

The U.S. Economic and Small Business Outlook

Spring 2019

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Economic update

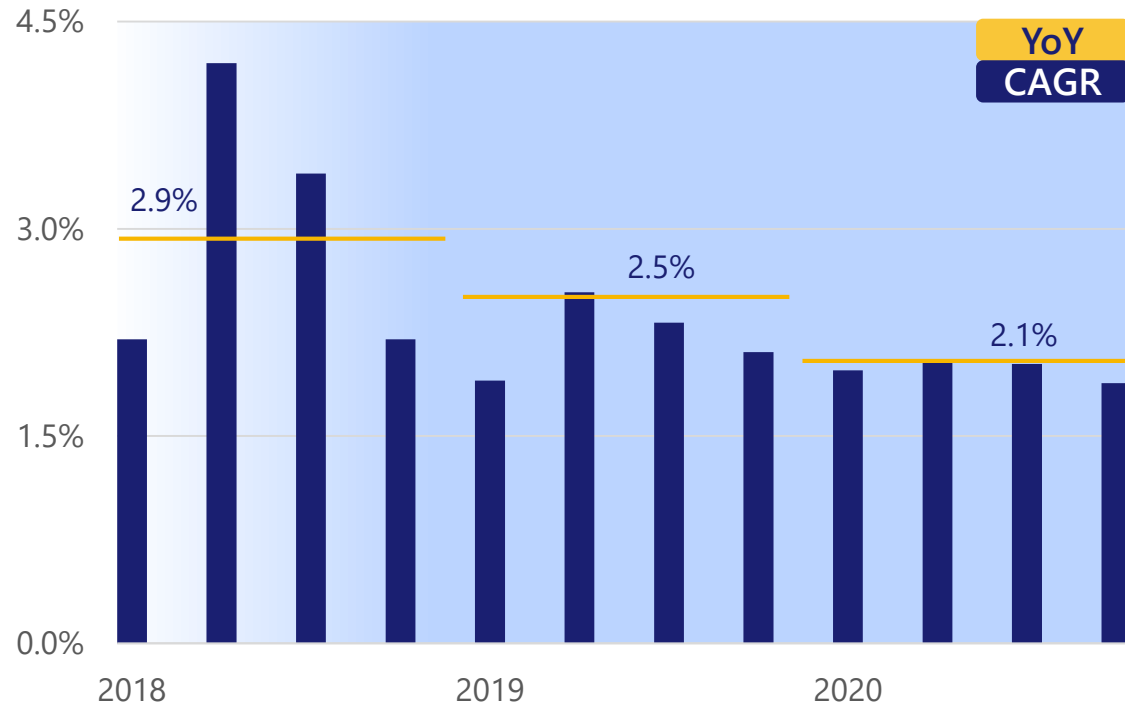


U.S. fundamentals remain strong in 2019 and 2020

Real GDP and likely real GDP forecast

Year-over-year percent change, compound annualized growth rate

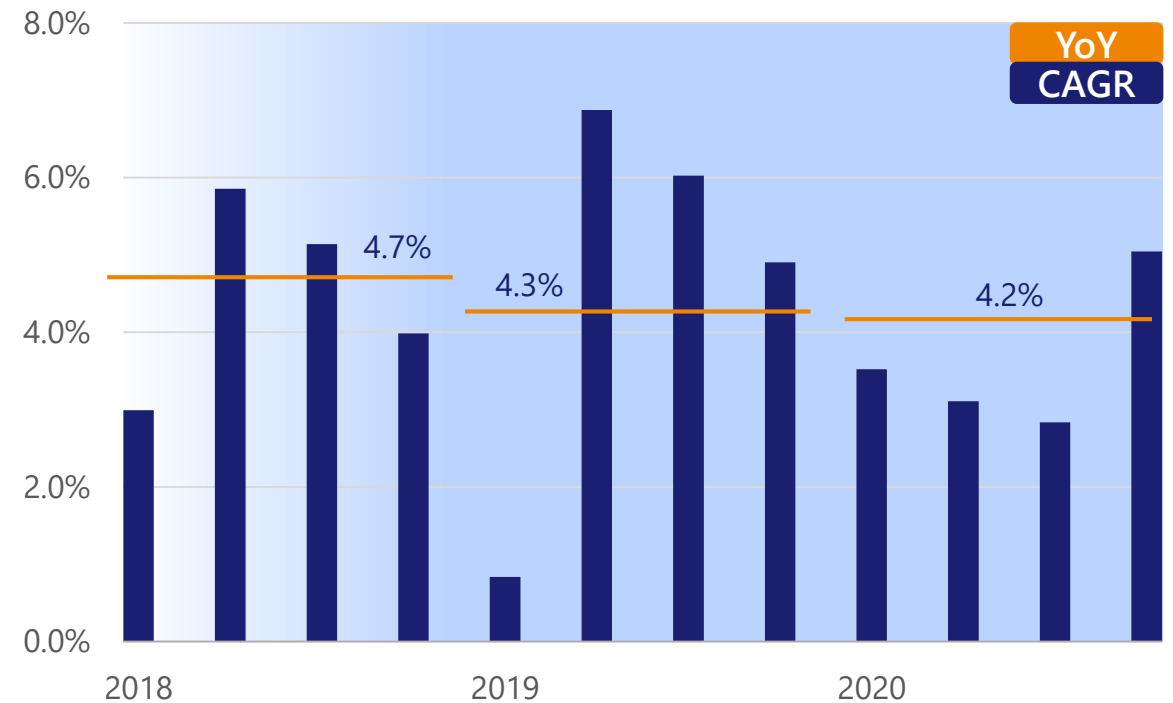
Last forecast: April 2019



Nominal consumer spending

Year-over-year percent change, compound annualized growth rate

Last forecast: April 2019

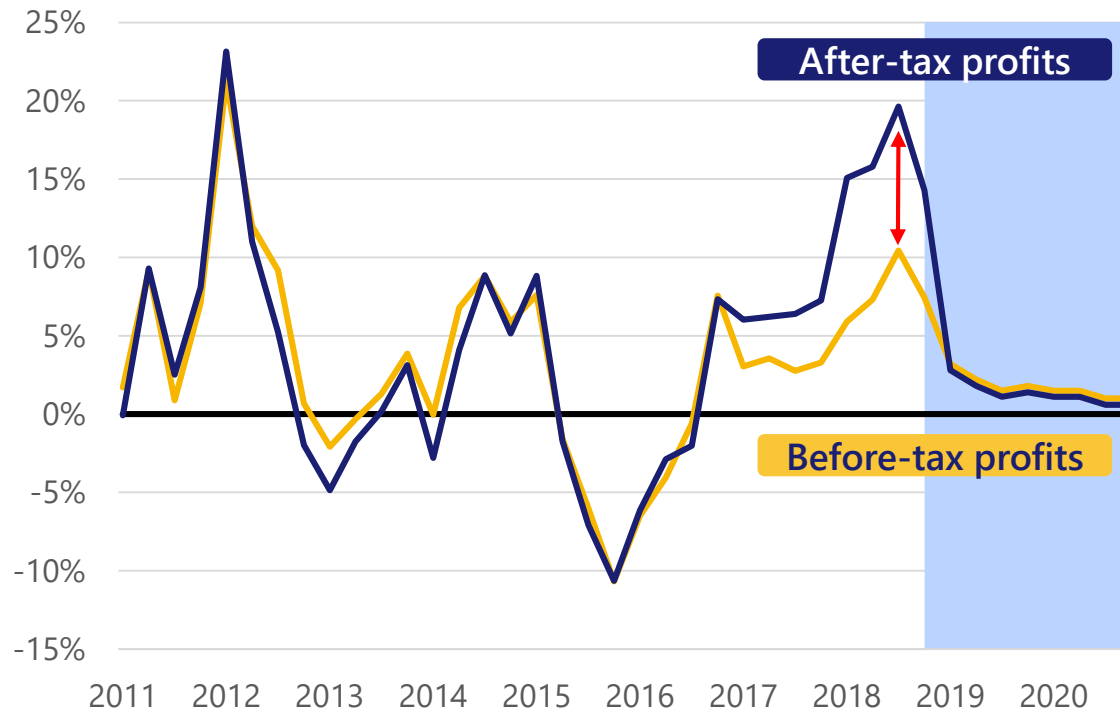


A gradual deceleration in growth is forecast through the end of 2020

Business investment is set to downshift

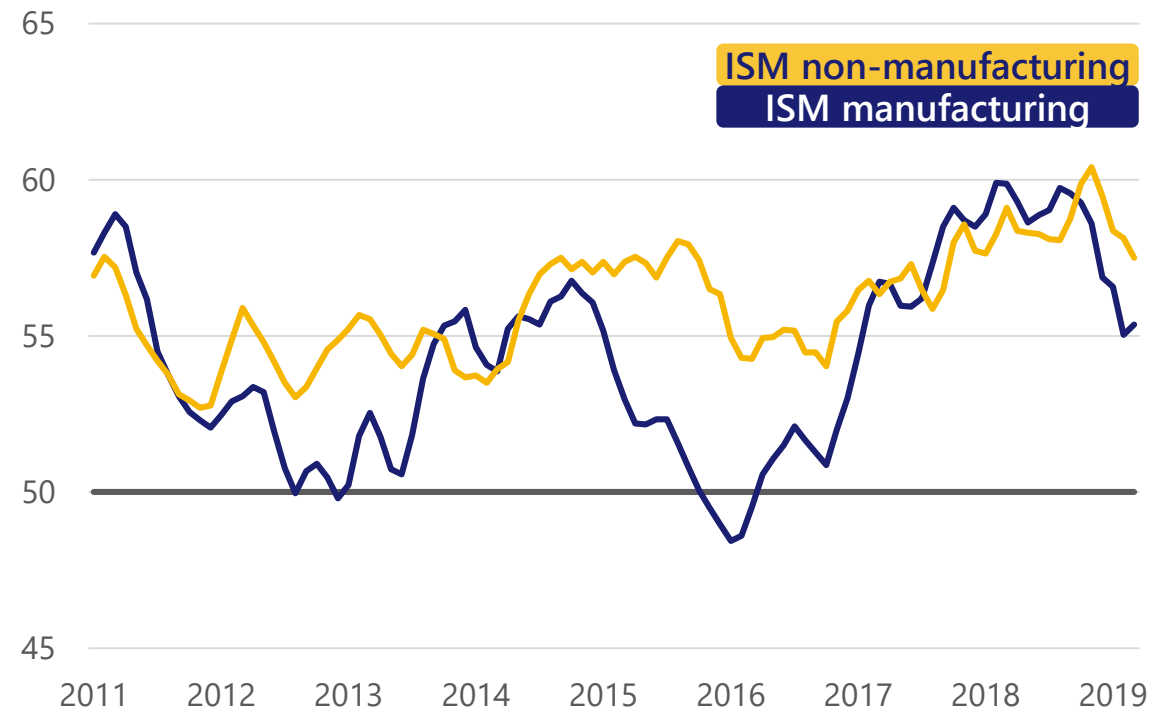
Corporate profits (Year-over-year percent change)

Last forecast: April 2019



ISM manufacturing vs. non-manufacturing (SA, 3-month moving average, index)

Last actual: March 2019



Tax cut effects were evident in corporate profits but business investment still lags

What is the current situation with trade issues?



