2019 ECONOMIC FORECAST

PROSPECTS FOR A RECESSION

Sometimes we are our own worst enemy

SUMMIT ECONOMICS

Peering into the future before it becomes present

Introduction

Summit Economics has been providing an annual forecast twice a year for almost a decade. We are a little late this year for good reason. The long federal government shutdown and other heightened political disturbances, both domestic and international, created a scenario of "we have no clue". With things settled a bit, we are comfortable providing some guidance for our clients and the communities we advise.

As we move forward into a period of greater uncertainty and heightened volatility, we encourage you to be proactive with determination to realize visions of your future. We are firm believers that individuals, organizations, and communities that persevere in creating their future are more likely to achieve sustainable economic growth and wellbeing – no matter the fundamentals they cannot control.

We always enjoy feedback. Feel free to give us your thoughts on the economy -- or any other economic issue of the day.

What's a recession and how do we know we're in one?

The National Bureau of Economic Research tells us we're in a recession – sometime not until we have begun to recover. This is how they define a recession:

The official **NBER definition** of **recession** (which is used to date U.S. **recessions**) is: A **recession** is a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales.

Economic downturn financial definition of Economic downturn
financial-dictionary.thefreedictionary.com/Economic+downturn

Being in a recession is like an epidemic. Not everyone is sick or will get sick, and it may take a while to determine how sick we really are. Fortunately recessions have been getting shorter in duration even though post recession recovery is less robust. Colorado tends to get milder cases of illnesses except in the late 1980s when the nation as a whole was healthy except for the Sunbelt which was on life support. That was the Savings & Loan Crises.

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Economic Cyclical Drivers & Indicators

Consumer

- Income expectations
- Credit
- Home building
- Durable goods

Business

- Inventories & Business investment
- Earnings expectations
- Credit

Government

- Federal expenditures (fiscal)
- State and local expenditures
- Credit

Trade

- Foreign economies
- Protectionism

Consumer Confidence
Residential Building Permits*
Consumer Credit Index
Auto purchases

Unemployment claims*

S&P 500 Price Index
Executive Confidence
Credit index
ISM New Orders - Inventories*

Yield Curve
Leading Indicators
Credit Indices
Federal Reserve Signals

* Higher correlations

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Consensus forecast for the U.S. 12

Median Forecasts for Selected Variables in the Current and Previous Surveys						
	Real GDP (%)		Unemployment Rate (%)		Payrolls (000s/month)	
	Previous	New	Previous	New	Previous	New
Quarterly data:						
2018:Q4	2.8	2.6	3.7	3.7	173.3	203.1
2019:Q1	2.5	2.4	3.7	3.7	161.5	172.4
2019:Q2	2.7	2.7	3.6	3.6	162.0	168.1
2019:Q3	2.6	2.4	3.6	3.6	150.1	159.7
2019:Q4	N.A.	2.2	N.A.	3.6	N.A.	142.9
Annual data (projections are based on annual-average levels):						
2018	2.8	2.9	3.9	3.9	194.8	198.5
2019	2.8	2.7	3.6	3.7	167.8	181.9
2020	1.8	2.1	3.7	3.8	N.A.	N.A.
2021	1.5	1.7	4.0	4.0	N.A.	N.A.

Philadelphia Fed

Average probability of recession in the next 12 months recently increased to 25% (double what it was in 2018) .

Conclusion – Prospects for a recession

There is a significantly higher probability of recession by the 4th quarter of this year and into 2020. The problem is that recessions in presidential election years almost always result in the incumbent party in the White House losing. Given the hyper emotional political landscape, a small fissure could become a major crack in the economy in rather short order.

Except for downside contagion from the political environment, a U.S. recession, if it occurs in the next 18 months, would be rather mild – nothing like 2008-09. Overall we assess the probability of a recession in the last quarter of 2019 or first half of 2020 at .33 (a 1 out of 3 chance) – slightly higher than the consensus of .25.

More concerning is persistent slower growth over the mid-term (3 to 5 years), increasing sovereign debt ratios as nations increase deficit spending around the world, rising corporate debt, aging populations, and a the potential for significant international trade barriers becoming the norm.

