

Interest Rates, Directional Drilling and Alternate Realities

Our job is to remind everyone why they call economics “the dismal science.” So as downside risks to the U.S. economy increased through the end of 2018 and into early 2019, we felt compelled to incorporate them in our U.S. economic forecast and to communicate about them. As a result, our real GDP forecast for the U.S. shows growth slowing significantly in 2020 and beyond. We have also increased our subjective probabilities of recession to show that there is a meaningful danger to this very long economic expansion lurking nearby. We hope that the downside risk story is no longer headline news, but something that is recognized in your planning process.

While we have covered the downside risk story for the U.S. economy in recent editions. There are two other important alternative stories. One alternative story describes an ongoing weak-to-moderate economic expansion. A key element of this potential outcome is the stabilizing power of the U.S. household sector. Wages and salaries account for about half of U.S. personal income. We know that the employment rate (the inverse of the unemployment rate) now stands at 96.2 percent. There is always some frictional unemployment in the system as available labor seeks its best opportunity, but it is fair to say that hiring conditions remain very favorable and almost everyone who wants a job has a job. Because of the general scarcity of available labor, wages in most occupations are being bid up. The yearly rate of change of average hourly earnings was 3.4 percent in February, well above the yearly change in the Consumer Price Index of 1.5 percent for the month. So most households are seeing real gains in earnings. At the same time homeowners’ equity in their homes is increasing and the personal saving rate remains elevated well above pre-recession rates. Overall consumer debt remains manageable. The household financial obligations ratio, debt payments as a percent of income, is still well below the historical average from 1980 through 2010.

There is also an upside story waiting to unfold if conditions allow. A resolution to the U.S./China trade war could be a catalyst for improved business confidence and investment. A long pause, or even a rate cut by the Federal Reserve would keep a lid on the cost of capital for businesses. The recent dip in home mortgage rates could provide a reset for the housing market. If earnings remain strong and corporate profits stay robust, then equity markets could stage another rally, generating significant wealth.

Our monthly U.S. forecast seeks to balance the upside and downside risk factors for the U.S. economy and show what we believe is the most likely near-term outcome. We expect to see ongoing economic growth this year after a very weak first quarter. We expect growth to moderate toward the end of this year and into early 2020 as the current economic expansion establishes a new record duration of more than 120 months.

The low-growth economy beyond 2019 will be vulnerable to downdrafts and may fall into technical recession without replaying the catastrophic cliff dive of 2008-2009. Barring a dramatic correction in global debt markets, the next recession could look more like the on-again-off-again pattern of 2001 than the classic V-shaped recession pattern.

We saw a bit of this this zag-zag pattern in GDP growth through 2011 and again in the second half of 2012 into early 2013. A revolution in oil field technology spurred a sustained peak in drilling activity, well servicing and investment in production and distribution systems that provided enough of a boost to business investment that we avoided a follow-on recession after the Great Recession. Without the Shale Gale we might have fallen into the Recession of 2011/2012. The current expansion cycle would then be dated much differently, with perhaps more potential to continue.

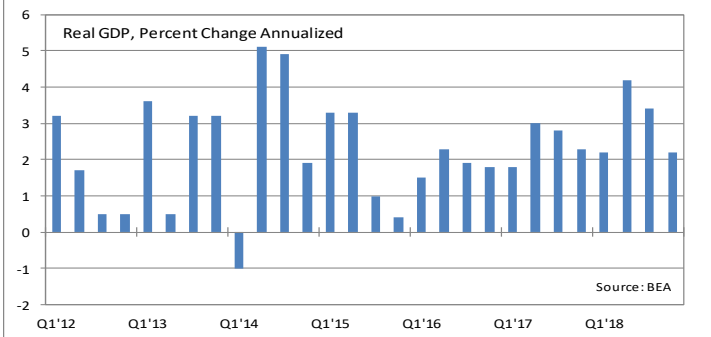
U.S. Economic Outlook, Summary

<i>a = actual f = forecast</i>	3Q'18a	4Q'18a	1Q'19f	2Q'19f	3Q'19f	4Q'19f	1Q'20f	2Q'20f	2018a	2019f	2020f
Real GDP (Percent Change Annualized)	3.4	2.2	0.6	3.8	2.5	2.5	2.3	2.1	2.9	2.4	2.3
CPI (Percent Change Year-over-Year)	2.7	2.6	2.2	1.6	1.7	1.7	1.9	2.2	2.1	2.4	1.7
Payroll Jobs (Average Monthly Diff., Ths.)	222.2	216.4	205.3	184.4	168.9	156.1	151.1	136.0	221.0	178.7	125.7
Unemployment Rate (Percent)	3.8	3.8	3.9	3.8	3.7	3.6	3.5	3.5	3.9	3.7	3.5
Federal Funds Rate (Effective)	1.92	2.22	2.40	2.38	2.38	2.38	2.38	2.38	1.83	2.39	2.38
10-Yr. Treasury Rate	2.93	3.03	2.65	2.53	2.65	2.75	2.83	2.88	2.91	2.64	2.89

