US Economic Outlook

Whole US economic picture behind the trade truce

Global investors keep a close eye on US economic prospects, which are critical for the future paths of global central bank policies, trade talks and world economy. US economy remains in good place so far. But is it heading to a soft landing or a steep decline? It largely depends on whether the trade-driven weakness in manufacturing will spread to the broader economy and whether the relative strength of consumption is able to continue. We expect the downshift of US economic growth to persist in the months ahead. Systematic risks are controllable and large-scale economic crisis is out of sight. That said, a short-lived recession is still on the table.

- **Employment and wages: mixed signal.** US labor market is still quite strong and has not taken a big turn for the worse. We expect continued job growth in the months ahead. However, wage growth remains muted.

- **Inflation: weak PPI and flat CPI support more easing.** Recent disappointing reading of CPI and PPI will give Fed one more reason to worry about the deteriorating outlook. Cost of Chinese imports fell amid tariff war and US faces little import price pressure.

- **Manufacturing: recession matters politically.** Manufacturing has officially fallen into recession, which may pose greater threat to Trump's re-election.

- **Retail sales: resilience to be tested.** US retail sales are expected to remain solid in 4Q19 thanks to the healthy job market and robust consumer confidence. Behind the decision to delay tariff on some consumer goods from China are many opposition voices which have made Trump undestand how different next 10% tariff would be comparing to the earlier rounds.

- **Foreign trade: trade spat takes a toll.** US trade with rest of the world is slowing dramatically. Imports from China decreased while its imports from other Asian trading partners increased. US total trade deficit widened, while its goods trade gap with China narrowed.

- **Housing market: price stalling, sentiment improving.** US housing market is cooling, while lower mortgage rates are giving the industry a boost recently.

- **Fiscal, monetary and financial sectors:** Tax cuts and massive spending package have further boosted the federal budget deficit. Now, the government debt is on an unsustainable path, leaving little room for more fiscal stimulus to fight economic downturns. Household debt is edging higher, but risks are under control. US dollar is likely to remain solid in 4Q19.

- **Outlook: set to slow further.** US consumer spending is likely to remain solid over the near term, but US could not immune to trade uncertainties and global slowdown. Therefore, the downshift of growth is likely to continue. The partial trade agreement, paving way for Trump-Xi APEC meeting, could provide short-term boost to business confidence, but uncertainties persist. We expect US economy to grow 1.7% in 3Q19 and 2.2% in 2019.

US economic forecast

	4Q18	1Q19	2Q19	3Q19E	4Q19E	2018	2019E
Real GDP growth	1.1	3.1	2.0	1.7	1.4	2.9	2.2
Inflation(core PCE)	1.9	1.6	1.6	1.7	1.7	2.0	1.7

Sources: CEIC, CMBIS estimates

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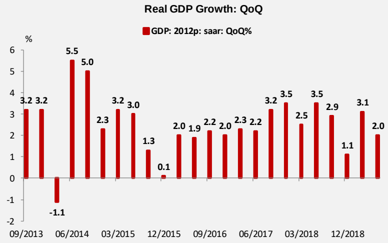
US real GDP growth



Sources: CEIC, CMBIS

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Contents

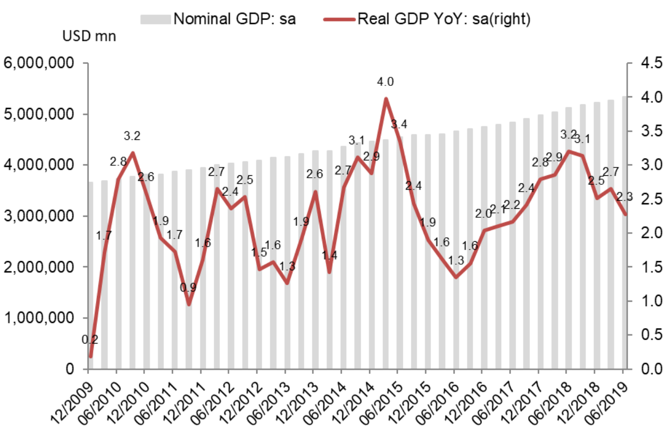
Overall economic activity: set to slow further

US economy remains in good place overall so far. Real GDP expanded by an annualized 2.0% in 2Q19, down 1.1ppt from the previous quarter, underpinned by the strong growth in consumer spending. In 1H19, US economy expanded 2.6%, still above the trend-rate.

Meanwhile, risks remain skewed to the downside. As the stimulus from US government's tax-cut packages and fiscal spending fade, US economy is gradually losing momentum and its economic growth has slowed a bit in recent months. Newly-added payroll employment turned out weaker than expected and wage growth has cooled. Manufacturing activity is contracting and trade tensions have weighed on exports. Manufacturing PMI slumped to 47.8 in Sep 2019. Business optimism dropped to three-year low during 3Q19.

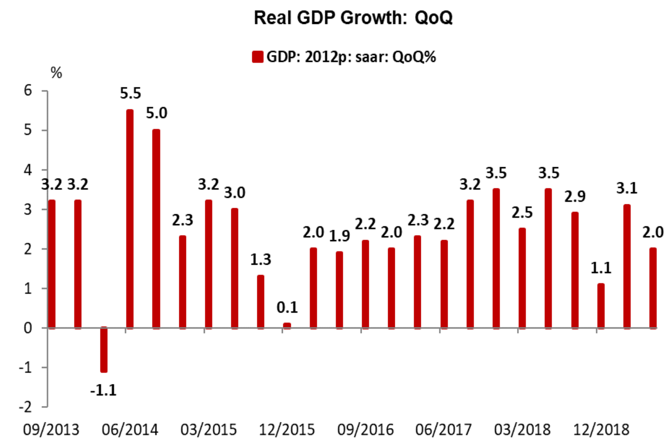
With the mixed economic signals, a short-lived recession is still on the table. The probability of recession over the next 12 months has been hiking to around 38%, a high level also seen during 2001-2002 and 2007-2008. More than half of CFOs in US expect the country to enter a recession prior to 2020 presidential election. And if the trade war drags on for longer, the worries may come true sooner than expected.

