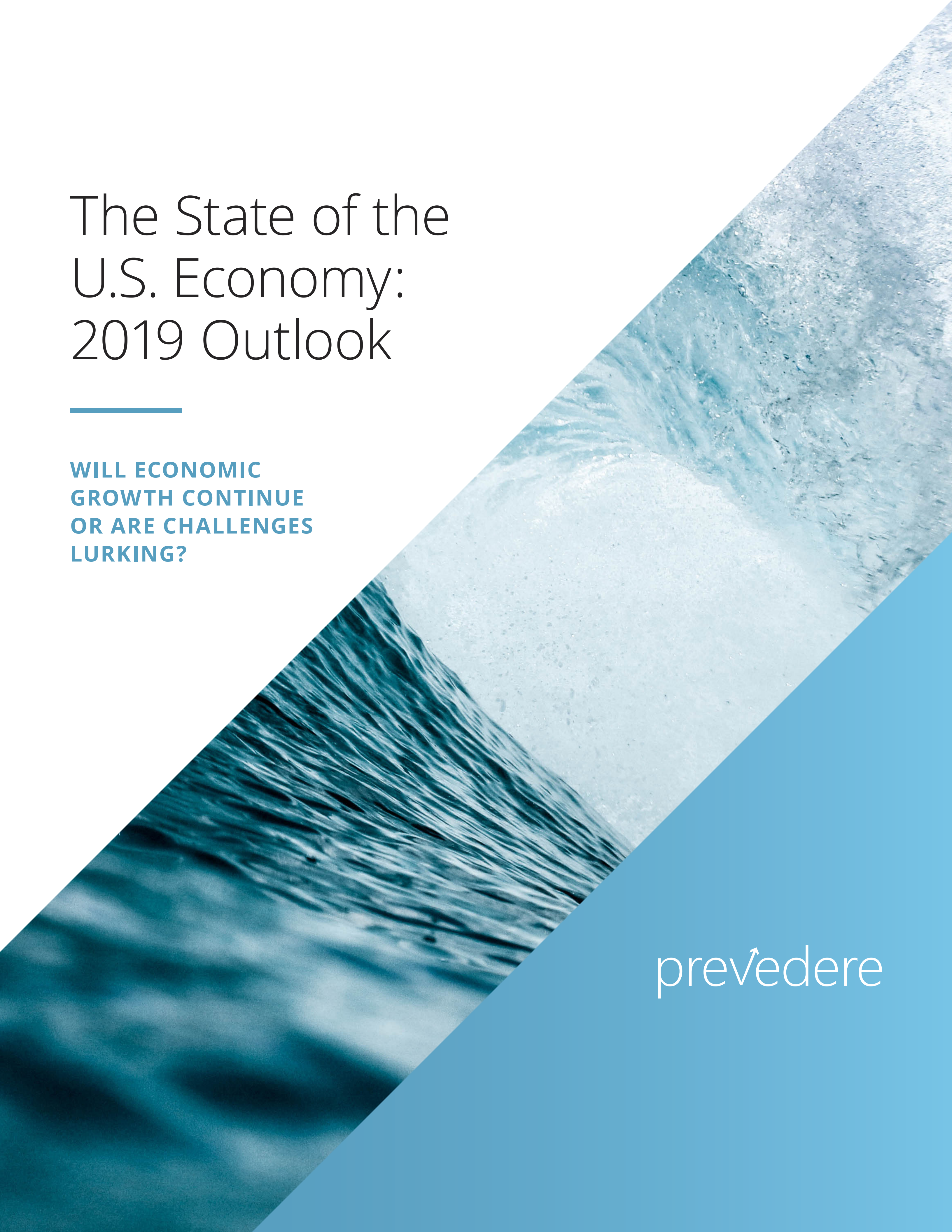
The State of the U.S. Economy: 2019 Outlook

WILL ECONOMIC GROWTH CONTINUE OR ARE CHALLENGES LURKING?



prevedere

Signs point to a global economy that is doing quite well.

The U.S. GDP is riding above short-term averages, with strong year-over-year growth felt across the economy.

Unemployment remains near record lows.

Wage growth has made modest gains.

While the outlook looks positive moving into 2019 for both the consumer and business-to-business sectors of the economy, global headwinds and fears of an overstimulated economy should not be overlooked.

Is the economy in for a slowdown? How can companies prepare for success amid global uncertainty?

Ongoing trade disputes, inflation-adjusted wage growth, weakness in the housing and auto markets, plus slowing manufacturing orders, are key areas to watch.

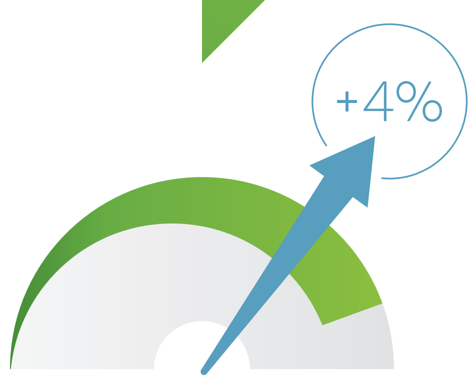
These factors, combined with historic examples, should give companies pause when finalizing their 2019 strategies. This guide explains three potential scenarios for 2019 and offers a list of economic indicators that business leaders should be monitoring.

