



the tampa bay economy

IS THE U.S. ECONOMY APPROACHING A CYCLICAL PEAK?

By Vivekanand Jayakumar, Ph.D.

The current U.S. expansionary cycle is poised to become the longest expansion in American history (the business cycle chronology maintained by National Bureau of Economic Research (NBER) starts in 1854). In longevity, the current expansion has already passed the 1960s' expansion cycle and will soon overtake the current record holder—the 1990s' expansion cycle (which lasted for 120 months, from March 1991 to March 2001). After years of underwhelming economic performance, GDP growth rate perked up in 2018 largely due to two factors—a synchronized uptick in the global economy (that began in 2017) and the large-scale U.S. fiscal stimulus (the Tax Cuts and Jobs Act of 2017 (TCJA) and Bipartisan Budget Act (BBA) that were signed into law on December 22, 2017 and February 9, 2018, respectively). Looking ahead, the cooling global economy and fading fiscal tailwinds are likely to lead to a moderation in U.S. economic growth during 2019.

Recent turmoil in the financial markets and gathering economic headwinds appear to have convinced the U.S. Federal Reserve (Fed) to forego further interest rate hikes (in fact, the futures market now indicates a rate cut as the likely next move). Following a sharp deterioration in

Euro Area growth prospects in recent months, the European Central Bank (ECB) made a policy U-turn at its March 2019 meeting and committed to keeping policy rates at current levels at least through the end of 2019 (initially, ECB had planned to begin policy tightening in the second half of 2019). Bank of Japan (BOJ), likewise, has shown limited appetite for ending its accommodative monetary stance. It has gradually dawned on market observers that

“Long-term structural forces (aging population, low productivity, and the slowdown in the pace of globalization) have begun to reassert themselves, and subpar growth rates observed through much of the post-crisis era will likely return.”

the 2017-18 synchronized global economic recovery provided only a brief respite from the so-called ‘new normal’. Long-term structural forces (aging population, low productivity, and the slowdown in the pace of globalization) have begun to reassert themselves, and subpar growth rates observed

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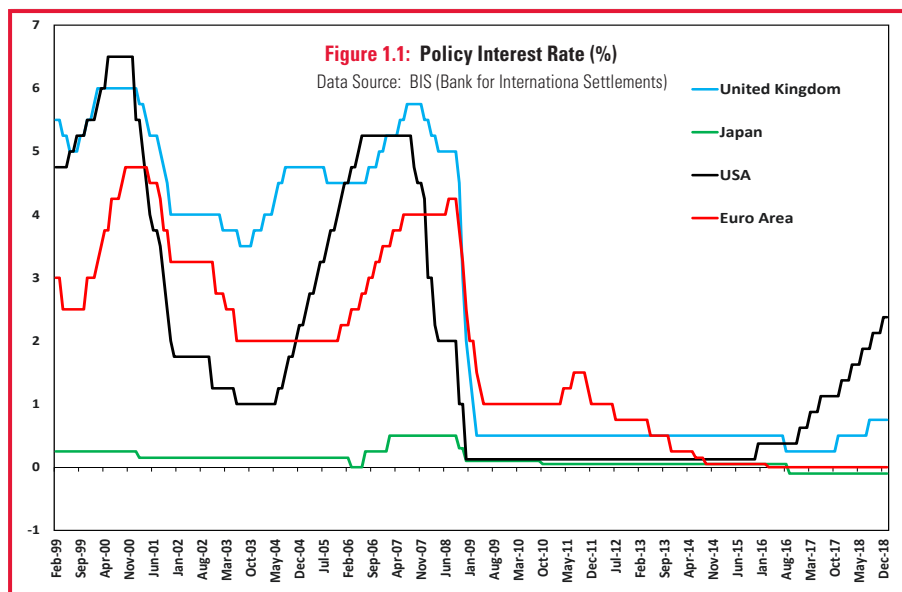
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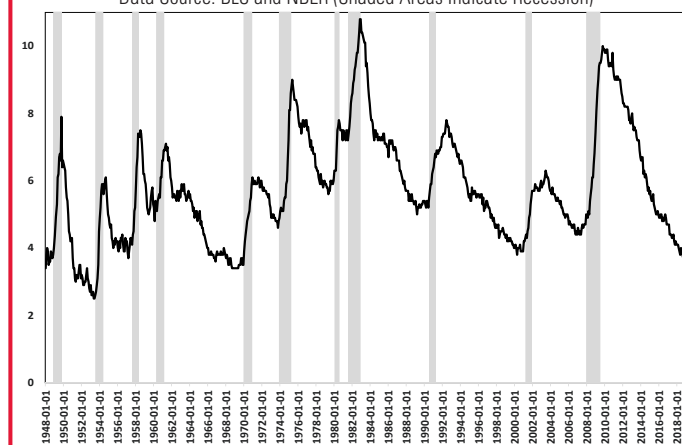
through much of the post-crisis era will likely return. Interestingly, a decade after the end of the global financial crisis, the world's leading central banks are still finding it hard to fully normalize monetary policy. Figure 1.1 shows that policy rates are still well below pre-crisis levels.

