



FEDERAL RESERVE BANK *of* ST. LOUIS  
CENTRAL TO AMERICA'S ECONOMY®

# The Outlook for the U.S. Economy

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# The Big Picture

- Climbing a wall of worry . . . the Fed cuts again to help insure against further weakness.
- Scant evidence of labor market weakness, but job growth should slow further for technical reasons.
- The economy is settling into a “good place.” Still, forecasters expect growth to dip below 2% in 2020.
- Inflation likely to remain below 2% in 2020.

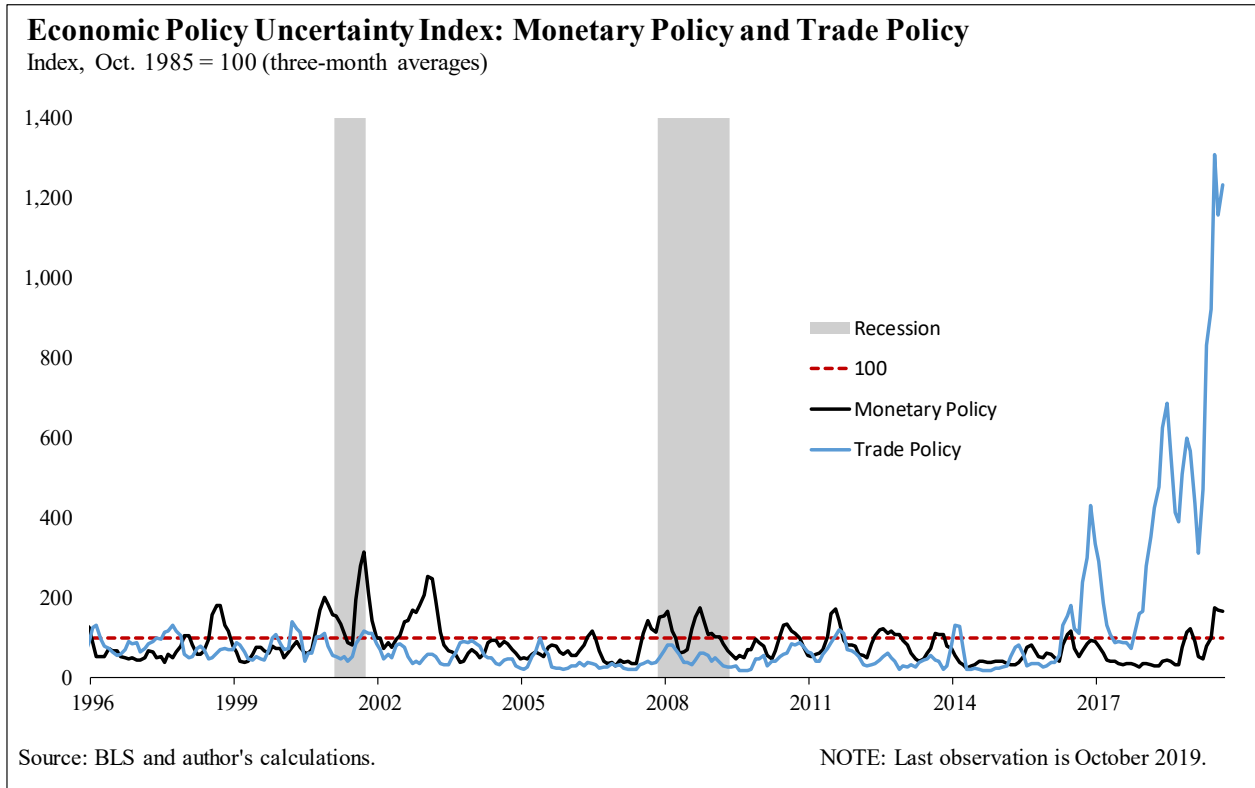
# Disclaimer

The views I will express today are my own and do not necessarily reflect the positions of the Federal Reserve Bank of St. Louis or the Federal Reserve System.

# Data Flows Have Been Okay

- Data flows condition Fed decision-making. So, . . .
- Third-quarter GDP growth slipped below 2%; something similar is expected for Q4.
- Retailers expect a solid Holiday sales season.
- Housing is rebounding (maybe temporarily), but manufacturing and business investment are weak.
- The October employment report was pretty strong.

# Trade Policy Uncertainty Skyrockets



# Trade Policy Uncertainty: Upside and Downside Risks to the Outlook

National Association for Business Economics

October 2019 | NABE Outlook

*NABE Outlook*

Trade policy is perceived as the dominant risk, **53%** cited it as the key **downside** risk to the economy through 2020. The next largest downside risk cited (12%) was slower global growth.

