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Tatiana Bailey: Reasons for forecasting a recession are plentiful

TATIANA BAILEY Special to The Gazette
Oct 8, 2023

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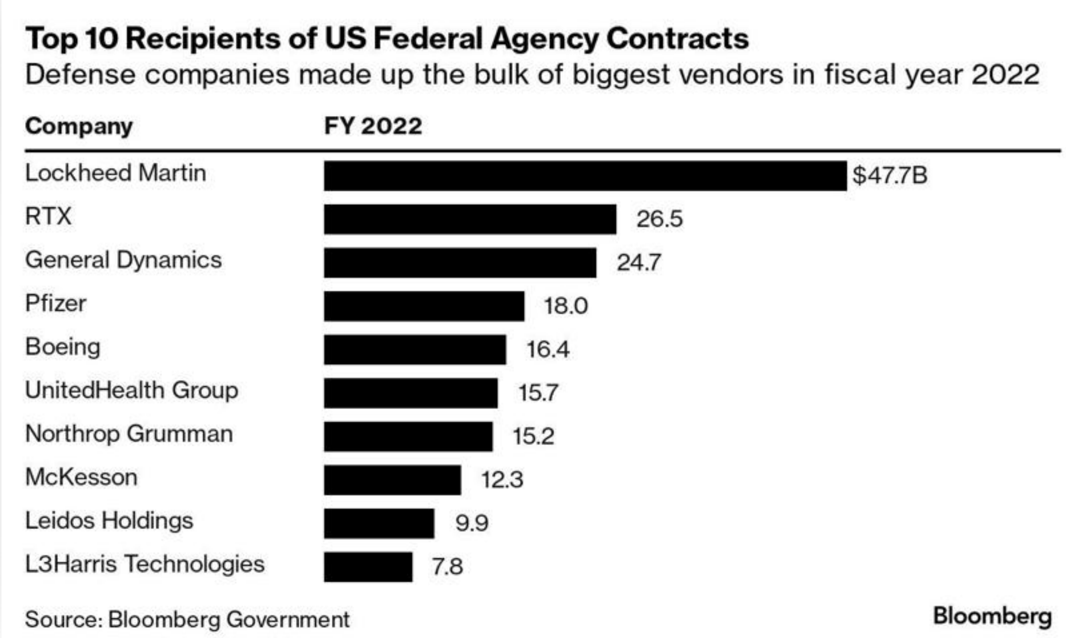

This month, there is a lot of new data to share with you. In the economic information I track every day and in community conversations, I see more than the usual shifts, many of which I believe to be structural and not cyclical. That's part of the motivation to share additional data points with you.

The third revision to gross domestic product showed a slightly lower growth rate (at 2.4%) than the previous estimate (2.5%). What's more interesting is that the GDPNow tracker from the Atlanta Federal Reserve is showing a high GDP growth rate for the third quarter of this year, which includes July through September.

That tracker simply incorporates various components that make up GDP (e.g., residential investments, exports) so by the time all inputs are in, the final growth rate can be quite different than it was even a week or two prior.

However, I do look at it as well as what other more subjective forecasters are saying, and it seems likely that we will have a 3% to 3.5% growth rate this quarter. This is higher than the U.S. trend growth rate of the past 20 years of around 2%.

If indeed 2023 Q3 ends up outperforming trend growth, that will help the overall 2023 picture. I've revised up my 2023 GDP forecast to 2.2% (from 1.7%). However, I did keep 2024 GDP at a subpar growth rate of 0.5% with what will likely be a shallow and relatively short recession.

The drivers behind a contraction include sticky inflation with concomitant high interest rates (dampening consumer buying and business investment), exhausted pandemic savings, increasing consumer debt and payment delinquencies, lower levels of government spending than previously anticipated mostly due to the Fiscal Responsibility Act (enacted to avert the previous debt ceiling crisis), labor shortages and disputes, possible declines in labor participation due to the closure of child care facilities resulting from the end of federal child care subsidies, and the resumption of student loan payments.

That's quite the list, right? And my list doesn't incorporate unexpected "exogenous" shocks that can happen. On the flip side, the labor shortages likely will keep unemployment rates low, enabling consumers to still feed the economic wheel of fortune through relatively stable consumption levels. This might keep the usual "hurt" of a recession from being too harsh or too long as I discuss in more detail below.

But what about the final quarter of this year, which we are just entering, Oct. 1 to Dec. 31? All the above-mentioned headwinds are still in play, but the economy looks and feels shakier to me. We narrowly averted another government shutdown last weekend, which would have reduced the annualized GDP growth rate by 0.2% for each week of a shutdown.

