A New Year, a New Decade - Can Anything Slow Down This 10-Year Period of Economic Expansion?

By Shawn Brydge, Executive Vice President of Wellington Financial

A new year, a new decade. As we enter 2020, our industry, economy, and political landscape are each going through periods of change. While change is inevitable, it often means uncertainty, which can produce a negative effect on the stock market, economic growth, and lending. However, can anything slow down this 10-year period of economic expansion, the longest the U.S. economy has ever experienced?

As a principal at Wellington Financial, a firm that has supported the shared ownership industry since 1981, and through our work as the exclusive Resort Finance correspondent for Liberty Bank, a lender that has financed the shared ownership industry uninterrupted since 1983, we've experienced many economic booms and busts as our industry has evolved. Twelve years ago, the Great Recession taught our industry a lot about being proactive in the face of economic uncertainty and about the importance of working with the right lending partner. As we enter the 2020's, let's summarize where we are and how we got here. Then we'll look ahead to what changes may be coming, and the resulting effects on the lending market.

Vacation Ownership Industry*

According to the AIF 2019 State of the Vacation Timeshare Industry: United States Study, the U.S. timeshare industry increased for the 9th straight year to $10.2 billion in sales. Our industry's diverse product offerings and timeshare providers' ability to adapt to changing buyer demographics and travel preferences is reflected with an 85% owner satisfaction rate and occupancy percentages exceeding those of hotels.

While the major consolidation wave we saw over much of the last decade has slowed in recent years, the number of timeshare developers in active sales continues to shrink. Combine that with the continued growth of the Fee-for-Service/Fee-Based-Service model, where a large timeshare developer provides sales and marketing services to a smaller timeshare operation in exchange for a commission, and a high percentage of industry sales are significantly concentrated with a small number of large developers. This leads to market efficiencies and economies of scale for the leading developers. As a result, there is increased competition for smaller established operators and high barriers for new entrants, which could ultimately lead to more consolidation.

With consolidation and concentration comes opportunity for market interrupters and new products, especially those that can be nimble and think creatively. The past few years have seen an increased interest in the industry's legacy resorts, as many are located in prime locations, but need help with sales, marketing, maintenance, and management. In addition to the very large, heavily-segmented legacy resort market, non-traditional offerings such as travel clubs, short-term membership clubs, experiential travel, and ownership with periodic opt-out options have entered the marketplace to take advantage of a new generation of buyers with a different set of travel priorities.

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U.S. Economy*

Since World War II, the U.S. economy has averaged a recession every seven years, and the longest stretch between recessions was 10 years (March 1991 to March 2001)…until now. The current post-Great Recession economic expansion, which started in June 2009, is now the longest in U.S. history and has been largely driven by consumer spending.

The stock market isn't the economy, but you can't ignore the effect equities have on the U.S. economy and the consumer psyche. The S&P 500 was up 27% in 2019, up 66% the last five years, and up 309% over the last 10 years. This means that consumers with stock and retirement portfolios have seen their net worth on paper increase significantly since the Great Recession.

