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U.S. Economic Outlook

January 29, 2019

Although economic growth likely remained robust in the last quarter of 2018, again buttressed by strong consumer spending thanks to rising wage growth and stellar labor market gains, all available signs point to a significant loss of momentum at the end of the quarter and into Q1 2019. Most notably, the December ISM Manufacturing index posted its worst monthly decline in a decade due to a sharp drop in domestic new orders. Consumers were also significantly less optimistic about the short-term outlook in December, suggesting private consumption might weaken in the first quarter. Furthermore, the partial government shutdown from 22 December to 25 January appears poised to dent Q1 GDP growth—though some analysts see a rebound effect occurring in Q2. In addition to the business disruptions caused by understaffed federal agencies, 800,000 federal workers were furloughed or working without pay in the period, while a significant number of federal contractors were left unemployed and without the prospect of back pay—both of which should hit private consumption in the quarter. Though the government could shut down again if no border security compromise is reached before 15 February, the scenario appears unlikely given the political pressure piling upon congressional Republicans.

AS/AD

United States Economic Growth

This year, the economy is poised to cool from 2018's high, with a number of headwinds combining to dampen activity. Though the Federal Reserve is seen slowing its tightening, higher interest rates should nonetheless put a lid on growth, while the stimulus of the 2017 tax cut is set to fade. A still-likely escalation of the trade war with China is the main downside risk and would amplify the ongoing global growth slowdown. A large fiscal deficit and high corporate debt levels are also main medium-term vulnerabilities. FocusEconomics panelists see GDP expanding 2.4% in 2019, which is down 0.1 percentage points from last month's estimate, and 1.7% in 2020.

United States Economy Data

	2013	2014	2015	2016	2017
Population (million)	317	319	321	324	326
GDP per capita (USD)	52,737	54,657	56,411	57,559	59,501
GDP (USD bn)	16,692	17,428	18,121	18,624	19,391

	2013	2014	2015	2016	2017
Economic Growth (GDP, annual variation in %)	1.7	2.6	2.9	1.5	2.3
Domestic Demand (annual variation in %)	1.3	2.7	3.5	1.7	2.4
Consumption (annual variation in %)	1.5	2.9	3.6	2.7	2.8
Investment (annual variation in %)	5.0	6.2	3.9	0.7	4.0
Exports (G&S, annual variation in %)	3.5	4.3	0.4	-0.3	3.4
Imports (G&S, annual variation in %)	1.1	4.5	5.0	1.3	4.0
Industrial Production (annual variation in %)	2.0	3.1	-1.0	-1.9	1.6
Retail Sales (annual variation in %)	3.6	4.3	2.6	3.1	4.3
Unemployment Rate	7.4	6.2	5.3	4.9	4.4
Fiscal Balance (% of GDP)	-4.1	-2.8	-2.4	-3.1	-3.4
Public Debt (% of GDP)	104	104	105	107	106
Money (annual variation in %)	6.7	6.2	5.8	6.8	5.6
Inflation Rate (CPI, annual variation in %)	1.5	1.6	0.1	1.3	2.1
Inflation (PPI, annual variation in %)	1.4	1.6	-0.9	0.4	2.3
Policy Interest Rate (%)	0.25	0.25	0.50	0.75	1.50
Current Account (% of GDP)	-2.1	-2.1	-2.4	-2.4	-2.4
Current Account Balance (USD bn)	-349.5	-373.8	-434.6	-451.7	-466.3
Trade Balance (USD billion)	-700.5	-749.9	-761.9	-751.1	-807.5

United States Economy Overview

•Highlight evidence of/reasons for America's position as a wealthy country.

Economic Overview of the United States

Despite facing challenges at the domestic level along with a rapidly transforming global landscape, the U.S. economy is still the largest and most important in the world. The U.S. economy represents about 20% of total global output, and is still larger than that of China. Moreover, according to the IMF, the U.S. has the sixth highest per capita GDP (PPP). The U.S. economy features a highly-developed and technologically-advanced services sector, which accounts for about 80% of its output. The U.S. economy is dominated by services-oriented companies in areas such as technology, financial services, healthcare and retail. Large U.S. corporations also play a major role on the global stage, with more than a fifth of companies on the Fortune Global 500 coming from the United States.

