2019 Economic Outlook

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Looking Back at 2018

GROSS DOMESTIC PRODUCT (GDP) AND EARNINGS GROWTH, RETURN OF MARKET VOLATILITY

Last year was a tale of two economies—a surging U.S. economy with above trend line growth and rising interest rates, and a global one with many developed countries mired in near-zero or negative interest rates and dwindling growth. Here are some of the most significant developments we saw:

- **Tax-cut driven growth –** With the Tax Cut and Jobs Act of 2017 as a major catalyst, the U.S. economy was an outlier from a global perspective, generating increased growth in the 3% range.
- **Robust corporate earnings –** Corporate earnings took off, with growth in the 20% to 25% range, another result of the tax cut and business-friendly federal policies.
- **Strong labor market –** Records fell in just about every measure of employment, contributing to high levels of consumer confidence.
- **Short-term interest rates back to neutral –** We saw a continuation of the quarter-point rate increases the Federal Reserve had projected and everyone was anticipating, driving rates up a full 100 basis points during the course of the year. These moves ratcheted rates back up to a normal level so that the Fed, once again, now has a viable policy tool—rate cuts—it could conceivably use to stimulate the economy in the future if needed.
- **Return of more typical market volatility –** Remember 2017 and how unusually calm the markets were? In 2018, volatility in both the equity and fixed-income markets returned, due in part to the unwinding of the Federal Reserve's quantitative easing program and interest rate hikes. The fourth quarter, in particular, proved to be a roller-coaster ride for the stock market with some deep dives.
- **First shots fired in the trade war with China –** The initial tariffs levied against one another by the U.S. and China in 2018 contributed to some roiling of the markets but weren't too disruptive. However, the initiation of a U.S.-China trade war could turn out to be a major event and seriously impact the global economy if we see further escalation, such as the 25% tariffs across more goods threatened by the Trump administration.
- **Gathering headwinds in Europe –** Growth slowed in Europe and little progress was made in Brexit negotiations, as pressure built for some sort of resolution in first quarter 2019 before the U.K.'s March 29 departure deadline.

Economy Remains in Good Shape for 2019

Growth and corporate earnings aren't expected to reach last year's lofty heights—and economists are closely watching several potentially destabilizing situations—but, all things considered, the U.S. economy appears to be headed for a strong 2019.

The tax-cut law helped drive robust U.S. economic performance in 2018, and we foresee only a slight deceleration this year.

The consensus expectation is the GDP growth trend will subside about half a percentage point to around 2.5% in 2019. Meanwhile, corporate earnings growth, after climbing to levels well above 20% in 2018, should fall back to a still quite healthy range of around 5–10%.

Uncertainty is helping to moderate economic performance projections for 2019, as a number of situations—including several on the global front—bear watching.

Short-term Interest Rates

The certainty of regular, quarter-point short-term interest rate hikes in 2018 is giving way to a lack of clarity over what action the Federal Reserve will take on rates in 2019. Increasingly, due to a number of potentially destabilizing situations around the world (see Trade section on page 3) and domestic market concerns, experts believe the Fed may slow or suspend the series of rate hikes it initiated back in late 2015. Many now believe no more than one or two quarter-point hikes are likely this year.

Trade

How the trade conflict between the U.S. and China gets resolved should also impact the economy this year.

The U.S. imposed a 10% tariff on a small selection of Chinese imports in 2018, the Chinese responded with tariffs targeting U.S. agricultural products, and the Trump administration threatened further escalation with 25% tariffs across a wider range of goods. The year ended with an agreement between Presidents Trump and Xi at the G20 Buenos Aires Summit that put a halt to imposition of any additional, higher tariffs but offered no assurances of a trade-friendly resolution.

Any further escalation of the trade war with China looms as a potentially destabilizing factor for the Chinese economy, one that could have a ripple effect globally, impacting Europe in particular because it's such a major Chinese trading partner. Given the integrated nature of the global economy, the U.S. ultimately could feel a negative impact as well. Port cities like New Orleans and Houston that rely on global trade could feel a real pinch.

Capital Spending

Capital spending has been somewhat restrained in the U.S. during the current economic cycle, due to uncertainty on various fronts that's impacting long-term planning. But the trade war with China could disrupt the global supply chain and actually alter that trend in one way: Some production of sensitive internet and network technology might start migrating from China back to the U.S., setting up the possibility of better-than-expected capital spending in 2019.

Developments in Europe

Further destabilization in Europe, where growth has been slowing, could create additional headwinds for the U.S. economy.

The European Central Bank has announced plans to end its quantitative easing program and start raising interest rates by mid-year. If it doesn't, there's the potential for a weaker euro and an even stronger U.S. dollar, which could put a crimp in U.S. manufacturing export profitability.

Brexit is another wild card in Europe. If the United Kingdom can't negotiate a favorable agreement for exiting the European Union by the end of the first quarter—and a looming March 29 E.U. departure date—that would likely be incredibly disruptive for the U.K. economy, at least for a couple of years.

The Consumer

U.S. consumers enter 2019 coming off a banner year of low unemployment, higher wages and lower income taxes. Another important bellwether for this year's economy: Does consumer confidence remain high?

We'll be watching consumers closely to see how they react to global economic developments, as well as other destabilizing events should they occur, such as a continuation of stock market volatility and political unrest. If consumer confidence does wane, the first cracks will likely appear in employment figures.

Too Early for the "R Word"

The U.S. economy has been growing since mid-2009, and expansions eventually end. With a global slowdown already underway, an unresolved trade war with China and a volatile stock market, among other concerns, some are starting to talk about the possibility of a recession in 2019. But such speculation seems premature. While the probability of recession has been inching up, it remains quite low. We continue to expect only minor deceleration in GDP growth, continued corporate earnings growth and generally strong economic performance for the year.

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