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Not if, but when: What Colorado businesses need to know about the next recession

Colorado financial experts discuss the economic cues they're watching — and how businesses and individuals can best prepare for possible economic downturn.

By Monica Vendituoli – Reporter, Denver Business Journal
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At more than nine years, the country's current economic expansionary period is the one of the longest in history.

And Colorado has blossomed as one of the strongest economies in the country since the Great Recession in 2008.

"The U.S. is in the midst of one of the longest economic expansions of all time and our region has benefited greatly from this period of opportunity and growth," Russel Schmucker, the regional president for Sunflower Bank's Denver metro region, said.

Compared to most cities in the U.S., Denver's recovery from the Great Recession has been strong.

But signs of economic uncertainty are lurking:

- The University of Colorado Boulder's Leeds Business Confidence Index survey of 288 Colorado business leaders from June 1 through June 20 found that their optimism has decreased regarding the quarterly outlook for the national economy, industry sales, industry profits, industry hiring and capital expenditures.
- The Federal Reserve recently raised the interest rate by a quarter point for the second time this year.
- The yield curve, which measures the relationship of short-term to long-term interest rates, is flattening.
- And signs are emerging that consumers and businesses are taking on more debt.

Leaders in Denver's financial services sector are closely watching these signs.

"Despite uncertainty, there are proactive moves consumers and businesses can make to position themselves in the event of a downturn, and it's smart to be prepared for what may come," Jon Moore, regional director at EP Wealth Advisors, said.

Local impact of rising interest rates
One economic indicator Denver financial leaders are watching closely is the interest rate set by the Federal Reserve.

Jim Glassman, managing director and head economist for JP Morgan Chase Commercial Banking, said he expects the Federal Reserve to raise the federal funds rate by .25 points at its September policy meeting, again at its December meeting and a few more steps during 2019.

The Federal Reserve uses the federal funds rate to influence interest rates.

Commercial banks lend to one another to ensure they have a certain amount of capital in their reserves. The rate that they lend money to one another at is set by the Federal Reserve through the federal funds rate.

When the Federal Reserve raises the federal funds rate for financial institutions, it then trickles down to consumers and businesses through interest charged by lenders on personal and business loans, credit card balances and auto loans.

When the Federal Reserve sets the interest rate lower, the idea is often to get people to spend more money. When the rate is set higher, people spend less.

“The Fed’s rate hike was widely expected, as policymakers continue the process of normalizing rates,” said , market leader for Fidelity’s Colorado Investors Centers.

The Fed also adjusts rates to stop inflation.

“Clearly, their goal is to slow down inflation and we are clearly seeing inflationary costs,” said Vectra Bank CEO Bruce Alexander of the Fed's plans.

"Clearly, their goal is to slow down inflation and we are clearly seeing inflationary costs," Vectra Bank CEO Bruce Alexander said. "In the short term, it probably won't be material, but in the long term, if they continue to raise rates, it will have an impact on the Colorado economy."

Larry Martin, a senior advisor at Golden-based Bank Strategies LLC, a consulting group for bank managers and boards, believes the interest rate upticks will increase the cost of borrowing for real estate projects.

"To accommodate the increase or future increases, real estate developers will have to raise the prices/rents of the finished projects to offset the increased cost," Martin said. "Some projects in the loan application stage may no longer be feasible."

But Glassman disagreed. He said he believes the raising of the interest rate will do the opposite.

"If the Fed held its policy rate, which anchors all short-term interest rates, at current levels, it would run the risk of creating financial imbalances and the risk of a new recession," Glassman said.

Others said regional differences regarding the impact of interest rates may benefit Colorado.

"Raising the interest rate usually has a greater impact on regions that are growing slower ahead of faster growing ones," Schmucker, the regional president for Sunflower Bank's Denver metro region, said. "Denver and Colorado's economies have been growing faster than the rest of the U.S. economy, so one would expect that a higher cost of capital should not derail the expansion as long as investors' capital costs remain below the expected return on investment."

Jon Moore, regional director at EP Wealth Advisors, added that Colorado's popularity amongst job seekers will make the interest rate impact minimal.

"The local economy will likely remain strong as more companies continue to relocate to Colorado," Moore said. "The business expansion will continue to fuel job growth and the question will become whether the transplanted workforce will become home buyers or renters going forward."

The yield curve

Frederick Taylor, president and co-founder of Northstar Investment Advisors, said he is more worried about the possibility of an inverted yield curve than interest rates.

The yield curve illustrates the differences in investor returns for short- and long-term government bonds.

An example is the difference between interest rates on two-year Treasury notes and 10-year Treasury notes. When the economy is doing well, the interest rate on longer-term bonds tends to be higher than short-term bonds. The rate is higher to compensate for the chance that inflation could result from the strong economy.

However, research by the San Francisco Federal Reserve has found that every recession of the past 60 years has been preceded by an inverted yield curve.

“Since 1956, every time short-term interest rates got higher than long-term interest rates, it has led to a recession six to 18 months down the road,” Taylor said.

How tariffs could hit Colorado

Taylor added that he is concerned about tariffs, or taxes imposed on imports.

“A nasty trade war with China, Mexico and Canada caused by high tariffs could be a disaster,” he said.

A trade war occurs when countries try to damage each other's economy by stifling trade through tariffs or export and import quotas.