The Global Outlook & Drivers

Long-Term

- Beginning of downturn in trade cycle and rising nationalism
- Aging population in developed world shifts spending patterns and stresses sovereign debt
- Climate change disruptions
- Massive migration pressures due to population and economic growth patterns and water shortages
- Rapid expansion of Artificial Intelligence and Machine Learning hindered by cyber security.
- Genetic engineering

Short-Term

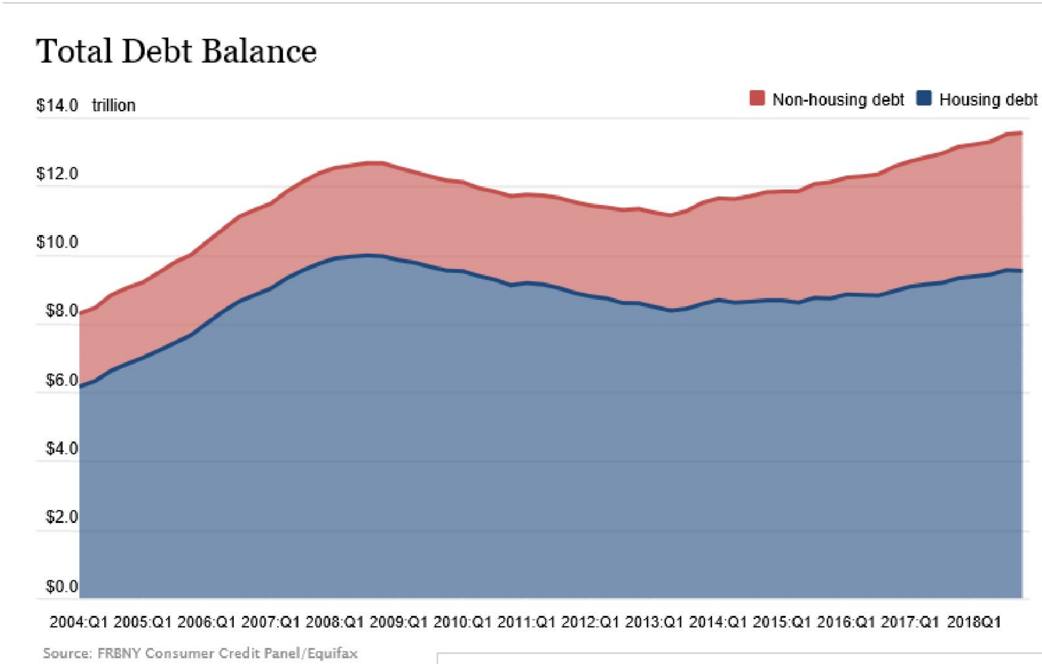
- Declining growth in the coming 12 months, but India and China remain solid thanks to continued U.S. strength and government actions
- Russia, Africa and South America struggle. Venezuela implodes causing renewed global tensions between China, Russia and U.S.
- Brexit comes to a head in the coming weeks

U.S.fundamentals

- **Cyclical:** The Fed and investors via the yield curve are signaling the end is near. Household credit is at reasonable levels, but corporate debt may be at the end of its easy credit cycle as leverage is high and interest rates are more volatile. Creative financing like “leveraged debt” (we thought all debt was leveraged) is cause for worry.
- **Expansionary Fiscal Policy:** The 2018 tax cuts will continue adding to GDP growth; albeit it lower rates as long as government spending isn’t curtailed.
- **Monetary Policy:** There will be conflicting signals in 2019 as the Fed exerts “patience” leaving rates alone while reversing Quantitative Easing.

- **Global Growth:** China is managing its debt burden without a much greater drag on growth; partially thanks to greater exports despite tariffs. This could change with a U.S. downturn. Higher U.S. interest rates make debt more challenging for emerging markets and other parts of the world.
- **Housing :** The housing market is cooling as rents and higher interest rates are stressing affordability among more and more households and buyers are reacting to greater economic uncertainty by “staying put”.
- **Healthcare** remains in turmoil as the sector approaches 19% of GDP – about twice the rest of the developed world. It’s a significant driver of the economy in terms of spending and job growth but relies heavily on federal and increasingly state spending. Even households with private health insurance are burdened due to high deductibles.