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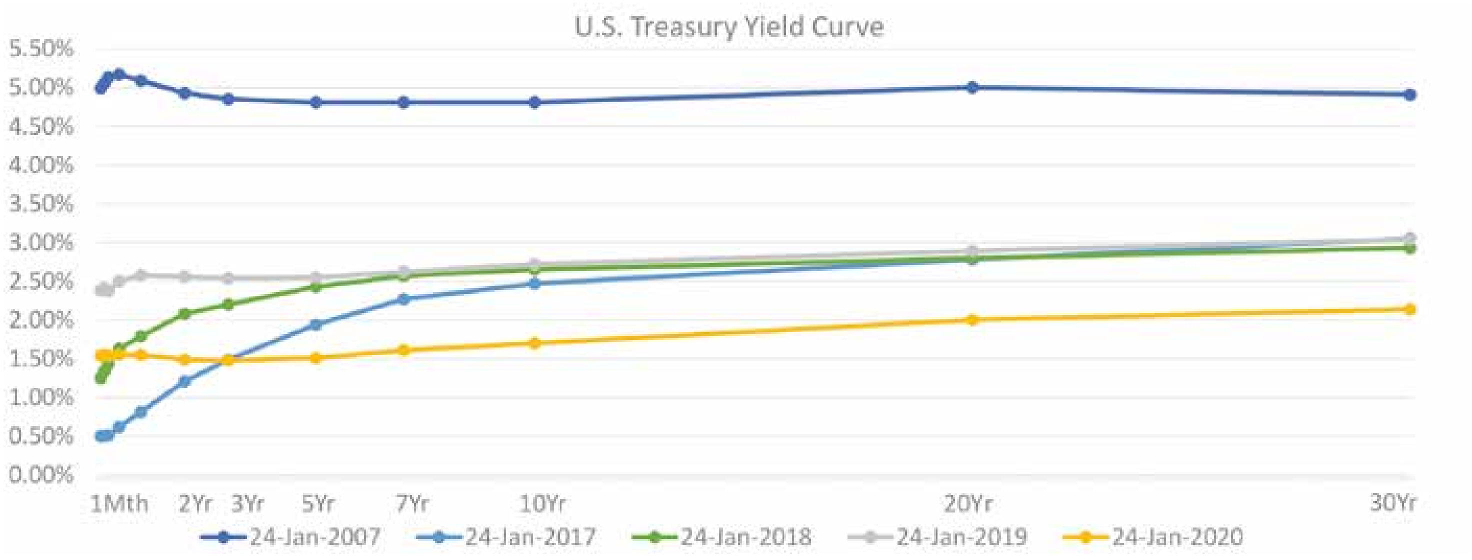
The unemployment rate is 3.5%, matching recent historical lows. In fact, unemployment has been at or below 4.0%, which is considered "full-employment," for 22 months. That's the longest sustained stretch in over 50 years, and long periods of full employment (12 months or longer) are historically followed by an economic downturn. However, unusual for this type of extended low-unemployment environment is the lack of material real wage growth, and an inflation rate and GDP growth that are below the Federal Reserve's and the White House's targets, respectively. Part of this is attributable to a rising underemployment rate, workers accepting jobs below their skill and pay levels, and a decreasing labor force participation rate, which means that a growing number of people are no longer looking for work and thus not included in the unemployment rate calculation. This all creates a significant departure from prior expansion periods and creates a complex scenario if we see an economic slowdown before we see substantial real growth.

With a strong job market, Americans are very optimistic about their current and future prospects for economic prosperity. Consumer Confidence and Sentiment remain very high by historic measures, eclipsed only by the irrational exuberance of the late 1990's (an expansion period which also included a Presidential impeachment, ironically). This is a function of a strong job market, strong equity markets, and an overall belief that next year will be better than this year. However, we've seen a small downtrend over the past 18 months, and the Surveys of Consumers chief economist has noted some conflicting points of view from the study explaining the recent trend. In October 2019, responses were favorable about jobs and income, but negative about the outlook for home and vehicle buying. New in December, the survey saw a division in consumer sentiment between higher income and lower income households. Households in the bottom two-thirds of income distribution were significantly less optimistic, specifically about the employment outlook. This is in part attributable to a slowdown in manufacturing and shipping industries, a trickle-down effect of the trade war, tariffs, and other restrictive trade policies.

Despite recent softness, the high level of consumer confidence continues to propel the economy forward. That sort of confidence typically leads to major purchases, and it has for much of the last decade. When Americans make major purchases, they usually finance them. Accordingly, consumer and household debt has risen steadily for



close to 10 years. In 2019, the mortgage loan market saw its biggest year since 2006, and it's no surprise that the largest percentage of Americans' total debt is mortgage related (68%). However, what may be surprising is that we've seen the largest percentage in debt growth during the current expansion come from student loans.

Over the past 15 years, student debt has grown 454% (significantly more than any other household debt type) and now makes up 11% of American consumers' total debt and 33% of non-mortgage debt. That means that the $1.50 trillion student loans market is larger than auto loans ($1.3T) and credit cards ($0.88T). Perhaps more worrisome is that the default rate for student loans was 10.9% in 19Q3, higher than credit cards (8.3%), auto (4.7%), and mortgages (1%). This means that the greatest source of non-mortgage consumer debt in the U.S. also has the highest default rate. More than 25% of Americans have student debt for themselves or a family member, with an average debt amount of over $29,000. Almost half of them are concerned they can't pay it back and 25% have been late on a payment more than once. There are no signs of this trend slowing down and its impact on discretionary spending during a recession has yet to be tested at these levels.

