Montrose County Economic Update

Fourth Quarter 2018

Colorado Mesa University

Provided by the Business Department of Colorado Mesa University

Economic Summary

- The Montrose economy remains strong and shows no signs of slowing with a 3.2% unemployment rate and increased employment and labor force numbers. Local wages continue to rise as a result of a strong economy and low unemployment.
- The local real estate market remains strong, however cracks are showing in the national housing market with rising inventory resulting from rising interest rates and home values moving beyond homeowners' ability to pay.
- The national economy is very strong, with a high growth rate of 3.5%. Unemployment remains at levels not seen since the 1960's at 3.8%. Rising interest rates and the potential for slowing housing are the only potential threats.

The Montrose County Economic Update is provided by the Business Department of Colorado Mesa University and is published quarterly. Please direct all correspondence to Dr. Nathan Perry, Associate Professor of Economics, 970.248.1888, naperry@coloradomesa.edu.

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Local Economic Indicators

	Q3 2018	Q2 2018	Q3 2017	% change since last quarter	% change since last year (comparable quarters)
Local Labor Market					
Unemployment Rate Montrose County-NSA	3.23%	3.07%	2.87%	0.17%	0.37%
Unemployment Rate Colorado - NSA	3.20%	2.70%	2.80%	-1.20%	-0.40%
Unemployment Rate U.S. - NSA	3.90%	3.80%	4.40%	-0.20%	0.20%
Labor Force	22,245	21,979	21,251	1.21%	4.68%
Employed	21,524	21,307	20,638	1.02%	4.29%
Unemployed	721	672	613	7.24%	17.68%
Business Confidence					
Leeds Colorado Business Confidence Index	56.5	59.6	56.5	-5.20%	0.00%
Sales/Use Taxes					
City Sales/Use Taxes (Quarterly)	$4,815,654	$4,460,929	$4,620,488	7.95%	4.22%
City Sales/Use Taxes (YTD)	$13,172,869		$12,262,014		7.43%
County Sales/Use Tax (Quarterly)	$3,481,635	$3,320,637	$3,256,441	4.85%	6.92%
County Sales/Use Tax (YTD)	$9,702,198		$9,252,147		4.86%
Montrose City Hotel and Restaurant Tax (Quarterly)	$171,286	$139,451	$158,799	22.83%	7.86%
Montrose City Hotel and Restaurant Tax (YTD)	$422,734		$396,239		6.69%

Montrose Regional Airport	Q3 2018	Q2 2018	Q3 2017	% change since last quarter	% change since last year
Enplanements	36,461	20,241	29,167	80.13%	25.01%
Local Labor Market Yearly Indicators	**2016**	**2015**	**2014**	**% change since 2015**	**% change from 2014**
Median Household Income	$43,285	$46,860	$46,336	-7.63%	-6.58%
Percent of Population Below Poverty Line	18.00%	19.00%	17.20%	-1.00%	0.80%
	2017	**2016**	**2015**	**% change since 2016**	**% change from 2015**
Population	41,784	41,160	40,534	1.52%	3.08%

SOURCES IN ORDER OF LISTING: State and Local Unemployment rates: Bureau of Labor Statistics (LAUS); National Unemployment rate: Bureau of Labor Statistics; Labor Force, Employed, and Unemployed: Colorado Department of Labor and Employment; Leeds Colorado Business Confidence Index: Leeds School of Business; Sales/Use Tax information: City of Montrose, Montrose County; Montrose Regional Airport enplanements/deplanements: Montrose Regional Airport; Population: U.S. Census Bureau; Personal income per capita: Bureau of Economic Analysis. Note that in all rows where percentages are presented the % change since last quarter and % change since last year represents the difference between the two percentages, not the actual percentage change. Also note that in data tables calculations are performed with two decimal points but in the report economic data is rounded to one decimal point.

The Local Labor Market

The Montrose County labor market continues to be strong with a 3.23% unemployment rate (non-seasonally adjusted). Comparatively the Colorado economy is at 3.20% unemployment and the national economy is at 3.90%. The labor force is up 994 people since the same quarter last year, while employment is up 886. The number of unemployed has increased by 108, which is an increase of 17.68%. This increase in unemployment seems to be the result of an increase in the labor force, which has grown slightly faster than the growth in employment (remember that labor force = employed + unemployed). If employment were falling the rising unemployment number may be more concerning, but this unemployment seems to be the result of more people wanting to work, or a rising labor force. The next two quarters are quarters where there is historically higher unemployment due to seasonal factors. As long as employment numbers keep growing at this pace the new labor force participants should be able to eventually find work. This of course assumes that the economy stays strong.

The Montrose economy is performing significantly better than it was five years ago. The labor force is up 2,620 people, with employment up 3,545, equating to a decline of unemployed totalling 926. Compared to 10 years ago, the Montrose economy has grown and surpassed the peak of 2008. In fact the Montrose economy has surpassed the 2008 totals for several quarters.

Montrose City sales and use tax continues to increase year over year, increasing 4.22% from last year. Current city sales tax numbers are at $4,815,654, compared to last year's $4,620,488. The year to date numbers are up 7.43%, reflecting the strong growth and economic activity in Montrose County. The hotel and restaurant tax, which is a proxy for visitations and tourism, is up 7.86% from last year. County sales tax numbers are up 6.92% year over year and 4.85% YTD.

Montrose airport Enplanements are up 25% from last year, showing a growing airport supporting a growing economy.