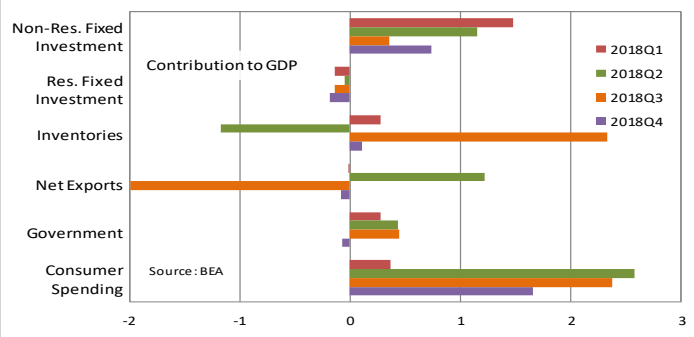
Risk of Recession Outlook

Probability of Recession (in the next)	6 months	12 months	24 months	36 months
March 2019	22%	35%	55%	63%

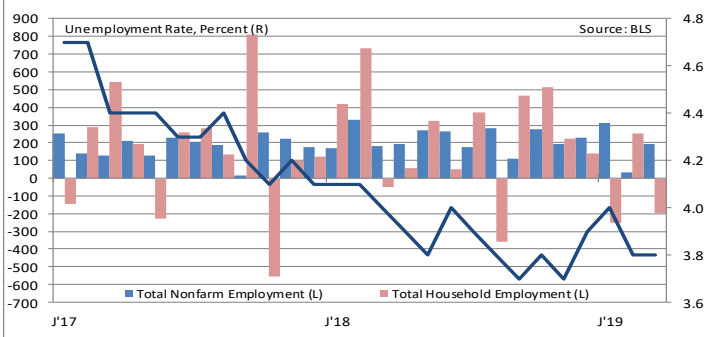
Q4 GDP Estimate at 2.2%



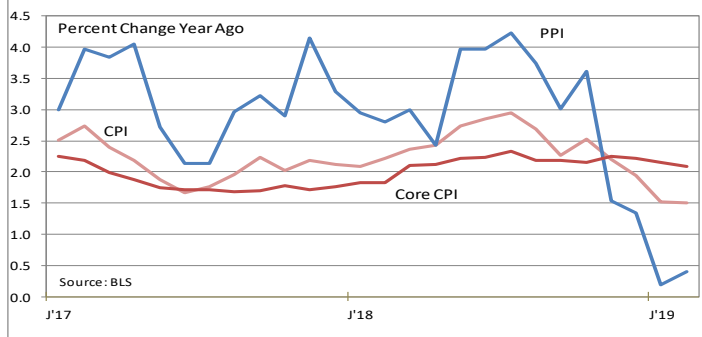
Trade and Inventories Swung Q4 GDP



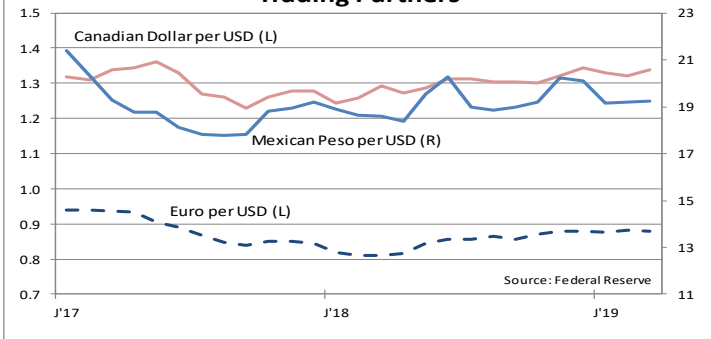
U.S. Added a Net 196,000 Jobs in March



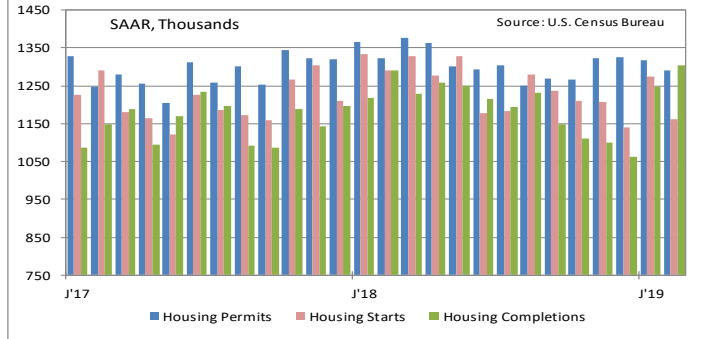
Consumer Inflation Cooled in February



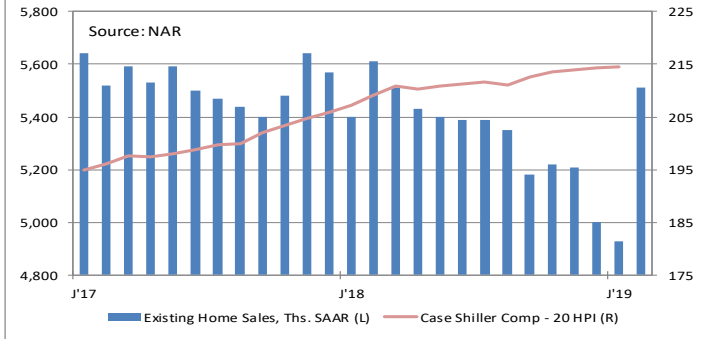
US Dollar Gains Against North American Trading Partners