Figure 1: US real GDP and its YoY growth



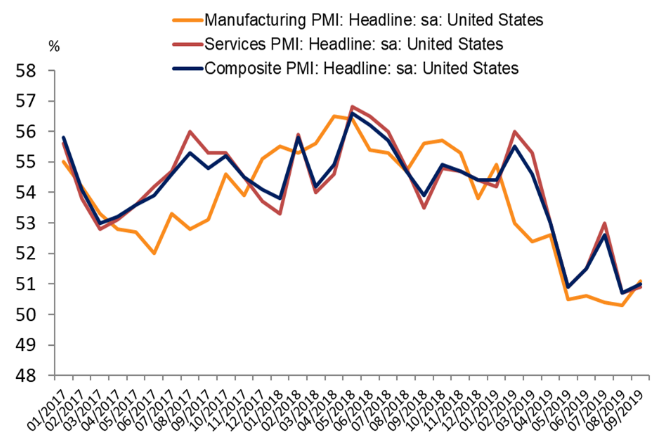
Source: CEIC, CMBIS

Figure 2: US annualized QoQ growth of real GDP



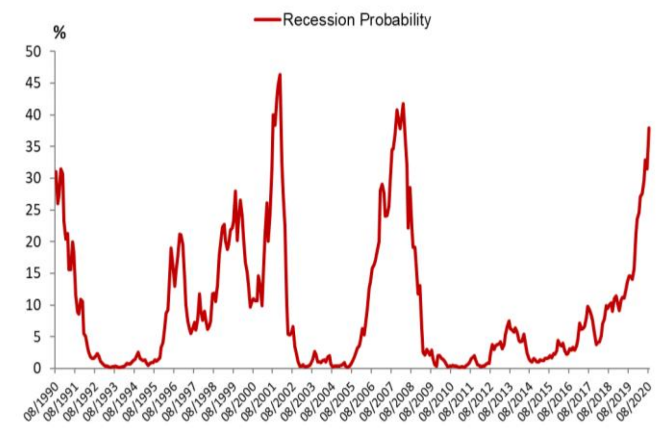
Source: CEIC, CMBIS

Figure 3: US PMIs show a broad-based downshift



Source: CEIC, CMBIS

Figure 4: US recession probability reaches the 2001-2002 and 2007-2008 levels



Source: CEIC, CMBIS

Employment and wages: mixed signal

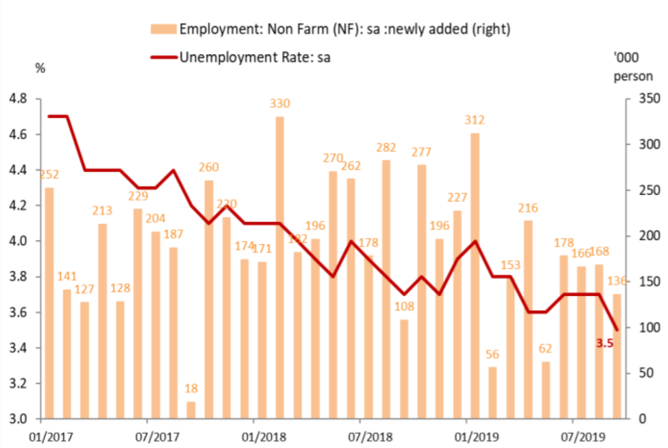
US labor market is still quite strong but wage growth remains muted.

US unemployment rate declined by 0.2pp to 3.5% in Sep 2019, a half-century low. Nonfarm payroll employment increased by 136,000, less than forecast, after growing 168,000 in Aug 2019. Job growth has averaged 161,000 per month thus far in 2019, compared with an average monthly gain of 223,000 in 2018. Taken the recent General Motors strike into consideration, we believe layoffs still remain low in US.

Wage growth, however, ticked down further in Sep 2019. Average hourly earnings YoY growth rate fell to 2.9% in Sep, down 0.3ppt from previous month, to US$28.09 per hour. The muted wage growth in strong job market could partly be explained by increasing lower-skilled workers in labor force, aging population and sluggish productivity growth, etc.

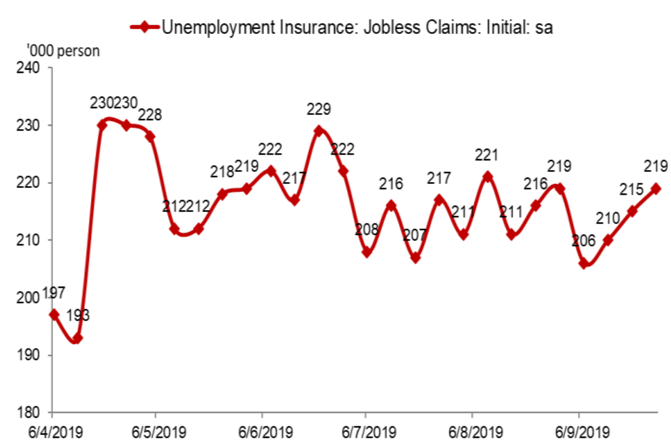
The question that matters is how long the labor market could stay strong amid multiple downside risks to the whole economy. Leading indicators such as the Employment Trends Index are signaling continued job growth in the months ahead. US labor market, as we see, has not taken a big turn for the worse, and will not in 4Q19.

Figure 5: US unemployment rate dropped to a 50-year low while newly-added nonfarm payroll missed expectation in Sep 2019



