No Recession on the Horizon

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by Brian Wesbury, Robert Stein

of First Trust Advisors

Since the earliest days of the current economic expansion, there have been naysayers asserting the US was on the brink of another recession. Remember all the fear about another wave of home foreclosures, or a disaster in commercial real estate, or the Fiscal Cliff, or Greece potentially leaving the Eurozone, or German bank defaults, or even the inverted yield curve earlier this year? The list goes on and on.

One by one, the pessimistic theories have been proven wrong. Yes, the US will eventually fall back into a recession. But we don't see it happening this year or next, and probably not in 2021, either.

It's early, but we think the US economy is poised to grow around 2.5% in 2020, about the same pace as this year. Earnings remain at solid levels in spite of the headwind of trade uncertainty, which should diminish in the months ahead. Technological innovation is proceeding at an amazing pace. The key M2 measure of the money supply has accelerated; M2 is up 6.6% in the past year versus a 3.5% gain the year ending one year ago. Businesses are continuing to adjust to a lower corporate tax rate and a better regulatory environment.

This does not mean that every aspect of the US economy is going to be rainbows, teddy bears, and flying unicorns. We are not experiencing the rapid economic growth we had back in the mid-1980s or late-1990s. But the economy has picked up from the Plow Horse pace of mid-2009 through early 2017.

While we expect the economy to grow around 2.5% next year, some sectors won't do quite as well. For example, fundamentals like driving-age population growth and scrappage rates suggest sales of cars and light trucks (like pick-ups and SUVs) will probably continue to slow somewhat in the next few years. This isn't reason to shed macroeconomic tears, however. Autos sales have been gradually slowing since 2016 while the overall economy has accelerated.

Just look at Friday's employment report, which beat consensus expectations and revised up job growth for prior months. Unemployment ticked up to 3.6%, but essentially it was unchanged (from 3.52% to 3.56%) and is at a 50-year low. And, just about every category - female, non-college graduate, minority groups - are seeing unemployment rates near the lowest levels on record.

Although some analysts are bemoaning softness in business investment, "real" (inflation-adjusted) business investment is still 14.3% of real GDP, which is a higher share of real GDP than in any previous business cycle expansion. As a result, while productivity growth looks to have been tepid in the third quarter, the underlying trend has picked up, and that means faster growth in living standards than during the Plow Horse phase of the expansion.

Perhaps the biggest oddity is that Federal Reserve just finished cutting interest rates at three consecutive meetings. At the end of 2018, the Fed was projecting it would *raise* short-term interest rates 50 basis points this year, while forecasting the US economy would grow 2.3%, unemployment would drop to 3.5%, and PCE prices would increase 1.9%. The forecasts for growth and unemployment look solid, although PCE prices will be up more like 1.5% this year versus 1.9%. That shortfall in inflation doesn't justify a turnaround from planned hikes to three cuts.

In turn, the current stance of monetary policy - and the Fed looking unlikely to raise rates anytime soon - suggests the path ahead is solid for economic growth and bullish for equities.
