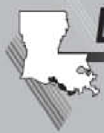
Louisiana Corporate Credit Union

ECONOMIC & FINANCIAL DIGEST

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Volume 26 April 2019

Back To The Future: 2% Growth

As advertised, the brutal headwinds that buffeted the U.S. economy late last year are having knock-on effects in the early months of 2019. To be sure, the economy's performance in the closing quarter of 2018 does not look bad at all as GDP advanced by a respectable 2.6 percent annual rate, according to the Government's preliminary estimate. That capped a full-year growth rate of 2.9 percent, which ties it for the fastest pace since 2005. But the year ended on a downbeat note amid escalating trade tensions, the start of a 35-day government shutdown, a debilitating plunge in stock prices that wiped out nearly $4 trillion in household net worth, and rising interest rates, fueled by fears that the Federal Reserve was tightening policy too aggressively.

Those headwinds took a severe toll on activity in the final month of the year, highlighted by a sharp drop in consumer spending and a plunge in factory output. As a result, the economy had to climb out of a deep hole to start the new year even as it struggled to overcome the government shutdown, which didn't end until the final week of January. Not surprisingly, the first quarter is tracking a lackluster path, with growth hovering under 1 percent. By any yardstick, that is perilously close to stall speed. Indeed, an increasing number of economists, including the Federal Reserve,are marking down their growth outlook for the year and the financial markets in late March priced in a 40 percent chance that the Fed's next move will be to cut rates, more than double the odds of a month earlier.

But just as the fourth quarter ended on a weaker note than it began, the first quarter should provide a stronger hand-off to the summer months. Amid the darker clouds overhanging the economy earlier in the year, some promising signs were already shining through. Consumers reopened their wallets and purses in January, workers received fatter paychecks, negotiations with China showed promise of a deal, easing trade tensions, and the late-year spike in interest rates was entirely erased, brightening prospects for home sales. A lethargic winter should be followed by a spring bounce – but don't expect another year of growth like 2018.

Rosy Outlook

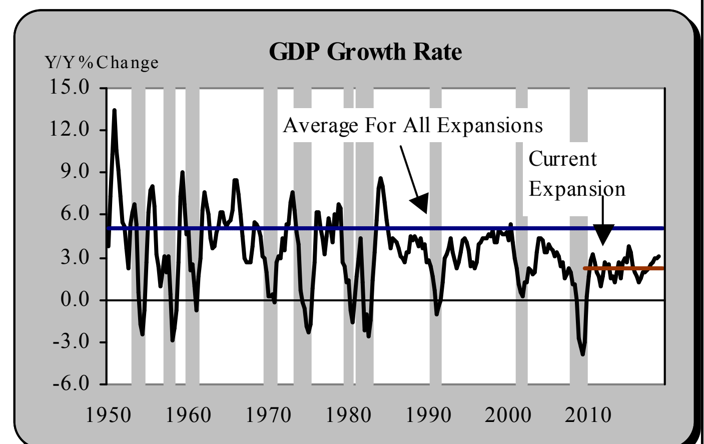
In its latest economic projections released with the new budget for fiscal year 2020, the administration expects the economy to at least match last year's stellar performance, pegging a growth rate of about 3.0 percent over the next five years and even stronger both this year and next. Most economists, however, scoff at that rosy outlook, noting that the economy just doesn't have the structural capacity to meet that speed limit. Both the Federal Reserve and the Congressional Budget Office expect growth this year to wind up closer to 2 percent than 3 percent and stay there over the next five years.

We concur with that more modest outlook, which would be consistent with the downshifting in the economy's growth potential. Over the ten previous postwar expansions, the economy grew on average 5.0 percent a year. But the average pace slowed over the last three upturns – to 3.6 percent in the 1990s and to 2.8 percent during 2001-2007 expansion; the current upturn, set to become the longest on record, has also been the weakest in the postwar era, averaging a 2.2 percent growth rate over its nearly 10-year span.

No doubt, the Great Recession's broad and devastating impact had lingering effects that contributed to the current expansion's weak performance relative to the earlier ones. But those effects dissipated years ago, as unemployment steadily fell, the financial system returned to health, corporate profits roared ahead and the astonishing rally in stock prices and housing values restored household wealth. By the start of 2015, consumer confidence had returned to prerecession levels and has since continued to climb. Yet, after spiking to above 4 percent in the second quarter of 2018, the economy's growth rate receded to 3.4 percent and 2.6 percent over the succeeding two quarters and, as noted, is on track to slow considerably further in the first quarter of this year.

Lack of Specifics

The administration, of course, is undaunted by the slowing trend and believes that the economy can sustain the 3.0 percent growth rate established in 2018 over the foreseeable future. Unfortunately, the assumptions in the budget document provide few specifics on how that goal would be achieved. The only



explanation given for the administration's above-consensus economic forecast is that it assumes the policies put in place and the proposals made in the budget will lift the long-run output potential of the economy. It goes on to say that "…other forecasters are unlikely to be operating under the same assumptions."

