

Economic Outlook

Robert Fry

Robert Fry Economics LLC

Philadelphia Council for Business Economics

Philadelphia, Pennsylvania

February 6, 2020

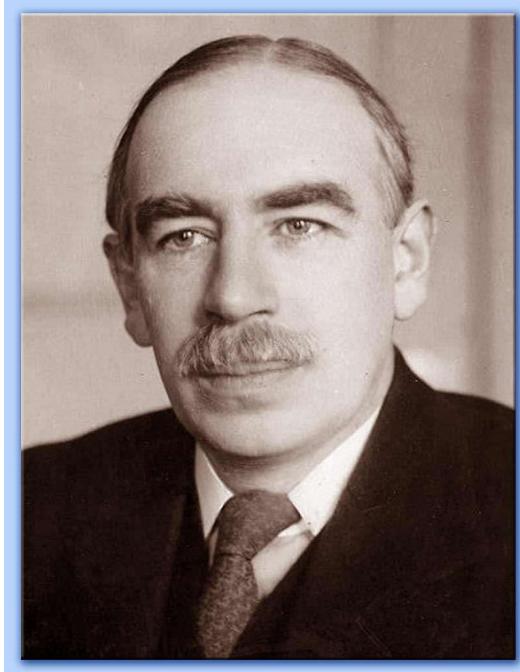
RobertFryEconomics.com

robert@robertfryeconomics.com

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If economists could manage to get themselves thought of as humble, competent people on a level with dentists, that would be splendid.

--John Maynard Keynes



**Excuse me.
Can you tell
me where I
am?**

**You're in
a balloon.**



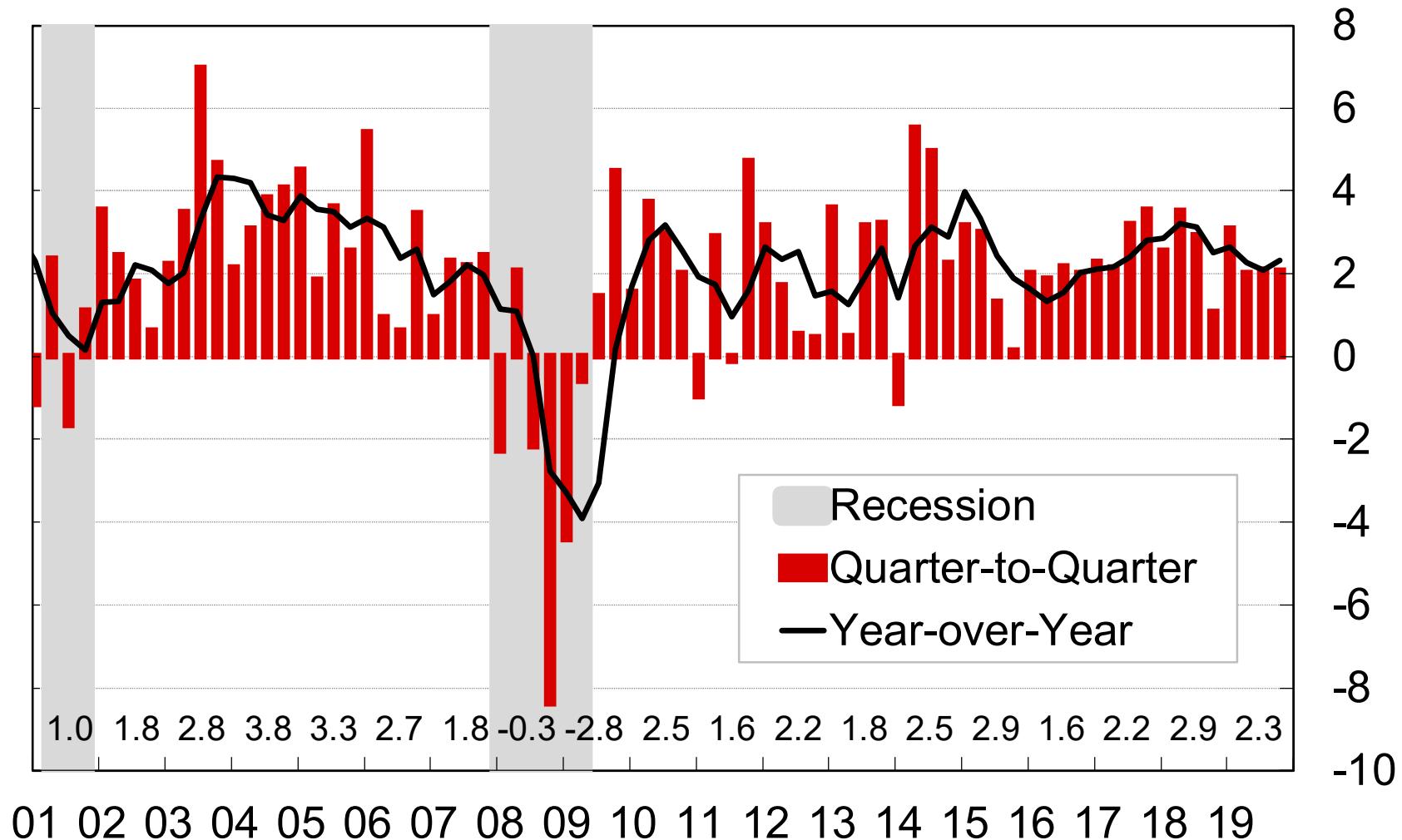


**You must
be a economist.
Your answer is
perfectly correct
and totally
useless.**

**You must be a manager. You
have a great view, but don't
know where you are.**

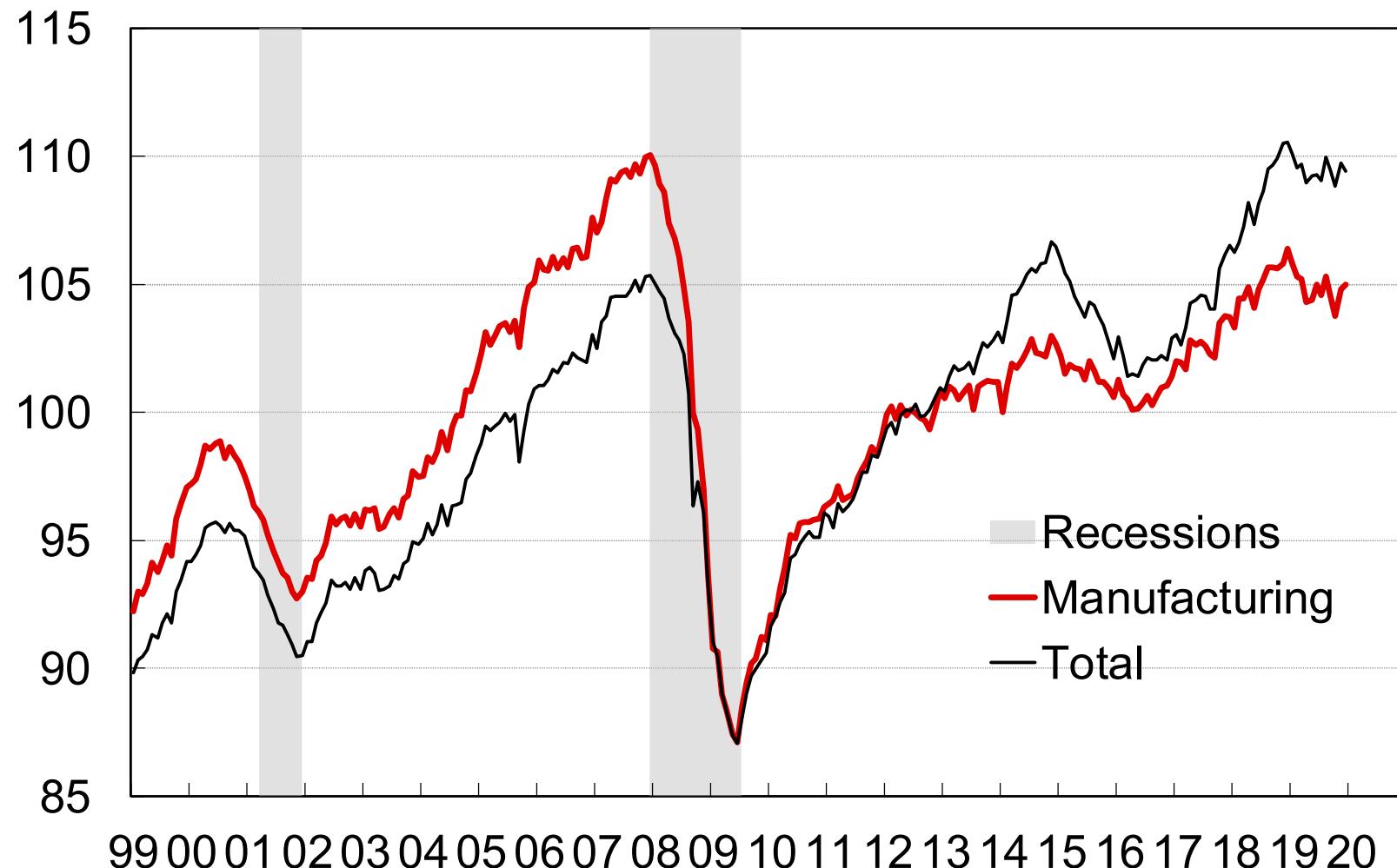


US Real Gross Domestic Product Annualized Growth Rates



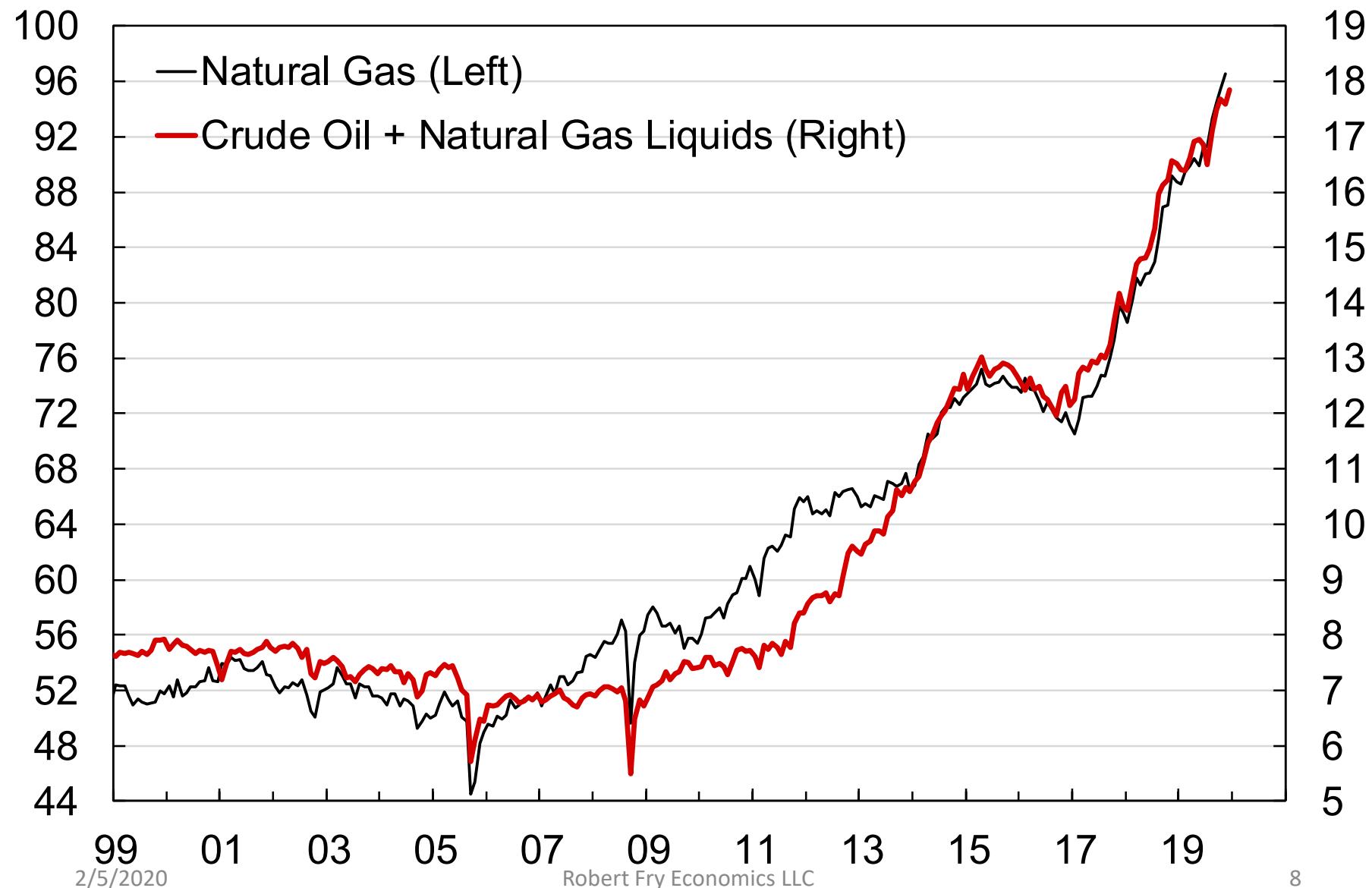
US Industrial Production

Indexes, 2012=100

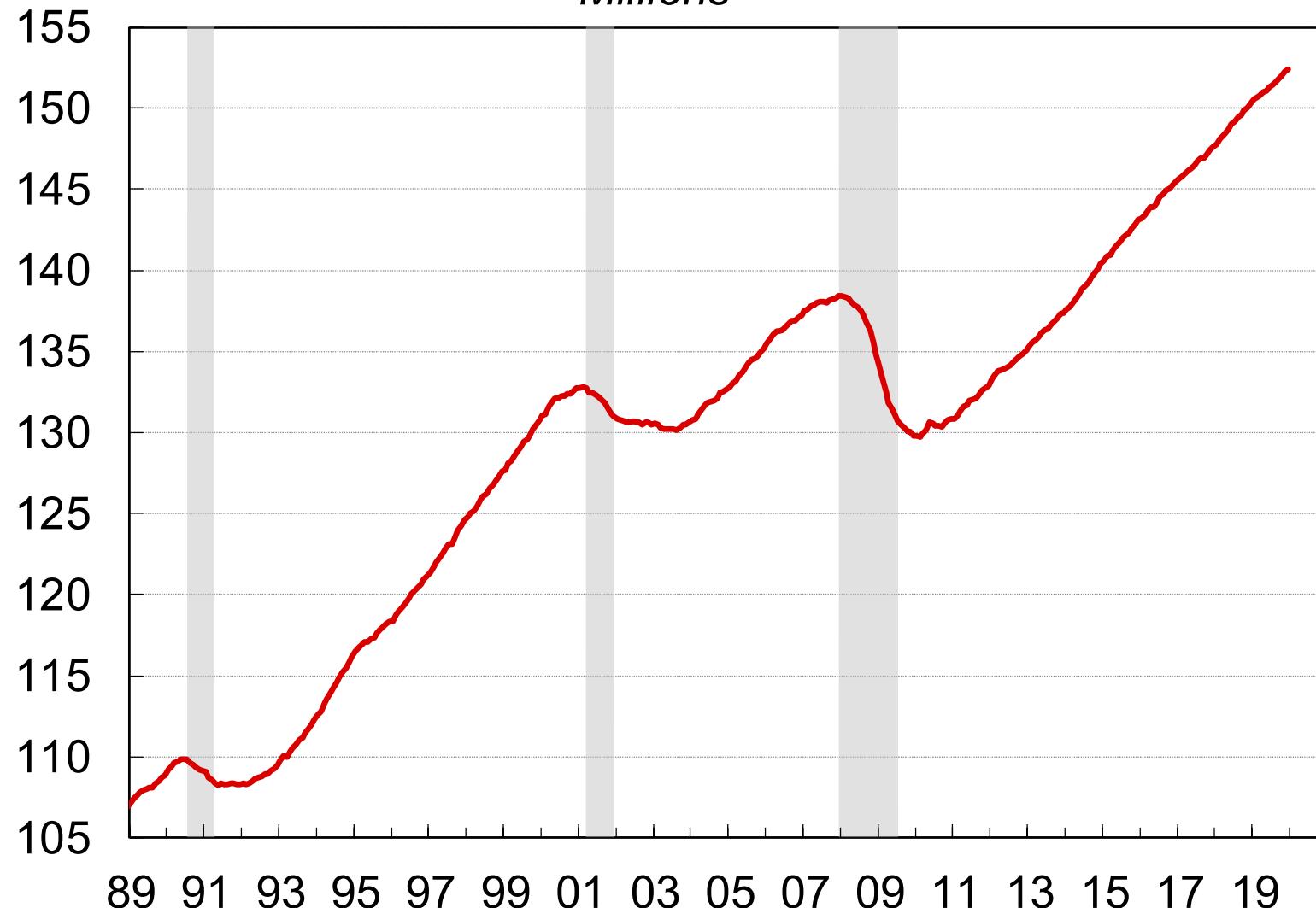


US Oil & Gas Production

Billion Cubic Feet per Day *Million Barrels per Day*



US Nonfarm Payroll Employment *Millions*



Growth slowed in late 2018 after 5-quarter acceleration.

Real GDP grew at a 2.1% annual rate from 2010Q4 to 2017Q2.

It grew at a 3.1% rate from 2017Q2 to 2018Q3.

Over the last five quarters, growth has returned to 2.1%

Industrial production, which accelerated with the election and when tax reform started to look likely, declined from December 2018 to October 2019.

