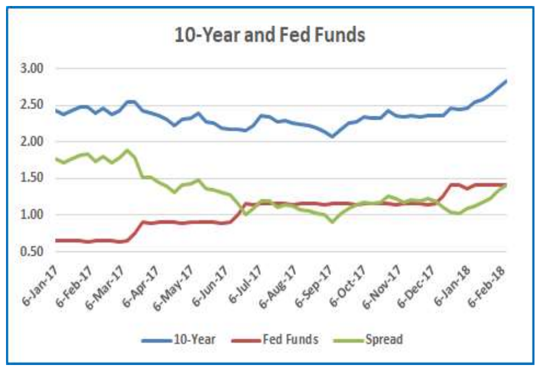
ECONOCAST WEEKLY

ECONOCAST™ UPDATE – February 12, 2018

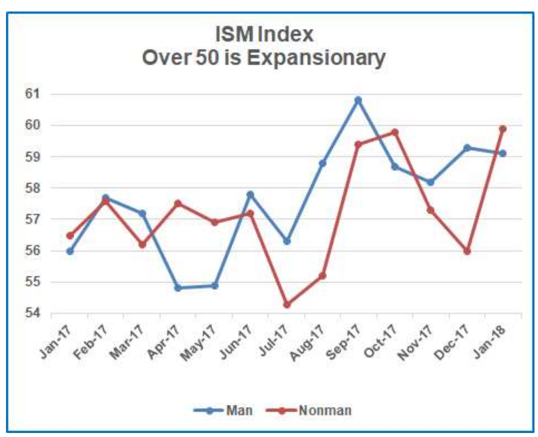
U.S. Economy – More Stimulus

The two-year budget deal Congress passed Friday adds $300 billion in federal spending; suspends the debt ceiling until March 2019; and includes $89 billion for disaster relief. This is on top of the $415 billion in tax cuts over the next two years. The combined fiscal stimulus totals $715 billion, pushing the deficit above $1 trillion in fiscal 2019. The good news is that the agreement provides fiscal certainty through the mid-term elections; avoids threats of a government shutdown; and raises the debt ceiling. Federal spending will grow by 7% per year – the highest rate since 2010 – stimulating demand. The bad news is that it promises even higher inflation and interest rates in an economy already at, or near, full capacity, thereby setting the stage for a recession in 2020.

The results are beginning to show up in financial markets. Price volatility in the stock market soared as the Dow swung by 1,000 points or more multiple times last week. Tellingly, the Dow was down 5% for the week and about 2% year to date. Interest sensitive sectors, such as utilities, are down 8% for the year. The 10-year treasury ended at 2.83%. The10-year has risen 37 basis points so far this year, and the spread between the 10-year and the funds rate has widened to 1.42%. These trends are likely to accelerate over the next 24 months.



That said, the economy is growing at a 3.5% pace. The ISM indices were very strong in February. Higher new orders and rising demand point to accelerating growth this year.



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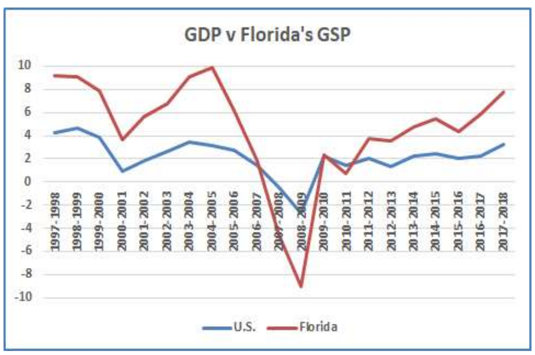
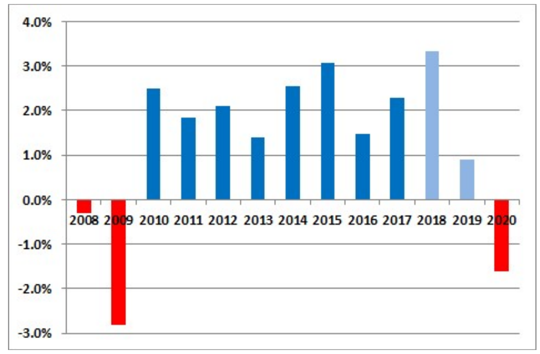
Florida Economy: The Budget Deal and Florida's Economy

The budget deal is great for Florida in the short run. Florida will receive billions in disaster relief funds for reconstruction, housing, and direct aid to families and businesses. The agreement also specifically includes $2.4 billion for crop losses, most of which occurred in Florida.

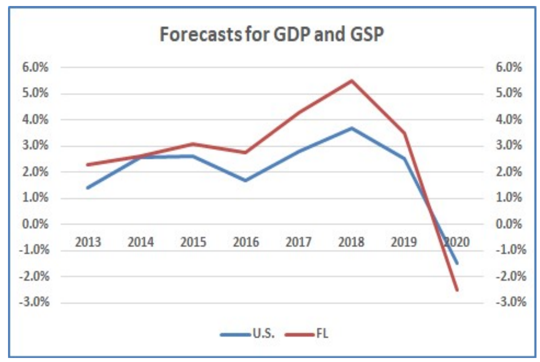
The increased fiscal stimulus will boost growth of real GDP by about 0.4% on top of the 0.6% from the tax cuts. Since Florida's gross state product is highly correlated with real GDP, Florida's economy will grow even faster in 2018. However, a recession in 2020 will hit Florida hard, because state gross product is more volatile than the trajectory for GDP.



While the precise timing and magnitude of a recession is difficult to gauge, 2020 is a likely time. By then the Fed will have increased the fund rate to 4% or more. The 10-year will then rise to about 6% pushing mortgages over 7%. Stocks will sell off triggering the downturn. Since there are few imbalances in the real economy, the contraction will be relatively mild and short lived. However, a 1.7% contraction is sufficient to cause Florida's economy to contract as well.



Given the historical relationship between GDP and state GSP, Florida's economy would fall by 2.5%. Most of the contraction will occur in construction and tourism. Slower population growth will take a toll on population related sectors.



Population growth benefits from the huge inflow from Puerto Rico in 2018, which also stimulates demand and construction. Because it takes people 6-12 months to move to Florida, the full impact of the recession on population growth is delayed to 2021.