; oil prices fell to an average of $49.14 in the final month of 2018.

1. Median forecasts of real gross domestic product and related items

	2017 (Actual)	2018 (Forecast)	2019 (Forecast)
Real gross domestic product[a]	2.5	**3.1**	**2.4**
Real personal consumption expenditures[a]	2.7	**2.7**	**2.4**
Real business fixed investment[a]	6.3	**6.4**	**3.4**
Real residential investment[a]	3.8	**–2.2**	**1.8**
Change in private inventories[b]	16.1	**57.1**	**45.0**
Net exports of goods and services[b]	–899.2	**–952.2**	**–990.0**
Real government consumption expenditures and gross investment[a]	0.1	**2.3**	**1.9**
Industrial production[a]	3.0	**3.4**	**2.1**
Car and light truck sales (millions of units)	17.1	**17.1**	**16.8**
Housing starts (millions of units)	1.21	**1.26**	**1.28**
Unemployment rate[c]	4.1	**3.7**	**3.7**
Consumer Price Index[a]	2.1	**2.4**	**2.3**
One-year Treasury rate (constant maturity)[c]	1.55	**2.70**	**3.26**
Ten-year Treasury rate (constant maturity)[c]	2.37	**3.20**	**3.55**
J. P. Morgan trade-weighted dollar index[a]	–4.1	**3.0**	**1.8**
Oil price (dollars per barrel of West Texas Intermediate)[c]	55.39	**69.26**	**68.75**

[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 2018.
Sources: Actual data from authors' calculations and Haver Analytics; median forecasts from Economic Outlook Symposium participants.

Even with higher oil prices for most of the year, more consumers chose to purchase larger, less fuel-efficient vehicles than in the year before: Sales of light trucks (including sport utility vehicles) were up 7.7% in 2018 compared with the previous year, while sales of passenger cars were down 12.8%. 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 69.1% of overall light vehicle sales in 2018.

Despite the slight increase in light vehicle sales, industrial production expanded at an annualized rate of 3.7% over the first 11 months of 2018—better than its growth rate of 3.0% in 2017. The improvement in industrial production was largely due to strengthening business investment. Real business fixed investment, which had already grown at a strong 6.3% pace in 2017, rose at an even better annualized rate of 7.5% over the first three quarters of 2018.

In contrast, residential investment did not fare as well. After expanding by 3.8% in 2017, real residential investment declined at an annualized pace of 2.8% during the first three quarters of 2018. That said, the annualized rate of housing starts still increased to 1.26 million units for the first 11 months of 2018—up 4.7% relative to the same period in 2017.

On an annualized basis, growth in real government spending was 2.2% over the first three quarters of 2018—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 2018: 2.64 million jobs were added last year. Moreover, in the final quarter of 2018, the unemployment rate stood at 3.8%—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).

Inflation, as measured by the Consumer Price Index (CPI), increased from a 2.1% reading in 2017 to a year-over-year rate of 2.2% in November 2018.

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 2018 relative to the fourth quarter of 2017 is estimated to be 3.1%—higher than the 2.3% 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 2018 from the most recent EOS.) Growth in real business fixed investment was quite a bit stronger 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 was actually 3.8% in the fourth quarter of 2018—0.3 percentage points lower than the value forecasted for the final quarter of 2018. Inflation, as measured by the CPI, is now expected to be 2.4% in 2018—0.4 percentage points above the previously predicted rate of 2.0% for the year. Even though oil prices moved up and down sharply in 2018, oil's actual average price in the fourth quarter of 2018 was $58.97 per barrel—modestly above its predicted average price of $53.18 per barrel. Light vehicle sales actually came in at 17.2 million units for 2018—above the 17.0 million units forecasted. The annualized rate of housing starts was 1.26 million units for the first 11 months of 2018; so, total housing starts in 2018 are expected to come in very close to the 1.26 million units previously predicted. The one-year Treasury rate in fact moved up to 2.67% in the fourth quarter of 2018—well above the 2.01% forecasted. The ten-year Treasury rate increased to 3.03% by the end of 2018—extremely close to the predicted rate of 3.01%.