The recent shift in the global monetary stance towards the accommodative end of the spectrum is likely to provide some short-term relief to financial markets. Even as fears of an imminent slowdown are somewhat allayed, there are growing signs that the U.S. business cycle is nearing its cyclical peak (Note: An expansionary cycle begins at the trough of a business cycle and ends at the peak, whereas, a recession/contraction starts at the peak of a business cycle and ends at the trough.) Business cycles represent the ebb and flow of modern capitalist economies, and intermittent slowdowns in economic activity may in fact be healthy over the long run as it allows for an unwinding of some of the excesses that invariably are built up during the boom phases of the economic cycle. A popular

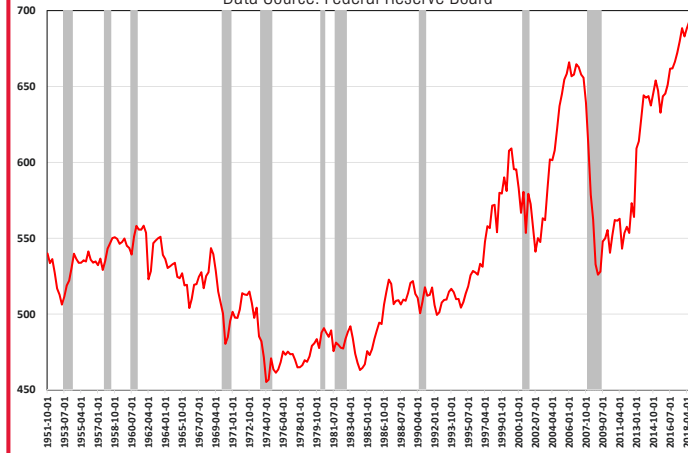
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Figure 1.2: U.S. Unemployment Rate (%)

Data Source: BLS and NBER (Shaded Areas Indicate Recession)

**Figure 1.3: U.S. Household Net Worth (% of Disposable Income)**

Data Source: Federal Reserve Board



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technical characterization of a contraction/recession as at least two consecutive quarters of negative gross domestic product (GDP) does not conform to the official definition of a recession in the U.S. The NBER, the arbiter of business cycle turning points in the U.S., defines a recession as “a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales.”

Table 1.1 highlights the key business cycle turning points for the U.S. economy in the post-WW II era. On average, post-WW II recessions have lasted for 10.83 months whereas expansions have lasted for 58.36 months (not counting the current expansion). As the current expansion nears the longevity record, the consensus view

is that a recession is not imminent. In fact, the strong labor market, the resilient equity market, the strength of household balance sheets, relatively high levels of consumer and business confidence, and subdued inflationary pressures may suggest that a turning point in the business cycle is some ways off. A careful examination of historical data and trends, however, indicates that the peak of the current expansionary cycle may be nearer than many assume.

Figure 1.2 demonstrates the fact that the unemployment rate is typically near its cyclical low as the economy approaches the peak of an expansionary cycle. Usually, the unemployment rate undergoes a noticeable deterioration only after the recession is well underway (it is economic weakness that causes a spike in unemployment rate). In economic parlance, the unemployment rate is a classic lagging indicator—given the non-negligible costs

associated with hiring and firing workers, firms wait until signs of a slowdown are clearly evident before laying off workers (hence, the delayed rise in unemployment rates following the technical start of a recession), and, they typically wait for a recovery to become entrenched before hiring/rehiring workers (hence, the delayed decline in unemployment rates following the technical end of a recession).

The stock market is often touted as a leading business cycle indicator. In theory, stock prices are supposed to reflect the present discounted value of expected stream of future earnings (profits). Anticipation of an economic slowdown would therefore adversely affect prospects for future earnings and profits, and consequently lead to a drop in current share values. Table 1.2 indicates the major bull and bear market cycles based on the performance of the S&P 500 index (prior to 1957, data refers to the S&P 90 index). A bear market is typically defined as a 20% or greater drop in the equity index. Historically, stock markets have had a mixed record at forecasting future business cycle turning points. Of the 13 bear markets since the end of World War II, five did not coincide with a recession (bear markets that coincided with a recession are highlighted in red and those that did not coincide with a recession are highlighted in green in Table 1.2). Whether or not the current bull market, already one of the longest on record, peaked in September 2018 is yet to be determined.