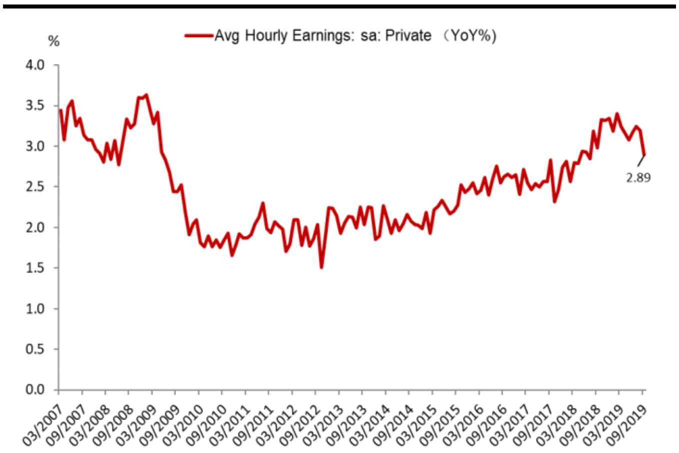
Source: CEIC, CMBIS

Figure 6: Initial jobless claims show that layoffs still remain low in US



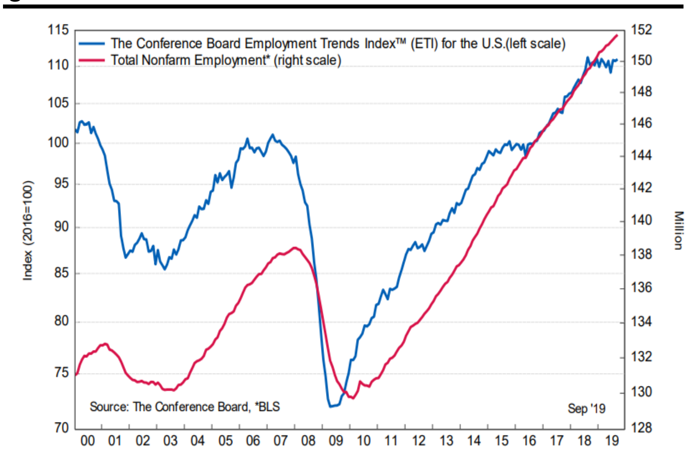
Source: CEIC, CMBIS

Figure 7: US wage growth seems to have peaked



Source: CEIC, CMBIS

Figure 8: Leading indicator signals continued job growth in the months ahead



Source: The Conference Board, BLS, CMBIS

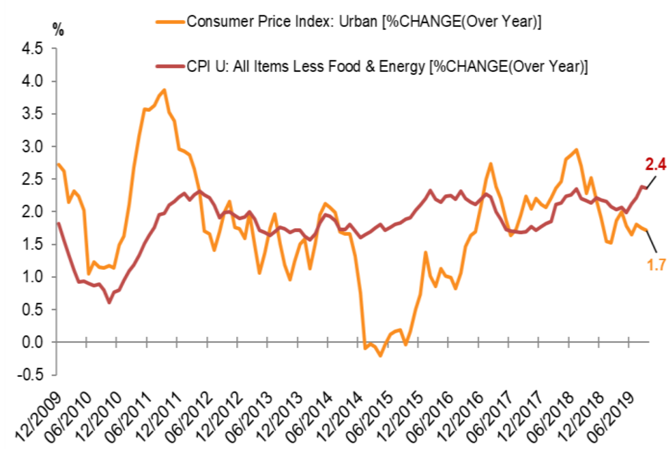
Inflation: weak PPI and flat CPI support more easing

Key inflation gauge has undershot Fed's target. Core personal consumption expenditures (PCE) price index, Fed's preferred gauge of inflation, rose 1.8% YoY in Aug 2019 after increasing 1.7% in Jul 2019, which has still undershot Fed's target of 2%. Total consumer prices, measured by PCE price index, increased by 1.4% in Aug 2019 YoY. Headline consumer prices increased by 1.7%YoY in Sep 2019, staying flat, while core CPI rose by 2.4%, matching Aug's rise. Consumer prices support expectations that Fed will cut rate in Oct 2019.

Fed should become more worried about PPI than CPI. US producer price index YoY growth fell to the lowest in nearly three years, indicating the weakness in manufacturing sector. PPI YoY growth of Sep 2019 increased 1.4%, the smallest gain since Nov 2016, after rising 1.8% in Aug 2019. Core PPI also edged lower from 2.3% in Aug 2019 to 2% in Sep 2019. The disappointing reading will give US fed one more reason to worry about the deteriorating outlook and to cut rates as manufacturing recession is spreading to the broader economy.

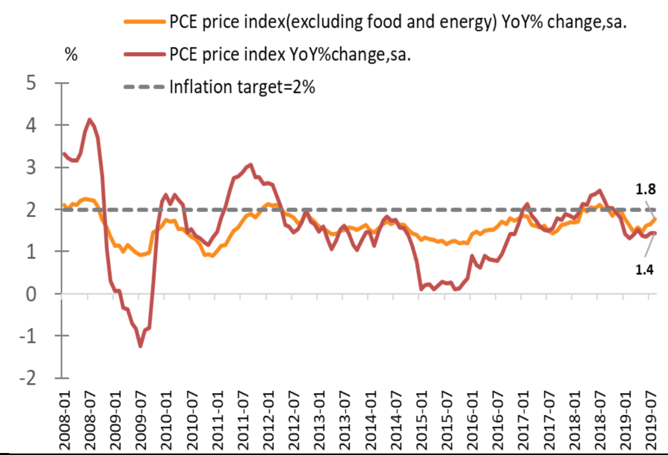
Cost of Chinese imports fell amid tariff war and US faces little import price pressure. Cost of imported goods fell 2% in Aug 2019 from a year earlier, mainly due to a decline in oil prices. Cost of imports from China dropped 1.6% YoY, which does not include the cost of tariffs. It indicates that Chinese suppliers have cut prices to retain market share in US.

Figure 9: US CPI and core CPI stayed flat in Sep 2019



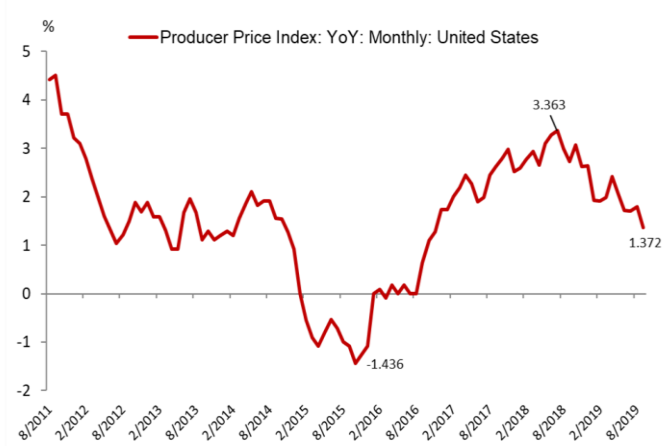
Source: CEIC, CMBIS

Figure 10: US PCE and core PCE price index



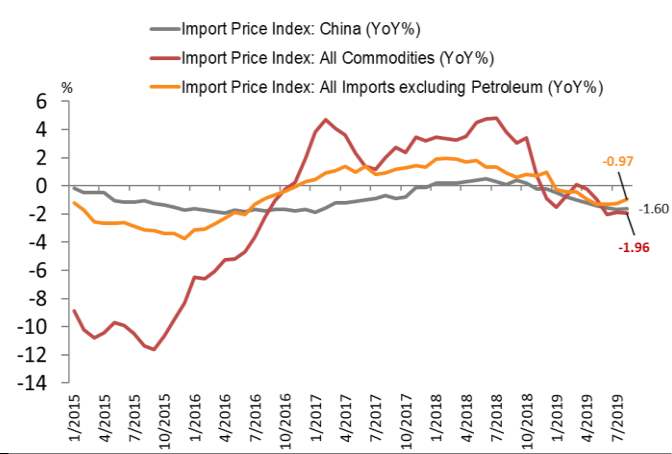
Source: Bureau of Labor Statistics via FRED, CMBIS

