First Trust
Monday Morning OUTLOOK
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Is 2020 the Year for Recession?

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According to former Fed Chair Ben Bernanke, the U.S. economy will get a Wile E Coyote surprise in 2020. You know, just when everyone thinks he caught the Roadrunner, Wile notices he has run straight off a cliff, plummets seemingly forever before hitting the bottom in a cloud of dust, and then, just for spite, an anvil lands on his head.

In other words, Bernanke sees a 2020 recession looming. Other analysts are saying it, too. And whenever they do, they get their name in the headlines. Scaremongering attracts attention.

But there is good news here: The Pouting Pundits of Pessimism don't think the crisis starts tomorrow. No longer does some exogenous crisis event – say, Brexit, or Grexit, student loan defaults, etc., – threaten imminent collapse. Now, the recession doesn't happen for another two years.

Another interesting detail: the new problem is that the economy is growing too fast. Remember when analysts used to say, "since the economy is growing less than 2% annually, it means a recession is coming"? Now, Bernanke says the U.S. applied stimulus (in the form of a tax cut) "at the very wrong moment," with the economy already at full employment. In other words, real GDP growth is too strong, so the Fed will over-tighten and a recession is inevitable.

Now we agree that a recession is coming – someday. Recessions are a fact of life, like death and taxes. But predicting one in 2020 - and being right about it – is like reading tea leaves, it's pure chance. No one, and we mean no one, can honestly see that far in the future – not with the clarity expressed by these dated forecasts.

No one knows exactly what the Fed will do, not even the Fed. Let's say they follow their forecasts, raising fed funds to 3.5% in 2019. That alone doesn't tell us if policy is "tight."

While most recessions are caused by an excessively tight Fed, we don't think the Fed is too tight until it drives the federal funds rate close to, or above, the rate of growth in nominal GDP. Over the past five years, nominal GDP has averaged about 3.9%. Which means if the Fed were to raise the funds rate by 0.25% three more times in 2018 and four times in 2019 (reaching 3.5%), **and** if nominal growth slowed to 3.5%, the Fed would be tight at that point. A recession would be *possible*.

However in the past year, nominal GDP growth has accelerated to 4.7%, and next year it could be as high as 6%. That means a 3.5% federal funds rate would not be restrictive. The Fed would have to raise rates faster and farther than any forecast we have seen in order to be "tight" going into 2020. At the same time, there are still at least $1.9 trillion in excess bank reserves. Until those reserves are eliminated, no one knows if raising rates can actually cause a recession.

We do have one major worry. Government spending is rising rapidly, and the deficits this spending creates will put pressure on politicians. If they were to raise tax rates, this could cause potential problems for U.S. growth.

But the bottom-line remains: the U.S. is not facing an imminent threat. That's why doom and gloomers have shifted to forecasting future recessions, not looming crises. But we think it's not going to be the economy that gets an anvil on its head in 2020. More likely, it'll be investors who believe in the recession forecast.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
6-12 / 7:30 am	CPI – May	+0.2%	**+0.2%**		+0.2%
7:30 am	"Core" CPI – May	+0.2%	**+0.2%**		+0.1%
6-13 / 7:30 am	PPI – May	+0.3%	**+0.3%**		+0.1%
7:30 am	"Core" PPI – May	+0.2%	**+0.2%**		+0.2%
6-14 / 7:30 am	Initial Claims – June 10	224K	**224K**		222K
7:30 am	Retail Sales – May	+0.4%	**+0.6%**		+0.2%
7:30 am	Retail Sales Ex-Auto – May	+0.5%	**+0.5%**		+0.3%
7:30 am	Import Prices – May	+0.5%	**+0.6%**		+0.3%
7:30 am	Export Prices – May	+0.3%	**+0.4%**		+0.6%
9:00 am	Business Inventories – Apr	+0.3%	**+0.3%**		0.0%
6-15 / 7:30 am	Empire State Mfg Survey – Jun	19.0	**19.1**		20.1
8:15 am	Industrial Production – May	+0.2%	**-0.1%**		+0.7%
8:15 am	Capacity Utilization – May	78.1%	**77.9%**		78.0%
9:00 am	U. Mich Consumer Sentiment- Jun	98.5	**98.5**		98.0

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.