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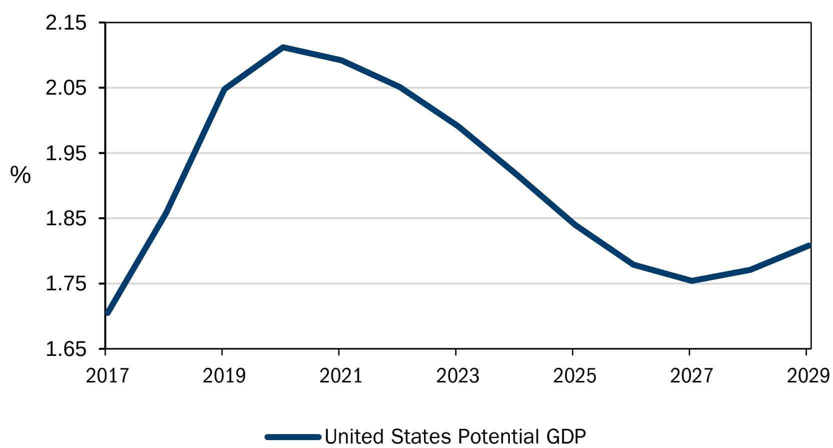
HEADING FOR A SLOWDOWN

2020 U.S. Economic Outlook

After a period of above trend GDP growth, we expect U.S. growth to slow down in 2020. In the last two years we have 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 Jobs Act. The Congressional Budget Office estimates U.S. trend growth at approximately 2%, while our own estimates—based on demographics, labor force participation rate, capital, and current pace of productivity—project trend growth in the range of 1.75% to 2.0%.

Exhibit 1: U.S. potential real GDP



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, much weaker than previous expansions when growth was more robust (Exhibit 2). This diminished expansion has a silver lining, though—it has been built with fewer imbalances.

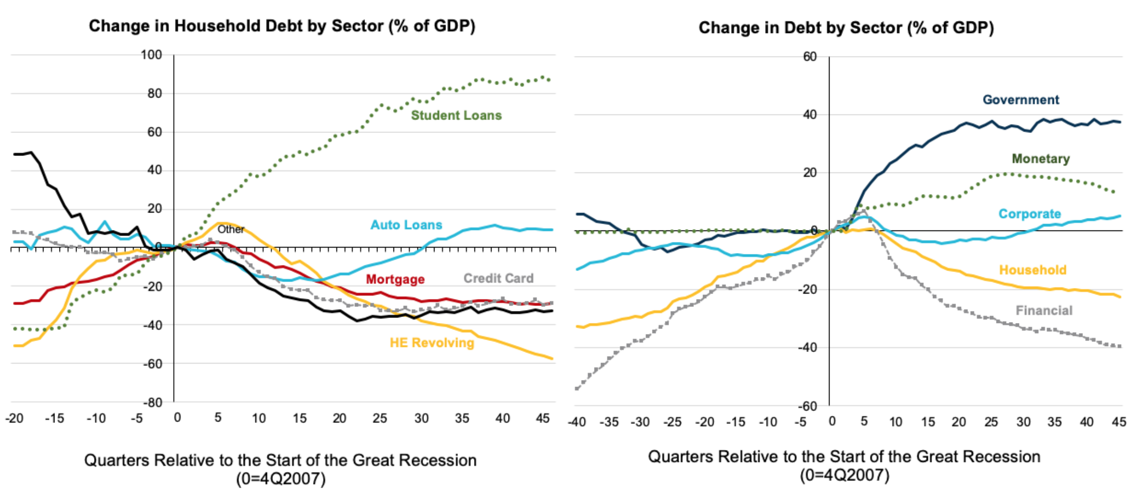
Exhibit 2: Duration and GDP levels of U.S. expansions

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

For example, 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, with increases in personal borrowing occurring in student loans and autos. Similarly, aside from pockets of concern, there is less leverage in business spending. Weak capital expenditure (capex) has been a feature of the expansion—lack of demand has meant lack of excessive capex.

Exhibit 3: U.S. change in debt by sector



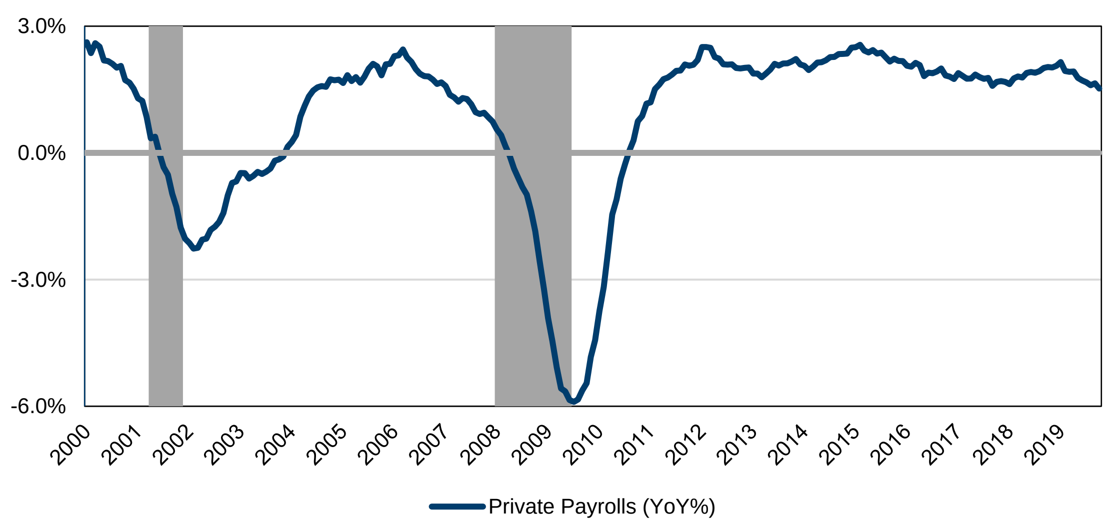
Source: Bernstein U.S. Economics. Additional data: Bureau of Economic Analysis; Federal Reserve Board; U.S. Treasury

However, 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 is some evidence of wage growth very slowly but steadily picking up, and there are numerous mentions of lack of skilled labor in small business surveys and home builder surveys—both of which point to a tight labor situation. The unemployment rate has been around 3.5% to 4% for almost a year now, partly due to increased labor participation, which has expanded the productive capacity of the economy somewhat.

Meanwhile, despite a tight labor market and some increase in wages, there has been very little pass-through of wage inflation into price inflation for the overall economy. This has given the Federal Reserve (Fed) room to revert to an easy monetary policy. Policy risk 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—or "insurance cuts"—to reverse its 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, with the pace of job growth likely to slow down relative to 2019.

Exhibit 4: U.S. payroll growth



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

Lack of imbalances can extend growth for a while—the consumer savings rate is elevated and can help cushion shocks to confidence. Also, 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 also improves productivity of workers. Given these inputs, we expect growth in 2020 near 2%, absent any shocks to confidence such as a re-escalation of trade issues 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 this summer. In 2020, as the fiscal stimulus provided by the tax cuts fades completely from the system and the GDP growth slows to our projected trend levels, we think that the economy will be more susceptible to recession due to a lowered ability to absorb shocks or surprises. The most common concerns are global trade and negative credit surprises that could damage confidence and cause businesses and consumers to retrench.

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