The new NAFTA agreement (USMCA) still needs to be approved by each country's legislature—changes may still occur



The 10% tariff on \$200 billion in Chinese goods remains in place and the increase to 25% is on hold for now

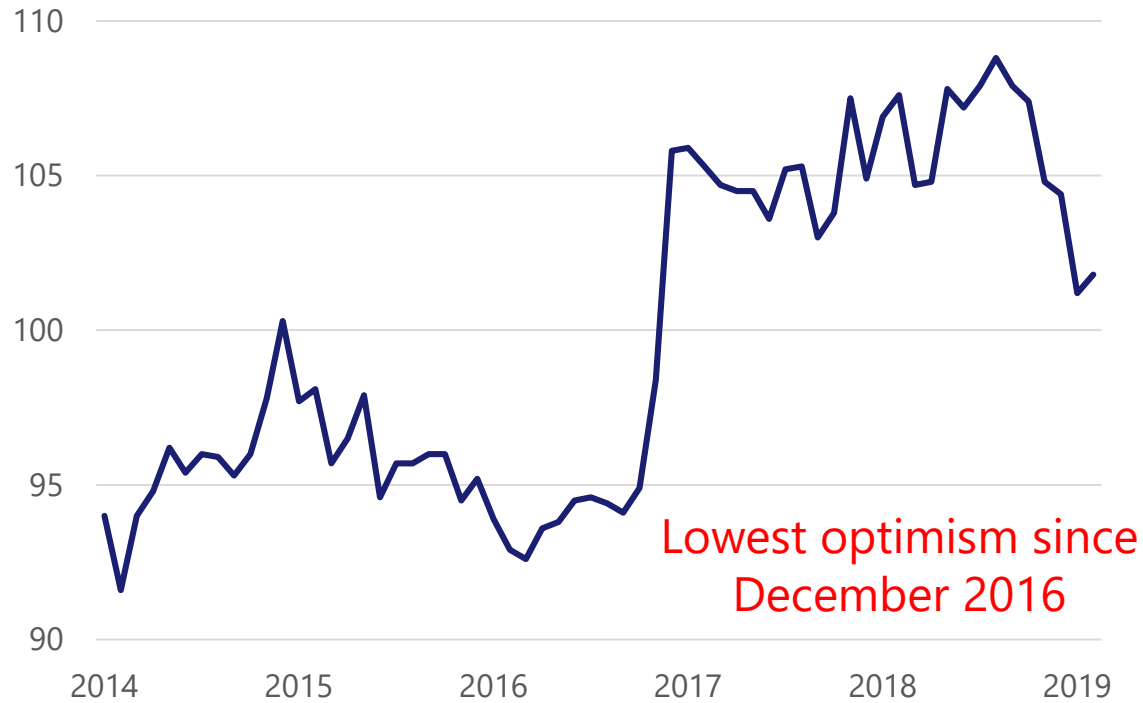


The global steel and aluminum tariffs remain in place

Small business optimism declined dramatically in the second half of 2018

NFIB Small Business Optimism
(1986 = 100)

Last actual: March 2018



Percent of firms expecting the economy to improve

Last actual: March 2018

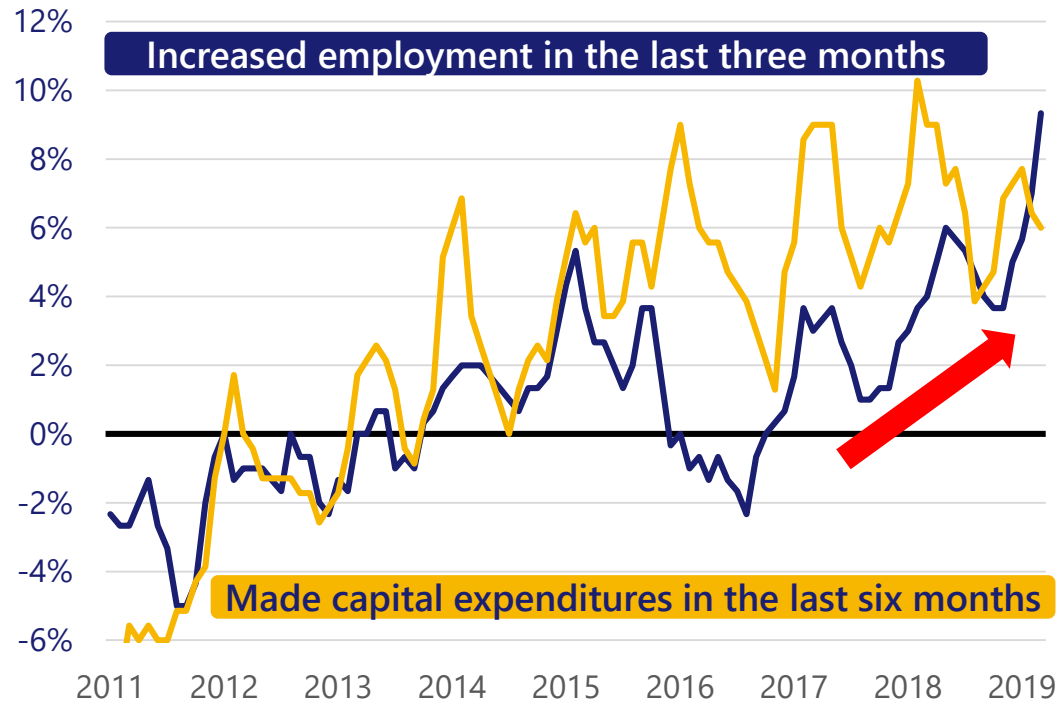


Why? It's the economy

Despite drops in optimism, small businesses continue to expand

Percent of small businesses increasing employment and capital expenditures (3-month moving average)

Last actual: March 2018



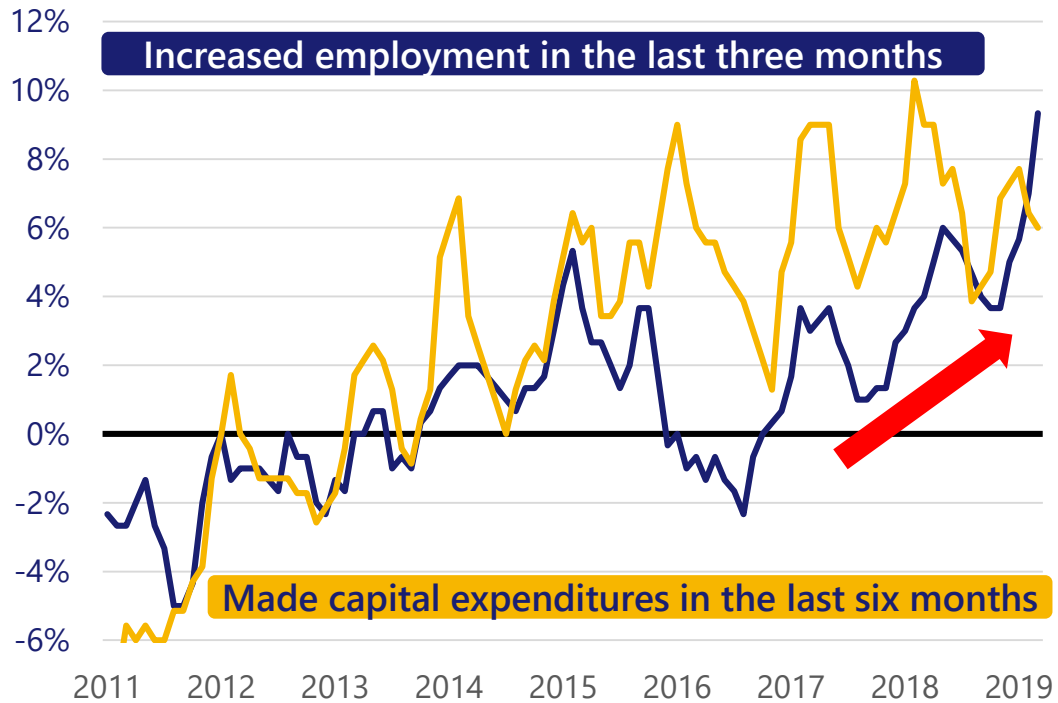
Percent of small businesses reporting some type of expansion

33%

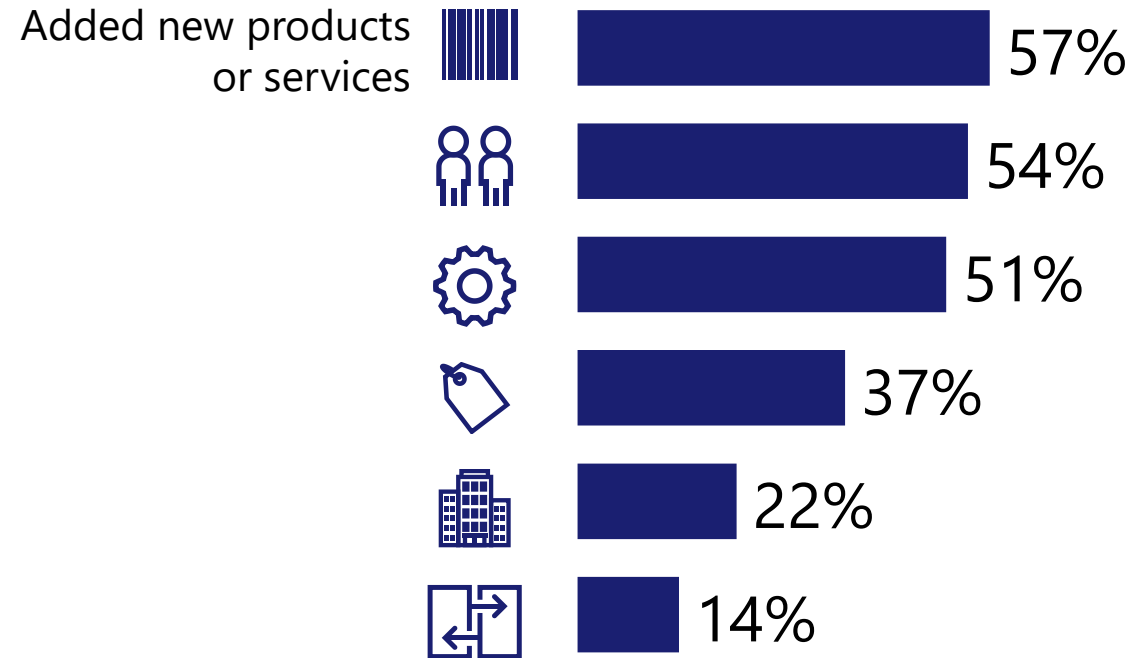
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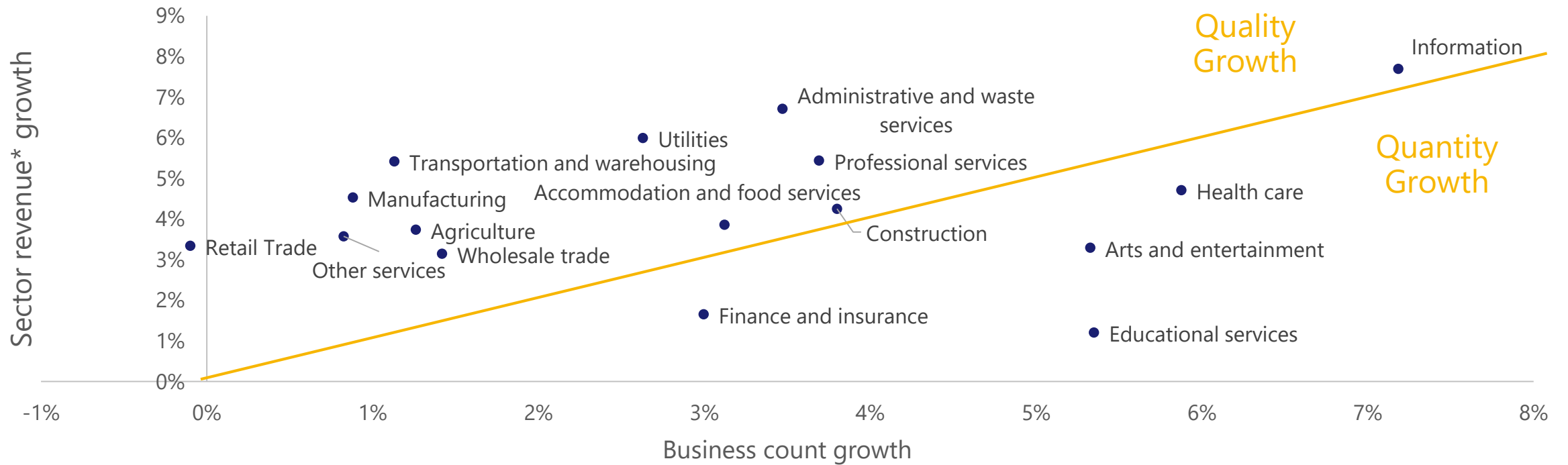
Type of expansion among businesses reporting expansion



Small businesses are hiring and investing to create new products/capabilities

Which industries are expanding?

