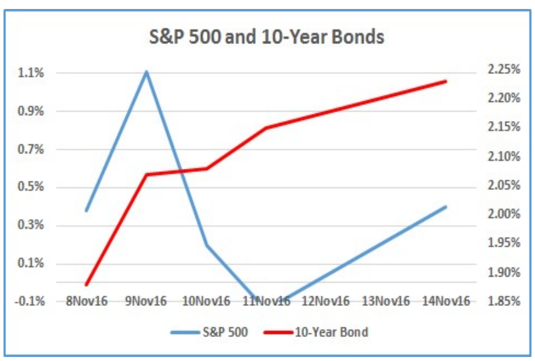
ECONOCAST™ UPDATE – November 14, 2016

U.S. Economy – Trump Wins, Stocks Rise and Bonds Fall

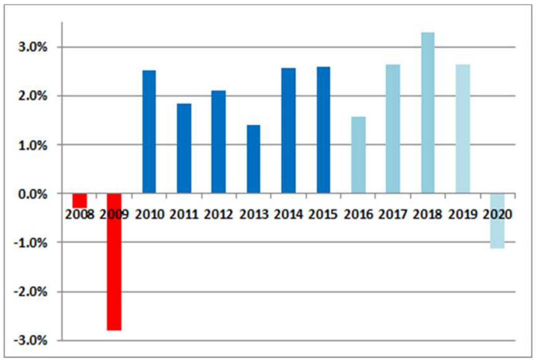
Donald Trump won the election, and after an initial selloff stocks rose strongly with the S&P rising 1.5% since election day. Bond prices plummeted pushing the yield on the 10-Year to 2.23% today. These reactions are omens of what is to come.



While both Mr. Trump's economic policies and his team are not fully formed, the appointments of Mr. Pence to lead the transition and Mr. Priebus as chief of staff signal a desire to govern effectively in the critical first 100-days of his presidency. Mr. Trump has announced plans to repeal many of President Obama's executive orders on healthcare, immigration and environmental regulations. In addition, he advocates major tax cuts and large increases in spending for infrastructure and defense. These plans are consistent with those of Speaker Ryan and they are likely to pass within the 100-day mark. In addition, Congress must pass a budget, deal with sequester rules which come back in 2017, and raise the debt ceiling. These have proven to be problematic in the past, but they will pass fairly smoothly this year with Mr. Trump and the Republicans in power.

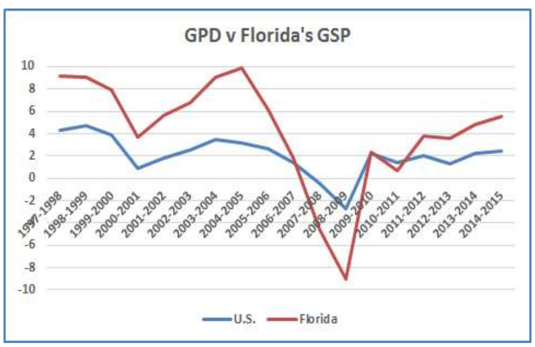
Ironically, the expected size of the stimulus from tax cuts and spending increases rivals the stimulus package passed in 2009. This stimulus comes at a time when the economy is approaching full employment and the Fed is poised to raise interest rates. In the short run this will boost growth by ½-to-1% so long as a trade war is averted and moves to deport undocumented workers are modest.

However, this policy mix will ultimately push interest rates dramatically higher by 2019 setting the stage for the next recession. With the fund rate expected to rise to at least 3%, by the end of 2018 the 10-Year will jump to 6% or more with mortgages at 7.5% or more. Further rate increases in 2019 and 2020 will probably cause a recession that may look something like this.



Florida Economy: What Will be the Impact on Florida?

Florida's economy is highly correlated with the U.S. As noted in prior commentary, the growth in Florida's real GSP has a correlation of 0.88 with the trajectory of real GDP. Furthermore, Florida's cycle is more volatile than the U.S. cycle.



Based on this relationship, the forecast for Florida is very strong through 2019. Stronger growth in real GDP coupled with relative low interest rates, albeit rising rates, is a prescription for stronger growth in Florida. Population growth would accelerate from its already strong annual pace of nearly 400,000 now to about 450,000 by 2018 supported by housing markets experiencing rising sales and higher prices making it easier for people to sell their homes and move to Florida. Residential construction would jump to 175,000 units by 2018 with gains in both primary homes and vacation homes. Job growth would soar from the current pace of 270,000 per year to more than 300,000 in 2018. Some of the buoyancy would be tempered by the appreciation of the dollar which will depress foreign investment further and cause foreign tourism to weaken even more.

The boom will top out in 2019 if interest rates rise as expected and growth in real GDP slows. Florida's economy is very sensitive not only to the trajectory of real GDP, but also to higher interest rates, especially higher mortgage rates.

Deficit-funded stimulus programs have never generated sufficient growth in GDP to close the spending gap caused by tax cuts and increases in government spending. This hard lesson was proven during the Reagan administration. Furthermore, when the spending occurs as the economy approaches full employment, as is the case today, inflation rises and rates are pushed higher even faster. Ultimately such cycles end with interest rates sufficient to trigger recession. While there are many uncertainties and 2020 is a long way off, we have been down this road before. With this in mind, the future may bring a moderate recession by 2020.