Household consumption accounts for more than two-thirds of U.S. aggregate spending. Since the Great Recession, household balance sheets have improved. In particular, household net worth has risen dramatically (see Figure 1.3). Since 1991, household net worth (as a percentage of disposable income) has exhibited significant fluctuations due mostly to swings in real estate and equity values. The 1990s saw the dot-com bubble, the 2000s saw the housing bubble, and the on-going post-crisis spike appears to be driven primarily by a surge in equity prices along with a modest recovery in

Table 1.1: Post-WW II US Business Cycle Turning Points (Data Source: NBER)

RECESSIONS		
Start Date	End Date	Duration
February 1945	October 1945	8 months
November 1948	October 1949	11 months
July 1953	May 1954	10 months
August 1957	April 1958	8 months
April 1960	February 1961	10 months
December 1969	November 1970	11 months
November 1973	March 1975	16 months
January 1980	July 1980	6 months
July 1981	November 1982	16 months
July 1990	March 1991	8 months
March 2001	November 2001	8 months
December 2007	June 2009	18 months
Average		10.83 months
EXPANSIONS		
Start Date	End Date	Duration
October 1945	October 1948	37 months
October 1949	June 1953	45 months
May 1954	July 1957	39 months
April 1958	March 1960	24 months
February 1961	November 1969	106 months
November 1970	October 1973	36 months
March 1975	December 1979	58 months
July 1980	June 1981	12 months
November 1982	June 1990	92 months
March 1991	February 2001	120 months
November 2001	November 2007	73 months
June 2009	?	?
Average (not including current expansion)		58.36 months

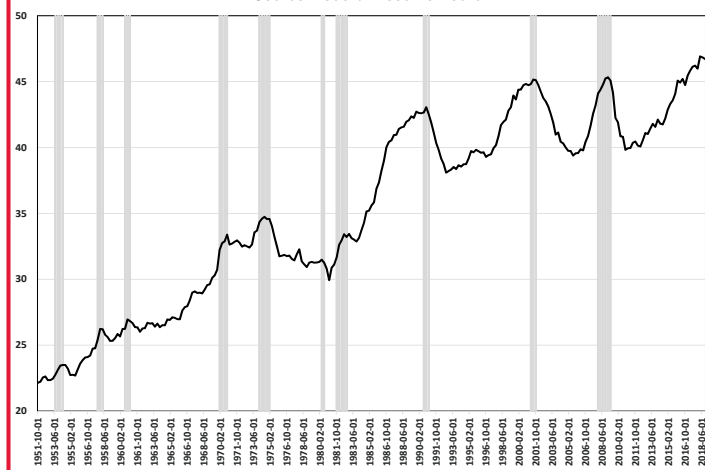
Table 1.2: S&P 500 Post-WWII Bull and Bear Markets

(Data Source: Charles Schwab and Bespoke Investment Group)

Cycle	Start Date	End Date	% Gain/% Loss
Bear	5/29/1946	5/19/1947	-28.5
Bull	5/19/1947	6/15/1948	23.9
Bear	6/15/1948	6/13/1949	-20.6
Bull	6/13/1949	8/02/1956	266.3
Bear	8/02/1956	10/22/1957	-21.6
Bull	10/22/1957	12/12/1961	86.4
Bear	12/12/1961	6/26/1962	-28.0
Bull	6/26/1962	2/09/1966	79.8
Bear	2/09/1966	10/07/1966	-22.2
Bull	10/07/1966	11/29/1968	48.0
Bear	11/29/1968	5/26/1970	-36.1
Bull	5/26/1970	1/11/1973	73.5
Bear	1/11/1973	10/03/1974	-48.2
Bull	10/03/1974	11/28/1980	125.6
Bear	11/28/1980	8/12/1982	-27.1
Bull	8/12/1982	8/27/1987	228.8
Bear	8/27/1987	12/04/1987	-33.5
Bull	12/04/1987	3/24/2000	582.1
Bear	3/24/2000	9/21/2001	-36.8
Bull	9/21/2001	1/04/2002	21.4
Bear	1/04/2002	7/23/2002	-32.0
Bull	7/23/2002	10/09/2007	96.2
Bear	10/09/2007	11/20/2008	-51.9
Bull	11/20/2008	1/06/2009	24.2
Bear	1/06/2009	3/09/2009	-27.6
Bull	3/09/2009	9/20/2018 (Recent Peak)	333.2

Figure 1.4: Non-Financial Corporate Debt (% of GDP)

Source: Federal Reserve Board



home prices. Ominously, the prior two peaks in the household net worth to disposable income ratio ended with the bursting of asset bubbles and recessions. The last quarter of 2018 saw a sharp pull back in net worth as stock prices took a year-end tumble.