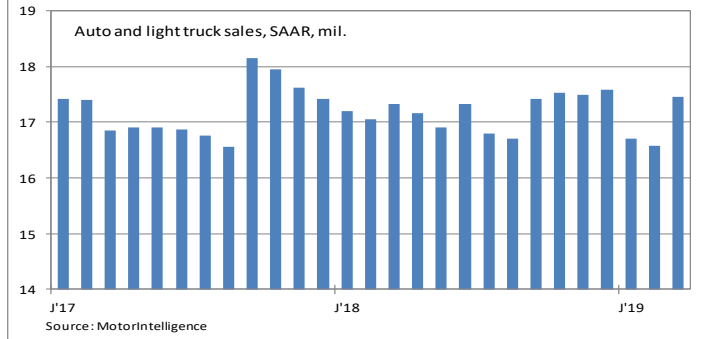
Housing Starts Moderated in February



Existing Home Sales Rebounded in February



Auto Sales Rev Up in March



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	3Q'18a	4Q'18a	1Q'19f	2Q'19f	3Q'19f	4Q'19f	1Q'20f	2Q'20f	2018a	2019f	2020f
Output											
Nominal GDP (Billions \$)	20658	20865	20982	21288	21526	21765	21995	22219	20494	21390	22323
Percent Change Annualized	4.9	4.1	2.3	6.0	4.6	4.5	4.3	4.1	5.2	4.4	4.4
Real GDP (Chained 2012 Billions \$)	18665	18765	18792	18968	19088	19205	19313	19413	18566	19013	19455
Percent Change Annualized	3.4	2.2	0.6	3.8	2.5	2.5	2.3	2.1	2.9	2.4	2.3
Pers. Consumption Expenditures	12953	13032	13027	13125	13193	13272	13345	13414	12888	13154	13443
Percent Change Annualized	3.5	2.5	-0.2	3.0	2.1	2.4	2.2	2.1	2.6	2.1	2.2
Nonresidential Fixed Investment	2727	2763	2792	2831	2868	2903	2935	2966	2714	2849	2979
Percent Change Annualized	2.5	5.4	4.2	5.8	5.3	4.9	4.5	4.2	6.9	5.0	4.6
Residential Investment	608	600	617	639	642	641	640	637	609	635	636
Percent Change Annualized	-3.6	-4.7	11.2	15.3	2.0	-0.4	-1.2	-1.3	-0.3	4.2	0.2
Change in Private Inventories	90	97	58	61	60	60	60	60	45	60	60
Net Exports	-950	-956	-948	-951	-955	-960	-965	-971	-912	-954	-975
Government Expenditures	3192	3189	3207	3224	3240	3248	3258	3266	3176	3230	3271
Percent Change Annualized	2.6	-0.4	2.3	2.2	1.9	1.0	1.2	1.1	1.5	1.7	1.3
Industrial Prod. Index (2007=100)	108.6	109.7	109.7	110.8	111.9	112.8	113.6	114.3	107.9	111.3	114.6
Percent Change Annualized	4.9	4.0	0.2	4.1	3.9	3.3	2.9	2.5	4.0	3.2	2.9
Capacity Utilization (Percent)	78.3	78.7	78.7	79.2	79.7	80.3	80.9	81.4	78.0	79.5	81.5
Prices											
CPI (1982-84=100)	251.8	252.8	253.1	254.9	256.2	257.4	258.7	260.0	251.1	255.4	260.6
Percent Change Annualized	2.0	1.5	0.6	2.8	2.0	2.0	2.0	2.0	2.4	1.7	2.1
PCE Price Index (2012=100)	108.5	108.9	109.2	109.9	110.4	111.0	111.5	112.1	108.2	110.1	112.4
Percent Change Annualized	1.6	1.5	1.1	2.6	2.0	2.0	2.0	2.0	2.0	1.7	2.0
GDP Price Index (2012=100)	110.7	111.1	111.6	112.2	112.8	113.3	113.9	114.5	110.3	112.5	114.8
Percent Change Annualized	1.8	1.7	1.7	2.1	2.0	2.0	2.0	2.0	2.2	1.9	2.0
PPI, Final Demand (Nov. 2009=100)	116.5	117.3	117.2	118.0	118.8	119.4	120.0	120.6	116.2	118.4	121.0
Percent Change Annualized	2.0	2.8	-0.5	2.8	2.7	2.2	2.0	2.0	2.3	2.6	2.1