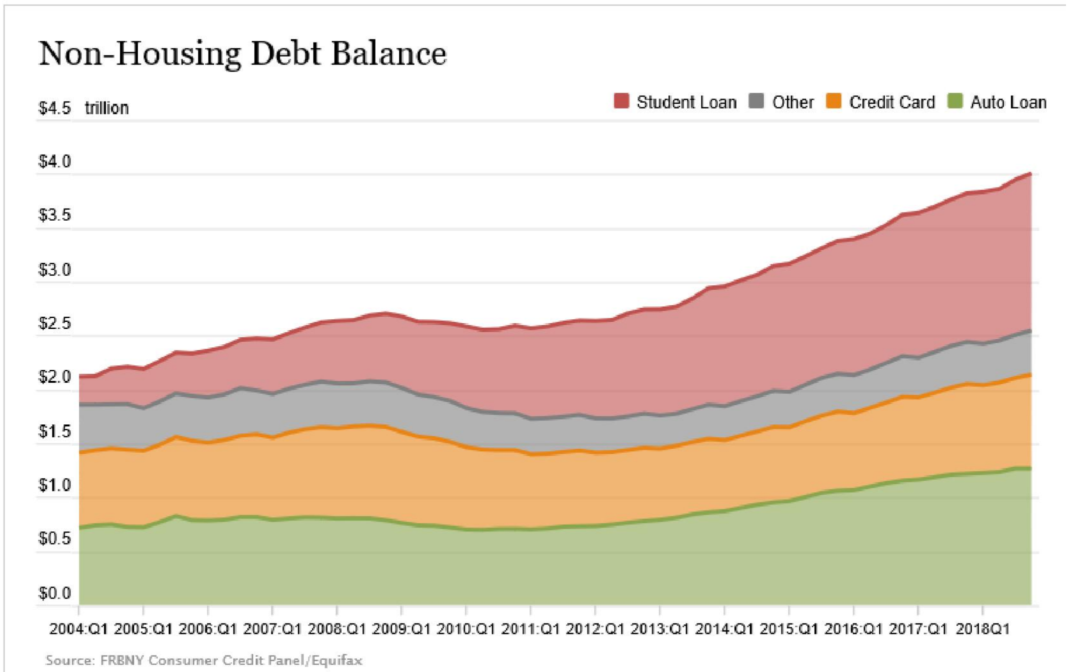
Household Debt



Total household debt is still comparable to 2008 thanks to less mortgage debt.

The major contributors to higher debt are student loans and autos.

Credit card applications are down while delinquencies on student debt, autos, and credit cards among younger and lower income are up.