While the decade-long equity market rally has significantly boosted household net worth, there are a couple of controversies surrounding the current bull market. First, there is some debate as to whether the benefits of the current equity bull market have been widely shared—research by New York University economist Edward Wolff suggests that while about half of U.S. households own stocks, the wealthiest 10% controlled around 84% of the total stock value in 2016. Second, a distinctive feature of the current equity bull market is the relative significance of stock buybacks. For instance, the total value of share repurchases undertaken by S&P 500 companies reached around \$800 billion in 2018 (total value of announced stock buybacks in 2018 exceeded \$1.1 trillion—a record). A recent Citigroup report noted that stock buybacks topped capital expenditure in 2018. Unsurprisingly, a debate has ensued regarding the efficacy of large-scale stock buybacks. Regardless of the controversies surrounding the equity bull market,

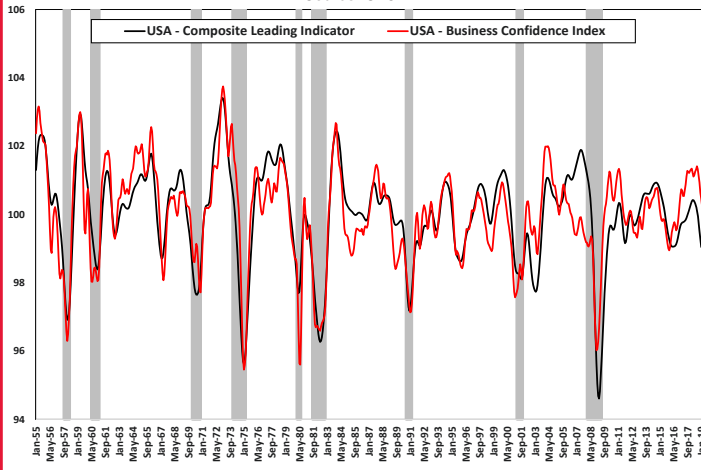
a sharp correction in stock prices will inevitably lower consumer and business confidence.

Going forward, it appears that the forces that drove equity prices sharply higher in 2017-18 are starting to dissipate. Favorable one-off changes arising from the passage of TCJA 2017, such as the jump in capital repatriation and the year-over-year increase (base effect) in after-tax profits, will be hard to replicate going forward. A recent report from the Blackrock Investment Institute (Bovins, Jean, et al. (2019), "Profit Margins Under Pressure," Macro and Market Perspectives—March) noted: "US profit margins don't look as strong as commonly thought once secular uptrends and favourable tax treatments are taken into account. And even the secular rise in profit margins does not have an entirely favourable interpretation—a lack of competition and concentration of market power appear to play an important role." The report goes on to suggest that a late-cycle squeeze on profit margins in conjunction with a slowing economy may result in an earnings recession in 2019.

While the above discussion suggests that household net worth to disposable income ratio may be nearing a peak, there is limited scope for a 2008-09 style asset market crash. On the liability front, households are less leveraged

Figure 1.5: Business Cycle Indicators-Amplitude Adjusted (Long-Term Average = 100)