Figure 11: US PPI YoY growth fell to the lowest in nearly three years



Source: CEIC, CMBIS

Figure 12: US faces little import price pressure



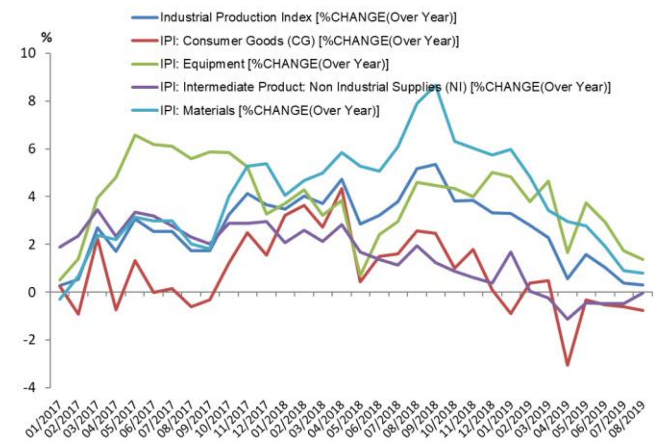
Source: CEIC, CMBIS

Manufacturing: recession matters politically

Manufacturing has officially fallen into recession due to the subdued demand conditions caused by trade war and global economic slowdown. Output in this sector shrank over the past two straight quarters, the worst situation in 10 years. Industrial production index shows that the output of materials, equipment, intermediate product and consumer goods have all experienced slumps since 2Q19. The temporary rebound in manufacturing production in Aug 2019 was mainly driven by the surge in oil and gas production, which could not alter the downward trend. As business sentiment about the year ahead remains gloomy, we expect US manufacturing recession to extend into its third quarter, even for longer time.

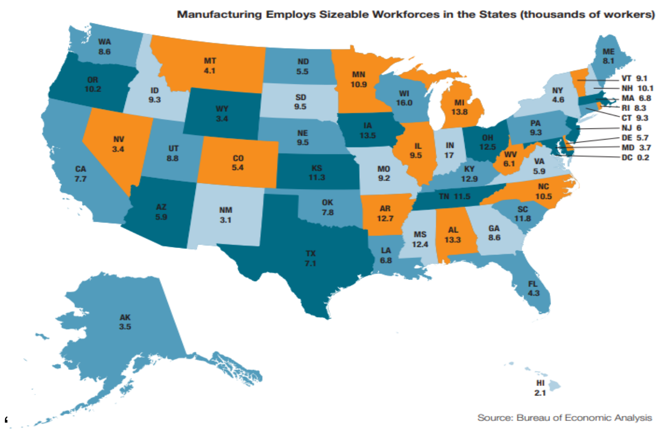
Industrial recession may pose greater threat to Trump's reelection campaign. Despite the fact that manufacturing only accounts for about 11% of US economy and 8% of total employment, its growth matters for President Trump as he has vowed to boost the industry and create millions of new manufacturing jobs since his last presidential campaign. States with highest shares of manufacturing jobs are hurt most and many of them are swing states. Many formerly Democratic states swung to secure Trump's victory in 2016 such as Wisconsin, Michigan, Iowa and Pennsylvania. Failing to boost manufacturing industry will surely pose a huge threat to Trump's 2020 reelection campaign.

Figure 13: US industrial production index unveiled the persistent weakness of the sector



Source: CEIC, CMBIS

Figure 14: Many of the states with highest shares of manufacturing employment are important swing states for Trump's re-election campaign

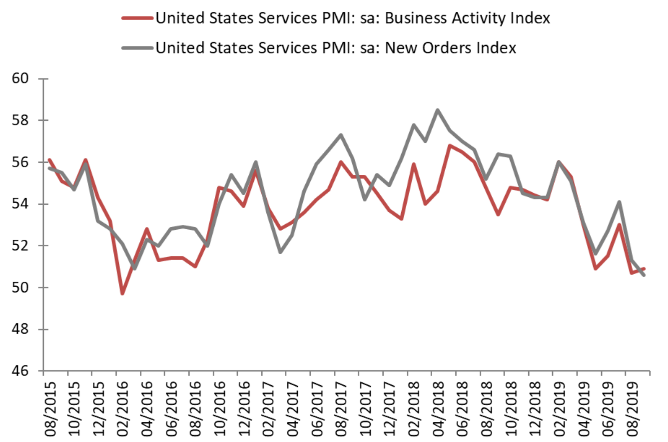


Source: Bureau of Economic Analysis

Services: growth hit 3-year low

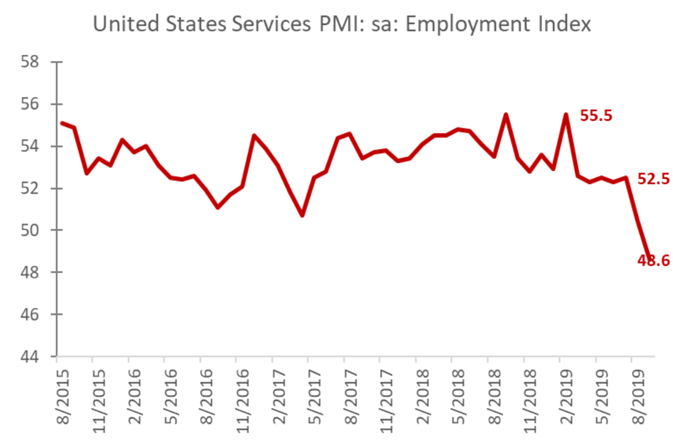
US service PMI, according to ISM surveys, slumped to 50.9 in Sep 2019, hitting 3-year low amid worries about rising tariffs. New orders index dropped from 51.3 in Aug 2019 to 50.6 in Sep 2019, indicating a glummer outlook. Employment in service sector fell for the first time since 2010, a major concerning part. The readings show that the trade war and policy uncertainties are biting US service sectors.

