The Outlook for the US Economy

Robust private consumption provides tailwind for economic growth despite growing uncertainty over trade

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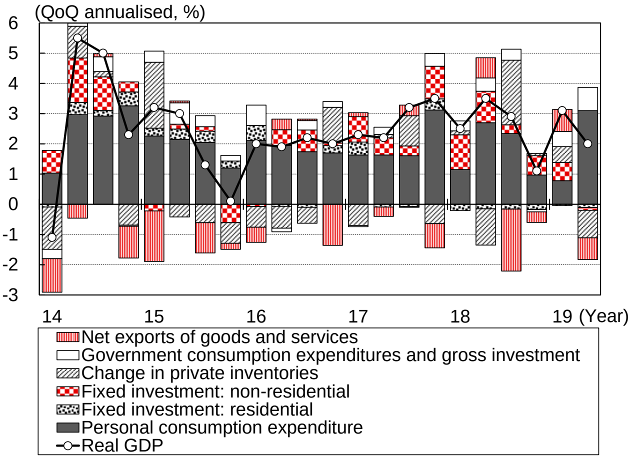
1. Current Conditions

The real GDP growth rate was 2.0% QoQ annualised in the April-June quarter, slowing again from last quarter's rise of 3.1% QoQ annualised (Chart 1). The main reason for the deceleration was the contribution by inventory investment (-0.9% points QoQ annualised, Jan-Mar quarter: 0.5% points QoQ annualised) dipping into negative territory for the first time in around a year owing to inventory adjustments related to the manufacturing of petroleum and coal products and the sale of motor vehicles and parts, as well as a -0.7% point contribution to growth by net exports brought about by a decrease in exports (-5.8% QoQ annualised, January-March quarter: 4.1% QoQ annualised), particularly those of passenger aircraft. In addition, fixed non-residential investment also fell by 0.6% QoQ annualised, entering negative territory for the first time since the January-March quarter 2016 (approximately three years). This was due to a fall in structure investments related to the petroleum oil and gas business and healthcare-related industries. On the other hand, growth of personal consumption expenditure accelerated considerably to 4.7% QoQ annualised from 1.1% QoQ annualised the previous quarter. Personal consumption expenditure slowed in the January-March quarter against the backdrop of a partial government shutdown, which continued until the end of January, a sharp fall in stock prices at the end of last year and bad weather. However, it appears the impact of this faded, which led to a rebound in personal consumption expenditure of both goods and services from the previous quarter. The small fluctuations in personal consumption expenditure have become larger since 2018, but growth continues to average around 3% annualised.

Current economic indicators reveal a weakness in industrial production and capital goods orders. Nevertheless, based on the clear recovery in retail sales (an indicator of trends in consumption), the economy is predicted to continue its trend of expansion into the July-September quarter. Meanwhile, there was a temporary lull in the friction over trade between the US and China due to the talks between US and Chinese leaders at the G20 summit, yet tensions reignited as President Trump announced additional tariffs against USD300 billions' worth of imported goods from China on 1st August (4th round of tariffs; take effect from 1st September). China subsequently announced its own tariffs in retaliation and President Trump responded saying the US will raise tariffs further. Turning to fiscal issues, a decision was reached regarding the problem of the US' government debt and the debt ceiling when bipartisan budget legislation was signed at the start of August.

Chart 1: Real GDP



Source: Department of Commerce, MUFG Bank Economic Research Office

Table 1: GDP Forecast (Calendar Year)

(YoY, %)

	2018 (Actual)	2019 (Forecast)	2020 (Forecast)
Real GDP	2.9	2.3	1.9
Private Consumption	3.0	2.6	2.5
Residential Investment	-1.5	-2.5	0.4
Nonresidential Investment	6.4	2.9	1.8
Inventory Investment (Contribution)	0.1	0.1	-0.1
Government Expenditures	1.7	2.3	1.4
Net Exports (Contribution)	-0.4	-0.3	-0.2
Exports	3.0	0.0	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