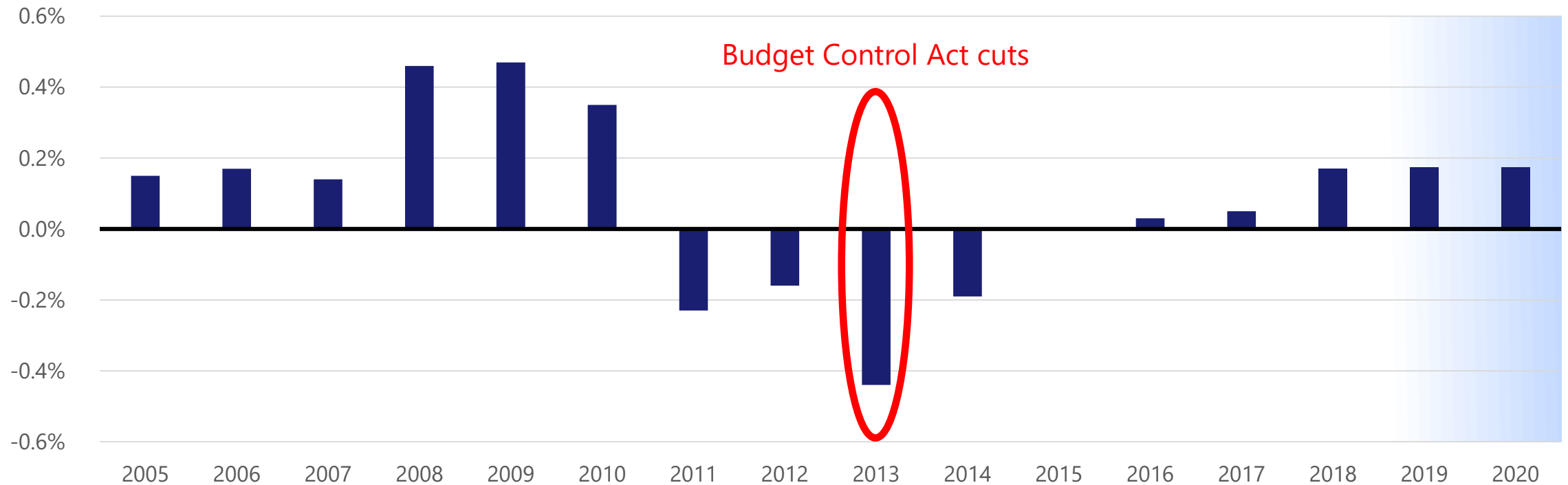
Scatterplot of business count growth vs sector revenue growth (YoY, 2017)



Most industries are experiencing quality growth

Federal government spending has boosted GDP growth

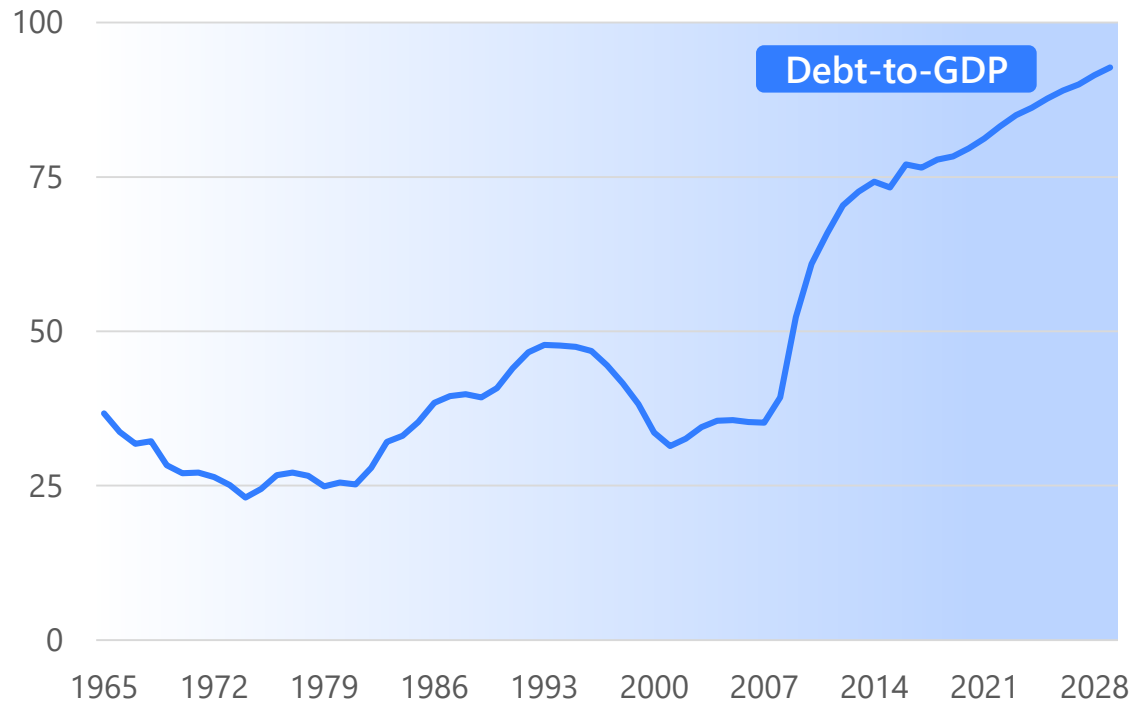
Contribution to real GDP growth from federal spending (percentage points)



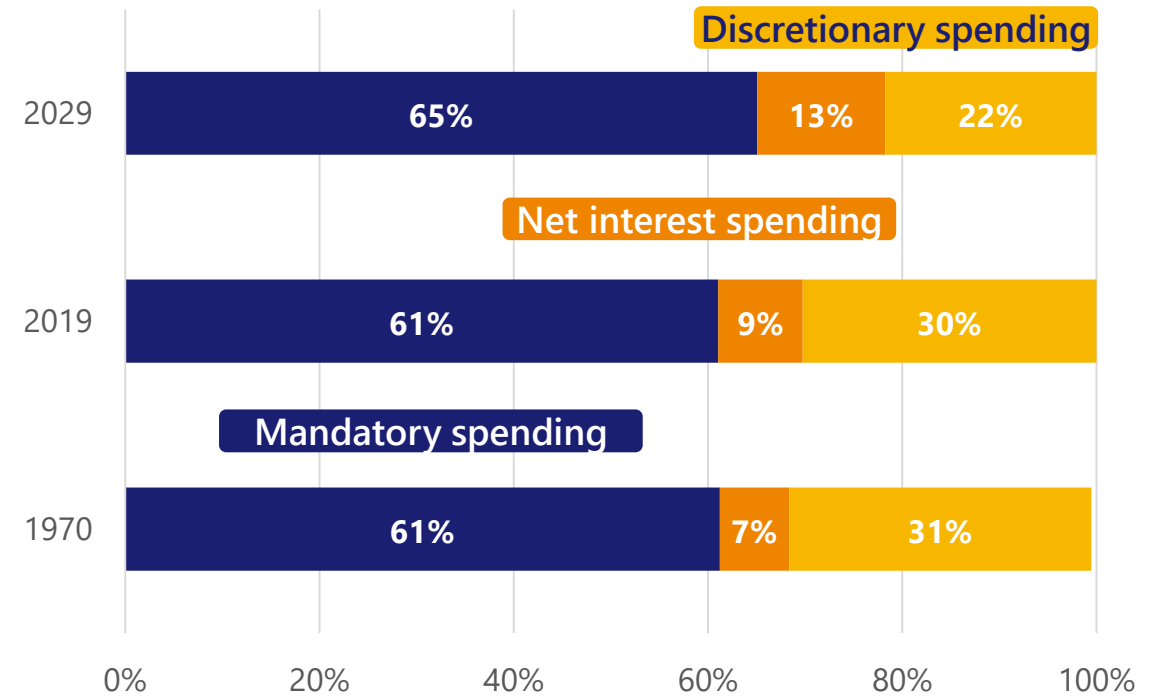
Without a deal from Congress, federal spending is set to downshift significantly in 2020

Government debt is expected to approach 100 percent of GDP

Government debt-to-GDP ratio
(Fiscal years, percent of nominal GDP)



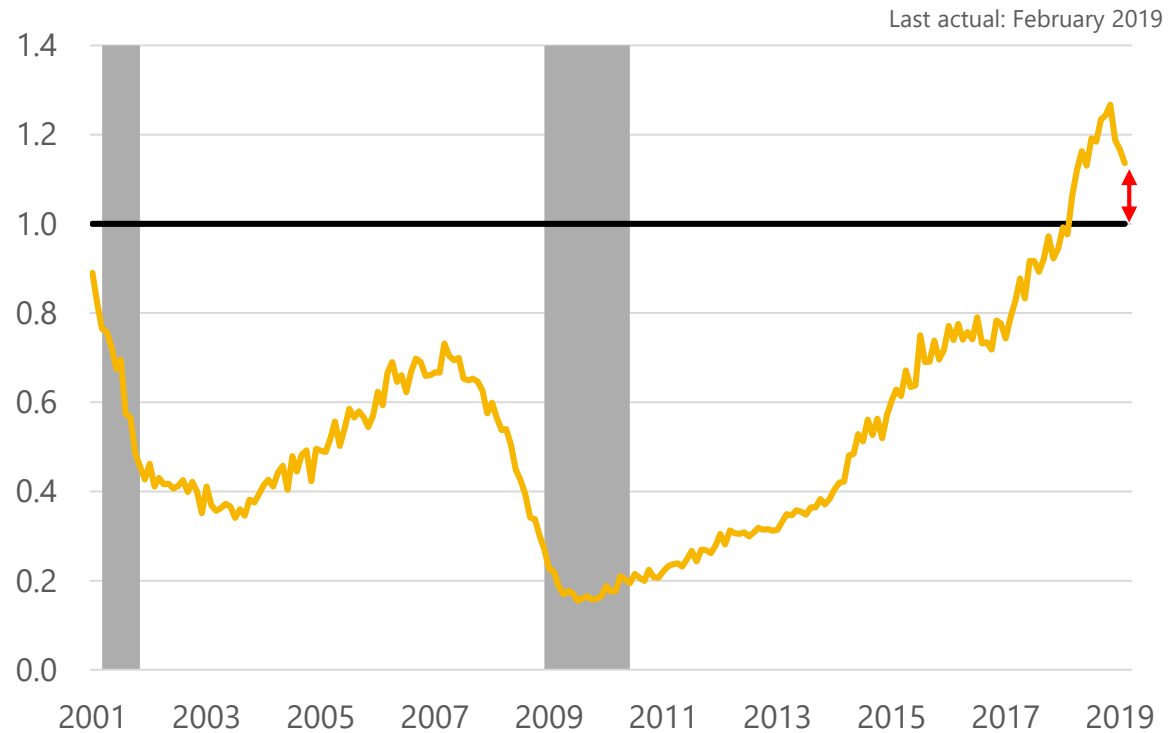
Share of federal spending
(Fiscal years, percent of total outlays)



