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Chicago Fed Letter

Economic Outlook Symposium: Summary of 2019 results and 2020 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 expand at a pace in 2020 near the long-term average, with inflation ticking up and the unemployment rate remaining low.

The Federal Reserve Bank of Chicago held its 33rd annual Economic Outlook Symposium on December 13, 2019. More than 140 economists and analysts from business, academia, and government attended the conference. This *Chicago Fed Letter* reviews participants' forecasts for 2019 from the previous EOS, and then analyzes their forecasts for 2020 (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/2019/economic-outlook-symposium.

In the third quarter of 2019, the U.S. economy entered the 11th year of its expansion, making this the 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 41 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 2018—a bit higher than the current expansion's average. However, the economy was challenged by a significant drop in the stock market as the year came to a close. The Standard & Poor's (S&P) 500 stock market index fell dramatically between September 21 and December 24, 2018, losing 19.8% of its value. This led to concerns by some about a potential recession in 2019. Yet, back in 1966, Nobel Prize-winning economist Paul Samuelson wrote that "Wall Street indexes predicted nine out of the last five recessions," indicating that declines in the stock market are not necessarily reliable signals for imminent economic downturns.[1] The negative signals of late 2018 also turned out to be incorrect, and the market began rising again in late December. By the end of April 2019, the S&P 500 had recovered the entire drop in its value.

The annualized rate of real GDP growth was 3.1% in the first quarter of 2019, and then, in part challenged by increased tariffs and threats of additional tariffs, it decelerated to 2.0% in the second quarter and 2.1% in the third quarter. The moderation in economic growth in 2019 was largely due to slowing business investment (likely resulting from heightened uncertainty surrounding trade policy).

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

	2018 (Actual)	2019 (Forecast)	2020 (Forecast)
Real gross domestic product[a]	2.5	**2.2**	**1.7**
Real personal consumption expenditures[a]	2.6	**2.7**	**2.0**
Real business fixed investment[a]	5.9	**0.5**	**1.8**
Real residential investment[a]	–4.4	**0.7**	**1.0**
Change in private inventories[b]	93.0	**53.0**	**48.1**
Net exports of goods and services[b]	–983.0	**–990.0**	**–1,002.6**
Real government consumption expenditures and gross investment[a]	1.5	**2.8**	**1.7**
Industrial production[a]	4.0	**–0.7**	**0.9**
Car and light truck sales (millions of units)	17.2	**16.9**	**16.6**
Housing starts (millions of units)	1.25	**1.26**	**1.28**
Unemployment rate[c]	3.8	**3.6**	**3.7**
Consumer Price Index[a]	2.2	**1.9**	**2.0**
One-year Treasury rate (constant maturity)[c]	2.67	**1.63**	**1.69**
Ten-year Treasury rate (constant maturity)[c]	3.03	**1.78**	**1.95**
J. P. Morgan trade-weighted dollar index[a]	4.3	**1.5**	**2.7**
Oil price (dollars per barrel of West Texas Intermediate)[c]	58.97	**55.90**	**56.52**

[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 2019.
Sources: Actual data from authors' calculations and Haver Analytics; median forecasts from Economic Outlook Symposium participants.

Real business fixed investment, which had expanded at a strong 5.9% pace in 2018, grew at a very weak annualized rate of 0.3% over the first three quarters of 2019. After registering a growth rate of –4.4% in 2018, real residential investment grew at an annualized rate of just 0.2% during the first three quarters of 2019. Moreover, the annualized rate of housing starts was 1.27 million units for the first 11 months of 2019—up 0.6% compared with the same period in 2018.

In contrast, consumer spending expanded at a solid pace in 2019: Real personal consumption expenditures grew at an annualized rate of 2.9% during the first three quarters of 2019—above the 2.6% rate recorded in 2018. The pace of light vehicle sales (car and light truck sales) was 16.9 million units in 2019—1.6% lower than the selling rate in 2018.

After averaging $67.19 during the first ten months of 2018, West Texas Intermediate oil prices moved down sharply in the final two months of that year. The average price of oil fell from $70.60 per barrel in October 2018 to $49.14 per barrel in December 2018. In 2019, oil prices did move above $50 per barrel, averaging $56.99 per barrel for the year.

With relatively lower oil prices, more consumers continued to purchase larger, less fuel-efficient vehicles than in the year before: Sales of light trucks (including sport utility vehicles) were up 2.7% in 2019 compared with the previous year, while sales of passenger cars were down 10.8%. 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 72.4% of overall light vehicle sales in 2019.

Industrial production had an annualized growth rate of –0.9% over the first 11 months of 2019—in stark contrast with its growth rate of 4.0% in 2018. The deterioration in industrial production was largely due to weakening business investment.