2. Key Points from the Outlook

An important point in forecasting the US economy will be how to predict which will ultimately be larger: the strength of personal consumption expenditure or the slump in external demand and manufacturing, as well as the downward pressure from government policies, such as that from the US-China trade friction, including the 4th round of tariffs. Pre-empting the conclusion, it is highly likely that the US economy will maintain growth at the pace of its potential growth rate of just under 2% until next year as personal consumption expenditure (accounts for 70% of GDP) remains robust for the time being (Table 1). However, it is important to be slightly cautious when it comes to corporate sector demand, such as non-residential fixed investment. While it is imperative to keep a close watch on the impacts from the 4th round of tariffs which still cannot be foreseen, such as developments in future talks and retaliatory tariffs, and the effect on household and business sentiment, it is possible that the impact may be absorbed given the low weight of trade on the US economy and the robust growth of personal consumption expenditure.

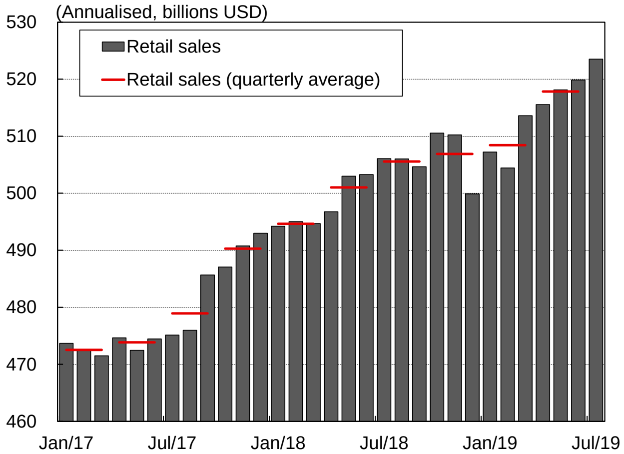
The Federal Reserve Board (FRB) will carry out another interest rate cut of 0.25% points at its Federal Open Market Committee meeting in September and will then leave rates at that level until the end of next year. However, there is a significant possibility that the FRB will be forced into raising interest rates again as a response to escalation in the trade friction between the US and China, or due to pressure from President Trump.

2.1 Personal consumption expenditure will maintain its robust growth on the back of the continued, firm increase in labour and income

An examination of retail sales – an indicator which represents personal consumption expenditure – reveals core retail sales (70% of total retail sales, excludes automobile and other motor vehicle dealers, building material and garden equipment and supplies dealers, and gasoline stations) recorded growth of 0.7% month-on-month in July (preliminary estimate), suggesting growth of personal consumption expenditure will be strong in the July-September quarter (Chart 2). The connection between growth of the US economy and personal consumption expenditure cannot be overstated: whether or not the US economy will be able to maintain its robust growth in future will depend on whether or not personal consumption expenditure remains strong.

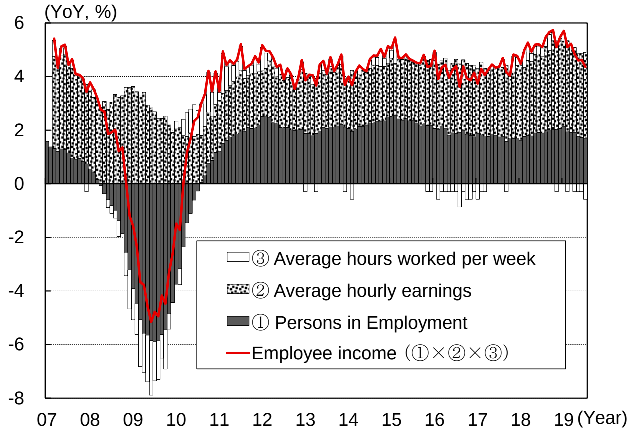
Consumption can be divided into “capacity for spending” and “appetite for spending”. Ascertaining the former means looking at the labour market and wage growth; the number of non-farm employees increased by 164,000 month-on-month in July, remaining on an upward trend despite a stagnant manufacturing sector. Although this is slower than the average month-on-month growth in the number of employees for 2018 (223,000), the increase in employees still maintains a firm pace of over 1% annualised while the period of economic expansion appears to have exceeded the previous record of ten years. Growth of wages is also stable at a high level, surpassing 3% annualised for about a year since August last year. In addition, plans by small and medium-sized companies to raise wages indicate earnings will continue to rise gradually in the future. When this increase in both employees and wages is multiplied, the resulting private income is expected to continue to rise by around 4% YoY on a nominal basis and by around 3% YoY on a real basis and will support growth of personal consumption expenditure, provided there is no change in “appetite for spending” (Chart 3).