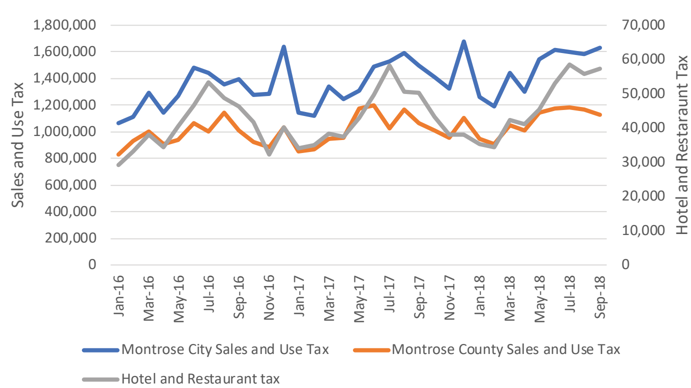
Table 1:

1, 5, and 10 year Employment Comparison (Based on Q1, 2018)

	Labor Force	Employed	Unemployed
Annual	994	886	108
5-Year	2,620	3,545	-926
10-Year	762	1,051	-288
Annual %	4.68%	4.29%	17.68%
5-Year %	13.35%	19.72%	-56.21%
10-Year %	3.55%	5.13%	-28.57%

Figure 1:

County and City Sales and Use Tax



Business Confidence and Poverty Rates

The Leeds Business School business confidence index for the state of Colorado is down from the previous quarter but up from the same time last year. Business confidence numbers are still at very high levels. The yearly indicator section in the data table above lists percentage of people below the poverty line for Montrose County and the most recent data point is 18%. For a comparison, other county numbers include Larimer County (13.2%), Mesa County (16.3%), Delta County (16.8%), Jefferson County (8.1%), and Pueblo County (20.2%). For Montrose, 2014 had a lower poverty rate than 2016 (17.2% vs. 18%). However, given strong 2017 and 2018 economic data there is good reason to believe that poverty rates can fall from the 2016 numbers.

Figure 2:
Montrose County Labor Force 2008-Present

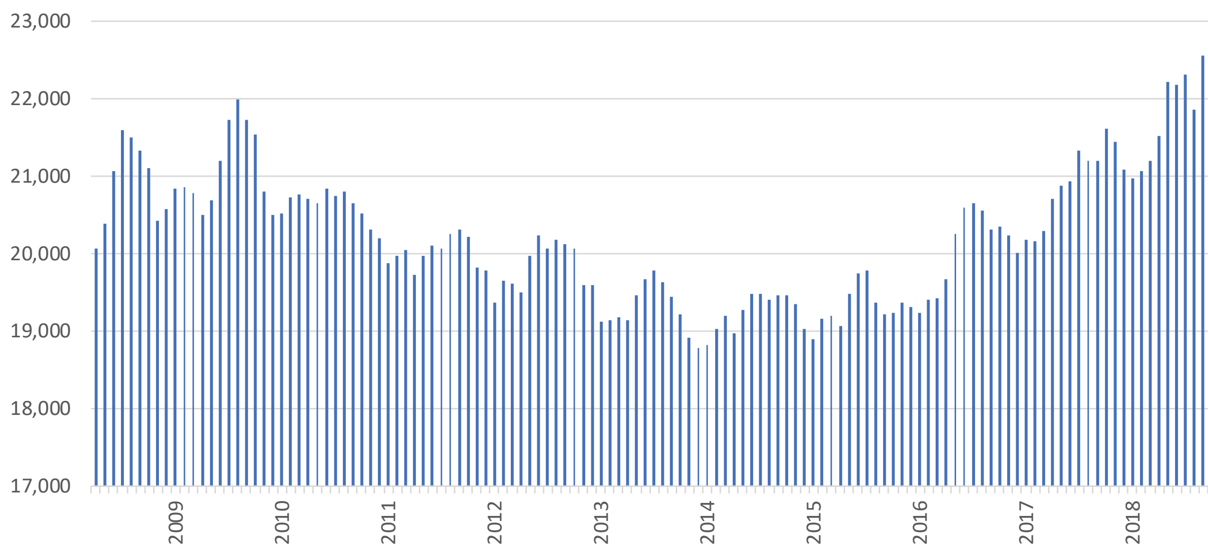
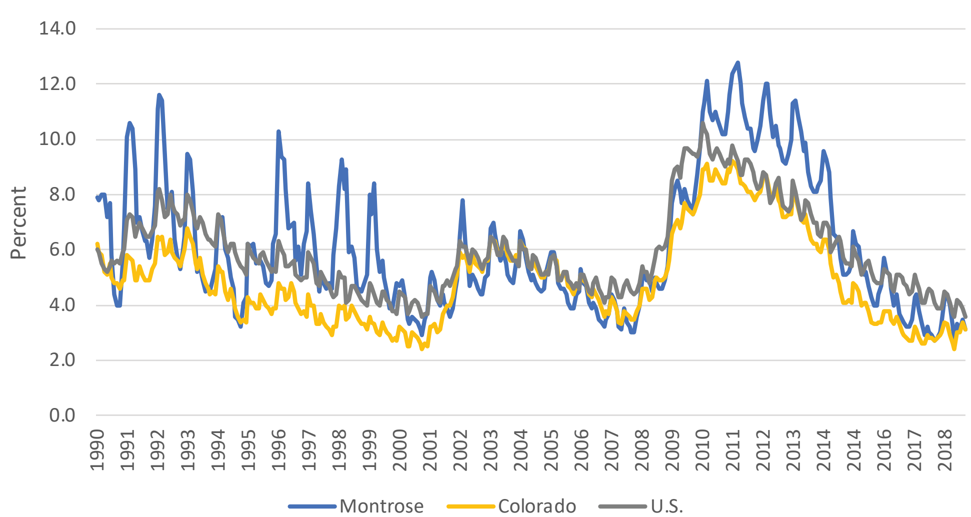


Figure 3:
Unemployment Rates (NSA) 1990-Present



SOURCE: Figure 1: Colorado Department of Labor and Employment. Figure 2: Bureau of Labor Statistics

Montrose County Employment Trends

(Note that QCEW data has not been updated by the Bureau of Labor Statistics since the last economic update released). Table 2 illustrates average employment, total quarterly wages, and average weekly wage for all major industries in Montrose County. The QCEW data utilizes employment insurance information to collect its data. This has a tendency to exclude many agricultural workers (migrant work, family workers, H1B1 Visas), as well as sole proprietors. Despite this, the QCEW data is one of the best sources for changes in industry employment and wages. For Q1 2017 (the most recent data available as of the writing of this report) construction (21.96%) and manufactuing (14.02%) lead the way in employment gains, while wholesale trade and "other services" saw the largest losses. Wage gains came from mining oil and gas (29.74%) utilities (10.87%), other services (16.72%), and agriculture and forestry (15.31%). Note that a different estimate of agricultural employment is in table 3 below, showing 1,275 agricultural workers in 2016.

