Outlook for the US Economy

ECONOMIC RESEARCH OFFICE
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MUFG Bank, Ltd.
A member of MUFG, a global financial group

Previous Outlook in May → Changes → Current Outlook

Outlook in May

➢**Main scenario:** Consumer spending likely will remain solid on continued growth in employment and income. As the effect of fiscal stimulus wears off, growth is expected to slowdown to the vicinity of potential growth rate. Escalation of US-China friction and US threat to impose tariffs against Mexico rekindled concerns over global economic slowdown and spread caution in the financial markets. But with many FOMC members considering low inflation as “transitory,” the Federal Reserve is expected to keep policy rate unchanged for the time being. Ongoing review of Fed’s policy framework and the 2020 presidential election could sway policy directions. The Fed is unlikely to resume rate hikes at least until the end of next year.

➢**Risk scenario:** The Trump administration may take a harder line in trade policy. Cumulative effect of earlier rate hikes and external shock factors like the trade friction may weigh on private-sector spending and lead to balance-sheet adjustments mainly in vulnerable sectors.

Changes since the Previous Outlook

➢US-China friction intensifies as the US announces the fourth round of tariffs and China retaliates (partial trade accord was subsequently reached in mid-October).

➢ Federal Reserve cuts policy rates at July, Sept FOMCs.

Current Outlook

➢ **Main scenario:** Employment growth is slowing but remains resilient. With wages rising at a solid pace and personal income growing, consumer spending likely will remain solid. US-China trade tension had subsided temporarily but intensified again in August as the Trump administration announced the fourth round of tariffs and China responded with a retaliation. This heightened uncertainty over the global economic outlook. Yet the US economy is expected to maintain growth of nearly 2% (close to its potential growth rate), supported by solid consumer spending. The Federal Reserve cut the policy rate at July and Sept FOMCs, but is expected to keep the rate unchanged from October through the end of 2020 because the policy rate is already low and the US economic growth is solid.

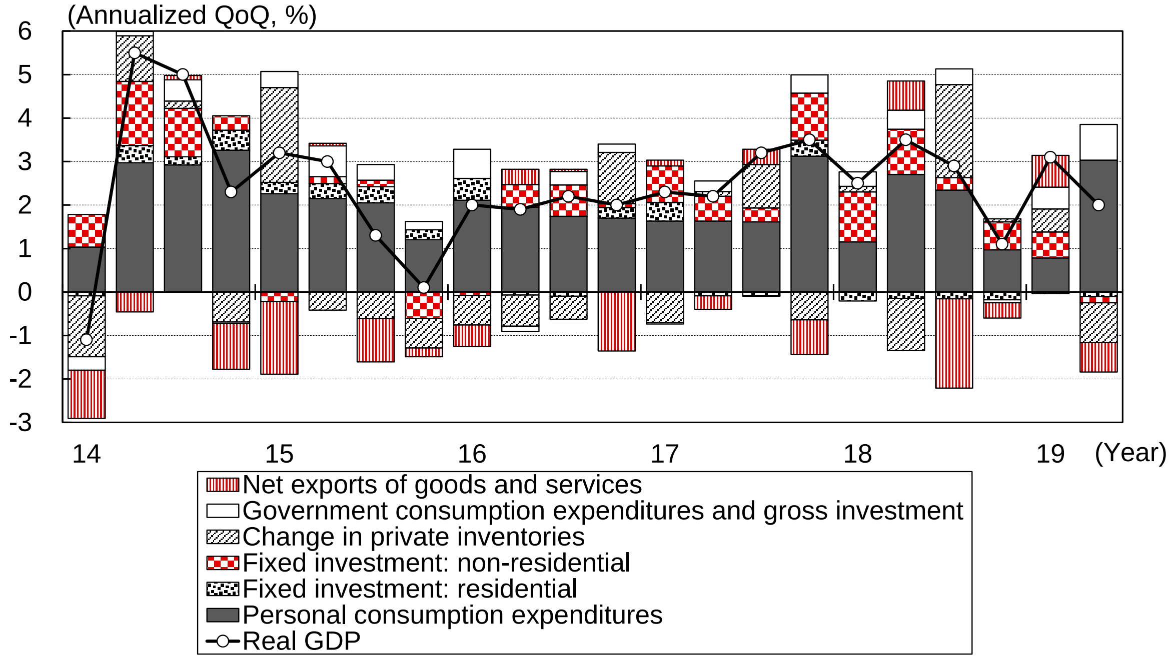
➢ **Risk scenario:** The Trump administration may take a harder line in trade policy. As corporate debt grows, a downtrend in the economy may prompt financial institutions to tighten lending standards. Vulnerable sectors and companies with lower creditworthiness may need to adjust balance sheets.

➢ **Outlook key points:** (1) Solid consumer spending (2) Business sentiment (3) US-China trade friction (4) Monetary policy and financial market trends (5) US corporate debt

Real GDP grew 2.0% annualized QoQ (third estimate) in the April-June quarter, slowing down from January-March quarter's 3.1% growth.

- Main reason for the slowdown is negative contributions by inventory investments and net exports (they had positive contributions in the previous quarter). The changes appear to stem from inventory adjustments in petroleum products and automobiles, and a decline in exports of civilian aircraft other items.
- Meanwhile, growth in personal consumption expenditures accelerated to 4.6% from a 1.1% increase in the January-March quarter. Consumer spending growth had slowed in the January-March quarter on the back of partial government shutdown through late January, a stock price plunge in late 2018, and inclement weather.