In other words, two weeks of a shutdown would shave almost a half-percentage-point off GDP — not insignificant. Congress has once again punted to November, so the risk remains. And shutdowns would likely impact our state more so than most other states because of our exposure to federal government contracts.

Most of the companies shown in the chart have a strong presence in Colorado (and Colorado Springs) and although not all contract workers would be furloughed in the event of a shutdown, many would be. Federally funded workers at parks and open spaces in our state would also be furloughed. And any decline in employment reverberates throughout the broader economy.

Before I leave this regrettable topic, I will mention that these legislative debacles brought on by extreme partisanship on both sides of the aisle were one of the reasons that the U.S. Fitch credit rating went from AAA to AA in August. It is a liability not only to the impacted federal workers, but also a downgrade to the international perception of the U.S. by buyers of Treasurys as well as other U.S. investments. Outside investors look at the totality of political extremism and how it translates to the inability to compromise in fiscal decision making.

On that note, I have yet to see anything successful that doesn't incorporate compromise — even a marriage.

Back to economics. Another major risk involves the labor disputes including the UAW and Kaiser Permanente. Although these disputes are most definitely a headwind for the U.S. economy, the strong labor market is much of the reason that I am sticking to my story that if we hit a technical recession, it will be shallow and short. It's ironic, but if employment stays relatively strong, consumers are going to keep buying and that will keep most businesses afloat.

Another dimension is the fixed mortgage rate policies we have in the U.S., which most European countries and Canada do not have. Homeowners in these other nations have variable rate loans that are reset every five years or so. Hence, when their central banks raise rates, the impact on spending is more pronounced, meaning higher rates are more effective at slowing the economy.

By contrast, in the U.S. those who have a low, fixed mortgage rate (e.g., at or even less than 3%), are enjoying relatively cheap housing, enabling them to have more discretionary income to spend out in the community. About 40% of American families have mortgages and most of those have anchored themselves in their homes precisely because of the low mortgage rates they have secured.

This is much of the reason that the Federal Reserve's rate hikes have not dented consumer spending as much as anticipated although it is true that consumer savings and spending have slowed from the heady stimulus check days.

The persistence in spending is contributing to inflation levels that are only slowly cooling. The net result is that the Fed needs to further turn the screws and boost interest rates or hold them higher for longer. This crimps business investment, which has longer lasting impacts on U.S. output and research and development.

Thus, with employment still strong and many households enjoying fixed mortgage rates, the Fed's higher-for-longer narrative is in play. Indeed, unemployment rates stayed almost identical from July to August for the nation (3.9%), state (3.5%), and our regional economy (3.8%). With the simple demographic headwinds and the child care shortages, I've talked about previously, I've kept my unemployment rate forecast in our monthly reports at 3.6% for this year and have lowered it to 4.2% for 2024, down from my previous forecast of 4.4%.

A good employment barometer is that the manufacturing sector has been in recession (contraction territory) for many months and yet, the employment index has not come down as much as you would think and even increased by 4.1 points in August (over July levels). Contraction values are below 50 and the manufacturing (sub) index for employment is at 48.5. Employers in this sector report that they are using attrition to manage employment alongside declines in revenue as opposed to layoffs. And this is for an industry that's been in overall contraction territory for 10 months. Skilled workers are too precious to let go.

Locally, we are seeing something similar. The ratio of workers per job openings in Colorado Springs increased again in August to 0.67 from 0.59 in July, due more so to fewer job openings (-2,500) than to more unemployed people (-130). I am not sure that we can say that job openings are on a slide, however. U.S. job openings for August ticked up again to 9.6 million openings, up about 700,000 from July levels and still well above pre-pandemic levels.

Switching to housing, I'd like to point out that we have recalculated the healthy number of permits for our region mostly using the methodology from a Common Sense Institute analysis, our previous calculations and input from the State Demography Office. This new analysis shows that between 2023 and 2028, our region needs to produce 8,500 new dwelling units per year, which includes both single and multifamily dwellings.

This calculation incorporates housing needs for new population that moves here as well as an existing housing shortage. As our report shows, there were 8,697 permits issued in 2022, which was helpful. However, with interest rates as high as they are, it's not surprising that through August 2023, there have only been permits issued for 3,978 dwelling units. Building also slows toward the end of the year, so our region will definitely fall short of the healthy number of permits in 2023.

Speaking of a slowdown in building, we had a decline in sales and use tax in August largely due to declines in building materials. We recently did an analysis on local sales and use tax that I covered in a Gazette article, which can be found on the Data-Driven Economic Strategies website. The analysis shows how inflation and pandemic-related savings skewed sales and use tax and how the picture looks if we back out the inflationary impacts.

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