

# The Kiplinger Letter

FORECASTS FOR EXECUTIVES AND INVESTORS

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Dear Client:

Washington, June 30, 2022

Odds of a recession: Now above 50-50, as we wrote you last week. The case for optimism that we cautiously cited this spring has weakened as the Federal Reserve scrambles to rein in inflation by slowing the economy. Now, it appears that the Fed is going to get what it was determined to sidestep.

**THE ECONOMY**

Note the warning signs emerging now:

Consumers are turning more cautious in their spending, either because of soaring prices or because they fear an economic downturn later.

Businesses sense this and will adjust plans for their capital investments or hiring. Earnings are mostly good now. But business confidence is poor. “Business is great, but I’m scared to death” is a sentiment that gets repeated a lot, we’ve heard. (Perhaps it applies to your own business these days.)

The labor market still appears to be strong.

But there are some signs of cracks forming.

Stories of formerly aggressive hiring plans getting put on hold, for instance. Layoffs in some industries that had been booming, like tech and e-commerce.

These trends can be self-reinforcing...

less spending leads to less hiring and investment, leading to yet more caution.

Another risk: Europe’s economy looks very shaky as it reels from the spike in energy prices related to the war in Ukraine. 23% of U.S. exports go to Europe, so a serious downturn there could act as a decent drag on GDP growth here.

If a recession does materialize, we look for it to arrive sometime next year.

Current recession talk seems a bit early. The economy contracted in the first quarter of this year, but that was because of a surge in imports that has since diminished. The second quarter looks like it’ll be better. And there are still sources of momentum, most notably the still-tight labor market. It’ll take a while for those to lose steam.

How bad of a downturn are we talking about? Probably not a severe one, we think. Unlike in 2008, there aren’t major risks to the financial system now that could turn a routine recession into a deep slump. The job market is so tight that unemployment would likely stay fairly low, rising to about 4.5%, from 3.6% now. Lower-skilled, lower-paid workers would bear the brunt of layoffs, as they usually do. GDP growth...slowing from 1.9% this year to a bit under 1% for the whole of 2023.

Recessions are never good. But a modest one might help on some fronts.

Namely, by cooling demand in sectors where supply is too tight, like autos and especially housing, and buying time for factories and home builders to catch up.

If supply chain problems improve, growth could surge after the recession as consumer confidence rebounds and shoppers take advantage of better selection.

But afterward, the economy will likely return to a 1.5%-2% growth path.

**COVID-19 Positive Tests per 100,000 Residents**

**U.S. daily average: 33**

**11 to 20**

Conn., Ga., Iowa, Kan., Maine, Mich., N.H., Ohio, Pa., S.D., Vt.

**21 to 30**

Ariz., Del., Idaho, Ind., Md., Mass., Mo., Mont., Neb., N.Y., N.C., N.D., Okla., R.I., Tenn., Utah, W.Va., Wis., Wyo.

**31 to 40**

Ala., Ark., D.C., Ill., Ky., La., Minn., Miss., Nev., N.J., S.C., Texas, Va.

**41 to 50**

Calif., Fla., N.M., Ore., Wash.

**51+**

Colo. (51), Hawaii (54), Alaska (59)

Seven-day average, June 22-28

## TRADE

President Biden is increasingly in favor of rolling back some tariffs in an effort to fight inflation, particularly those on Chinese imports. The question is which goods will see tariff relief, and how much they will get. The federal government has imposed new tariffs on a whopping \$300 billion of imported Chinese goods, including clothing, fabric, footwear and furniture.

But any effort to do so will take time. Imposing tariffs is easier than lifting them, which may require a lengthy regulatory process under U.S. law. Quicker relief may depend on Biden issuing selective waivers for certain goods.

Note that the administration will not cut tariffs on Canadian lumber imports to fight inflation, despite requests from home builders and other stakeholders to do so. Washington continues to accuse Ottawa of unfairly subsidizing domestic producers.

## AG

After reaching record highs this spring, fertilizer prices are now declining. A closely watched index of North American fertilizer prices is down 32% since peaking in late March, as inventories rise. One reason: Demand is dropping. With prices so high this spring, many farmers either rationed their fertilizer use or switched from crops that require more of it, like corn, to those that need less of it, like soybeans. Also, fears that fertilizer supplies from Russia would be shut off due to sanctions punishing Moscow for invading Ukraine have not panned out. Even Uncle Sam has been quietly urging importers to purchase Russian fertilizer.