Real GDP



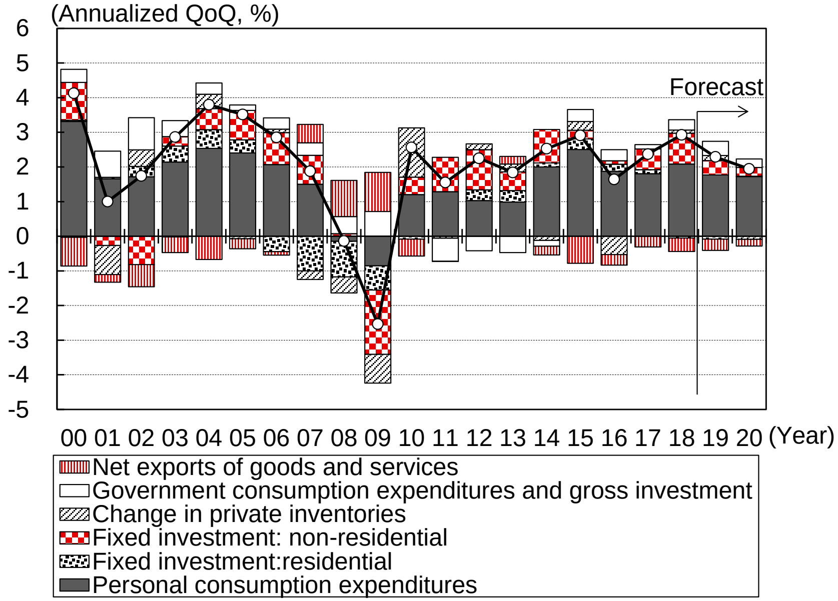
Source: Department of Commerce, MUFG Bank Economic Research Office

1. Overview (2) Outlook

Despite heightened uncertainty over the US-China trade friction, the US economy likely will maintain expansion around its potential growth rate, supported by solid consumer spending. The Federal Reserve is expected to keep policy rate unchanged starting in October.

- Business sector demand (including capital spending) calls for a more cautious outlook amid heightened uncertainty from the US-China trade friction. But personal consumption expenditures, which account for roughly 70% of US GDP, likely will remain solid for some time, keeping the US economy on course to growth of nearly 2% annualized QoQ, close to its potential growth rate.
- After an additional 0.25% point rate cut at Sept FOMC, the Fed likely will attempt to keep the rate unchanged until the end of 2020. But with President Trump demanding significant rate cuts to bolster the domestic economy in view of the US-China trade friction and the 2020 presidential election, the Fed may be forced to cut rate again.

Real GDP



Source: Department of Commerce, MUFG Bank Economic Research Office

GDP Forecast (Calendar Year)

(YoY, %)

	2018 (Actual)	2019 (Forecast)	2020 (Forecast)
Real GDP	2.9	2.3	1.9
Personal consumption expenditures	3.0	2.5	2.5
Fixed investment : residential	-1.5	-2.5	0.4
Fixed investment : nonresidential	6.4	2.9	1.7
Change in private inventories (contribution)	0.1	0.1	-0.1
Government consumption expenditures and gross investment	1.7	2.4	1.4
Net exports (contribution)	-0.4	-0.3	-0.2
Exports	3.0	0.1	1.1
Imports	4.4	1.8	1.9
Nominal GDP	5.4	4.2	4.0

Source: Department of Commerce, MUFG Bank Economic Research Office

1. Overview (3) Outlook Conceptual Diagram

Upside factors

- **Continued growth in employment and consumption**

  Employment growth is resilient although the pace is slowing, and wages continue to rise moderately. Thus, personal income is expected to continue growing at current pace. Personal consumption expenditures are expected to continue solid expansion.

Downside factors

- **Trade friction with China**

  Economy could be weighed down by 1) higher prices of imports from China due to additional US tariffs; and 2) a drop in exports to China due to a cost increase from China's retaliatory tariffs and China's domestic demand slowdown. If the US and China both impose 30% tariffs on all imports from the other, negative impact through trade channels is expected to push down US real GDP growth rate by 0.4% point.

Downside risks

- **Even more protectionist trade policy**

  If the US leans toward a more protectionist policy that broadly limits product imports, the real economy could take a major hit from cost increases, an export decline and other factors.

- **Deterioration of credit conditions**

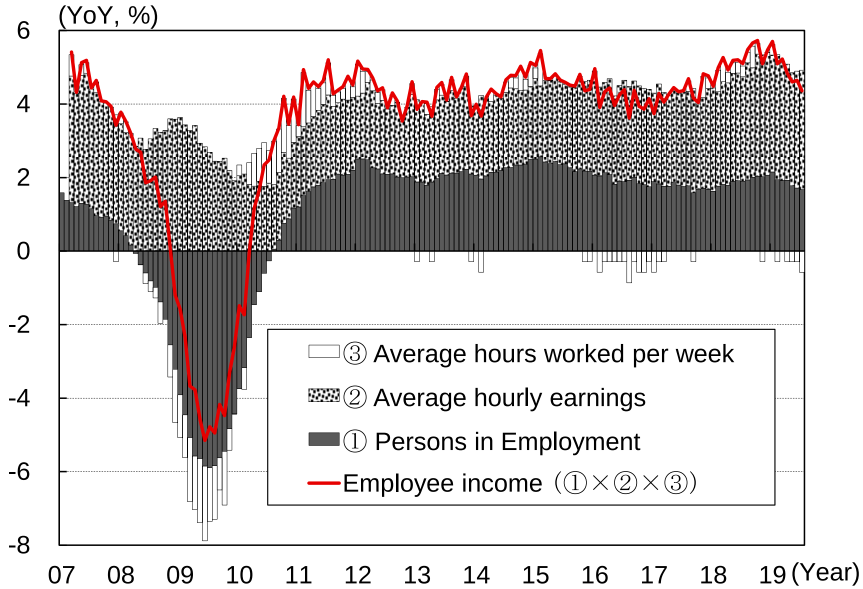
  Corporate debt's proportion to nominal GDP is at record high level. Despite the support from monetary easing, an economic downturn could prompt financial institutions to tighten lending standards. As a result, vulnerable sectors and companies with lower creditworthiness may be forced to adjust their balance sheets.