A typical treasury yield curve (a chart of U.S. Treasury yields for maturities 1-month to 30-years) slopes up steeply in the near term and more gently as duration increases. Three years ago, the yield curve had a relatively normal shape, indicating the expectation of economic growth, moderate inflation, and a continued tightening by the FOMC to keep that inflation in check. GDP was growing and the inflation rate was meeting the Federal Reserve's target, so they were slowly moving interest rates higher, toward more traditional levels. However, in the past two years, volatility in trade policies and geopolitical relations, combined with trade tariffs that negatively affect the American consumer's pocketbook and depress GDP growth contributed to the FOMC cutting their benchmark rate 0.75% in 2019.

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The current treasury yield curve is extremely flat right now and slightly inverted in the short- and mid-term with the 1-month yield higher than the 5-year yield, very similar to the beginning of the Great Recession 13 years ago. This portends the fear of near-term weakness and lots of market uncertainty; and with the spread between the 1-month and 10-year yields being minimal, the market expects very little in the form of economic growth pushing up inflation, and thus little need for the Federal Reserve to increase rates. An inverted treasury yield curve has predicted the last seven recessions, and while we're only moderately inverted right now, the dichotomy between a long economic expansion, very low inflation, very low interest rates, and the shape of the yield curve has generated many novel ideas about what comes next.

With early signs of weakness in the global economy, six of the last eight quarters of GDP growth below the White House target of 3%, and 2019 GDP growth (2.3%) the lowest since 2016, there is a legitimate concern surrounding how many tools the U.S. has available to stimulate the economy in a slowdown. With rates so low, the FOMC has limited ability to provide interest rate easing. Typically, during a long economic expansion, U.S. budget deficits shrink as growth drives tax revenue higher and requires less investment by the government. In contrast, the Trump administration's spending policies have increased the federal budget deficit 50 percent since taking office, essentially providing stimulus that is usually reserved to pull the country out of a recession. Quantitative easing (QE) is another tool the Federal Reserve uses to control money supply to encourage lending and investment. Though they have stated they aren't officially employing QE right now, their actions in 2019Q4 and 2020Q1 have a similar effect. This all highlights the concerns that despite the longest economic expansion in the history of the U.S., we're employing a lot of resources just to maintain sub-optimal GDP growth and inflation. What happens if the U.S. finally does see a recession, or a trade war between two of the largest global economies continues to depress growth and that drives the world into a global slowdown? All at a time when the U.S. and many other countries have limited tools left to spur recovery? There are lots of theories, but we're in uncharted waters.

Political Landscape*

Campaigning for the 2020 election feels like it's been underway for years. With the election eight months away, that typically means not much significant legislative work will get done between now and November. Couple that with the lack of bi-partisan teamwork the Democratic-led House and the Republican-run Senate demonstrated over the past year, and the only safe bet is that Americans will continue to give Congress a lower satisfaction rating than their cable company's customer service.

The Trump administration's lack of a clear plan on economic, trade, domestic, or foreign policy creates a great deal of uncertainty, and this is exacerbated by geopolitical tensions and the U.S.-China trade war. The current administration's clearest path for re-election is that

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the economy remains robust through November 2020. They have demonstrated an economic strategy that includes running huge spending deficits to get short-term returns, and exerting political influence over the FOMC, which most consider a neutral body. The odds are good that they'll continue to double-down on that approach until the election.

Lending Crystal Ball

With economic crisis usually comes a more conservative lending environment. The factors that led to the Great Recession also caused the number of timeshare lenders to shrink dramatically and for the securitization market for timeshare receivables to seize temporarily. This resulted in a significant liquidity crunch for timeshare developers and ultimately changed much about the vacation ownership industry. We all learned a lot. During the current expansion, the number of lenders to the timeshare industry has grown, lending terms have become more aggressive, and the securitization market has flourished.

The economy has begun to show signs of a slowdown as consumers become more conservative. However, with strong stock portfolios and low mortgage rates, affluent Americans continue to build wealth and accumulate assets. But we also need to consider how a slowdown would hurt the lower and middle classes; two demographics with significant consumer debt, limited wage growth, a recent decrease in consumer confidence, and who are more directly affected by slowdowns in manufacturing and shipping industries. How might a consumer-led recession change purchase and payment habits for discretionary items, including vacation ownership and travel?
We all hope the current economic expansion continues for years to come, but history says that's unlikely to happen. While times are still good, take the opportunity to look at your business and personal finances and make sure you're working with the right partners for when times get tough. It's paramount to make sure that your lender will be there to weather the bad times, as well as the good. Working with an experienced lender with a strong track record of industry support and years of experience in economic booms and busts provides you and your business peace of mind and financial support during those uncertain times.

*Author's Note: This was written in January 2020 using political, industry, and economic data available at that time.

BIO

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