Figure 15: US service PMI dropped to 50.9 in Sep 2019



Source: CEIC, CMBIS

Figure 16: Employment in service sector fell in Sep 2019

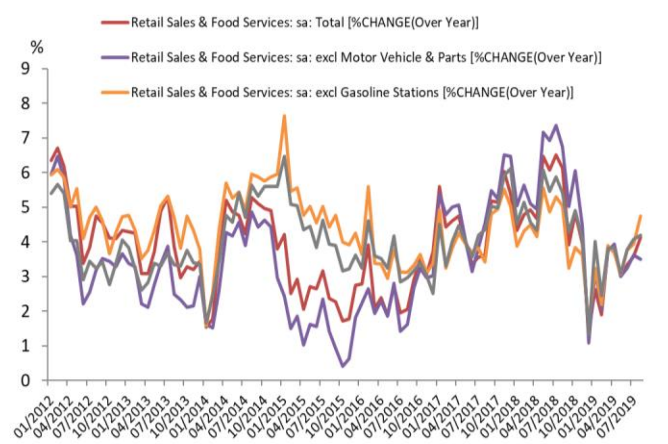


Source: CEIC, CMBIS

Retail sales: resilience to be tested

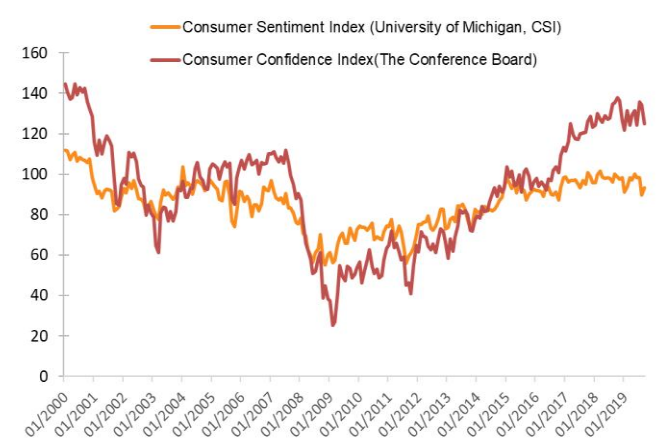
Retail sales trended upward since the beginning of this year and remained solid as of Aug, registering a 4.1% YoY and 0.4% MoM increase in Aug 2019, showing the continuing strength of US retail sales. Both consumer sentiment and consumer expectations remained close to their average level since the beginning of the year. Looking ahead, US retail sales, which accounts for about 70% of the whole economy, are expected to remain solid in 4Q19 given the healthy job market and high consumer confidence. However, retailers could not immune to the impact of trade uncertainties and trade war will determine how long the strong retail sales could persist. Resilient personal consumption is also one of the most important data that many Fed committee members are monitoring before making policy decisions. If the retail sales data released on 16 Oct gives negative message, another rate cut in Oct will be almost certain.

Figure 17: US retail sales growth remained solid



Source: CEIC, CMBIS

Figure 18: US consumer confidence remained strong



Source: CEIC, CMBIS

Special topic: Delaying tariff to protect consumption

About two weeks after President Trump threatened 10% tariffs on the remaining US$300bn Chinese imports, US announced on 13 Aug to delay placing additional tariffs on some items including cellphones, laptop and toys from China.US government claimed that the decision was based on "health, safety, national security and other factors". Trump's expression, however, seems closer to the true story that the delay was in part to avoid hitting US customers during the coming Christmas holiday shopping season.

Behind the decision to delay tariff are many voices of opposition which have made Trump undestand how different next 10% tariff would be comparing to the earlier rounds. Large retail trade groups including the National Retail Federation (Amazon and Walmart as members), Retail Industry Leaders Association (Apple and Nike as members), American Apparel & Footwear Association, Footwear Distributors and Retailers of America, have accused Trump of "using American families as a hostage in his trade war negotiations".

In choosing the products in or out of the tariff list, US administration was likely guided by how much US relies on China for providing these products, and whether the sectors are critical for US. According to the data of 2018, China's share of US total imports was still as high as 21.56%, only down by 0.3ppt from that of 2017. Among the imports, a variety of products even take up more than 50% of US imports. For instance, more than 80% of toys, games and sports requisities imported into the US were made in China in 2018. That explains why the gaming giants Sony, Microsoft and Nintendo have penned a joint letter to Trump administration urging the removal of console games from the tariff list. According to the letter, the tariff would make console game consumers pay US$840mn more and harm the whole industry including manufacturers, developers and retailers.

With additional tariffs delayed, US holiday retail sales in Nov and Dec 2019 are expected to grow by 3.8% and 4.2% YoY, according to the National Retail Federation.

Figure 19: Products that US depends heavily (over 40%) on China's imports

Note: Data for the year of 2018
Source: ITC calculations based on US Census Bureau statistics, CMBIS estimates

Foreign trade: trade spat takes a toll

US trade with the rest of the world is slowing dramatically. US goods exports and imports increased only 0.1% and 0.3% respectively MoM in Aug 2019. In terms of YoY growth, both goods exports and imports have been shrinking, showing that Trump's protectionism trade agenda has curbed trade between US and the rest of the world. We expect net exports to drag on GDP growth from 3Q19 to next year.

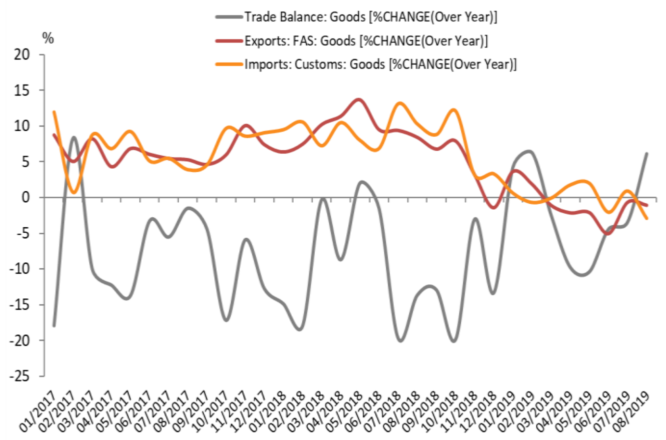
US imports from China decreased while its imports from other Asian trading partners (South Korea, Vietnam, Malaysia, etc.) increased. The trend has been clear since early 2019 and is likely to continue. China has dropped to America's third largest trading partner from the second.

US total trade deficit widened, while its goods trade gap with China narrowed. US trade deficit widened in Aug 2019 to US$54.9bn from US$54bn in Jul 2019 as exports increased but imports increased more. However, its goods trade gap with China has been narrowed since 4Q18.