TABLE OF CONTENTS

Review of the Current Economy

Looking back, 2018 provided solid year-over-year growth in the United States.

The U.S. GDP hit seasonal peaks of over 4 percent—a sign of a healthy economy. This higher GDP offered a welcome jolt to consumer spending and business investment to the delight of consumer and manufacturing industries.



GDP 2018

Highlights of this growth include:

- Year-over-year wage growth improved to 3.1%*.
- National unemployment rate dipped down to 3.9%*.
- Travel to, and within, the United States grew by 3.2% in October 2018 compared to October 2017.

Still, slower growth toward the end of the year and signs lurking beneath the surface may provide a warning of things to come. Recent tax cuts, for example, have provided a short-term stimulus to the economy. It remains to be seen whether this stimulus will carry growth forward above long-term averages going into 2019.

** As of Nov. 2018 figures.*

2019
FORECAST

2019 Forecast

Looking forward, significant indicators suggest the economy will not see the same strong growth in 2019 that it saw in 2018.

Three important indicators that impact economic growth, especially on the consumer side, could push down the 2019 U.S. GDP closer to its long-term pace of near 2 percent.

1. The rise in interest rates.
2. Commodity prices.
3. The potential for increased inflation—especially if inflation outpaces wage growth for American workers.

Rising interest rates will have impacts felt across the economy and could put a damper on growth. Current low interest rates have boosted the housing and automotive markets, but rising interest rates could push down sales by making these purchases more expensive. At the same time, rising home prices may also limit purchases, especially in large metro areas where prices are increasing quickly.

Weakness in the housing and auto markets have preceded economic slowdowns in the past, but these factors do not mean the economy will necessarily contract into recession. Rather, it seems the economy may have reached its peak, and if that is true, it may grow at a slower rate than the last few years. This is more likely to occur if inflation and commodity prices go up.

Combined, these forces make it a challenging year with great uncertainty for economic forecasters. A look into the past, however, provides insight into where the economy might go from here. Over the past three decades, the economy was in a similar state, near the peak of its business cycle, three times:

1990

High real estate valuations brought the economy to its peak, but monetary policies and the Gulf War soon pushed it into a **minor recession followed by a fast recovery** in 1991.

2000

Raising interest rates and commodity prices put the economy in a vulnerable position. After the dotcom crash, the economy entered a **full recession followed by a slow recovery**.

2015

The economy experienced a **bump in the road** as industrial production dropped. However, consumer spending kept the economy going and manufacturing recovered with growth through today.

Most slowdowns in the economy level out on their own. It is quite possible in 2019 that the economy will experience one of these dips, only to barrel ahead and continue the second longest cycle of economic growth ever recorded.

That said, the U.S. economy is in a very weak place going into 2019. High stock market volatility at the end of 2018 points to undermined investor confidence in the economy, and several indicators suggest the slowdown will continue into 2019.

Hard-to-predict impacts from external events will likely spell the difference between whether the economy simply slows down or goes into full-blown recession. For example, a major industry bubble burst, Brexit, trade wars or a significant rise in inflation or currency values could push the economy over the edge.

▶▶ BOTTOM LINE

2019 will look very different from 2018. One of three potential scenarios is likely to play out.

OUTLOOK 1

Bump in the road with minimal economic impact

In 2015 and 2016, some Americans felt as though the economy was weak, despite the fact that it kept growing at a macro-level. That is because the manufacturing and mining industries technically entered a minor recession in 2016 following a collapse of oil prices. However, most consumers did not feel these struggles, and the overall economy stayed strong thanks to their spending power.

There are a few parallels between that time period and today. Oil prices have dropped below $60–80 a barrel, which is spilling over into a manufacturing industry already facing global headwinds amid U.S. trade disputes. In this scenario, some segments of the economy might experience a slowdown, while others forge on with minimal impact. Barring a major global event that could tip the scales and push the economy into a recession, this is a strong option.

OUTLOOK 2

Minor recession followed by a fast recovery

In 1990, the real estate industry was overvalued and experienced a slowdown. This is not dissimilar from real-estate trends in the economy today. This period's slowdown, in conjunction with the more restrictive monetary policies put in place to slow inflation, put the larger economy in a vulnerable state. Left on its own, the economy may have recovered without experiencing more than a minor bump in the road. However, once the Gulf War started, additional stresses pushed down on the economy, leading to a mild recession by historic standards.

Thankfully, the economy recovered relatively well within a few months, but this example illustrates how a vulnerable economy can quickly turn in the face of global events.

OUTLOOK 3

Economic recession

The last scenario from recent history with similar underpinnings to today is the recession of 2000–2001, which followed the collapse of the dotcom bubble.