Source: OECD

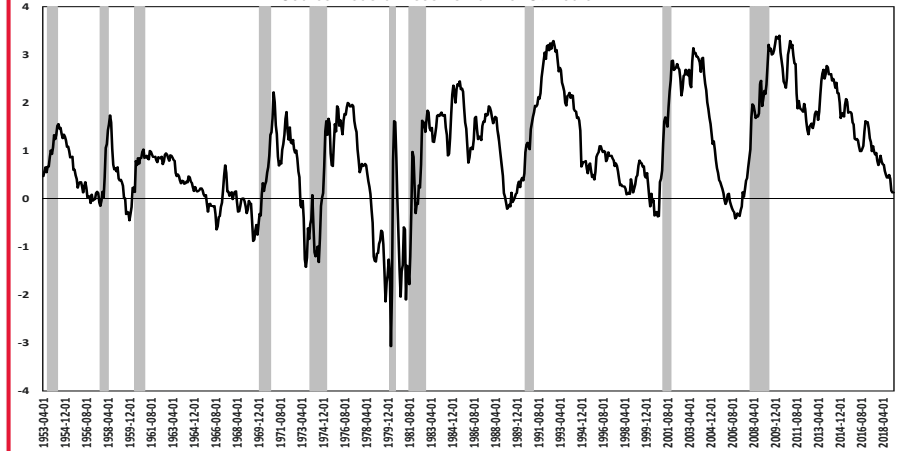


than in previous cycle (there are, however, a few pockets of stress: auto loan delinquencies and student loan delinquencies have shown a spike in recent months). The financial sector balance sheet is healthier and less concerning than in 2007-08. Of greater concern is the extraordinary increase in U.S. non-financial corporate debt (which primarily consists of bonds and loans). Figure 1.4 indicates that the non-financial corporate debt to GDP ratio is currently higher than it was in 2008. The lead up to the 2007-09 financial crisis saw a surge in mortgage backed securities and other asset backed securities. This time around there has been a dramatic increase (\$600 billion at the end of 2008 to \$1.2 trillion at the end of 2018) in syndicated leveraged loans to the corporate sector. In a recent essay ("Corporate Debt as a Potential Amplifier in a Slowdown," March 5, 2019), Rob Kaplan, president of the Federal Reserve Bank of Dallas, noted the growing popularity of Collateralized Loan Obligations (CLOs), which are specialized "investment vehicles that buy pools of floating-rate leveraged loans from banks." Kaplan highlighted their ability to "turn lower-credit-quality loans into mostly investment-grade-rated bonds via securitization." Over-leveraged non-financial corporations will pose a threat to the real economy if credit conditions worsened and liquidity suddenly dried up.

The analysis so far suggests the possibility that the American economy may be nearing a cyclical peak. Additional evidence can be obtained by considering a few forward-looking indicators. Figure 1.5 indicates the OECD's Composite Leading Indicators (CLI) and the Business Confidence Index (BCI) for the U.S. economy. The CLI measure is designed to provide early signals of business cycle turning points. Of late, both CLI and BCI have trended lower. Whether this is a temporary aberration, or the beginning of a more sustained decline is yet to be determined. From a bond market perspective, the flattening and ultimate inversion of the yield curve (Figure 1.6) has been a persistently good

*continued on page 6***Figure 1.6: Yield Curve Spread (10 Year T-Note Yield - 1 Year T-Bill Yield)**

Source: Federal Reserve Bank of St. Louis



TAMPA BAY FORECAST: SIGNS OF SLOWING GROWTH

By John R. Stinespring, Ph.D.

Recent economic data suggest a growth slowdown may be occurring in the Tampa Bay economy (TBE). While growth is expected to remain positive for the foreseeable future, signs of its moderation have appeared in the local labor, consumer, and housing markets. In this update, we review several economic indicators from the Tampa Bay metropolitan area (consisting of Hernando, Hillsborough, Pasco, and Pinellas counties combined) to compare economic activity since the end of the previous recession to the start of 2019. Whereas the local economy had experienced stable upward trends that had outpaced the national trends, growth in the Tampa Bay economy appears to be plateauing.

This change is most prevalent in labor markets. Figure 2.1 shows a recent plateau in unemployment's historically long decrease that began in December 2009 and continued through September 2018, when unemployment dipped

to 2.9% for the TBE. In the last quarter of 2018, unemployment rose from this 2.9% low up to 3.6%. This rise moves the TBE closer to the national unemployment rate that stabilized near 4.0% over the last quarter and above the Florida average—a rarity in the data—of 3.4% in January. Though the TBE unemployment rate is below its pre-Great Recession historic average of 4.7%, it is well above its historic low of 2.8% recorded in June 1999. This is seen in the U.S. rate, as well, which is below its 1990-2007 average of 4.7% and above its 3.7% low, and currently hovering near 4%.

The increase then plateau in unemployment is mirrored by a decrease then plateauing in payroll growth as shown in Figure 2.2. The plot of monthly job growth shows an upward trend of 0.4% from the last quarter of 2010 to mid-2016, and then its mirror image of negative 0.4% until 2018, with a plateauing thereafter. These results are made clear after netting out the September 2017 and 2018 spikes caused by Hurricane Irma. Though TBE payroll growth had

been substantially above the national average over this period, data for January 2019 show 1.6% growth for the TBE compared to 1.9% for the U.S.

The trend reversal and plateauing of job growth and unemployment are reflected in average wages. Figure 2.3 shows inflation-adjusted weekly earnings growth (left axis) to have declined significantly in the last quarter of 2018, a change from their upward trend from 2012 to mid-2016. TBE seasonally-adjusted monthly wages (right axis) leveled out near \$940 over the April 2018 to May 2018 period and then declined precipitously to \$906 in January 2019.