Figure 20: US goods exports, imports and trade deficit

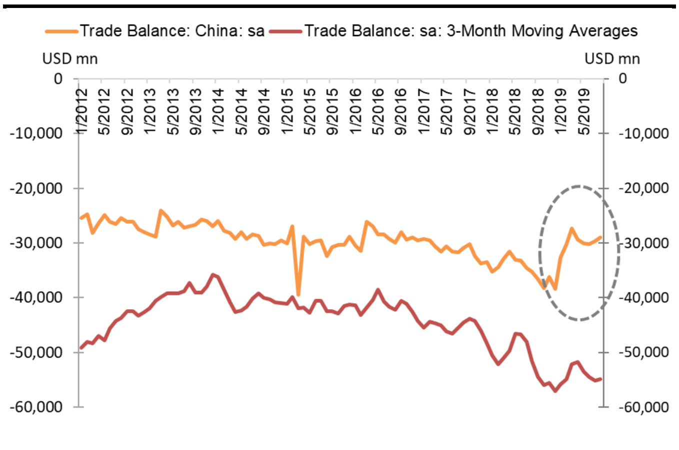
Source: CEIC, CMBIS

Figure 21: US goods trade decelerated, trade deficit widened



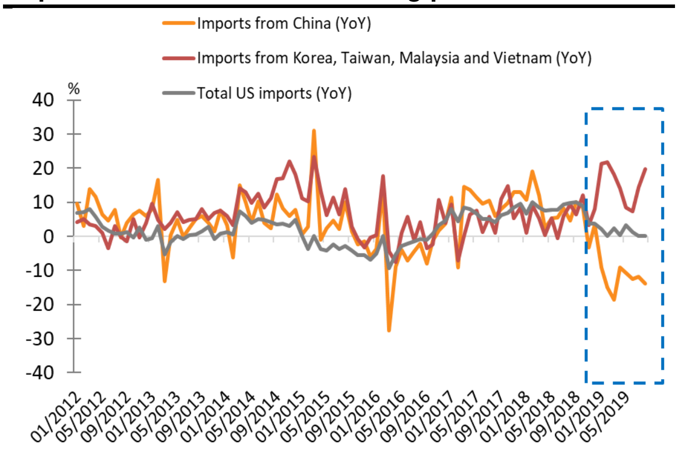
Source: CEIC, CMBIS

Figure 22: US trade deficit with China narrowed



Source: CEIC, CMBIS

Figure 23: US imports from China decreased while its imports from other Asian trading partners increased



Source: CEIC, CMBIS

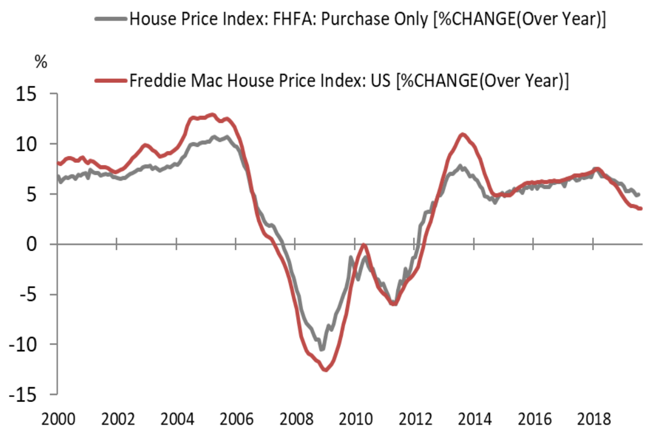
Housing market: price stalling, sentiment improving

After six years of strong house price growth, US housing market is cooling. S&P/Case-Shiller seasonally-adjusted national home price index rose by just 1.46% in 2Q19. Freddie Mac House Price Index in the US rose by just 3.6% YoY in Aug 2019, the slowest pace in seven years.

Meanwhile, lower mortgage rates are giving the industry a boost. The housing market is gaining footing. Home builder sentiment and new housing unites started are rising. New housing starts continued to increase at a solid pace to 121,100 units by Aug 2019.

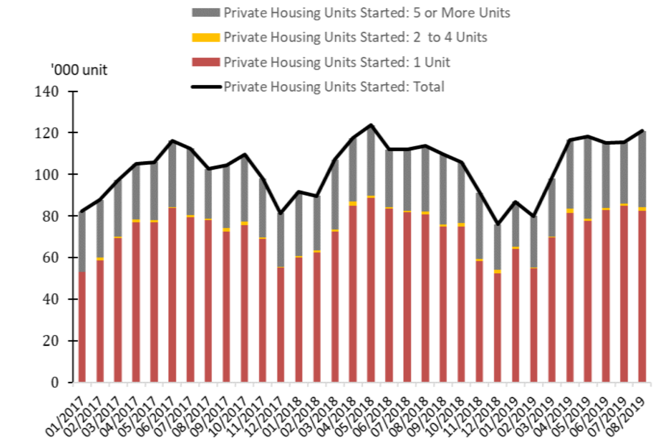
US Fed's two recent rate cuts are fueling more mortgage refinancing. As US housing market is highly sensitive to mortgage rates, we expect US housing market to be supported by historically low mortgage rates for the next two or three quarters.

Figure 24: US house price rises are decelerating



Source: CEIC, CMBIS

Figure 25: US housing starts are gaining footing



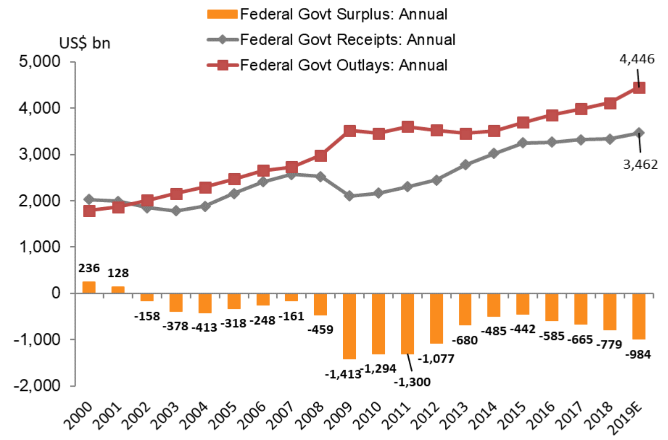
Source: CEIC, CMBIS

Fiscal sector: Federal budget deficit surges

Trump's tax cuts and massive spending package have further boosted the federal budget deficit. According to the latest estimates of the Congressional Budget Office, US federal budget deficit rose further to US$984bn during FY19, up from the previous year's US$779bn, to the highest since 2012. As a result, the budget deficit is expected to widen to 4.7% of GDP in 2019, up from 3.5% in 2017 and 3.8% in 2018.

