ECONOMIC OUTLOOK

U.S. Economy

The U.S. economy has settled in around its potential in recent quarters. Real GDP is growing at a two percent annual pace and expected to maintain similar gains through the middle of next year. Encouragingly, the two major risks to the outlook have improved in recent months. The signing of the Phase One trade deal in January between China and the U.S. signals that trade tensions are no longer escalating. The yield curve also un-inverted following the shift in Federal Reserve policy last year. Financial markets and economists are more optimistic about the near-term outlook and the probability of recession is declining. That said, the concerns over the novel coronavirus drove another inversion of the yield curve in recent weeks and forecasters are still assessing the potential, and mounting economic impacts.

But first, the underlying economy in the U.S. remains in good health. Business and consumer sentiment is high. Interest rates are low. Asset prices are growing and household debt burdens remain tame. The manufacturing sector is finding its footing, even as it remains weak. Overall, the strong labor market is driving economics gains today and in the next few years. Households will continue to spend so long as they are confident in their prospects. With layoffs near all-time lows, consumer confidence remains high.

Jobs are increasing quicker than is needed to keep pace with labor force and population gains. The unemployment rate continues to reach new historic lows as a result. That said, the pace of hiring both national and locally is slowing as the economy begins to run into supply side constraints, labor chief among them. Encouragingly, the strong economy is creating a labor force supply side response. The share of working-age Americans with a job or looking for one continues to increase. More workers are being pulled in off the sidelines given job opportunities are more plentiful and wages are rising. The economy has yet to truly reach full employment, but continues to make progress.

Now, this does not mean the economy is perfect. There are always issues and risks to both the upside and downside. Today those may include potential equity market corrections, subprime auto loan delinquencies, and depending upon the outcome of the 2020 presidential election, large federal policy changes. Even so, the largest current risk to the outlook may be the novel coronavirus, for both its direct economic impact and the potential to be a coordinating event that could serve as a recession catalyst.

Forecasters and health experts alike are still assessing the situation. It is important to remember in times of war, famine and disease that the largest impacts are human and social. That said, there are also economic damages as a result. The starting point for many analyses of the coronavirus is the Brookings Institution’s research on the 2003 impact of SARS. Brookings found that SARS subtracted one percentage point off Chinese GDP and had minimal impacts across the global economy, including less than 0.1 percent of real U.S. GDP at the time.

Clearly this is not a perfect comparison to today, but it does provide a starting point to help think through the potential impacts. The most concerning would be that a severe pandemic serves as a coordinating event and recession catalyst. Fears over the human and economic impact could potentially reach critical mass where consumers pull back and delay spending money and employers put off investment and hiring decisions. Provided
the recession catalyst scenario is avoided, the more direct impacts on the economy generally fall into three categories: reduced global trade, a drop in international tourism, and financial market uncertainties.

How the Chinese shutdown and quarantine affects integrated global supply chains is where the greatest economic impact is likely to be felt. A key difference today relative to the SARS outbreak in 2003 is China’s role in the global economy. Today, China is the second largest economy and accounts for 16 percent of world GDP. This indicates that the effects of the coronavirus on China’s economy will be more widely felt today.

In the U.S. about 20 percent of all intermediate goods used in manufacturing are imported from abroad. To the extent that plant shutdowns in China means suppliers cannot provide parts to factories around the globe then slows down the whole supply chain. Stockpiles and shortages emerge depending upon exactly where in the chain a given firm is located. These issues, combined with lower Chinese demand for goods and services, would result in lower levels of global trade overall.

China remains Oregon’s number one foreign market for exports, accounting for 20-30 percent of state totals. In recent years, Oregon exports to China have largely avoided the brunt of the trade war, however it is unlikely they will be spared any prolonged effects of a Chinese shutdown. The same goes for Oregon-based firms with operations or clients in China as well.

Additional impacts of the coronavirus may show up in international tourism to the U.S. being reduced. Based upon the trends seen during the SARS outbreak, national travel forecasters currently expect a 25 percent drop in Chinese tourism to the U.S. in 2020. According to Travel Oregon reports, in around 70,000 Chinese tourists visited the state. In 2018, Chinese tourists in Oregon spent approximately $261 million, which is 2 percent of total tourism spending statewide. A 25-50 percent decline in tourism from China this year would mean a 0.5-1.0 percentage point hit to the Oregon tourism industry, everything else being equal.

The third main channel in which the coronavirus could impact the economy is through financial markets and heightened risks. This could mean a stronger U.S. dollar, wider credit risk spreads, or a drop in equity markets themselves. All of these impacts, should they come to pass, work to slow current economic growth via fewer exports, less borrowing and lending activity, and lower levels of consumer spending and business investment.

All told, both IHS Markit and Moody’s Analytics currently forecasts global GDP to be reduced by 0.3 or 0.4 percentage points in 2020. These impacts are larger early this year, but fade over time as factories get back up and running and employees return to their offices in the weeks and months ahead. The two forecasting firms differ just a little in how much the coronavirus will impact the U.S. directly. Moody’s estimates full year 2020 GDP will be 0.15 percentage points lower, while IHS’ impact is less than 0.1 percentage point. Of course, the longer the shutdowns last, the larger the impacts will be. To the extent the health situation worsens – the virus could prove more contagious and/or deadly – then the economic impacts will likewise increase as well.

Bottom Line: The U.S. economy is growing at its potential. Productivity gains have firmed over the past year and inflation remains below the Federal Reserve’s target. The bright spot remains the labor market and consumer spending. The developing coronavirus situation represents a risk to the outlook but to date appears unlikely to derail the longest economic expansion on record.