But keep in mind, prices are still up nearly 25% versus this time last year, and up 129% compared with the same period in 2019. Prices of major staple crops, such as corn and wheat, are also still elevated, both because of supply disruptions related to the war in Ukraine and because farmers elsewhere face high operating costs.

## ENERGY

The government wants to improve the efficiency of residential gas furnaces. A new Dept. of Energy proposal would require nonweatherized gas furnaces and those in mobile homes to achieve an annual fuel utilization efficiency of 95%, which means yielding 95 British thermal units of heat for every 100 BTUs of gas used. New condensing furnaces already manage that by capturing heat from exhaust gases.

The new rule will come into effect in 2029, if all goes according to plan, and will save consumers an average of \$60 annually on their utility bills, says the DOE.

Critics in the gas industry say the standard can't be hit in older homes that can't host the venting that condensing furnaces need. DOE's proposal, they say, is an effort to push more households to use electric heating systems instead of gas.

Meanwhile, the Dept. of Energy is also trying to improve heat pumps, which are being touted by the Biden administration as a cleaner alternative to traditional gas furnaces that will also help consumers reduce their electric bills.

A particular focus is making the technology work better in cold climates. While traditional furnaces generate heat by burning fuel, such as natural gas, heat pumps run on electricity and work basically like a refrigerator in reverse: They pull heat from the air, ground or a water source, then use it to warm the inside of a home. Because of this, heat pumps often struggle in subfreezing temperatures, which DOE hopes to change with its Cold Climate Heat Pump Technology Challenge. Manufacturer Lennox has delivered the program's first prototype. Early tests show it can work in weather as cold as 5 °F, with twice the efficiency of today's heat pumps.

Look for Washington to boost domestic purchases of enriched uranium to wean the U.S. off Russia, which provides 23% of U.S. nuclear fuel. The White House is working with Congress on a \$4.3 billion plan to rev up domestic enrichment and other steps needed to turn uranium into nuclear reactor fuel. Among other things, it would create a government buyer for uranium, including fuel for new reactor types.

The U.S. currently has only one remaining commercial enrichment facility. A second one is in the works in Ohio from Md.-based Centrus Energy.



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## INSIDE D.C.

Note the emergence of a new national pro-business advocacy group: The American Free Enterprise Chamber of Commerce, or AmFree, born out of frustrations with the U.S. Chamber of Commerce. The voice of American business for more than a century has earned its fair share of critics in recent years, who say the organization is betraying its core mission by trying to address such issues as social justice and immigration reform.

The group is specifically targeting small and midsize businesses and aims to revamp what it calls outdated federal regulations and tax policies. It's also taking a tougher stance on China...a contrast with the U.S. Chamber.

And it will be based in Iowa, rather than in Washington, D.C., bolstering its anti-establishment credentials. The location may have something to do with the organization's leadership, which includes Terry Branstad, the former GOP governor of Iowa and Donald Trump's ambassador to China.

## POLITICS

Will the Supreme Court overturning *Roe v. Wade* be a political earthquake? Or will it be a small seismic event? Time will tell. While a majority of voters say they are unhappy with the outcome, it's less clear how much it will matter in Nov.

Other issues will likely take precedence, most notably the economy. Inflation is still at a multi-decade high. Meanwhile, efforts by the Federal Reserve to fight it could trigger a recession next year, or at the very least, slow U.S. economic growth.

Abortion could still matter in specific states and races. One example: Wis., which has a law on the books that has already halted abortions in the state. Another: Pa., where abortion has already emerged as an issue in state elections. Both states have competitive Senate races that Democrats will likely need to win to maintain control of the chamber. And both narrowly backed Joe Biden in 2020.

Conventional wisdom holds that the issue will primarily energize Democrats. But Republican voters may also be mobilized by the possibility of new laws that ban or restrict abortion access in states where it remains legal. As a result, state legislative and gubernatorial contests will have even higher stakes this year.

That could be awkward for GOP candidates trying to downplay abortion in their campaigns. For example, Adam Laxalt...the Republican nominee for Senate in Nev...has said the issue is moot, since the state has already legalized abortion.