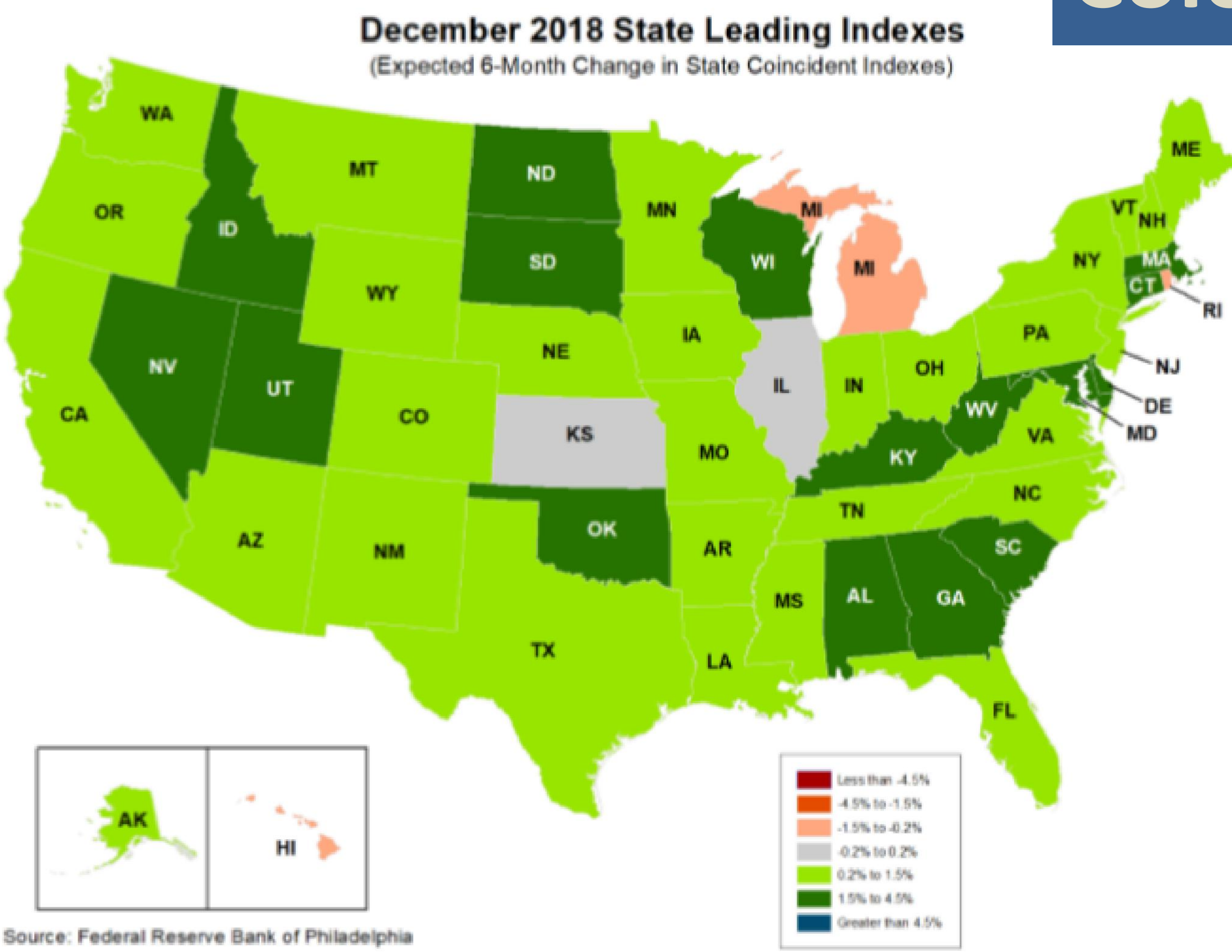


Conclusion – U.S. Economic Outlook

- GDP growth will moderate and return to the to 2% range (lower than the consensus).
- Major layoff stories will abound in retailing and autos. Trade deficits will peak. Housing starts will decline. Job additions will moderate. Companies and public stock prices will struggle with slower growth and higher labor costs.
- Interest rates may even decrease slightly.

State Leading Indexes show cooling economies much of the nation.

What about Colorado?