Economic outlook for 2019

The EOS consensus forecast for 2019 is for the pace of economic growth to be somewhat above the long-term average. In 2019, the growth rate of real GDP is expected to be 2.4%—lower than the projected 3.1% rate for 2018. The quarterly pattern reveals a fairly steady performance (close to the annual pace) for real GDP growth during the first three quarters of 2019; however, the annualized rate of GDP growth is predicted to slip down to 2.1% in the final quarter of the year. The unemployment rate is expected to remain steady at a very low 3.7% for each quarter through the final quarter of 2019.

Inflation, as measured by the CPI, is predicted to tick down from an estimated 2.4% in 2018 to 2.3% in 2019, according to the EOS consensus forecast. As mentioned before, oil prices collapsed in November 2018 (shortly after most of the EOS forecasters had submitted their 2019 projections); oil prices are predicted to be fairly steady throughout much of 2019 (but at a much higher level than where these prices had actually settled by the end of 2018). Real personal consumption expenditures are forecasted to expand at a rate of 2.4% in 2019. Light vehicle sales are expected to fall to 16.8 million units this year. After two strong years of growth, the pace of real business fixed investment growth is anticipated to moderate to a still solid 3.4% in 2019. Industrial production is forecasted to grow by 2.1% this year—below its long-run average rate of growth.

The housing sector is predicted to resume its extremely slow march toward normalization in 2019. The growth rate of real residential investment is forecasted to rebound to 1.8% in 2019 from –2.2% in 2018. And housing starts are anticipated to edge up to 1.28 million units in 2019—nearly in line with the 20-year annual average of roughly 1.3 million starts.

The one-year Treasury rate is expected to rise to 3.26% in 2019, and the ten-year Treasury rate is forecasted to increase to 3.55%. The trade-weighted U.S. dollar is predicted to rise 1.8% in 2019, and the nation's trade deficit (i.e., net exports of goods and services) is anticipated to increase to $990.0 billion by the final quarter of 2019.

Consumer and banking outlook

Carl Tannenbaum, chief economist, Northern Trust, presented his outlook for consumers and the banking sector. To start, Tannenbaum pointed out trends that bode well for U.S. consumers, which include very strong labor and financial markets, as well as moderating mortgage and credit card debt. Tannenbaum stated that it is rare to see the labor market perform this well—with the unemployment rate at a historically low 3.7% through November 2018. It's no wonder that measures of consumer confidence and sentiment remain quite high, he said. Tannenbaum then observed that while the tax cuts enacted in late 2017 have helped support consumer spending, their overall impact on GDP growth over the longer term remains unclear.

While the outlook for consumers remains positive on the whole, there are some factors that may pose risks to it, Tannenbaum noted. Even with very low unemployment, wage growth has not been as high in the current expansion as in past ones, he said. And while households generally have more savings than a decade ago and have better control of their leverage, the income distribution today is more skewed. Tannenbaum remarked that even though most people are managing their debts better than ten years ago, they are still "dramatically under-saved" for retirement. He also stated that the growing amount of student debt has been a headwind to housing and could impair consumption more generally over the near and long terms.

Turning to the banking sector, Tannenbaum commented that it is much healthier now than it was in 2007. The largest banks have better capital positions, and they have reduced their use of volatile short-term funding, replacing it with deposits. However, Tannenbaum cautioned, non-financial corporate debt is higher now than it was in 2007, and rising corporate debt poses a risk to financial stability.

Automotive outlook

Charles Chesbrough, senior economist, Cox Automotive, stated that high consumer confidence and low unemployment have contributed to robust vehicle sales nationwide in recent years. Increased credit availability has also been a significant factor in strong sales. But it is unclear how long these positive trends will last, he cautioned. According to Chesbrough, new light vehicle sales peaked at 17.5 million units in 2016. At the time of the most recent EOS, he said new light vehicle sales were expected to reach 17.1 million units in 2018. Partly because of rising fuel prices, plus increasing interest rates, Chesbrough said he expects new light vehicle sales to fall to 16.6 million units in 2019 and then to 16.5 million units in 2020. However, certain market events could cause these sales to drop even further, he noted. The implementation of a 10% tariff on aluminum imports from most countries in 2018 is estimated to have already increased the average price of new vehicles by 1%, Chesbrough said. Should an automotive tariff of 25% also be instituted, this could increase the average new vehicle price by $4,000 and push down annual sales to 15 million units, he explained.