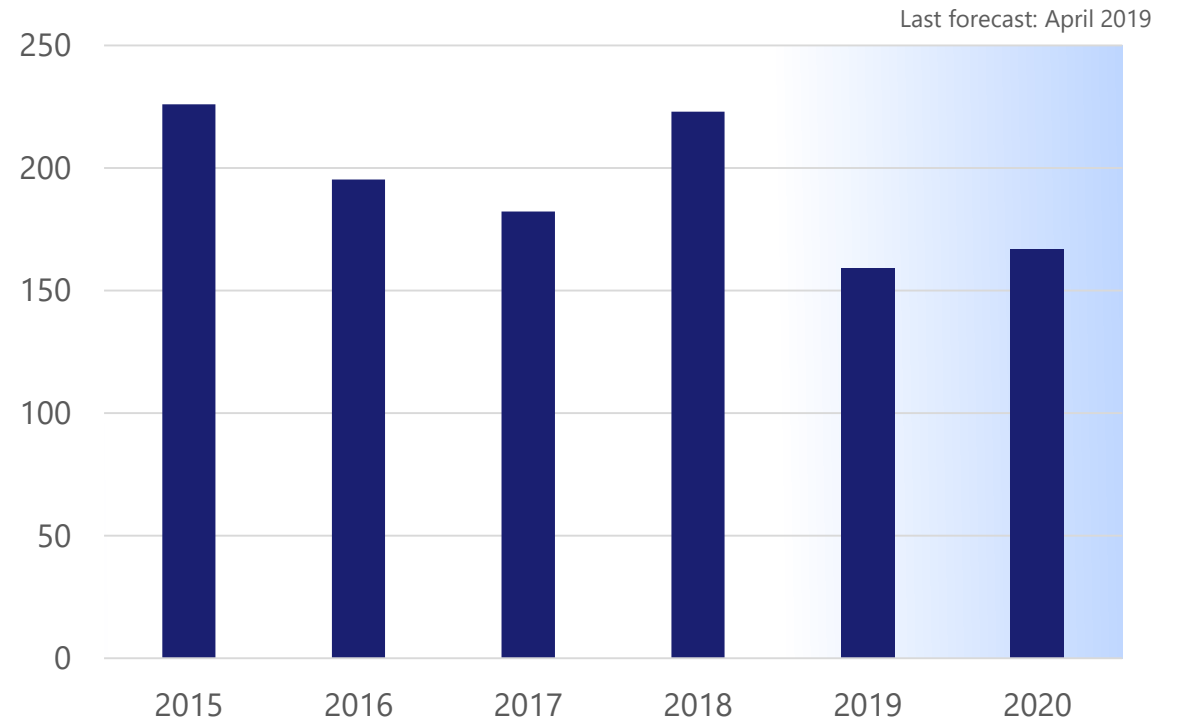
It will likely be more difficult to intervene in the next downturn

The labor market remains very tight

Job openings per unemployed person
(Number)



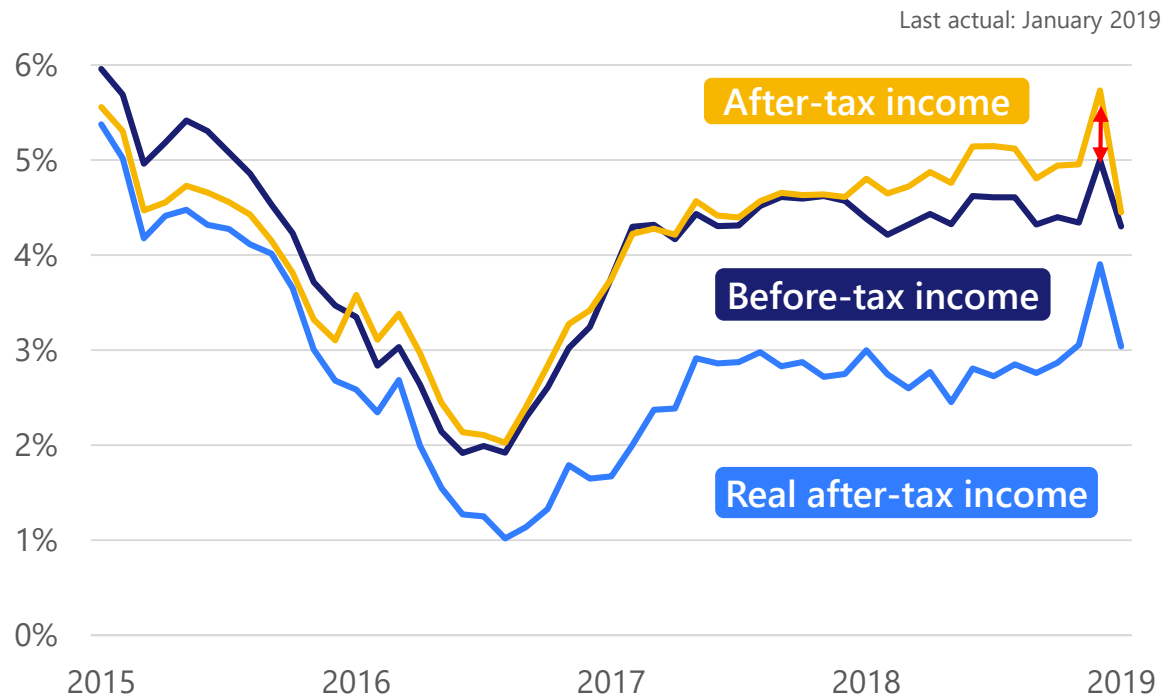
Employment growth forecast
(Thousands, monthly average)



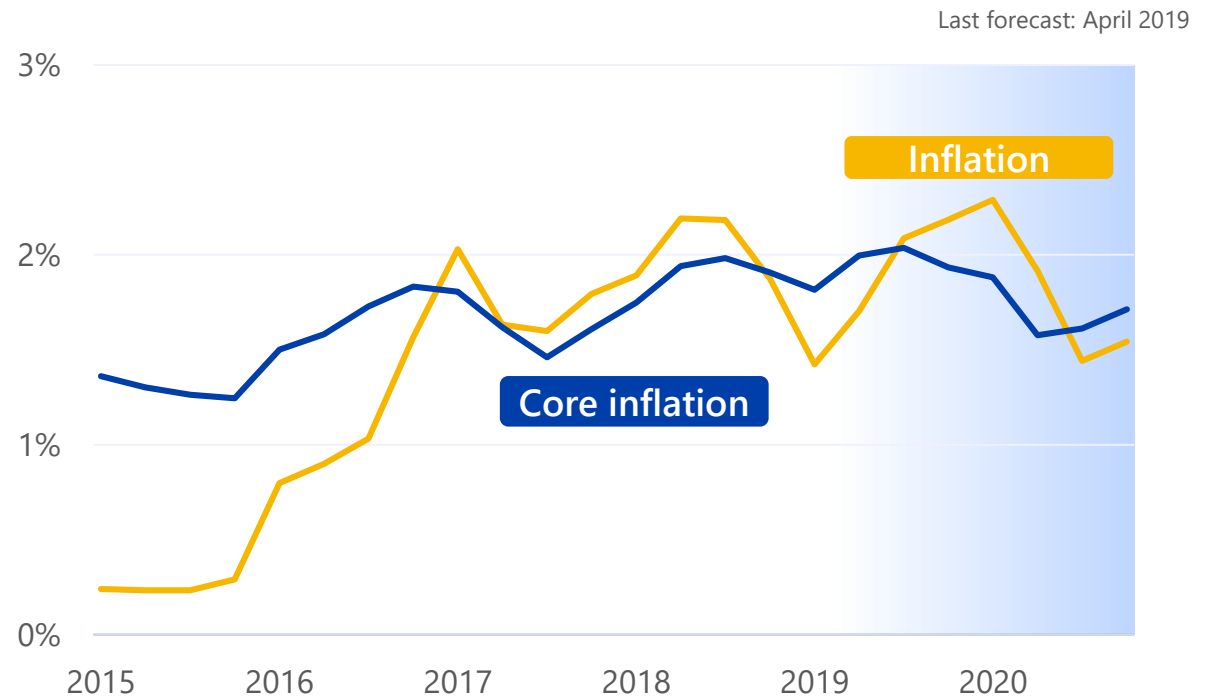
Job downshift? No, just running out of workers!

The tax cuts helped to boost after-tax income

Personal income growth
(SA, year-over-year percent change)



Inflation vs. core inflation
(SA, year-over-year percent change)

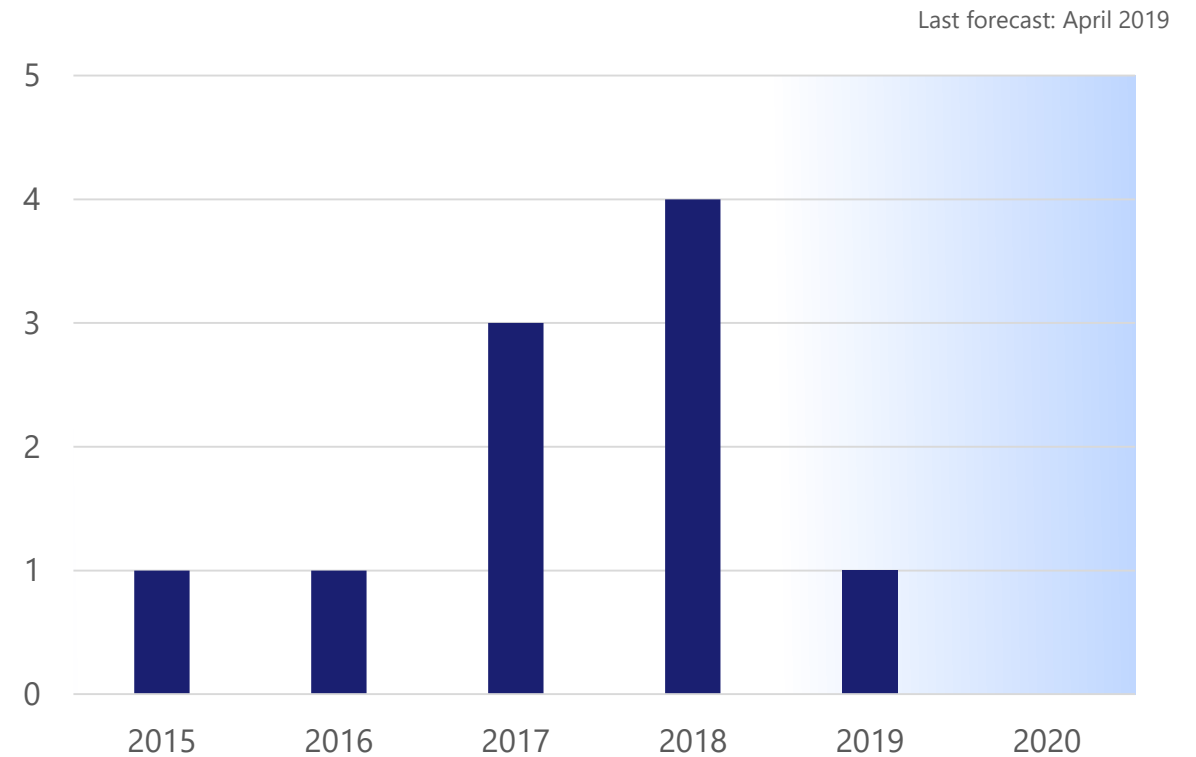


Inflation remains well within the Fed's ~2 percent range

What is the outlook for interest rates?



Federal funds rate hikes (number per year)