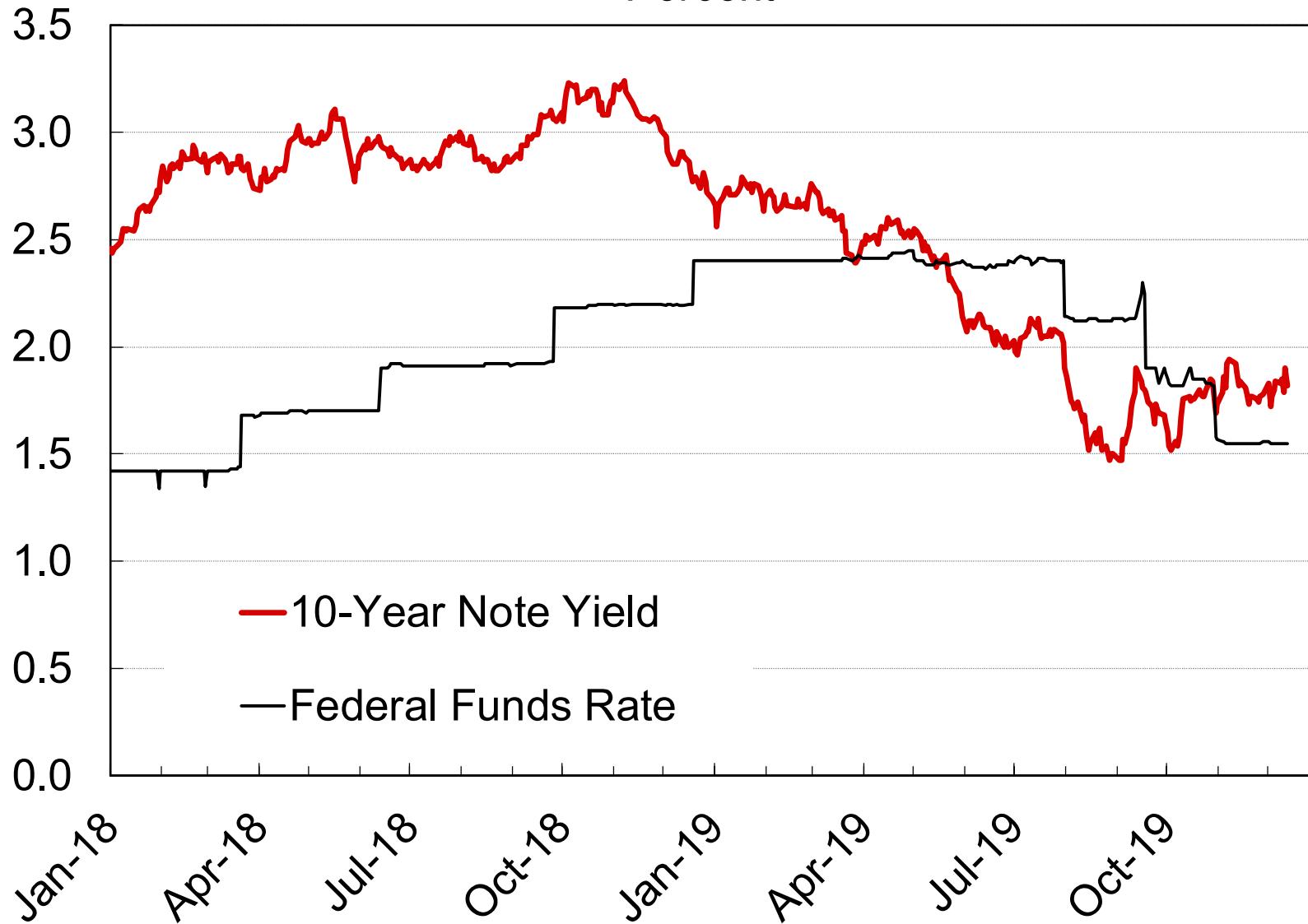
Growth in employment has slowed, and will be revised down tomorrow, but is still more than enough to absorb growth in adult population.

Timing suggests deregulation and tax cuts played a role in the acceleration.

What caused the slowdown?

US Interest Rates

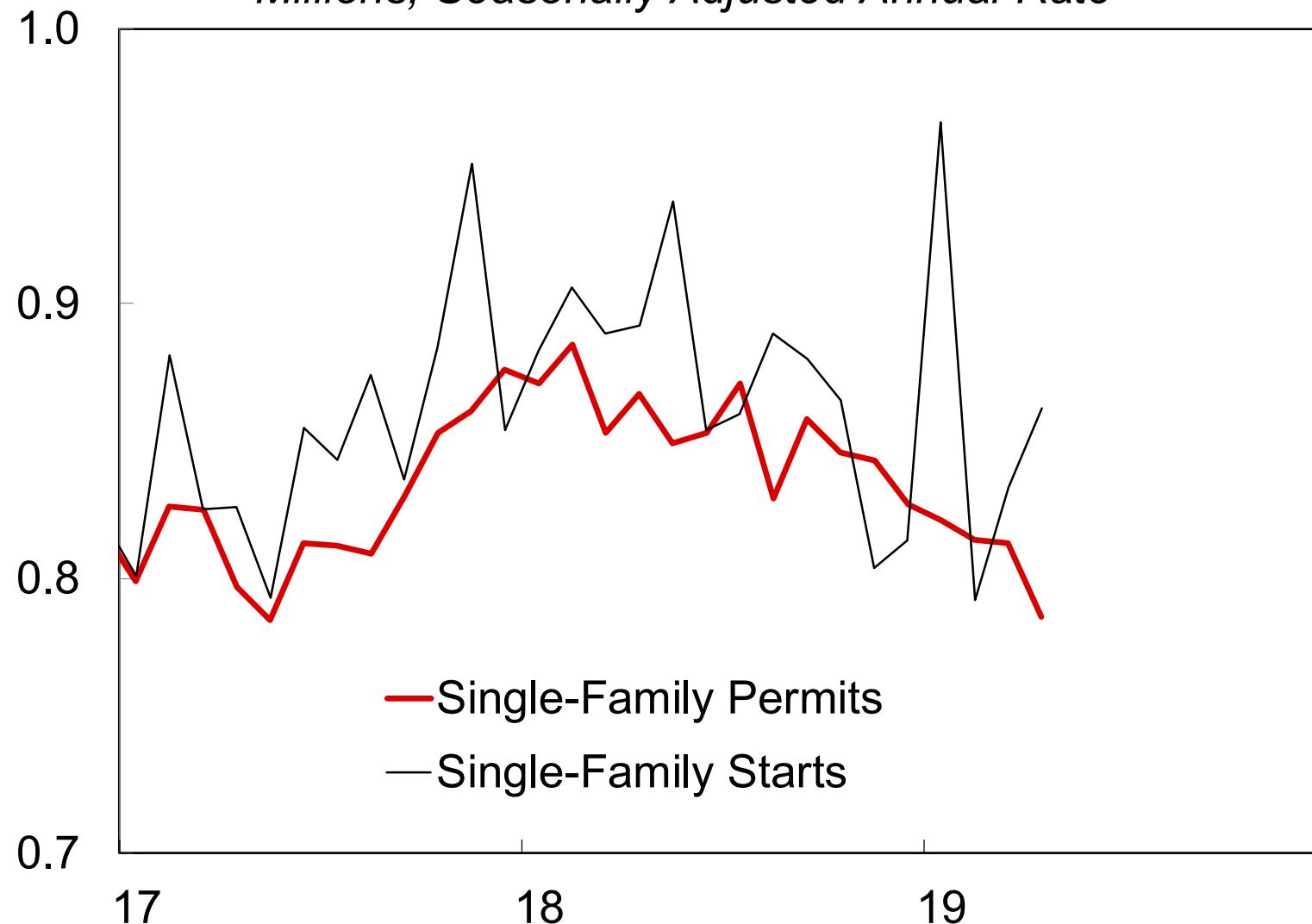
Percent



Source: Board of Governors of the Federal Reserve System (US)/Federal Reserve Bank of New York/FRED
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US Housing Starts & Building Permits

Millions, Seasonally Adjusted Annual Rate



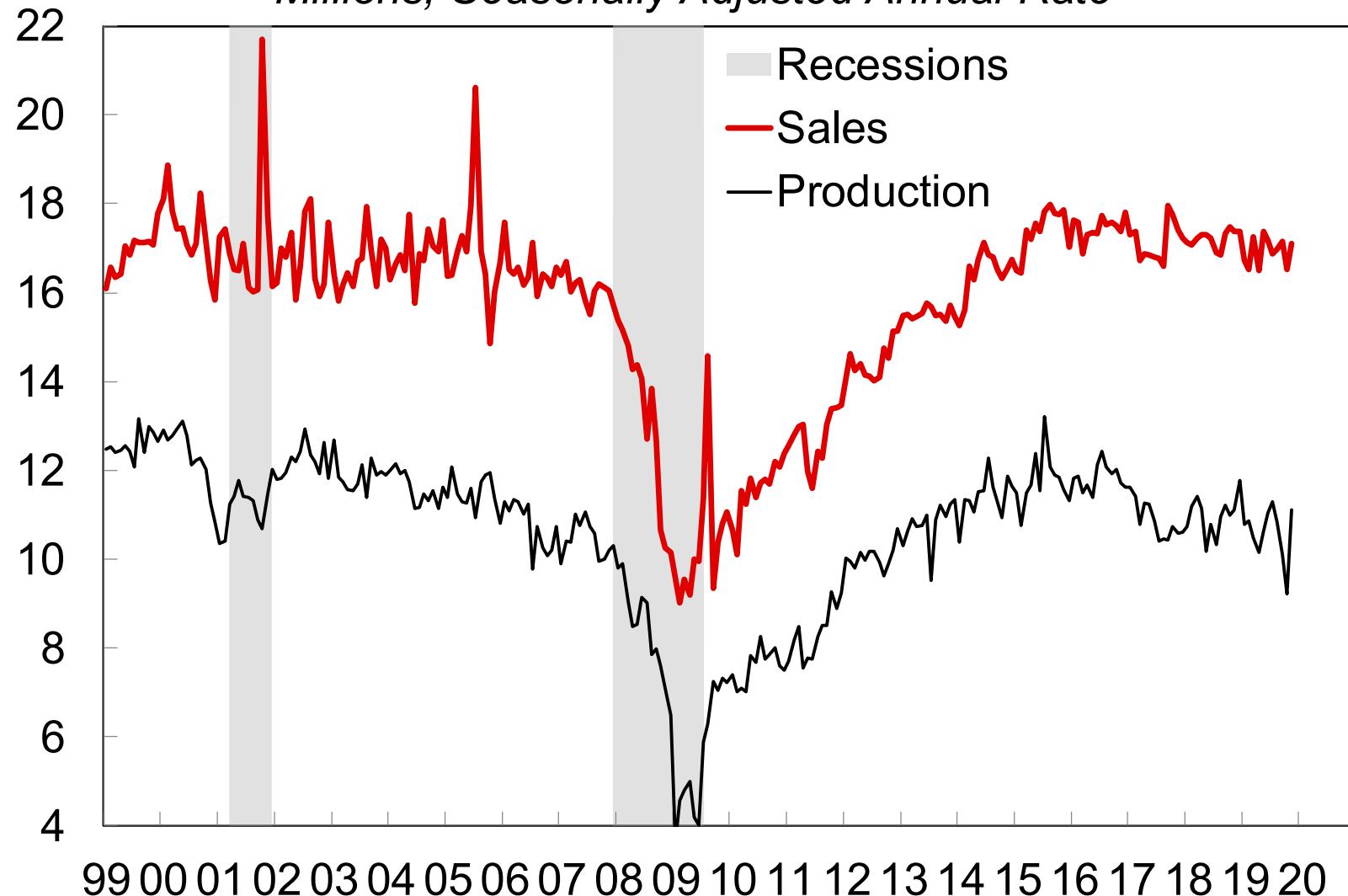
S&P 500 Stock Price Index



Source: S&P Dow Jones Indices LLC/FRED

US Light Vehicle Sales & Production

Millions, Seasonally Adjusted Annual Rate



Tariff actions taken by Trump Administration

November 2017: Softwood lumber

February 2018: Washing machines

March 23, 2018: Steel & aluminum (with exemptions)

June 2018: Steel & aluminum (without exemptions)

September 24, 2018: 10% tariffs on \$200 billion in Chinese exports

May 10, 2019: Tariffs on Chinese exports raised to 25% (after two delays)

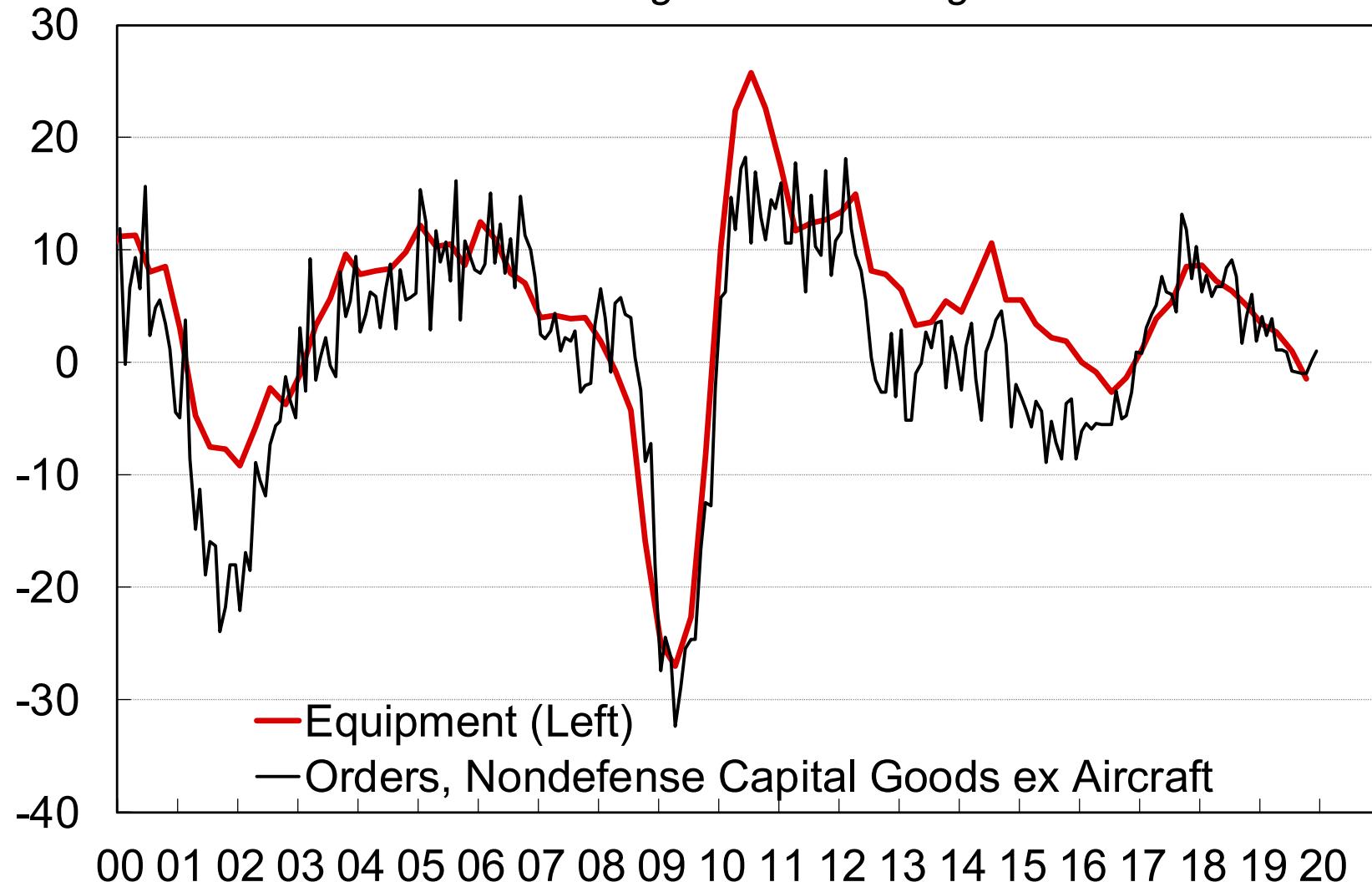
June 10, 2019: 5% tariffs on all imports from Mexico (avoided . . . for now)

**September 1, 2019: 10% tariffs on additional \$300 billion in Chinese exports
(Half delayed until December 15)**

October 15, 2019: 25% tariffs raised to 30%. 10% tariffs raised to 15%.

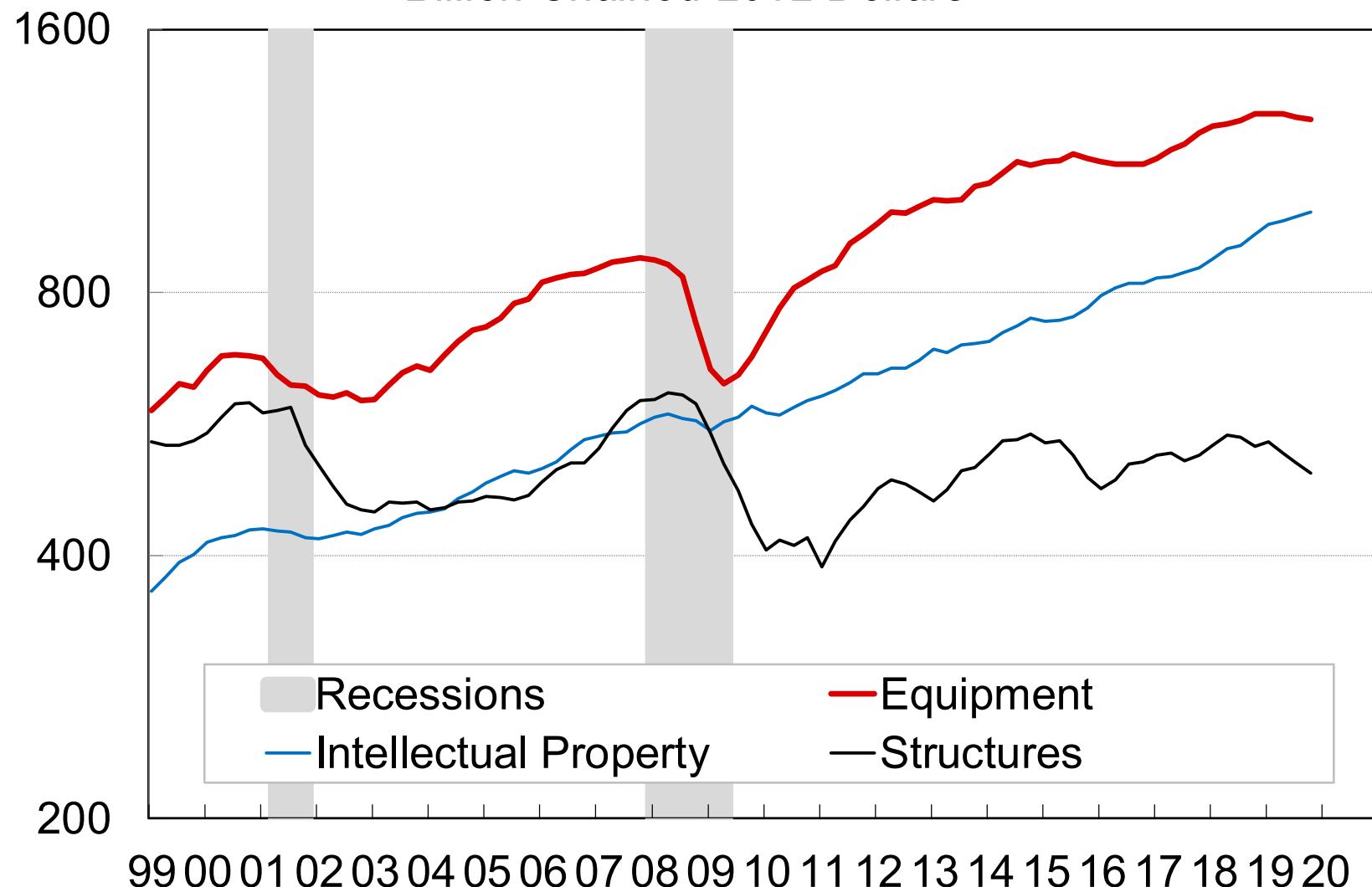
Real Investment in Equipment vs Capital Goods Orders