**35%** of respondents indicate reduced trade protectionism is the greatest **upside** risk to the economy. Stronger wage growth was cited as another key upside risk to the outlook. The other most commonly cited upside risks are infrastructure spending, easier Fed policy, and stronger global growth.

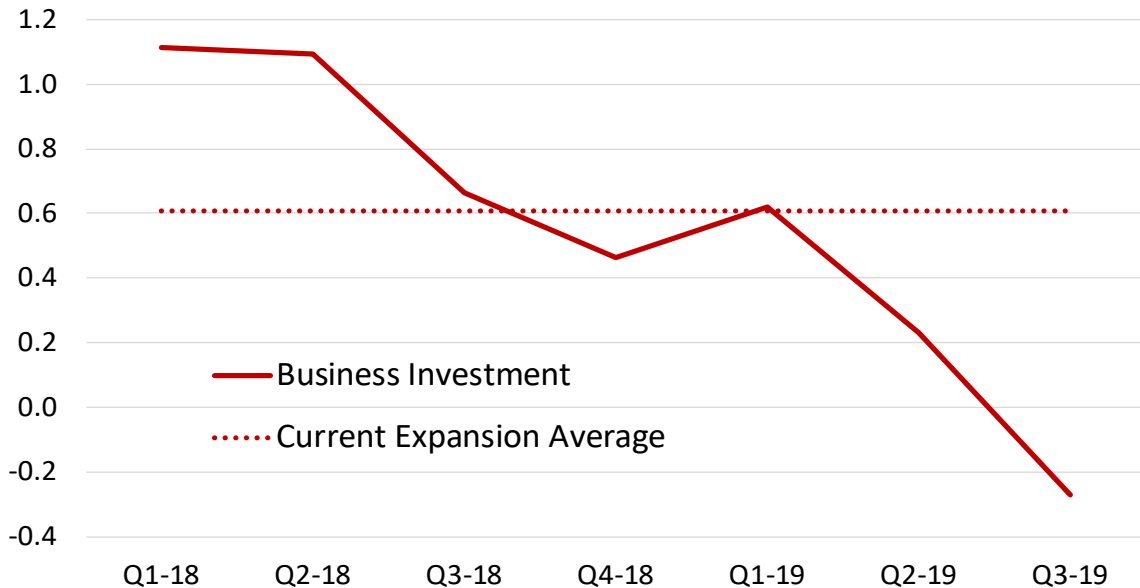
# Uncertainty: Bad for Business . . .

- “Much of corporate activity is directed at reducing uncertainty.” (Greenspan, 2008)
- Macro-level factors are important in the micro-level investment decisions. Long-live investment projects can be very economically costly to reverse. (Bernanke, 1983).
- Firms (and lenders) are reluctant to commit scarce resources to irreversible, long-lived investments with an uncertain payoff.