2. Outlook Key Point (1) Solid Consumer Spending

Resilient growth in employment and earnings is expected to support solid personal consumption expenditure.

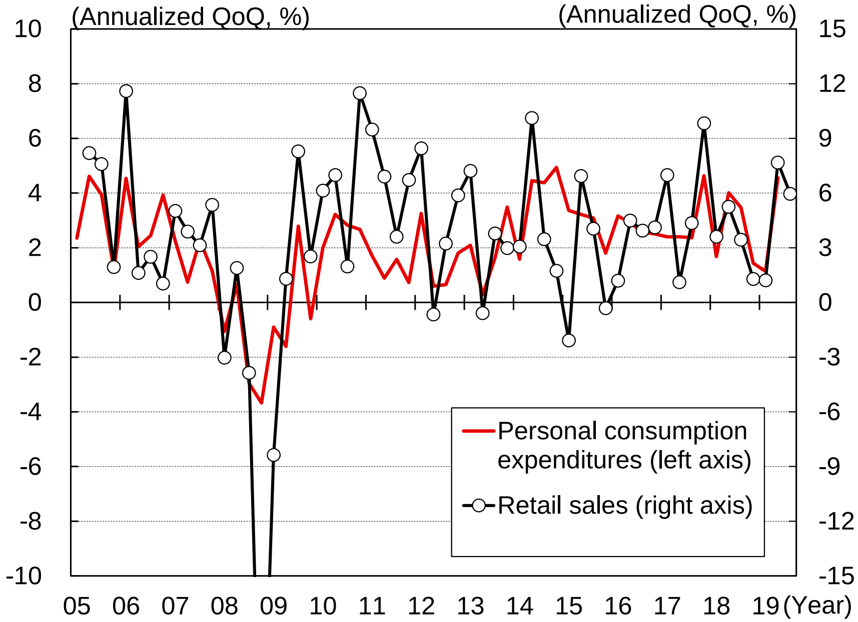
- Payroll growth has slowed somewhat from the second half of 2018 but remains steady as the economy continues to grow beyond the record expansion streak of 10 years. Hourly earnings are rising at a solid pace of around 3% YoY. As the number of employed persons rise, nominal personal income calculated with hourly earnings and hours worked per week is expected to keep growing at around 4% YoY.
- As personal income grows, personal consumption expenditure likely will remain solid for the time being. Retail sales in the July-Sept quarter rose 6.0% annualized QoQ.

Employee Earnings



Source: Department of Commerce, Department of Labor, MUFG Bank Economic Research Office

Retail Sales and Personal Consumption Expenditures

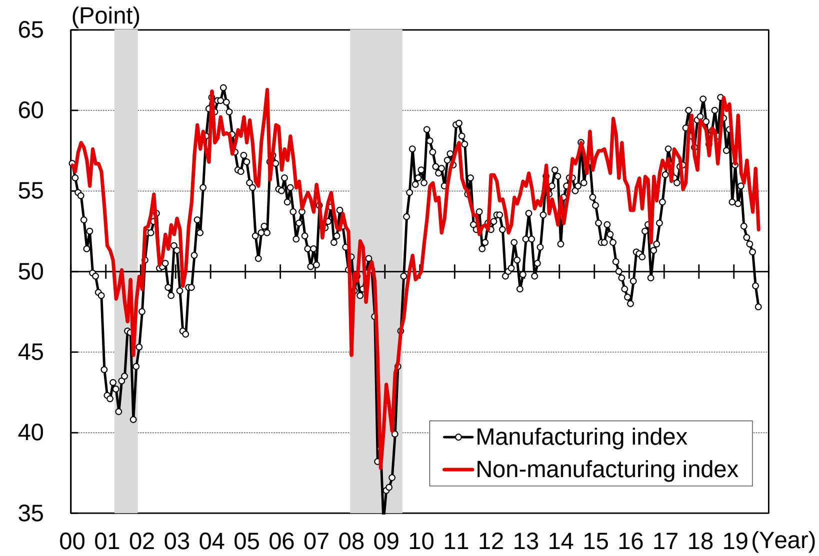


Souce: Department of Commerce, MUFG Bank Economic Research Office

Manufacturing business sentiment fell below the neutral line between growth and contraction for a second straight month, but in the non-manufacturing sector, which accounts for the majority of the economy, business sentiment is still pointing to expansion. Thus, there is no sign that the overall economy will languish or contract.