On an annualized basis, growth in real government spending was 3.1% over the first three quarters of 2019—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 2019: 2.11 million jobs were added last year. Moreover, in the final quarter of 2019, the unemployment rate stood at 3.5%—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), decreased from a 2.2% reading in 2018 to a year-over-year rate of 2.0% in November 2019.

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 2019 relative to the fourth quarter of 2018 is estimated to be 2.2%—somewhat lower than the 2.4% rate predicted at the previous EOS. (For the remaining comparisons of GDP components, annual values for 2019 are calculated based on the consensus estimates for the fourth quarter of 2019 from the most recent EOS.) Growth in real business fixed investment was much lower than forecasted; growth in real personal consumption expenditures was a little stronger than expected; and growth in real residential investment came in weaker than predicted. The unemployment rate was actually 3.5% in the fourth quarter of 2019—0.2 percentage points lower than the value forecasted for the final quarter of 2019. Inflation, as measured by the CPI, is now expected to be 1.9% in 2019—0.4 percentage points below the previously predicted rate of 2.3% for the year. West Texas Intermediate oil's actual average price in the fourth quarter of 2019 was $56.91 per barrel—well below its predicted average price of $68.75 per barrel. Light vehicle sales actually came in at 16.9 million units for 2019—above the 16.8 million units forecasted. The annualized rate of housing starts was 1.27 million units for the first 11 months of 2019; so, total housing starts in 2019 are expected to come in close to the 1.28 million units previously predicted. The one-year Treasury rate in fact moved down to 1.58% in the fourth quarter of 2019—well below the 3.26% forecasted. The ten-year Treasury rate decreased to 1.79% by the end of 2019—also well below the predicted rate of 3.55%.

Economic outlook for 2020

The EOS consensus forecast for 2020 is for the pace of economic growth to be close to the long-term average. In 2020, the growth rate of real GDP is forecasted to be 1.7%—lower than the projected 2.2% rate for 2019. The quarterly outlook reveals a fairly steady expected performance throughout 2020 (close to the annual pace) for real GDP growth. The unemployment rate is predicted to remain relatively steady, at or near a very low 3.7% for each quarter, through the end of 2020.

Inflation, as measured by the CPI, is predicted to tick up from an estimated 1.9% in 2019 to 2.0% in 2020, according to the EOS consensus forecast. Oil prices are projected to edge higher throughout 2020. Real personal consumption expenditures are forecasted to expand at a pace of 2.0% in 2020—somewhat slower than in 2019. Light vehicle sales are expected to fall to 16.6 million units this year. The pace of real business fixed investment growth—which has averaged 3.0% over the past 20 years—is anticipated to improve to a still modest 1.8% in 2020. Industrial production is forecasted to grow by 0.9% this year—below its long-run average rate of growth.

The housing sector is predicted to improve modestly and continue its extremely slow march toward normalization in 2020. The growth rate of real residential investment is forecasted to move up to 1.0% in 2020 from 0.7% in 2019. And housing starts are anticipated to edge up to 1.28 million units in 2020—nearly in line with the 20-year annual average of roughly 1.27 million starts.

The one-year Treasury rate is expected to edge up to 1.69% in 2020, and the ten-year Treasury rate is forecasted to increase to 1.95%. The trade-weighted U.S. dollar is predicted to rise 2.7% in 2020, and the nation's trade deficit (i.e., net exports of goods and services) is anticipated to increase to a little over $1 trillion by the final quarter of 2020.

Consumer outlook

Diane Swonk, chief economist, Grant Thornton LLP, presented a generally positive outlook for U.S. consumers in 2020. According to her projection, growth in real consumer spending is expected to be slightly above 2% this year. She indicated that this forecast is supported by a strong labor market. Overall, employment levels were high last year, even with the average monthly jobs gain 20% lower in 2019 than in 2018. Swonk attributed some of this slowdown to increased uncertainty surrounding trade policy. In addition, she noted that employment growth had been held back in part by a shortage of workers in some sectors, such as trucking, and by reduced demand for labor in others, such as retail. As they did in 2019, the monthly jobs gains are predicted to slow somewhat but remain solid in 2020, according to Swonk. Relatedly, real wage growth is anticipated to be flat in 2020, she said. Workers in entry-level positions have seen their wage growth picking up in recent years, she observed, yet those in managerial jobs have experienced slowing wage growth. Moreover, last summer there were upticks in unemployment and underemployment among new college graduates. More of the same is predicted for 2020, indicated Swonk.