# Slows Business Fixed Investment . . .

## Contributions to Real GDP Growth From Business Fixed Investment

Two-quarter averages in percentage points

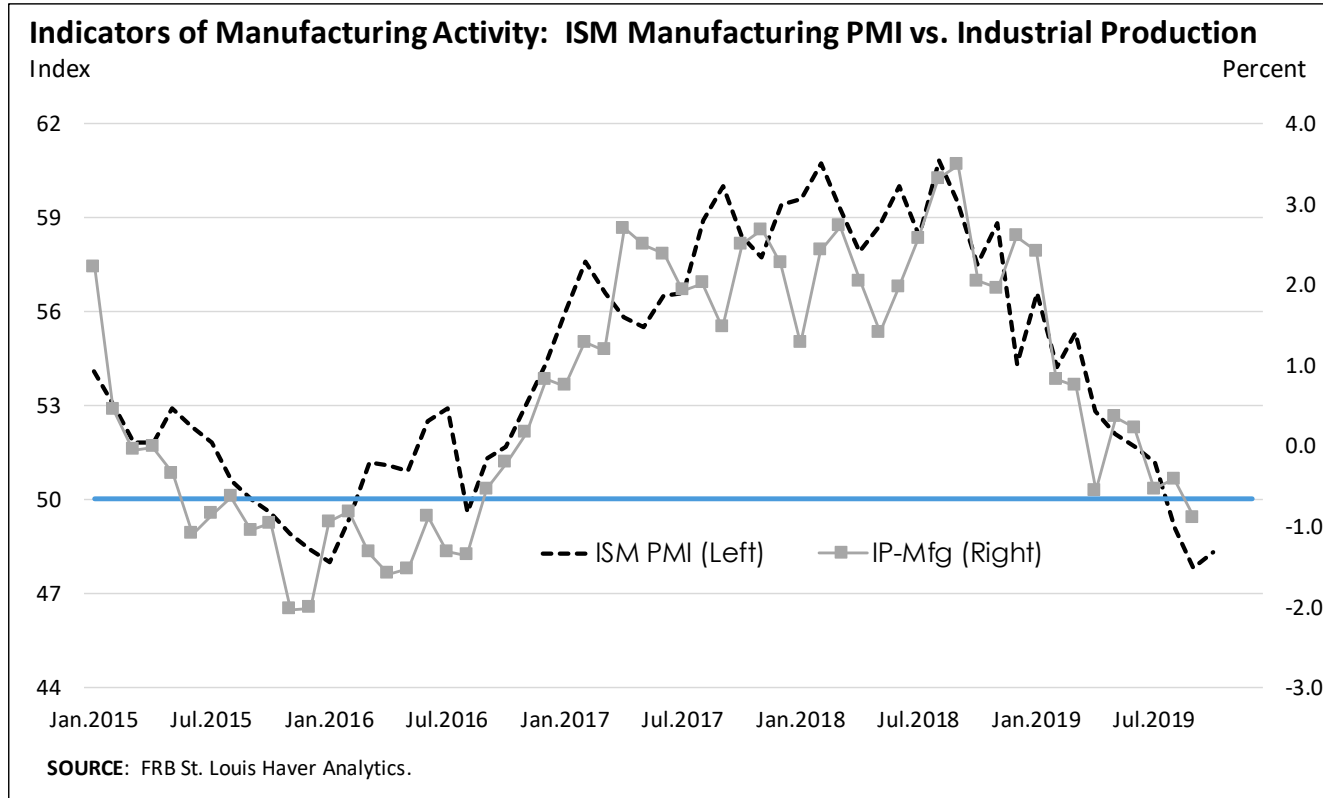


SOURCE: Bureau of Economic Analysis, Haver Analytics, and FRB St. Louis

Most measures of business sentiment deteriorated, analysts' expectations of firms' longer-term profit growth declined further, and **trade policy concerns** continued to weigh on firms' investment decisions. (Minutes of Sept. 17-18 FOMC Meeting)



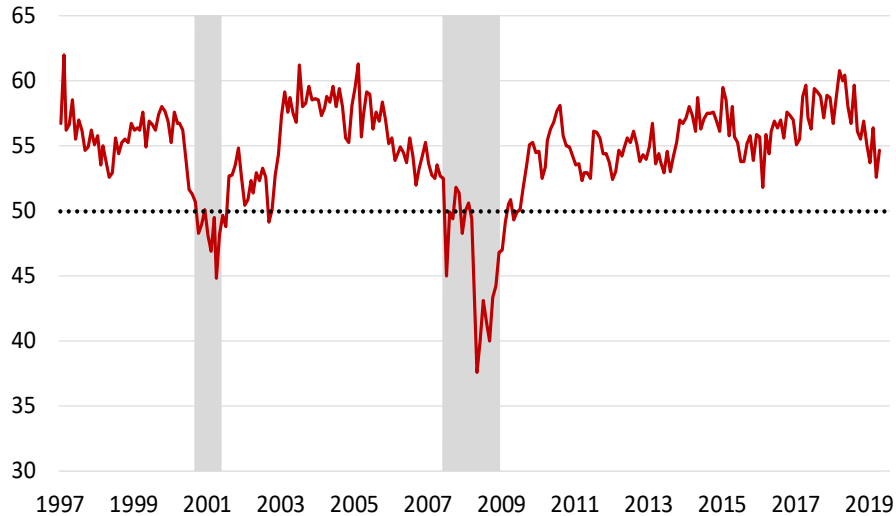
# And Weakens Manufacturing Activity



# But Services Still Posting Solid Growth . . .

## The ISM Nonmanufacturing Purchasing Managers Index

Diffusion index; +50 equals expansion

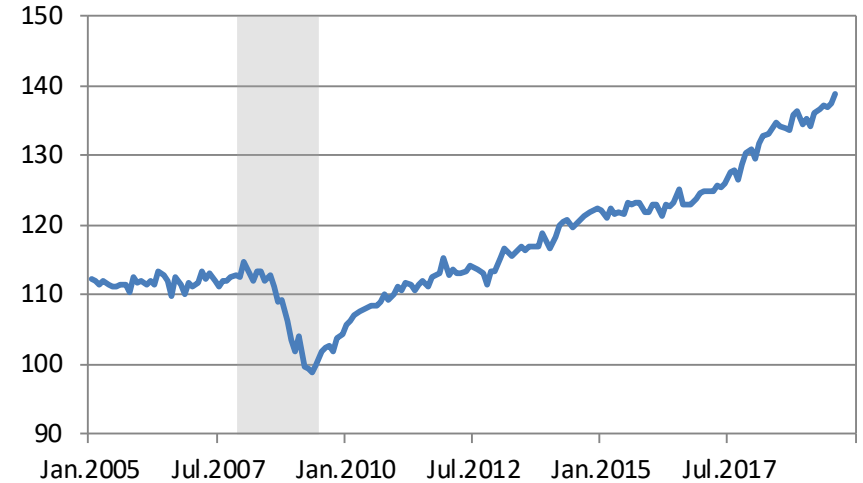


SOURCE: Haver Analytics and FRB St. Louis

Last observation is October 2019.