International trade + subsidy

Micro subsidy

Even though the services sector is the main engine of the economy, the U.S. also has an important manufacturing base, which represents roughly 15% of output. The U.S. is the second largest manufacturer in the world and a leader in higher-value industries such as automobiles, aerospace, machinery, telecommunications and chemicals. Meanwhile, agriculture represents less than 2% of output. However, large amounts of arable land, advanced farming technology and generous government subsidies make the U.S. a net exporter of food and the largest agricultural exporting country in the world.

PPC

The U.S. economy maintains its powerhouse status through a combination of characteristics. The country has access to abundant natural resources and a sophisticated physical infrastructure. It also has a large, well-educated and productive workforce. Moreover, the physical and human capital is fully leveraged in a free-market and business-oriented environment. The government and the people of the United States both contribute to this unique economic environment. The government provides political stability, a functional legal system, and a regulatory structure that allow the economy to flourish. The general population, including a diversity of immigrants, brings a solid work ethic, as well as a sense of entrepreneurship and risk taking to the mix. Economic growth in the United States is constantly being driven forward by ongoing innovation, research and development as well as capital investment.

Business cycle

Tritecta: AS/AD, LF, ID

The U.S. economy is currently emerging from a period of considerable turmoil. A mix of factors, including low interest rates, widespread mortgage lending, excessive risk taking in the financial sector, high consumer indebtedness and lax government regulation, led to a major recession that began in 2008. The housing market and several major banks collapsed and the U.S. economy proceeded to contract until the third quarter of 2009 in what was the deepest and longest downturn since the Great Depression. The U.S. government intervened by using USD 700 billion to purchase troubled mortgage-related assets and propping up large floundering corporations in order to stabilize the financial system. It also introduced a stimulus package worth USD 831 billion to be spent across the following 10 years to boost the economy.

Money market

The economy has been recovering slowly yet unevenly since the depths of the recession in 2009. The economy has received further support through expansionary monetary policies. This includes not only holding interest rates at the lower bound, but also the unconventional practice of the government buying large amounts of financial assets to increase the money supply and hold down long term interest rates—a practice known as "quantitative easing".

Lorenz Curve

While the labor market has recovered significantly and employment has returned to pre-crisis levels, there is still widespread debate regarding the health of the U.S. economy. In addition, even though the worst effects of the recession are now fading, the economy still faces a variety of significant challenges going forward. Deteriorating infrastructure, wage stagnation, rising income inequality, elevated pension and medical costs, as well as large current account and government budget deficits, are all issues facing the US economy.

U.S. Economic History

The end of World War II marked the beginning of a golden era for the U.S economy. This period was marked by a surge in economic activity and productivity, a growing and more prosperous middle class, and the rise of the baby boomer generation. From the late 1940s to the early 1970s, U.S. GDP grew at an average annual rate of nearly 4%. By the 1970s, the structural change in the economy away from industry and manufacturing to services was in full force. However, after several decades of unprecedented growth, the economy began to show signs of slowing and a series of events, including the collapse of the Bretton Woods system, the 1973 oil crisis and increased global competition, precipitated important economic changes. The 1970s were marked by a period of stagnating growth and inflation referred to as "stagflation".

AS/AD stagf'n

The 1980s gave rise to Reaganomics, a series of economic policies promoted by President Ronald Reagan. The main objectives were reduced government spending and regulation, as well as lower taxes and a tighter money supply. Regan was highly successful in overhauling the tax code and pushing ahead with deregulation in several major sectors of the economy; and while growth and productivity increased, the government's debt multiplied significantly. In a broader sense, Reaganomics marked a turn toward free-market supply-side economics and away from the Keynsian-inspired economics that had been favored since the Great Depression.

Keynesian AS
supply-side policy

AS/AD

Increasing global integration and the rise of new technology, including the adoption of productivity-enhancing IT in the workplace and the surge of high-tech companies, helped fuel an economic boom in the 1990s. The period between 1993 and 2001 marked the longest sustained expansion in U.S economic history, and powered a steep rise in employment, income and consumer demand.