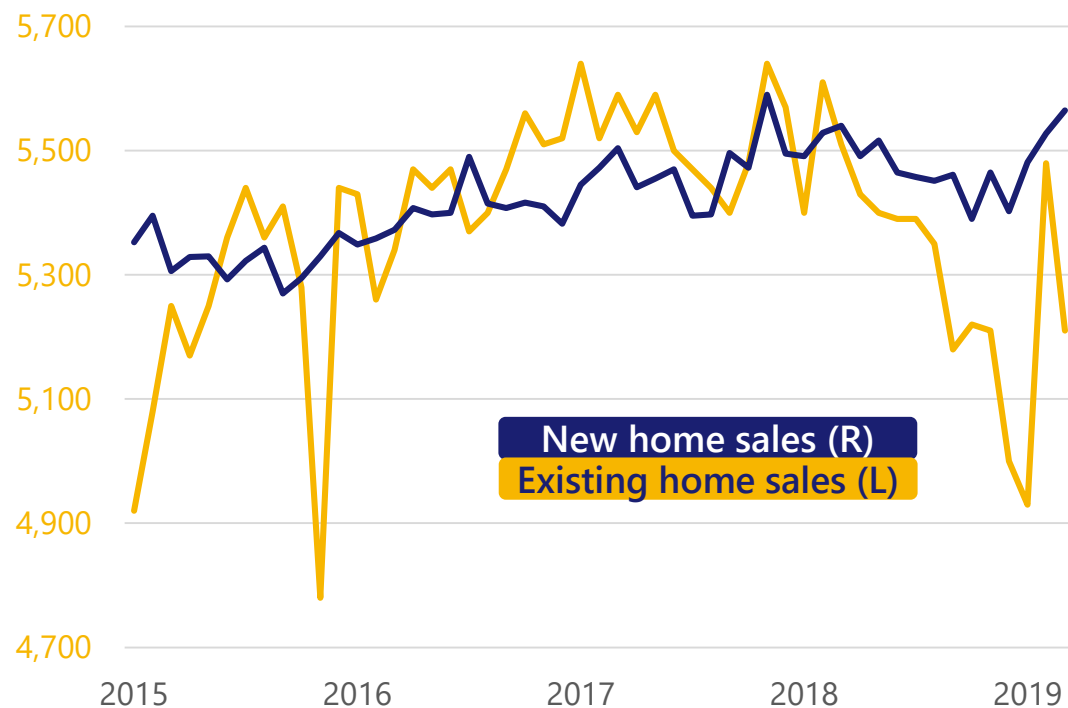


We expect one more rate hike from the Federal Reserve this year

Home sales volumes have decelerated for most of 2018

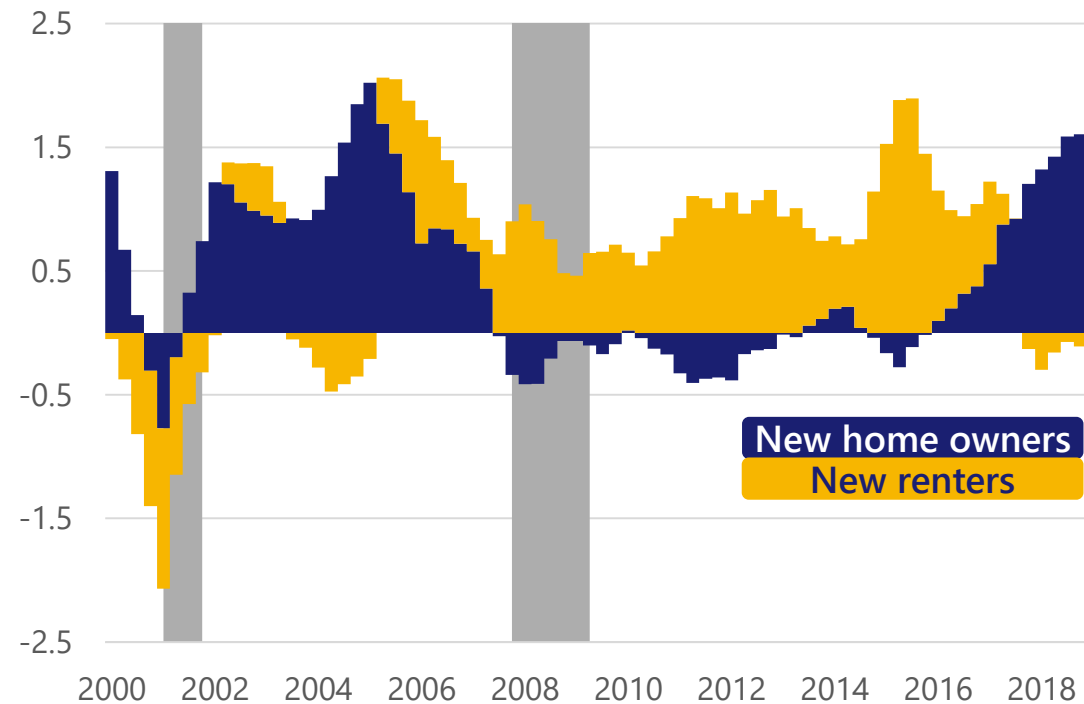
New and existing home sales volume
(SA, annualized rate)

Last actual: March 2019



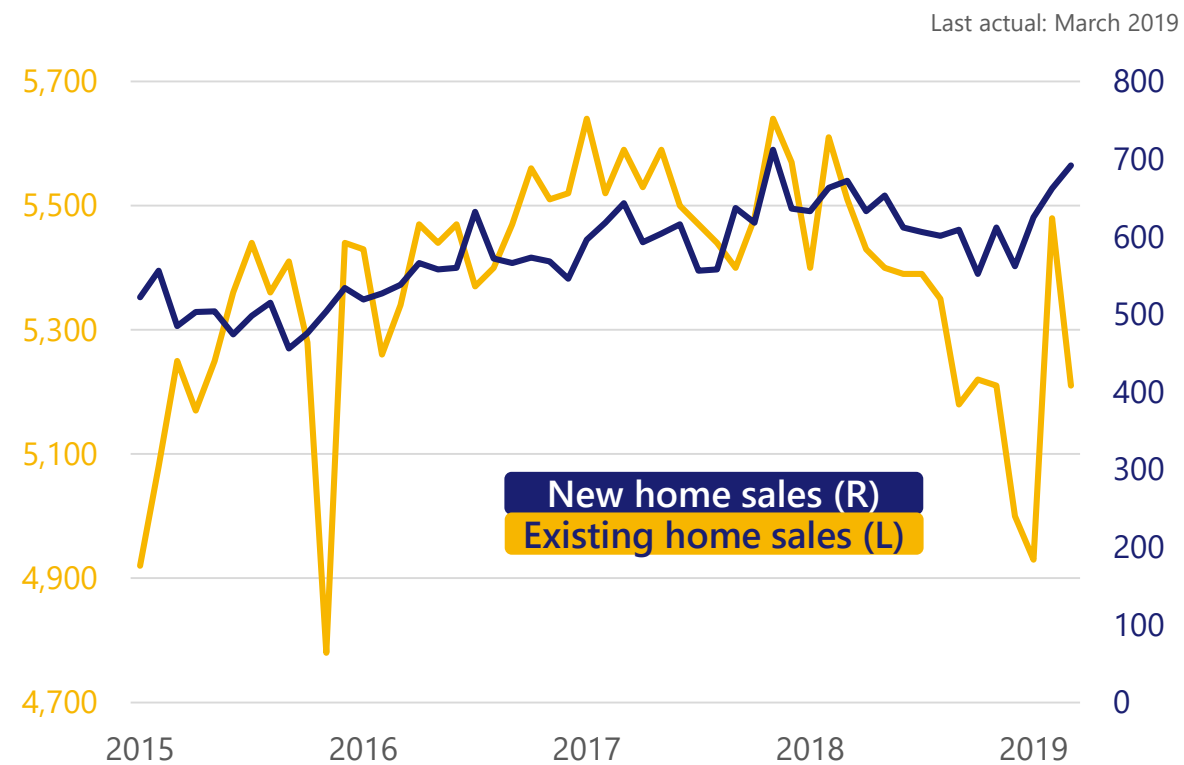
Household formation renters vs. buyers
(Millions, annual change in four-quarter average)

Last actual: 4Q2018

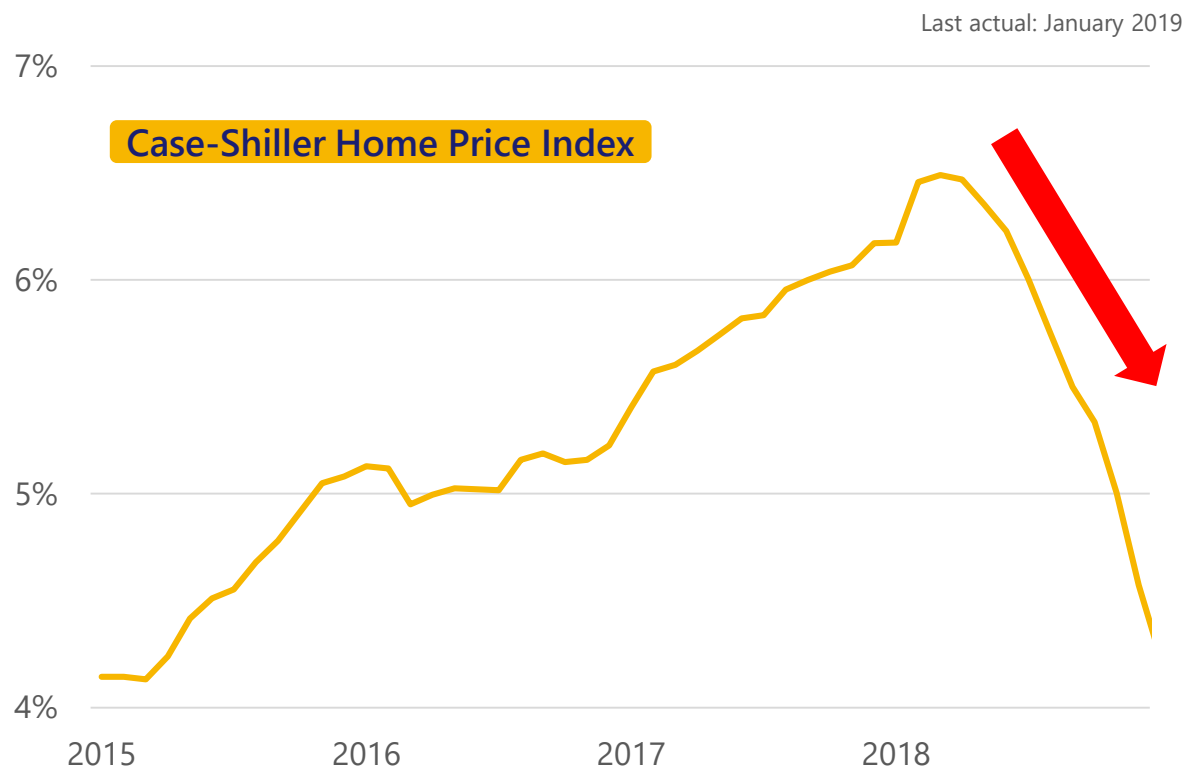


Home sales volumes have decelerated for most of 2018

New and existing home sales volume
(SA, annualized rate)



Nationwide home prices
(Year-over-year percent change)



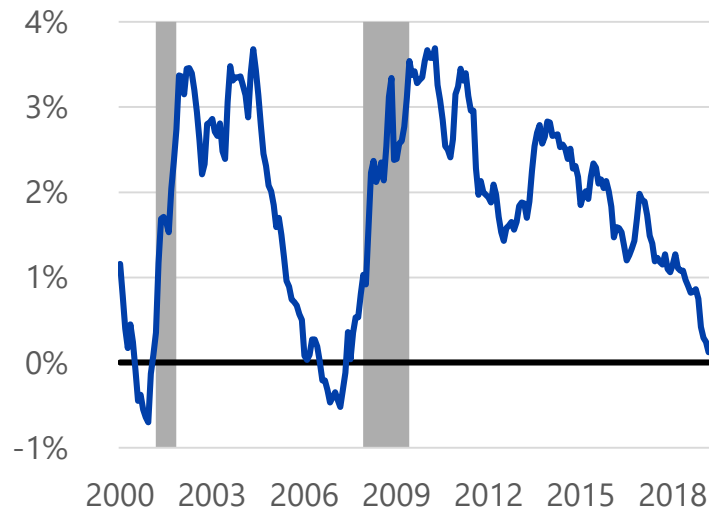
Home price appreciation has also slowed as demand started to cool

Indicators to watch for signs of a downturn



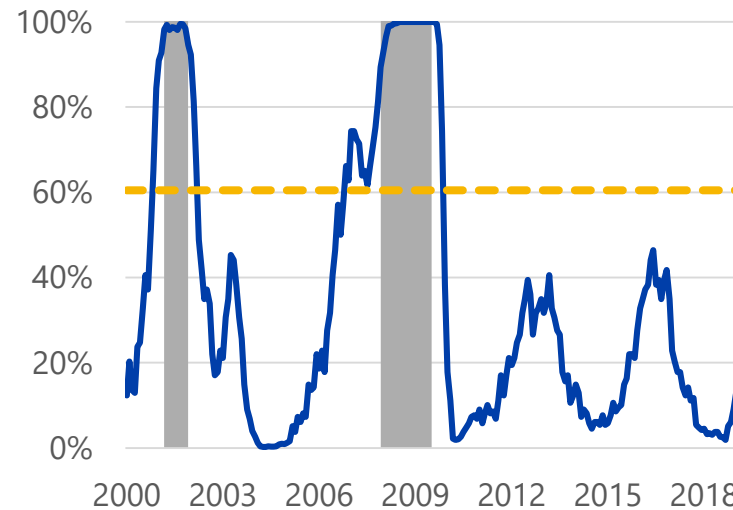
10-year U.S. Treasury spread

Percent
Last actual: March 2019



Leading indicators based
recession probability

Percent (>60% implies recession risk)
Last actual: February 2019



Initial jobless claims

SA, thousands, four-week moving average
Last actual: March 2019



What is keeping us up at night?



