ECONOMIC OUTLOOK

Economic Summary

The current expansion is now the longest on record, celebrating its tenth birthday over the summer. The economic data flow remains solid overall and classic recession catalysts like an overheating economy are not rearing their heads. The good news is that expansion do not die of old age and the outlook calls for ongoing growth. However, expansion do tend to die due to bad behavior and policy mistakes. As such, the risk of recession is clearly rising in recent months. Revisions to both GDP and employment reveal a weaker and slower-growing economy than previously believed. The trade war escalation is spilling over and weighing on the economy to a larger degree as well. Businesses are wary as they delay investments and slow their pace of hiring. All of this has financial markets on edge and the Federal Reserve taking out insurance rate cuts in hopes of heading off a recession. Time will tell whether this is the top of the cycle or just a rough patch.

Oregon continues to see healthy rates of economic growth, however the state is no longer outpacing the rest of the country to the same degree as earlier in the expansion. The state is not immune to national and international developments. While topline manufacturing indicators in the state look good, cracks may be forming due to the trade war. All told, Oregon continues to hit the sweet spot for now. Growth is strong enough to keep up with an increasing population and deliver economic and income gains to Oregonians. The share of working-age residents with a job is higher than the average state and both wages and overall household incomes continue to rise at a faster rate.

U.S. Economy

The economic outlook remains intact for now, but risks are mounting. While the current expansion celebrated its tenth birthday over the summer, making it the oldest on record for the U.S., recent data revisions reveal a weaker and slower-growing economy than previously believed. Updated GDP figures show growth peaking in early 2018, slowing since then, and currently growing around its potential. The economic impact of the federal fiscal stimulus – tax cuts and increased spending – was smaller and shorter-lived than economists expected, and those initial expectations were minimal outside of a near-term boost to consumer spending. Similarly, the 2018 acceleration in job growth nationwide is set to be revised away, revealing an improving labor market but one that is closer to treading water than one beyond full employment.

Overall the underlying economic backdrop remains solid, even if it is weakening. Classic recession catalysts, like an overheating economy, financial imbalances, oil shocks, and the like are not rearing their heads either. However, the risk of recession is clearly rising.

Expansions do not die of old age but due to bad behavior and policy mistakes. The ongoing escalation of the trade war has businesses wary and financial markets spooked. While the baseline outlook calls for continued growth, concerns remain over potential policy mistakes. In real time, the Federal Reserve is trying to adjust monetary policy, which is a powerful, but blunt tool, to account for shifting administrative and fiscal policies. Whether or not the Fed can thread the needle and keep the expansion going is the key question.
In terms of the trade war, it is not necessarily the direct effect of the tariffs that will send the economy into recession. To date the increases in prices to American businesses and consumers amount to a couple tenths of a percent of GDP, although that number is set to head higher in the coming months given recent escalation. That said, it is really the broader impact of what the tariffs represent: an ongoing dispute between the world’s two largest economies with few signs of agreement or de-escalation.

The spillover effects of the trade war are weighing on the economy. The combination of a strong U.S. dollar, slowing global growth, and a weak manufacturing sector is at least in part due to the tariffs and trade tensions. Business behavior reveals them to be wary as investment in structures and equipment is weak, and their pace of hiring is slower. If enough firms delay investment or pull back at the same time, it slows economic growth and can even cause a recessionary dynamic. The U.S. is not there yet, but it remains a risk today.

All of this has financial markets on edge. Equities, while volatile, are largely unchanged over the past year, but it’s the bond market signaling the largest cause for concern. The yield curve is at least partially inverted, and nearly fully inverted – meaning short-term interest rates are higher than long-term rates. An inversion is not necessarily causal by itself, although banks may curtail lending given they borrow short and lend long. That said, the signal from an inverted yield curve has long been a reliable leading indicator of a recession in so far as the bond market sees economic weakness and expect the Federal Reserve to cut interest rates.