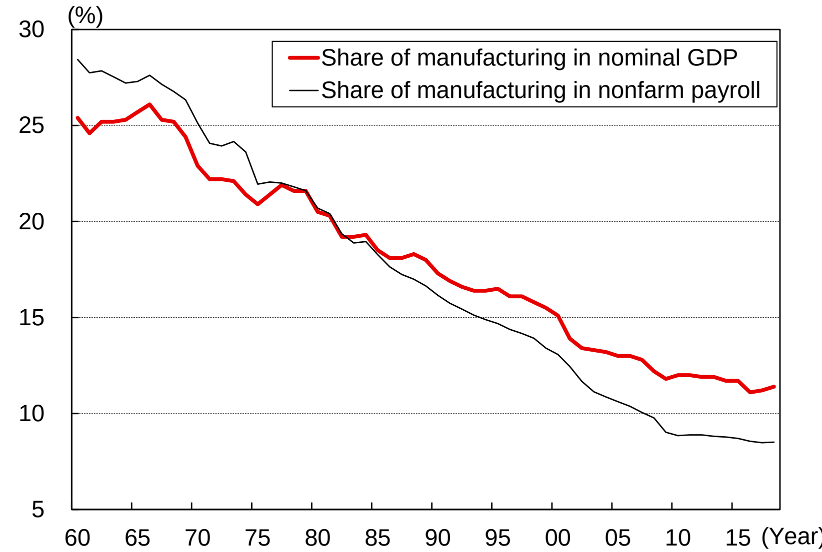
- September ISM Manufacturing Index was 47.8, falling below the 50 line separating expansion and contraction for a second month in a row. Manufacturing business sentiment appears to be worsening as the US-China tension heightens amid US' fourth round of tariffs and China's retaliation.
- Yet, as the service sector's weight in the overall economy grows, the share of manufacturing in GDP and in employment has declined over the years. The ISM non-manufacturing index has declined slightly but is still indicating expansion. At this point, there is no sign that the overall economy will languish or contract along with the manufacturing sector. Nonetheless, the situation should be monitored closely.

ISM Indices



Note: Gray-shaded areas show recessions.
Source: Institute for Supply Management, MUFG Bank Economic Research Office

Shares of Manufacturing in Nominal GDP and Employment



Source: Department of Commerce, Department of Labor, MUFG Bank Economic Research Office

2. Outlook Key Point (3) US-China Trade Friction ①

US tariffs for $300 billion of imports from China – newly subjected to additional tariffs – will affect consumer goods for which the US relies heavily on China for supply. The tariffs may directly impact consumers and therefore fuel concern.

- President Trump announced August 1 plans to impose 10% tariffs on $300 billion worth of imports from China effective September 1. But shortly after, the US decided to postpone the tariffs for some items until December 15.
- President Trump said the delay is to prevent impact on Christmas shoppers, but in reality the tariffs are being delayed for items that are difficult to source from places other than China.
- Even after the tariffs go into effect, the US will need to keep importing from China products that are difficult to import from elsewhere. The products affected by the fourth round of tariffs are consumer goods. Therefore, consumers may feel direct impact, unlike with earlier rounds of tariffs.

Summary of the Fourth Round of Tariffs Imposed by the US

	Value of Imports			Number of products
	From China (Billion, $) ①	Total (Billion, $) ②	China Dependency ① / ② %	
Fourth round of tariffs (as of May)	269.4	641.1	42	3,812
Effective Sep 1	110.7	455.3	24	3,232
Effective Dec 15	156.0	179.0	87	555
Exempt	2.7	6.8	40	25
Reference				
First round of tariffs (Jul 2018)	30.6	482.6	6	818
Second round of tariffs (Aug 2018)	14.6	116.9	13	279
Third round of tariffs (Sep 2018)	213.1	1,017.7	21	5,745

Note: "Value of Imports" is based on actual trade in 2018.
Source: Department of Commerce, MUFG Bank Economic Research Office

Top 10 Product Categories of Imports from China to Be Subject to Tariffs from December

Rank	Product Category	Value of Imports		
		From China (Billion, $) ①	Total (Billion, $) ②	China Dependency ① / ② %
1	Mobile phones	43.2	52.8	82
2	Laptop computers	37.5	39.7	94
3	Toys	11.9	14.1	85
4	Video game consoles	5.4	5.5	98
5	Monitors for personal computers etc.	4.6	5.5	84
6	Footwear for women	2.1	2.6	78
7	Tableware, kitchenware	2.0	2.3	83
8	LED lamps	1.8	1.9	94
9	Christmas decorations	1.7	1.8	95
10	Television transmission set top boxes	1.5	1.7	91

Note: "Value of Imports" is based on actual trade in 2018.
Source: Department of Commerce, MUFG Bank Economic Research Office

2. Outlook Key Point (3) US-China Trade Friction ②

On Oct 11, the US and China reached a "phase one" trade deal, and the US decided to postpone the Oct 15 tariff hike on $250 billion of imports from China. The two sides aim to sign an agreement at the APEC summit in mid-November.

➢ Details of the "phase one" deal reached on Oct 11 are not published, but President Trump's remarks suggest that China has agreed to increase agricultural imports from the US to an annual $40-50 billion within two years, and to open up its domestic market for financial services. The US decided to cancel the Oct 15 tariff hike for $250 billion of imports from China to 30% from 25%. The two sides still need to put the agreement on paper for signing at the APEC summit to be held in Chile in mid-November.