Continued equity market sell-offs resulting in lost consumer confidence



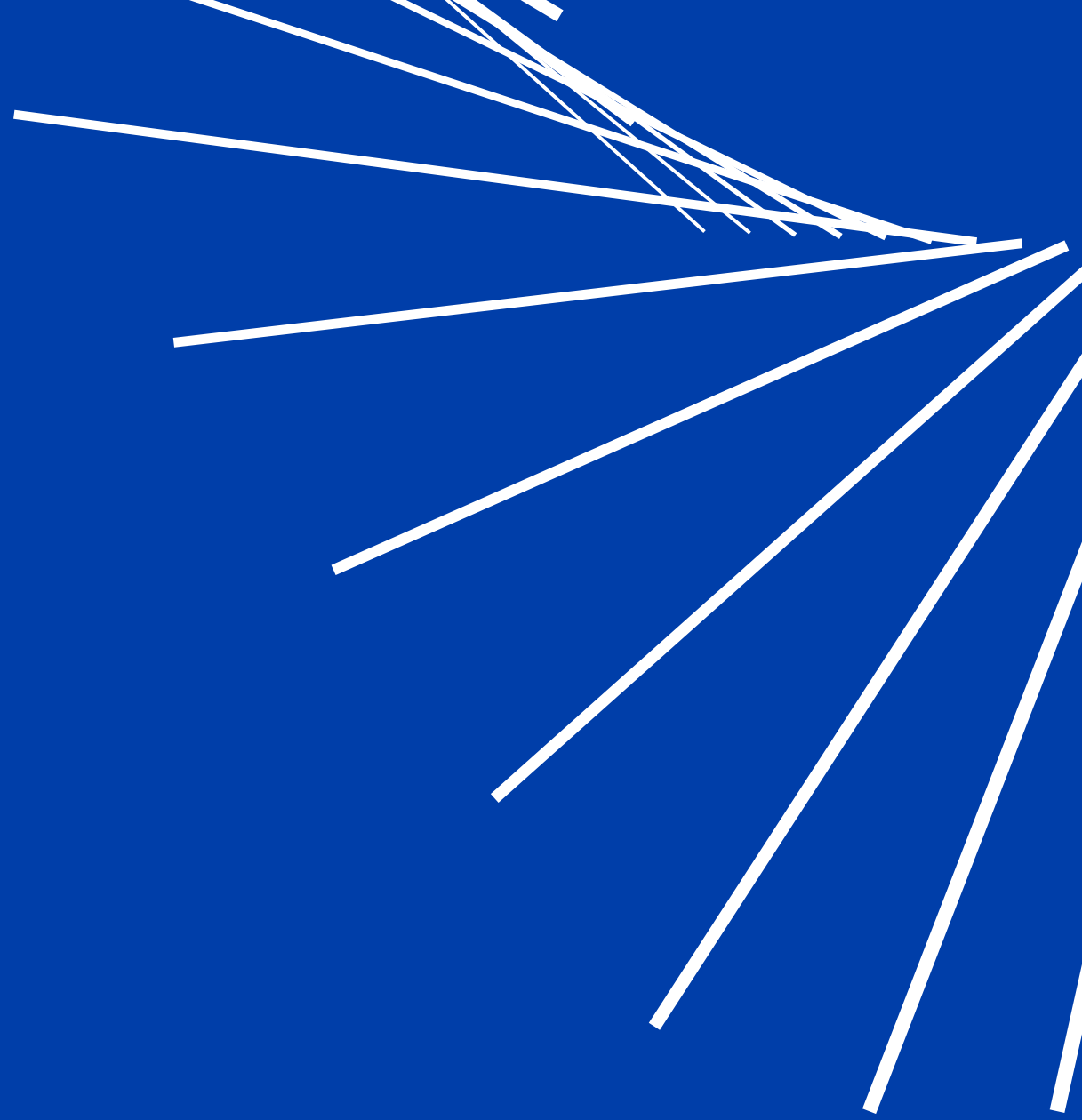
Global geopolitical risks that could lead to a market sell-off



Nonfinancial corporate debt outstanding

Risks from the next recession

The death of economic growth is greatly exaggerated



The nature of the next downturn

Nominal personal spending
(Year-over-year percent change)

Last actual: 4Q2018

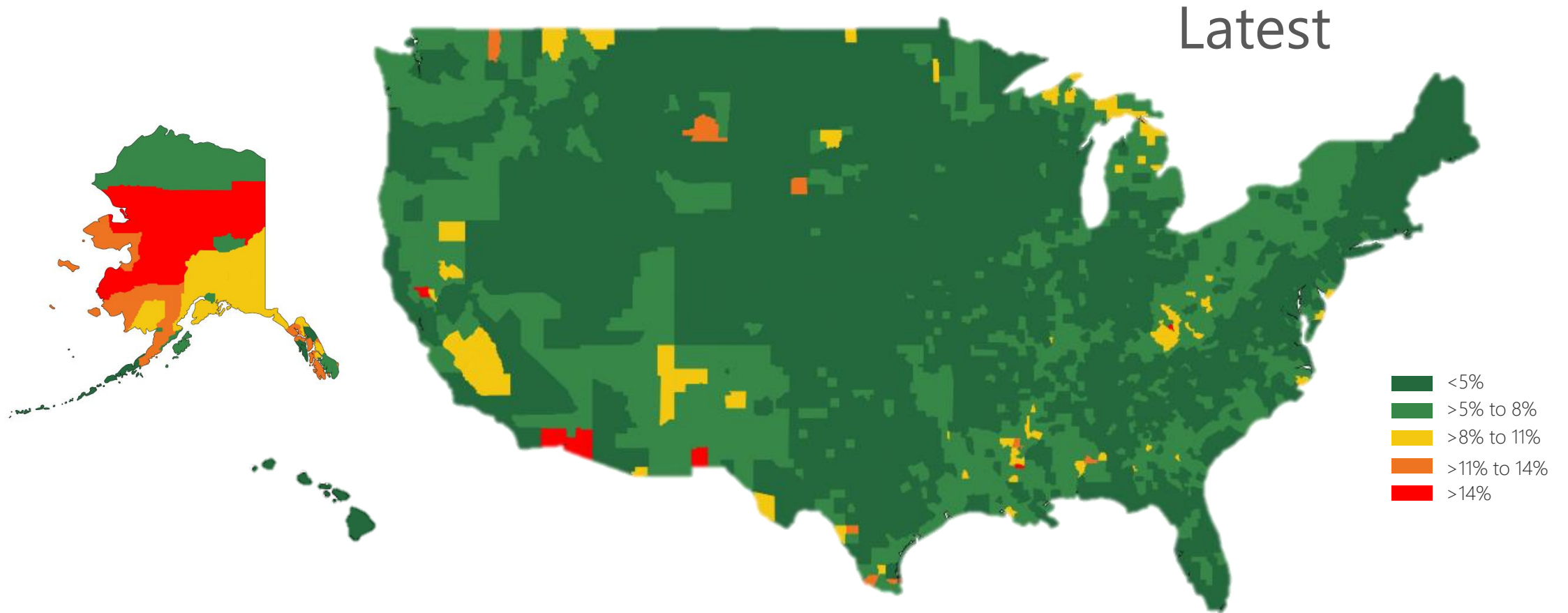


Look for a 2001-style, balance sheet recession

- Signs of stress likely begin with corporate debt markets
- Affects business investment disproportionately
- Equity markets sell off, consumer confidence falls
- Consumer spending contracts but nothing like 2008
- Due to demographics, we may see less movement in labor market indicators (jobless claims, unemployment rate)
- Business credit suffers more than consumer credit markets, but both are affected

The current situation

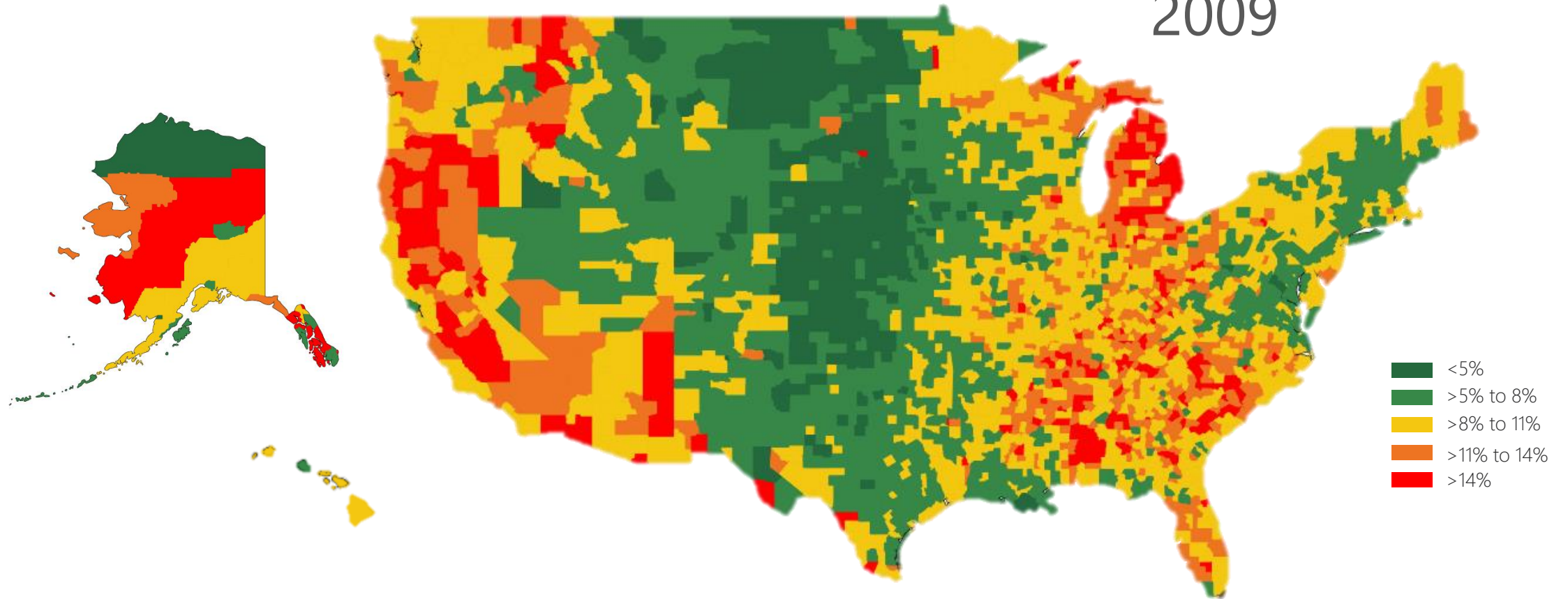
Unemployment rate by county



Let's take a step back

Unemployment rate by county

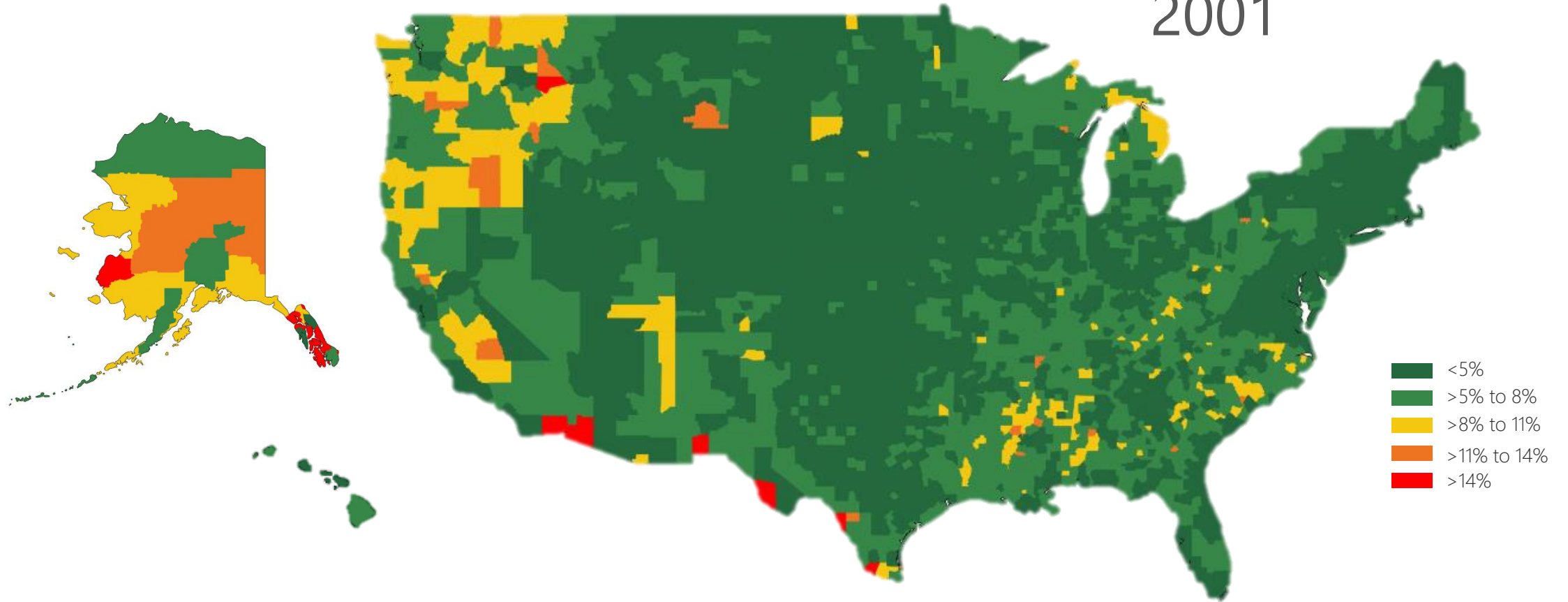
2009



How did things look during the dot-com bust?

