DRAGAS CENTER FOR ECONOMIC ANALYSIS AND POLICY

Contact Dr. Robert M. McNab
Telephone 757 683 3153
Email rmcnab@odu.edu
Website www.ceapodu.com

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2019 NATIONAL AND COMMONWEALTH FORECAST

U.S. and Virginia Economic Growth Projected to Slow in 2019

Norfolk, VA, January 30, 2019 – The Economic Forecasting Project of the Dragas Center for Economic Analysis and Policy projects that the U.S. economy will slow in 2019 due to uncertainty surrounding the operations of the federal government, slowing global economic growth, volatility in equities markets, and declining consumer expectations. The Commonwealth of Virginia will see a moderation of economic growth in 2019 relative to 2018, primarily due to the lingering impacts of the partial government shutdown, the end of the Bipartisan Budget Agreement of 2018 (BBA 2018), and policy uncertainty regarding the operations of the federal government.

Due to the partial government shutdown, 4th quarter data for U.S. Gross Domestic Product (GDP) is not available, however, we estimate that real (inflation-adjusted) GDP grew at an annual rate of 3.0 percent in 2018. The current economic expansion is in its 114th month and there is a distinct possibility that this expansion will become the longest on record. The most recent earnings season suggests that consumer demand remains strong and that the U.S. economy is positioned for continued growth in 2019.

We are increasingly concerned, however, that the policies and practices of the federal government may result in a slowdown or outright contraction in national economic activity. The partial government shutdown is one example of how political conflict can dramatically affect the lives of federal employees and those that provide goods and services to the federal government. The increasing impact of trade conflicts has slowed economic growth in China and harmed U.S. agricultural exporters. The end of fiscal stimulus and the quantitative tightening of the Federal Reserve may also increase the headwinds against economic growth in 2019.

We forecast that U.S. real GDP will increase at an annual rate of 2.5% in 2019. Virginia's real GDP will increase at a slightly higher pace, largely due to increases in federal discretionary spending. We forecast Virginia real GDP will increase at an annual rate of 2.6% in 2019.

Labor market conditions continue to improve in the United States and Virginia. The U.S. has added over 20.4 million jobs since the trough of the Great Recession in February 2010. Virginia has added almost 436,000 jobs over the same period. There are now 8.6% and 6.4% more jobs in the U.S. and Virginia, respectively, then there were prior to the Great Recession. The number of unemployed individuals per job opening fell to 0.87 in November 2018 for the U.S., signaling the challenge facing employers to fill open positions. Voluntary job quits remain at or near historical highs.

Unemployment rates continue to fall in the United States and Virginia, though the gap has narrowed since 2010. In December 2018, the U.S. employment rate rose slightly to 3.9% as more individuals re-entered the labor force. In December 2018, the Virginia unemployment rate declined to 2.8%. Both the U.S. and Virginia economies are at or below what is typically considered full employment. Overall, the labor market in the U.S. reflects the increasing competition for scarce workers. Job quits continued to increase in 2018 as workers sought out improved wages and salaries.

We forecast that the unemployment rate in the U.S. and Virginia will continue to decline in 2019. U.S. unemployment is projected to be 3.7% at the end of 2019 while Virginia's unemployment rate is forecast to be 2.7%. We project modest growth in civilian jobs in 2019. U.S. job growth is projected to average 1.2% while Virginia's job growth is forecast to average 1.5%.

We also project that the federal government will have $1 trillion annual deficit in Fiscal Year (FY) 2019 and continued $1 trillion annual deficits for the foreseeable future.

The Tax Cuts and Jobs Act of 2017 appears to have altered the growth of personal and corporate tax revenues. In the 2018 calendar, individual tax receipts totaled approximately $2.6 trillion. If one accounts for inflation, individual tax receipts declined by 0.5 percent. Corporate tax receipts were lower in nominal and inflation-adjusted terms. Corporate tax receipts were $233 billion in 2018, down from $316 billion in 2017, a decline of 26 percent. If we account for inflation, corporate tax receipts declined by approximately 28 percent. Coupled with increasing expenditures, the fiscal position of the federal government is deteriorating in the midst of an economic expansion.

Second, equities markets remain volatile and price-to-earnings ratios remain (even with the declines in November and December of 2018) above historical averages. Slowing global growth and a loss of confidence in the federal government could spark a much more significant correction in equities prices.

Third, while inflationary pressures have moderated, the Federal Reserve lacks monetary policy space relative to prior to the Great Recession. The Federal Reserve continues to unwind its balance sheet and has raised the target of the Federal Funds Rate. Slowing growth would create pressure for the Federal Reserve to lower interest rates. Household debt continues to climb, which exceeded $13 trillion in the third quarter of 2018. Households are more indebted than prior to the Great Recession and, with a majority of households living paycheck to paycheck, are less able to weather economic or political turbulence.

Fourth, the federal government and many states have significantly less fiscal space than prior to the Great Recession. U.S. federal debt exceeds $21 trillion. Virginia is an exception. The Commonwealth has wisely increased its Revenue Stabilization Fund and we believe it would be prudent to place a significant amount of any windfall in this fund to prepare for the next economic downturn. A prolonged increase in expenditures or a decrease in state taxes would be imprudent given that federal tax policy can change significantly over the coming decade.

Lastly, political shocks have grown increasingly frequent over the last five years. The federal government appears unable to pass appropriations bills in a timely manner, increasing uncertainty and hampering growth in Virginia. The partial shutdown will slow 1st quarter economic growth in 2019 and further gridlock would likely undermine business and consumer confidence. Virginia is especially vulnerable to these shocks given its relatively large dependence on federal spending.

With these factors in mind, we project the risk of an economic correction is now a distinct possibility, with a one-in-three chance of a contraction in the fourth quarter of 2019. We caution that the current political and fiscal environment makes forecasting quite difficult and there is a significant degree of uncertainty with regards to our 2019. At this time, we assign a higher likelihood of the economy slowing in 2019 than continuing at the same pace of growth observed in 2018.

Actuals and Forecasts

	2017 Actual	2018 Forecast (May)	2018 Actual*	2019 Forecast
U.S. Real Gross Domestic Product	2.3%	3.1%	3.0%	2.5%
Civilian Job Growth	1.2%	1.2%	1.6%	1.2%
Unemployment Rate	4.1%	3.6%	3.9%	3.7%
Consumer Price Index	2.2%	3.0%	2.4%	2.7%
Core Consumer Price Index	1.7%	2.3%	2.1%	2.3%
3-month Treasury Bill	1.4%	2.1%	2.4%	2.5%
10-year Treasury Bill	2.4%	3.3%	2.8%	3.0%
30-year Treasury Bill	2.8%	3.6%	3.1%	3.6%
30-year Conventional Mortgage	4.0%	5.0%	4.6%	4.8%
Federal Deficit	-$666 Billion	-$825 Billion	-$793 Billion	-$998 Billion
Virginia Real GDP*	2.0%	2.7%	2.6%	2.6%
Virginia Employment Growth	1.4%	1.5%	1.9%	1.5%

*2018 actuals may contain actual annual data or estimated annual data due to the partial government shutdown.

The Dragas Center for Economic Analysis and Policy in the Strome College of Business at Old Dominion University undertakes a wide range of economic, demographic, transportation and defense-oriented studies. If you would like more information about this topic, please contact Dr. Robert M. McNab at 757 683 3153 or email at rmcnab@odu.edu.