## Transportation Services Index (Freight + Passenger)

Index

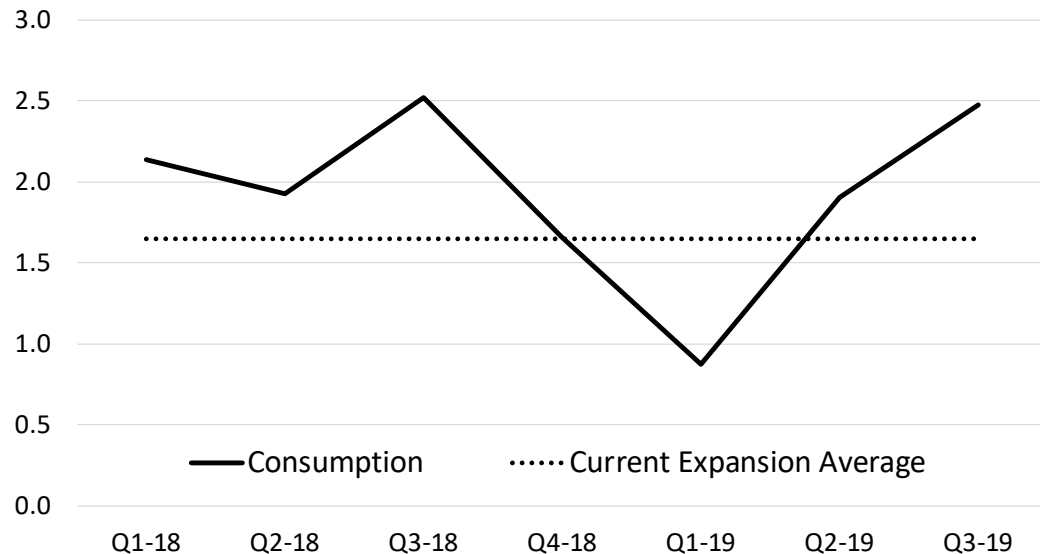


SOURCE: U.S. Bureau of Transportation Last observation is August 2019.

# And Consumption is Strengthening

## Contributions to Real GDP Growth From Consumption Expenditures

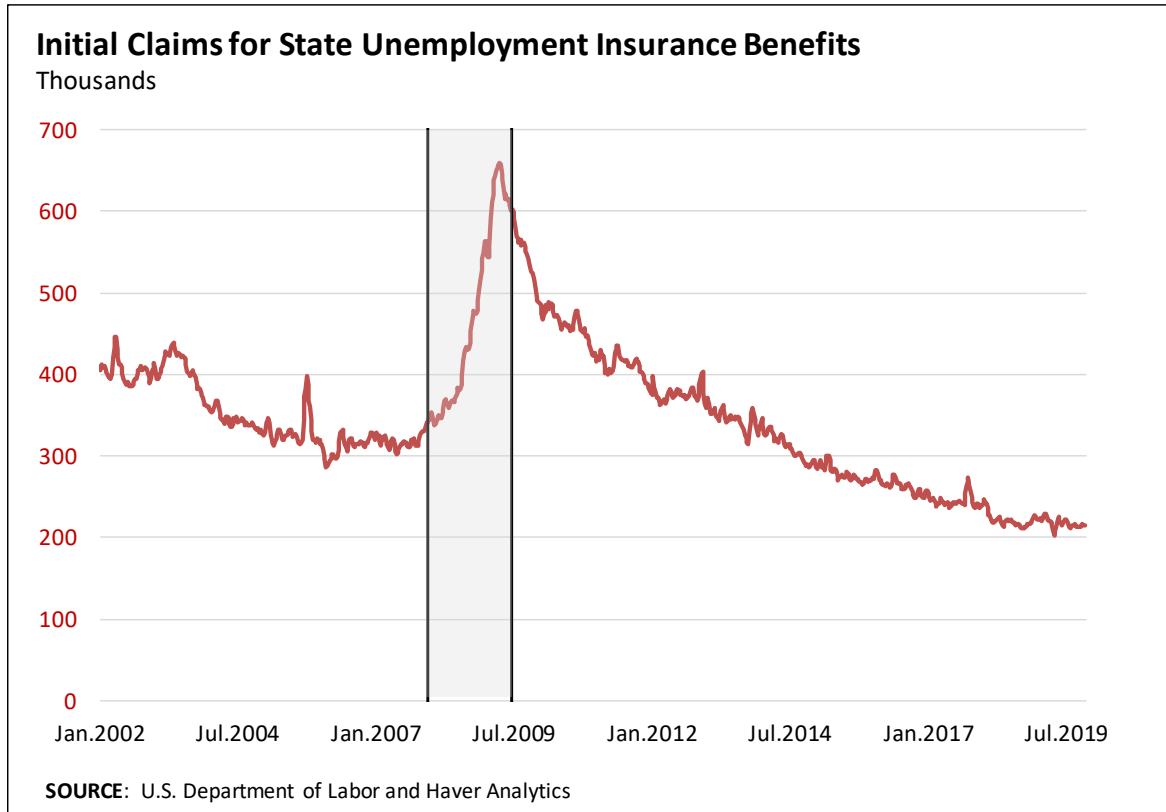
Two-quarter averages in percentage points