Unemployment rate by county

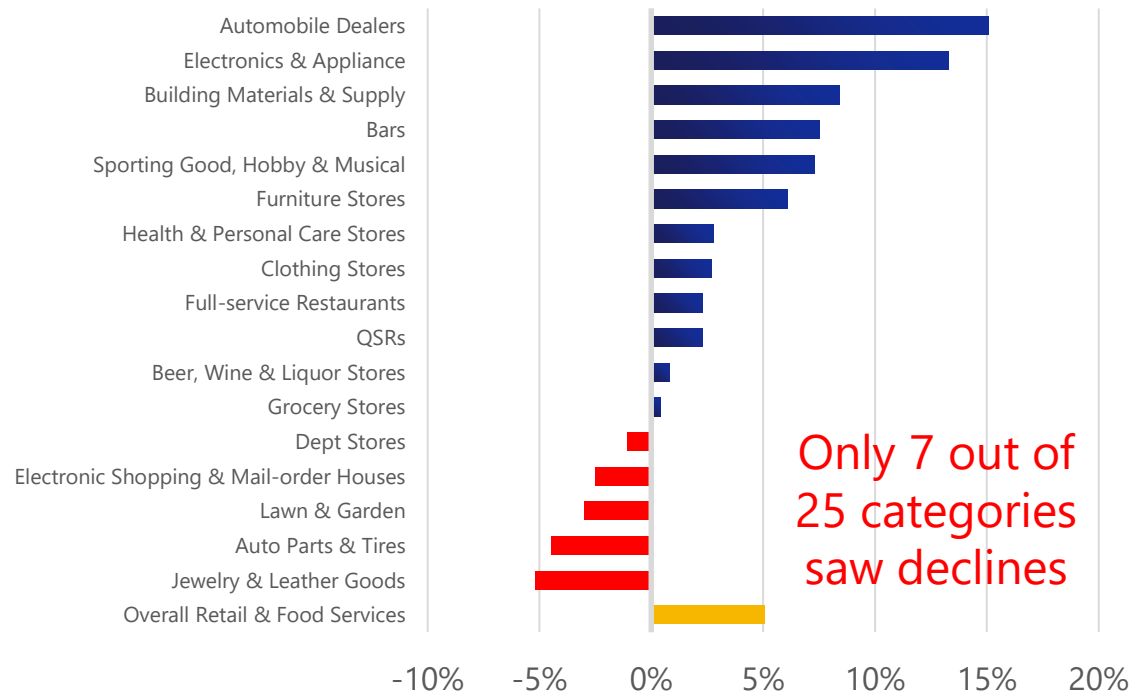
2001



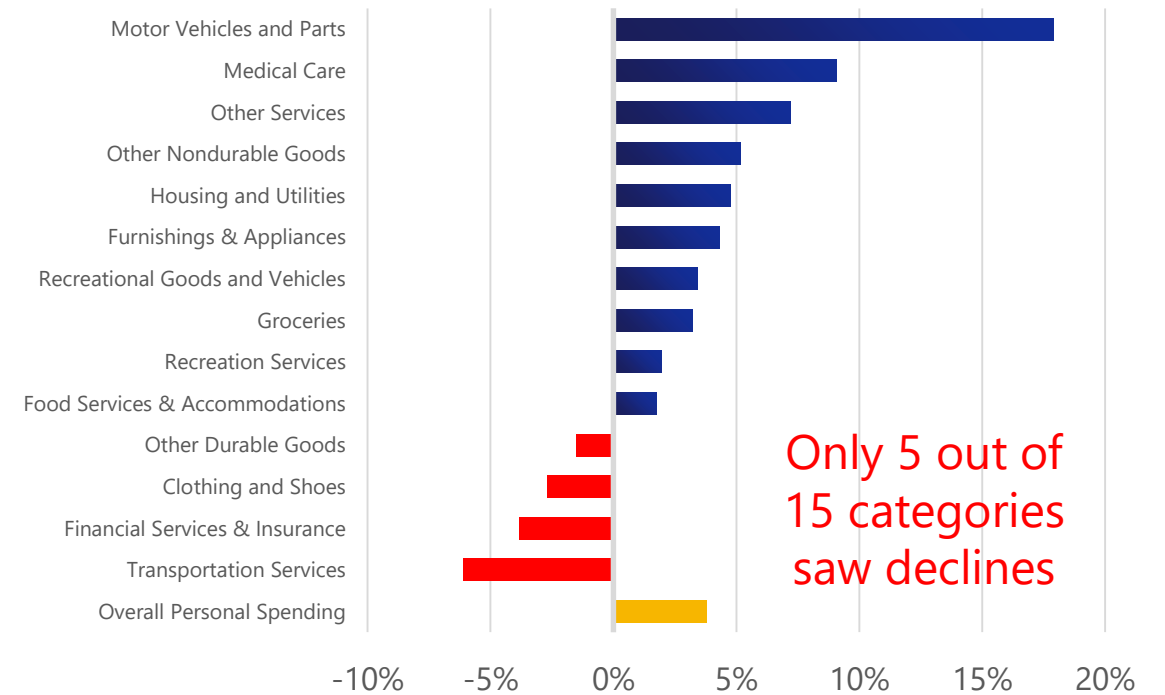
The Great Recession's recency biases our perspective

Retail sales growth remained robust throughout the 2001 recession

Retail sales growth by category, 4Q2001
(YoY percent change)



Nominal Personal Spending, 4Q2001
(YoY percent change)

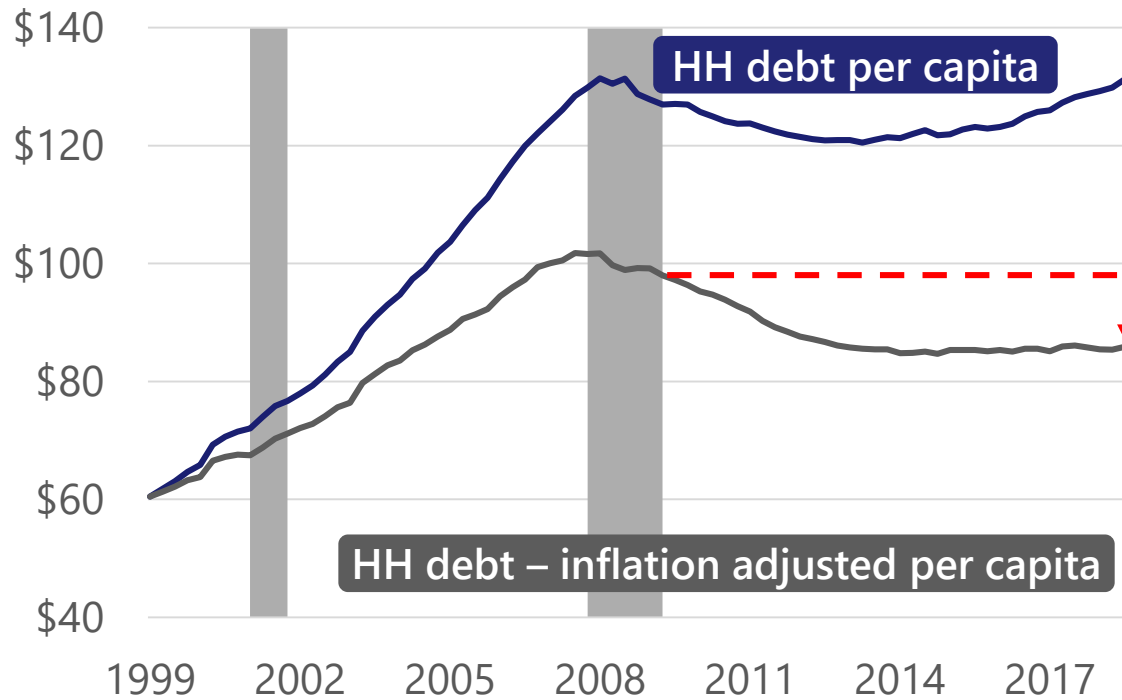


A business-led recession reduces discretionary goods and services spending

But aren't consumers in too much debt?

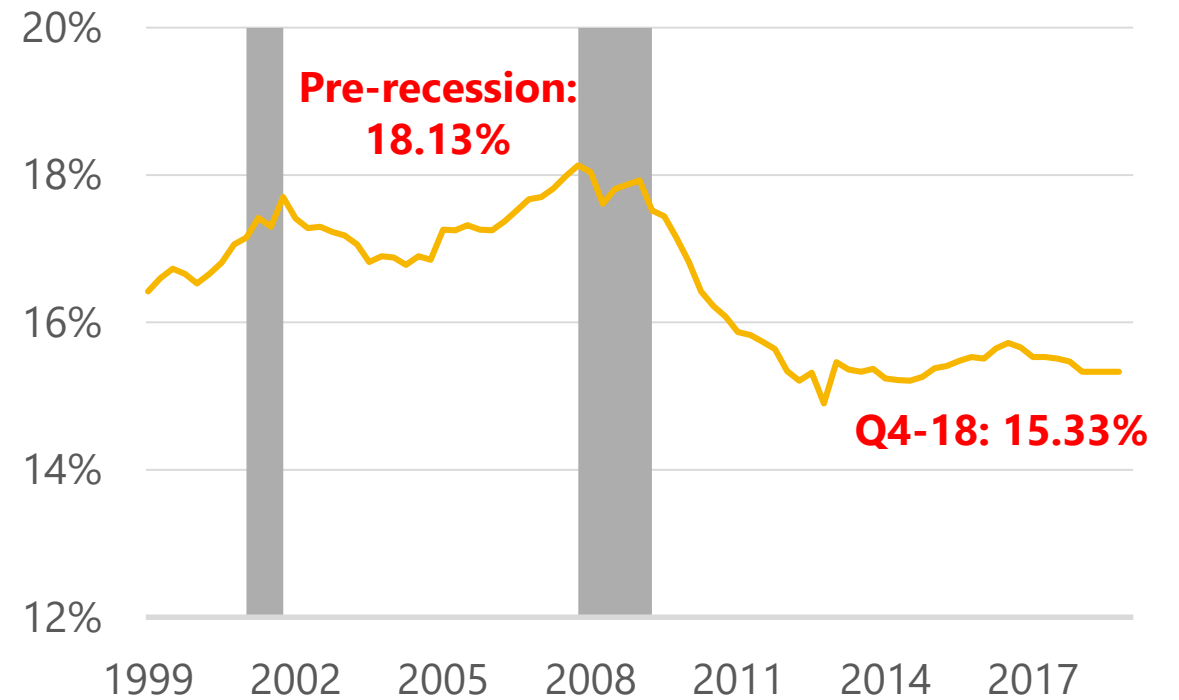
Total household debt per household (thousands)

Last actual: 4Q2018



Financial obligations ratio (percent)

Last actual: 4Q2018



Consumers can better handle debt now than they could prior to previous recessions

What will happen to wealth?