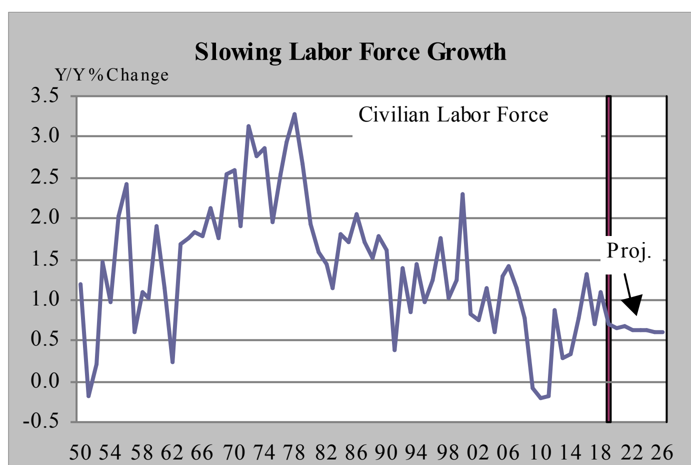
More than likely, those policies, particularly the Tax Cut and Jobs Act enacted in late 2017 and the budget-spending bill passed in early 2018 provided a temporary sugar high that juiced the economy's growth rate in 2018. It is hard to see how the proposals in the new budget, which includes nondefense spending cuts, would sustain that improvement or increase the output potential of the U.S. economy.

Keep in mind that the reasons causing the nation's lowered growth potential are not easily reversible. For one, the population is aging and spurring an ever-rising tide of retiring baby boomers, which is restraining labor force growth. True, older workers are staying on the job longer than in earlier decades, but that is only slowing the inevitable decline in the labor force participation rate not reversing it. For another, productivity growth has declined significantly in recent decades, and it is unclear if or how it can return to its earlier pace. With the labor force growing around 0.5 percent a year and productivity at 1.5 percent, the administration would have to provide more compelling evidence than it has that the economy can sustain growth above 2.0 percent.

Not Stall Speed

That said, it is also necessary to view a 2.0 percent growth rate in a different light than in the past. Throughout most of the postwar period, the economy's growth potential was considerably higher, ranging between 3 and 4 percent. Following the Second World War, the labor force expanded briskly as soldiers returned to civilian life seeking jobs and their services were eagerly sought after by companies facing a huge pent-up demand for goods and services. In the 1960s and 1970s, growth in the labor force was fueled by the surging postwar birth rate and the influx of women into the workforce.

From 1949 through the 1980s, the labor force increased by an annual rate of just under 2.0 percent, a period that included seven recessions. Growth slowed to 1.2 percent in the 1990s and to 0.8 percent since the turn of the century. The Labor Department expects the labor force to continue slowing — to a 0.6 percent growth rate through 2026. Simply put, the slower growth in the labor force alone has sliced the economy's potential growth rate by more than a full percentage point compared to earlier decades.



That, in turn, largely explains why the majority of economists believe 2.0 percent growth is the "new normal" for the U.S. economy. In the past, that would have been referred to a stall speed, a pace that is so slow that any adverse event would tip the economy over into a recession. Indeed, in every postwar cycle when the annual growth slipped to that threshold for more than a quarter, a recession soon followed. In other words, soft landings are historically rare occurrences.

Slow But Steady

Clearly, that pattern has been broken during the current expansion, as the annual growth rate has slipped below 2.0 percent in 16 of the 37 quarters since the recession. Yet one of the outstanding features of the upturn, besides its lackluster pace, is that it has been the least volatile of the postwar cycles. The standard deviation, a common measure used to quantify the amount of variation in a series, shows that volatility in the current expansion has been a third lower than the average of previous postwar cycles. Simply put, slow and steady growth has extended the life of the expansion.

That said, the slower an economy grows, the more vulnerable it is to an external shock, which is why economists place more than trivial odds that a recession will take place within the next year or two. And it is not hard to find potential sources that could tip the economy into a downturn. While reports of progress on trade negotiations with China are hopeful, nothing concrete has yet emerged and an outright trade war could still erupt. As it is, global growth slowed significantly in the second half of last year; if the struggles of overseas economies worsen, the U.S. would feel the pain through lower exports and corporate profits. On the home front, lawmakers will be confronting a debt-ceiling battle later this year, which raises the prospect of another confidence-shattering government shutdown.

These and other unforeseen developments could well trigger a recession sooner than later. But the economy has absorbed several shocks during the expansion – a sovereign debt crisis, a plunge in oil prices and two government shutdowns, including the most recent one – which have not derailed the expansion even as it barely maintained a 2.0 percent growth rate. A key reason for this resilience is that the main culprit behind previous recessions, excessive policy tightening, has been absent this time. The Fed has been accommodative throughout the expansion, increasing rates only gradually from the emergency-era zero bound as the expansion matured.