The slowing growth rate may be apparent in gross sales, which serves as a proxy for the aggregate demand in our local economy. Figure 2.4 shows that gross sales trend up with local expansions amid seasonal spikes in December, March, June, and September. The red dotted forecast plot shows where gross sales would be through June 2019 if they followed the trend that began in June 2009. The actual series

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Figure 2.1: Unemployment Rate (%) for U.S. and Tampa Bay MSA, December 2009–Jan 2019

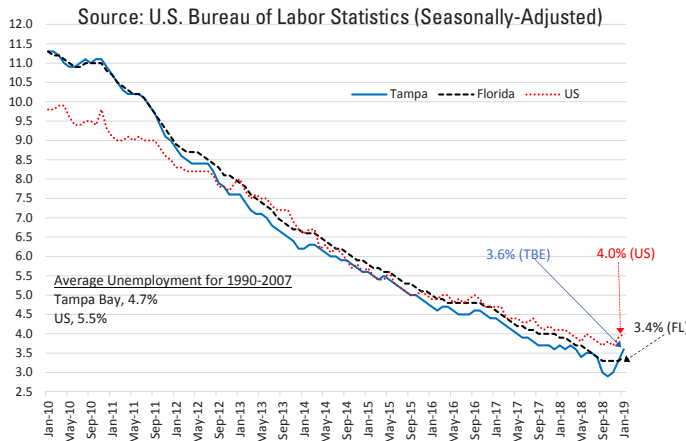


Figure 2.3: Actual and Percentage Change (Y-Y) in Monthly Real Earnings: June 2012–January 2019

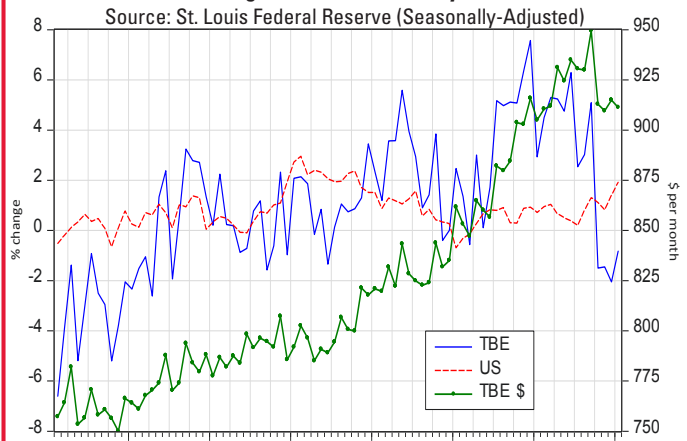


Figure 2.2: Percentage Change in Monthly Nonfarm Payrolls, 2010–2019

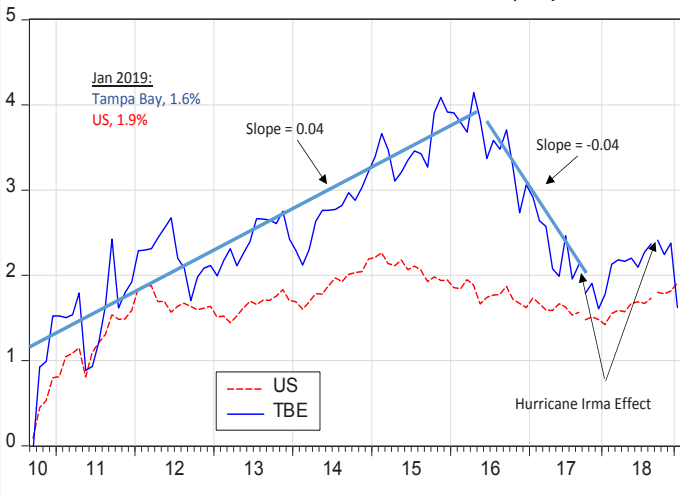
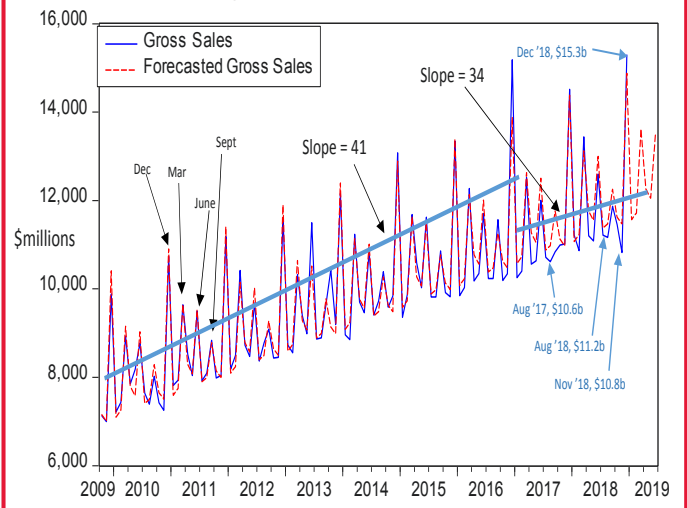


