USA TODAY

5 red flags for the economy: Are they signaling a slowdown or even a recession?

Paul Davidson, USA TODAY
February 15, 2019

A dismal report on December retail sales Thursday capped a batch of weak economic data, raising questions about whether last year's robust economy is simply slowing or sputtering toward a recession later this year.

Most economists are betting on the former.

"I see this simply as a transition from a faster growing economy to a more moderate pace," says **Bernard Baumohl, chief global economist of the Economic Outlook Group.**

"The only question is the extent to which the economy's growth rate is declining," says Joe LaVorgna, chief economist of the Americas for research firm.

LaVorgna estimates growth of 3 percent in 2018 will slow to about 2 percent this year, a tepid pace that's more in line with most of the nearly 10-year-old economic expansion.

Besides retail sales, the flurry of disappointing reports the past couple of weeks highlighted worrisome trends in service-sector activity, consumer and business confidence, layoffs and bank lending standards.

At the same time, the labor market has remained strong, with a booming 304,000 jobs added in January and annual wage growth averaging 3.2 percent, near a 10-year high. Job openings hit a record 7.3 million in December, signaling continued strong hiring in the months ahead that should support solid consumption.

But there are challenges, including recent stock market volatility, President Trump's trade war with China, the now-resolved partial government shutdown, and the fading effects of the Republican tax cuts and federal spending increases. Federal Reserve interest rate hikes the past few years are also slowing borrowing activity.

Sales fell 1.2 percent in December. Some of the drop can be blamed on tumbling gasoline prices, since the Commerce Department simply estimates the total amount Americans spent. But a core measure that excludes volatile items -- gasoline, autos, building materials and food services – was also down 1.7 percent. The decline will likely shave economic growth in the fourth quarter from 3.1 percent at an annual rate to about 2.5 percent, Capital Economics says.

Ian Shepherdson, chief economist of Pantheon Macroeconomics, says the report was so feeble that it likely reflects faulty measurement by the department. He notes that a private report revealed surging chain store sales in December. The government shutdown, economists say, could have disrupted Commerce's retail sales survey.

Paul Ashworth of Capital Economics has more faith in the numbers, though he says they likely overstate the underlying weakness. He expects consumer spending to pull back as the bump from the $1.5 trillion tax cut fades.

Layoffs

A gauge of layoffs, the initial claims for unemployment benefits, rose to 239,000 from 235,000 the week ending February 9, the Labor Department said Thursday. And claims averaged 220,000 in the fourth quarter, up from 211,000 in the prior quarter.

The trend is "consistent with at least some slowing in employment growth," says economist Jim O'Sullivan of High Frequency Economics. Many economists expect average monthly job growth to slow from about 220,000 in 2018 to 170,000 this year.

Consumer and business confidence

Consumer confidence fell to an 18-month low in January, the Conference Board said. And a measure of small business optimism, while still high, dropped to the lowest level since before the 2016 election, according to the National Federation of Independent Business. The portion of small business owners saying now is a good time to expand slid.

Economists largely blame the market turbulence, the trade fight and the government shutdown. A more stable market and a trade deal could foster a brighter business outlook in the months ahead, says economist Shernette McLeod of TD Economics.

Ashworth, however, says consumer confidence was bound to retreat after reaching the highest level in decades.
Service-sector activity

A measure of orders, production and other activity among mining, finance, construction and other services firms fell last month. Economists partly blame the government shutdown, which hurt government contractors, and the trade standoff, which dinged confidence broadly.

Bank lending

Banks imposed more rigorous lending standards for both business and consumer loans in the fourth quarter, according to the Federal Reserve's senior loan officer survey. And a measure of banks' willingness to lead to consumers posted the largest decline since 2009, LaVorgna says.

Yet some of the pullback coincided with interest rates that rose for riskier borrowers during the market volatility, LaVorgna says. He reckons bank lending criteria eased in the current quarter.

Still, he says the tougher lending standards for business loans will likely curtail investment.

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