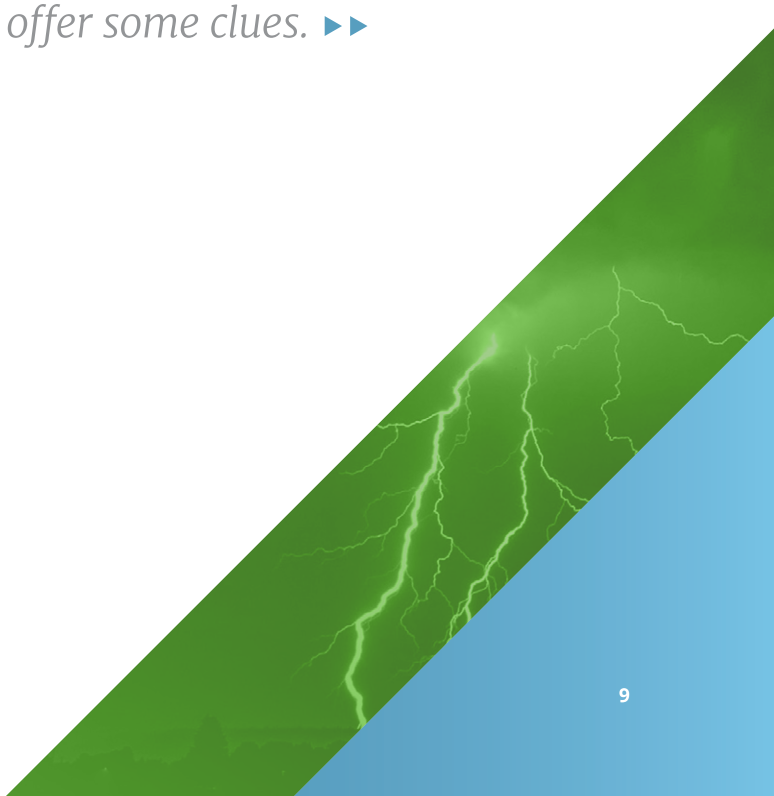
During this time period the Federal Reserve raised interest rates, even as commodity prices were rising, to mitigate the effects of the overvalued stock market in the early 2000s. After the tech bubble burst, over-leveraged companies lost value or went bankrupt quickly.

This scenario shows how the collapse of one industry can impact the whole economy if conditions are already vulnerable. If an industry were to unexpectedly collapse within the next six months, the economy could suffer a similar fate and fall into recession.

This scenario is the most dangerous. Companies can easily be caught relying on an economy that seems strong but is held up by foundations that are weaker than they appear.

How can executives tell the difference? What signs should business leaders look for to determine what outcome the economy might take?

Three economic indicators offer some clues. ▸▸



Hidden Uncertainty: Economic Indicators to Watch

With an economic slowdown likely in the coming months, it is important to watch now for signs that could predict what direction the economy will take. Will the economy face a bump in the road or a full-blown recession?

HERE ARE THREE ECONOMIC INDICATORS TO WATCH:

PURCHASING MANAGERS INDEX (PMI)

PMI is a reliable indicator for industrial production. It shows non-defense spending on infrastructure and peaked in late 2017 with slowed growth through 2018. This indicator becomes particularly vulnerable when the United States enters into trade negotiations. As trade talks with major partners stretch into 2019 and continue to add uncertainty in the market, PMI may keep falling, offering a key sign of a weakening economy.

HIDDEN UNCERTAINTY: ECONOMIC INDICATORS TO WATCH

GROWTH OF WAGES

Wage growth is an indicator of the health of consumers. Typically, in times of low unemployment like the current economy, wages go up, and after years of slow or stagnant wage growth, wages have been rising. However, they are not outpacing inflation in the long run. While 2018 saw near record-low unemployment rates, many employees did not feel their wages improve because of inflation rates. Moving into 2019, inflation-adjusted wage growth will be important to watch, posing a significant challenge to the overall economy as manufacturing slows.

ARCHITECTURAL BILLINGS INDEX (ABI)

A key indicator of strength or weakness in the overall economy, the Architectural Billings Index tracks nonresidential construction activity. It has been in decline on a year-over-year basis. This signals weakness at the top of the construction market, with hot real estate markets potentially slowing down in 2019. On the other side of the coin, a backlog of residential real estate projects could begin construction in 2019 and help normalize the construction industry.

How to Prepare for the Uncertain Economy

2018 may have been a banner year for economic growth, but 2019 is not shaping up to fare the same. Several key indicators point to a broad slowdown in the economy in 2019, at best. Business leaders need to be prepared for potential changes.

Thankfully, leaders can take steps now to review how their companies, industries and customers performed in past situations when the economy neared the peak of the business cycle. An analysis of past events typically yields useful insights that can be applied to prepare for various eventualities, including the scenarios listed in this report.

Prevedere recommends taking a conservative approach until the economy shows signs of recovery. Executives should avoid using 2018 as a model to justify riskier practices, such as refinancing their debt or paying out shareholders, to minimize the risk of overleveraging their companies in the event of a serious economic slowdown or recession.