Favorable outlook for 2020: Still a few speed bumps but rolling in the right direction

We are still finalizing our forecasts for the 2020 economy but from this vantage point we expect steady growth going forward. 2019 was certainly an interesting year, with a lot of economic and political uncertainty. Global growth and trade uncertainty throttled back the U.S. economy throughout 2019 even though solid fundamentals in the household sector continued to support consumer spending. The economy looks like it finished the final quarter of 2019 by slowing to an expected 2 percent pace of growth. With three quarters of actual data available, 2019 is on track to hit our forecasts.

NRF had forecast that real gross domestic product growth would slow from 2.9 percent in 2018 to a 2.5 percent range in 2019. We also expected that personal consumption growth would decelerate from 3 percent to 2.5 percent. We will know whether those forecasts were correct when the first estimate of fourth-quarter GDP and personal consumption spending becomes available at the end of January.

It is too early to fully gauge the success of retail sales either for the full year or the 2019 holiday season. We await details from the U.S. Commerce Department, which will release preliminary data for December and revised data for previous months on January 16. We forecast last February that retail sales as calculated by NRF – excluding automobile dealers, gasoline stations and restaurants – would increase between 3.8 and 4.4 percent in 2019. While retail sales were up an average 3.5 percent during the first 11 months of the year, December sales will be a critical month for 2019 for reasons addressed below.

NRF projected that holiday retail sales would increase between 3.8 and 4.2 percent. November retail sales showed modest growth and were up only 2.1 percent unadjusted year over year. November sales had considerable base effects to overcome given the unusually strong 4.7 percent year-over-year increase seen in November 2018 and because 2018 included an earlier Thanksgiving that kept sales on the Sunday after Thanksgiving and on Cyber Monday within the month of November. In 2019, those two days occurred in December, which will add to the importance of December’s numbers in determining the overall results for the 2019 holiday season. Year-over-year comparisons for December will have a low base effect to overcome because December 2018 sales were down 0.2 percent from the same month the year before.

The composition of economic growth looks different than a year ago. Consumer spending is doing OK, but business investment spending has really slowed with two back-to-back quarters of negative growth. The consumer remains the linchpin to growth. Households continue to be supported by a solid labor market, rising disposable income and strong balance sheets, which when combined explain elevated consumer confidence. While business spending in the fourth quarter of 2019 will likely turn out to have been positive, the trade war has weighed down on business investment, which in turn has slowed down the economy. The trade truce on a “phase one” agreement with China has been well received but uncertainty prevails. Looking forward it is still very difficult to plan for capital spending. When will there be a substantive trade agreement? Moreover, political uncertainties are adding to the challenge as decision makers may wait to see the outcome of the 2020 election.
By signaling a shift in policy and cutting interest rates by 0.75 percentage points over three meetings, the Federal Reserve has helped mitigate fears of a downturn and has allowed both the private and public sectors to borrow cheaply. Lower interest rates will revitalize the nation’s struggling housing sector along with supporting rate-sensitive purchases of goods. The missing ingredient in this outlook is inflation. Inflation continues to be below the Fed’s target and there are few signs that it is about to break higher. Federal Reserve officials are likely to keep policy unchanged unless there is a significant and persistent rise in inflation and a material change in their outlook for the U.S. and global economies.

Taking a much longer view about the economy, it has been 12 years since the onset of the Great Recession and more than 10 years since the recovery and expansion began. History shows that it generally takes about 10 years for the economy to recover from a severe financial crisis. The 10-year mark is behind us by several months and the current expansion is now the longest on record. While we have been in a record-long expansion since last July, it has also been the weakest, growing at about 2.3 percent per year. Nonetheless, economies do not run out of steam and a big event is needed to knock down a $20 trillion economy. The passage of time does not necessarily suggest that the economy is more vulnerable to a slowdown and it does not appear to be due for one in 2020. Recessions often correct for imbalances in the economy, but none appear to be evident.
November’s year-over-year retail sales increase of 2.1 percent basis compared with the ultra-strong 4.7 percent posted in 2018 when sales on the Sunday and Monday after Thanksgiving were recorded in November.

The retail industry’s tight job market persisted in November with record-low unemployment of 3.5 percent; openings of 866,000 outnumbered 691,000 new hires.

Consumer sentiment remains strong, rising modestly in December to its highest level since May. Retail sales grew at a healthy rate in the previous three months despite modest growth in November.

Household financial obligations and debt service ratios remain at record lows suggesting that consumers on average are not credit constrained and have ability to pay their debts.

Payroll employment increased by 266,000 jobs in November and gains for September and October were revised higher by a combined 41,000. The overall unemployment rate edged down to 3.5 percent.

Inflation readings remain subdued and not likely to pick up soon. The Consumer Price Index in November rose 2.1 percent from 1.8 percent. Core inflation remained at 2.3 percent.
Consumer income and outlays both increased at a modest pace in November. The healthy labor market is underpinning income growth, supporting consumer spending and the broader economy.

The outlook for the U.S. economy continues to point to further softening. The Conference Board’s Leading Economic Index was unchanged in November following declines of 0.2 percent in the three previous months.