**SOURCE:** Bureau of Economic Analysis, Haver Analytics, and FRB St. Louis

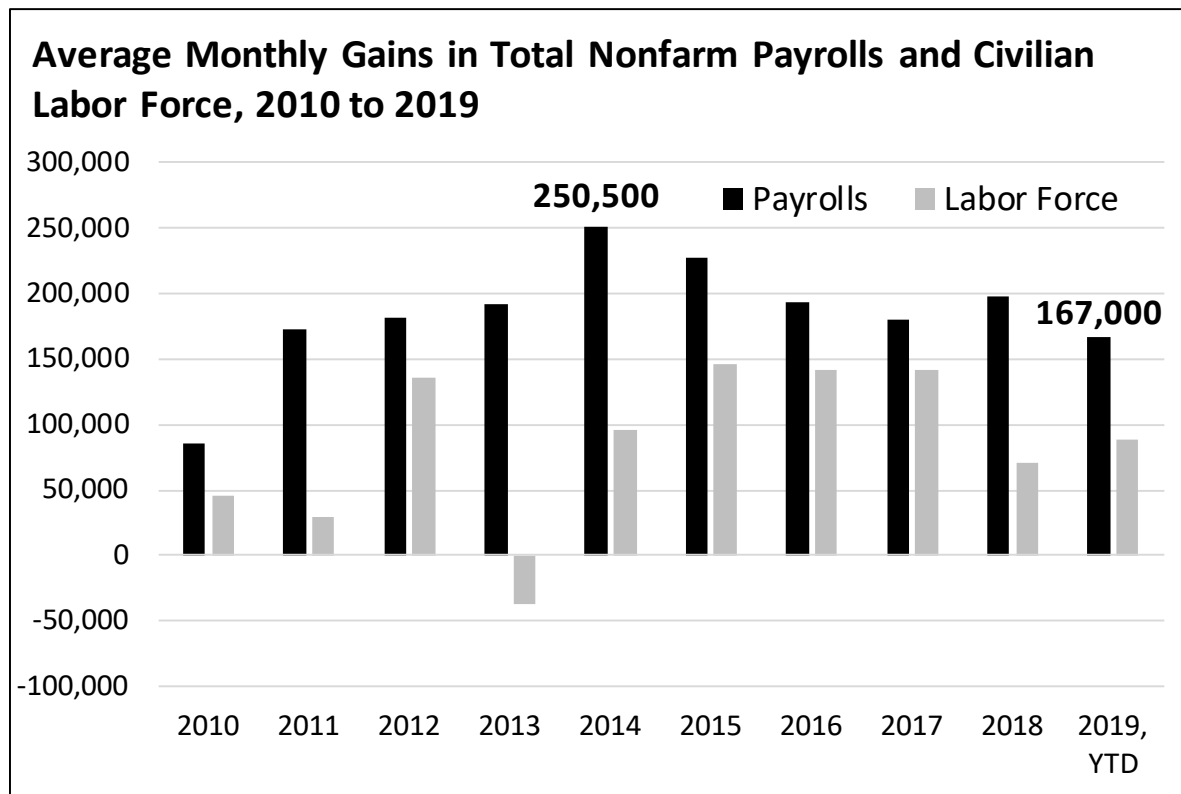
The National Retail Federation Forecasts Holiday Sales Will Grow Between 3.8% and 4.2%, which is above last year's 3.7% gain. While consumers are in good financial shape and retailers expect a strong holiday season, confidence could easily be eroded by continued deterioration caused by uncertainty over trade.

# Unemployment Claims are Very Low



The U.S. unemployment rate measured 3.6% in October, a nearly 50-year low.