Chart 2: Retail Sales



Source: Department of Commerce, MUFG Bank Economic Research Office

Chart 3: Employee Income



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

That being said, “appetite for spending” may be affected by the direction taken by the trade friction between the US and China, tariffs, movements in financial markets and developments in next year’s presidential election. However, it appears the labour situation will remain stable, as mentioned above, so it is unlikely that “appetite for spending” will experience a large, continuous fall.

Even though its growth rate in the April-June quarter was almost too good to be true, personal consumption expenditure will probably make a firm contribution of just below 2% annualised to the real GDP growth rate up until next year, considering the above situation. Furthermore, it may also provide a buffer to offset the stagnant external demand and investment.

2.2 The impact of the 4th round of tariffs

After the 4th round of tariffs was announced on 1st August, there was a further announcement on the 13th August stating the tariffs on some of the goods which are scheduled to take effect on 1st September will be postponed until 15th December. Looking separately at the goods which will come under tariff from 1st September and those which will not face a tariff until 15h

December (both on a HTS code basis), the former group contains 3,232 goods: 85% of the total goods subject to the 4th round of tariffs (3,812 goods) (Table 2). On the other hand, the value of imports (based on data from 2018) of the latter group of imports from China is USD 156 billion, equating to approximately 58% and over half of the value of all Chinese imports subject to tariff under the 4th round of tariffs (USD 269.4 billion). The breakdown of the listed products reveals the majority of consumer goods are mobile phones, laptop computers and toys (Table 3). The US is dependent on China for approximately 87% of these goods (amount of imports from China as a percentage of the US' total amount imported), surpassing its dependency for the products which will be subject to tariffs from September (24%). Compared with the previous three rounds of tariffs which have already come into effect, substituting these consumer goods with imports from other countries will be difficult and the impact of a rise in prices due to the tariffs could easily spread directly to consumers. As a result, President Trump made it clear in his speech that the delay of some of the tariffs was to avoid an impact on the Christmas season at the end of this year.

Table 2: Summary of the Fourth Round of Tariffs Imposed by the US

	Amount of imports			Number of products
	From China (USD billions) ①	Total (USD billions) ②	Degree of dependency on China (%) ①/②	
Fourth round of tariffs (as of May)	269.4	641.1	42	3,812
Take effect from 1 Sep	110.7	455.3	24	3,232
Take effect from 15Dec	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: "Amount of imports" is actual result from 2018
Source: US Department of Commerce, MUFG Bank Economic Research Office

Table 3: Top Ten Products in Terms of Amount of Imports from China Subject to Tariffs from December

Rank	Product	Amount imported		
		From China (USD billions) ①	Total (USD billions) ②	Degree of dependence (%) 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 laptops etc.	4.6	5.5	84
6	Footwear for women	2.1	2.6	78
7	Tableware, kitchen appliances	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: "Amount of imports" is the actual result from 2018
Source: US Department of Commerce, MUFG Bank Economic Research Office

At this current point in time, it is difficult to forecast what will happen after 15th December regarding changes to this dizzying situation, such as additional retaliatory measures by China and the US' response to these, as well as the suggestion of a subsequent about turn and a re-opening of trade talks. There is a possibility that the US will repeatedly extend the implementation of tariffs against consumer goods for which it is highly dependent on China in light of the impact the tariffs will have on the presidential election. However, it is very likely that the US will enact these tariffs in the end so that US companies start to review their supply chains and China's role as their hub. This is due to the underlying conflict between the US and China over technological dominance and security in the medium to long term, in addition to Tweets by President Trump saying, "we don't need China and, frankly, would be far better off without them" and "our great American companies are hereby ordered to immediately start looking for an alternative to China, including bringing your companies HOME and making your products in the USA".