Percent Change from Year Ago

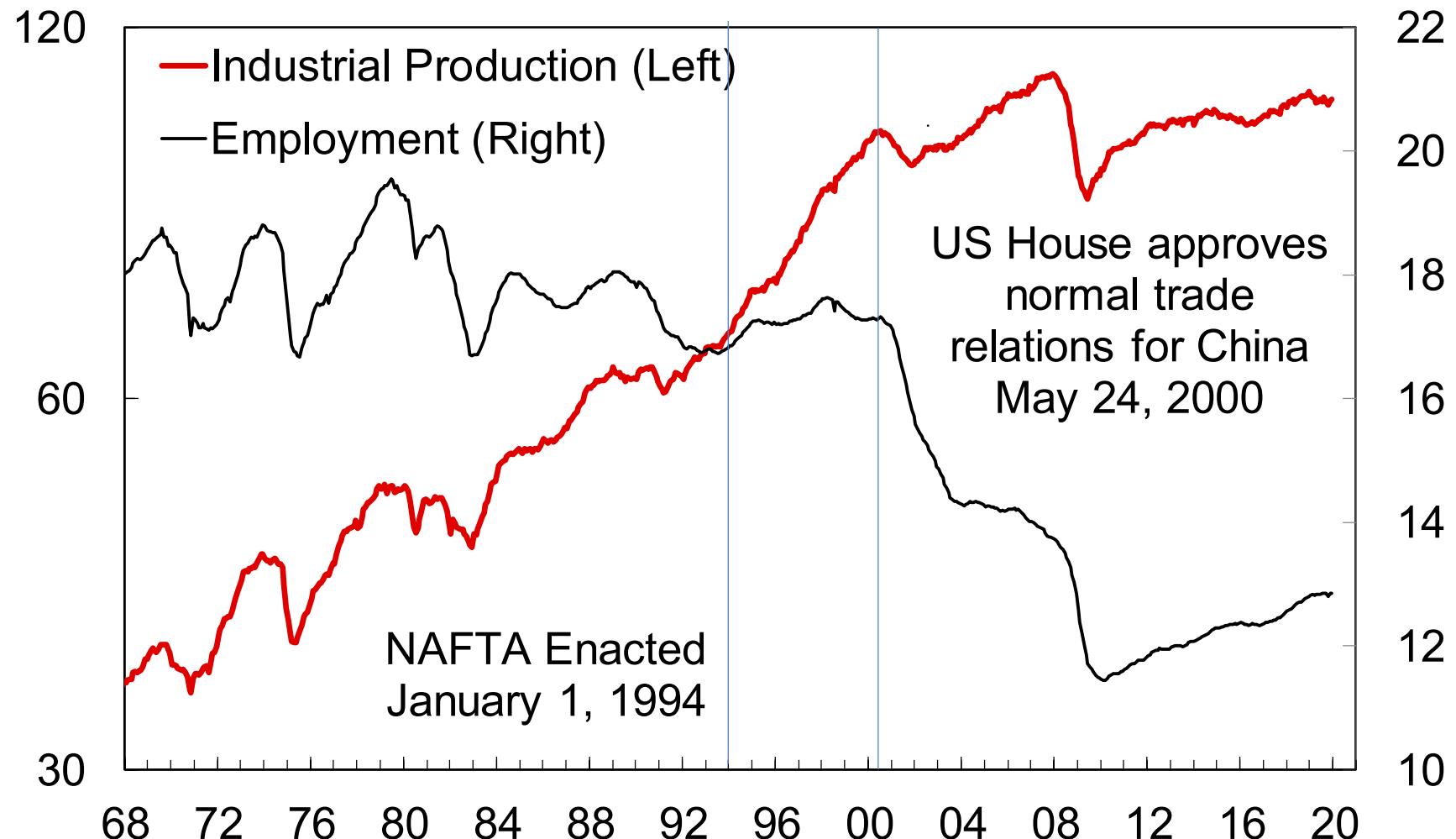


US Nonresidential Fixed Investment

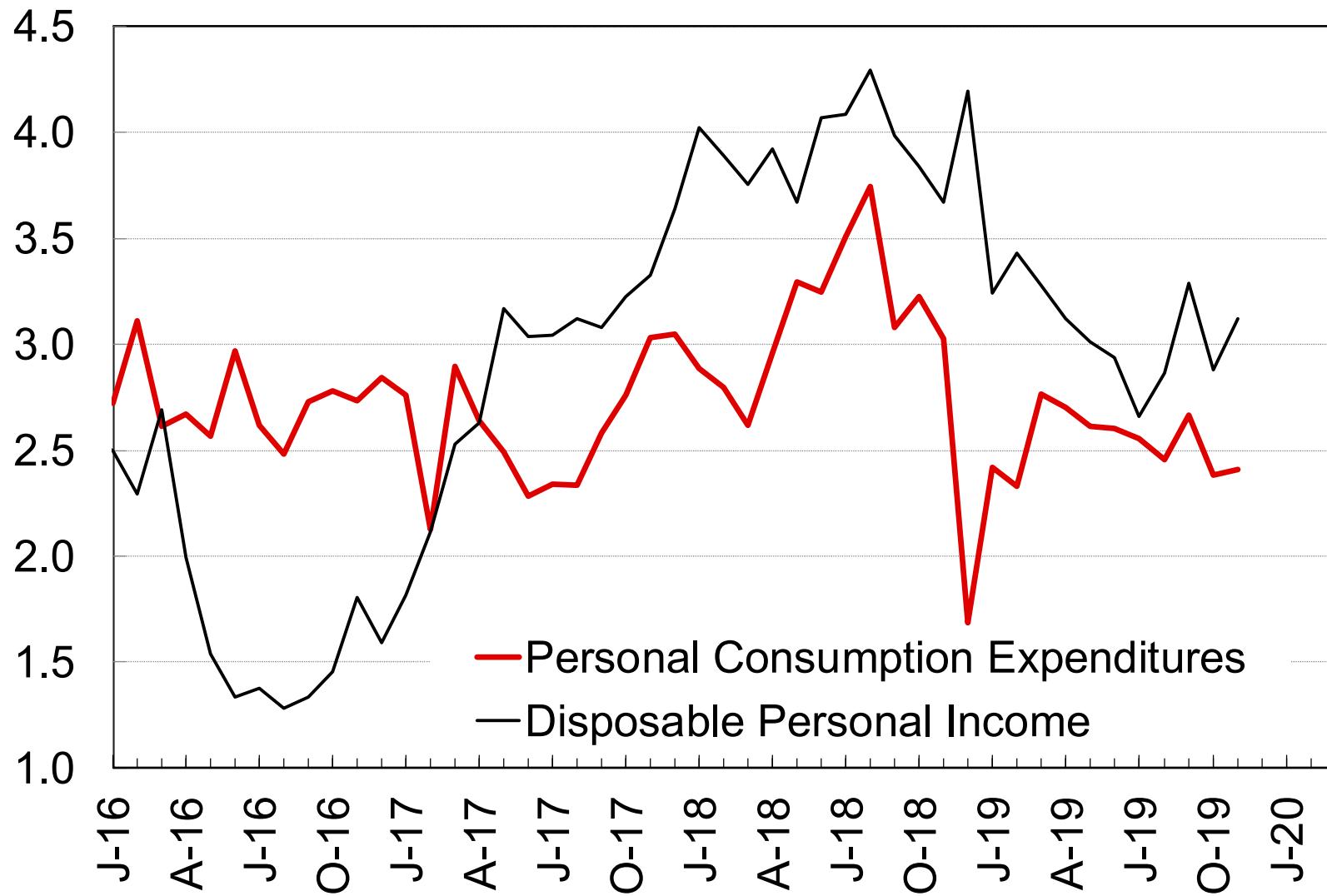
Billion Chained 2012 Dollars



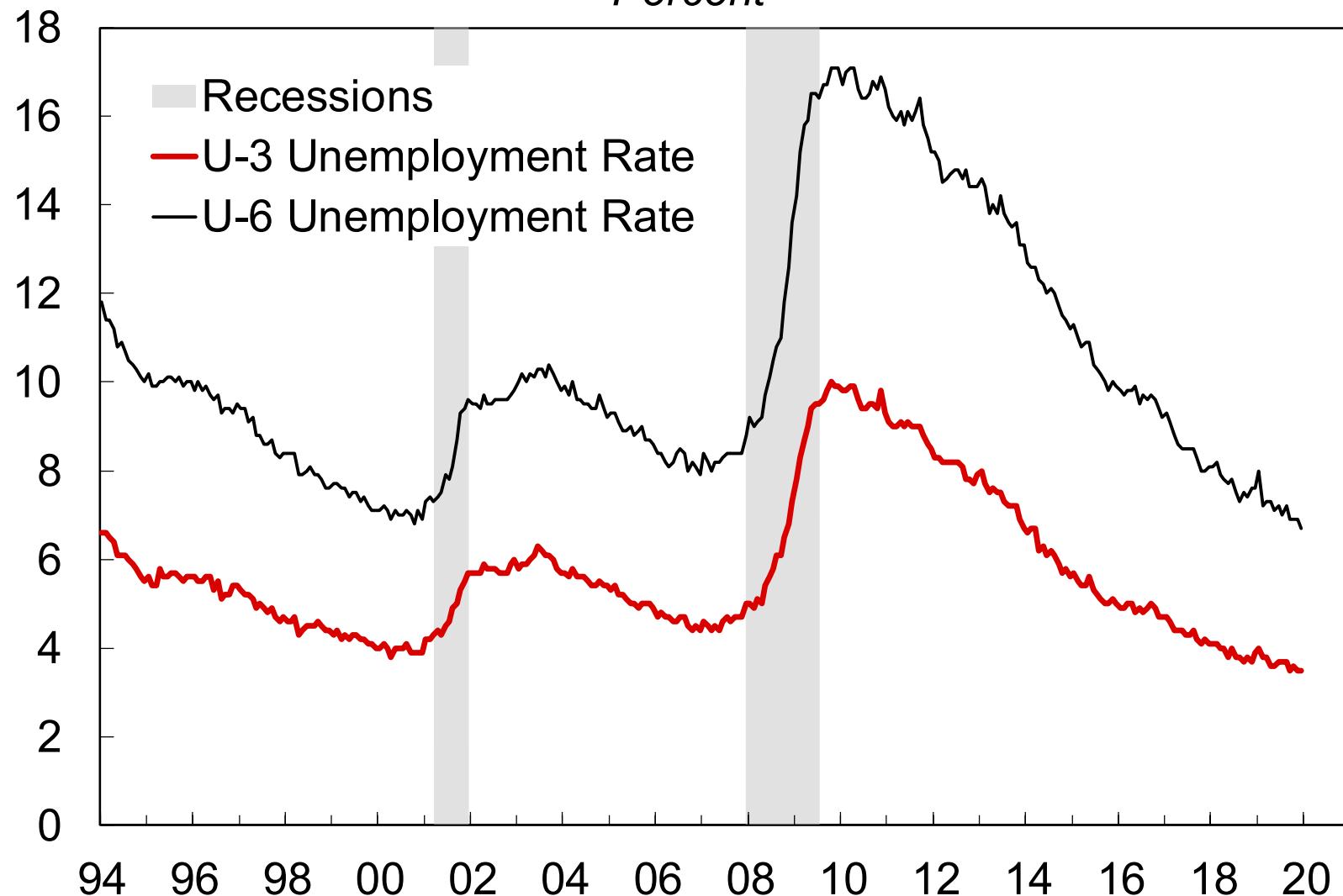
US Industrial Production & Employment: Manufacturing Index, 2012=100 Millions



US Real Consumer Spending & Disposable Income *Percent Change from Year Ago, Chained 2012 Dollars*