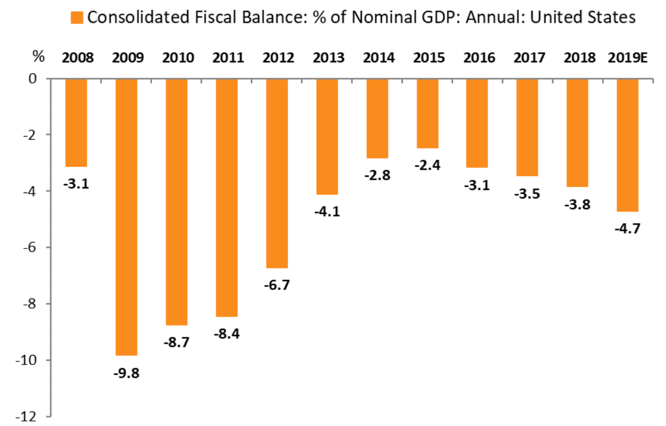
Now, the government debt has risen to US$22,712bn, over 106% of US GDP, which is on an unsustainable path. Extremely high government debt increases both the borrowing cost and future spending to pay off interest costs, leaving little room for more fiscal stimulus to fight economic downturns.

Figure 26: US federal budget deficit rose to US$984bn in FY19



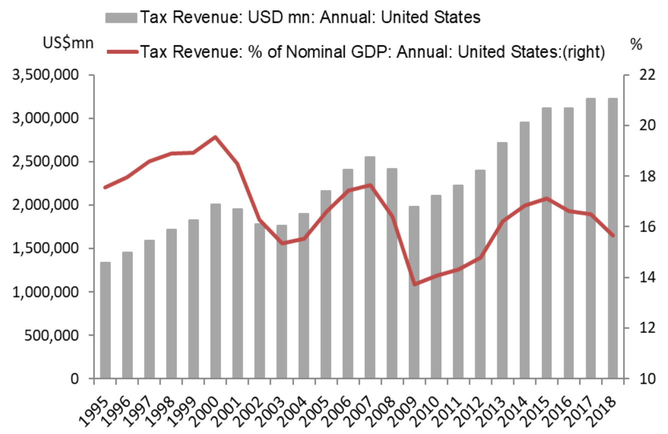
Source: CEIC, Congressional Budget Office, CMBIS

Figure 27: US fiscal deficit relative to GDP reaches the highest since FY12



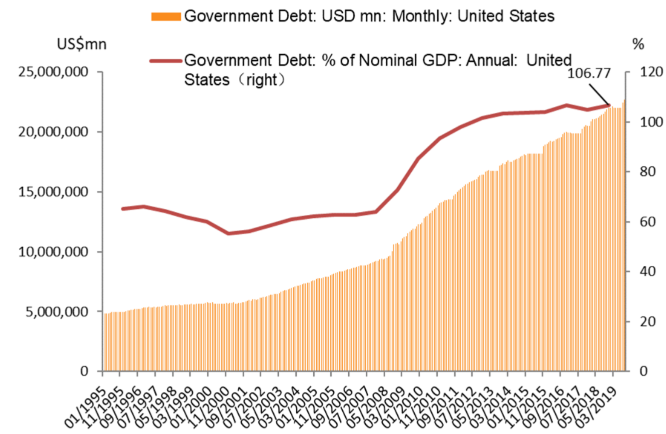
Source: CEIC, Congressional Budget Office, CMBIS

Figure 28: US tax revenue to GDP ratio is declining



Source: CEIC, CMBIS

Figure 29: US government debt equalled to about 107% of GDP



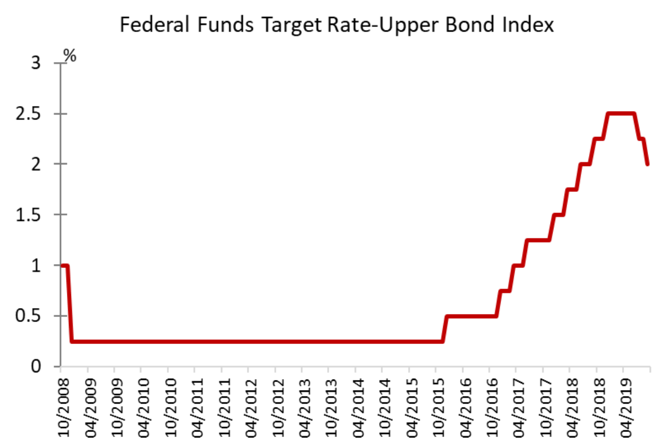
Source: CEIC, CMBIS

Monetary and financial sector: lower for longer

Fed may cut rate further. Fed funds rate currently stands in 1.75-2% after two insurance rate cuts in Jul and Sep 2019 to sustain economic expansion and counter downside risks. Fed officials were further split over the rate decision and the committee seems to have no clear direction about the next move. As we see, recent disappointing economic data and latest views expressed by Fed voting members suggest a possible 25bp cut still in Oct 2019 before Fed pauses rate changes to see the impacts.

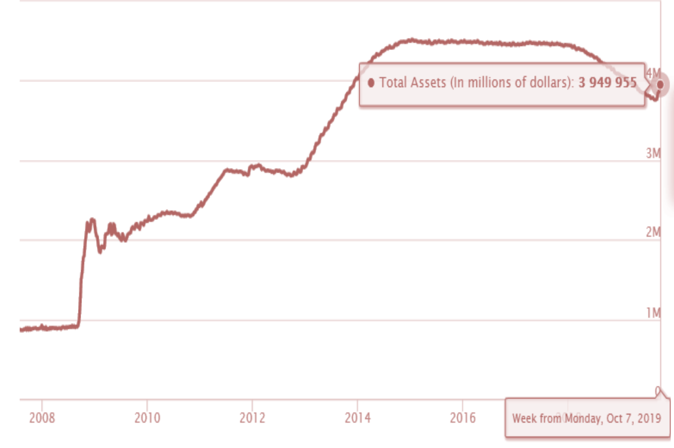
Fed will expand balance sheet soon. Fed Chairman Powell announced on 9 Oct that Fed will be launching a program to expand the balance sheet to ensure smoother functioning of US short-term funding markets. The decision is made amid recent concerns on US banks' inadequate supply of reserves.