Table 2:

Quarterly Census of Employment and Wages for Q1 2018

Sector	Average Employment 1st Quarter 2018	Total Quarterly Wages	Average Weekly Wage	Annual Percent Change in Employment (Compared to Q1 2017)	Annual Percent Change in Average Weekly Wages (Compared to Q1 2017)
Total	14,880	$142,930,368	$739	3.19%	2.92%
Government Total	3,128	$38,000,827	$935	0.58%	0.75%
Total Private	11,752	$104,929,541	$687	3.90%	4.09%
Health Care and Social Assistance	2,123	$18,396,640	$667	2.81%	6.04%
Retail Trade	2,055	$15,635,107	$585	2.14%	4.84%
Construction	1,133	$12,146,089	$825	21.96%	3.90%
Manufacturing	1,350	$11,892,166	$678	14.02%	-3.83%
Accommodation and Food Services	1,298	$5,584,165	$331	2.93%	2.48%
Professional and Technical Services	439	$5,578,970	$978	2.33%	-0.91%
Wholesale Trade	437	$5,258,520	$926	-10.45%	8.69%
Utilities	212	$4,497,745	$1,632	-1.85%	10.87%
Transportation and Warehousing	543	$4,488,282	$636	5.23%	3.41%
Finance and Insurance	308	$4,273,986	$1,067	1.99%	-2.11%
Other Services, Ex. Public Admin	357	$3,662,314	$789	-18.86%	16.72%
Administrative and Waste Services	458	$3,536,922	$594	1.10%	0.51%
Real Estate and Rental and Leasing	326	$3,000,242	$708	4.49%	8.26%
Management of Companies and Enterprises	106	$1,981,985	$1,438	2.91%	3.23%
Agriculture, Forestry, Fishing & Hunting	225	$1,695,980	$580	-1.32%	15.31%
Information	158	$1,482,757	$722	-0.63%	1.26%
Mining, Oil, and Gas Extraction	48	$1,126,837	$1,806	-4.00%	29.74%
Arts, Entertainment, and Recreation	149	$641,143	$331	18.25%	-4.06%

Table 3:

Farm Employment

Agriculture	2016	2015	2014	% change since 2015	% change from 2014
Farm Employment Estimate	1,275	1,273	1,296	0.16%	-1.62%

SOURCE: Table 2: Colorado Department of Labor and Employment (QCEW). Table 3: Bureau of Economic Analysis

Local Real Estate

	Q3 2018	Q3 2017	% change since last year
Real Estate			
Inventory of Homes for Sale (3 month avg)	282	292	-3.43%
New Residential Listings (3 month total)	336	277	21.30%
Sold Residential Listings (3 month total)	248	238	4.20%
Median Sales Price	$240,717	$224,733	7.11%
Average Sales Price	$268,127	$241,298	11.12%
Days on Market	92.16	87.67	5.13%
Months Supply of Inventory	3.94	4.20	-6.17%
Total Building Permits	192	158	21.52%
Total Building Permit Valuation	$20,215,943	$14,951,843	35.21%
Single Family Home Permits	73	50	46.00%
Single Family Home Permit Valuation	$11,903,811	$8,739,080	36.21%
Foreclosures			
Foreclosure Filings	13	14	-7.14%
Foreclosure Sales	6	9	-33.33%
Mortgage Rates			
30 Year Mortgage Rate	4.03%	3.17%	0.86%
15 year Mortgage Rate	4.57%	3.88%	0.69%

SOURCES IN ORDER OF LISTING: Sources in order of listing: Current and Sold Residential Listings, Absorption rate, Median Sales Price, Single Family Home Sales: Atha Real Estate Team (from MLS); Building Permits and Valuation: Montrose County and Montrose City; Foreclosure Filings and Sales: Montrose County; Mortgage rates: Freddie Mac.

Local Real Estate Indicators

The Montrose County real estate market continues its strong performance with a 7.11% increase in median home value year over year, changing from $224,733 in Q3 0f 2017 to $240,717 in Q3 of 2018. Average home values have risen even more, moving from $241,298 to $268,127 for an 11.1% increase. The average moving higher than the median indicates that there are high income homes being sold, pushing the average higher. Inventory of homes has fallen 3.43%, while new residential listings are up 21.30%. Sold residential listings are up 4.20%. Months supply of inventory is down 6.17%, moving from 4.20 to 3.94, while days on market has increased by 5.13% from 87 to 92 days. The number of total building permits and single family home permits are up drastically, 21.5% and 46% respectively, while valuation numbers are up approximately 35% for both total permits and single family permits. Overall, the Montrose quarterly data for real estate looks strong and new building permit growth is likely a big part of the reason that construction employment is higher.

The monthly data shows a slight decrease in sold homes in September 2018 compared to September 2017 by 10.8%, but this did not cause an increase in inventory, which is a warning sign of a slowing housing market. Neighboring Mesa County saw a rise in inventory in September which followed a national trend of rising inventory, but Montrose did not have this same rise in inventory. There are signs nationally that the housing market is slowing, and several cities have seen large increases in inventory which will translate to falling prices and lower listing prices relatively soon, but so far this has not affected Montrose.

