MSKAPPA

2019 OUTLOOK

Financial Consulting

Mount Shasta Inc

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Highlights

With China and the Eurozone seemingly on the ropes, it’s difficult to be optimistic about the global economy’s performance this year. Fortunately, the persistence of low inflation should allow major central banks to keep monetary policy accommodative while some governments, including China’s, also have room to dispatch fiscal stimulus should downside risks to growth materialize.

While last month’s government shutdown will temporarily restrain Q1 output, we are leaving our 2019 forecast for U.S. GDP growth unchanged at 2.3% expecting a subsequent rebound. Concerns about a trade war, a slowing housing market and the possibility of an inverted yield curve should keep the Federal Reserve in pause mode for a while.

The U.S. economic outlook is healthy according to the key economic indicators. The most critical indicator is the gross domestic product, which measures the nation's production output. The GDP growth rate is expected to remain between the 2 percent to 3 percent ideal range. Unemployment is forecast to continue at the natural rate. There isn't too much inflation or deflation. That's an optimal economy.

	2018	2019	2020
United States			
GDP	2.90%	2.30%	1.90%
CPI inflation	2.40%	2.10%	2.10%
Fed Fund Target Rate*	2.50%	2.75%	2.75%
Ten-year bond yield*	2.69%	3.34%	2.71%
Canada			
GDP	2.00%	1.80%	1.70%
CPI inflation	2.30%	1.70%	2.10%
Fed Fund Target Rate*	1.75%	2.25%	2.00%
Ten-year bond yield*	1.96%	2.67%	2.65%
* end of period			

US ECONOMY

Overview

U.S. GDP growth will slow to 2.3 percent in 2019 from 3 percent in 2018. It will be 2 percent in 2020, and 1.8 percent in 2021. That's according to the most recent forecast released at the Federal Open Market Committee meeting on December 19, 2018. The projected slowdown in 2019 and beyond is a side effect of the trade war, a key component of Trump's economic policies.

The unemployment rate ends the year at 3.7 percent in 2018. It will fall to 3.5 percent in 2019, and rise slightly to 3.6 percent in 2020, and 3.8 percent in 2021. That's lower than the Fed's 6.7 percent target. But former Federal Reserve Chair Janet Yellen noted a lot of workers are part-time and would prefer full-time work. Also, most job growth is in low-paying retail and food service industries. Some people have been out of work for so long that they'll never be able to return to the high-paying jobs they used to have.

Structural unemployment has increased. These traits are unique to this recovery. Yellen admitted that the real unemployment rate is more accurate. It's double the widely-reported rate.

Inflation was forecast to be 1.9 percent in 2018 and 2019. It will rise to 2.1 percent in 2020 and 2021. The core inflation rate strips out those volatile gas and food prices. The Fed prefers to use that rate when setting monetary policy. The core inflation rate will be 1.9 percent in 2018 and 2019. It will rise to 2 percent in 2020 and 2021. Fortunately, the core rate is close to the Fed's 2 percent target inflation rate. That gives the Fed room to raise interest rates to more normal levels. The U.S. inflation rate history and forecast provides a good basis for predicting the coming years' inflation levels.

WORLD GDP

Highlight

The IMF just downgraded its 2019 forecast for world GDP growth. Some downside risks

Brexit, A hard Brexit would not be good news for an already fragile eurozone, True, the common currency area grew a decent 1.8% last year. But the second semester, which saw real GDP grow less than 1% annualized, was the worst in five years.

Eurozone has potential to bounce back. Last year's weak second half was partly due to extraordinary events that impacted Germany's economic activity, including tougher pollution standards (which hurt auto sales) and an extended drought which affected major waterways (and hence goods transportation) including the crucial Rhine river

China - US trade War, China's slowdown is also hurting investor confidence. While the world's second largest economy grew a decent 6.6% last year, that was the lowest GDP growth print since 1990. The deceleration should, however, not be surprising all things considered.

World Economic Outlook

	Forecast		
	2018	2019	2020
Advanced countries	***2.3***	***1.9***	***1.8***
United States	2.9	2.3	1.9
Euroland	1.8	1.6	1.7
Japan	0.9	1.1	0.5
UK	1.4	1.5	1.6
Canada	2.0	1.8	1.7
Australia	3.2	2.7	2.7
New Zealand	3.1	2.7	3.1
Hong Kong	3.8	2.4	3.0
Korea	2.8	2.5	2.8
Taiwan	2.7	2.2	2.3
Singapore	2.9	2.6	2.7
Emerging Asia	***6.5***	***6.3***	***6.3***
China	6.6	6.3	6.2
India	7.3	7.4	7.7
Indonesia	5.1	5.1	5.2
Malaysia	4.7	4.5	4.8
Philippines	6.5	6.3	6.6
Thailand	4.6	3.8	3.7
Latin America	***1.1***	***1.8***	***2.0***
Mexico	2.1	1.9	2.2
Brazil	1.3	2.4	2.2
Argentina	-2.6	-1.1	2.2
Venezuela	-18.0	-12.8	-2.0
Colombia	2.8	3.4	3.7
Eastern Europe and CIS	***3.0***	***2.0***	***2.1***
Russia	1.7	1.5	1.7
Czech Rep.	3.1	2.9	2.5
Poland	4.4	3.7	3.0
Turkey	3.5	-0.2	2.6
Middle East and N. Africa	***2.1***	***2.5***	***3.0***
Sub-Saharan Africa	***3.1***	***3.7***	***3.9***
Advanced economies	***2.3***	***1.9***	***1.8***
Emerging economies	***4.6***	***4.6***	***4.7***
World	***3.7***	***3.5***	***3.5***

Source: NBF Economics and Strategy

OIL AND GAS PRICES

At a Glance

The U.S. Energy Information Administration provides an outlook from 2019 to 2050. It predicts crude oil prices will average $61/barrel in 2019. That's for Brent global. West Texas Crude will average around $7/barrel less. The EIA warned that there is still some volatility in the price. It reported that commodities traders believe WTI prices could range between $36/b and $77/b by March 2019.

Since oil contracts are priced in dollars, a strong dollar depresses oil prices. Oil companies are laying off workers. Some may default on their debt. High yield bond funds haven't done well as a result.

The oil market is still responding to the impact of U.S. shale oil production. That reduced oil prices by 25 percent in 2014 and 2015. The good news for the economy is that it also lowered the cost of transportation, food, and raw materials for business. That raised profit margins. It also gave consumers more disposable income to spend. The slight slowdown is because both companies and families are saving instead of spending.

The EIA's energy outlook through 2050 predicts rising oil prices. By 2025, the average Brent oil price will increase to $86/b. This is a quote in 2017 dollars, which removes the effect of inflation. After that, world demand will drive oil prices to the equivalent of $114/b in 2050. <u>By then, the cheap sources of oil will have been exhausted, making crude oil production more expensive.</u>

SUMMARY

2019 will experience subdued economic growth, although a recession is unlikely. The effects of President Trump's tax cuts have led to increased stock buybacks, not the jobs he promised. Also, companies are concerned about uncertainty resulting from the trade war. As a result, the yield curve in Treasury notes created an inversion for about a week in December. It signaled that investors believed another recession is probably two to three years out.

The stock market hit several new highs in 2018. That indicated the peak of the business cycle. But it also dropped significantly, stirring fears of a recession. It will probably move sideways in 2019 as investors wait to see how the trade war resolves.

Plummeting commodity prices, including gold, oil, and coffee, will return to the mean. All in all, an excellent time to reduce debt, build up your savings, and increase your wealth.

“A goal without a plan is just a wish.”
— **Antoine de Saint-Exupéry**

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