Key Points from US-China "Phase One" Deal

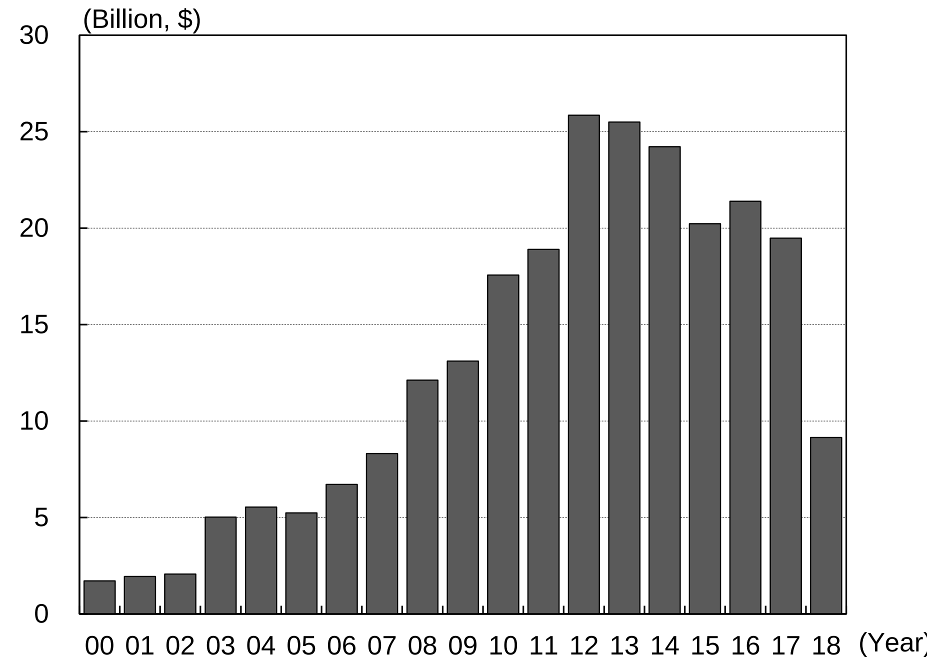
➢ Agreement in the following five areas:
- ① China to increase agricultural imports from the US to an annual $40-50 billion over two years
- ② Solutions for agricultural structural issues
- ③ China to open up markets to financial service companies
- ④ Improve transparency of China's foreign exchange markets
- ⑤ Solutions to forced technology transfer

➢ The US cancels Oct 15 tariff hike on $250 billion of China imports to 30% from 25%.

➢ The two sides to put the agreement on paper for signing at the APEC summit to be held in China in mid-November.

Note: No official press release on the agreement has been published.
Source: White House, MUFG Bank Economic Research Office

US Agricultural Exports to China



Source: Department of Agriculture, MUFG Bank Economic Research Office

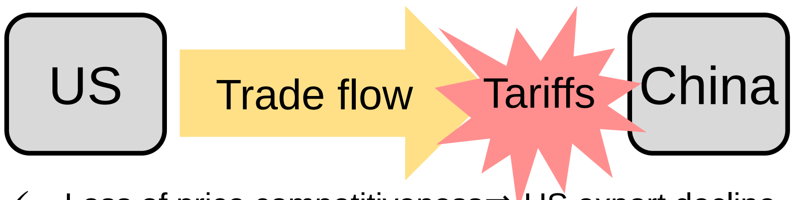
2. Outlook Key Point (3) US-China Trade Friction ③

Direct impact thorough trade channels likely will be absorbed, but future developments and impact on consumer and business sentiment should be monitored carefully.

- Even if both countries raise tariffs on all imports from the other to 30%, direct impact through trade channels is expected to push down US real GDP growth by just 0.4% point.
- Resilient US domestic demand suggests that the tariff impact likely will be absorbed. But the situation still needs to be monitored carefully as many things remain uncertain, such as how the talks will unfold, as well as negative impact on household sentiment and business sentiment.

Impact of US-China Trade Friction (Concept)

1. US Export to China



- ✓ Loss of price competitiveness⇒ US export decline (see ① in table on right)
- ✓ Lowering of export price⇒ drop in real income ⇒US domestic demand decline (see ② in table on right)

2. US Import from China

- ✓ Drop in real income due to higher import prices ⇒US domestic demand may decline (see ② in table on right)

Impact of US-China Tariffs on US Real GDP

Price elasticity of exports to China	▲ 1.3
Average rate of Chinese retaliatory tariffs against US (%)	30.0
Rate at which companies pass on higher costs to prices (%)	50
Impact on real exports to China	▲ 19.1
China's share in overall US exports (2018, %)	7.2
Impact on real exports (%)	▲ 1.4
Proportion of goods exports in GDP (2018, %)	9.6
US value-added ratio in exports to China (%)	90
Impact of export decline on real GDP growth (% point) ①	▲ 0.1
Impact of tariff-related real income drop in the US private sector to real GDP growth (% point) ②	▲ 0.3
Impact of US and China tariffs on real GDP growth (①+②) (% point)	▲ 0.4