In early July, President Donald Trump imposed a 25 percent tariff on $34 billion worth of Chinese goods. The Chinese government responded by slapping $34 billion of tariffs on U.S. imports. Last week, the administration posted a list of $200 billion additional products that may be subject to tariffs.

Trump is also in favor of tariffs against Mexico, Canada and the European Union.

The U.S. Chamber of Commerce, the world’s largest business lobbying group, has strongly condemned the proposed tariffs.

“Tariffs imposed by the United States are nothing more than a tax increase on American consumers and businesses, including manufacturers, farmers, and technology companies, who will all pay more for commonly used products and materials,” the U.S. Chamber said in a statement. “Retaliatory tariffs imposed by other countries on U.S. exports will make American-made goods more expensive, resulting in lost sales and ultimately lost jobs here at home.”

In late June, the group released a study regarding the possible impact of tariffs on each state as measured by the amount of state exports to China, Mexico, Canada and the European Union.

The group found that about 733,900 jobs in Colorado are supported by trade and $276,868,555 is the total amount of exports threatened by possible tariffs.

Tariffs make American-made goods more expensive and higher prices eventually trickle down to consumers, Alexander, the CEO of Vectra Bank, said.

He noted that consumers make up about 70 percent of the market. If they have too much debt, coupled with rising interest rates, consumers could spend less — triggering another recession.

“Debt levels are moving upwards, consumer delinquencies are moving upwards, and so we’re paying close attention to that,” Alexander said.

“A nasty trade war with China, Mexico and Canada caused by high tariffs could be a disaster,” said Frederick Taylor, president and co-founder of Northstar Investment Advisors.

When and how big?

The exact timing of the next economic downturn is up for debate.

Zillow, an online real estate database company, made headlines in late May when half of financial experts it surveyed said they expect the next recession to start in 2020.

Taylor, of Northstar Investment Advisors, agrees with that date for several reasons.

“First, the positive fiscal stimulus from the 2017 tax cuts should have run their course,” Taylor said. “Second, if the Federal Reserve raises short term interest rates several more times in the next two years, that will slow down consumer spending on new homes and autos.”

Dan Kampen, chief financial officer at Bellco Credit Union, said that while the credit union itself does not make predictions on this issue, they are watching employment rates, real income, retail sales and industrial production.

“Some economists within the credit union industry have predicted a recession in 2020 as well,” Kampen said. “Our members are always our first priority, so should recession hit, we will do all we can to protect their best interests.”

Others are more optimistic.

Glassman, of Chase Commercial Banking, said that the prediction that a recession will occur in 2020 is not based on any visible threats.

Rather, he said economists are basing their prediction on the fact that the expansion has been ongoing for 10 years and expansions tend to run between six and nine years. He added that just because the economy is reaching full employment doesn’t mean a recession is coming either.

“Economic cycles are more like baseball games rather than football games,” Glassman said. “It is fair to describe the U.S. expansion as being at the bottom of the ninth inning, but that it is likely to go well into extra innings,” Glassman said. “That’s because there is nothing visible on the horizon that looks remotely similar to the red flags that triggered past recessions.”

But many financial professionals in the Denver metro think such predictions are impossible.

“Since we cannot accurately predict the timing of a recession, we suggest focusing on the things businesses and consumers can control,” Moore said.

Tips for recession planning

Financial experts said there are many ways for both individuals and businesses to prepare for an economic downturn before it happens.

“Economic booms and recessions are a natural occurrence of any economy,” Tom Tulodzieski, the president of KeyBank’s Colorado market and Rocky Mountain region. “Don’t panic and overreact. Be smart and prepare yourself, and try not to overextend yourself from a debt capacity.”

Smith, the market leader for Fidelity’s Colorado Investors Centers, emphasized investment strategy. He cited 401(k) investors during the Great Recession who moved their money out of stocks with an average starting balance of $89,000. As of the second quarter of 2017, their accounts had grown 157 percent to $223,000 — but mostly because they continued to contribute.

But Smith said those who had an average balance of $79,000 and stayed put in the stock market saw their account balances increase by 240 percent to $267,000.

“The latter group started with less but ended with more,” Smith said.

Kampen, at Bellco Credit Union, said people who are closer to retiring should especially seek professional advice regarding their 401(k) investments.

“It’s easy to ignore your investments when the economy and the stock market have been growing, but if you’re close to retirement, it’s important to keep a close watch on them,” Kampen said.

He said there are many similarities between how businesses and individuals should prepare for a recession. For example, both businesses and individuals should have emergency savings fund ready at all times.

“Cash on hand for the unexpected can help business owners breathe a little easier should a recession hit,” Kampen said.

He said both businesses and consumers should also create a budget and financial forecast for the next few years that takes into account what would happen if salaries and revenue were cut.

“Contemplating this in advance, rather than in the moment, gives a business options and time,” Kampen said. “Likewise, you may discover areas you can cut costs now that will help better prepare your business for the future.”

Nearly all local financial experts said that businesses should look at recessions as possible opportunities — and get creative.

“Can you diversify your products or services? Try new, more cost-effective marketing tactics?” Kampen said. “Many businesses have flourished during recessions by being smart and savvy.”

Moore, the regional director at EP Wealth Advisors, echoed Kampen’s optimism. He said businesses and individuals who prepare can grow during economic contractions.

“If they are in a strong position, then they’ll be able to take advantage of investment opportunities that arise during recessions,” Moore said. “You may be able to acquire real estate, stocks, or businesses at a discounted price.”