Macroeconomic Outlook

Will the Fed's Pivot Save the Day?

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Despite the Fed's dovish turn, our recession forecasting tools still point to recession starting in six to 12 months.

First quarter U.S. economic growth of 3.1 percent was much better than initially projected. The resilience of the economy was impressive, given headwinds that included tighter financial conditions, the government shutdown, severe weather, tax refund delays, and seasonal adjustment challenges. However, underlying growth was not as strong as it appeared: Consumption and investment spending, which together account for 85 percent of gross domestic product (GDP), grew by a meager 1.3 percent. Inflation also continued to decelerate, with the price deflator for core personal consumption expenditures (PCE) rising by 1.0 percent, the third consecutive quarterly reading below the Fed's target (see chart, top right).

Several factors that boosted growth early in 2019 should fade. Inventories, which have risen for three straight quarters, will eventually need to reverse. Similarly, big gains from trade and highway construction are unlikely to last. And the third quarter will bring fiscal battles that could rattle markets and undermine confidence: In September, Washington will have to agree on a new spending bill to avoid another government shutdown, a debt ceiling increase to avoid a technical default, and higher spending caps to avoid fiscal tightening baked into current law for fiscal year 2020.

U.S.-China tensions have flared up again, and consumer and business confidence are likely to suffer as a result. The boost to consumer spending from tax cuts has faded, and consumer confidence surveys already point to a worrisome slowdown in the pace of improvement in current conditions, which typically occurs in the year before a recession. Similarly, while the labor market remains strong, the pace of improvement has moderated. The rate of increase in job openings has slowed sharply in the past six months, while the pace of decline in the unemployment rate has slowed to just 0.2 percentage point in the year through May. Historically, a flattening out of the unemployment rate has been a strong leading indicator of recession, especially when accompanied by a flat or inverted Treasury yield curve (see chart, bottom right).

Our recession forecasting tools continue to indicate that a downturn could begin as early as the first half of 2020. Should this prove overly pessimistic, the excesses will continue to build with more corporate leverage and increasingly inflated equity prices against the backdrop of growing trade tensions and declining corporate operating margins, which will increase downside market risk once the recession takes hold. Relatively high valuations in a period of increasing uncertainty warrants a cautious stance with regard to risk assets.

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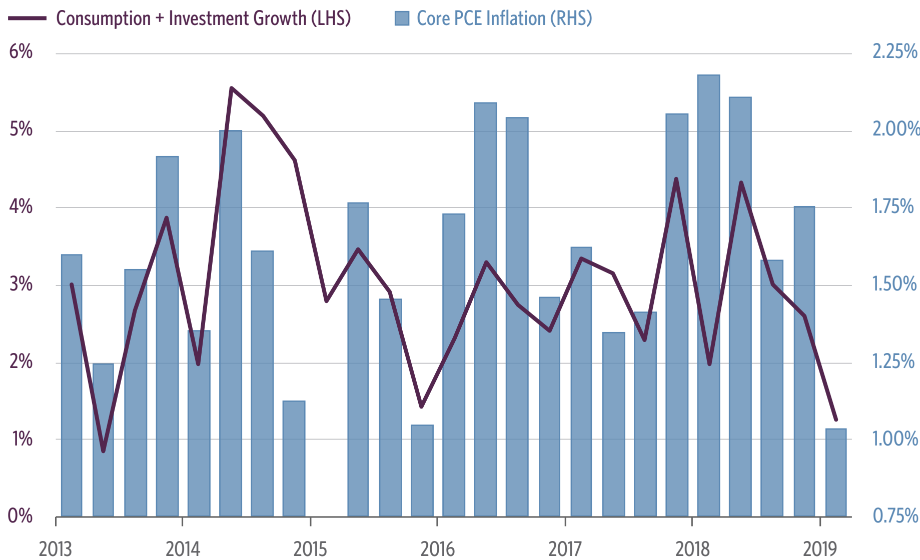
Underlying U.S. GDP Growth and Inflation Have Weakened

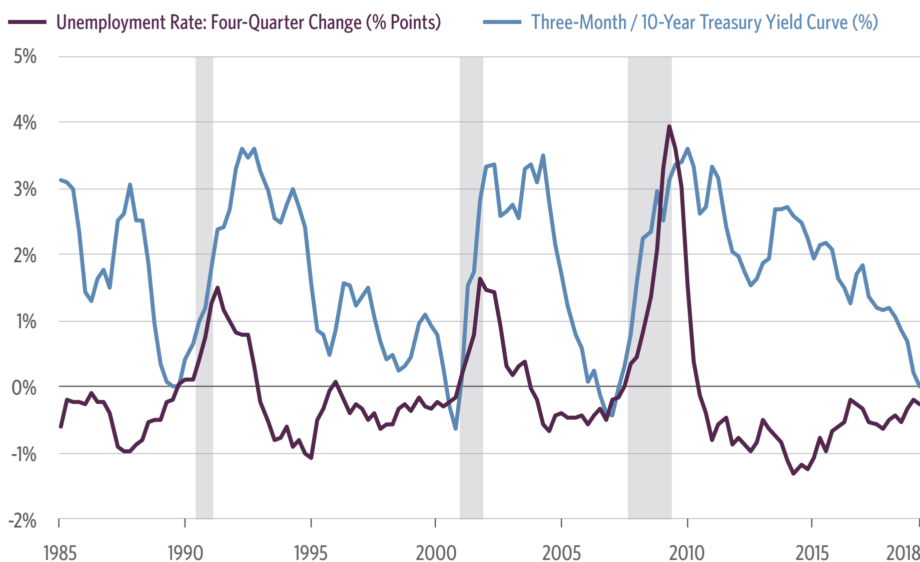
Quarterly % Change, Seasonally Adjusted Annual Rate



Source: Guggenheim Investments, Haver Analytics, BEA. Data as of 3.31.2019.

Consumption and investment spending, which together account for 85 percent of GDP, grew by a meager 1.3 percent in the first quarter, while core CPE inflation fell further below the Fed's target to just 1.0 percent annualized.

The Labor Market Is Confirming the Yield Curve's Late-Cycle Warning



Source: Guggenheim Partners, Haver Analytics, BEA. Quarterly average data as of 3.31.2019. Q2 based on data through 6.11.2019.

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