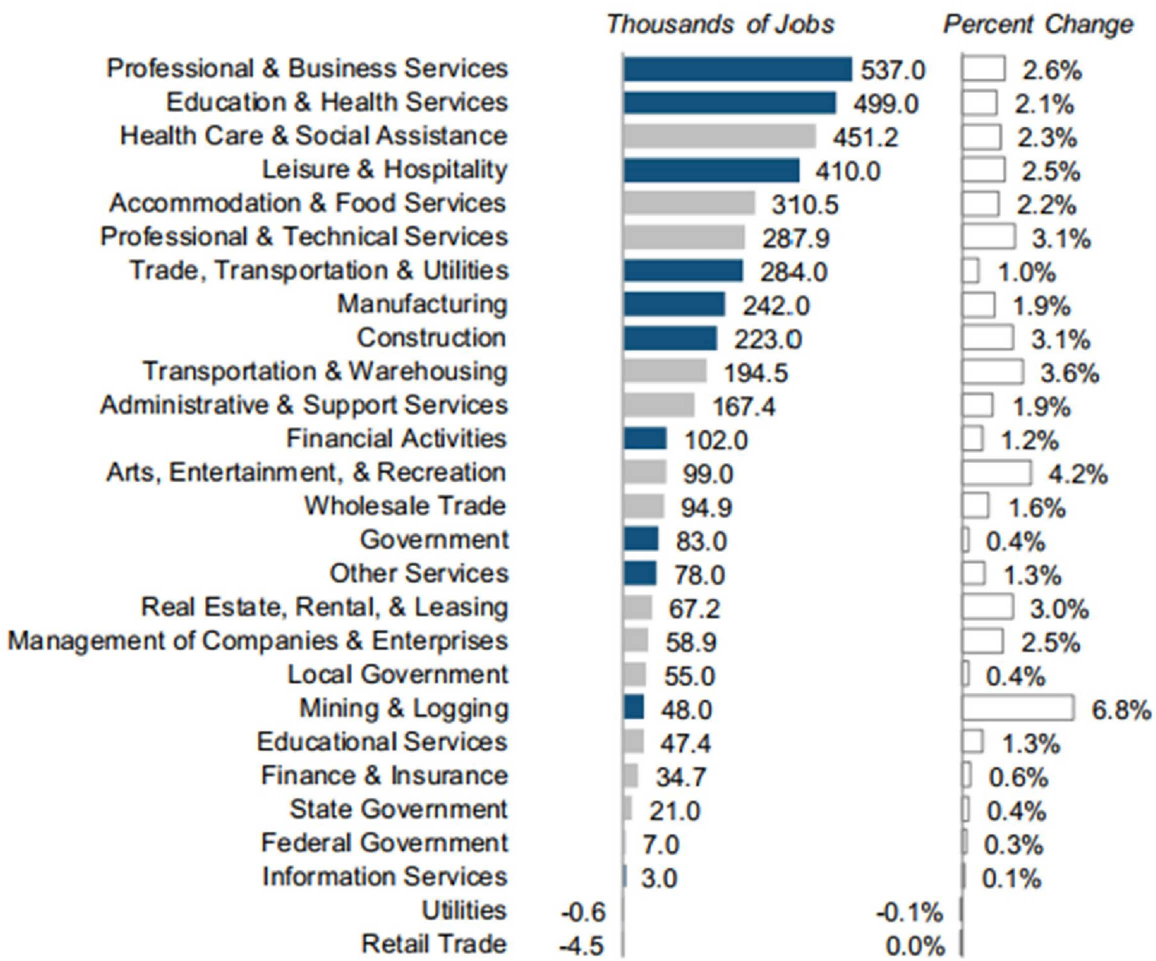


Source: Federal Reserve Bank of Philadelphia

From the Colorado Legislative Council

Sector Growth

Figure 12
U.S. Job Gains and Losses by Industry
Year-over-Year Change, February 2019 over February 2018



Source: U.S. Bureau of Labor Statistics. Data are seasonally adjusted. Blue (dark) shading indicates a supersector while grey (light) shading indicates a subsector.

Strong growth related to real estate and construction as well as tourism. Professional and Business Services bodes well for long-term economic base as does Management of Companies and Enterprises. Health care is a long trend, but who will pay the bills?

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Colorado Fundamentals

- Relative to the nation, Colorado enjoys long term economic growth thanks to natural assets, regional branding, and the steady flow of young educated in-migrants.
- While housing costs and transportation hinder growth, the strongest regional economies always have these challenges and the state is positioned to pursue new and “smart” approaches to solutions.
- Governor Polis and a Democratic controlled legislature will significantly change policy priorities. How much will it impact the “pro-business” climate touted by many as oil and gas fall out of favor and worker interests are advanced in areas like universal health care and paid family leave. Will construction of townhomes and condos provide more affordable ownership opportunities or will development be stymied by construction defects? In short, will policy changes reinforce Colorado’s progressive reputation attracting a new generation of companies, hinder growth, or be neutral?
- Will the robust tourism economy slow with national growth in 2019?
- Front Range metro areas outside Denver-Boulder are leading the way with strong economic and population growth and intra-state migration and housing cost favor Denver’s suburbs.
- The state’s reputation for aerospace and defense contracting will benefit from global posturing.

COLORADO

Annual Percent Change 2019 from 2018

	Current $ Personal Income	Retail Sales	Wage & Salary Employment	Population Growth	Single Family Housing Permits
Consensus Forecast	***5.3%***	***5.1%***	***2.1%***	***1.4%***	***10.1%***
Summit Economics	6.5%	5.5%	2.0%	1.5%	10.0%

With the exception of personal income (Summit is higher), we are close to the consensus forecast.

Colorado Conclusions

- It should be a good year for wage and salary growth throughout much of the state supporting consumer expectations and retail growth.
- Housing will remain strong even though new starts are peaking along with mortgage interest rates. Price growth will slow.
- Employment growth will soften with construction, healthcare expansion, and tourism approaching cyclical peaks.

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Pikes Peak Forecast

- Momentum from last couple of years still strong, but cooling along with the state.
- Strong growth seems most related to DoD, commuting to Denver, healthcare expansion, retirement, general economic expansion nationally, and lower average wages compared to Denver metro and northern Front Range.
- Strong DoD contracting in the local economy should continue as greater need for missile defense globally positively reinforces the economic base.
- The housing market will sputter a bit with national economic uncertainty and less affordable inventory.

