The Best Surprise is No Surprise

BY CHARLIE HALL

All of the major economic indicators are pointing to a good 2016. But business owners still need to be prepared for anything that could happen.

The outlook for this spring is a good one. There are very few red flags among current economic indicators to suspect any surprises in economic performance in the first couple of quarters of 2016. One of the bright spots in the coming year is the housing market, a prime influencer of derived demand for green industry products and services.

Even though housing starts have more than doubled from its recession-inflicted bottom, overall starts are still way below the average level of 1.5 million per year from 1959 through 2000. Demographics and household formation suggests starts will increase to around 1.5 million over the next few years. That means starts will probably increase another 40 percent or so from the October 2015 level of 1.06 million starts (SAAR). Residential investment and housing starts are usually the best leading indicator for the economy, so this suggests the economy will continue to grow in 2016.

And for commercial real estate, the AIA Architecture Billings Index is usually a leading indicator for commercial real estate (CRE), and the readings over the last year suggest more increases in CRE investment in 2016 (except oil and power with the recent decline in oil prices). Again, it appears the economy is poised for more overall growth in 2016.

SHIFTING DEMOGRAPHICS

Last year, I discussed some demographic data for the U.S. and I pointed out that even without the financial crisis we would have expected some slowdown in growth this decade (just based on demographics). The good news is that will change soon. Changes in demographics are an important determinant of economic growth, and although most people focus on the aging of the Baby Boomer generation, the movement of younger cohorts into the prime working age is another key story in coming years.

There was a huge surge in the prime working age population in the 1970s, 1980s and 1990s — and the prime age population has been mostly flat recently (even declined a little). The prime working age population peaked in 2007, and appears to have bottomed at the end of 2012.

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The good news is the prime working age group has started to grow again, and should be growing solidly by 2020 — and this should boost economic activity in the years ahead. These young workers are well educated and tech savvy and they will have babies and buy homes soon.

OIL AND GAS PRICES

As far as gas prices are concerned, the EIA forecasts that Brent crude oil prices will average $53 a barrel in 2015 and $56 a barrel in 2016. Forecast West Texas Intermediate (WTI) crude oil prices average $4 a barrel lower than the Brent price in 2015 and $5 a barrel lower in 2016. The monthly average price of U.S. regular retail gasoline was $2.16 per gallon in November, a decrease of 13 cents per gal from October and 75 cents per gallon lower than in November 2014. EIA forecasts U.S. regular gasoline retail prices to average $2.04 per gal in December 2015 and $2.36 per gal for 2016. Right now, gasoline prices are down to around $2.02 per gallon nationally according to Gasbuddy.com.

MORE JOBS, LESS UNEMPLOYMENT

The National Association for Business Economics says the average forecast is for growth of 2.6 percent next year, down slightly from 2.7 percent in its survey conducted in September. But they expect the jobs market to continue strengthening, with the unemployment rate dropping to 4.7 percent by the end of 2016. The rate now stands at 5 percent.

Further out, two-thirds of those surveyed expect potential economic growth between 2 and 2.5 percent over the next five years.

Certainly, there are some important aspects of the economic picture that are weaker than, say, a year ago. The energy sector — both investment and employment — is a prime example. The external sector — captured in the GDP accounting as net exports — is another aspect of the economy that is weaker than in 2014. Domestic manufacturing has been a bit softer as a result.

Still, on balance, the data have been encouraging, in my view, and affirm that the economy is growing at a moderate pace. Real final domestic demand data have been quite solid, driven in large part by robust consumer spending. Supporting consumer spending, employment conditions are undeniably, in my opinion, much improved relative to even a year ago.

The inflation picture, however, is not so clear. Inflation has been running below the Federal Open Market Committee's (FOMC) longer-run target (2 percent) for a while. But I expect the gap to close gradually as the reduction in resource slack puts upward pressure on commodity prices and the effects of the decline in oil prices and the rise of the dollar exchange rate start to subside.

For many months, Federal Reserve officials have indicated that the pace of policy tightening is much more important than the timing of the initial move. In recent comments, Fed Chair Janet Yellen has emphasized that monetary policy will still be accommodative after the initial increase in short-term rates, future policy moves will be data-dependent, and economic conditions are expected to evolve in such a way as to warrant a gradual pace of rate increases over the next couple of years. ■

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