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ECONOMIC TALKING POINTS

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October 30, 2019

A Stronger 3Q GDP Report Makes Today's Rate Cut Unnecessary--- But The Fed Will Do So Anyway.

Once again, those who argue the seeds of recession have been planted for 2020 now face a more difficult task to support that view following today's release of 3rd quarter GDP.

The 1.9% growth rate is a reminder of an elementary lesson in economics. While many Americans may express exasperation at the prolong trade conflict with China and contentious impeachment hearings in Washington, when it comes personal spending it's important to return to basics: job and income security. Companies are still actively hiring and wages continue to climb faster than inflation. As long as both these two trends are in place, consumers will keep the economy out of trouble.

In fact, there is no better metric to reflect that point than household spending on durable goods from today's GDP release. These are typically high-priced items (furniture, major appliances, cars) and are usually purchased on credit. If shoppers were truly anxious about an economic downturn and potential reduction in income, we would see a marked slowdown if not decline in such expensive purchases.

But these outlays rose at a healthy 7.6% annual rate the last quarter--- and that followed a 13% jump in 2Q. They represent the biggest 6-month surge in durable goods purchases in more than a decade and underscores another important lesson: While consumer confidence levels may appear to wobble, the more relevant barometer are the actions people actually take.

Most fascinating is how Americans have been bucking the trend observed in past economic cycles. Historically, consumption rebounds in the early years of recovery and then tapers off a few later years as pent-up demand is satiated and the cost of borrowing rises. However, no such pattern has emerged in this cycle --- even after more than ten years of uninterrupted economic growth.

Certainly, low interest rates helped perpetuate spending. But the biggest factor --- and one that economic models have struggled to incorporate --- is how technology has profoundly altered the way Americans purchase goods and services, pay their bills, monitor their finances and even raise funds. Online shopping, for example, has become so hassle-free, so frictionless that it has spawned "impulse buying," which has sustained household outlays far longer than previous consumption cycles.

Nevertheless, the question we get most often comes back to the durability of this record long economic expansion. Consumers may be the backbone of this economy, but given all political uncertainties at home and geopolitical eruptions abroad, **how many more blows can this aging business cycle take?**

That question took on more relevance this morning as social unrest in Chile forced that government to cancel the APEC meeting next month. That event was to have been the venue where President Trump and China's Xi Jinping planned to sign an interim ("phase one") accord that would lessen trade tensions between the world's two largest economies. Now new questions arise on when and where these two national leaders will meet to conclude an agreement. We expect Trump and Xi will ultimately ink out an accord before the end this year in large part because it is in their mutual political and economic interests to do so.

The more immediate question today is whether the Federal Reserve will cut rates another 25 basis points today as additional insurance to prevent an economic slump next year?

We expect they will do so, but primarily to satisfy market expectations and that is unfortunate. Lowering short-term rates, however, will have absolutely no effect on reviving the depressed manufacturing sector in this country. The problem US factories face is NOT the high cost of borrowing. It's NOT a lack of liquidity. There's ample private capital looking for investments. Indeed, the Fed's own senior lending officer surveys show that banks are still making it easy for small, medium and large firms to obtain loans.

The massive foot on the economy's industrial neck today is NOT tight monetary policy but the ongoing trade war with China, the threat of new tariffs against Europe and the disruptions this has caused to global supply chains. Lower rates will do nothing to ameliorate those issues.

While a rate cut is unnecessary in our view, the FOMC will likely vote to do so today to avoid destabilizing financial markets. But we see no further rate reductions the rest of this year or next. Our forecast calls for the next move to be a rate increase sometime in early 2021 as economic growth in the US and abroad accelerates.

Moreover, we hope the Fed will also consider suspending the dot plot and scale back talk on forward guidance. Both strategies came into being during the 2008- 2009 recession to assure investors and business leaders that monetary policy will remain highly accommodative. But those two approaches no longer play a constructive role. They create more confusion than clarity and too often place the Fed in the uncomfortable position of submissively responding to market expectations.

So let's return to the data. The economy is in fundamentally sound shape thanks to the resilience of the consumer. Fear of recession next year remains excessive. It's just not that easy for a $22 trillion, free market, highly liquid and technologically dynamic economy to stumble into a downturn. For that to happen, you need a confluence of negative events of such magnitude that it can shove the biggest and most sophisticated economy off course, and we see nothing on the horizon that poses such a threat.

