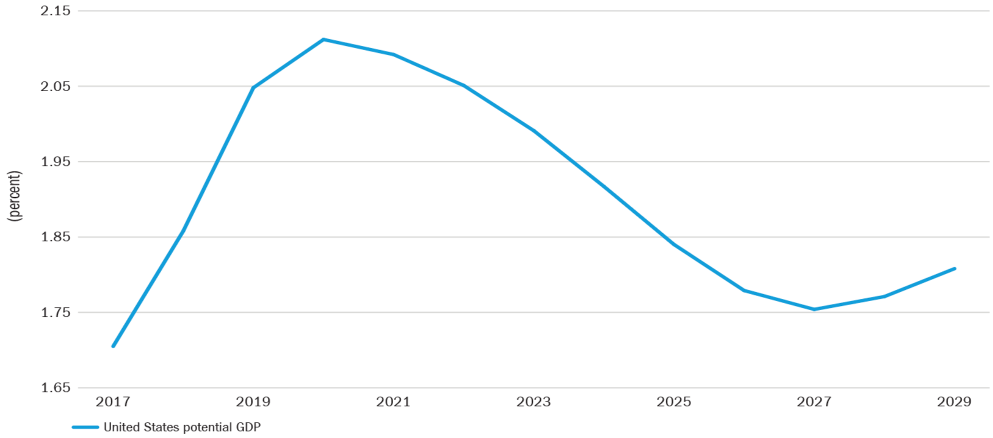
Heading for a slowdown: 2020 U.S. economic outlook

January 2, 2020

A recession in the next 12 months is still not our base case, but risks have risen materially.

After a period of above-trend GDP growth, we expect U.S. growth to slow down in 2020. In the last two years, we've seen an economic growth rate that exceeded the productive capacity of the economy — mainly due to the fiscal policy boost from the 2017 Tax Cut and Job Openings Act. The Congressional Budget Office estimates U.S. trend growth at approximately 2%. Our own estimates, based on demographics, labor force participation rate, capital and current pace of productivity, are in the range of 1.75%–2.0%.

Above-trend GDP growth is expected to slow down



Source: Congressional Budget Office

The uninterrupted U.S. expansion since the global financial crisis has been one of the longest, but also one of the weakest. Growth has averaged only about 2.3% per quarter, which is much weaker than previous expansions. There is a silver lining though: it's been built with fewer imbalances.

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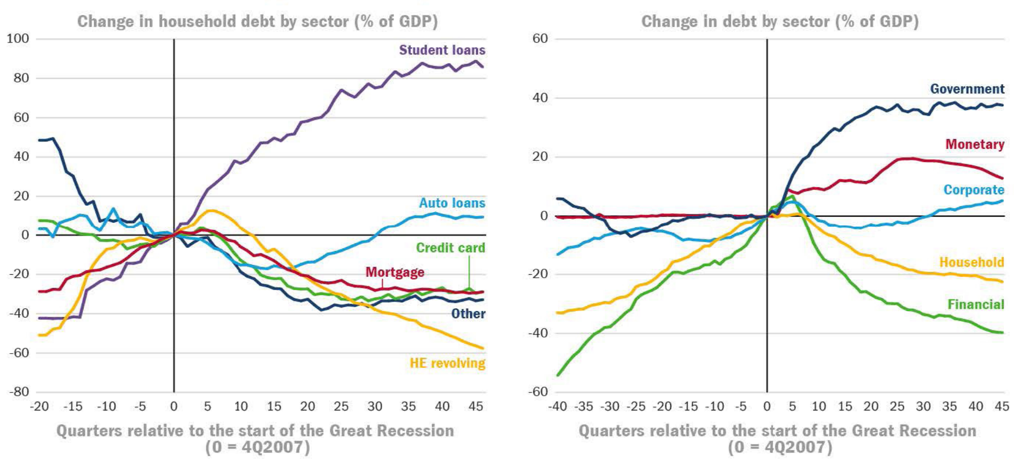
In the current U.S. expansion, growth has averaged just 2.3% per quarter

Rank	Start of expansionary period	End of expansionary period	Length of expansion (quarters)	Average GDP quarterly change (ann.)	Cumulative GDP growth
1	Q3-2009	Ongoing	41	2.3%	26.4%
2	Q2-1991	Q1-2001	40	3.6%	42.6%
3	Q2-1961	Q4-1969	35	4.9%	51.9%
4	Q1-1983	Q3-1990	31	4.3%	38.2%
5	Q1-2002	Q4-2007	24	2.9%	18.7%
6	Q2-1975	Q1-1980	20	4.3%	23.2%
7	Q1-1950	Q2-1953	14	7.7%	29.3%
8	Q3-1954	Q3-1957	13	4.1%	13.7%
9	Q1-1971	Q4-1973	12	5.2%	16.1%
10	Q3-1958	Q2-1960	8	5.6%	11.4%