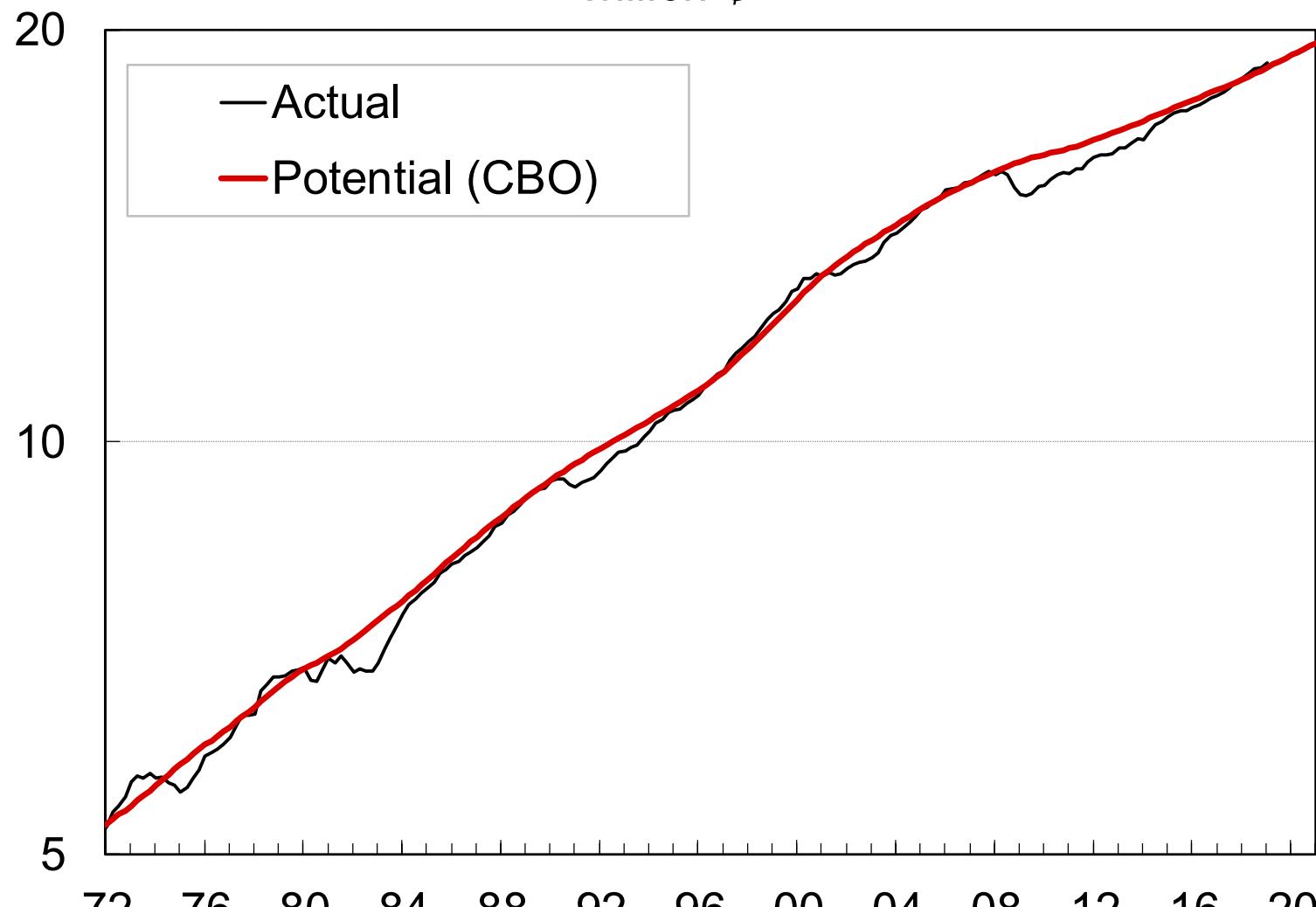


US Civilian Unemployment Rate *Percent*



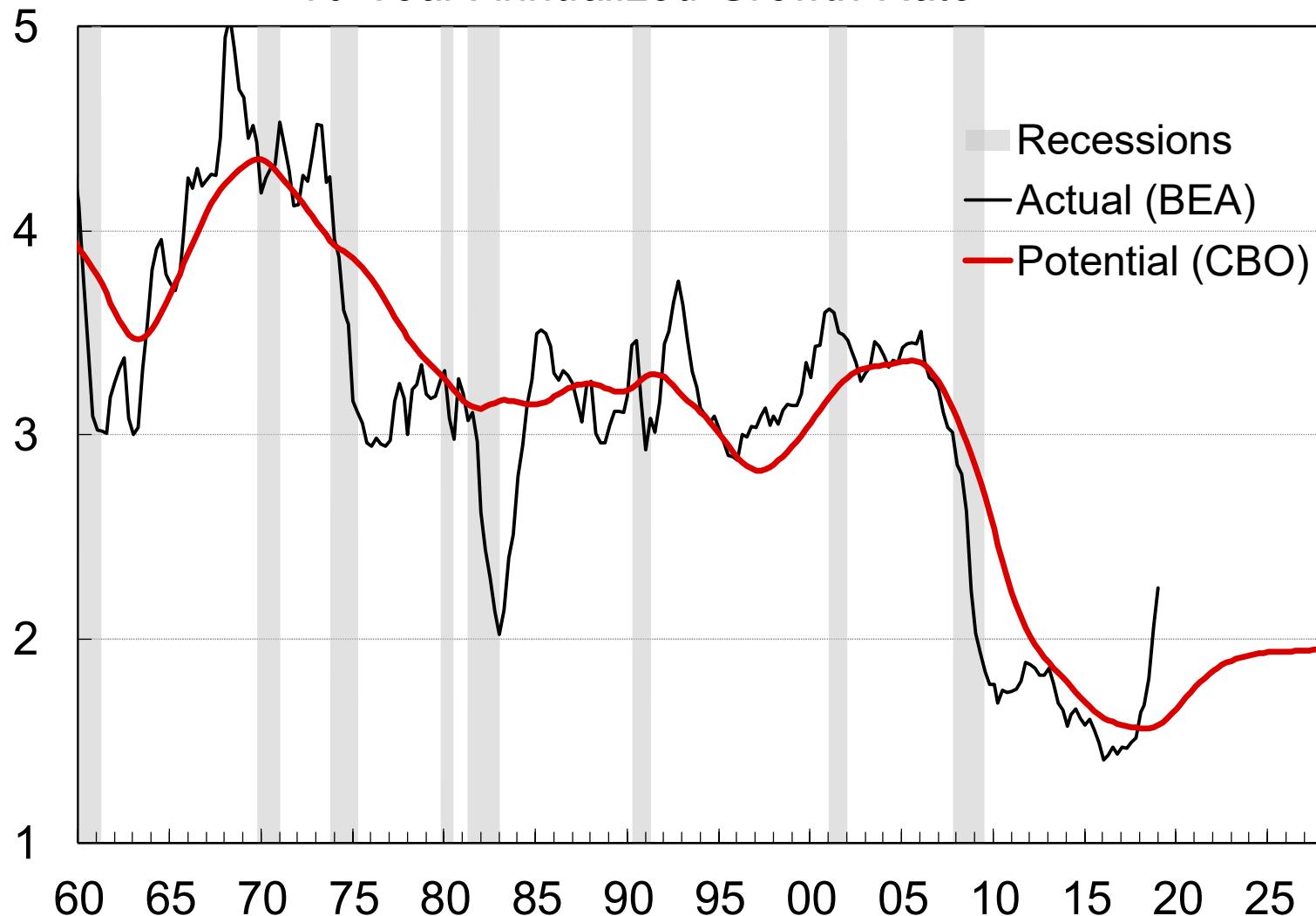
US Real Gross Domestic Product

Trillion \$

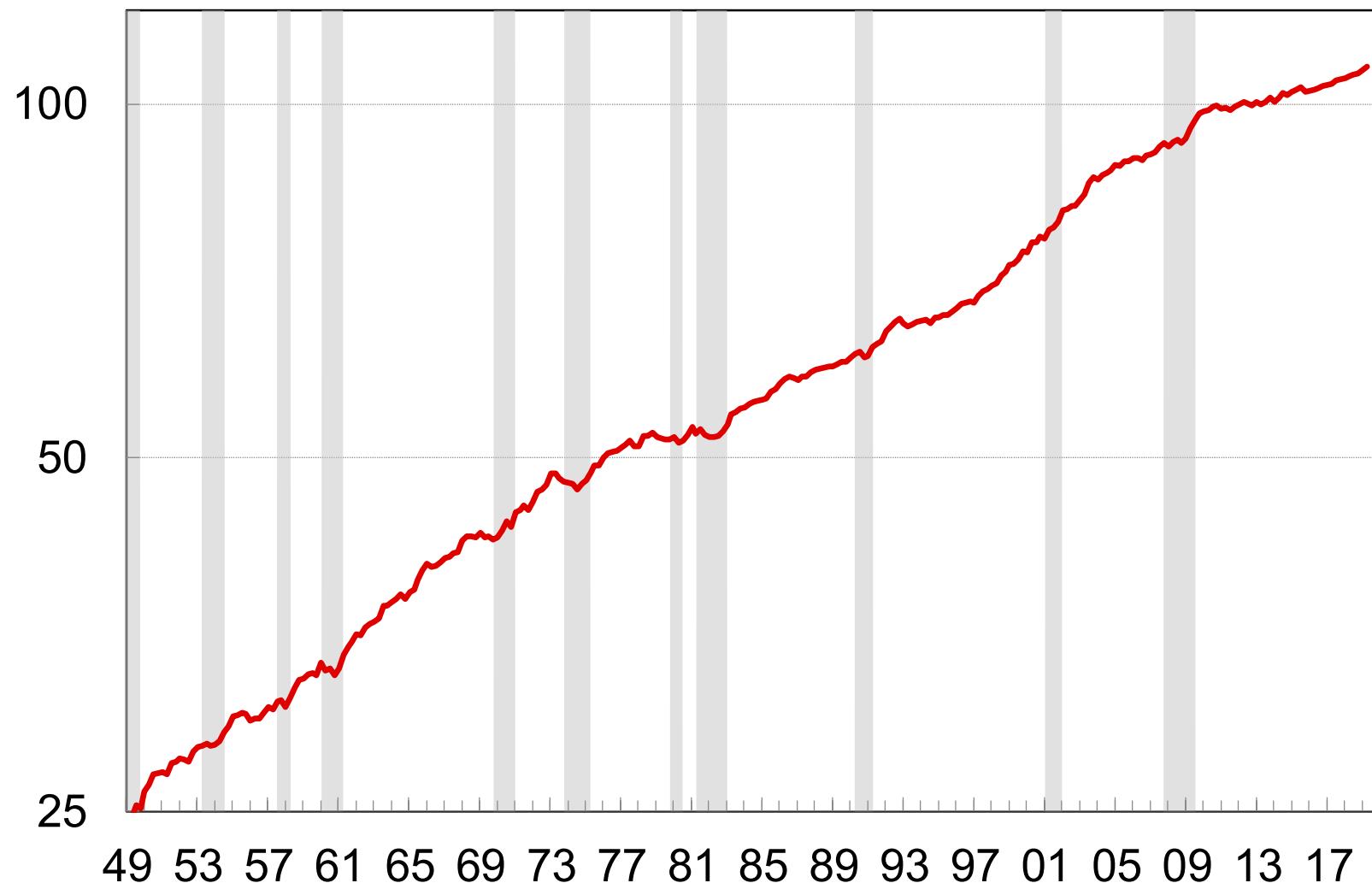


Source: U.S. Bureau of Economic Analysis/U.S. Congressional Budget Office/FRED

US Real Gross Domestic Product 10-Year Annualized Growth Rate

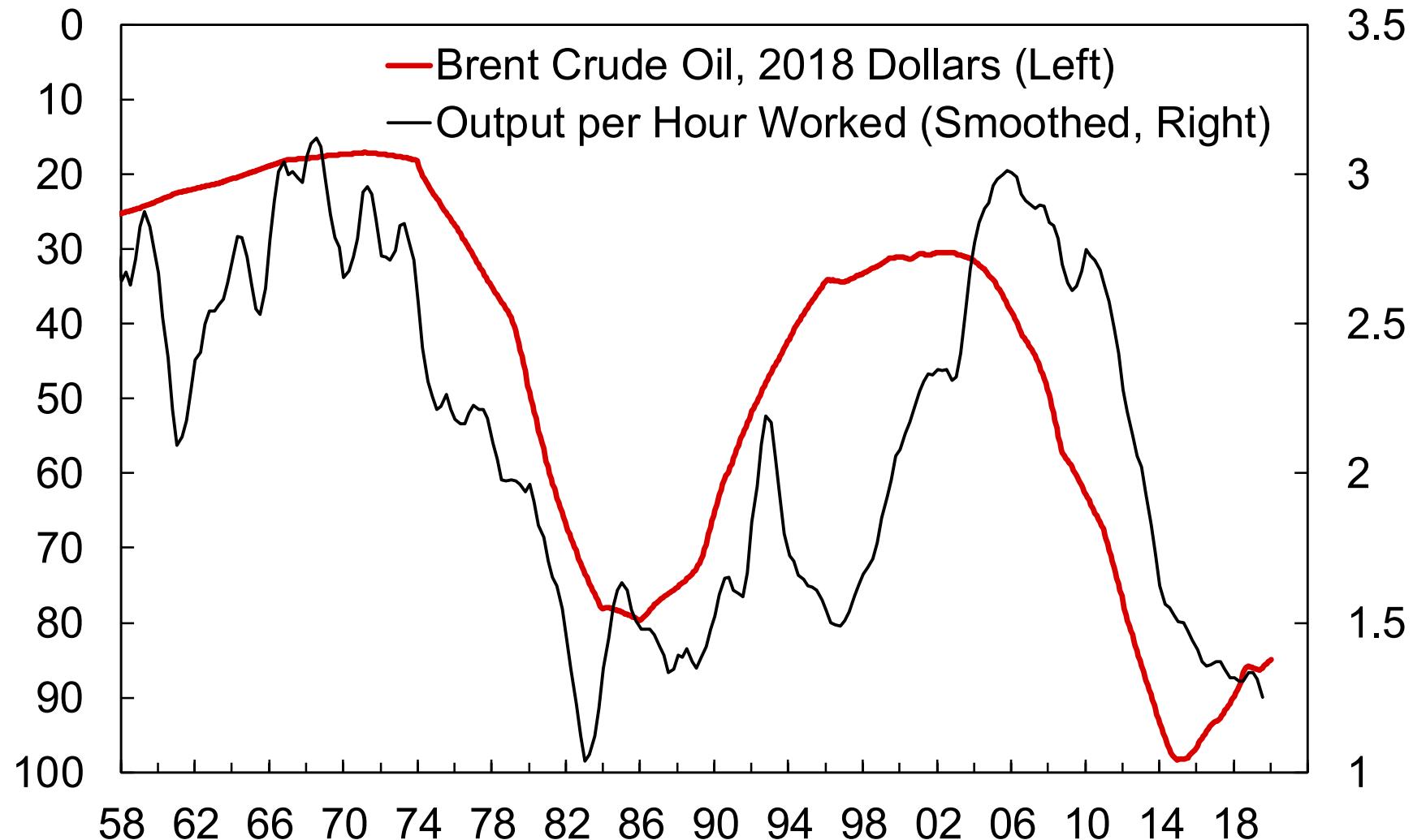


Real Output Per Hour: US Nonfarm Business Sector 2012 = 100, Logarithmic Scale



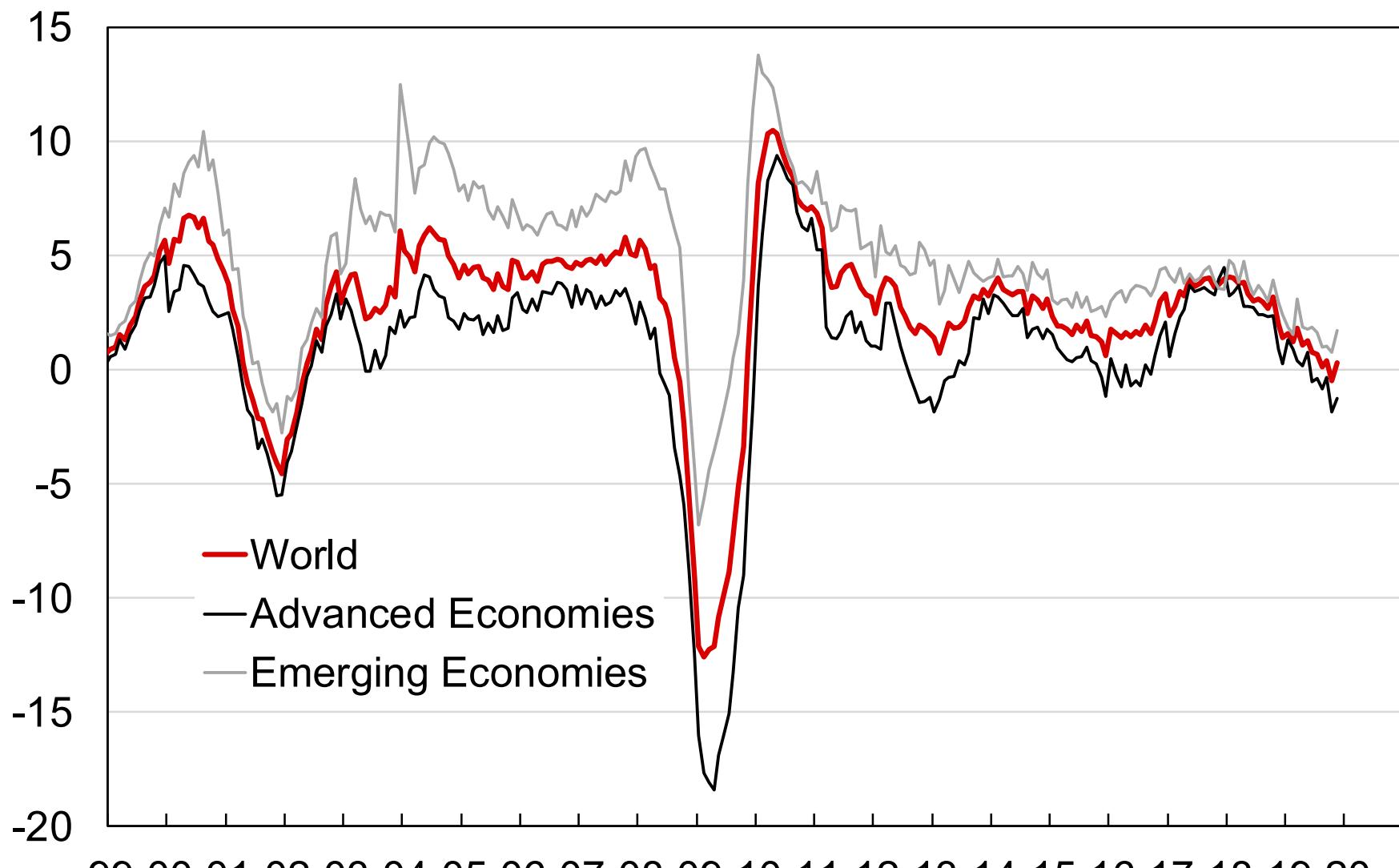
Oil Prices & US Productivity Growth

10-Year Moving Average 10-Year Annualized Growth Rate



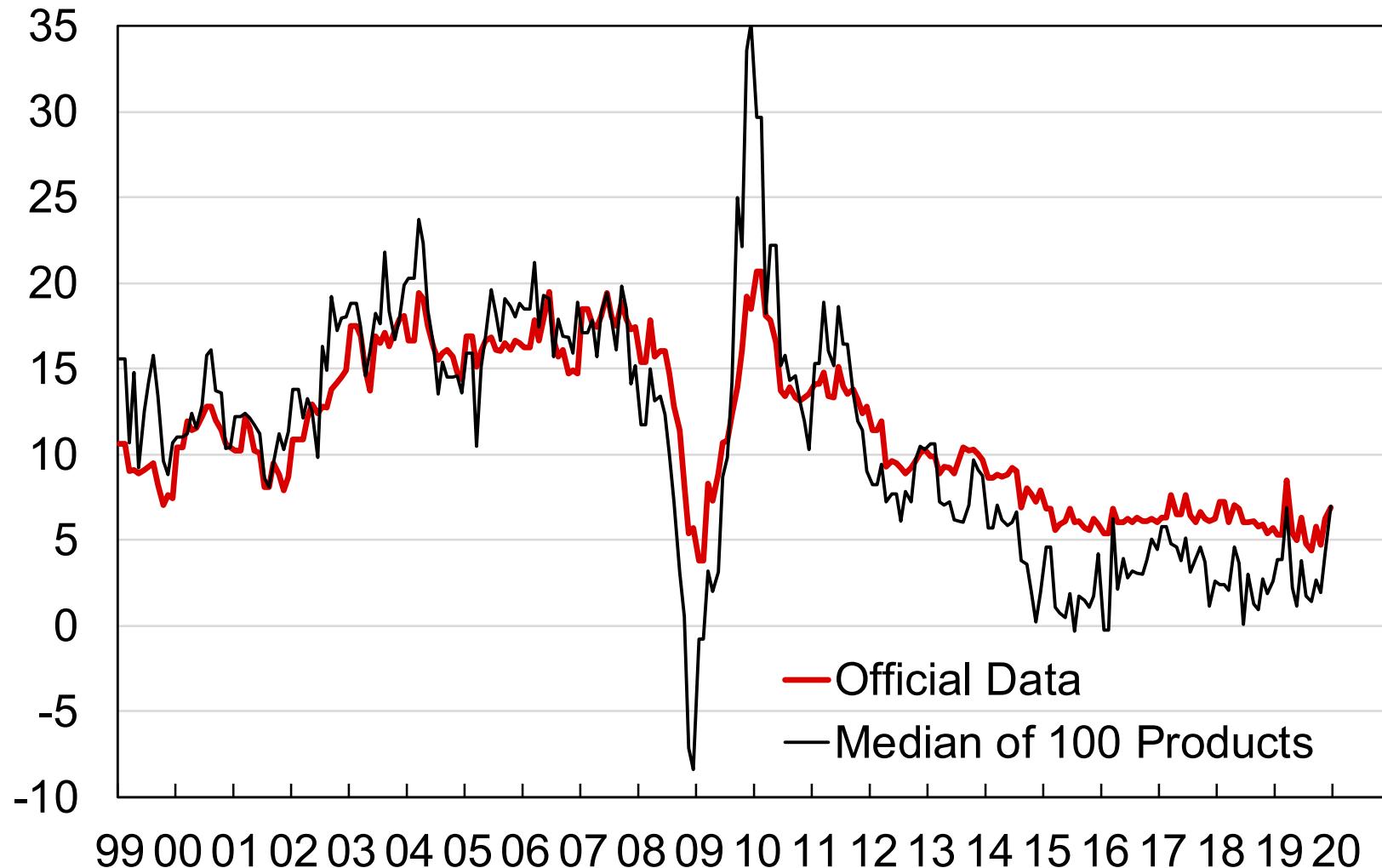
Industrial Production ex Construction

Percent Change from Year Ago



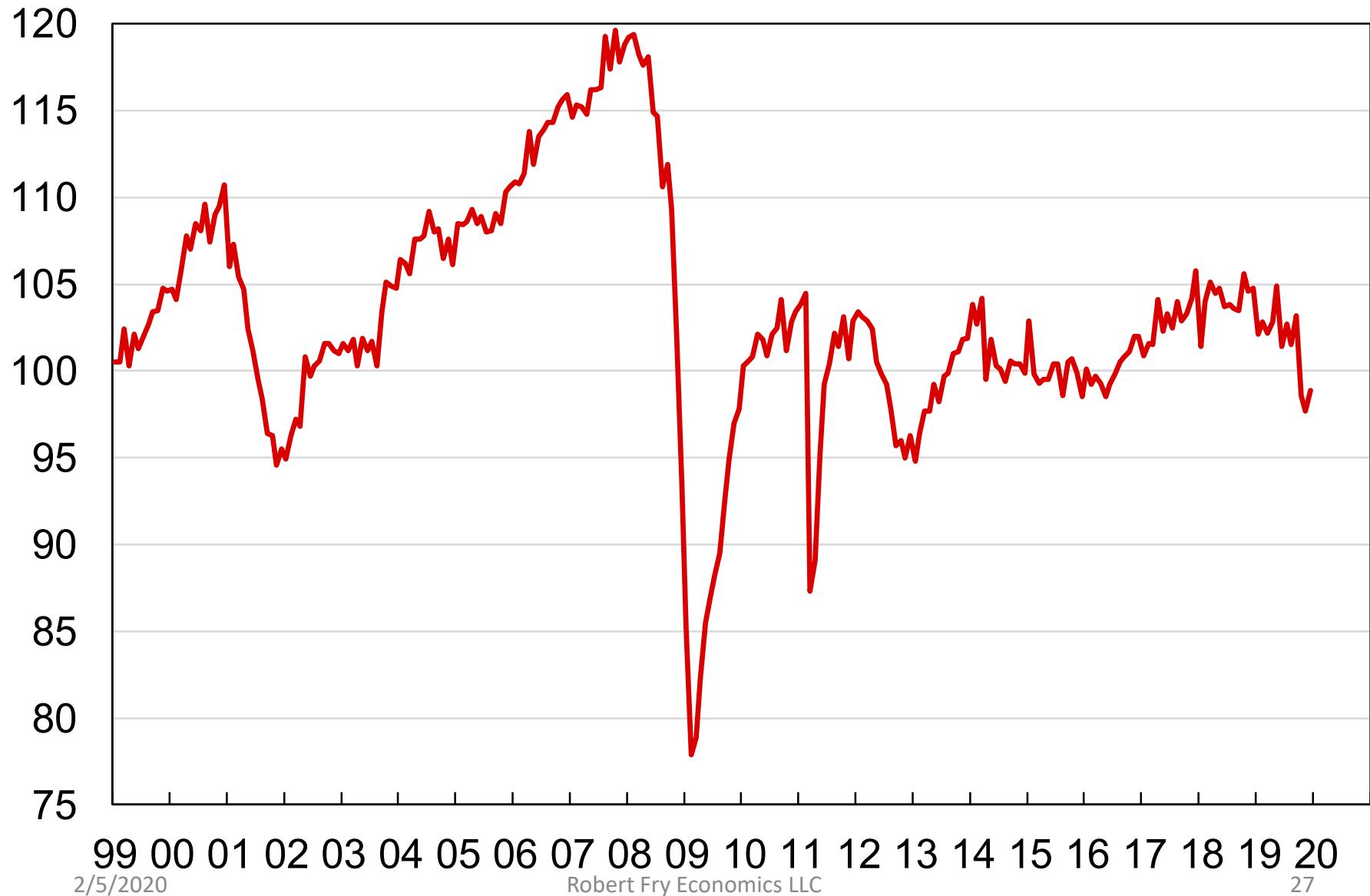
Value Added of Industry (Industrial Production): China