The positives outweigh the negatives in 2019

- The Downtown renaissance will be a driver in 2019 as the U.S. Olympic Museum moves towards completion, Weidner Stadium and Robson Arena break ground, and new apartments and hotel rooms are developed.
- Tourism continues strong, but may soften slightly towards the end of the year based upon national economic conditions.
- Recent healthcare expansion at Children's Hospital, Memorial North, and St. Francis come to an end.

About Summit Economics

Summit Economics was founded in 2008 to focus on data, information, and knowledge creation for clients. We consider business, community, and financial aspects for organizations and teams. As applied social scientists we elaborate on the economic, social, cultural, and political contexts. We strive to do this in an objective, balanced, and transparent manner.

Our most frequent engagements support decision-making, quantify visioning and planning, develop performance metrics, or assist with risk management – all related to the 5Ps of policies, projects, programs, products, and processes.

Our clients include governments, for-profit companies, non-profit organizations, economic development groups, real estate developers, and public-private partnerships. Some of our most recent engagements include:

- The economic value of national defense to the Colorado economy
- Prospective and retrospective looks at the economic benefits of urban greenway development
- Business planning for the City for Champions' sports center development
- Fiscal impacts of public private partnerships associated with tourism events and development, highway expansion and interchanges, museum and office development, and new subdivision development.
- The social return on investment associated with non-profit organizations.

More detailed look at Colorado

- Governor's Office of Budget & Planning https://drive.google.com/file/d/16Rj4DZKhbJQ8Cde17pjoX7yEiB667-rm/view
- Colorado Legislative Council https://leg.colorado.gov/sites/default/files/mar2019forecast.pdf
- CBER 2019 Forecast https://cber.co/wp-content/uploads/2019/01/cber.co-2019-Colorado-Economic-Forecast.pdf
- Leeds Business Confidence Index https://www.colorado.edu/business/sites/default/files/attached-files/lbci_q1_2019_final.pdf
- Leeds School of Business https://www.colorado.edu/business/sites/default/files/attached-files/2019_colorado_business_economic_outlook_011719.pdf

Table 3 – Markov Switching Results Rankings (1959Q2 – 2011Q1)

Relation of recession signal obtained by Markov Switching model to actual date of recession

variable	(1) score	(2) one to three quarters before recession	(3) first quarter of recession	(4) all quarters during recession except first and last two	(5) second to last quarter of recession	(6) last quarter of recession	(7) one to three quarters after recession	(8) other
Current US LEI	21	9	8	9	3	2	0	3
US LEI with LCI and no M2	20	9	7	9	4	4	0	1
New US LEI	19	7	7	10	5	5	0	0
Interest rate spread (levels)	17	16	4	5	1	1	0	7
New unemployment claims	12	7	4	10	4	4	1	4
Residential building permits	9	8	6	6	3	3	0	8
ISM new orders - inventories (levels)	8	7	3	9	4	4	1	6
New orders of consumer goods	6	8	3	7	4	7	1	4
S&P 500 Index	5	5	4	8	5	1	2	9
Reuters/Michigan survey of consumer expectaions	4	5	3	9	4	4	2	7
ISM new orders (levels)	1	3	5	7	5	7	2	5
Capacity utilization in manufacturing	1	3	3	8	7	8	2	3
New orders of capital goods excluding aircraft orders	1	4	3	8	5	5	3	6
Average weekly working hours	0	4	4	7	4	5	1	9
M2	-2	7	4	4	2	2	3	12
ISM Purchasing Managers' Index	-3	2	4	6	7	8	3	4
ISM supplier delivery index (levels)	-6	4	4	4	4	5	6	7
New orders of capital goods	-8	4	1	6	4	4	5	10
ISM supplier delivery index in differences	-12	4	3	3	2	3	0	19

Except when otherwise indicated, the series are all used in first differences rather than levels

Note: The variables are ranked according to the score they received in column 1. The score is calculated by adding the number of signals that occur before or during recessions and subtracting the number of signals that occur during expansions. That is. cols. 2+3+4-6-7-8. A signal occurs if the Markov switching model indicates a switch in the regime.

Most reliable recession predictors.