Figure 2.4: Gross Sales in Tampa Bay, June 2009–December 2018



Tampa Bay Forecast: Signs of Slowing Growth

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appears below the forecast for most months indicating the growth in gross sales began to slow after mid-2016. This is apparent from the trend (computed by removing the seasonal effects from the data) that shows gross sales flattens from a previous \$41 million increase per month to \$34 million after June 2106.

Perhaps the most watched business cycle signal is housing. Whereas labor market indices are *lagging indicators*—indicating where the economy was in the business cycle—and gross sales is a *coincident indicator*—indicating the economy's current position in the business cycle, housing is a *leading indicator* which suggests where an economy is headed. The TBE's sustained increases in housing construction from mid-2009 to mid-2017 foretold of the economic expansion our local economy has enjoyed. Figure 2.5 shows the increasing upward trend in permits over that period. Like the labor market data, a possible plateauing appears after mid-2017. To see this, the prior trend is extrapolated through mid-2019 in the

plot. While the pre-mid-2017 forecast fits the actual data well, the post-mid-2017 data do not. Actual permits fall well below predicted for many of the forecasted months (see December 2017 and 2018). Though supply remains well below the 2005 monthly average of 2,241, the pace of permitting may have peaked.

"While growth is expected to remain positive for the near term, signs of its moderation have appeared in the local labor, consumer, and housing markets."

This possible plateau in TBE housing supply may be appearing in a slowing of house price appreciation in many ranges. Figure 2.6 shows the Case-Shiller Home Price Index for low-, middle-, and high-tier home prices in the region (note each index = 100 in year 2000). Over the past five years, the price increases have averaged 14% for low-tier, 8% for middle-tier, and 5% for high-tier as illustrated by the slopes of these lines for the period 2013 to the present. After bottoming out

in 2011, TBE home prices rose significantly and persistently. High-tier and middle-tier home prices rose 55 percent and 88 percent, respectively, while low-tier homes have more than doubled in price at 158 percent above their trough. There may still be room to grow as all tiers remain below their 2006 peak prices.

The most expansive view of the TBE's economic performance is given by the index of aggregate economic activity estimated by the Federal Reserve and shown in Figure 2.7 (where values above zero indicate an expanding economy while those below indicate contraction). Over the 105 months of economic expansion in the TBE from January 2010 until the most recent data, September 2018 (the most recent month of data), a clear upward trajectory is evident from January 2010 to November 2015. A clear downward trajectory is visible from December 2015 to September 2017 when Hurricane Irma occurred. Did the growth rate accelerate or plateau from that point forward? Given the plateaus seen in the labor, sales, and housing data, the latter scenario may be likelier.

The economy is giving mixed signals. Our previous report described an economy that was outpacing the national economy. Local growth was accelerating at that time while the national rate moderated. Now the most recent data suggest that our local economy moderated in the last quarter of 2018, as the U.S. had. This is not surprising as our local growth rate is highly correlated to that of the nation. This correlation implies that our local economy is exposed to the economic tensions created at the national level by uncertain trade, immigration, monetary, and other, policies. These policy vicissitudes will help determine whether the recent TBE moderation results in a "Goldilocks" economy, neither growing too fast nor slow, or simply brings the bears home sooner.

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Figure 2.5: New Residential Building Permits in Tampa Bay: 2009–2019

