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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2020 NATIONAL AND COMMONWEALTH FORECAST

U.S. and Virginia Economic Growth Projected to Slow in 2020

Norfolk, VA, January 29, 2020 – The Dragas Center for Economic Analysis and Policy forecasts that real (inflation-adjusted) economic activity in the United States will further slow in 2020 even as the risks of an outright recession recede for the short-term. Slowing global growth, declining business confidence, and uncertainty regarding monetary and fiscal policy will tamper the prospects for economic growth in 2020. Growth in Virginia will slow even though we expect federal government expenditures in the Commonwealth to increase through 2020, largely spurred by increases in defense procurement.

We estimate that real Gross Domestic Product (GDP) for the United States grew at an annual rate of 2.3 percent for 2019, a moderation from the 3.0 percent growth in real GDP in 2018. Nationally, nonfarm payrolls (jobs) have grown for a record 126 months. Unemployment was 3.5 percent in December 2019 and the number of open positions continues to be greater than the number of unemployed persons. Historically low mortgage rates and relatively warm winter weather have spurred refinancing and construction activity. There is much good news to report about the state of the U.S. economy at the end of 2019.

We are concerned, however, that the gains of the last decade have left a number of Americans behind. Real median earnings increased by 1.6 percent in 2019 even though the average national unemployment rate fell to 3.7 percent. The gains in equities markets in 2019 provided above normal returns to investors but approximately 50 percent of Americans did not have enough funds to invest in stock markets. The Federal Reserve reported in May 2019 that 39 percent of Americans could not weather a $400 unexpected expense and that 25 percent of adults avoided necessary medical care in 2018 because they were unable to afford the expense.

We forecast that U.S. real GDP will increase at an annual rate of 2.2% in 2020. Virginia's real GDP will increase at a slightly lower pace, even with increases in federal expenditures in the Commonwealth. We forecast Virginia real GDP will increase at an annual rate of 2.0% in 2020.

Labor market conditions remain challenging for employers in the United States and Virginia. The U.S. has added over 22.5 million jobs since the trough of the Great Recession in February 2010. Virginia has added almost 450,000 jobs over the same period. There are now 10.1% and 6.9% 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 rose to 0.86 in November 2018 for the U.S., illustrating that there are more job openings in the nation than there are unemployed individuals to fill those jobs.

Unemployment rates continue to fall in the United States and Virginia, though the gap has narrowed since 2010. In December 2019, the U.S. employment rate was 3.5 percent compared to 2.6 percent for the Commonwealth. The unemployment rate is below 3 percent in each of Virginia's metropolitan areas and is approaching 2 percent in some metros. Overall, the labor market in the U.S. reflects the increasing competition for scarce workers. The number of individuals who quit their jobs continued to increase nationally in 2019 as workers sought out improved wages and salaries.

With slowing economic growth, we project that the unemployment rate in the United States and Virginia will tick upward in 2020. Nationally, the unemployment rate will average 3.7 percent in 2020 while Virginia's unemployment rate will average 2.7 percent. The lack of slack in labor markets and slower growth will lead to slower growth in civilian jobs in 2020. We forecast that U.S. job growth will average 1.2 percent and Virginia's job growth will average 1.1 percent over 2020.

As a result of the Bipartisan Budget Agreement of 2019, federal discretionary budget expenditures will increase in Fiscal Year 2020 (FY 2020). Department of Defense (DoD) expenditures will increase in FY 2020 and we await the President's FY 2021 budget which may signal a change in national security policy. The DoD may refocus its efforts on the 'Great Power Competition' and away from the capabilities required for operations in Afghanistan, Iraq, and other locales. Given the DoD projects relatively flat spending over the next five years, a change in strategy will require a shift in resources from the "Fourth Estate" (administration) to combatant commands. The change in strategy may also lead to shifts in DoD procurement, to include the early retirement of ships and planes that are not viewed as supportive of the "Great Power" strategy.

At the same time, the federal fiscal house is on fire. The Tax Cuts and Jobs Act has unequivocally increased the federal deficit by lowering revenue growth. Coupled with the increases in discretionary expenditures from the Bipartisan Budget Agreements and the inexorable increases in mandatory (entitlement) programs, the fiscal position of the federal government is unsustainable. At some point, whether by choice or by external aegis, the federal government will have to increase taxes and reduce spending to bring its fiscal house into order. When this occurs, the DoD budget, as the largest discretionary program, is a likely target for reductions in personnel and systems. While the recent increases in DoD expenditures have spurred growth in Virginia, we caution that these increases will not be sustainable over the decade. As the adage goes, 'No tree grows to the sky.'

We project that the federal government will have $1.1 trillion annual deficit in Fiscal Year 2020 and a continued $1 trillion or greater annual deficits for the foreseeable future.

The remarkable run of equities markets over the last decade should also give one pause. Price-to-earnings ratios remain above historical averages. The Federal Reserve has reversed course since early 2019 by lowering the target Federal Funds rate and injecting liquidity into short-term repurchase markets. While these measures may boost growth in the short-term, we argue that the Federal Reserve's policy space is considerably more constrained when compared to prior to the Great Recession.

Virginia should be wary of calls for fiscal expansion. The Commonwealth has wisely increased its Revenue Stabilization Fund and we believe it would be prudent to continue to prepare for the next economic downturn, whenever it comes. Virginia should focus on improving its infrastructure, antiquated tax system, regulatory reform, and adapting to climate change instead of parlaying its fortunes on casinos or large economic development projects.

Actuals and Forecasts

	2018 Actual	2019 Forecast (May)	2019 Actual*	2020 Forecast
U.S. Real Gross Domestic Product	3.0%	2.5%	2.3%	2.2%
Civilian Job Growth	1.6%	1.5%	1.4%	1.2%
Unemployment Rate	3.9%	3.7%	3.5%	3.7%
Consumer Price Index	2.4%	2.7%	2.3%	2.4%
Core Consumer Price Index	2.1%	2.3%	2.3%	2.5%
3-month Treasury Bill	2.4%	2.5%	1.6%	1.8%
10-year Treasury Bill	2.9%	2.9%	1.9%	2.1%
30-year Treasury Bill	3.1%	3.3%	2.3%	2.5%
30-year Conventional Mortgage	4.5%	4.6%	3.8%	4.2%
Federal Deficit	-$779 Billion	-$900 Billion	-$984 Billion	-$1.1 Trillion
Virginia Real GDP*	2.8%	2.7%	2.2%	2.0%
Virginia Employment Growth	1.1%	1.4%	1.4%	1.1%

*2019 actuals may contain actual annual data or estimated annual data due to the timing of data releases.

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.