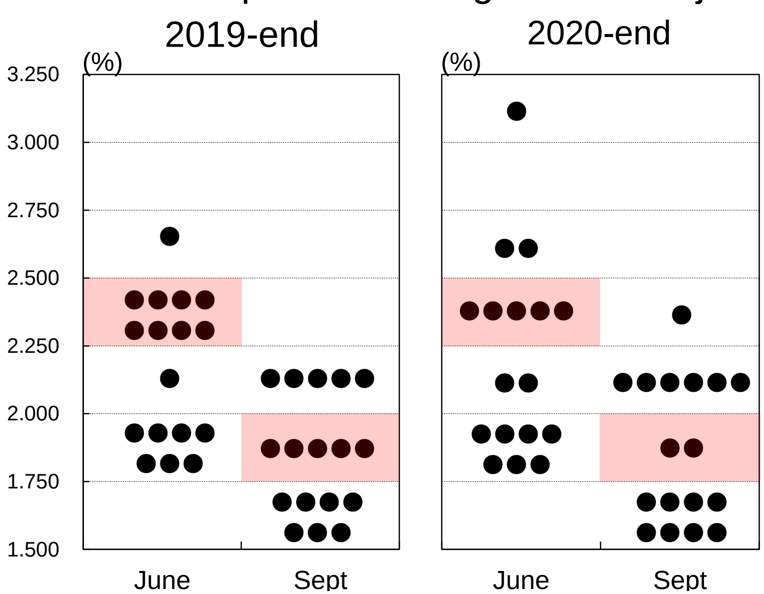
Note: For China's tariffs against the US, estimates assume a 30% tariff on all imports from the US.

Source: Department of Commerce, Department of Labor, MUFG Bank Economic Research Office

The Federal Reserve cut the policy rate at two FOMC meetings in a row in July and Sept. FOMC participants' rate projections vary widely, but any further adjustments to the rate would be minimal.

- The Fed cut the policy rate for the first time in 10 years and 7 months in July, and again cut the rate in September in view of uncertainty over the US-China trade friction, further slowing of the global economy, and inflation rate below the target of 2%.
- Quarterly-released policy rate projections by FOMC participants continue to vary widely, but there is a consensus that the economy is maintaining moderate expansion.
- Chair Powell has stressed repeatedly that the policy considerations going forward will be data dependent and suggested that future policy rate adjustments would be minimal.

FOMC Participants' FF Target Rate Projections



Note: Shade indicates the FF rate target range at the time of forecast release.
Source: Federal Reserve, MUFG Bank Economic Research Office

Economic Projections of FOMC Participants

(%)

		Median				
		2019	2020	2021	2022	Longer run
Real GDP growth rate	June '19 projection	2.1	2.0	1.8	-	1.9
	Sept '19 projection	2.2	2.0	1.9	1.8	1.9
Unemployment rate	June '19 projection	3.6	3.7	3.8	-	4.2
	Sept '19 projection	3.7	3.7	3.8	3.9	4.2
PCE inflation rate	June '19 projection	1.5	1.9	2.0	-	2.0
	Sept '19 projection	1.5	1.9	2.0	2.0	2.0

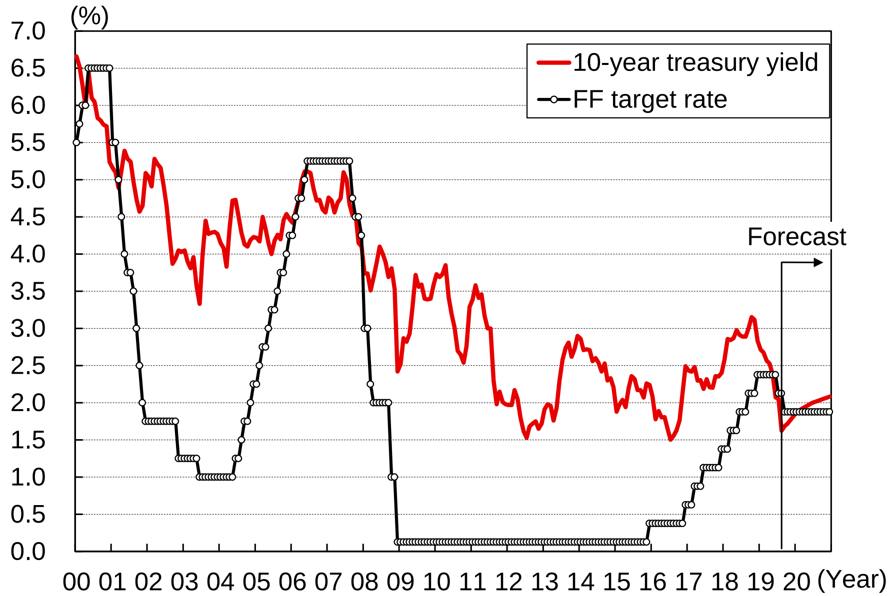
Note: Projections for "GDP" and "inflation rate" are percent changes from the fourth quarter of the previous year to the fourth quarter of the year indicated. Projections for the unemployment rate are for the average unemployment rate in the fourth quarter of the year indicated.

2. Outlook Key Point (4) Monetary Policy and Market Trends ②

The US economy is expected to maintain resilient growth and the policy rate is already low. Thus, the Economic Research Office projects that the Fed will hold the rate unchanged through the end of 2020.

