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ECONOMIC TALKING POINTS

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Check Beneath the Hood To Better Understand the Health and Path of the US Economy

There has been a growing undercurrent of concern and fear across the nation that a recession in 2020 is not only possible, but probable. One survey released in September by Duke University reported that optimism among business leaders dropped to the lowest level in three years. Nearly 7 out of every 10 CFOs polled by the university believed a recession will happen before the end of next year. And if that was not sobering enough, a recent spate of key economic indicators, such as retail sales, housing and industrial production, appear to show an economy losing steam.

So is an economic downturn in the cards next year? Not at all!

It's true all three indicators mentioned above came in well below expectations. But it is vitally important to dig a little deeper and see why those metrics were so depressed. Once you do, a different picture emerges on health of the economy.

Let us start with retail sales, which fell 0.3% in September. This was the biggest drop in consumer spending in seven months and it unnerved business leaders and investors. After all, shoppers alone have managed to keep this economic expansion alive and well into its record 11th year. If they begin to pull back on spending, then a recession ***is*** a virtual certainty. But if you look underneath the hood of that data point, it becomes apparent Americans did not reel in their shopping.

What hammered sales in September was that drivers spent less on gasoline and autos. However, paying less for gasoline and on motor vehicles does not mean they purchased less! Retail sales simply reports what Americans spent in nominal dollars. What few realized is that the actual unit price for gas and autos has been dropping. We know that because in a separate report on inflation (CPI), the price tag for both gasoline and new vehicles (as well as for used cars and trucks) declined that month. In fact, Americans purchased ***more*** gasoline, not less --- and motor vehicle sales ***increased*** to a 17.2 million unit annual rate in September, above the 17 million rate in August.

Here's another example. Existing home sales fell 2.2% in September. But housing stats can be especially choppy on a month-to-month basis. What's preferable is to look at a 3-month moving average to detect a trend. In doing so, we see the pace of such sales has gradually picked up.

What about new home construction that month? It plummeted more than 9%! But that was attributed to a massive and rare (28%) decline in the building of large apartment buildings. New starts on single-family homes, however, rose in September for the fourth consecutive month and they deliver a much greater GDP punch per unit than large multi-unit buildings.

Finally, let's take a look at the latest figures on US industrial output. They were indeed dismal in September and it's not a mystery why. Certainly the strike at GM, which shut down automobile production, made matters worse. But what has truly sucked the air out of US factories is the protracted trade war with China and the disruption it has caused to global supply chains. New orders to US manufacturers have shriveled up in recent months and that does pose a drag on economic growth.

Here's the good news. I do expect that China and the US will reach an interim (so-called "phase one") trade deal in the coming weeks. Beijing will ramp up purchases of US farm products and both sides may roll back certain tariffs. There's talk President Trump will even postpone or cancel his decision to place tariffs on consumer goods in December. Such an agreement, even if it is limited in scope, should help lift consumer and business confidence.

Now if you add to that continued low unemployment, wages rising faster than inflation, historically low interest rates and modest energy prices, the doom and gloom scenario so many CFOs see for next year appear unjustified. Make no mistake, 2020 will be a turbulent year given the upcoming presidential election and ongoing impeachment hearings. But we continue to see the economy growing a little over 2% next year. This economic expansion still has legs, even if those legs are tiring a bit given its marathon run.