Of the eight rate increases since December 2015, four came last year as the fiscal stimulus gave a temporary jolt to growth. With that stimulus fading, inflation remaining bottled up and growth slowing back towards 2.0 percent, the Fed has put rate hikes on hold at levels that are far below the peaks that prevailed prior to past recessions. At the March 19-20 policy meeting, the majority of Fed officials signaled that they might not raise rates at all this year. As long as this economic and policy backdrop remains in effect, there is every reason to believe that the expansion still has a ways to go, even at the new normal speed limit of 2.0 percent. Indeed, should the administration's above-trend growth forecast for this year come to pass, the risk of excessive policy tightening would increase, as would the odds of a more imminent recession.

KEY ECONOMIC AND FINANCIAL INDICATORS

FINANCIAL INDICATORS*

	February	January	December	November	October	September	August	12-Month Range High	12-Month Range Low
Prime Rate	5.50	5.50	5.35	5.25	5.25	5.03	5.00	5.50	4.58
3-Month Treasury Bill Rate	2.39	2.37	2.37	2.33	2.25	2.13	2.03	2.39	1.70
5-Year Treasury Note Rate	2.49	2.54	2.68	2.95	3.00	2.89	2.77	3.00	2.49
10-Year Treasury Note Rate	2.68	2.71	2.83	3.12	3.15	3.00	2.89	3.15	2.68
30-Year Treasury Bond Rate	3.02	3.04	3.10	3.36	3.34	3.15	3.04	3.36	3.01
Tax-Exempt Bond Yield	4.22	4.21	4.13	4.30	4.32	4.12	3.96	4.32	3.88
Corporate Bond Yield (AAA)	3.79	3.93	4.02	4.22	4.14	3.98	3.88	4.22	3.79
Conventional 30-Year Mortgage Rate	4.37	4.46	4.64	4.87	4.83	4.63	4.55	4.87	4.37
Dow Jones Industrial average	25606	24158	23806	25252	25569	26233	25630	26233	23806
S&P 500 Index	2755	2607	2567	2723	2785	2902	2858	2902	2567
Dividend Yield (S&P)	2.04	2.08	2.22	1.99	2.02	1.88	1.87	2.22	1.87
P/E Ratio (S&P)	18.3	17.8	16.6	18.9	18.7	20.1	21.0	21.0	16.6
Dollar Exchange Rate (vs. Major Currencies)	91.4	91.8	92.1	91.7	90.8	90.0	90.4	92.1	86.2

** Monthly Averages*

ECONOMIC INDICATORS

	February	January	December	November	October	September	August	12-Month Range High	12-Month Range Low
Housing Starts (In Thousands)		1230	1037	1206	1209	1237	1280	1329	1037
New Home Sales (Thousands of Units)		307	652	628	552	609	601	672	307
New Home Prices (Thousands of Dollars)		317	319	307	328	328	321	335	307
Retail Sales (% Change Year Ago)		2.3	1.6	4.0	4.6	4.0	6.4	6.6	1.6
Industrial Production (% Change Year Ago)	3.5	3.9	3.9	4.3	4.3	5.7	5.5	5.7	3.0
Operating Rate (% of Capacity)	78.2	78.3	78.7	78.8	78.5	78.5	78.5	78.8	77.5
Inventory Sales Ratio (Months)			1.38	1.36	1.35	1.34	1.34	1.36	1.33
Real Gross Domestic Product (Annual % Change)			2.6			3.4		4.2	2.2
Unemployment Rate (Percent)	3.8	4.0	3.9	3.7	3.7	3.7	3.9	4.1	3.7
Payroll Employment (Change in Thousands)	20	311	227	196	277	108	282	311	20
Hourly Earnings (% Change Year Ago)	3.4	3.1	3.3	3.3	3.3	3.0	3.2	3.4	2.8
Personal Income (% Change Year Ago)		4.3	5.0	4.3	4.4	4.3	4.6	5.0	4.2
Savings Rate (Percent of Disposable Income)		7.6	6.1	6.4	6.4	6.4	6.4	7.6	6.0
Consumer Credit (Change in Blns. Of Dollars)		17.0	15.4	21.1	24.6	14.6	24.8	24.8	4.7
Consumer Prices (% Change Year Ago)	1.5	1.6	1.9	2.2	2.5	2.3	2.7	2.9	1.5
CPI Less Food & Energy (% Change Year Ago)	2.1	2.2	2.2	2.2	2.1	2.2	2.2	2.4	2.1
Wholesale Prices (% Change Year Ago)	1.8	2.0	2.5	2.6	3.2	2.8	3.0	3.4	0.3

Louisiana Corporate

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Fourth Quarter 2018 – By the Numbers

$4.24 billion	Total credit union issuance outstandings.
1,436	Number of credit unions that have issuance agreements in place, prepared to issue share certs, should the need arise.
$249 million	Total outstandings for SimpliCD's largest share certificate issuer.
407	Number of credit unions that currently have share certificate issuance balances through SimpliCD.

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