Rising inventory nationally is an important piece of evidence that the real estate market may have topped in August, which is a common belief among economists regarding the national real estate market. To be clear, a top does not necessarily mean prices will fall or that there will be a crash, but the concensus is that the price growth we have seen the last few years is likely to start slowing.

The arguments for a slowing housing market are twofold: First, interest rates are rising, with the Federal Reserve committed to increasing rates to thwart potential inflation, asset price bubbles, and to make sure that if we enter a recession the Federal Reserve has a policy tool that they can use (more on this later). The Fed is expected to continue to increase rates. Figure 8 shows that since

2016, the Federal Funds rate has increased to 1.75%. The 30 year mortgage rate has increased approximately 1% during the same time period. If the Federal Reserve has four more rate hikes as many expect, assuming they increase rates by 25 basis points (0.25 percentage points) each time, that would push the Federal Funds rate to 2.75%, likely pushing the 10 year and 30 year mortgage rates up anywhere from 0.5% to 1%, increasing the 30 year mortgage rate from 4.8% to let's say 5.5%. As an example, a $200,000 mortgage for a buyer with good credit at an interest rate of 3.8% a year ago would have had a monthly payment of $932. Today the same home would cost $1,049 at 4.8% interest. If the Fed increases rates as many expect, a 5.5% mortgage rate would increase the house payment to $1,136. That is a total increase of almost $200 in the monthly payment, which is how most people view the cost of the home. This will hurt housing demand.

The second issue is that home values have simply increased faster than what any measure of household income can sustain. Figure 4 illustrates per capita income and the Case Shiller home price index. Notice that per capita income moves in a very linear fashion but home values swing up and down since 2000. Figure 5 uses a linear trend to show how the Case Shiller index is now above the linear trend. Both figures show that home values are overvalued compared to either the trend of per capita income or a simple linear trend.

Figure 4:
Per Capita Income and Case-Shiller Index

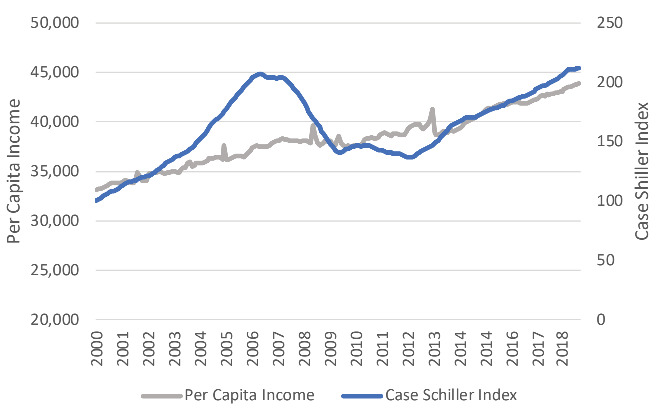


Figure 5:
Case Shiller Index and Linear Trend Line

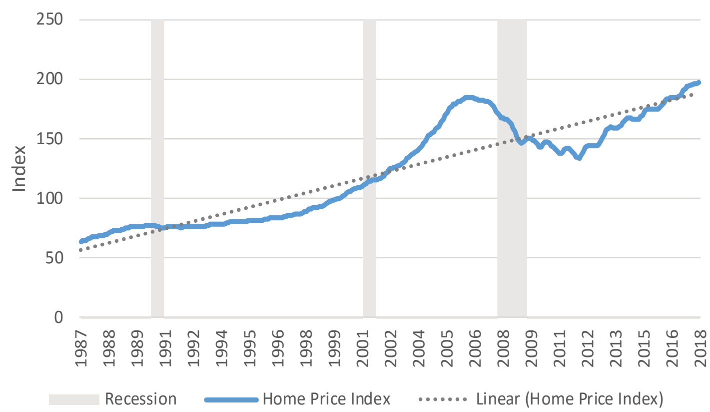
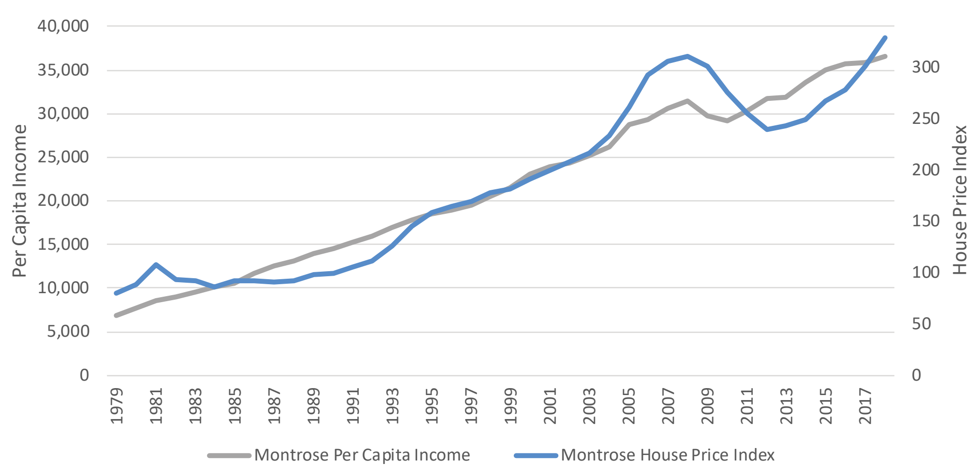


Figure 6:
Montrose County Per Capita Income and Montrose County House Price Index (1979-Present)



SOURCES: Case Shiller Home Price Index: S&P Dow Jones Indices LLC; Per capita income: Burea of Economic Analysis; FF rate and 10 year treasury: Federal Reserve; Local House Price Indices: Federal Housing Finance Agency. 2017 and 2018 per capita income numbers are calculated by the author using a regression forecasting technique. 2018 house price index number is calulated indexing the previous index to median household income numbers. These two procedures provide a complete dataset.