In addition to the overall healthy labor market, the low interest rate environment is helping to keep consumer spending growing, Swonk suggested. Historically low mortgage rates are expected to lead to more home sales in 2020. And low mortgage rates should continue to encourage current homeowners to refinance their mortgages, freeing up funds to be spent on other goods.

Swonk did discuss a few downside risks to her outlook for U.S. consumers in 2020. Credit market conditions tightened in 2019, as evidenced by the drop in credit card application approvals last summer. Swonk also pointed out that credit card and auto loan defaults increased last year. If more such tightening and defaults are seen in 2020, consumer spending could be more muted than anticipated.

Automotive outlook

Michael Robinet, executive director, automotive advisory services, IHS Markit, presented his outlook for the auto industry. According to his forecast, after reaching 94.2 million units in 2018, global light vehicle production is expected to fall to 88.8 million units in 2019 before moving up slightly to 89.0 million units in 2020. On the whole, global light vehicle production is predicted to decrease over the period 2018–21—its compound annual growth rate over this span is projected to be –0.9%. Robinet cited slowing economic growth across the world and further international trade conflicts as potential factors driving down global automotive output even further. Robinet remarked that China's influence on the auto industry is expanding, and its vehicle market is expected to reach the size of the U.S. auto market by 2025. Between 2018 and 2026, over half of the world's growth in light vehicle production will be from China (another 30% will be from India and its South Asian neighbors).

Turning to North America, Robinet said that he projects light vehicle production to increase from 16.3 million units in 2019 to 16.6 million units in 2020. According to Robinet's baseline forecast, U.S. light vehicle sales are expected to move down slightly from their 2018 level to around 17 million units in 2019 and 2020. Light vehicle sales in the U.S. were strong throughout 2019 despite a nearly six-week-long labor strike at General Motors (GM) last fall, he noted. (Because of the temporary labor shortage in late 2019, Robinet said he expects 150,000 units of production to be shifted into 2020.) Robinet said low unemployment and solid consumer demand were key factors supporting his U.S. light vehicle sales outlook. Growing demand for the delivery of goods also bodes well for vehicle sales. Still, the rising number of subprime auto loan defaults and escalating trade tensions pose downside risks, Robinet cautioned.

Robinet explained that the product mix of auto manufacturers is quickly changing to meet consumer tastes favoring sport utility vehicles over sedans. Further updates in auto companies' product lineups are expected in the coming years as they invest in and implement more-sophisticated technologies to produce electric and/or autonomous vehicles. Robinet observed that auto manufacturers are forming new partnerships to increase their scale of production and reduce the risks and costs of incorporating new technologies.

Steel industry outlook

Amy Ebben, division manager, strategic marketing, ArcelorMittal USA, noted that U.S. steel consumption decreased 0.6% from 2018, to just above 111 million tons in 2019. Ebben indicated that slowing activity in the construction and automotive sectors—the top two final markets for steel in the U.S.—primarily drove the dip in domestic steel consumption in 2019; spending on residential construction was down markedly from 2018, and both light vehicle sales and production were lower. Declining output by the machinery industry—another key final market—was also a factor in decreased steel consumption; new orders for machinery fell in 2019 as uncertainty about trade policy grew, Ebben explained. She added that steel tariffs have been helping U.S. steel mills gain domestic market share, yet steel exports from these mills have been falling.

According to Ebben, domestic steel consumption is anticipated to increase slightly in 2020, given that flat to modest growth for most of the major final markets for steel is predicted this year. While activity in the construction sector is forecasted to slow again in 2020, it won't drop sharply enough to hurt steel consumption much. Additionally, cutbacks in light vehicle production in 2019 (partly due to the labor dispute at GM) are expected to help improve the auto industry's output in 2020—which should boost steel demand. With tax credits for solar energy installations decreasing by the end of 2021, corporations are forecasted to order more steel to finish up such projects in 2020 (similar to what happened before tax credits for wind energy projects expired at the end of 2019). In addition, steel service centers, which serve as a bridge between steel producers and final consumers, are expected to partly replenish their inventories in early 2020, as they were destocked last year to their lowest levels since 2010. A downside risk to her outlook, noted Ebben, is for imbalanced trade with other countries to continue to have a negative impact on demand for U.S.-produced steel.

Ebben stated that global steel consumption is projected to increase 1.7% in 2020—to 1.8 billion metric tons—after rising 3.9% in 2019. With several infrastructure projects under way, India is expected to boost its steel consumption by 7% in 2020. And China—the largest steel consumer by a very wide margin—is predicted to raise its steel consumption by 1% this year. Ebben remarked that annual world steel consumption is now about a billion metric tons higher than it was two decades ago, and she indicated it should continue to grow in the years ahead.

