Slowing but Refreshing!

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Economic Overview

• U.S. economy decelerating further but recession avoided.
• Manufacturing, Retail, Energy, and Transportation remain vulnerable.
• Inflation: headline slightly below 2%; core slightly above 2%.
• Federal Reserve comfortable with current policy of 1.50% to 1.75%.
• List of risks and uncertainty long but occurrence probability low.
## Forecast and Outcome: 2019

### Forecast: 2020 – 2021

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2019</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Real GDP</strong></td>
<td>2.4</td>
<td>2.6</td>
<td>2.3</td>
<td>1.9</td>
<td>1.9</td>
</tr>
<tr>
<td><strong>PCE</strong></td>
<td>2.3</td>
<td>2.7</td>
<td>2.6</td>
<td>2.4</td>
<td>2.1</td>
</tr>
<tr>
<td><strong>Non-Res</strong></td>
<td>4.2</td>
<td>4.1</td>
<td>2.2</td>
<td>1.1</td>
<td>2.6</td>
</tr>
<tr>
<td><strong>Exports</strong></td>
<td>------</td>
<td>-990</td>
<td>-972</td>
<td>-979</td>
<td>-1018</td>
</tr>
<tr>
<td><strong>Industrial Prod</strong></td>
<td>2.7</td>
<td>2.7</td>
<td>0.9</td>
<td>0.5</td>
<td>1.4</td>
</tr>
<tr>
<td><strong>Light Vehicle</strong></td>
<td>16.7</td>
<td>16.8</td>
<td>16.9</td>
<td>16.6</td>
<td>16.5</td>
</tr>
<tr>
<td><strong>CPI</strong></td>
<td>2.2</td>
<td>2.1</td>
<td>1.8</td>
<td>2.2</td>
<td>2.0</td>
</tr>
<tr>
<td><strong>Unem Rate</strong></td>
<td>3.8</td>
<td>3.6</td>
<td>3.7</td>
<td>3.6</td>
<td>3.7</td>
</tr>
<tr>
<td><strong>T-Bill (3mo.)</strong></td>
<td>2.4</td>
<td>2.6</td>
<td>2.1</td>
<td>1.5</td>
<td>1.4</td>
</tr>
<tr>
<td><strong>T-Note (10 yr)</strong></td>
<td>3.2</td>
<td>3.0</td>
<td>2.1</td>
<td>1.9</td>
<td>2.1</td>
</tr>
</tbody>
</table>

Deviations: Industrial Production decline lead to softness in Non-Residential investment.

Softness in headline CPI which was mirrored by PCE prices.

Federal Reserve timely response lowered rates significantly.
Since mid-2018 manufacturing employment has weakened. It turned negative toward end of 2019.

Trucking, with a lag, has followed suit.

Little, so far, to suggest that a recovery or even a flattening has occurred.
GDP growth:
2018 = 2.9%
2019 = 2.3%
2020 = 1.8%
2021 = 2.0%

GDP: Consumption strong, trade deficit drag. Business investment positive even as it slows.

Vulnerable sectors:
Manufacturing, freight, retail, energy.
Uncertainty and Risks

- Tariff and Trade.
- Spill-over from manufacturing and associated sectors.
- Election(presidential) Uncertainty.
- Slow growth in global economy, especially Europe and China.
  - Brexit
- Financial market and/or credit weakness.
- Fiscal Policy: potential for activism absent.
- Geopolitical.
- Federal Reserve errors
Consumer: Positive Outlook

• Employment
• Wealth
  - Income, stock market, house prices
• Household Debt/Income: 0.3 versus 3.0 in 2008
• Servicing Debt: 9.7 versus 13% in 2008
• Saving Rate: 8%, nearly double 20 years ago
• Sentiment

Consumer Confidence

Business Confidence

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Weakness in structure expenditures, (black), is partially due to energy sector as well as uncertainty facing manufacturing.

Equipment spending, (red) spikes in Q4’19 as striking UAW workers return.

Intellectual outlays slow down but still are more robust that other segments.

As fear of recession eases increased spending starts growing too.
Headline inflation likely to be below the 2% mark, while core rate is above 2%.

Swings in energy and commodities are major source of price volatility.

Tariffs are likely to impact price numbers in early 2020.

Wage increases moderate and manageable.
The potential effect of tariff imposition is shown in the rightmost column of the attached table.

Neither the CPI nor the import price index show any significant rise in prices in the past several months.

Various explanations can be offered but a puzzle remains none-the-less.
Current fed funds target is 1.50% to 1.75%.

Federal Reserve Policy moderate and measured. Currently comfortable with its stance.

FOMC policy, if necessary, will tend to ERR on the side of caution.

Steady policy unless a significant weakness occurs. FOMC won’t tighten until inflation is over the 2% benchmark and economic activity robust.
Recessions

• Don’t Die of Old Age
  - Current recovery is already a record setter; 10 ½ years and going strong.
• Usually financial and often the Fed’s doing(fault?)
  - A shock or inevitable
• No one sector, one item or one signal
• Inverted Yield curve. Which yield curve? Why?
• Sectoral Imbalances (old days it was inventories)
• Fiscal Policy: potential for activism absent.
• Manufacturing weak but will there be spillover?
Summary

• Continued positive growth slightly below trend of 2%
  - Prospects of a strong rebound or a dramatic fall are low.
• Consumer should continue robust; Investment positive but cautiously so.
• Inflationary pressures remain contained but risk of a modest rise cannot be ignored.
• Policy Posture: Monetary - activist; Fiscal - dysfunctional.
• Trade issues, particularly vis-à-vis China remain regardless of who sits in the White House or Congress.
• Oil prices: Not soaring; Not collapsing but plodding along.