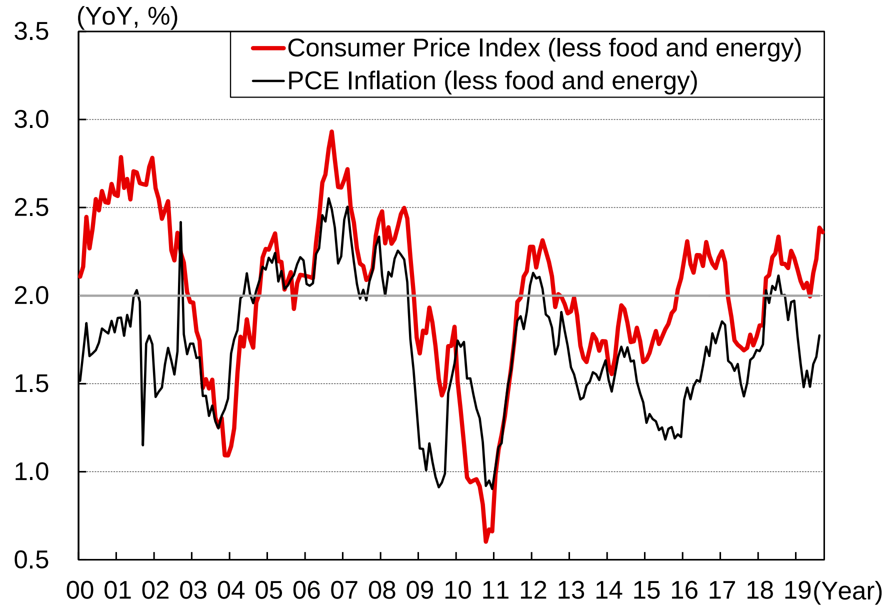
- The US economy is expected to maintain resilient growth and the FF target rate is already at a historically low level. Therefore, the Fed likely will be cautious of a further rate cut and attempt to hold the rate unchanged through the end of 2020.
- Inflation rate excluding food and energy has been accelerating of late. Yet part of the price increases may be driven by higher tariffs. Therefore, rather than making monetary policy decisions based on the recent inflation trends, the Fed is expected to step to the sidelines for the time being.
- Still, a further rate cut remains a possibility if the US-China tension were to intensify again.

10-Year Treasury Yield and FF Target Rate



Note: "FF target rate" is shown as the range mid-point from Dec. 2008.
Source: Bloomberg, MUFG Bank Economic Research Office

Consumer Price Index and PCE Inflation Rate

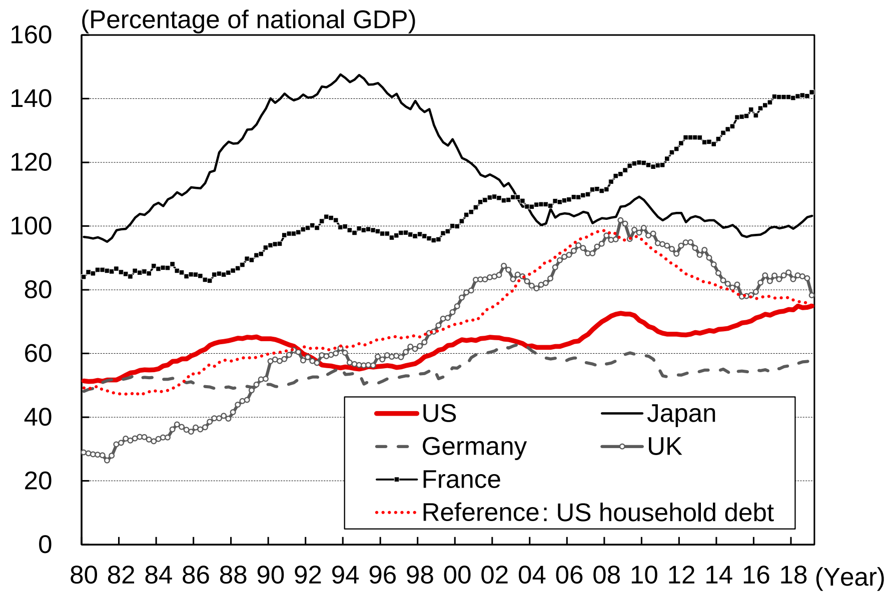


Source: Department of Labor, Department of Commerce, MUFG Bank Economic Research Office

US corporate debt as a percentage of GDP has risen to a record level but is still lower than in other advanced economies. Financial positions of US companies are relatively healthy.

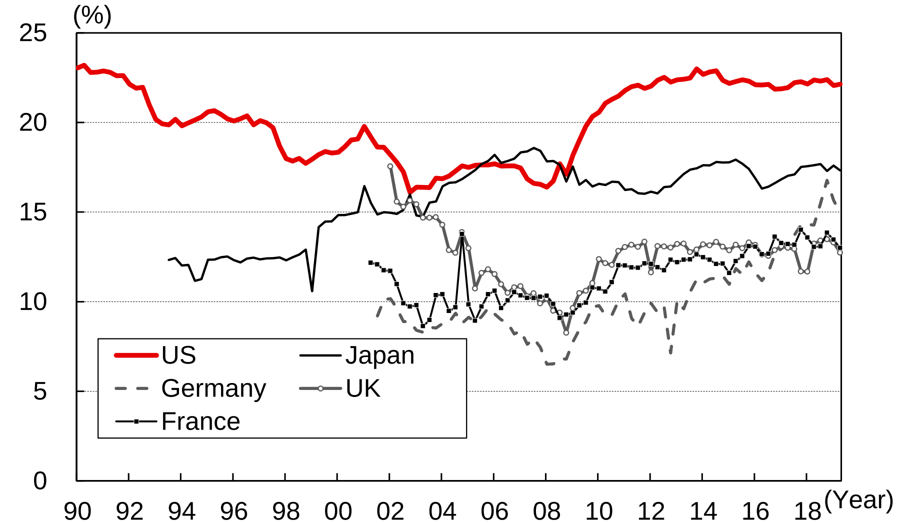
- US corporate debt as a percentage of nominal GDP (as of March 2019) reached 74.9%, surpassing the 72.6% peak reached in December 2008 during the financial crisis. Yet, compared with other advanced economies, the percentage is still lower than that in Japan, the UK and France, while it is higher than in Germany. As an advanced economy, the US may not have hit its limit on corporate debt, although differences in economic structures need to be kept in mind.
- The equity-to-asset ratio (net asset divided by total asset) of S&P500 components has risen after the 2008 financial crisis, hovering higher than comparative figures for other advanced economies. Companies appear to be maintaining relatively healthy financial positions.