Chesbrough remarked that as new vehicle prices have risen lately, consumers have been increasingly seeking out used vehicles. Moreover, the supply of used vehicles is anticipated to increase, as 4.1 million off-lease vehicles (typically late-model, low-mileage cars in good condition) hit the market in 2019 and nearly as many roll onto dealer lots in 2020. This is another factor likely to lower new vehicle sales this year and next. According to Chesbrough, used vehicle sales are forecasted to remain at 39.5 million units in 2019 and to dip a little to 39.2 million units in 2020.

In closing, Chesbrough commented that auto dealers continue to face tough market conditions, including rising expenses and growing competition. Additionally, many dealers are concerned about how their bottom lines will be negatively affected if further auto-related tariffs are imposed.

Steel industry outlook

Amy Ebben, division manager, strategic marketing, ArcelorMittal USA, noted that U.S. steel consumption in 2018 increased 1–2% from 2017, reaching just over 110 million tons (the highest level since 2014). Multiple factors contributed to the modest growth in domestic steel demand. Changes in the energy industry—which uses a lot of steel for extracting and transporting oil and gas—had a positive impact on steel consumption last year, noted Ebben. For example, the number of U.S. oil and gas rigs had risen to over 1,000 by late 2018 from around 700 in early 2017 (and about 400 in mid-2016). Other contributing factors included a jump in spending on nonresidential construction (the largest final market for steel), continued strong auto demand, and a recovery in machinery demand. Moreover, industrial production performed somewhat better in 2018 than in 2017. Shipments and inventories of steel were also up in 2018 relative to a year earlier. According to Ebben, domestic steel consumption is anticipated to grow another 1–2% in 2019, given that she projects flat or modest growth for most of the major final markets for steel. While steel demand continues to improve, it remains below pre-recessionary levels, she said. The top downside risks to her outlook for domestic steel demand are trade tensions, higher inflation, and rising interest rates, she noted. These all have the potential to adversely affect manufacturing output and consumer demand, which in turn would hurt steel consumption.

As part of her presentation, Ebben discussed the new U.S. tariffs on steel imports put into place in March 2018. Most countries (including Canada and Mexico) currently face a 25% duty on their steel shipments to the U.S. Since the tariffs were implemented, steel imports have declined slightly and idled domestic steel operations have been restarted, said Ebben. Meanwhile, steel exports have also declined as retaliatory tariffs have come into effect. Steel prices had surged just after the tariffs were instituted, but since the summer, they have been drifting lower, she observed. Ebben noted that the full effects of the new trade policy have yet to be determined.

According to Ebben, global steel consumption in 2019 is projected to increase a modest 1.4% from 2018, to 1.68 billion metric tons. Reduced demand for steel from Asia and Oceania is the primary factor behind the expected slowdown in global steel consumption growth, which was around 4% in 2018.

Heavy machinery outlook

Laura Speake, regional chief economist, Caterpillar, presented a fairly positive outlook for the heavy machinery industry. Speake began by noting that when global real GDP growth is greater than 2.5%, heavy machinery sales typically improve. According to the forecasts from Bloomberg that Speake cited, the growth rate of world real GDP is expected to be 3.6% in 2019, slightly lower than the 3.8% rate in 2018. Heavy machinery sales in markets across the globe have been moving up since 2016, and Speake indicated she expects this trend to continue into 2019.