Percent Change from Year Ago

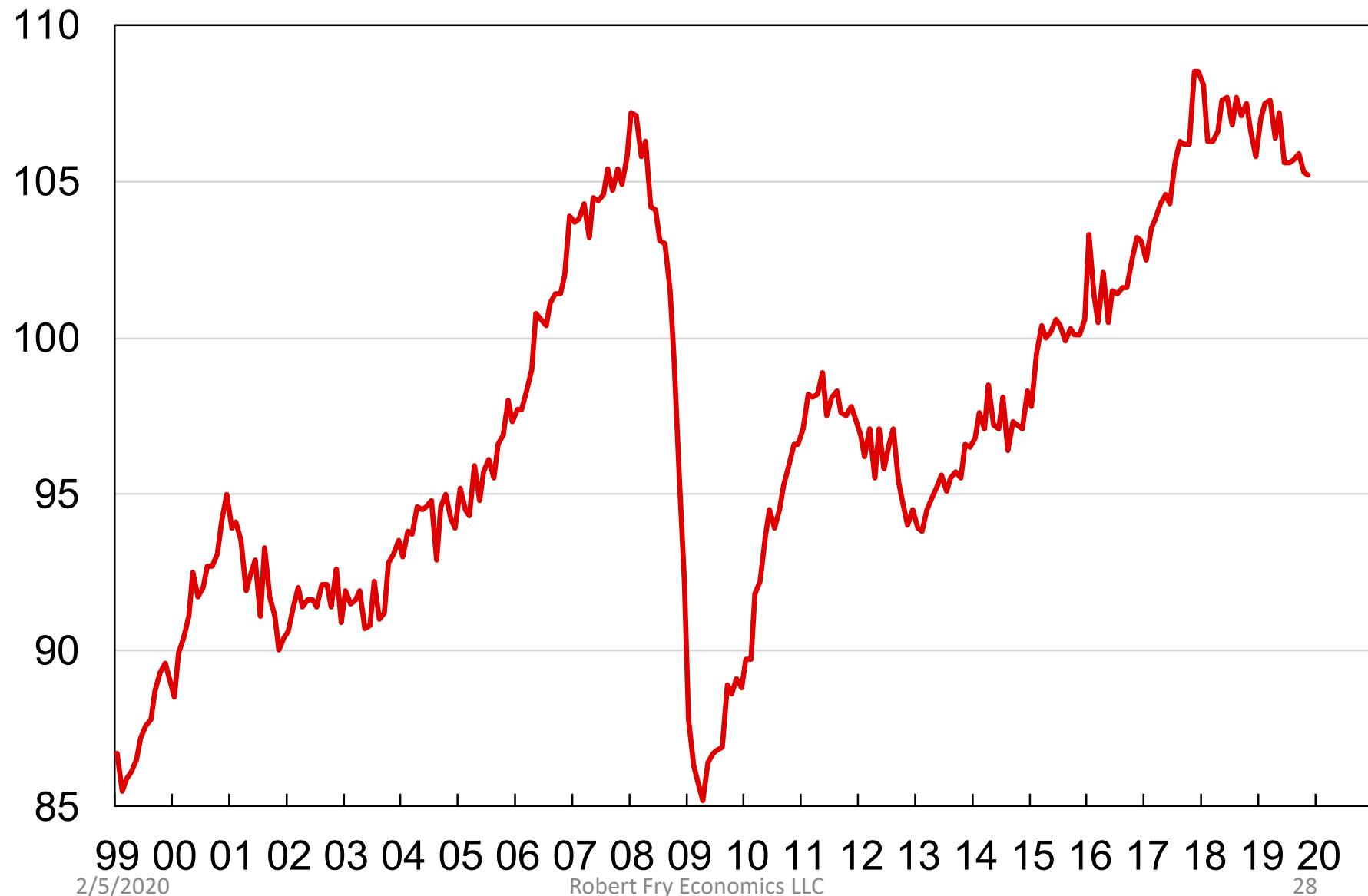


Industrial Production, Manufacturing: Japan

Index, 2015 = 100

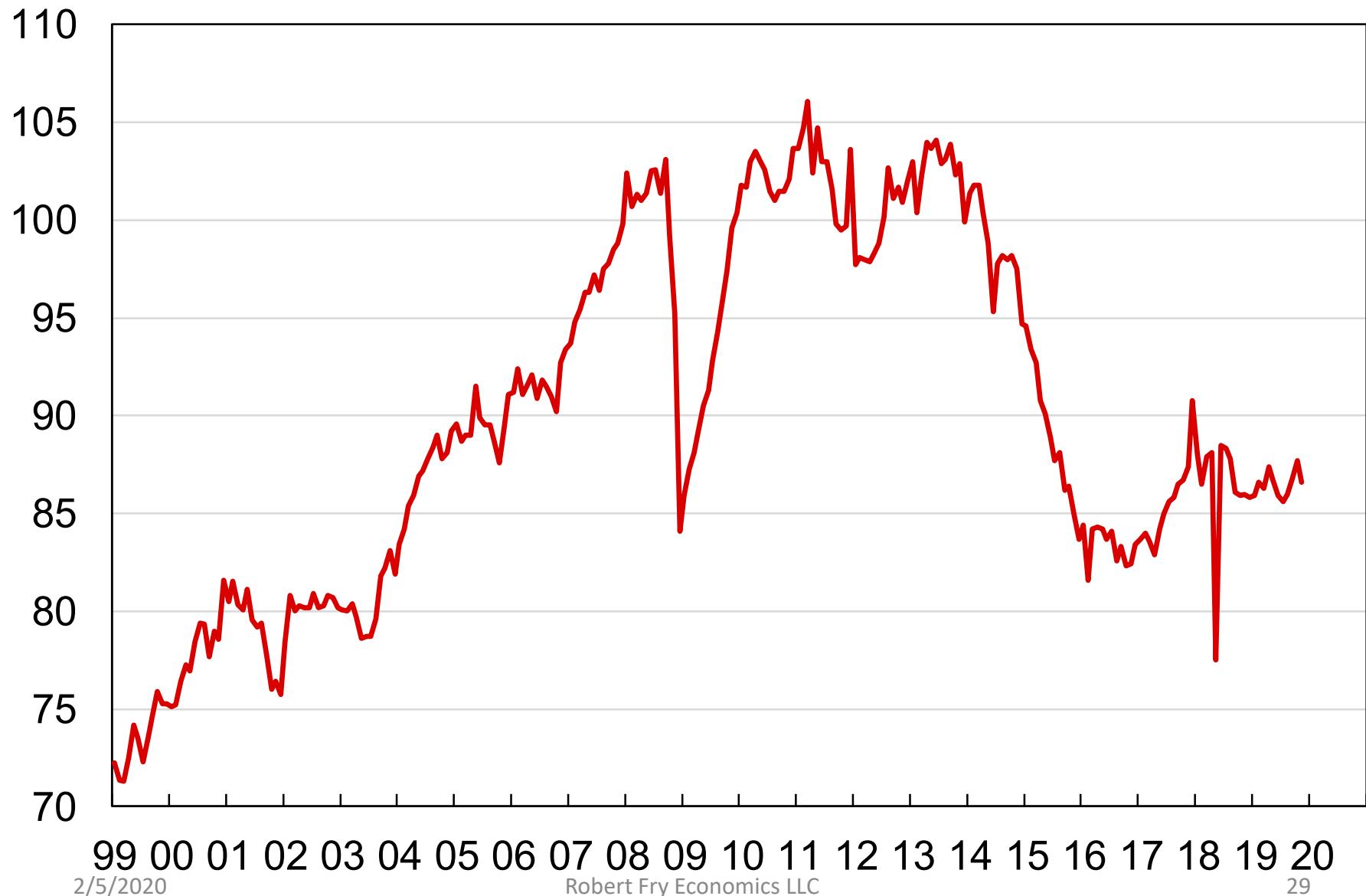


Industrial Production, Manufacturing: European Union *Index, 2015 = 100*



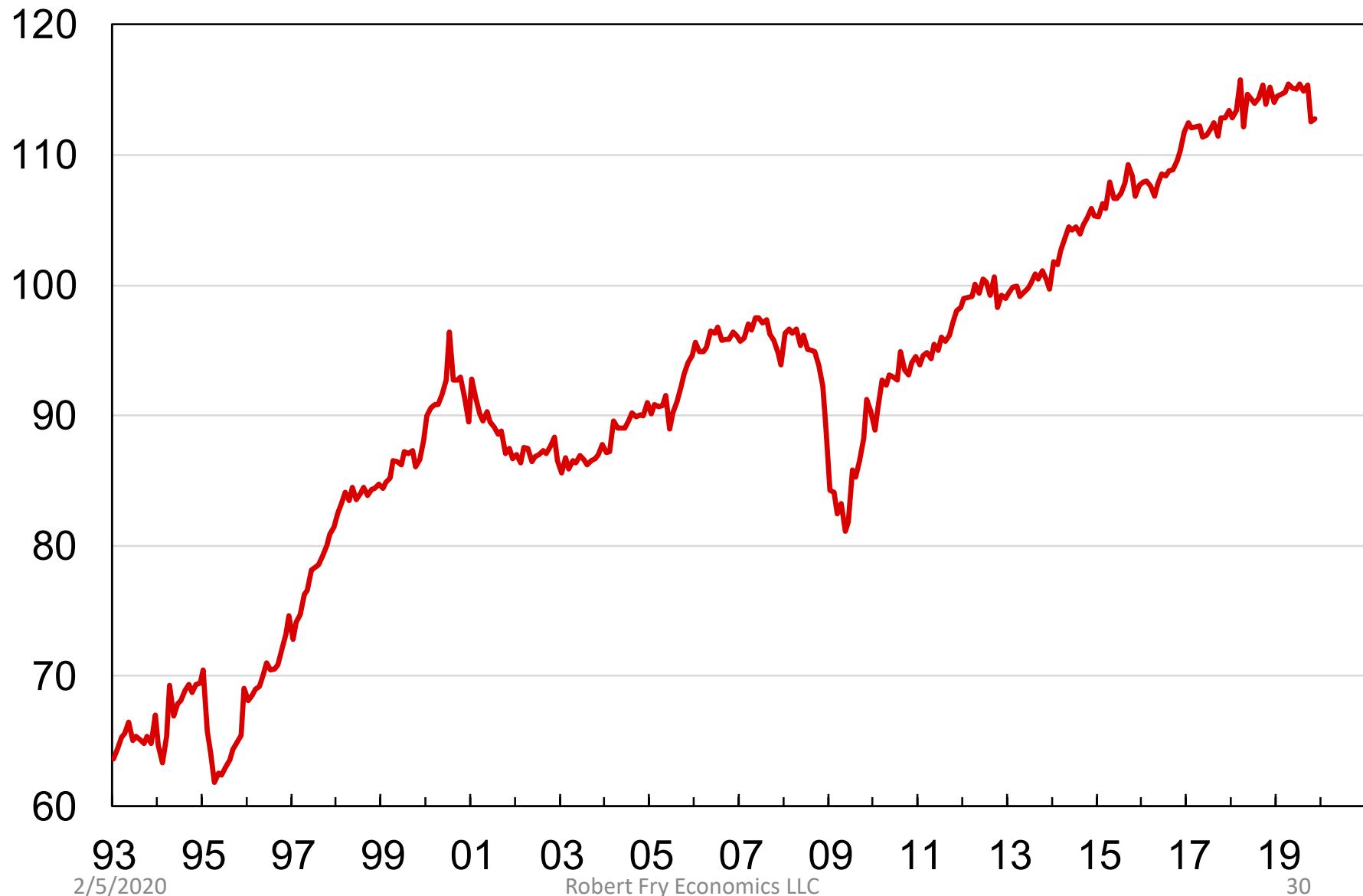
Industrial Production, Manufacturing: Brazil

Index, 2012 = 100



Industrial Production, Manufacturing: Mexico

Index, 2008 = 100



Why did growth slow?

Trump: “It’s the Fed’s fault.”

- December 2018 rate hike a mistake; allowing yield curve to invert a bigger mistake.

Free-trade, free-market Republicans: “It’s the tariffs.”

- Uncertainty about resolution of trade war put business investment on hold.

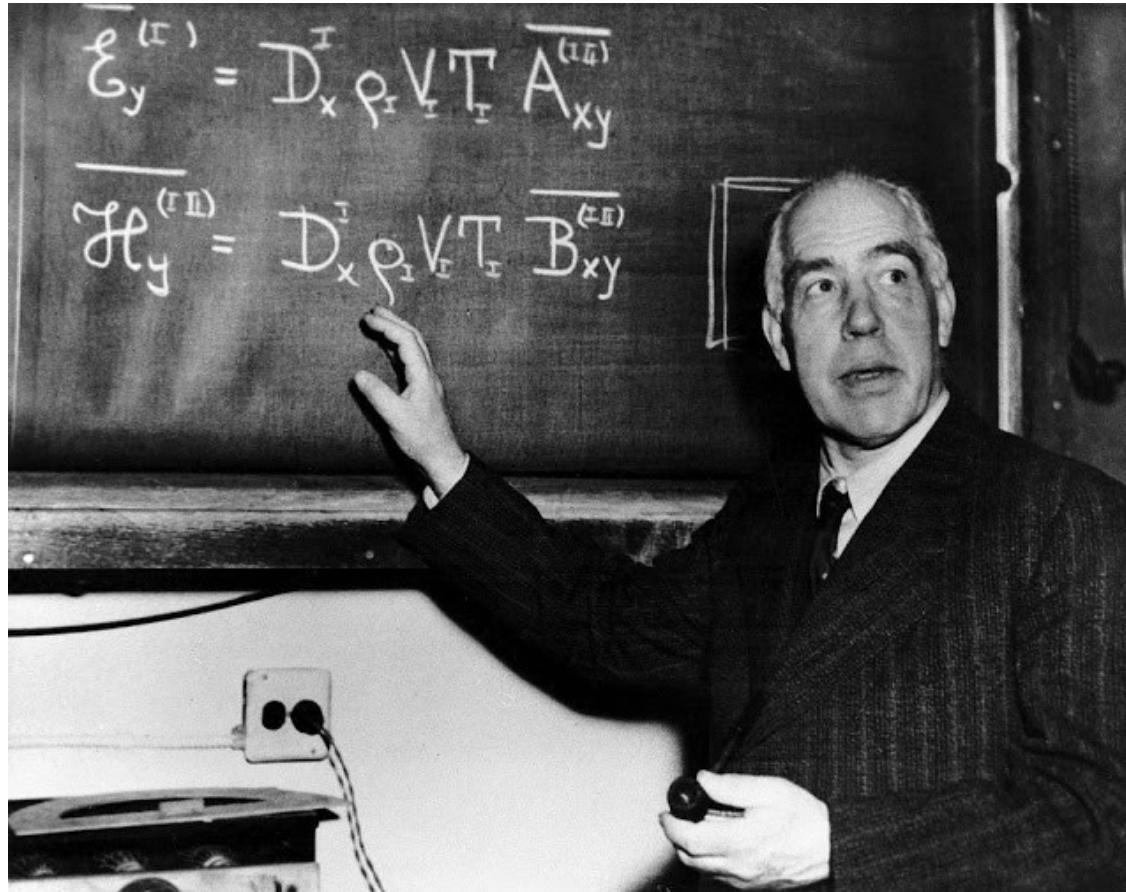
Democrats/CBO: return to “new normal” after temporary “sugar high.”

- Consumer spending accelerated after tax cut (but not much or for long).
- I think 2010-2017 productivity growth is “great aberration,” not “new normal.”

Less political explanation: Growth has slowed sharply in rest of world.