This is exactly the economic environment the U.S. is in today. However the policy dynamics are a bit different this time. Typically, the Fed has continued to raise interest rates after a yield curve inversion. The flow of economic data remains solid at the top of the business cycle and the Fed is more worried about inflation.

Today, however, the Fed has already cut interest rates and expects to do so again, even as the data flow remains solid overall. These cuts can largely be viewed as insurance against the risk of a weakening expansion due to the decelerating growth, trade policy uncertainty and low levels of actual inflation. The cuts can be thought of as prudent risk management. In fact, one way to read the bond market is that the inversion of the 10 year – 3 month spread but not generally the 10 year – 2 year spread is that the market believes the Fed will cut interest rates sufficiently to head off a recession. Time will tell whether this fundamental shift in Fed policy will be enough for a continued expansion or if the yield curve inversion remains a reliable indicator of recession.

Finally, it is important to remember that behind the financial market turmoil and trade uncertainty remains an economy that is largely doing well. U.S. consumer spending is holding up as the labor market remains strong; job opportunities and wages continue to grow. Additionally, households currently have a solid savings rate and the increases in debt remain in-line with income gains.

Now, consumer spending is more of a concurrent or even a lagging indicator of the economy. Households will spend until given a reason to be scared. The scariest prospect is job loss. However, labor market leading indicators continue
to largely flash green, particularly as initial claims for unemployment insurance – a measure of layoffs – remain near historic lows.

The concern is that should firms pull back further on hiring and unemployment rises, then expectations are that consumer spending will weaken as household confidence wanes. Another risk for spending is that the latest escalation of the trade war will impact consumer products the most and those higher prices will curb household spending. At that point, a vicious, recessionary cycle can take hold as consumers pull back, giving firms even more reason to be wary, delay investments and lay off workers.

**Bottom Line:** The U.S. economy remains in expansion and the baseline outlook calls for continued, albeit slower, growth. However the risk of recession is clearly rising. The typical catalysts for recession are not rearing their heads but the ongoing and escalating trade tensions are weighing on the economy and business activity. Expansions do not die of old age, but rather due to policy mistakes. All of this has financial markets spooked and the Federal Reserve taking out insurance rate cuts in hopes of heading off a recession. Time will tell whether this is the top of the cycle or just a rough patch. It’s important to remember that the U.S. does not know what the eleventh year of an economic expansion looks like as we have never experienced one. The expansion has now entered into uncharted and choppy waters.

**Oregon Economy**

Oregon continues to see healthy rates of growth when it comes to employment, income, and GDP. However the state is no longer significantly outpacing the nation like it was a couple years ago. While local job gains are effectively matching the average state in recent quarters, we know forthcoming U.S. revisions will widen the gap a bit.

Personal income growth remains stronger, meaning Oregon income per capita, per worker, and per household is rising faster than nationwide. This is a continuation of the so-called sweet spot where economic growth is strong enough to keep up with the growing population but also deliver ongoing gains to Oregonians. This pattern of growth is expected to continue until the next recession, whenever it comes.

The slower pace of job gains today is not unexpected. To date it appears that the slower net employment growth is due to higher employment rates among working-age Oregonians, increasing Baby Boomer retirements, and slower in-migration in a mature expansion. Unemployment is not increasing, and new entrants into the labor market represent the largest share of Oregonians currently unemployed. Overall the slowing in Oregon job growth appears to be for good economic reasons.

Like the nation overall, the Oregon economic outlook calls for ongoing, but slower growth from today’s relatively strong vantage point. This has a few different implications for firms and households.

Businesses face a combination of issues. First, sales will continue to grow. Firms will need to invest and hire to chase those increasing sales, market share, and profits. Second, however, the pace of those sales increases will be slower. Migration and job growth are tapering in a mature expansion, meaning there will be more potential customers but the increases next year will be smaller than this year. Third, the increased uncertainty regarding the economic outlook may have firms wary of investing and hiring as they may be less confident they can recoup