Money Mkt + Loanable Funds

Moreover, the strong growth and low unemployment during this time were particularly remarkable because the government budget was reigned in simultaneously and actually achieved a surplus for four years between 1998 and 2001. The fiscal improvement was made possible in part by tax increases introduced by President Bill Clinton, but also thanks to the booming economy and surging stock market. The stock market was driven up by the rise of internet-based companies in what is known as the "dot-com bubble", which generated vast sums of unanticipated revenue for the government on capital gains taxes and rising salaries. However, the overvaluation of dot-com stocks eventually became apparent and the bubble burst in 2000.

The first years of the 2000s saw a sharp drop in economy activity following the dot-com burst. The terrorist attacks on September 11, 2001, and several corporate scandals put a further damper on economic activity and business confidence. The Federal Reserve (the Fed), under Alan Greenspan, stepped in to counteract the struggling economy by introducing low interest rates. This move would later be considered a major factor in causing the massive

Imports to the United States

More 80% of total imports brought to the United States from abroad are goods. Roughly 15% of these imports are in the form crude oil, fuel oil and petroleum products. Industrial machinery, supplies and equipment represent another 15% of imported goods. Almost 25% of imported goods are capital goods, such as computers, computer accessories, electronics, medical equipment, and telecommunications equipment. Consumer goods represent another 25% of imported goods. Cellphones, pharmaceuticals, toys, household equipment, textiles, apparel, televisions, and footwear are the main types of consumer goods imported to the United States. An additional 15% of imported goods are automotive vehicles, parts, and engines. Food and beverages represent only about 5% of imported goods. Services represent only 20% of total imports, and are primarily financial services, as well as travel and transportation.

United States' Economic Policy

AS/AD, LF, MMkt

The U.S. government has faced the momentous task of reversing the effects of the recession with a combination of expansionary fiscal and monetary policy. On the fiscal side, government stimulus spending and tax cuts prevented further deterioration of the economy. On the monetary side, the Federal Reserve has tackled economic weakness with both traditional and unconventional policies.

The United States is typically regarded as the home of free-market economic policies. However, the U.S. government exercises a significant amount of regulation over economic, commercial and financial activities. Following the recession, the government stepped up its oversight in the financial sector. The Dodd-Frank act, passed in 2010, represents the most comprehensive reform of financial markets regulation since the Great Depression.

United States' Fiscal Policy

LF: Private Only

The U.S. government tends to spend more money than it takes in, and thus has incurred fiscal deficits almost uninterruptedly during the past several decades. The only time when the government managed to balance a budget in recent history was between 1998 and 2001, when the strong economy resulted in higher-than-usual tax revenues. The fiscal deficit reached the highest point since 1945 in 2009 at 9.8% of GDP, but has improved progressively since then; the deficit dropped to 2.4% of GDP in 2015.

The largest portion of government spending is mandated by existing laws, with a large amount of funds allocated to entitlement programs such as Social Security and Medicaid. Mandatory spending represents nearly 60% of total government spending. The remainder is referred to as discretionary spending, and is determined by the annual federal budget. About half of the discretionary budget is spent on the military and defense, with the other half spent on government programs and public services.

Nearly 50% of tax obtained by the U.S. government comes from income taxes on individuals, with an additional 10% coming from income taxes on businesses and corporations. Another 35% of collections come from payroll and social security taxes. Excise taxes charged on goods such as liquor, tobacco and gasoline bring in a smaller amount, less than 5%. Tax revenues equaled about 18% of GDP on average between 1970 and 2010. Total tax revenues as a percentage of GDP were about 18% in 2015.

Micro tax

housing market bubble that burst and precipitated the Great Recession that began in 2008.

United States' Balance of payments

FOREX: USD/€

(PED inel.)

Micro: Oil S&D

Over the past several decades, the U.S. current account balance has been heavily influenced by international trade flows, with the ongoing trade deficit resulting in a consistent current account deficit. Earnings on U.S. assets and investments owned abroad have a very small part in the current account, and a surplus in this category is not nearly enough to offset the large trade deficit. Overall, the current account deficit implies that the value of the goods and services being purchased from abroad by the United States exceeds the value of the goods and services being sold to foreigners. The U.S. current account deficit widened progressively since the 1990s and reached an all-time record and global high of 5.8% of GDP in 2006. The deficit has since narrowed due in part to increased domestic oil production.