Figure 30: Fed has cut rates by 50bp since Jul 2019



Source: CEIC, CMBIS

Figure 31: Fed will expand its balance sheet soon

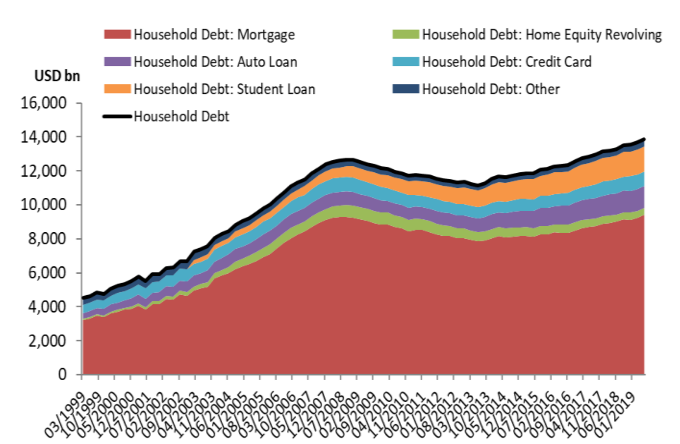


Source: US Fed, CMBIS

US household debt is edging higher to historical record, but the risks are under control. Household debt reached US$13.68tr as of 2Q19, passing its 2008 peak. However, the composition of debt has changed since 2008, making the current debt structure more healthy and sustainable.

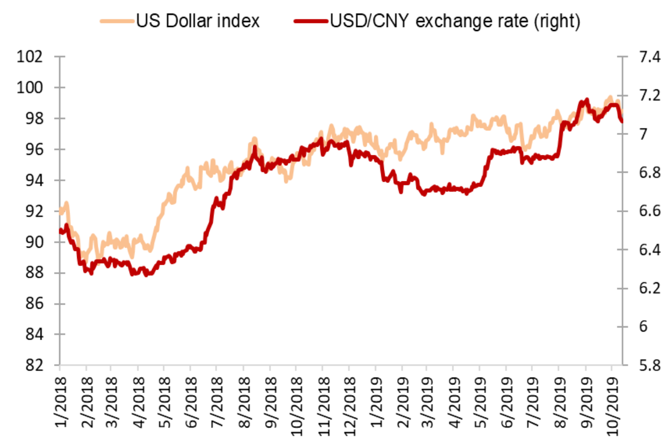
US dollar: stronger for longer. US dollar index has trended upward since early 2018 and now stands at its multiyear-high around 98.4. Despite US Fed's recent easing policies, US dollar is likely to remain solid due to the growth differential between the US economy and other leading world economies, as well as the risk aversion is likely to persist.

Figure 32: US household debt is edging higher



Source: CEIC, CMBIS

Figure 33: US dollar remains strong



Source: CEIC, CMBIS

Outlook and risks

US economic expansion, now in its 11th year, is under threat from trade uncertainties and global slowdown. Is US economy heading to a soft landing or a steep decline? It largely depends on whether the trade-driven weakness in manufacturing will spread to the broader economy and whether the relative strength of consumption is able to continue.

In our view, US consumer spending is likely to remain solid over the near term, boosted by healthy job market and robust consumer sentiment. The partial trade agreement, paving way for Trump-Xi APEC meeting in mid-Nov 2019, could provide short-term boost to business confidence, but uncertainties persist. Overall, US could not immune to trade uncertainties and global growth slowdown. Therefore, the growth momentum is easing and the downshift of US economic growth is likely to continue. We expect US economy to grow by 1.7% in 3Q19 and 2.2% in 2019.

We see upside and downside risks to our forecast. On the upside, comprehensive US-China trade deal, Fed's more aggressive easing measures due to political pressure, more fiscal stimulus, all could pose an upside risk to our forecast. On the downside, the unexpected escalation of trade disputes with China or Europe, sharper-than-expected slowdown of consumption growth and geopolitical risks all could lead to worse growth performance of US.

Overall systematic risk of US economy is controllable and a large-scale economic crisis is still out of sight. That said, a short-lived recession is still likely to happen in 2H20 to 1H21 before a gradual recovery emerges in 2021.

Key data in spotlight includes Sep 2019 retail sales (released on 16 Oct) and industrial production (released on 17 Oct). Both will have huge influence on Fed members' policy decisions. We forecast a modest retail sales growth and a decline in industrial sales in Sep 2019. We expect one more 25bp rate cut by FOMC, most likely in Oct 2019.

Apprendix: US economic data calendar

Local Start Date	Indicator Name	Period
16/10/2019	Retail Sales MM	Sep
17/10/2019	Housing Starts Number	Sep
17/10/2019	Initial Jobless Claims	12 Oct, w/e
17/10/2019	Philly Fed Business Index	Oct
17/10/2019	Industrial Production MM	Sep
22/10/2019	Existing Home Sales	Sep
24/10/2019	Durable Goods	Sep
24/10/2019	Initial Jobless Claims	14 Oct, w/e
24/10/2019	Markit Flash PMI	Oct
24/10/2019	New Home Sales-Units	Sep
25/10/2019	University Michigan Sentiment Final	Oct
29/10/2019	Consumer Confidence	Oct
30/10/2019	GDP Advance	Q3
31/10/2019	Fed Funds Target Rate/ Interest On Excess Reserves	30 Oct
31/10/2019	Consumption, Adjusted MM	Sep
31/10/2019	Initial Jobless Claims	21 Oct, w/e
1/11/2019	Non-Farm Payrolls	Oct
1/11/2019	Unemployment Rate	Oct
1/11/2019	Average Earnings YY	Oct
1/11/2019	Markit Mfg PMI Final	Oct
1/11/2019	ISM Manufacturing PMI	Oct
4/11/2019	Factory Orders MM	Sep
5/11/2019	International Trade $	Sep
5/11/2019	Markit Final PMI	Oct
7/11/2019	Initial Jobless Claims	28 Oct, w/e
8/11/2019	U Mich Sentiment Prelim	Nov
13/11/2019	CPI MM, SA	Oct
14/11/2019	Initial Jobless Claims	4 Nov, w/e
15/11/2019	Retail Sales MM	Oct
15/11/2019	Industrial Production MM	Oct
19/11/2019	Housing Starts Number	Oct
21/11/2019	Initial Jobless Claims	11 Nov, w/e
21/11/2019	Philly Fed Business Index	Nov
21/11/2019	Existing Home Sales	Oct
22/11/2019	Markit Comp Flash PMI	Nov
22/11/2019	Markit Mfg PMI Flash	Nov
22/11/2019	Markit Svcs PMI Flash	Nov
22/11/2019	U Mich Sentiment Final	Nov
26/11/2019	Consumer Confidence	Nov
26/11/2019	New Home Sales-Units	Oct
27/11/2019	Durable Goods	Oct
27/11/2019	GDP 2nd Estimate	Q3
27/11/2019	Initial Jobless Claims	18 Nov, w/e
27/11/2019	Consumption, Adjusted MM	Oct

Source: Refinitiv Eikon, CMBIS

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