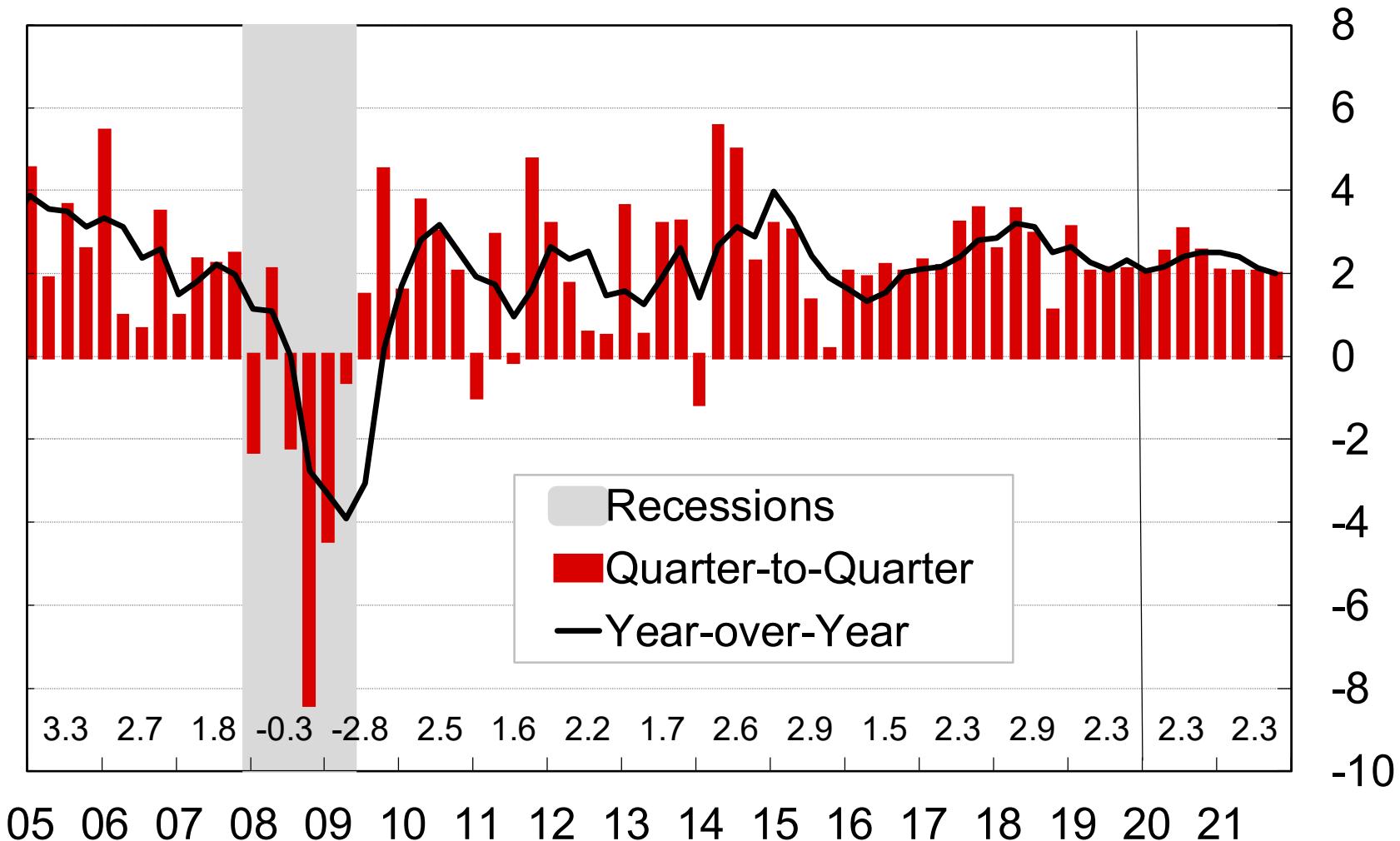
- Slowdown in China predated US tariffs, due mostly to demographics and debt.
- European growth hurt by Brexit, populist politics, reduced demand from China.
- US tax reform shifted activity to US, as intended.

Whether or not growth reaccelerates depends on which explanation is correct.



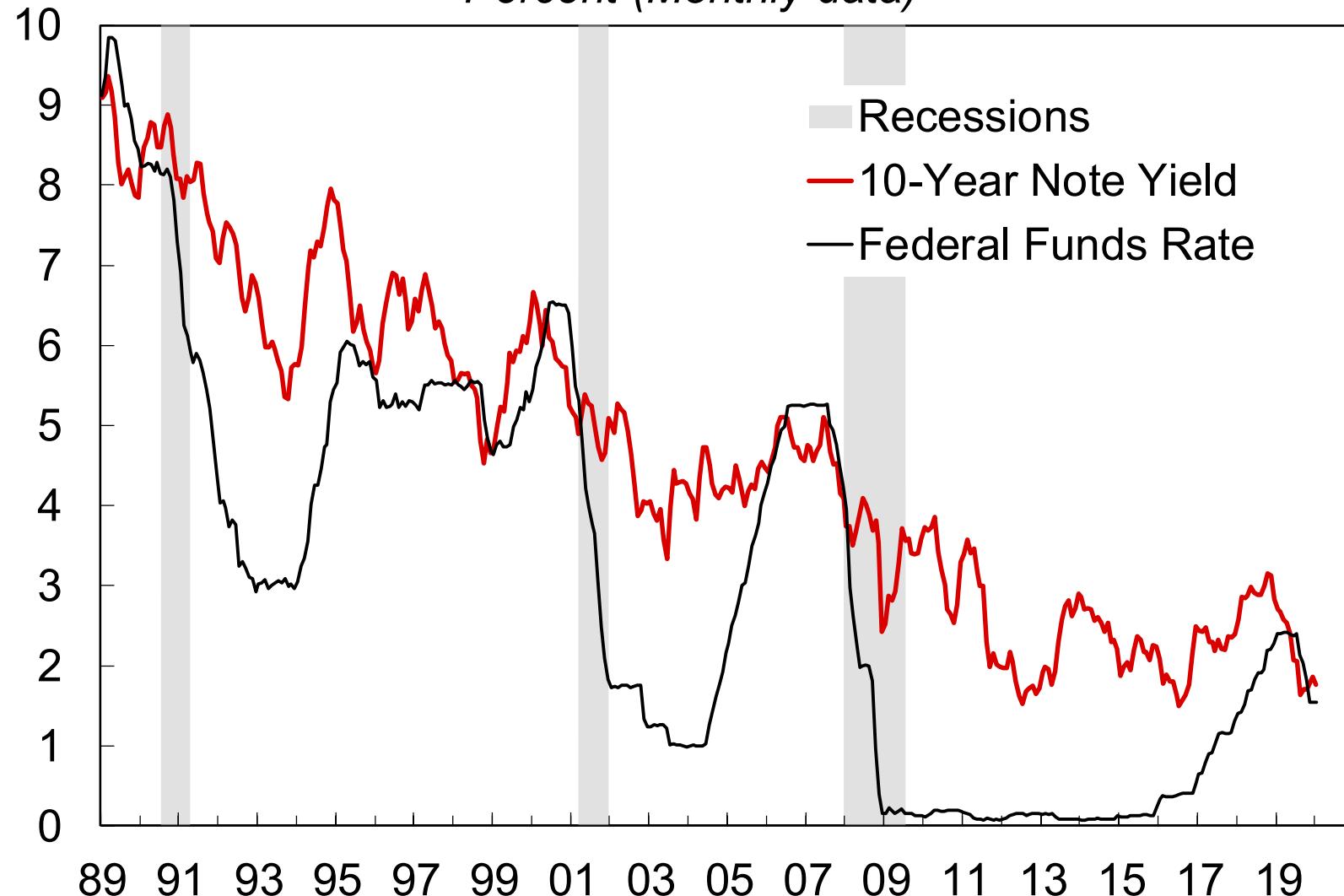
“Prediction is very difficult, especially about the future.”
--Niels Bohr, 1885-1962
Nobel Laureate, 1922

US Real Gross Domestic Product Annualized Growth Rates



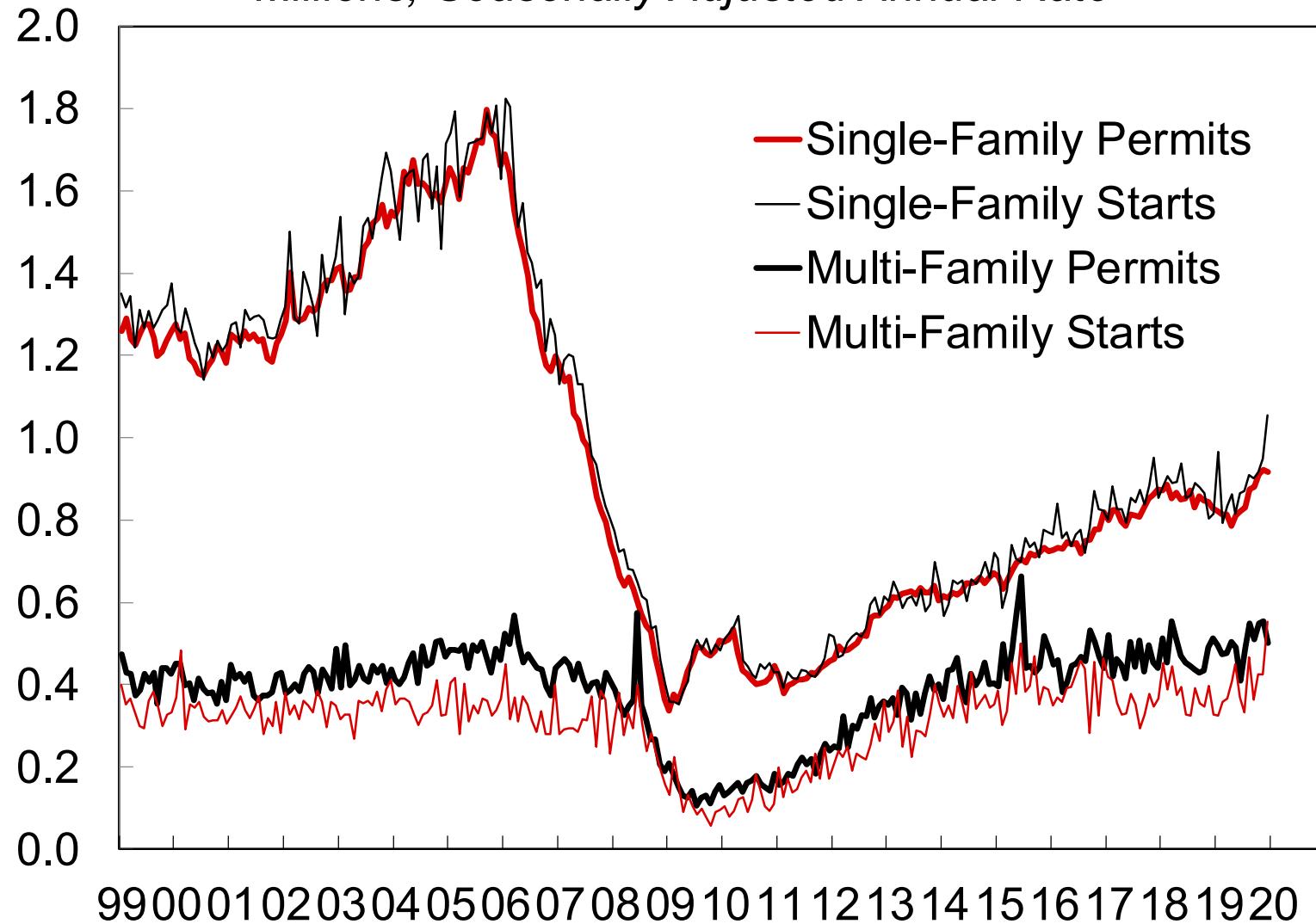
US Interest Rates

Percent (Monthly data)

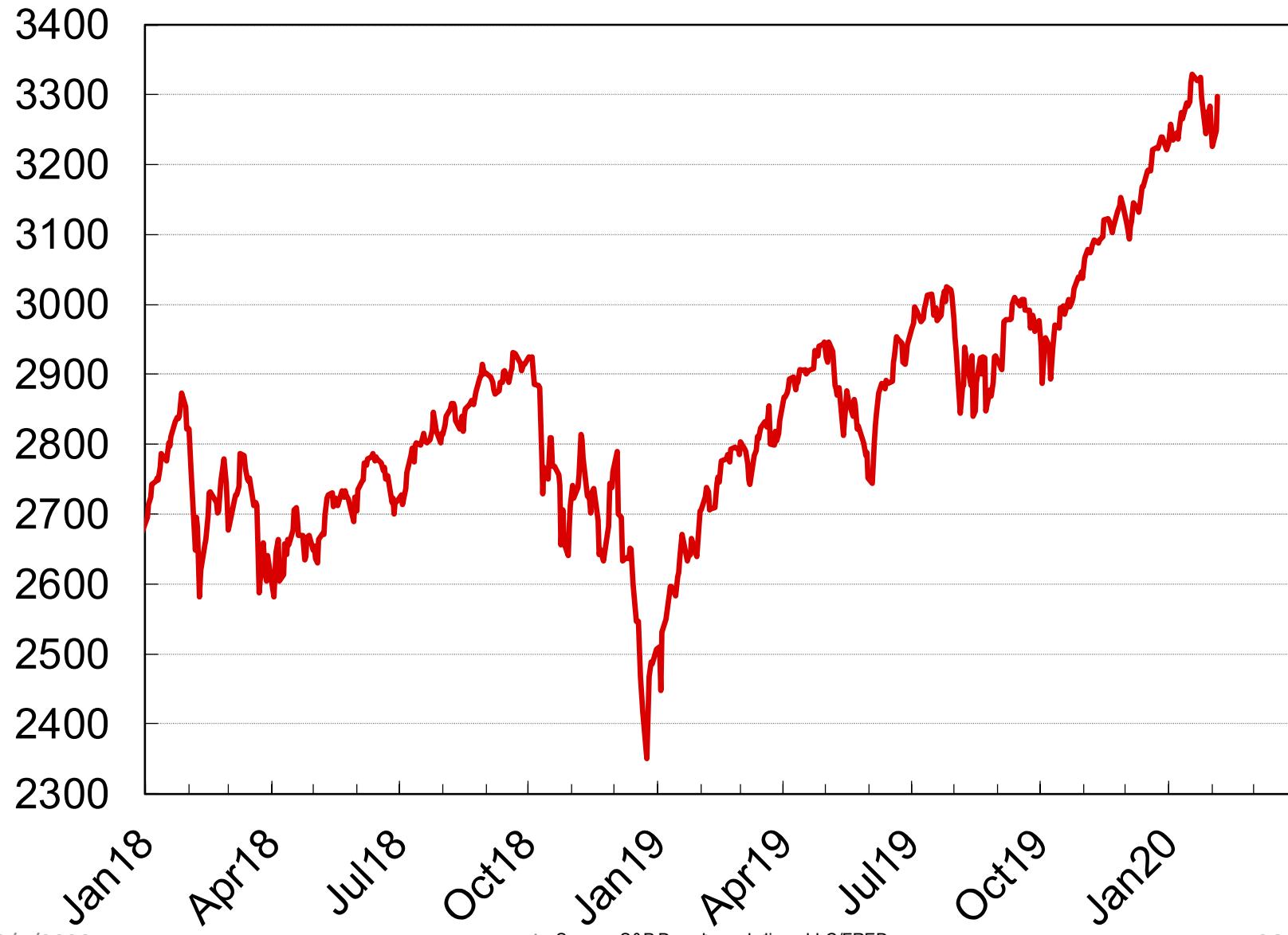


US Housing Starts & Building Permits

Millions, Seasonally Adjusted Annual Rate



S&P 500 Stock Price Index





**“Every election is a sort of advance
auction sale of stolen goods.”**

--H. L. Mencken, 1880-1956

How fast will the US economy grow? It depends.

Fed has cut rates, expanded balance sheet. (Ditto for other central banks.)

- We might finally get a real housing recovery.
- Higher stock prices signal higher growth (in short run, not long run).

Is Phase 1 trade deal with China enough?

- Deal eliminates worst-case scenario but leaves many tariffs in effect.
- Ratification of USMCA might be a bigger deal.

IF CBO is right, this is as good as it gets.

- I don't think CBO is right.

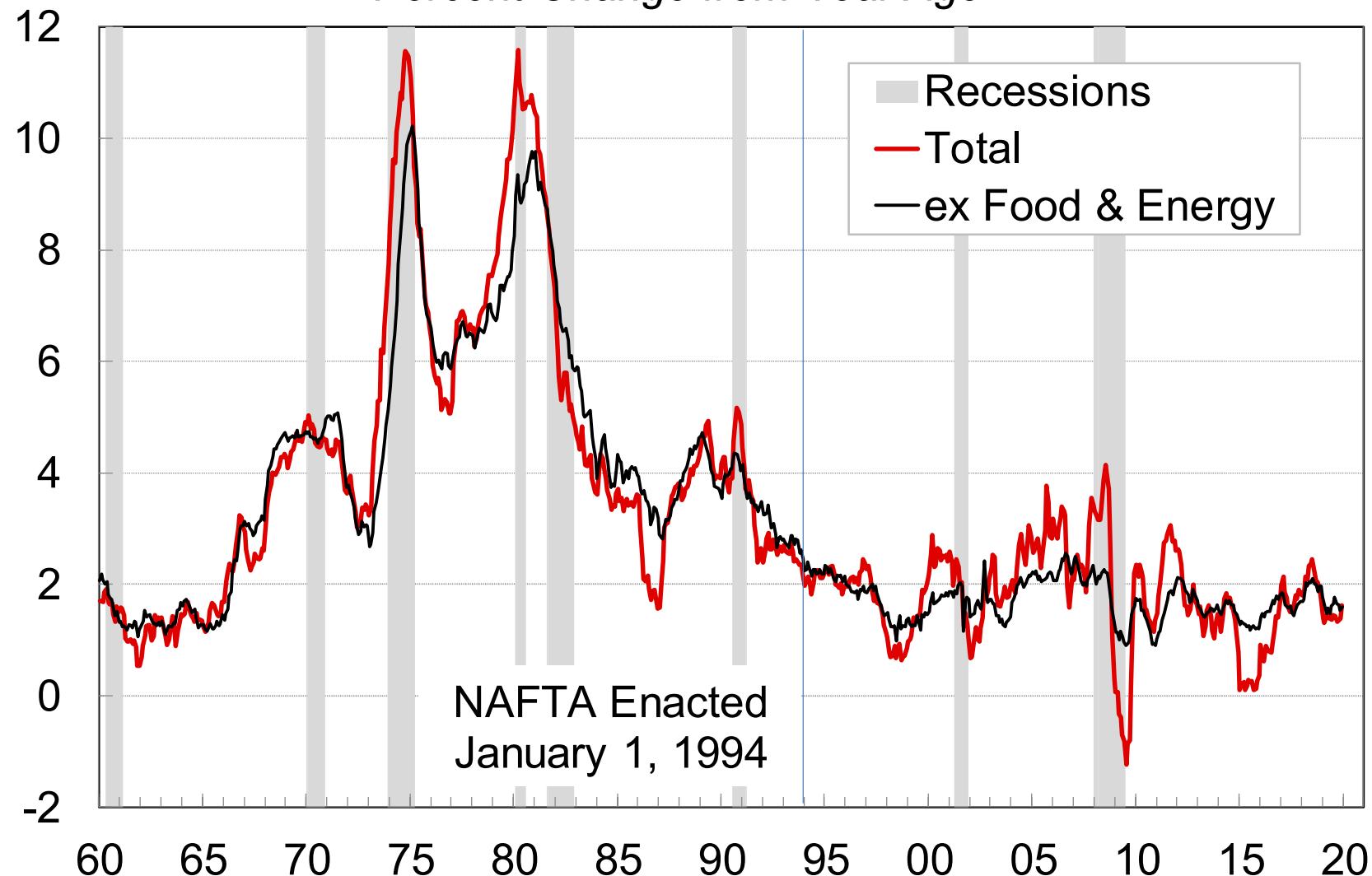
Response of business investment to trade deal will determine:

- How fast economy grows this year and longer term.
- Who wins the election.
- Whether tax cut was a good idea and whether it will be repealed.