Investment

The current account deficit is mirrored by a capital account surplus. The net amount of capital inflows received in the United States from abroad makes it possible to finance the current account deficit. Foreigners continue to invest in U.S. assets and companies, and so the net international investment position of the United States has grown over time. The United States is by far the top recipient of foreign direct investment (FDI). About 80% of FDI in the United States comes from a set of just nine industrialized countries. The UK, Japan and the Netherlands are the top sources of FDI in the U.S. The U.S. manufacturing sector draws about 40% of FDI.

United States' Trade Structure

The U.S. is the 2nd leading exporter of goods and services in the world and the number one leading importer. The U.S. has consistently run a trade deficit, mainly due to the dependence on foreign oil to meet its energy needs and high domestic demand for consumer goods produced abroad, however thanks to advances in domestic oil production, the energy gap is closing. The main trading partners of the U.S. are Canada, China, Mexico and Japan. Canada is the main destination for U.S. exports, whereas China is the main source of imports.

Free trade

The U.S. plays a major role in the international trade system and is generally seen as a proponent of reduced trade barriers and free trade agreements. The United States currently has more than a dozen free trade agreements in place. Among them are the North American Free Trade Agreement (NAFTA), which was created in conjunction with Canada and Mexico in 1994. The United States is also an active member of the World Trade Organization (WTO).

Exports from the United States

Although the United States has lost some of its competitive edge in recent decades, material goods still represent two thirds of its total exports. The United States mainly exports high-value capital goods and manufactured products, including industrial machinery, airplanes, motor vehicles and chemicals. In 2015, the U.S. exported USD 1.510 trillion in goods.

The United States is the world's leading exporter of services. This includes financial and professional business services as well as other knowledge-intensive services. Travel, transportation and tourism services are also a major export. Services represent about one third of total exports.

The stimulus package introduced by the Obama administration in 2009 included USD 288 billion in tax cuts and incentives. Less than two years later, Obama announced an extension to the tax cuts that had been introduced during the Bush administration at a cost of more than USD 400 billion over two years.

United States' Monetary Policy

The U.S. Congress has established that the monetary policy objectives of the Federal Reserve are to promote maximum employment and price stability in what is known as the "dual mandate". The Federal Open Market Committee (FOMC) is the Fed's monetary policymaking body. The FOMC meets about eight times a year to discuss developments and the outlook for the U.S. economy and to debate different policy options, including the level of interest rates. The federal funds rate, the main interest rate managed by the Fed, is the rate which deposit banks charge each other to trade funds overnight in order to maintain reserve balance requirements. The federal funds rate is one of the most important in the U.S. economy because it influences all other short term interest rates.

Loanable Funds

During the years since the recession hit, the Fed has been very active.. Interest rates were initially supposed to be kept low only until the unemployment rate dropped to 6.5% or inflation surpassed 2.5%. However, this specific forward guidance was revamped in March 2014 when the Fed announced that any future decisions to hike interest rates no longer depended on previously-established quantitative thresholds, but rather on the assessment of a broad range of more qualitative information. In an additional response to counter the effects of the recession, in December 2012, the Fed announced an unconventional policy known as "quantitative easing". This policy involves the purchase of vast sums of financial assets in an attempt to increase the money supply and hold down long-term interest rates.

United States' Exchange Rate Policy

FOREX: USD - managed

The U.S. dollar is often referred to as the world's currency because it is by far the most used currency in international transactions and also the most widely held reserve currency. Almost two thirds of currency reserves held throughout the world are in U.S. dollars.

Although the Treasury Department has the primary authority to oversee international financial issues, the Treasury's decisions regarding foreign exchange are made in consultation with the Federal Reserve. However, U.S. intervention in the foreign exchange market has become increasingly less frequent. U.S. authorities typically let the open foreign exchange market and domestic monetary policies determine rates.

3 Ah-has	3 questions you have