Speake said that the U.S. heavy machinery industry has some upside in 2019 mainly on account of the positive trends seen in the construction sector. U.S. housing starts and permits have continued to rise over the past few years (though perhaps not as quickly as expected given generally solid economic conditions), she stated. Housing starts are projected to grow 3.1% in 2019, according to Speake. Notably, U.S. construction employment was up by 4.7% on a year-over-year basis in October 2018—much higher than the 1.7% growth rate for total employment. The National Association of Realtors' Housing Affordability Index has been moving lower of late, but it remains well above 100, which suggests that conditions remain favorable for home purchases. Indeed, even though mortgage rates having been inching up, house prices have been moderating, helping to keep home-buying affordable in most markets except some out West. Speake said that she expected spending on infrastructure improvements to grow in the future; however, even if a federal infrastructure bill were to be passed soon, its effects would not be observable until 2021 or 2022.

Speake noted that the U.S. oil and gas industry's output has been on the rise since 2016. She said she expects domestic production of oil and gas to continue to grow in the coming years. Moreover, she remarked that she does not anticipate an oil price collapse due to global overproduction (unlike the situation in 2014–16). This all bodes well for future heavy machinery sales, she indicated. Unlike U.S. oil and gas production, domestic mining production is weakening, so heavy machinery sales won't be helped much by the mining sector. Yet solid U.S. economic fundamentals—plus strong global real GDP growth—are expected to remain supportive of heavy machinery purchases, she said.

Global economic risks

Tony Nash, CEO and founder, Complete Intelligence, spoke about what in his view are the top risks to global economic growth. His presentation focused on the slowdown of the Chinese economy and the increasing strength of the U.S. dollar. In particular, global trade dynamics may be affected by both China's slowing GDP growth and the U.S. dollar's dominance, considering that China is currently the world's largest trading nation and the rising strength of the U.S. dollar impacts demand for U.S. exports and the supply of imports.

Nash discussed some of the structural changes to China's economy that have increased uncertainty about its growth. China is the top trading partner for the U.S., but trade tensions between the two nations have intensified over the past year. Nash argued that China's economic growth depends more on exports than that of the U.S., and as such, it may have more to lose. According to Nash, China is now experiencing weakened foreign demand for its goods and its manufacturers have had to reduce production—even to the point of temporarily shuttering entire factories. Also, China's economy is losing steam because of rising government and consumer debt levels, plus slowing domestic infrastructure spending, said Nash. Moreover, Nash contended, China's foreign infrastructure investment program—the Belt and Road Initiative[1]—is failing to gain solid momentum because of lack of funding from other countries and growing political tensions. Nash said his main concern regarding a Chinese economic slowdown is the negative economic effects it will have on other countries that depend heavily on Chinese demand for their goods.

Nash turned his attention to the effects of an appreciating U.S. dollar. According to Nash, the U.S. dollar's dominance can have a dramatic impact on trade and, hence, the U.S. economy's growth. A strengthening dollar makes U.S.-made goods more expensive to foreign customers, thus reducing the demand for such goods and lowering the growth of exports. It also hurts the value of international sales for U.S. firms. Additionally, while a rising dollar can increase the demand for foreign-made goods in the U.S., it can still be detrimental to emerging market economies (e.g., Brazil) as investors retreat from them in favor of putting their capital to work in the U.S. Finally, historically, there's been an inverse correlation between the value of the U.S. dollar and commodities prices. Nash observed that prices for gold and silver, for instance, were falling on the strength of the U.S. dollar (and weakness in emerging markets). Nash said that the U.S. dollar is predicted to continue to rise against most major currencies this year, so commodities prices are expected to move lower in 2019.

Conclusion

In 2018, the U.S. economy expanded at a pace well above the long-term average. The economy in 2019 is forecasted to grow at a slower pace than it did in 2018, though still above the long-run trend, according to EOS participants. Business investment is predicted to moderate in 2019, while the housing sector is projected to improve this year. The unemployment rate is expected to stay low, at 3.7%, through the end of 2019, and inflation is predicted to move down slightly to 2.3%.

[1] Details on China's Belt and Road Initiative are available online, https://www.economist.com/the-economist-explains/2017/05/14/what-is-chinas-belt-and-road-initiative.

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