Heavy machinery outlook

Jim Meil, principal, industry analysis, Americas Commercial Transportation (ACT) Research Co. LLC, shared his outlook for the heavy machinery industry in 2020. According to Meil, U.S. heavy machinery shipments are projected to be flat to slightly lower this year, given the headwinds facing the nation's manufacturing industry, as well as its agricultural, construction, and energy sectors.

Manufacturing output in the U.S. expanded by nearly 3% in 2018, said Meil. But manufacturing production shrank in 2019; through October 2019, its year-to-date growth rate was –1.5%, he noted. Moreover, in August 2019, the Institute for Supply Management's Manufacturing PMI (Purchasing Managers' Index) fell below 50% (which is suggestive of a contraction in the manufacturing sector) and stayed there the rest of the year. Given that manufacturing activity declined in 2019, Meil said he projects U.S. industrial machinery shipments to be flat in 2020, after rising by 3% last year.

Next, Meil turned his attention to the farm, construction, and energy sectors, all of which rely on heavy machinery for their output. He said that corn, soybean, and wheat prices had all fallen in recent years, in large part because of the trade war between the U.S. and China and a surplus of crops. Until crop exports rise again, farm machinery demand is anticipated to continue slipping. Building activity was fairly flat in 2019, and it is expected to be steady yet again in 2020, Meil indicated. So, little is driving up construction equipment demand. Meil also noted that volatile movements of crude oil prices over the past few years had stalled the recovery in U.S. mining and energy equipment sales from their 2016 nadir; he contended that until there is some assurance that oil prices will stay above $50 per barrel longer term, demand for such equipment is likely to continue to slide. Meil said he predicts declines ranging from 5% to 8% for shipments of U.S. farm, construction, and mining and oil field equipment in 2020. With regard to heavy machinery exports, Meil commented that a stronger U.S. dollar, weaker growth in industrial output in the European Union and India, and higher trade barriers are all hurting heavy machinery sales to foreign customers.

Fiscal condition of Illinois

Rick Mattoon, senior economist and economic advisor, Federal Reserve Bank of Chicago, discussed Illinois's fiscal health and potential solutions to the state's fiscal problems. According to analysis by the Institute of Government and Public Affairs (IGPA) at the University of Illinois, the state has been running a budget deficit since fiscal year (FY) 2000.[2] Mattoon explained this deficit was partly unrecognized because of poor accounting: For a long period, Illinois's public accounting structure failed to identify the true level of tax revenues needed to cover government spending. This led to unpaid bills, delayed infrastructure projects, and public pension underfunding. Recently, the State of Illinois has been moving in a better direction to address its fiscal woes, said Mattoon. For instance, the state recently passed its FY2020 budget on time with bipartisan support (it had faced a budget impasse in FY2016–18, resulting in service cuts and a credit rating downgrade), and it approved a new capital plan that established a sustainable stream of revenues (which includes an increased gas tax) for funding infrastructure projects. However, even after issuing bonds in 2018 to help address its fiscal problems, Illinois still has $6.5 billion in unpaid bills—and its public pension plans remain severely underfunded, said Mattoon. There have been several attempts to pay for or modify the state's unfunded pension liability, but they've generally been unsuccessful. For example, a state law passed in late 2013 that would have restructured the state's public pensions (by reducing pension payments or cost-of-living adjustments) was struck down by the Illinois Supreme Court in May 2015 as a violation of the Illinois Constitution. This decision restricted the state to addressing its unfunded pension liability only through raising revenues, absent a constitutional change. An example of a relatively transparent and generationally fair way to divide this burden would be a statewide property tax, according to Mattoon and other researchers. However, Mattoon added that it might not be feasible for a new property tax alone to fund this liability because Illinois already has higher property taxes than almost all other states. To conclude, he said that a good first step toward addressing Illinois's unfunded pension liability would be to improve the transparency of government balance-sheet accounts.

Conclusion

In 2019, the U.S. economy expanded at a pace just above the long-term average. The economy is forecasted to grow at a slower pace in 2020 than in 2019, though still near its long-run trend, according to EOS participants. Business investment and the housing sector are projected to improve in 2020. The unemployment rate is expected to stay low, at around 3.7%, through the end of 2020, and inflation is predicted to move up slightly to 2.0%.

Notes

[1] Paul Samuelson, 1966, "Science and stocks," *Newsweek*, September 19, p. 92.

[2] See the 2015 IGPA report, available online, https://igpa.uillinois.edu/sites/igpa.uillinois.edu/files/reports/FF_Apocalypse_Now_Jan_2015.pdf.

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