# And Job Growth Remains Healthy

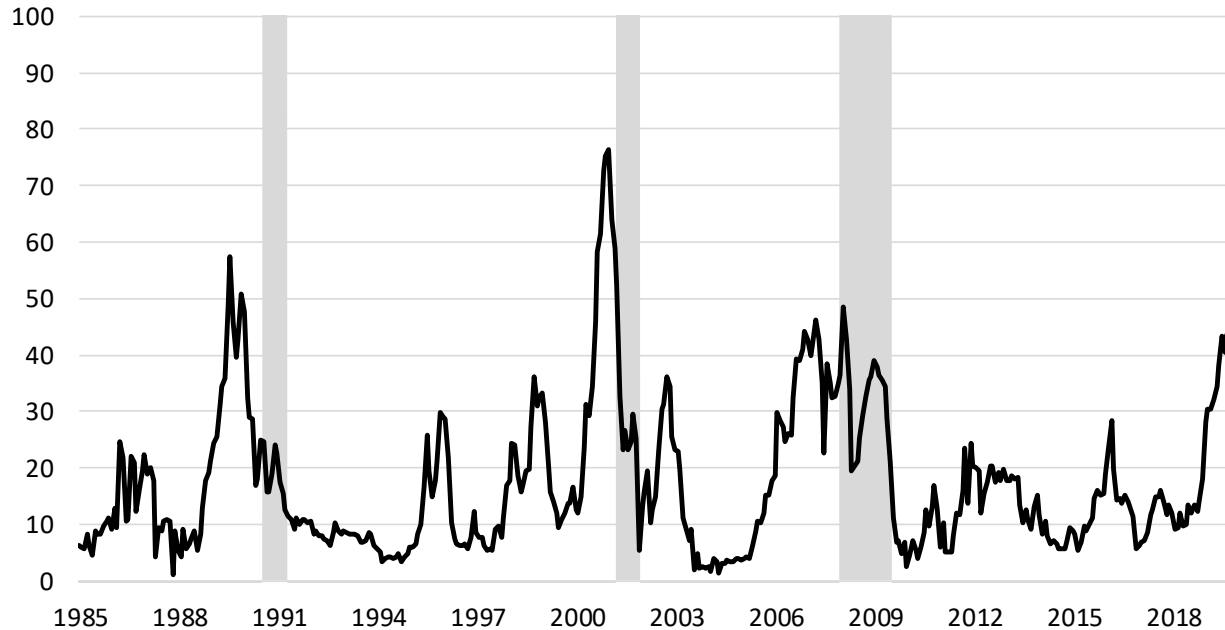


The UAW strike against GM temporarily reduced job gains in October by about 46,000.

# But Elevated Recession Probabilities

## What is the Probability of a Recession Within the Next 12 Months

Percent probability



SOURCE: Federal Reserve Bank of New York and Haver Analytics

The chart shows the average probability based on three models that use financial market conditions as predictors.

# The Fed Buys More Insurance

- The FOMC lowered the target range another 25 basis points (1.5% to 1.75%) at the Oct. 29-30 meeting.
- A sustained expansion of economic activity, strong labor market conditions, and inflation near 2% are the most likely outcomes, but uncertainties remain.
- Three and done? Not sure, but there are parallels with the 1998-99 mid-cycle correction.

# Current Inflation Developments

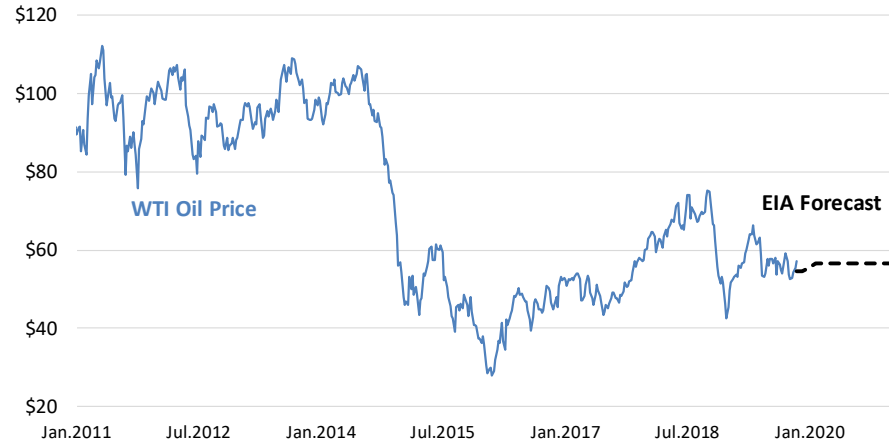
- Inflation in 2019 likely remained below 2% for the eighth straight year.
- Some see increased risk of higher inflation because the unemployment rate is near a 50-year low. I don't.
- Others see trade-related developments (i.e., tariffs) raising inflation. But a stronger dollar and low oil prices offsets much of these risks.
- Consumers and financial market participants still expect inflation to remain low. This is crucial



