Economic Forecast 2019: Good, But Not as Good as 2018

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Despite increasing political uncertainty, a split Congress, trade concerns, financial-market volatility, and slowing global growth, from an economic perspective, the next 12 months should be decent. The odds of a recession have roughly doubled but remain relatively low – about 25% -- despite being just a few months away from the longest economic recovery in US history. While growth is slowing in all major economies, inflationary pressures are surprisingly tepid. As a result, the Fed will have the luxury of raising rates at a very leisurely pace, and thus hopefully avoid prematurely ending the continuing, albeit slowing, expansion that we will experience in 2019.

A major reason for the slowdown is the fading of fiscal stimulus from tax cuts passed in December 2017 and debt-financed spending increases totaling $400 billion passed in February 2018. Collectively, this should clip GDP by close to half a point. Add to that global slowing, trade concerns, a strengthening dollar, Brexit fears, and other threats -- and GDP growth during the next 12 months should average 2.3%, down from 3.0% in 2018.

Despite slowing growth, unemployment will continue declining from the current rate of 3.7% to 3.5% and maybe as low as 3.4%, rates not seen in more than 50 years! As the labor market tightens, wage growth should increase in 2019, from 3%/year last year to 3.3%/year and maybe 3.5%/year by year end 2019, a healthy rise. Inflation, as measured by the PCE, the Fed's favorite measure, looks to flatline at 2% in 2019, while core inflation (which excludes food and energy) will edge up slightly from 1.9% to 2.1% due to rising wages.

Because of the very slow rise in core inflation, the Federal Reserve will raise the federal funds rate from 2.375%, where it is now, to at most 2.875% by year's end, with a quarter-point rate increase in June and possibly another one in December. 10-year Treasuries will end 2018 at 3.35%, up from the current 2.8%, and the rate on 30-year mortgages will end 2019 no higher than 5.1%.

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As for housing starts, the combination of high land costs, rising worker wages and input costs, and the reduced benefits of homeownership resulting from last year's tax reform should see them increase by no more than 2% to 1.28 million. Single-family starts will likely total 900,000, up from 883,000, while multifamily starts should flatline at about 380,000.

New and existing home sales should both remain largely unchanged in 2019 and end the year at 620,000 and 5.3 million respectively, with mortgage purchase volume rising by $50 billion due to higher prices. Refinance activity should fall by about $60 billion because of the rise in mortgage rates. Housing inventories will rise slightly, but due to the combination of continued strong household formation and insufficient new home building, home prices will still rise by 4%, less than last year.

In summary, growth in 2019 looks to be slower than what we became accustomed to in 2018. This is attributed to slowing global growth, increasing trade concerns, a growing worker shortage, higher interest rates, and substantially less fiscal stimulus coming from Washington. Although the Fed may raise rates as much as two times next year, strong consumer spending combined with continued employment growth and rising wage growth should keep the economy on track. The chances of a recession, while meaningfully higher than in 2018, remain relatively low.

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