US economy to expand, but at a slower pace, reaching about 2% growth in 2020: economics

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The U.S. economy will continue to expand for a 12th consecutive year in 2020, but by only about 2 percent and struggling to remain at that level by year's end. Indiana's economic output will be more anemic, growing at a rate of about 1.25 percent, according to a forecast released today by the Indiana University Kelley School of Business.

Over the past year, political dysfunction and international trade friction have disrupted supply chains and eroded both consumer and business confidence. U.S. employment has grown during 2019 but will decelerate throughout 2020, well short of 150,000 jobs per month and possibly to about 100,000 by year's end. A tight labor market will continue to be an issue for many companies.

"The total number of job openings in the economy peaked in late 2018," said Bill Witte, associate professor emeritus of economics at IU. "Average hours worked have been flat over the past year, and auto sales have been flat for nearly two years. Given the reliance of the U.S. economy on consumer spending, these are disturbing signs. But they are vague signs, and not enough to convince us that the end of the expansion is in sight.

"We expect that growth will be weaker than in the past two years, and this outlook is likely a best-case outcome," he added. "There is massive uncertainty in the current situation."

The Kelley School presented its forecast this morning to Indianapolis community and business leaders at IUPUI. The Business Outlook Tour panel also will present national, state and local economic forecasts in seven other cities across the state through Nov. 20.

Indiana's more meager economic growth expected in 2020 can largely be attributed to the outsized presence of manufacturing and particularly tight labor markets, said Ryan Brewer, associate professor of finance at Indiana University-Purdue University Columbus and author of the panel's Indiana forecast. Manufacturing contracts more rapidly versus other areas of the economy, and tight labor markets limit employers' capacity to grow, he said.

Expectations about business investment have fallen short, and corporations have been buying back stock instead of making capital investments. The trade war with China and slowing global expansion have also affected state manufacturers.

The world is about to record its slowest economic growth since the financial crisis of 2009. Next year, global growth is projected at 3.4 percent, with downside risks continuing to build. China and the European Union each face structural issues amid tariffs imposed by the United States. Brexit remains unresolved.

Recent data from the Institute for Supply Management showed that manufacturing activity has slowed to its lowest rate since the beginning of the Great Recession. Indiana has sought to diversify its economy in recent decades, but manufacturing output represents nearly 28 percent of gross state product. Indiana continues to lead the nation in manufacturing employment, with more than 17 percent of its jobs in that sector.

"Constrained by a historically tight labor market, Indiana is expected to experience slow growth in jobs and gross output, along with the possibility for continued rising wages," Brewer said. "With fewer and fewer available people to hire, tightness of the Indiana labor markets will serve as a drag to output and employment growth."

The outlook for the Indianapolis-Carmel-Anderson metropolitan statistical area is slightly better, with expected growth between 1.5 and 2 percent.

"Indianapolis continues to draw in talent and investment that should help it exceed the overall state level of growth," said Kyle Anderson, clinical assistant professor of business economics. "However, there is risk that weakness in the broader economy, and especially weakness in manufacturing, could make this forecast too optimistic."

Other highlights from the forecast:

- The national and state unemployment rates will hold steady. The nation's rate could be below 4 percent by year's end, and the state will stay at or below full employment through 2020.
- Inflation will rise and end 2020 close to the Federal Reserve's 2 percent target.
- The stock market will struggle to get average returns with headwinds from trade, supply chain disruption and policy uncertainty.Earnings continue to exceed expectations, yet lack of definitive trade consensus continues to drive headwinds.
- Interest rates will remain low. The 10-year Treasury rate should stay below 2 percent and mortgages below 4 percent.Speculative grade bond yields have been rising, indicating increased risk of insolvency for marginal firms.
- Entry-level wage growth could cause costs to rise, earnings to fall and growth to stagnate for firms heading into 2020.Energy prices will be relatively stable, with average prices similar to those in 2019.
- Business investment will remain weak, although a little improved from this year. Housing will achieve a meager increase, ending two years of negative growth. Government spending will grow, but much more slowly than the past year, as the impact of the 2018 budget deal ends.

The starting point for the forecast is an econometric model of the United States, developed by IU's Center for Econometric Model Research, which analyzes numerous statistics to develop a national forecast for the coming year. A similar econometric model of Indiana provides a corresponding forecast for the state economy based on the national forecast plus data specific to Indiana. A select panel of Kelley faculty members, led by Indiana Business Research Center co-director Timothy Slaper, then adjusts the forecast to reflect additional insights it has on the economic situation.

A detailed report on the outlook for 2020 will be published in the winter issue of the Indiana Business Review, available online in December. In addition to predictions about the nation, state and Indianapolis, it also will include forecasts for other Indiana cities and key economic sectors.

Provided by Indiana University