Recession fears prompted by the multi-month inversion of the yield curve earlier this year, appear to be abating. The New York Fed's recession probability model, which purports to measure the risk of an economic downturn within the next twelve months, now forecasts a less than 1 in 4 chance of a recession in 2020. That same model had forecast a 40% chance of recession just three months ago.

After three interest rate cuts this year, it is all but certain that the Fed will leave policy rates unchanged for the foreseeable future. Following the late October meeting, the Fed made clear that the current policy was "likely to remain appropriate," barring a material reassessment of the outlook. Fed Chair Jerome Powell reiterated that stance in subsequent Congressional testimony, and other Fed officials are echoing the same message. This consensus is in sharp contrast to the dissent expressed by a vocal minority of Fed governors following past meetings.

Events since the October meeting seem to support the Fed's position. Economic numbers remain soft, but show signs of bottoming. Third quarter GDP growth was revised upward from 1.9% to 2.1%, annualized. November manufacturing data came in below expectations, but remains at a level consistent with economic growth of 1.5%, which is also the consensus expectation for the 4th quarter.

Globally, the picture is becoming a little brighter, as well. The global manufacturing Purchasing Manufacturing Index (PMI) improved slightly in November, and while the surveys show that activity is still soft, the pace of contraction has now eased for four consecutive months. It is even more encouraging to note that the more forward looking data contained in these surveys point to continued improvement in the months ahead.

The overall softness in the economy has thus far not affected the labor market. Non-farm payrolls grew by a stronger than expected 266,000 in November, inflated by the return of 41,000 striking GM workers. The multiplier effect of the returning GM workers resulted in a gain of 54,000 manufacturing jobs, after declining by 43,000 the previous month. It should be noted that monthly employment reports are notoriously volatile, and the data is best viewed over longer periods. On that basis, the latest 3-month moving average rate of payroll growth is 205,000, which compares favorably with the prior 3-month rate of 187,000 and last year's same period growth of 194,000. Adding to the good news is that the unemployment rate dropped back to 3.5% from 3.6%, and hourly wages continued to rise modestly at an annual rate of 3.1%. With employment growth holding up and wage pressures subdued, there is every reason to expect that the Federal Funds Rate will remain unchanged for the foreseeable future.

The stock market is ending the year at a very different place than where it began. We entered 2019 with stock prices having fallen nearly 20% in the latter half of 2018, driven by growing recession fears following a series of Fed rate hikes in the face of weakening economic forecasts. But this year has seen stock prices climb to a series of new highs, buoyed by hopes that a series of interest rate cuts from a chastened Fed will lead to a "soft landing" instead of an economic downturn. While the initial indicators are encouraging, as we have said, risks still remain.

Inversions of the yield curve, such as occurred on a sustained basis from August to mid-October of this year, have always pre-dated a recession anywhere from six to twenty-four months following the inversion. The curve has become positively sloped again as short term rates have been cut and long term rates have risen in anticipation of a soft landing. But similar "dis-inversions" have occurred in the past and recessions have ensued nonetheless. As Michael Darda, Chief Economist for MKM Partners has counseled, while dis-inversion is *necessary* to engineer a soft landing, it is not in itself *sufficient*. Economic data, particularly employment data and jobless claims, will have to be monitored closely in the coming months. Any unexpected weakness that would cause long term rates to again fall below the Fed's target rate, and absent further Fed cuts, would cause the yield curve to re-invert and heighten recession fears once again. But for now at least, hope is growing that we have dodged that bullet.

But all of that is next year's concern. For us at Chemung Canal Trust Company and Capital Bank, and our clients, 2019 has been a very rewarding year, and we have much to celebrate and be grateful for. We wish all of you much happiness this season, and we look forward working and meeting with you again in 2020 and beyond.

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