Source: Federal Reserve, Bureau of Economic Analysis, and Columbia Threadneedle Investments

Households have limited their appetite for debt since the start of the Great Recession. Mortgage debt build-up, often a primary cause of bankruptcies and defaults, is minimal relative to the past — increases in personal borrowing are mostly in student and auto loans. Aside from pockets of concern, there is less leverage in business spending. Weak capital expenditures (capex) has been the feature and not a bug of the expansion — lack of demand has meant lack of excessive capex.

Debt trends show significant improvement for households



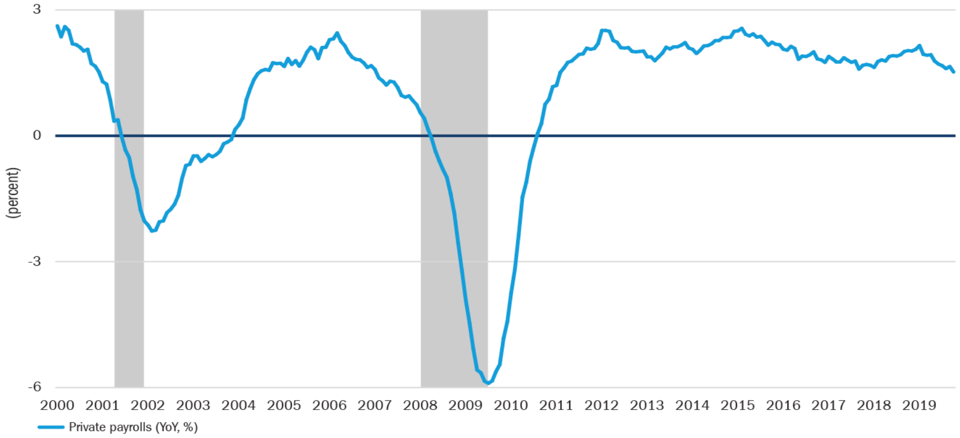
Source: Bernstein U.S. Economics. Additional data: Bureau of Economic Analysis; Federal Reserve Board; U.S. Treasury

But even this expansion is showing signs of being long in the tooth. The labor market is getting tight, an indication that economic growth is peaking. There's some evidence that wage growth is very slowly but steadily picking up. And there are numerous mentions of the lack of skilled labor in small business and home builder surveys — both of which point to a tight labor situation. The unemployment rate has been around 3.5%–4% for almost a year now, which is partly due to increased labor participation. This has somewhat expanded the productive capacity of the economy.

Meanwhile, despite a tight labor market and some increase in wages, the overall economy has seen very little pass-through of wage inflation into price inflation. This has given the Federal Reserve (Fed) room to revert to an easy monetary policy. Policy was one of the key risks to the expansion in 2019, as the Fed set out on an overly restrictive path of rate increases. It didn't take long for residential spending, which is heavily reliant on borrowing rates, to slow. In response, the Fed made a U-turn and initiated a new cycle of policy easing (insurance cuts) to reverse their earlier tightening. By changing course, the Fed seems to have avoided a policy error that could have ended in a recession.

In the absence of more stimulus, such as government spending or tax policy changes to induce additional consumption, we expect economic growth to persist at our projected trend, and the pace of job growth is likely to slow down relative to 2019.

U.S. payroll growth will most likely slow down in 2020



Source: Bureau of Labor Statistics; January 1, 2000 through October 31, 2019. Gray areas are recession periods.

The lack of imbalances can extend growth for a while — the consumer savings rate is elevated and can help cushion shocks to confidence. A tight labor market helps squeeze out productivity gains as firms substitute capital for labor. Business spending on newer equipment, software and technical enhancements adds to growth and improves productivity of workers. Given these factors, we expect growth in 2020 near 2% unless there are any shocks such as heightened escalation in the trade conflict with China.

What are the risks to our outlook?

In 2019, we maintained that recession risks were low, despite financial markets being on edge for most of the summer. But the fiscal stimulus provided by the 2017 tax cuts is fading completely, and GDP growth is slowing to trend levels. Because of this, we think that the economy in 2020 will have a lowered ability to absorb shocks or surprises. The most common concerns are the ongoing trade war and negative credit surprises that could damage confidence and cause businesses and consumers to retrench. The current economic expansion is already the longest on record and is in the middle of a global manufacturing slowdown with the Fed trying to engineer a soft landing. We need *both* monetary easing and de-escalation of trade tensions for the expansion to continue.

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