Figure 6 illustrates Montrose County per capita income, overlayed with a Montrose County house price index. The county level graph shows that the house price index has surpassed the per capita income level in a similar fashion to the national data. This is not a perfect analysis, as there is more to the consumer choice for housing than per capita income, but it does provide a baseline equilibrium and illustrates that Montrose County home values are following a similar trend to the nation. Although both national data and local data illustrate that homes are moving beyond their "equilibrium" value, notice that the gap between the current home price and per capita income is smaller than in the 2008 housing bubble. As of now, the inevitable slowing of the national housing market due to rising interest rates and rising home values is unlikely to cause a large housing downturn similar to what was witnessed 10 years ago. This could change as the broader economy changes.

Figure 7 illustrates Mesa, Montrose, Colorado, and the U.S. housing price indices from 1979 to the present. Both Mesa and Montrose witnessed a larger increase in house price appreciation during the bubble 10 years ago, and each county remains higher than the U.S. index. The Colorado Index has had a sharp upturn the last 5 years and has overtaken Mesa and Montrose counties.

Figure 7:

Local Home Price Indices

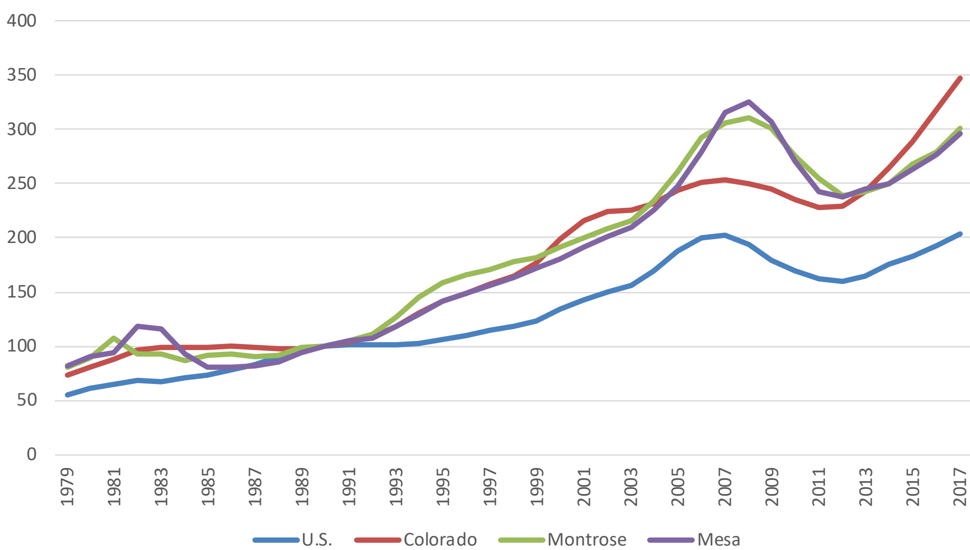
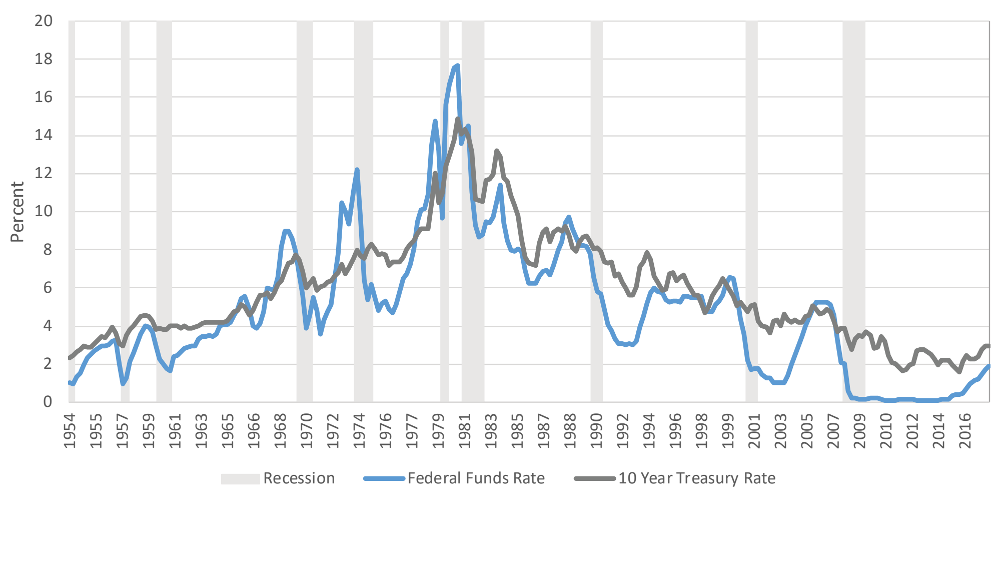


Figure 8:

Federal Funds Rate and 10 Year Treasury Rate



Regional Energy

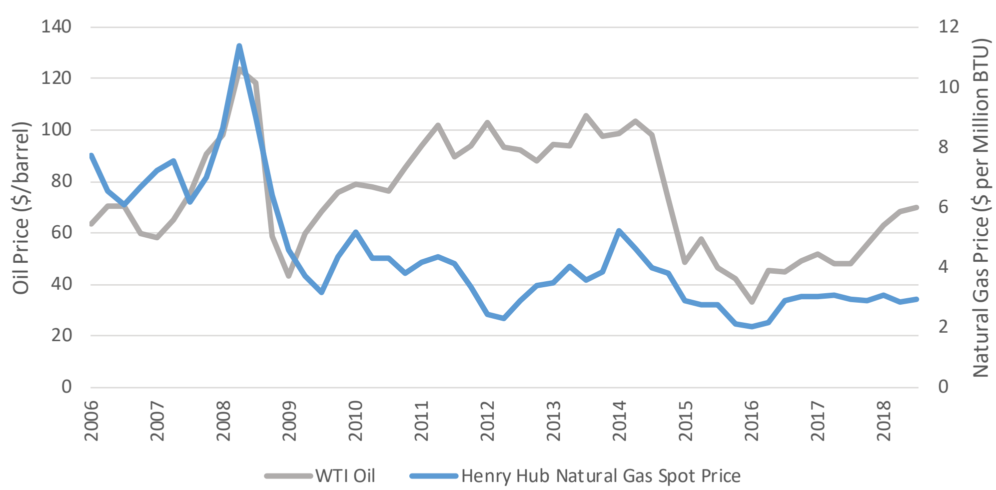
	Q3 2018	Q2 2018	Q3 2017	% change since last quarter	% change since last year (comparable quarters)
Energy Prices					
WTI Crude Oil	$69.69	$68.07	$48.18	2.38%	44.65%
Henry Hub Natural gas	$2.93	$2.86	$2.95	2.45%	-0.68%
Retail Gasoline Price	$2.77	$2.75	$2.36	0.54%	17.38%