# Energy Prices: Same Old Thing?

### Spot WTI Crude Oil Prices: Actual and October 2019 EIA Forecast

Dollars per barrel

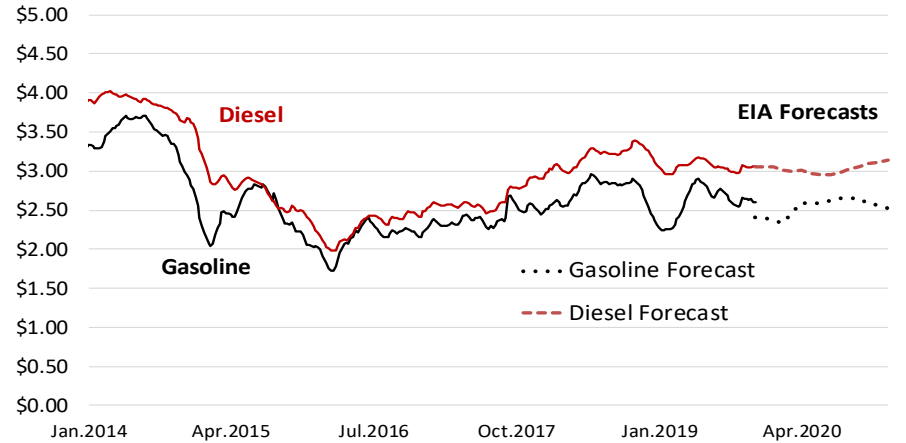


SOURCE: U.S. Energy Information Administration.