All the ramifications of the *Roe* decision won't be felt for several years and will depend on several factors. While a majority of Americans favor legal abortion to some degree, many also favor greater restrictions than *Roe* allowed. Democratic talk of axing the Senate filibuster to codify abortion rights, however unlikely, is a turnoff to both moderate and conservative voters. Republican efforts to restrict access to certain types of birth control could also potentially run afoul of public opinion.

## CONGRESS

Congress has passed its most extensive gun control measure in decades. But notably, many lawmakers aren't even referring to it as "gun control," instead using terms like "gun safety" or "gun violence prevention." For Republicans who backed the bill, this is a way to sidestep critics who say they're soft on gun rights. For Democrats, it's a signal that they think the new law doesn't go far enough.

The law includes narrow restrictions on gun ownership, with the goal of keeping firearms away from individuals experiencing mental health problems: Enhanced background checks for gun buyers under 21 years old. Incentives for states to adopt "red flag" laws that allow for the temporary confiscation of guns from individuals regarded as a threat to themselves or others. Plus, hundreds of millions of dollars in support of school safety and mental health services.

Don't expect Congress to do anything else on guns, despite big talk from Democrats, who have neither the votes nor the time to pass additional bills.



## TECH

A rising challenge for streaming media: More cost-conscious subscribers.  
Any future upticks in monthly price will be more risky than in recent years, when subscribers would generally absorb the cost. The price of streaming video apps is now the No. 2 reason for canceling, says market research firm NPD Group. And today's consumers are increasingly on the hunt for promotions and discounts.

Free streaming apps supported by advertisements will see viewership jump as consumers look to save money. Examples include Roku, Pluto TV and Peacock.

Netflix's coming ad-supported service will gain popularity quickly, too.

But it will be a big challenge, with early stumbles. It's a tight timeline to launch an ad-supported, free service this year, and the company lacks experience in ad technology. Still, advertisers are eager to reach Netflix's young-skewing users.

Over coming years, tens of billions of dollars of TV ad budgets will shift from traditional linear television to ad-supported streaming services. These apps will find new ways to personalize messages and give marketers more detailed data.

## TRAVEL

Historically high gas prices aren't stopping Americans from hitting the road.  
The July 4 holiday weekend will see a record 42 million folks take a car trip of at least 50 miles during the holiday period, says the automotive group AAA. Plus, another 2.4 million will travel by bus, train or cruise ship. Last July 4, 41.8 million took road trips. In 2019, the figure was 41.5 million. Pent-up desire for vacation time after pandemic-era lockdowns and restrictions is driving the trend. Another factor: Folks aiming to avoid soaring airline ticket prices, flight cancellations and delays. Still, 3.6 million Americans are expected to fly, a slight increase versus 2021's tally.  
Top U.S. destinations will be Orlando, Seattle and New York City, says AAA.

One form of travel that Americans are increasingly spending on: RVing.

The latest splurge will keep folks connected even at a remote campground, courtesy of SpaceX's broadband satellite service Starlink, which is now available for RVs for \$135 per month and a one-time hardware cost of \$600. The service isn't mobile, so you'll have to park and set up the small satellite dish. You'll need power, too.

Satellite internet is likely to be a hit with many RVers. The fast speed of the connection will outdo most cellular coverage that many RVers opt for today. A popular part of the service will be the ability to pause the subscription at any time and then restart it whenever...good for vacationers that camp only part of the year.

## AUTOS

Something to ponder when buying your next vehicle: Its color's resale value.  
Cars painted bold colors tend to hold their resale value best, while colors that are common depreciate at an average rate, says a new study from iSeeCars.com, an auto search engine that compared prices of over 650,000 recently resold cars that were three years old. Yellow cars retain their resale value best, losing only 4.5% of the sticker price after three years, 70% less than the average vehicle. Orange was a distant second, depreciating 10.7%. Then purple, red, green and blue, all around 14%. Overall, the average three-year depreciation for all cars was 15%.

Why do bold colors like yellow and orange retain value? It's part novelty, since they're not common colors and can be sought-after in the secondhand market. They're also popular colors for sports cars, muscle cars and other low-volume models.

Yours very truly,

*Knight Kiplinger*  
 THE KIPLINGER WASHINGTON EDITORS

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