How do we expect the next recession to impact wealth?

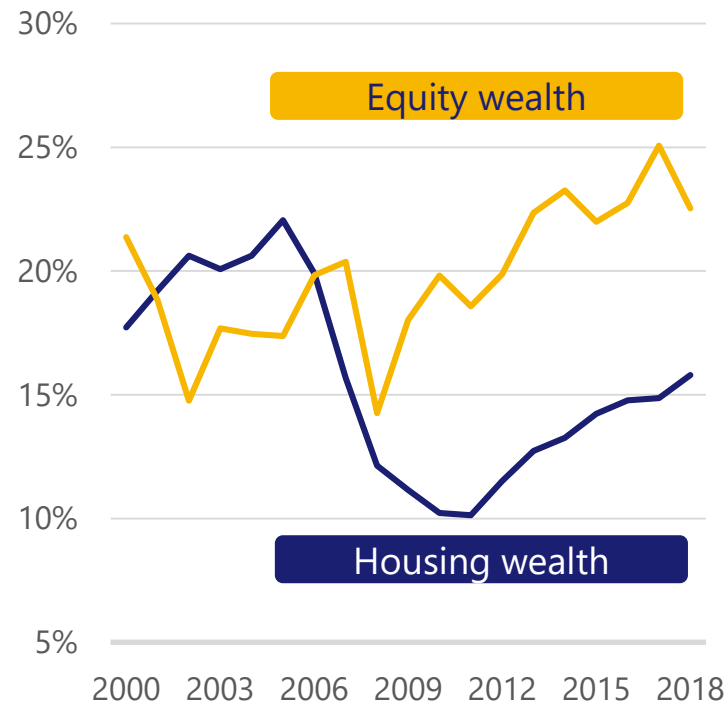


Strong demand and limited supply means home prices should be unaffected

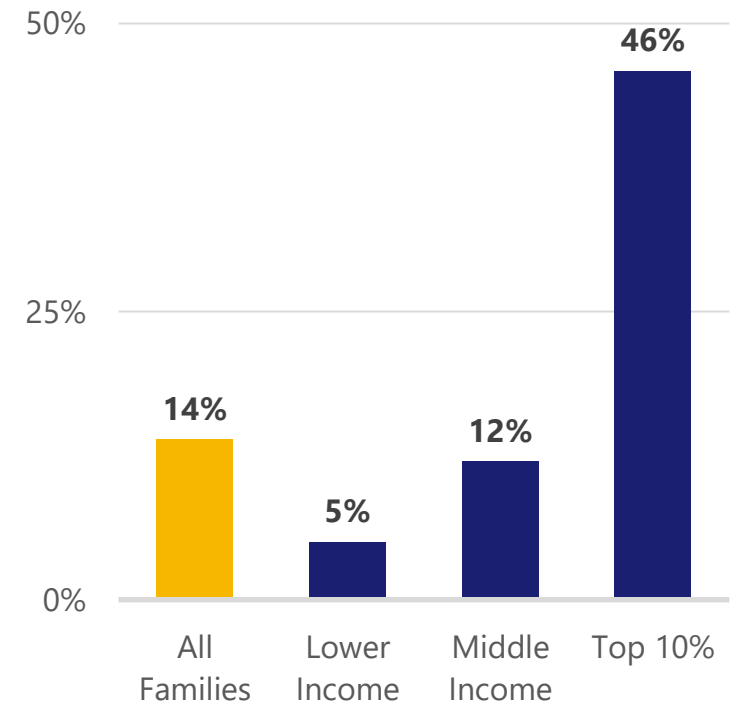


Equity sell-off likely to adversely affect financial wealth

Share of total net worth in homes and stocks



Percent of families directly holding stock (by income, 2016)



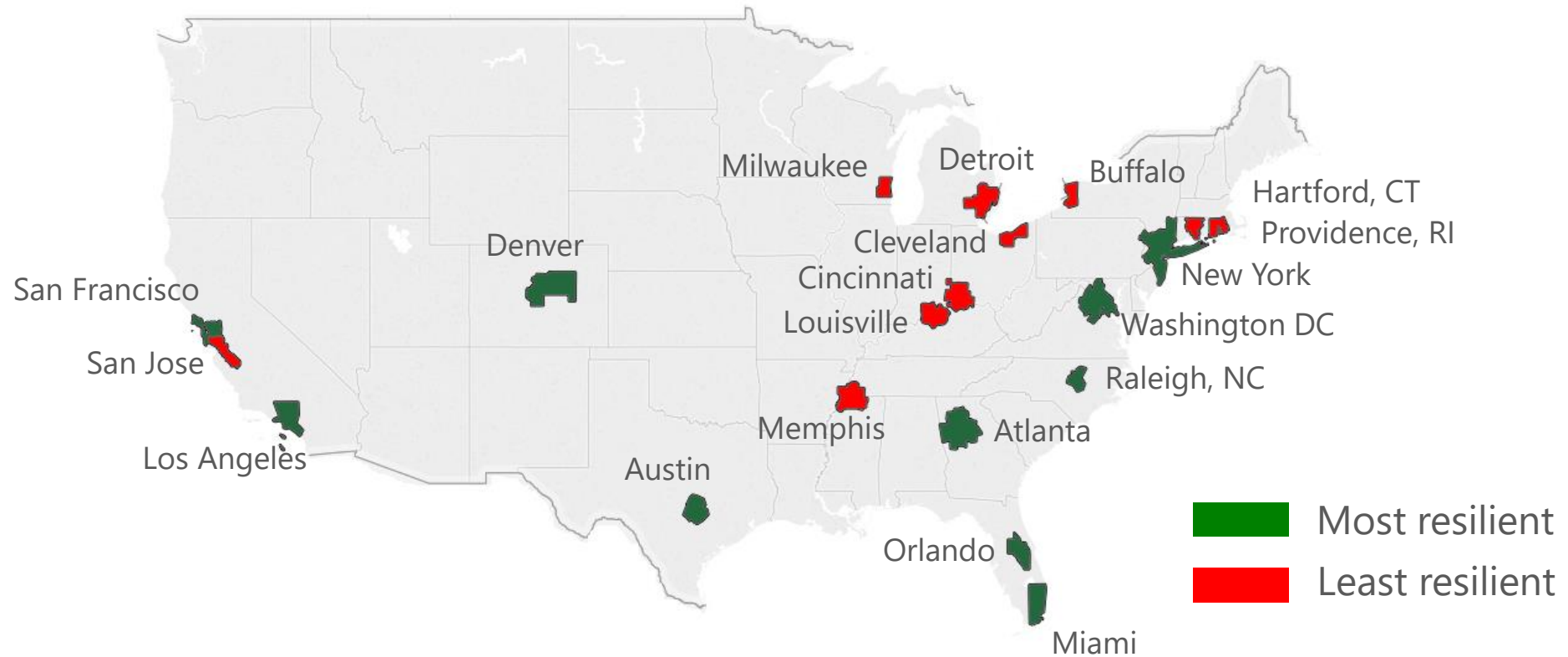
Equity sell-off means the affluent are more likely to feel the (wealth) effects

Which areas likely to be impacted this time?

Ten most-resilient and least-resilient metro areas

Factors:

- Total population size (+)
- Share of population with college degrees (+)
- Manufacturing share (-)



The effects of the next downturn are more geographic, less demographic

What does this mean for **you**?

The effects of the next recession will be more geographic and less demographic

- Retail spending will likely remain robust with consumers less affected than businesses

Wealth effects are likely to be limited to higher income earners

- Housing values are not expected to collapse
- Equity exposure is unequal across income categories, limiting overall impact on spending

Some metros are vulnerable in the next downturn

- More susceptible: high concentration of manufacturing and a lower skilled workforce
- Less resilient cities are highly reliant on affluent spending, tied to equity markets




New ways to track economic developments

VISA

Monthly Consumer Monitor

November 2018
Business and Economics Insights

Visa's analysis of the most recent consumer sector economic data shows that consumer confidence remains high and spending remains robust.



Wayne Best
Chief Economist, Visa Inc.

Consumer spending is off to a good start in Q4

Data for the first month of Q4 showed that consumer spending remained elevated as seen by both retail sales and overall nominal personal spending:

- October's month-over-month rise in nominal personal income was the strongest reading since January. The growth was primarily driven by a sharp rise in proprietors' income which captures earnings of small business owners.
- After adjusting for inflation, real consumer spending rose 0.3 percent in October. The solid monthly gain sets up a strong start to consumer spending in Q4 and should support robust economic growth for the quarter.

"Economic data this month shows that consumers continue to serve as the engine of economic activity. Consumer confidence remains very elevated which should support further spending in the fourth quarter."

Key Monthly Consumer Indicators:

Retail Sales Excluding Auto Sales
Year-over-year percent change

Nominal Disposable Personal Income
Year-over-year percent change

Nominal Personal Spending
Year-over-year percent change

The orange lines represent the normal range for each measure in the current business cycle defined as one standard deviation above and below the average change since July 2009.

Sources: U.S. Census Bureau, U.S. Bureau of Economic Analysis and Visa Business and Economic Insights.

Visa Business and Economic Insights

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U.S. Economic Outlook

March 2019

First quarter weakness should give way to stronger growth

There is no question that economic data so far this year has been soft. Employment growth downshifted more than expected in February while both industrial production and existing home sales contracted in January. It would be easy to sound the alarm bells, but there are several signs that things are not as bad as some recent headlines have suggested. For starters, February's disappointing employment reading appears to have been a combination of effects from severe winter weather and payback for the impressive 311,000 jobs added in January. One less-noted aspect of the employment report was that average hourly earnings grew 3.4 percent year-over-year, the fastest pace since the end of the recession. In addition, consumer confidence rebounded sharply in February and the delayed release of retail sales for January showed a modest increase in retail activity.

Key Takeaways

- Mixed messages from February's employment report
- The downshift in growth appears temporary
- Just one more rate hike expected from the Federal Reserve this year
- Brexit remains the key near-term risk

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Visa's March U.S. economic forecast continues to show that the U.S. economy downshifted to just 0.7 percent annualized growth in Q1, but will likely bounce back to around 2.8 percent in Q2, reflecting the firmer high frequency leading economic data. Nominal consumer spending is still expected to rise 4.3 percent this year. In inflation-adjusted (real) terms, overall consumer spending likely downshifted in Q1 to a 1.5 percent annualized pace, but should pick up mid-year.

Nominal consumer spending forecast (SA, CAGR and YoY percent change)

6-month ahead recession probability (percent)

Source: Visa Business and Economic Insights and U.S. Department of Commerce.

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VISA

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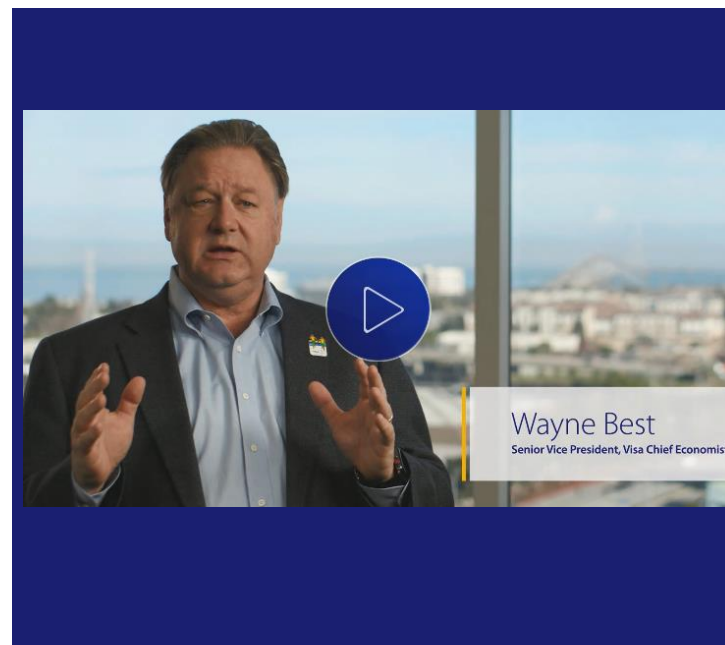
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