Drilling Permits	**2018 YTD (as of Oct 1st)**	**2017 YTD (as of Oct 1st)**	**2017 Total**	**% Change since same time last year**
Drilling Permits (Mesa County)	63	171	215	-63.16%
Drilling Permits (Rio Blanco County)	66	113	118	-41.59%
Drilling Permits (Garfield County)	525	442	612	18.78%
Drilling Permits (Moffat County)	4	4	5	0.00%
Total Permits (Mesa, Rio Blanco, Garfield, Moffat)	658	730	950	-9.86%
Total Permits (Colorado)	3,118	2,952	3,909	5.62%

Local Rig Count	**Nov-18**	**Aug-18**
Rig Count (Western Colorado, Mesa, Rio Blanco, Garfield, Moffat)	7	7

SOURCES IN ORDER OF LISTING: All energy prices: Energy Information Agency; All permit data from Colorado Oil and Gas Conservation Commission (COGCC); Local Rig Count: Baker Hughes Rig Count as of November 1st, 2018.

Figure 9:
Oil and Natural Gas Prices



Natural Gas Prices

Natural gas prices rose slightly in Q3 2018 to $2.93/MMBtu from $2.86/MMBtu in Q2. In early October, the price of natural gas has been steadily increasing, and as of October 30th sits at 3.23/MMBtu. Higher temperatures in the lower 48 states led to an increase in natural gas demand for power generation compared to supply inventory. This reduction puts inventories at 2,866 billion cubic feet (Bcf), which is 18% less than one year ago, and 17% less than the 5 year average of inventory. Although this reduction in inventory may be large it will likely not be met with a comparible increase in price due to the high level of natural gas production that the U.S. is experiencing. The Energy Information Agency forecasts that natural gas prices will average 2.99/MMBtu for the rest of 2018, increasing to 3.12/MMBtu for 2019.

Source: https://www.eia.gov/outlooks/steo/marketreview/natgas.php

Oil and Gasoline Prices

The West Texas Intermediate (WTI) price of oil hit a 4 year high on October 3rd reaching $76.4/barrel. Since this 4 year high, the price has fallen to $55.63/barrel (as of November 13th). Prices were rising due to the re-imposition of sanctions on Iran that will reduce Iranian exports of crude oil and thus world oil supply. In June OPEC met and decided to increase oil production, more than offsetting the reduction in Iranian and Venezuelan exports. The increase in price indicated that the market did not have faith that Saudi Arabia and other OPEC members can keep production as high as agreed upon. However, since this rise in oil a slowing economy, a reactive U.S. oil industry, and the rising dollar have caused the price of oil to plummet. The world economy has slowed considerably, which will reduce the global demand for oil in the near future. Oil is priced in dollars, and as the U.S. dollar continues to appreciate it makes it more expensive for foreign nations to purchase oil denominated in dollars, reducing the quantity demanded. The U.S. is now the largest producing oil country in the world, and as prices increase the law of supply kicks in and U.S. oil producers start producing more oil, flooding the market, and reducing the price. These mixed signals over the last 2 months make oil prices difficult to forecast.

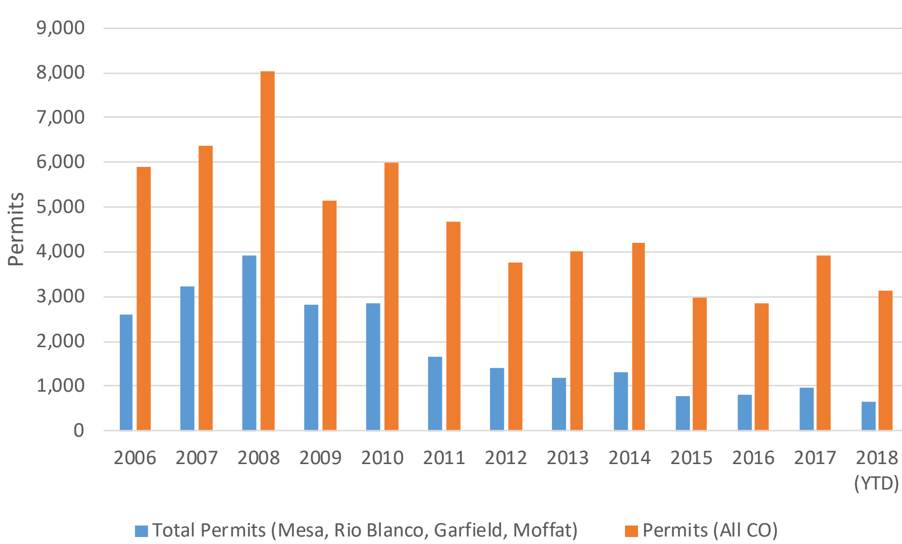
Gasoline prices remain constant from last quarter but are up 17.4% since last year. Thus far into November, gasoline prices have not fallen as a result of the falling price of oil.

