Weekly Market Summary

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Is the Glass Half Full or Half Empty?!! The Road to Recession Remains Foggy…

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This week, Federal Reserve Chairman Jerome Powell struck an upbeat tone in gauging the ability of policymakers to extend the record US economic expansion, while signalling interest rates would probably remain on hold.

"At this point in the long expansion, I see the glass as much more than half full," Powell said in the text of remarks he's scheduled to deliver Monday evening in Providence, Rhode Island. "With the right policies, we can fill it further, building on the gains so far and spreading the benefits more broadly to all Americans."

He said Monday the cuts have already proved successful at preventing the year's woes from significantly eroding the overall outlook for growth in the U.S.

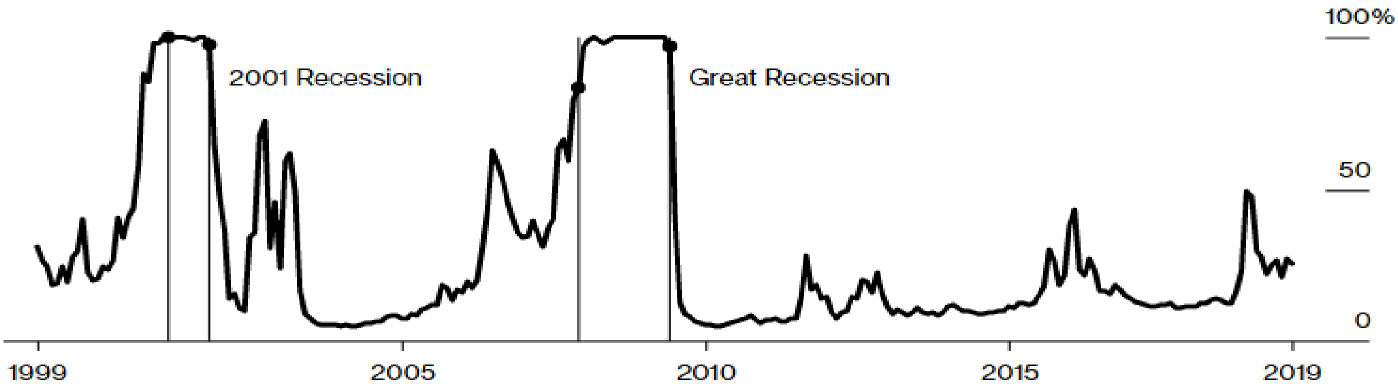
Powell followed up with the well-worn caveat that policy "is not on a pre-set course" and the Fed would adjust if there were a "material" change in its outlook. According to many analysts, the outlook is bleak with views that a recession is on its way soon. A paper by Scott A. Wolla and Kaitlyn Frerking for the Federal Reserve Bank of St. Louis warns that the Fed's own policy could lead to "economic ruin." The paper titled "Making Sense of National Debt" explains the pros and cons of national borrowing in typical Keynesian fashion. According to Wolla and Frerking, debt only becomes an issue when it outpaces GDP, or national income, as they call it. If debt grows at a faster rate than income, eventually the debt might become unsustainable. It shows that the federal debt is projected to grow at a faster rate than GDP for the foreseeable future. A significant portion of the growth in projected debt is to fund social programs such as Medicare and Social Security. Using debt held by the public (instead of total public debt), the debt-to-GDP ratio averaged 46 percent from 1946 to 2018 but reached 77 percent by the end of 2018. It is projected to exceed 100 percent within 20 years." In addition, among the downside risks, the largest seems to be the US-China tariff war, as it may have a detrimental impact on consumers as well as businesses (on a positive note however, Americans will buy their Thanksgiving Turkey a bit cheaper J). According to the latest IMF forecasts, tariffs from the United States and China could shave 0.8% off world-wide economic output next year. Business investment is a weak spot for the economy. Non-residential fixed investment – which reflects business spending on software, research and development, equipment and structures – fell at a 2.7% annual rate in the third quarter following a 1% pace of decline in the prior quarter. Corporate profits have weakened which could cause the labor market to deteriorate if boardrooms slow hiring or lay off workers to cut costs, which would likely hit consumer spending. Meanwhile, the spread between three-month and 10-year Treasury securities became less negative in September, before turning positive in October. That spread has inverted before each of the last seven recessions.

Others, on the other hand, believe that the American economy is in good shape, and will continue to support consumer spending, business confidence and investments, as well as market valuation. Healthy consumer confidence and solid gains in disposable income growth and household wealth should keep consumption growing at a roughly 2.5% pace next year. The drag on goods-sector output from the inventory adjustment is probably nearing an end. Since the first quarter of 2019 inventory investment as a share of real GDP hit its highest level since mid-2015, the monthly numbers have slowed steadily and the inventory components of both the ISM and the Markit PMI have fallen below 50. The US is in its longest expansion phase in decades. American indices are reaching an all-time high, and the US unemployment rate is hovering around a 50-year low. Inflation-adjusted wages continue to grow at a healthy, albeit subdued, pace. Before the 2007-2009 recession, real wage growth declined sharply amid softening labor demand and a bounce in inflation. This restrained consumer purchasing power at a vulnerable time. The United States and China are close to agreement on the first phase of a trade deal. This week, Trump said Washington was in the "final throes" of work on a deal that would defuse a 16-month trade war with Beijing. Trump's upbeat comments about the trade talks lifted markets, with Wall Street's three major indexes hitting all-time highs. Bloomberg Economics created a model to determine America's recession odds. Right *now, the indicator estimates the chance of a U.S. recession at some point in the next year is 26%, down slightly from 27% in early October. That reading is higher than it was a year ago but significantly lower than before the last recession.*

While the Federal Reserve lowered interest rates for a third straight meeting last month, that leaves the central bank with relatively limited means to stimulate the economy should things worsen. Ahead of the Great Recession, interest rates hovered around 5%, leaving ample room to lower borrowing costs. At the start of this year, the benchmark interest rate was half that. At the end, while recessions are, by their very nature, unpredictable, the greatest near-term threat to the economy is not rising interest rates or various financial excesses, but, instead, unforeseen actions in areas like trade or geopolitics.

Risks Stabilize

Probability of U.S. recession within 12 months



Source: Bloomberg Economics

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