United States

	I 2018	II 2018	III 2018	IV 2018	I 2019	II 2019	III 2019	IV 2019	I 2020	II 2020	III 2020	IV 2020	I 2021	II 2021	III 2021	IV 2021
Real Gross Domestic Product (GDP):																
%	2.5	3.5	2.9	1.1	3.1	2.0	1.9	2.2	2.0	2.7	2.1	2.3	2.2	2.7	2.6	2.8
Personal Consumption Expenditures:																
PCE %	1.7	4.0	3.5	1.4	1.1	4.6	2.9	1.8	2.2	3.0	1.9	3.4	2.7	3.8	3.0	4.1
Inflation, end of period, year-over-year:																
CPI %	2.4	2.9	2.3	1.9	1.9	1.6	1.7	1.8	1.9	2.0	2.0	2.2	2.5	2.7	2.7	2.8
Unemployment Rate (end of period):																
%	4.1	4.0	3.7	3.9	3.8	3.7	3.5	3.5	3.8	3.9	4.0	4.1	4.1	3.9	3.9	3.7
Non-farm Payrolls, monthly avg. thousand:																
	228	243	189	233	174	152	157	150	135	140	125	125	135	155	160	165
Treasury 10-yr Note Yield % (end of period):																
	2.74	2.85	3.06	2.76	2.42	2.00	1.65	1.80	1.85	1.70	2.00	2.25	2.70	3.10	3.80	4.10
Federal funds rate % (end of period):																
	1.63	1.88	2.13	2.38	2.38	2.38	1.88	1.63	1.63	1.63	1.63	1.63	2.13	2.38	2.63	2.63

Economic & Geopolitical Risks to Monitor

Projections are for 2019 and 2020

PROBABILITY	U.S.
HIGH	US and China to reach an interim agreement on trade by mid-2020. Financial markets reacts positively.
HIGH	Higher tariffs on Chinese imports slows US economy. Trump pressures the Fed to cut rates further.
Moderate	Fed to lower rates three times of 2019, each 25 basis points. No cuts foreseen in 2020.
HIGH	10 Yr. Treasury yield climbs in 2020 as investor appetite for US government debt wanes.
HIGH	U.S. firms slow CAP EX thru 2020 due to global economic slowdown and trade tensions.
Low	U.S. economy suffers a recession by end of 2020.
	FOREIGN
HIGH	Venezuela's Maduro regime collapses in 2020; new elections are planned.
HIGH	China sends paramilitary into Hong Kong to quash pro-democracy protests.
HIGH	Foreign adversary launches cyber attack that paralyzes parts of US economy.
Moderate	Iran proceeds to enrich uranium toward 20%. Risks increase of a military response by US or Israel.
Moderate	India and Pakistan clash over Kashmir. Both nuclear-armed countries edge closer to war.
HIGH	New UK elections likely as PM Boris Johnson counters efforts to delay passage of latest BREXIT deal.
Moderate	Rising Tensions in the Persian Gulf pushes WTI oil price higher, even as global demand for crude falters.

GDP Growth - Global Economy

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
US	2.6	1.6	2.2	1.8	2.5	2.9	1.6	2.4	2.9	2.3	2.2	2.5
Eurozone	1.7	1.4	-0.9	-0.3	1.2	1.6	1.7	2.5	1.9	1.0	1.3	1.8
United Kingdom	1.7	0.7	0.3	1.8	2.9	2.2	1.9	1.8	1.4	1.0	0.8	2.0
Japan	4.6	-0.4	1.6	1.5	-0.1	1.1	1.0	1.9	0.8	0.9	0.6	1.7
Canada	3.1	3.1	1.7	2.2	2.5	0.9	1.4	3.0	1.9	1.5	1.1	2.4
India	8.4	8.6	6.7	4.9	7.4	8.0	8.1	7.2	6.8	6.5	6.3	7.3
China	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.6	6.2	5.8	6.1
Brazil	7.5	2.7	0.9	2.3	0.1	-3.5	-3.5	1.4	1.1	0.9	1.0	1.7
Mexico	5.2	4.0	3.9	1.4	2.3	2.7	2.9	2.1	2.0	0.4	0.0	2.2
Australia	2.8	2.6	3.6	2.4	2.6	2.5	2.4	2.4	2.7	2.0	1.8	2.6
Russia	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.6	2.5	1.5	1.3	2.2
World	4.2	3.0	2.6	2.9	3.0	2.8	2.6	3.3	3.2	3.0	2.6	3.3