Source: U.S. Department of Housing and Urban Development and author calculations

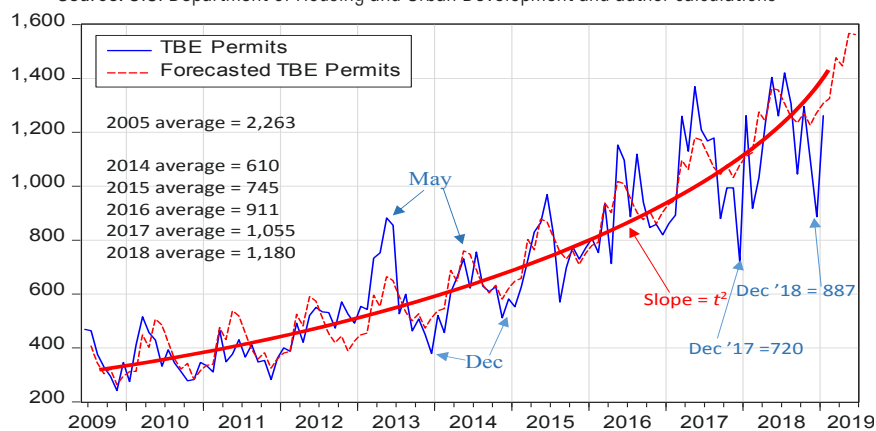


Figure 2.6: Case-Shiller HPI for Tampa MSA (SA) December 2011–December 2018 (Index = 100 in Year 2000)

Source: St. Louis Federal Reserve

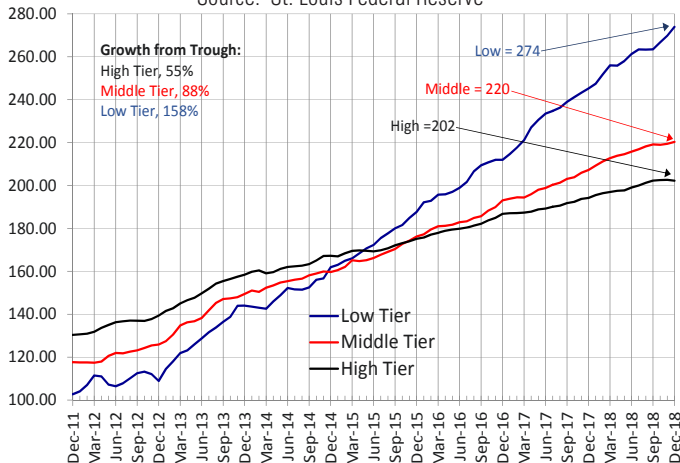
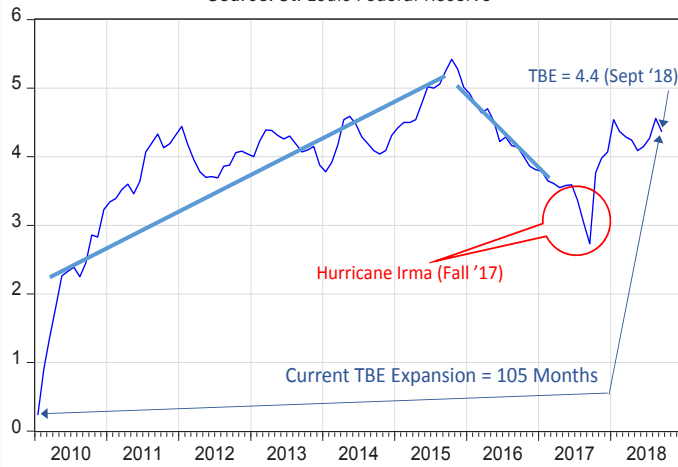


Figure 2.7: Monthly Economic Activity Indices, U.S. and Tampa Bay MSA January 2010–September 2018

Source: St. Louis Federal Reserve



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indicator of economic downturns. The recent inversion of the yield curve does support the notion that the expansionary cycle is nearing its end. Even on the housing front there are some early indicators of an approaching cyclical peak—recent trends in new housing starts, median home prices, and sales of existing homes suggest a cooling housing market.

A broad-based examination of domestic growth prospects suggests that the year ahead will be challenging for both investors and economic prognosticators. The tailwinds that led to strong growth performance in 2018 have already started to dissipate. Factors such as trade wars, Brexit uncertainty, diminished growth prospects in China and the Euro Area, and increased market volatility have contributed to a lowering of expectations. Additionally, some business sector headwinds in the form of high levels of corporate debt and reduced profit margins pose near-to-medium term risks. A potential earnings recession may finally bring an end to one of the longest equity bull markets in U.S. history. On the plus-side, the recent decision by the Fed to delay or abandon further rate hikes is likely to provide some temporary relief. A moderation in growth in 2019 appears

certain but the possibility of an economic soft or hard landing in 2020 depends to a large extent on the ability of policy makers to avoid major policy missteps. In particular, the following three potential policy errors have the ability to disrupt both the U.S. and the global economy: a no-deal Brexit and a fraught separation between the U.K. and the EU, the opening of a new front in the trade war with the possible imposition of tariffs on autos from EU by the Trump administration, and the failure to resolve the U.S.-China trade conflict. Given the inherent late-cycle dynamics, a major policy error will almost certainly push the U.S. economy (and possibly the global economy) into a recession next year.



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