Non-Financial Sector's Corporate Debt in Major Advanced Economies



Source: BIS, MUFG Bank Economic Research Office

Equity-to-Asset Ratio of Listed Companies in Major Advaned Economies



Note: Data covers components of a major stock index in each country.
US = S&P500, Japan = TOPIX, Germany = DAX, UK = FTSE350, France = CAC40

Source: Bloomberg, MUFG Bank Economic Research Office

US Economic and Financial Market Outlook (Summary)

Outlook for the US Economy

Forecast

	2018				2019				2020				2018	2019	2020
	1～3	4～6	7～9	10～12	1～3	4～6	7～9	10～12	1～3	4～6	7～9	10～12	(Actual)	(Forecast)	(Forecast)
1. Key Economic Indicators															
Real GDP (QoQ annualized, %)	2.5	3.5	2.9	1.1	3.1	2.0	1.8	2.1	2.0	1.9	1.9	1.8	2.9	2.3	1.9
Personal Consumption Expenditures	1.7	4.0	3.5	1.4	1.1	4.6	2.5	2.5	2.4	2.2	2.2	2.1	3.0	2.5	2.5
Fixed Investment - Residential	-5.3	-3.7	-4.0	-4.7	-1.0	-3.0	-0.3	0.2	0.9	0.9	0.9	0.9	-1.5	-2.5	0.4
Fixed Investment - Nonresidential	8.8	7.9	2.1	4.8	4.4	-1.0	1.7	1.8	1.9	2.0	2.1	2.1	6.4	2.9	1.7
Change in Private Inventories (Contribution)	0.1	-1.2	2.1	0.1	0.5	-0.9	-0.2	0.0	0.0	0.0	0.0	0.0	0.1	0.1	-0.1
Government Expenditures	1.9	2.6	2.1	-0.4	2.9	4.8	2.7	1.0	1.0	1.0	1.0	1.0	1.7	2.4	1.4
Net Exports (Contribution)	0.0	0.7	-2.1	-0.4	0.7	-0.7	-0.4	0.0	-0.2	-0.2	-0.2	-0.1	-0.4	-0.3	-0.2
Exports	0.8	5.8	-6.2	1.5	4.1	-5.7	1.8	1.6	1.5	1.5	1.5	1.5	3.0	0.1	1.1
Imports	0.6	0.3	8.6	3.5	-1.5	0.0	3.4	1.2	2.0	1.9	1.9	1.8	4.4	1.8	1.9
Final Sales to Private Domestic Purchasers	2.5	4.3	3.0	1.8	1.6	3.3	2.3	2.3	2.3	2.1	2.1	2.1	3.4	2.4	2.3
Nominal GDP (QoQ annualized, %)	5.0	7.1	4.8	2.9	3.9	4.7	3.9	4.2	4.0	3.9	3.9	3.8	5.4	4.2	4.0
Industrial Production (QoQ annualized, %)	2.3	4.6	5.2	3.9	-1.9	-2.1	1.3	1.3	1.4	1.3	1.2	1.1	3.9	1.0	1.1
Unemployment Rate (%)	4.1	3.9	3.8	3.8	3.9	3.6	3.6	3.6	3.5	3.5	3.5	3.5	3.9	3.7	3.5
Producer Price Index (YoY, %)	2.8	3.0	3.0	2.8	1.9	2.0	2.2	2.2	2.1	2.0	1.9	1.9	2.9	2.1	2.0
Consumer Price Index (YoY, %)	2.2	2.7	2.6	2.2	1.6	1.8	2.0	2.1	2.1	2.1	2.2	2.2	2.4	1.9	2.1
2. Balance of Payments															
Trade Balance (billion, $)	-221	-206	-228	-232	-217	-223	-228	-232	-217	-223	-228	-232	-887	-897	-907
Current Account Balance (billion, $)	-114	-107	-126	-144	-136	-128	-131	-134	-137	-140	-143	-146	-491	-496	-501
3. Financial Indicators															
FF Rate Target (%)	1.50-1.75	1.75-2.00	2.00-2.25	2.25-2.50	2.25-2.50	2.25-2.50	1.75-2.00	1.75-2.00	1.75-2.00	1.75-2.00	1.75-2.00	1.75-2.00	2.25-2.50	1.75-2.00	1.75-2.00
Euro Dollar (3-month) (%)	1.9	2.3	2.3	2.6	2.7	2.5	2.2	2.0	2.0	2.0	2.0	2.0	2.3	2.4	2.0
10-Year Treasury Yield (%)	2.8	2.9	2.9	3.0	2.7	2.3	1.8	1.8	1.9	2.0	2.0	2.1	2.9	2.1	2.0

Note: *FF Rate Target* is for the end of the period, *Euro Dollar (3-month)* and *10-Year Treasury Yield* are averages for the period.
Source: Various statistics, Bloomberg, MUFG Bank Economic Research Office