FINANCIAL MARKETS

IS THE US ECONOMY LOSING STEAM?

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IS THE TIDE SET TO TURN?

FOREWORD

In recent years, the US economy has been an undeniable success story. The level of economic growth has outperformed other major economies.

However, nervousness has gripped the financial markets of late. US stocks have seen a selloff, while the Federal Reserve has seemingly given itself more flexibility to slow its interest rate hiking cycle.

In this eBook, we'll analyse the performance of the US economy in 2018 (so far). We'll also explore its prospects for the next few months.

Patrick Latchford
CEO, Blackwell Global Investments (UK) Limited

THE YEAR SO FAR

GROSS DOMESTIC PRODUCT

Gross Domestic Product (GDP) measures the overall size of a nation's economy. It is the broadest measurement of its output of goods and services.

Broadly speaking, GDP is calculated by taking the production value of goods and services, minus the value of the goods and services needed for production.

GDP is typically measured across three-time frames: monthly, quarterly and annually. Most economies track and compare GDP growth across these time frames to establish a clear short-term and long-term picture.

US GROWTH IN 2018

In the first two quarters of 2018, we saw an aggressive expansion of the US economy. With a number of tax cuts, sturdy customer and business spending and unemployment hitting a 48-year low, the economy 'heated up'.

RECENT US GDP DATA

Recently, US GDP data has been published for the second half of 2018.

Firstly, we have the revised US GDP data for the third quarter. This is unchanged from October's advanced estimate, coming in at 3.5% (annual rate) for the quarter.

Though the headline figure is unchanged, the revised data shows a clear difference in how certain sectors of the US economy are performing.

Initially, let's consider household spending - which is the most important factor that drives GDP. In October's advanced estimate, household spending in the third quarter had grown by 4%. However, in the revised data, this has been amended to 3.6%.

In addition, the growth in both local and state government spending was revised down to 2%, compared to the original estimate of 3.2%.

Despite these metrics being revised downwards, levels of business investment were revised upwards from October's advanced estimate.

For instance, investment in equipment was flatlining in October's report. However, this has now been revised to 3.5% growth.

Meanwhile, spending on business structures fell by only 1.7% (rather than the originally reported 8%).

There was also an upward revision in the production of inventories to $86.6 billion (originally $76.3 billion). US plans to increase import tariffs on Chinese products in January 2019 has clearly encouraged businesses to secure inventories before January 2019.

While exports fell by 4.4%, which is slightly more than expected, imports remained almost unchanged at 9.2%. Remember - an increasing trade deficit can actually drag on GDP.

CORPORATE PROFITS

Another sign of robust US business performance comes from corporate profits data. The annual increase in US corporate profits has hit its highest rate in six years. By September 2018, profits had rocketed by 10.3% in comparison to the previous year.

WHAT TO EXPECT NEXT

EXPECTATIONS FOR Q4

With six months of positive growth, the US economy is on track for an overall expansion in 2018. Specifically, the year should top 3% for the first time since 2015.

However, many economists expect the US economic growth to slow in both Q4 of 2018 and Q1 of 2019.

There are two primary reasons for this.

Firstly, the Trump administration's approach to global traders is making business and investors anxious. In particular, ongoing trade talks between the US and China is creating uncertainty.

Plus - there's a threat of further tariffs and counter-tariffs from both the US and Chinese governments. If there's a further escalation in tariffs, we could see certain US sectors face increased costs.

Secondly, the fiscal stimulus of President Trump's tax cuts will inevitably start to fade for businesses as we move into 2019.

Having said all of this, it's important to emphasise that the US economy is still likely to grow at a healthy rate. Estimates from JPMorgan Chase forecast that GDP growth will be 2.5% in Q4 2018 and 2.2% in Q1 2019.

REACTION OF THE FED

But the market's nervousness has seemingly made the Federal Reserve manoeuvre to give itself more flexibility.

At the time of writing, the Federal Reserve is in a cycle of hiking its benchmark interest rate in response to its expanding economy.

As recently as September 2018, one further rate hike in December 2018 and three further hikes in 2019 were viewed by most economists as likely.

However, recent minutes from the FOMC suggest a more flexible monetary policy path for 2019 after a hike in December 2018. In other words, the Federal Reserve is giving itself room to slow its hiking cycle.


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