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U.S. economic outlook for the rest of 2018

Singapore Management University

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31 Oct 2018

Fed rates to inch up as GDP grows but China-U.S. trade war is a major worry

In its last meeting in September the U.S. Federal Reserve Open Market Committee (FOMC) raised the fed fund rates by an expected 25 basis points to a range of 2 percent to 2.25 percent. In a sign that further reflects a recovering U.S. economy, the September 26 statement also dropped language saying that "the stance of monetary policy remains accommodative", which last appeared in the previous FOMC statement on June 13.

"Actual GDP growth has been stronger than expected, actual unemployment has trended lower, and actual inflation has been a little bit lower than expected," elaborates **James Bullard**, President and Chief Executive of the Federal Reserve Bank of St. Louis and member of the FOMC. Citing unemployment projections from March 2017 (4.5 percent) against current figures (3.7 percent), the FOMC member articulates the consequence of the U.S. economy's robust performance.

"The constant upside surprise has allowed the FOMC to have enough confidence to go ahead with its rate increases even though we suffered through one of the worst recessions on record between 2007 to 2009 which pushed policy rates down to zero," Bullard explained to the audience at the recent SMU Sim Kee Boon Institute for Financial Economics seminar, *'US Economy and Monetary Policy'*.

"Another is that the equities markets have been very strong. This is because the global economy has surprised to the upside, and this helps U.S. equities because a lot of U.S. equities have their sales overseas.

"Finally, the strengthening U.S. dollar is a key issue in global financial markets. The weakened dollar in 2017 is in part due to larger growth surprise abroad. The U.S. looks stronger in 2018 relative to the other economies, and the U.S. dollar has strengthened accordingly."

But will the American economy continue to grow at this rate?

"I think the key issue here is the U.S. potential growth rate is widely thought to be relatively low in part due to demographics in the U.S.," Bullard elaborates. "In particular, labour force growth has been slower since 2008. If we are going for faster growth on a sustained basis, it has to come from productivity growth.

"I think this is a definite possibility if U.S. investments improve, which could happen because of tax reform and if the technology we see around us gets transformed into business processes and really start to drive productivity in the U.S. at a faster pace than we've seen up until now."

The Trump effect

While Bullard explained that the rest of the world "surprised us even more" with regard to growth since the start of 2017, which helped lifted the U.S. economy, a question from the floor was asked about the role of tax cuts by the Trump administration.

“The corporate tax reform has been a big factor in thinking about how the U.S. would evolve over a two-year period,” Bullard answered. “The economists’ views of the U.S. are in flux, and I think there is a tension between some who might feel like these are just temporary factors that are pushing the economy higher, and therefore it would go back to the potential growth rate of about 1.8 percent. That is the standard forecast.

“But now some people are wondering, ‘Wait a minute. Maybe we’ll get some of these productivity improvements and higher investments, and the potential growth rate will come up.’ I think that’s where we are.”

While the U.S. economy may be in rude health, the ongoing trade war with China casts an ever expanding cloud over the big economic picture. 169 members of the House of Representatives wrote earlier this month to the Trump administration seeking permission for companies to ask for exclusions from duties on $200 billion worth of Chinese goods.

Bullard concedes it is a concern.

“It’s a major issue since the Trump administration came to power,” he says. “I do think there’s been a very important development recently, which is U.S., Canada and Mexico have come to an agreement about NAFTA 2.0. It’s important because it shows that agreements can be had, that it doesn’t have to be tit-for-tat and that you can come to an agreement.

“I think it sends a great message around the world that other agreements can be reached. Businesses will like that a lot because a lot of the uncertainties can be reduced. Unfortunately between the U.S. nnd China, both sides seem to be digging in instead of negotiating, so I’m not quite sure how that’s going to end.”

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