Western Slope Drilling Activity

Western Slope drilling activity in Q3 of 2018 is unchanged from Q2, staying at 7 rigs. All rigs in the Piceance are currently engaged in natural gas drilling. Drilling permits for Mesa County and Rio Blanco County are down 63% and 41% respectively from the same time last year. Permits in Garfield County are up almost 19%. Piceance basin permits in total as are down approximately 10% from last year. Montrose has not had any drilling permit applications since 2011.

Figure 10:

Total Drilling Permits: Piceance vs. Colorado



National Economic Indicators

	Q3 2018	Q2 2018	Q3 2017	% change since last period	% change since last year (comparable quarters)
Business Cycle Indicators					
Real GDP	3.50%	4.20%	2.80%	-0.70%	0.70%
Real Personal Consumption Expenditures (PCE)	3.05%	2.61%	2.36%	0.44%	0.68%
Private Fixed Investment	7.69%	8.33%	6.04%	-0.65%	1.64%
National Consumer Confidence	98.1	98.3	95.1	-0.20%	3.15%
Industrial Production Index	108.5	107.3	103.3	1.16%	5.05%
Initial Weekly Unemployment Claims (4 week MA)	213,096	223,288	248,571	-4.56%	-14.27%
Non Farm Payroll Change (in thousands)	2,446	2,376	2,169	2.95%	12.75%
Unemployment					
Unemployment Rate-U3-SA	3.80%	3.90%	4.30%	-0.10%	-0.50%
Unemployment Rate-U6-SA	7.50%	7.70%	8.50%	-0.20%	-1.00%
Interest Rates					
Federal Funds Rate	1.91%	1.73%	1.16%	0.18%	0.75%
10 Year U.S. Treasury	2.93%	2.92%	2.24%	0.01%	0.69%
30 Year U.S. Treasury	3.06%	3.09%	2.82%	-0.03%	0.24%
Inflation Measures					
Inflation Rate (CPI)	2.61%	2.65%	1.97%	-0.03%	0.64%
Core Inflation Rate (All Items Less Food and Energy)	2.23%	2.19%	1.70%	0.04%	0.53%
Inflation Rate (Shelter)	3.39%	3.41%	3.24%	-0.03%	0.14%
Producer Price Index (PPI)	4.95%	4.88%	3.72%	0.06%	1.22%
Employment Cost Index	2.83%	2.78%	2.51%	0.06%	0.32%
Stock Prices					
S&P 500	2,850	2,703	2,467	5.42%	15.50%
Dow Jones Industrial Average	25,595	24,556	21,891	4.23%	16.92%
International and Debt					
USD Exchange Rate (trade weighted)	125	121	119	3.53%	4.96%
Trade Balance (% of GDP)	-646.487	-549.781	-557.269	17.59%	16.01%

SOURCES: GDP, Consumption, Investment, and Trade Balance: Bureau of Economic Analysis; Consumer Confidence: University of Michigan; Industrial Production, Interest Rates and USD Exchange Rate: Board of Governors of the Federal Reserve System; Weekly Unemployment Claims: U.S. Employment and Training Administration. Non-Farm Payroll, Unemployment Rates, Inflation Measures: Bureau of Labor Statistics; Stock Prices: S&P Dow Jones Indices, LLC.;

Figure 11:

Real GDP

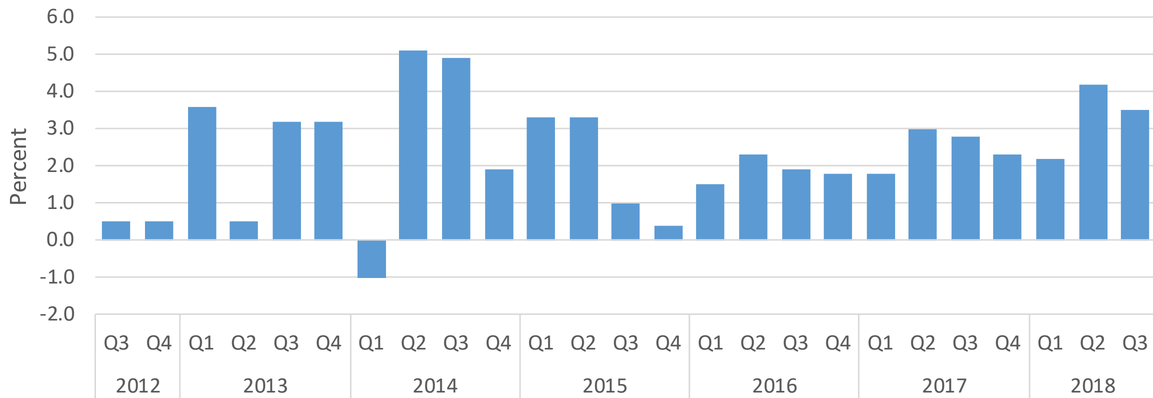
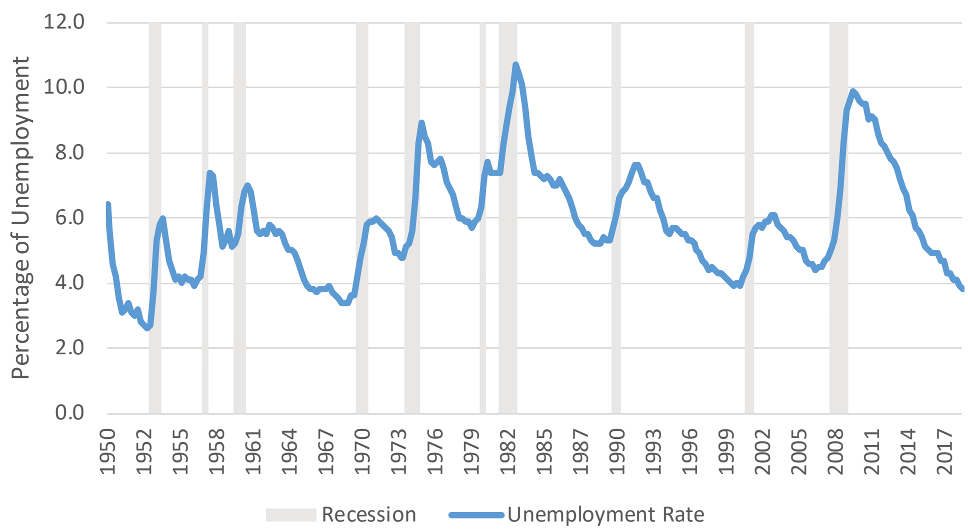