The impact on the US' real GDP from the trade tension between itself and China (including the fourth round of tariffs) through trade channels is calculated at -0.4% points of downward pressure, even in the case that both countries impose tariffs of 30% against all imported goods from the other. Considering the firm growth of domestic demand in the US, it is thought this impact can be absorbed at present. Corporations are expected to abandon their wait-and-see approach when it comes to assessing the direction of tariff policy and to restart their investment activities, even if they do not have a clear outlook, so it is premature to say that the US-China trade friction will lead to a continuous contraction of the US corporate sector. Nevertheless, there are still many elements which are difficult to foresee, such as future discussions and countermeasures and the impact on household and business sentiment, so the utmost caution is still necessary.

3. Monetary Policy and Long-Term Interest Rates

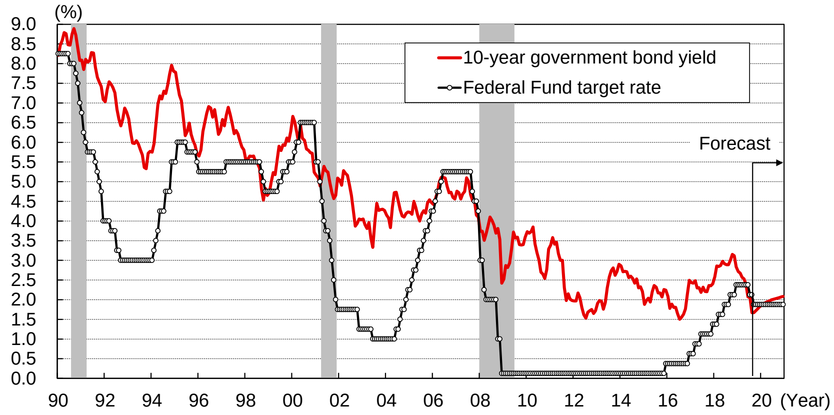
At the Federal Open Market Committee (FOMC) meeting in June, the Federal Reserve Board (FRB) revised its stance of “the Committee will be patient as it determines what future adjustments…may be appropriate” at the start of the year to “the Committee will closely monitor the implications of incoming information… and will act as appropriate”: a large change in direction towards cutting interest rates. In March, all seventeen FRB members predicted that the federal funds (FF) rate would be maintained at current levels or would be raised in their quarterly assessment for the FF rate, but in June, eight members – almost half – projected interest rates will be lowered this year. On top of this, at the FOMC meeting held at the end of July, the target range for the FF rate was lowered by 0.25% points from 2.25%~2.50% to 2.00%~2.25%, as was widely predicted. This is the first FF rate cut in around ten and a half years, the last being in December 2008. In addition, the FRB decided to bring the end of its balance sheet reductions forwards two months so the programme finished at the end of July this year, rather than the end of September when it was initially scheduled.

At the press conference following the FOMC meeting, FRB Chair Powell gave three points as reasons for the rate cut: to insure against downside risks from weak global growth and trade policy uncertainty; to help offset the effects these factors are currently having on the economy; and to promote a faster return of inflation to the symmetric 2 percent objective. He emphasised that it was a preventative measure. Furthermore, Chair Powell said that the FRB considered the rate cut “essentially in the nature of a (economic) mid-cycle adjustment to policy” and that the FRB does not have a set course for the FF rate in the future; additional rate cuts would be “data dependent”.

In its July FOMC statement, the FRB maintained its stance of continuing to “monitor the implications of incoming information… and will act as appropriate” which it published in its FOMC statement in June, and it acknowledged “uncertainties about this outlook remain”. At the symposium in Jackson Hole in late August, Chair Powell acknowledged another rise in uncertainty related to trade problems, starting with the announcement of a fourth round of tariffs, as well as a growing sense that the global economy is slowing. In light of this, it is likely the FRB deems it best to carry out an additional interest rate cut of 0.25% points at the FOMC meeting in September. The FF rate is already low (around 2%) at present, so in terms of maintaining leeway for lowering interest rates in preparation for another crisis, not to mention taking into account the fact the US economy appears to be expanding at a firm pace, it is likely the FRB will be cautious about another interest rate cut and will maintain rates from September until the end of the year (Chart 4).