Crude Oil, WTI (\$/barrel)	69.7	59.4	54.2	60.0	62.0	62.0	62.0	62.0	65.0	59.6	62.0
Labor Markets											
Payroll Jobs (Average Monthly Diff., Ths.)	222.2	216.4	205.3	184.4	168.9	156.1	151.1	136.0	221.0	178.7	125.7
Unemployment Rate (Percent)	3.8	3.8	3.9	3.8	3.7	3.6	3.5	3.5	3.9	3.7	3.5
Average Weekly Hours	34.5	34.5	34.5	34.5	34.5	34.5	34.5	34.5	34.5	34.5	34.5
Population (Millions)	327.7	328.3	328.9	329.5	330.1	330.7	331.3	331.9	327.5	329.8	332.2
Percent Change Annualized	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.6	0.7	0.7
Personal Income											
Average Hourly Earnings (\$)	27.21	27.44	27.64	27.87	28.12	28.38	28.64	28.90	27.10	28.00	29.03
Percent Change Annualized	3.5	3.3	3.0	3.3	3.6	3.8	3.7	3.6	3.0	3.3	3.7
Real Disp. Income (2012 Billions \$)	14375	14527	14648	14735	14853	14970	15082	15188	14351	14801	15237
Percent Change Annualized	2.6	4.3	3.4	2.4	3.3	3.2	3.0	2.8	2.9	3.1	2.9
Personal Saving Rate (Percent)	6.4	6.8	7.1	6.8	6.8	6.8	6.8	6.8	6.8	6.9	6.8
Housing											
Housing Starts (Ths., Ann. Rate)	1234	1185	1250	1266	1276	1276	1278	1278	1249	1267	1278
Exst. SF Home Sales (Ths., Ann Rate)	4717	4567	4645	4715	4750	4742	4738	4736	4742	4713	4724
New SF Home Sales (Ths., Ann Rate)	605	584	657	666	672	672	673	673	620	667	673
Case/Shiller HPI (Jan. 2000=100)	203.6	205.9	207.9	210.0	212.3	214.7	217.2	219.7	202.8	211.2	220.9
Year/Year Percent Change	5.8	5.0	4.1	4.1	4.3	4.3	4.5	4.6	5.9	4.2	4.6
Consumer											
Household Economic Stress Index	0.7	1.1	1.3	1.4	1.1	1.1	1.2	0.9	0.5	1.2	1.0
Auto Sales (Millions)	17.0	17.5	16.9	17.0	16.9	16.8	16.7	16.4	17.2	16.9	16.3
Interest Rates (Percent)											
Federal Funds Rate (Effective)	1.92	2.22	2.40	2.38	2.38	2.38	2.38	2.38	1.83	2.39	2.38
Prime Rate	5.01	5.28	5.50	5.48	5.48	5.48	5.48	5.48	4.90	5.49	5.48
1-Month LIBOR	2.11	2.35	2.50	2.47	2.47	2.47	2.47	2.47	2.02	2.48	2.47
3-Month LIBOR	2.34	2.63	2.69	2.60	2.62	2.62	2.62	2.62	2.31	2.63	2.62
1-Yr. Treasury Rate	2.47	2.67	2.54	2.47	2.54	2.58	2.61	2.63	2.33	2.53	2.63
5-Yr. Treasury Rate	2.81	2.88	2.47	2.36	2.52	2.61	2.69	2.75	2.75	2.49	2.76
10-Yr. Treasury Rate	2.93	3.03	2.65	2.53	2.65	2.75	2.83	2.88	2.91	2.64	2.89
30-Yr. Fixed Rate Mortgage	4.57	4.78	4.37	4.11	4.20	4.25	4.26	4.25	4.54	4.23	4.26

a = actual f = forecast

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