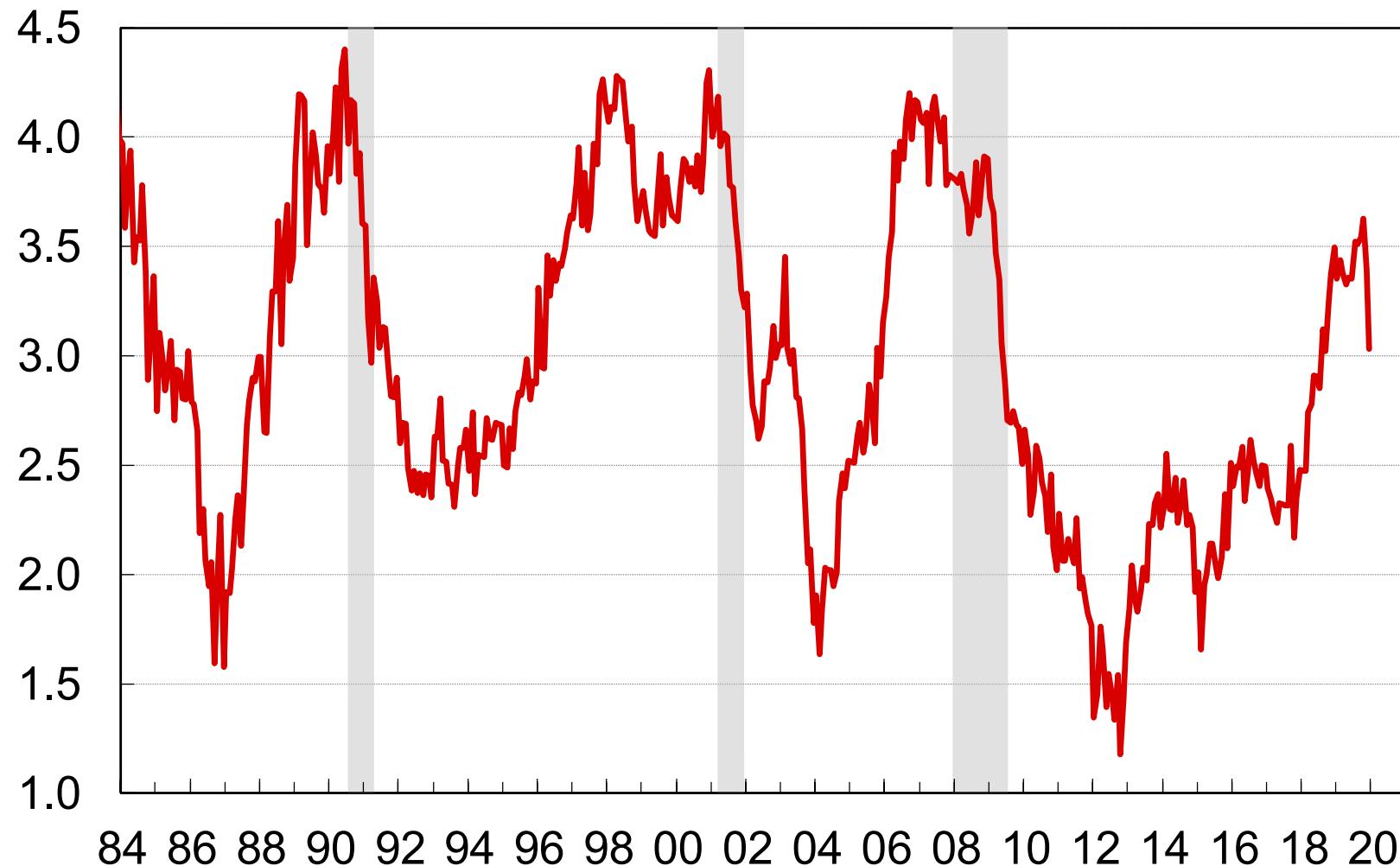
But how long will the expansion last?

US Personal Consumption Expenditures Price Index

Percent Change from Year Ago



Average Hourly Earnings, Production & Nonsupervisory *Percent Change from Year Ago*



Source: U.S. Bureau of Labor Statistics/FRED

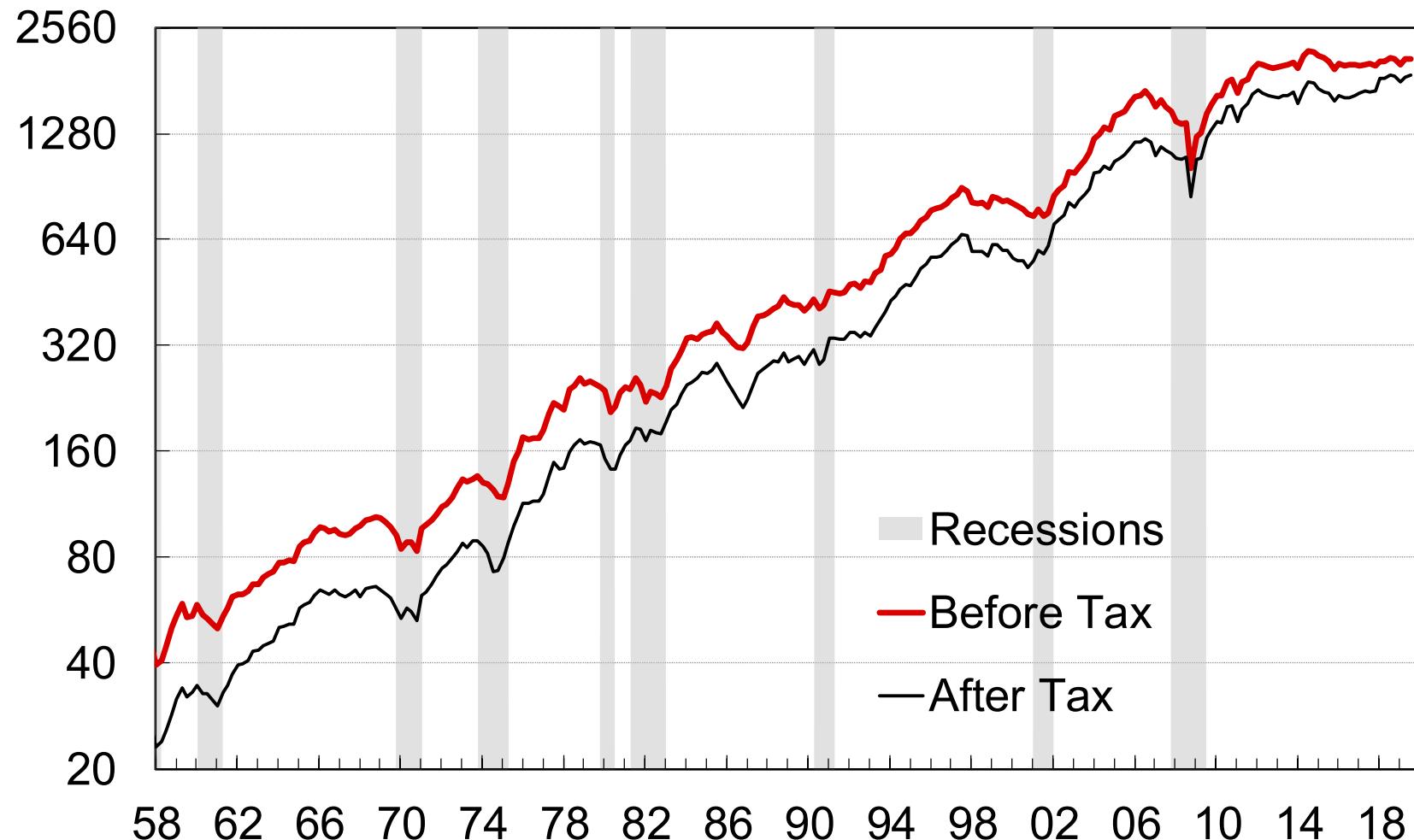
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Corporate Profits with IVA and CCAdj

Billion \$



Source: U.S. Bureau of Economic Analysis/FRED

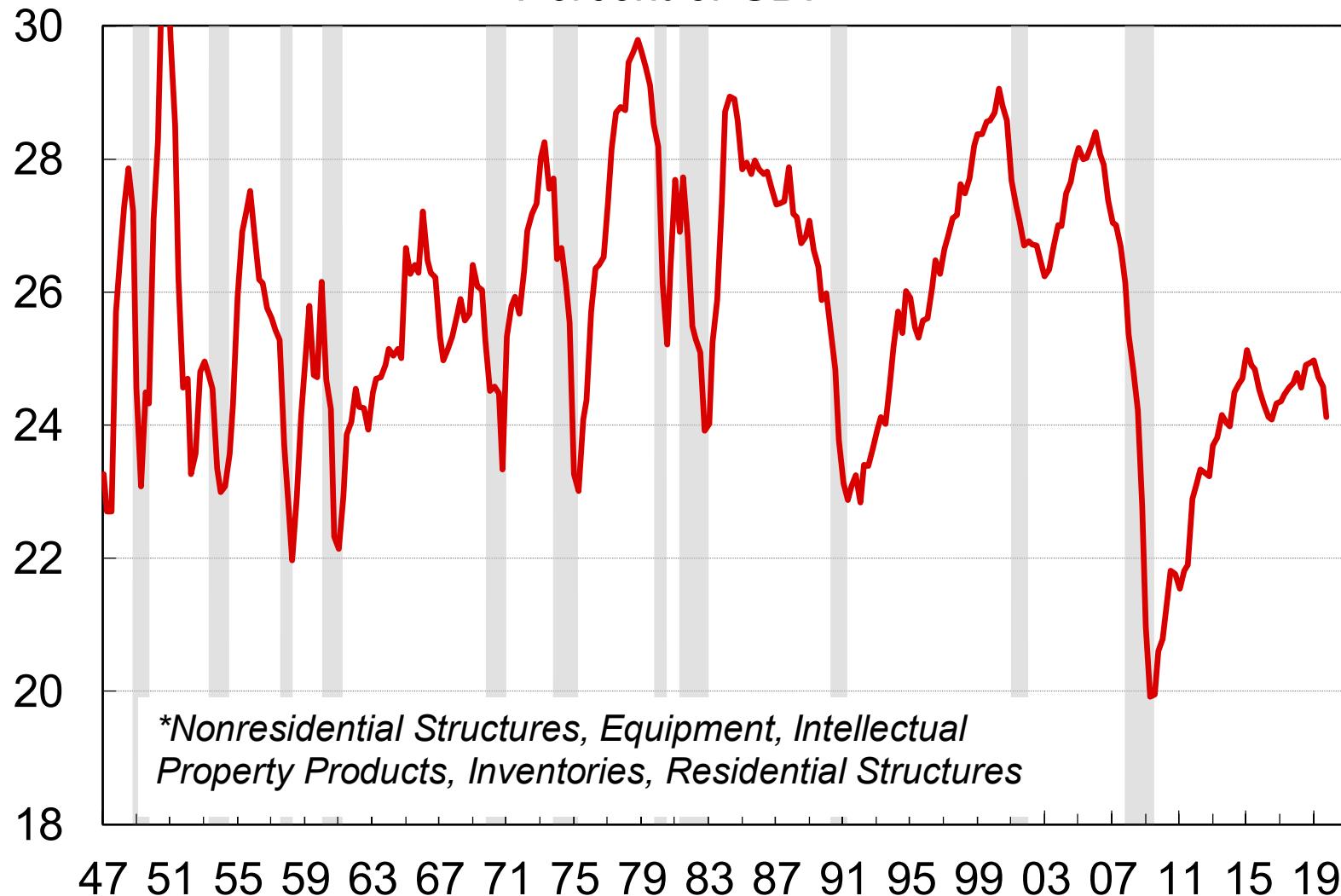
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US Investment* + Consumer Durables

Percent of GDP



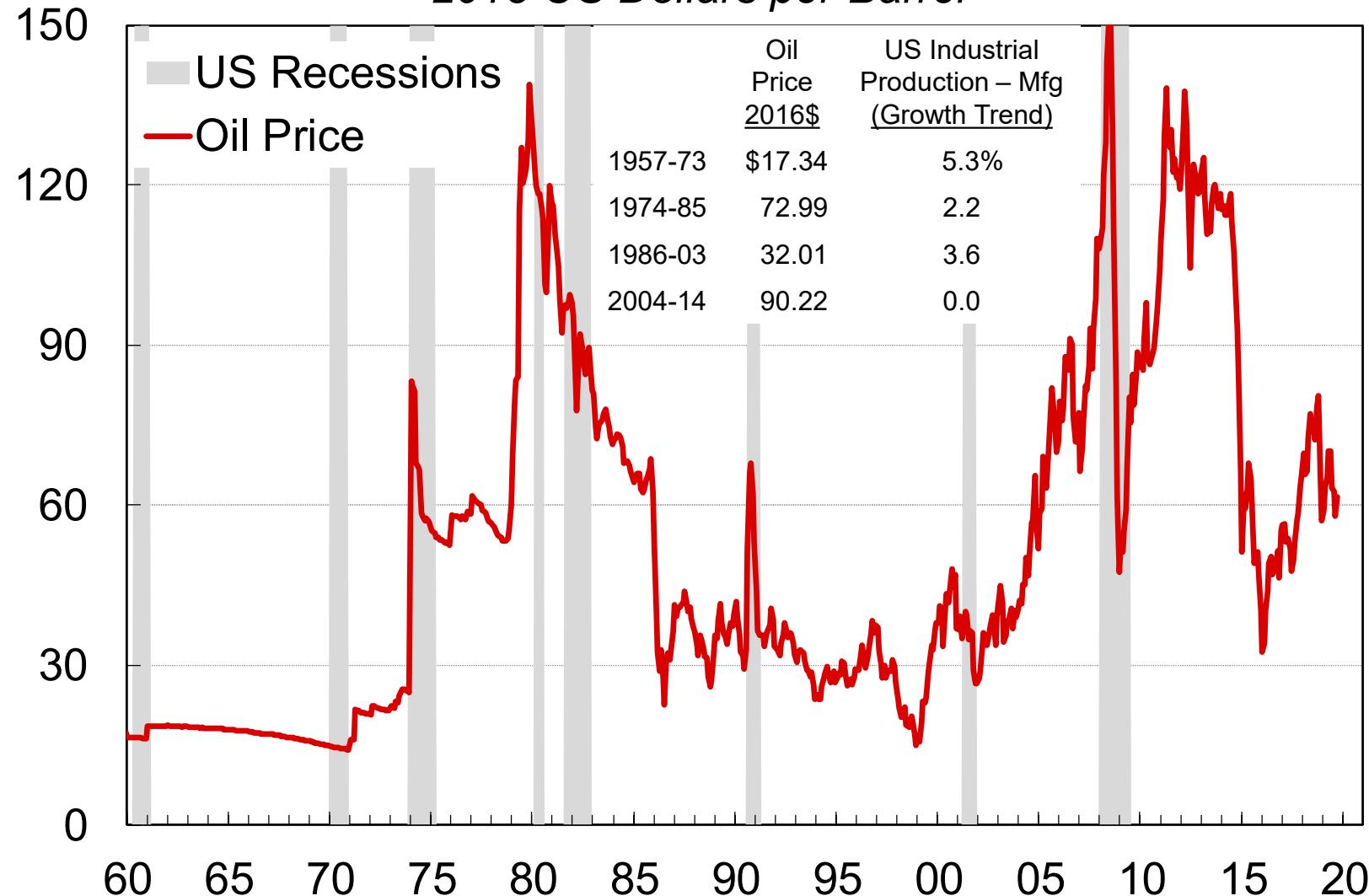
Source: U.S. Bureau of Economic Analysis/FRED

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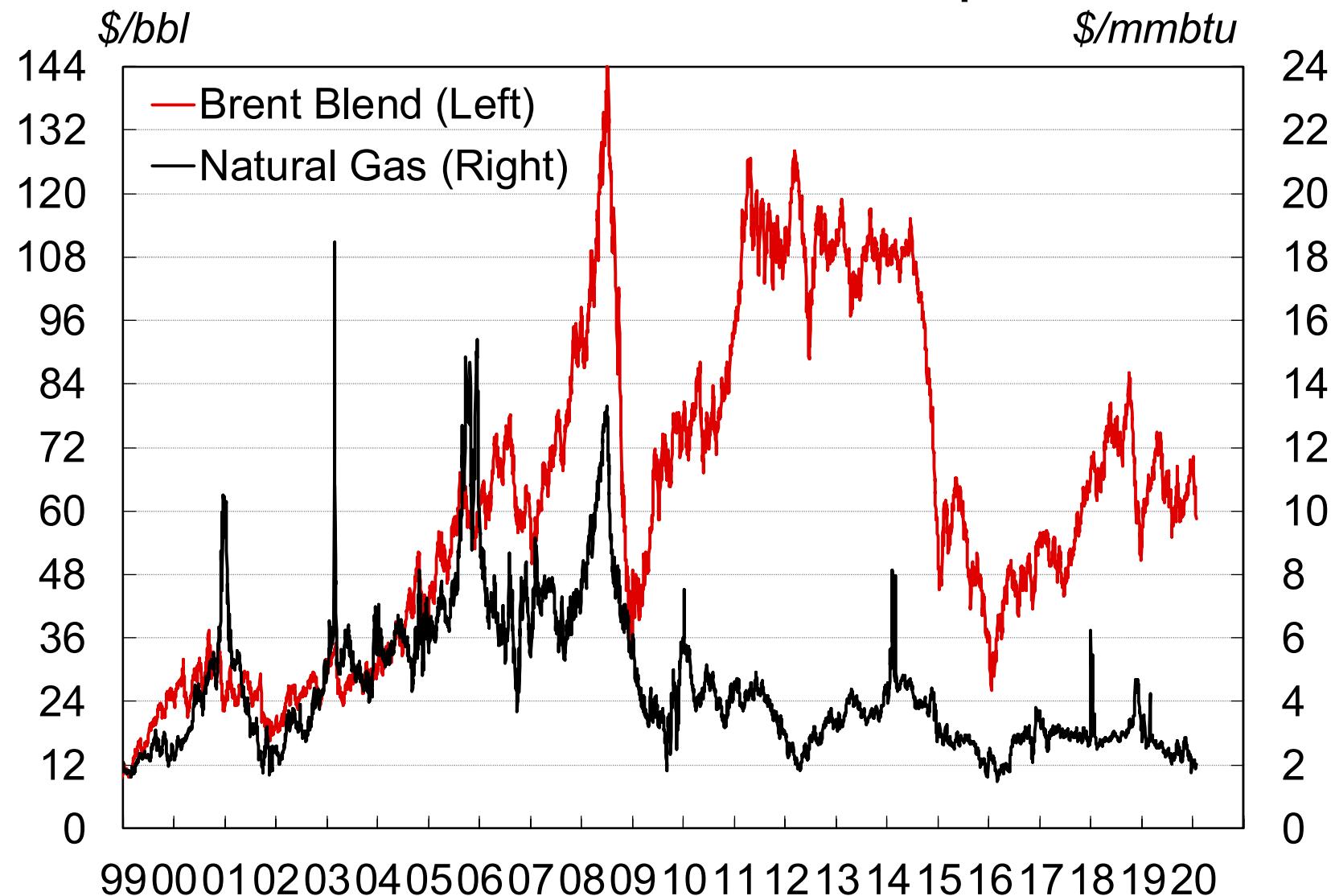
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Brent Blend Oil Price 2018 US Dollars per Barrel