Given the unconventional circumstances surrounding monetary policy decisions, it is important to be sufficiently cautious and to bear in mind downside risks to interest rates more than ever before. President Trumps’ public demands to Chair Powell for an interest rate cut have not let up despite the decision to lower the FF rate at the end of July: “what the Market wanted to hear from Jay Powell and the Federal Reserve was that this was the beginning of a lengthy and aggressive rate-cutting cycle”, and “China is not our problem…Our problem is with the Fed”. In response, former FRB chairs issued a statement calling for the FRB to maintain its independence as a central bank, yet President Trump does not seem to have heeded their warning. As the 2020 presidential election approaches, President Trump – who is conscious of next year’s election – cannot allow a slowing of the economy or a fall of stock prices as opinion polls currently place his support rate below that of Democrat candidate Biden. It is possible President Trump will demand larger interest rate cuts from the FRB. Therefore, there is an undeniable chance that the situation will develop in an atypical manner. In fact, the majority of market participants are making note of President Trump’s statements and his attitude, and are incorporating the notion of an additional three interest rate cuts this year into their predictions. This has prompted a decrease in long-term interest rates resulting in an inverted yield curve, which is a reminder of economic recessions, and stock markets are reacting negatively: a repeat of past experiences. The current message from FRB officials excluding Chair Powell is mixed with some saying additional interest rate cuts are necessary and others suggesting a wait-and-see stance for the time being. However, with the escalation of friction over trade between the US and China, pressure from President Trump and encouragement from financial markets, who have taken into account the former two factors, it will be important to keep in mind the risk scenario where the FRB is pushed into lowering interest rates several times, even if economic indicators from October onwards are not sufficiently weak.

Chart 4: 10-Year Government Bond Yield and Federal Fund Target Rate



Note: 1. Shaded areas denote periods of economic recession
2.Since December 2008, the Federal Funds Target Rate is the median of the target range.
Source: Bloomberg, MUFG Bank Economic Research Office

Translated by Elizabeth Foster

Forecast for the U.S. Economy

Forecast →

	2018				2019				2020				2018 (Actual)	2019 (Forecast)	2020 (Forecast)
	1～3	4～6	7～9	10～12	1～3	4～6	7～9	10～12	1～3	4～6	7～9	10～12			
1. Main 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	4.7	2.5	2.5	2.4	2.2	2.2	2.1	3.0	2.6	2.5
Fixed Investment (Residential)	-5.3	-3.7	-4.0	-4.7	-1.0	-2.9	-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	-0.6	1.7	1.8	1.9	2.0	2.1	2.1	6.4	2.9	1.8
Changes in Business 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	4.5	2.7	1.0	1.0	1.0	1.0	1.0	1.7	2.3	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	-5.8	1.8	1.6	1.5	1.5	1.5	1.5	3.0	0.0	1.1
Imports	0.6	0.3	8.6	3.5	-1.5	0.1	3.4	1.2	2.0	1.9	1.9	1.8	4.4	1.8	1.9
Domestic Private End User Demand	2.5	4.3	3.0	1.8	1.6	3.5	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	4.6	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	1.9	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 (hundred million dollars)	-2,207	-2,064	-2,279	-2,323	-2,165	-2,227	-2,272	-2,317	-2,165	-2,227	-2,272	-2,317	-8,873	-8,973	-9,073
Current Account (hundred million dollars)	-1,140	-1,073	-1,257	-1,439	-1,304	-1,352	-1,384	-1,415	-1,447	-1,478	-1,508	-1,539	-4,910	-4,960	-5,010
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 (3M) (%)	1.9	2.3	2.3	2.6	2.7	2.5	2.3	2.0	2.0	2.0	2.0	2.0	2.3	2.4	2.0
10-year Treasury Note's 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 Targets is end-of-period figures, Euro Dollar (3M) and 10-year Note's Yield are averages for periods.
Source: Compiled by MUFG Bank Economic Research Office from various reports and Bloomberg

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