NOTE: Last actual observation is week ending Nov. 5, 2019

### Retail Gasoline and Diesel Prices: Actual and October 2019 EIA Forecast

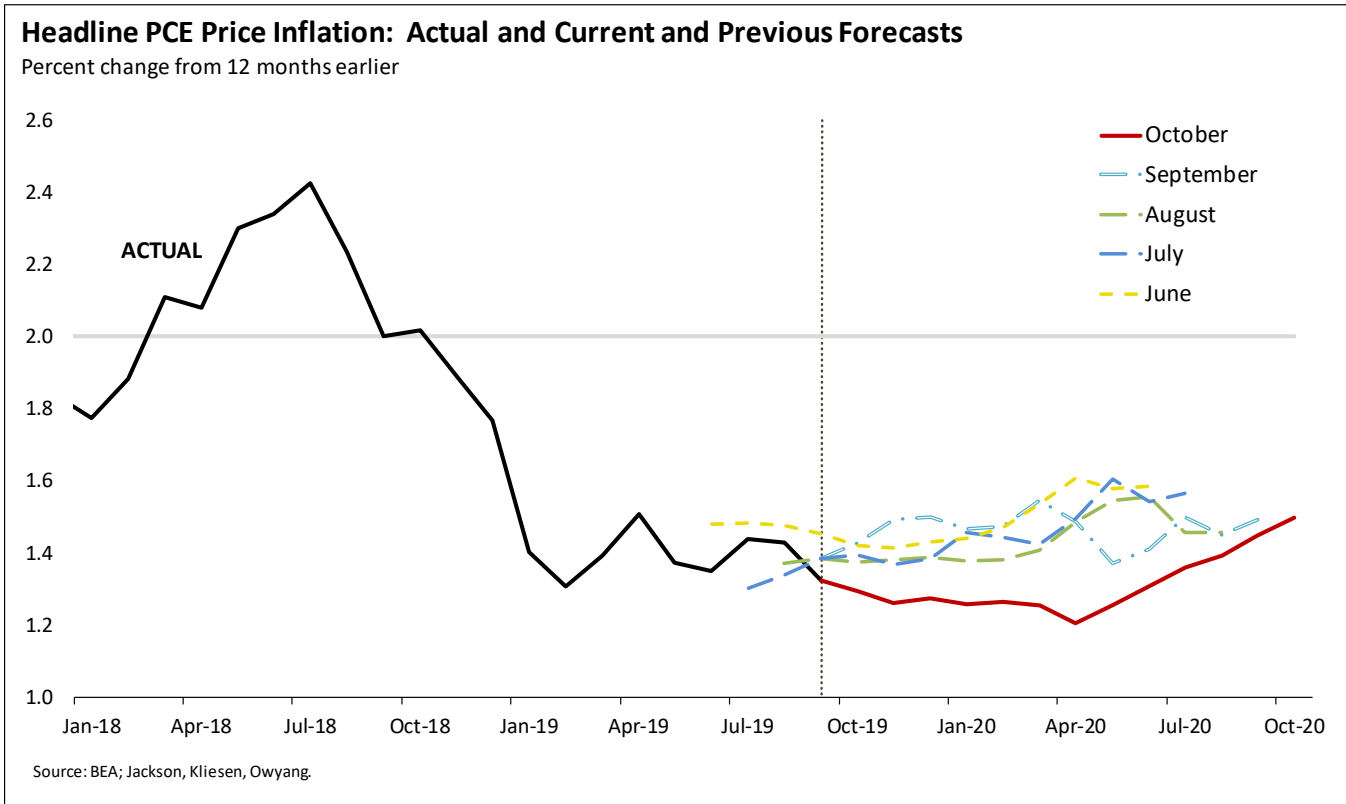
Dollars per barrel



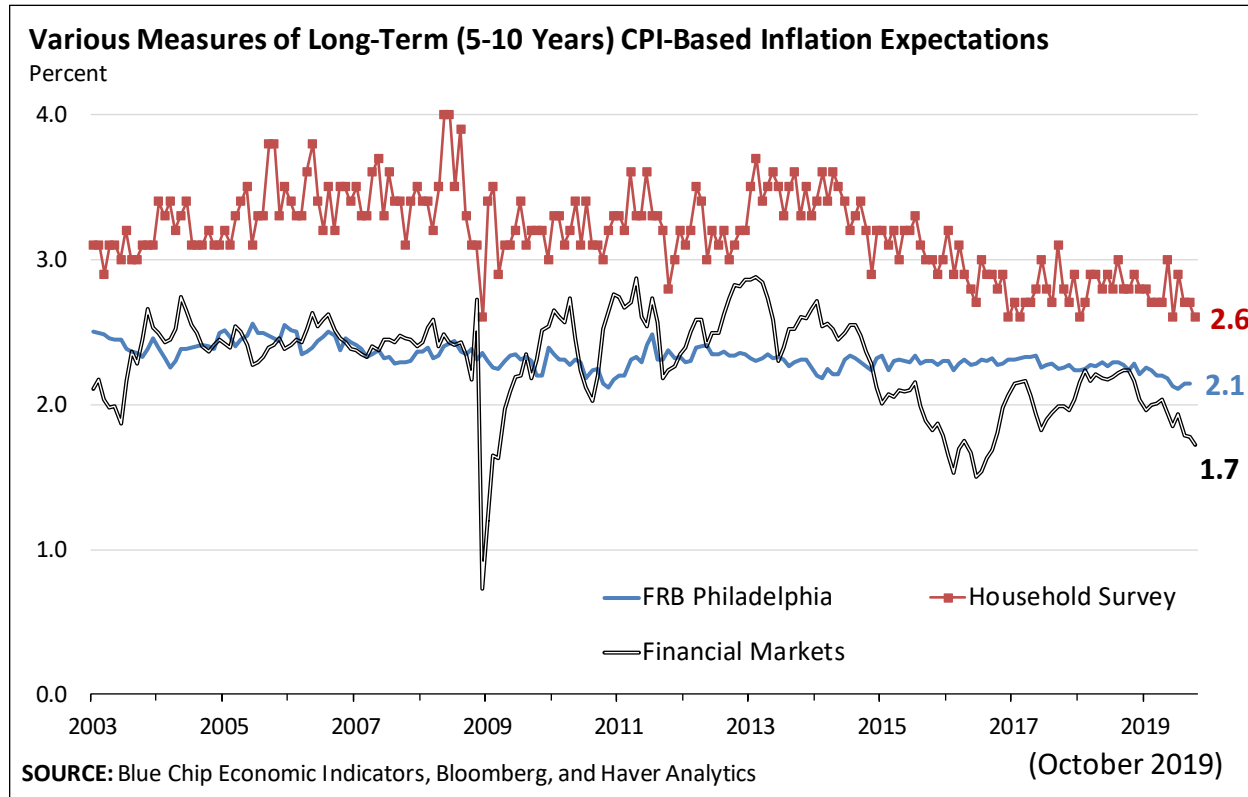
SOURCE: U.S. Energy Information Administration.

NOTE: Last actual observation is week ending, Nov. 4, 2019

# Inflation: Life in the Slow Lane



# Inflation Expectations Drift a Little Lower



# A New Normal for Inflation?

- Some wonder whether 2% inflation is attainable because of structural changes in the economy.
- These changes include the fracking revolution in oil production, the rise of online retailing (e.g., the “Amazon effect”), and an aging population.
- But there are risks on the other side that could cause rising inflation pressures over the long run. One risk is rapidly rising levels of public debt due to entitlements.

# Main Takeaways

- Recession risks have moderated, but threats to the downside persist. Sub-2% growth is likely in 2020.
- However, the Fed's easier monetary policy and diminished headwinds—should they occur—could produce modestly faster growth in 2020.
- Inflation has moderated and the St. Louis Fed's model continues to predict low inflation in 2020.

# St. Louis Fed Resources

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News and views about the economy and the Fed

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For every stage of life

## Community Development

Promoting financial stability of families, neighborhoods

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