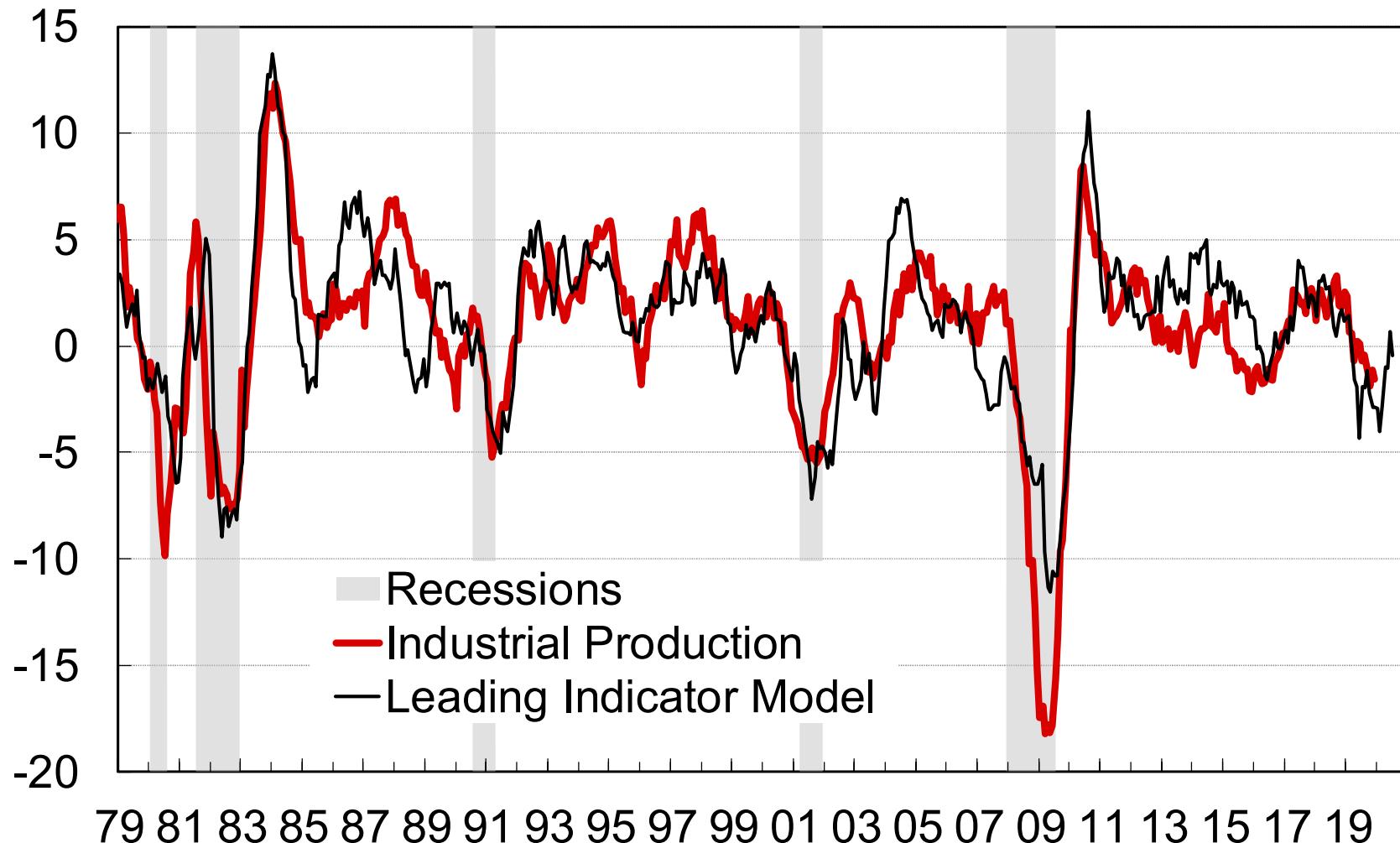


Global Crude Oil and US Natural Gas Spot Prices

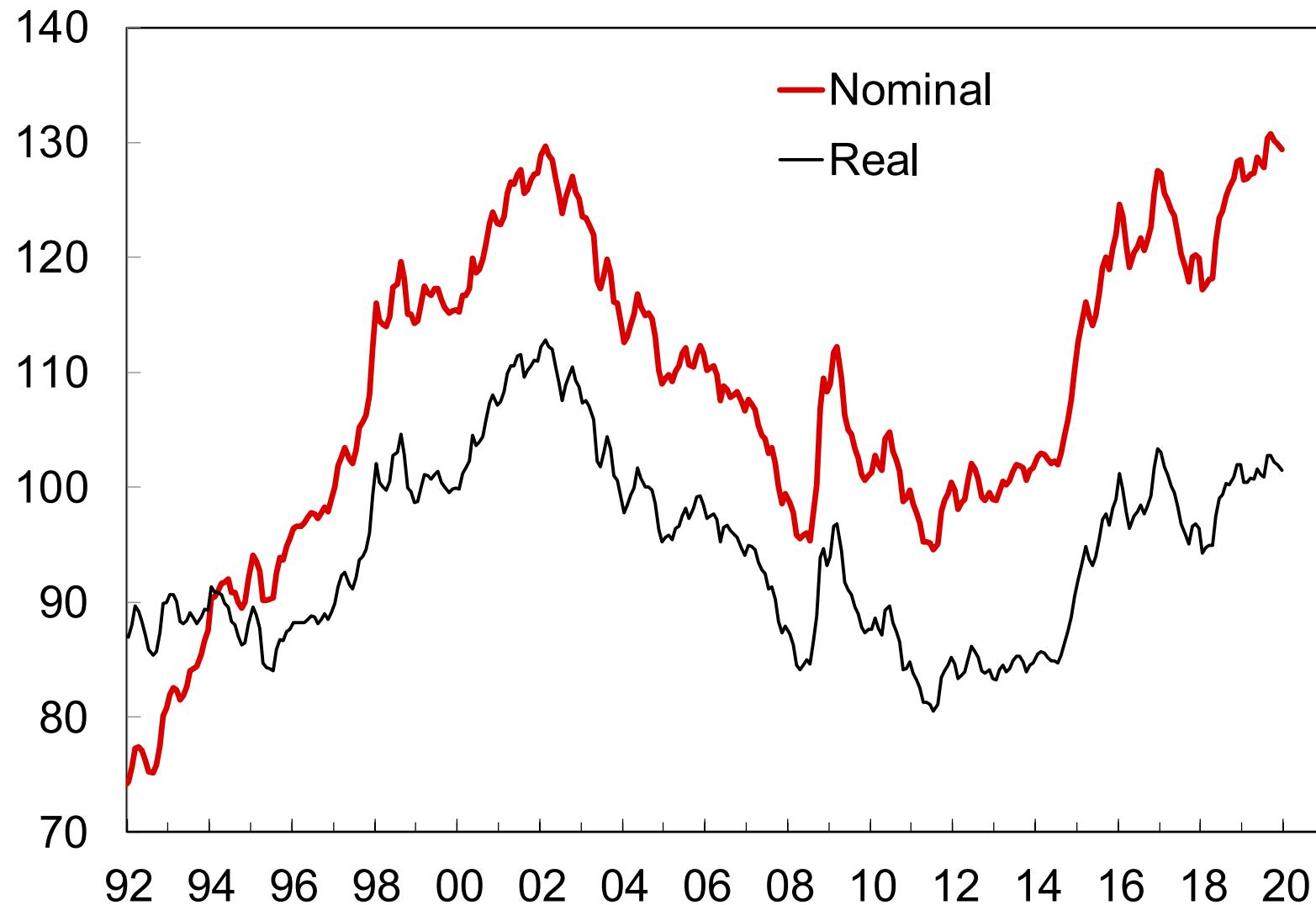


US Industrial Production: Manufacturing ex high-tech

Percent Change from Year Ago



Federal Reserve Broad Dollar Index



Expansion could last a lot longer (if we get past Q1).

Inflation and wage growth won't push Fed to tighten soon.

Corporate profits are rising again.

Cyclical sectors haven't boomed; it's hard to have a bust without first having a boom.

All recessions since 1973 have been preceded by oil price shocks.

Yield curve is inverted again, but stock prices are only slightly below record levels and Baa bond yields are near 60-year lows.

My leading index for manufacturing seems to have bottomed.



"The crisis takes a much longer time coming than you think and then it happens much faster than you would have thought."

Rudiger Dornbusch, 1942-2002

Real GDP

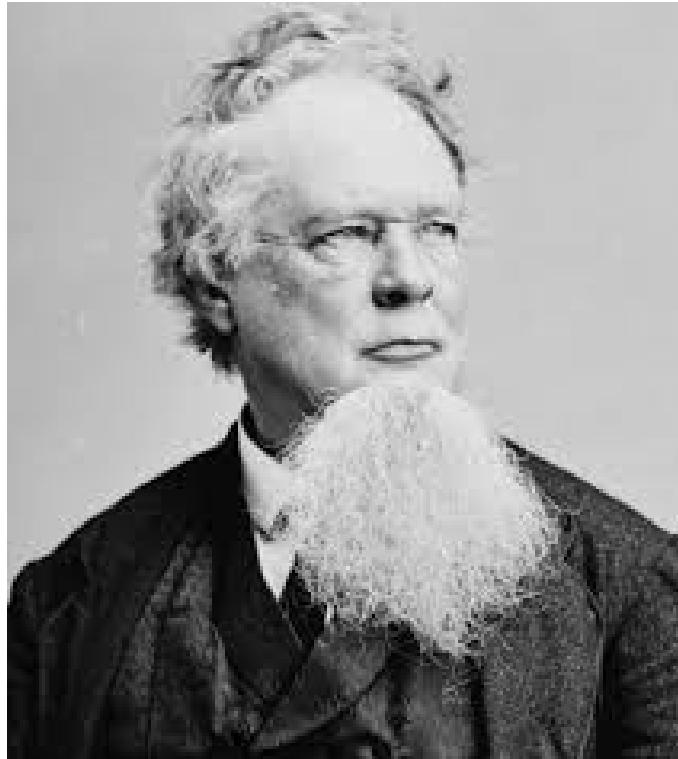
(Annual % Change)

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>
World	3.2	3.1	2.4	2.6	2.8
North America	2.4	2.8	2.2	2.2	2.2
Latin America (x Mex)	0.8	0.6	-0.1	1.8	2.5
Western Europe	2.4	1.8	1.2	1.2	1.3
C & E Europe	4.2	3.3	2.1	2.7	2.6
Middle East & Africa	1.8	1.7	1.0	2.7	2.9
Asia/Pacific	5.0	4.4	4.1	4.0	4.3
China	6.9	6.6	6.1	5.7	5.7
Japan	2.2	0.3	1.0	0.4	0.8
India	7.2	6.8	6.1	7.0	7.4

Industrial Production

(Annual % Change)

	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>
World	1.9	3.6	3.1	0.1	1.8	2.8	2.4
Advanced economies	0.2	3.1	2.4	-0.3	1.1	2.0	1.3
United States	-2.0	2.3	3.9	0.8	1.2	2.2	1.8
Japan	0.2	2.6	1.0	-2.0	0.5	1.0	0.5
Euro Area	1.7	3.1	1.0	-1.5	0.5	2.0	1.2
Other advanced	1.4	4.3	3.0	1.0	2.0	2.5	1.5
Emerging economies	3.6	4.0	3.7	0.5	2.6	3.7	3.5
China	6.0	6.6	6.3	5.5	4.5	4.5	4.0
Emerging Asia ex Chi	3.7	4.2	3.7	0.0	3.0	5.0	4.0
C & E Europe	1.6	3.2	2.9	2.0	2.5	2.5	2.0
Latin America	-3.6	-0.8	-2.2	-5.0	0.0	2.0	2.5
Middle East & Africa	3.6	0.7	1.1	-3.5	1.0	3.0	3.5



**“Economists put decimal points in their forecast to
show they have a sense of humor.“**

William Gilmore Simms, 1806-1870

Key takeaways

Headwinds that slowed growth over last five quarters have eased.

- Fed has cut rates and is expanding balance sheet again.
- Phase 1 deal with China, ratification of USMCA have removed worst-case scenario.
- Growth has bottomed in the rest of the world.

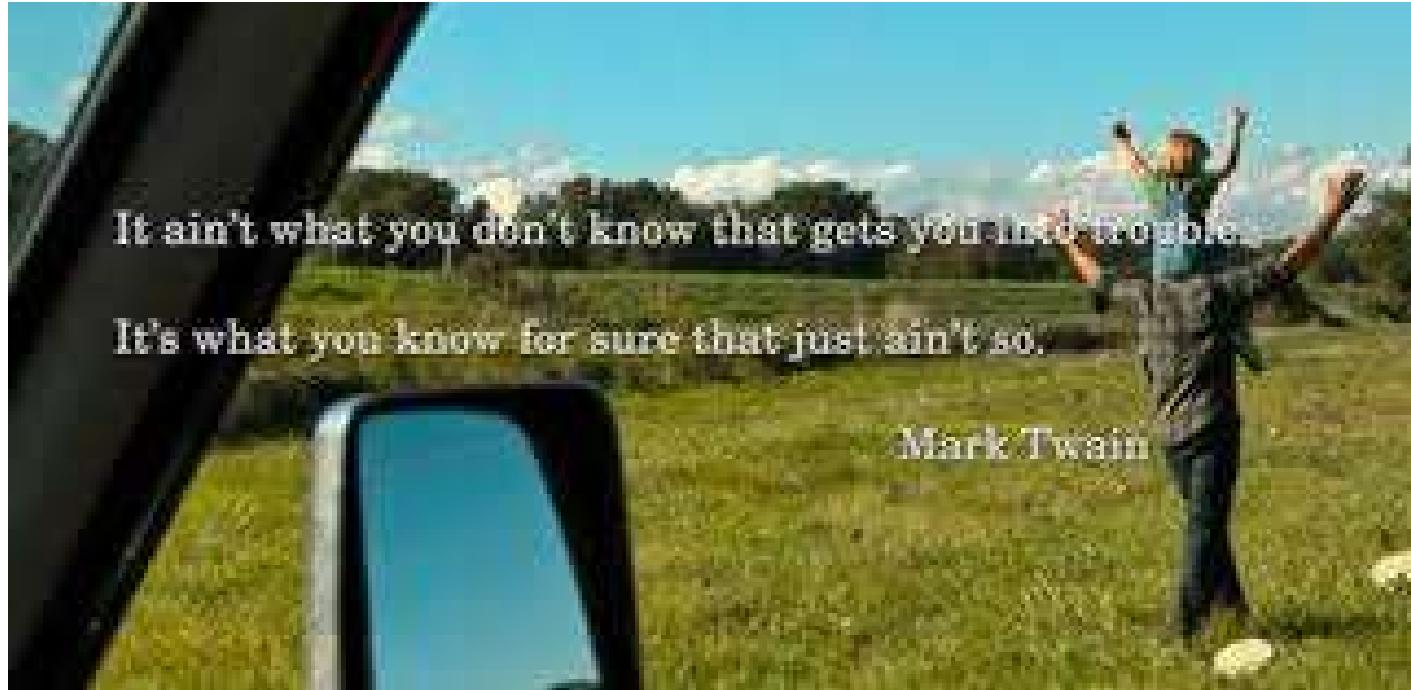
But labor markets are still tight by most measures, and

Boeing and coronavirus will slow growth in Q1.

Business investment will determine growth rate and election results.

Regardless of near-term growth, US expansion could last a long time.

- Can't have a housing bust without first having a housing boom.
- Ditto for business investment.
- Low inflation will keep Fed on hold for a long time.



It ain't what you don't know that gets you into trouble.

It's what you know for sure that just ain't so.

Mark Twain

“It ain’t what you don’t know that gets you into trouble. It’s what you know for sure that just ain’t so.”

The Big Short, paraphrasing Josh Billings, misattributed to Mark Twain

What economists know that just ain't so:

Rate cuts are always stimulative.

- Read Brunnermeier and Koby's "The Reversal Interest Rate."
- In aging society with large government debt, loss in interest income can offset incentive effects. (ZIRP backfired.)
- Rate cuts are generally not stimulative if borrowers expect more rate cuts. (Forward guidance backfired.)

Long-term interest rates are more important than short-term interest rates.

- If that were true, the yield curve wouldn't be such a good forecasting tool.
- Marginal home buyer gets an ARM. Marginal business borrower borrows at prime-plus.

Wealth effects are an effective tool of monetary policy.

- Read Willem Buiter's "Housing Wealth Isn't Wealth."
- Gains to owners of houses and stocks are offset by losses to buyers of these assets.
- Wealth effects only work until the buyers (young people) realize they've been screwed. (QE helped only in short run.)

We can always boost inflation by expanding money and credit.

- There is no law that easy money stimulates aggregate demand more than aggregate supply.
- Money now chases financial assets, not goods. You can get bubbles even if you don't get inflation.

A little inflation is a good thing.

- People with inflation-indexed pensions shouldn't be allowed to set inflation targets.



“Helicopter money only seems silly to people who don't understand metaphors (and bankers who think monetary policy should always benefit them).”

Robert Fry, 1958-

Robert Fry Economics LLC

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Publications by Robert Fry

Low Interest Rates Are Hurting Growth:

<https://www.forbes.com/sites/realspin/2016/10/04/low-interest-rates-are-hurting-growth/#58cff2edb605>

Put An Economist on Your Board:

http://media.wix.com/ugd/d2d439_73ba8ec9866a4c5c859d79effe7c60e1.pdf

10 Things To Look For In A Fed Governor:

<https://www.forbes.com/sites/realspin/2017/01/20/10-things-to-look-for-in-a-fed-governor/#17c4c41b27ee>