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Flattening Yield Curve Signals Single Remaining Rate Hike in 2018

ATLANTA–Expect the Federal Reserve to raise interest rates in September, then hold firm until long-term interest rates inch up, Rajeev Dhawan of the Economic Forecasting Center at Georgia State University's J. Mack Robinson College of Business says.

"In his July testimony, Fed Chairman Jay Powell pretty much sealed September's rate hike," Dhawan wrote in his 'Forecast of the Nation,' released today (Aug. 29). "The only justification for delay would be a calamitous drop in financial markets in the next 30 days."

Foreign currency crises in Argentina and Turkey, as well as the weakening yuan (China), real (Brazil) and ruble (Russia), could raise caution at the Fed. Another cause for concern among economists and the financial press is the tightening U.S. yield curve, which shows interest rates for Treasurys with maturities from one to 30 years.

"Some flatness is to be expected as the Fed raises the short end of the yield curve," Dhawan wrote. "The problem is the long end o has barely budged, even as the short end has risen by 100 basis points."

Dhawan pointed to the 20-odd basis point spread between two-year and 10-year Treasurys as the reason for only one more rate hike in 2018. If the ongoing emerging market currency crisis intensifies further and affects U.S. financial markets, especially investors flocking to Treasurys for safety, it could wipe out the remaining spread and jeopardize the September rate hike.

"For future rate hikes, the Fed will wait for long bond yields to inch up," Dhawan said. "When the Treasury Department goes to market to finance more debt, I anticipate the long bond yield will rise."

Look for the Federal Reserve to take a pause from raising rates in December and restart in 2019, resuming their watchful course of raising rates, he said.

"The Fed always watches inflation, which measures the heat of the economy. But inflation is well within the target range of two percent and current economic growth is running at just about 3.0 percent," Dhawan said. "To sustain this growth we will need to see the currently good investment numbers get even stronger, and investment will need to grow at a high double-digit clip, as it did in the late '90s, for the U.S. economic supertanker to speed ahead at more than four percent growth."

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Intensifying trade spats with the nation's major trading partners are creating uncertainty for future growth, he said.

"The first round effect of trade spats is postponement of domestic investment expenditures," Dhawan said. "But the real damage occurs when retaliation by allies results in upheaval in the Treasury bond market. This does not appear likely yet, but the game is still young."

Highlights from the Economic Forecasting Center's National Report

- Following robust GDP growth of 4.1 percent in the second quarter of 2018, the economy will expand at 2.8 percent in 2018, 2.4 percent in 2019 and 2 percent in 2020.
- Business investment grew 7.3 percent in 2018's second quarter. Expect growth to finish at 7.4 percent in 2018, 5.8 percent in 2019 and 4.9 percent in 2020. Jobs will grow by a monthly rate of 205,000 in 2018, 142,600 in 2019 and 125,700 in 2020.
- Housing starts will average 1.283 million units in 2018, fall slightly to 1.258 in 2019 and rise to 1.300 in 2020. Expect auto sales of 16.8 million units in 2018, 16 million in 2019 and 15.8 in 2020.
- The 10-year bond rate will average 3.1 percent in 2018, 3.9 percent in 2019 and 4 percent in 2020.

Domestic-Demand Sectors Drive Georgia Job Growth

ATLANTA–Georgia's job creation in the first six months of 2018 primarily arose from domestically driven sectors, according to Rajeev Dhawan of the Economic Forecasting Center at Georgia State University's J. Mack Robinson College of Business.

The state created 36,300 jobs in the first half of the year, lower than the last half of 2017 and opposite the U.S. trend of slight acceleration in job growth.

"In the first half of 2018, domestically driven sectors, chiefly hospitality, education, healthcare, construction and retail trade, created 40,000 jobs," Dhawan wrote in his quarterly "Forecast of Georgia and Atlanta" released today (Aug. 29). "Meanwhile, globally connected sectors (such as manufacturing, corporate, information and transportation) lost 3,700 jobs."

Trade uncertainty and a strong dollar resulted in weaker job growth in manufacturing, but the primary cause of the deviation from the national trend was a drop in corporate employment.

"Surprisingly, corporate sector employment dropped by 6,000 positions in the first half of 2018," Dhawan wrote. "These two Peach State trends, weak gains in manufacturing and job losses in the corporate sector, are not evident in national figures."

Despite the recent lack of job growth in the large corporate sector, job losses from this sector have not spilled over into the rest of the economy. As evidence, Dhawan points to his triangle of money concept, which looks at tax collections to form a complete picture of job quality and purchasing power.

"Georgia's state tax revenues, such as gross sales receipts, are not showing any weakness," Dhawan says. "Thus, the moderation in the corporate sector job growth is likely an aberration in the data and will get sorted out in next year's benchmarking release."

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Corporate expansions in Atlanta, Brunswick, Demorest and Carrolton, along with decisions by healthcare technology companies to locate in Atlanta, are leading to job growth in healthcare and construction, buoying overall job growth and reflecting an underlying growth trend.

Medium- and small-sized businesses also are trending positively.

"The news of expansion and headquarter relocations, especially for medium-sized firms, is reassuring," Dhawan said. "Due to steadily climbing consumer confidence, the prognosis also is good for small businesses that mostly depend on domestic demand.

Domestic demand also has positively affected the hospitality sector, which experienced strong gains in the first half of 2018 through a 20 percent increase in rooms booked over the last six months of 2017.

Dhawan anticipates the negatives of global pressures on catalyst sectors will be offset in 2018 by the positives of recent tax cuts and rising confidence among consumers and small businesses, driving domestic demand sectors and resulting in a continuation of 2017's job growth trend.

Highlights from the Economic Forecasting Center's Report for Georgia and Atlanta

- Georgia will add 78,400 jobs (12,500 premium jobs) in 2018, 61,700 jobs (11,800 premium) in 2019 and 54,800 (10,800 premium) in 2020.
- Nominal personal income will rise 4.4 percent in 2018, 5.2 percent in 2019 and 5.2 percent in 2020.
- Atlanta will add 53,600 jobs (9,400 premium jobs) in 2018, 42,900 jobs (9,100 premium) in 2019 and 39,500 jobs (8,400 premium) in 2020.
- Atlanta permitting activity in 2018 will rise 11.7 percent, fall 1.3 percent in 2019 and rise 0.7 percent in 2020.

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