Figure 12:

U.S. Unemployment: 1950-2018



National Economic Performance

Quarter 3 GDP growth registered at 3.5%, which is a solid growth rate and means the economy continues its strong push forward (Figure 9). Real personal consumption expenditures increased from last quarter at 3%, up from 2.6%. Private fixed investment continues to be strong at 7.7%, while the industrial production index shows continued expantion of industrial production. National consumer confidence remains strong at 98.1. The last time consumer confidence remained this consistently high was in the late 1990's.

The national labor market continues to be strong, with weekly unemployment claims continuing to fall and non-farm payroll numbers increasing. Unemployment moved from 3.9% in Q2 to 3.8% in Q3. The U.S. has not seen unemployment at 3.8% since the late 1960's (Figure 10). Not even in the technology boom of the 1990's did unemployment get to 3.8%. The U6 measure of unemployment, that counts so called discouraged workers, has not been at 7.5% since 2001, right before the tech bubble burst.

Interest rates are the only bad news for the economy, and quite frankly they have not gone up very much by historical standards. The Federal Funds rate has increased from 1.2% to 1.9% the past year, or an increase of 70 basis points. In the same time period, the 10 year treasury rate has increased 2.2% to 2.9%, roughly the same amount. This has pushed mortgage rates higher and forced the housing market to cool. All measures of inflation have held constant from last quarter, although all measures are up from Q3 last year. Specifically, the producer price index is up 1.2% year over year, which is troubling because it is a leading indicator for the consumer price index.

Although the stock market shows gains from last quarter and from last year, the consensus from economists is that the fiscal policy impact from the recent tax cuts will begin to diminish soon, reducing corporate earnings, and tempering potential gains.

Figure 13:
Employment Cost Index

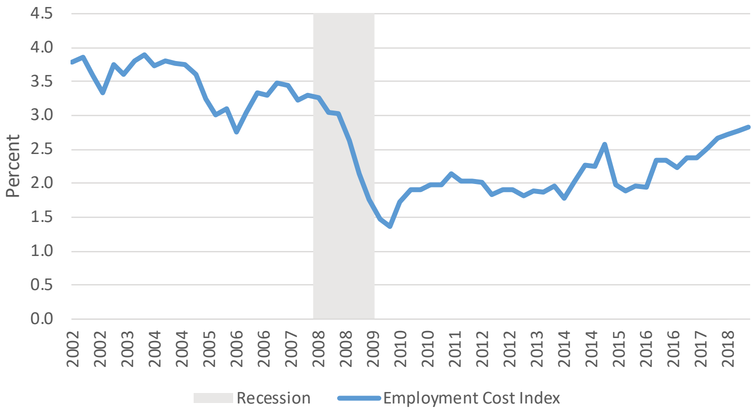
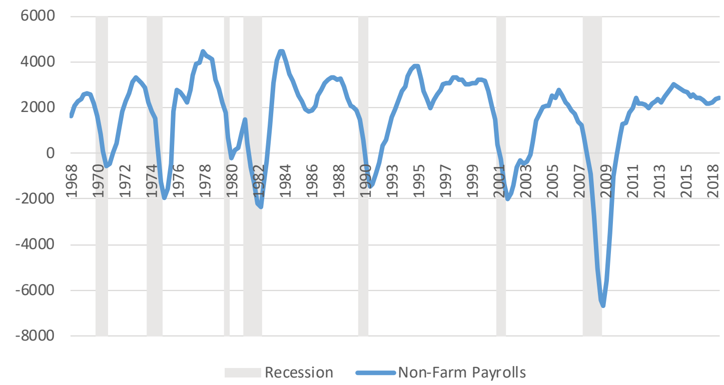


Figure 14:
Change in Non-Farm Payrolls



The Rise of the U.S. Dollar

The U.S. dollar exchange rate continues to rise primarily due to the strength of the U.S. economy compared to world economies and the Federal Reserve increasing rates, which makes U.S. treasury yields more attractive. Global growth is slowing, and investors prefer to be in U.S. stock and bonds vs. other countries' assets with lower GDP growth. This rise in the dollar has several effects internationally. The first is that it makes U.S. exports more expensive, and imports cheaper, widening the trade deficit. Second it has had the effect of making foreign debt denominated in U.S. dollars more expensive to service. This has caused financial turmoil in countries such as Argentina, Brazil, and Turkey. The third point is that a rising dollar also causes inflation in developing countries (called the exchange rate pass through effect), which can cause additional economic and political turmoil. As long as the Federal Reserve keeps raising rates and as long as U.S. growth remains strong relative to global growth, the U.S. dollar will likely remain strong.

Threats to Growth

The national economic data is strong, with only the potential cooling of the housing market and slowing global growth to report as threats for slower U.S. economic growth. Rising interest rates are hurting both the real estate market as well as the stock market. The Federal Reserve has a dual mandate of keeping inflation and unemployment low. Unemployment is very low by historical standards, so the Federal Reserve is choosing to focus on inflation. However, inflation numbers are within an acceptable range (2-3%), and there is a reasonable argument that the Federal Reserve is raising rates too fast or without a good reason to do so. One of the reasons the Federal Reserve may be raising rates is to ensure that during the next recession they have a policy tool by which to fight the recession. If interest rates are kept at zero and a recession hits, the Fed has very few tools to fight unemployment. Another reason may be to thwart a potential bubble forming in the housing market as well as the stock market. Both of these are smart reasons to raise rates, however, it may come at the cost of continued high growth rates.

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