Flash Economics

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Can US growth be stopped from falling below potential growth?

Many investors are worried that the US economy could begin to slow in the second half of 2019. This raises an important question: can US growth be stopped from falling below potential growth (which has actually become quite high due to the upturn in productivity gains)?

Monetary policy and fiscal policy are highly expansionary in the United States; real wages and employment are growing and corporate profitability is high: all this should bolster demand and activity.

So what are the risks?

- A negative wealth effect caused by falling share prices? No;
- A slowdown in global trade and in exports? Yes;
- A loss of confidence due to geopolitical tensions and the trade war? No.

Altogether, these risks are unlikely to cancel out the strong demand stimulus.

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Is growth going to fall below potential growth in the United States?

Thanks to the upturn in productivity gains **(Chart 1A), potential growth has risen in the United States (Chart 1B).**

Chart 1A
United States: Per capita productivity (Y/Y as %)

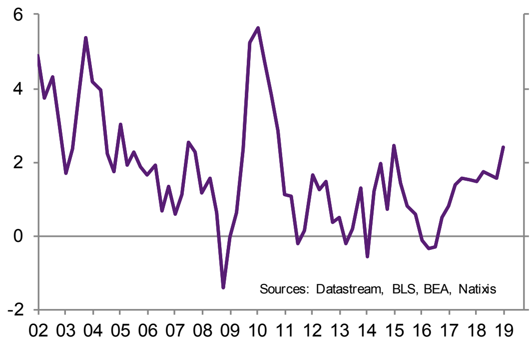
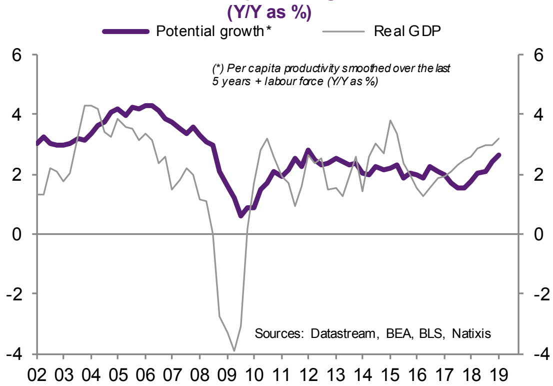
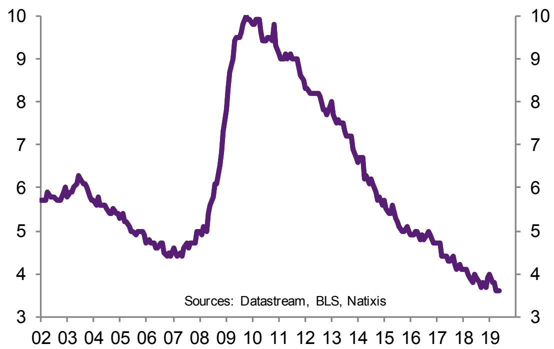


Chart 1B
United States: Real potential growth and GDP (Y/Y as %)



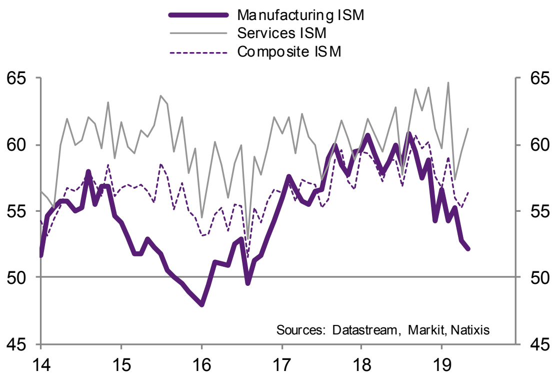
Because **the United States is at full employment (Chart 2),** its **growth is going to be at best equal to its potential growth (Chart 1B).** But could growth fall below potential growth in the United States?

Chart 2
United States: Unemployment rate (as %)



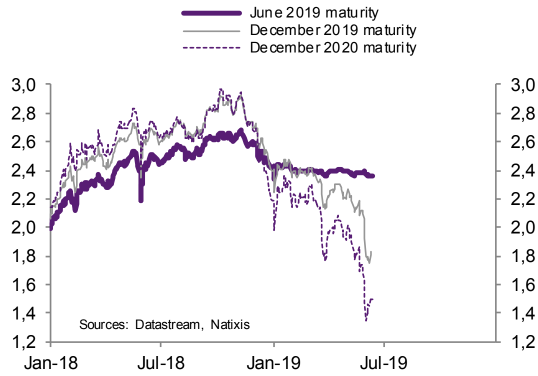
Cyclical indicators **(Chart 3)** are at middling levels.

Chart 3
United States: PMI (ISM, index)



Many investors are worried that **US growth could fall,** which explains why they now expect significant cuts in the Fed Funds rate **(Chart 4).**

Chart 4
United States: Fed Funds futures contracts



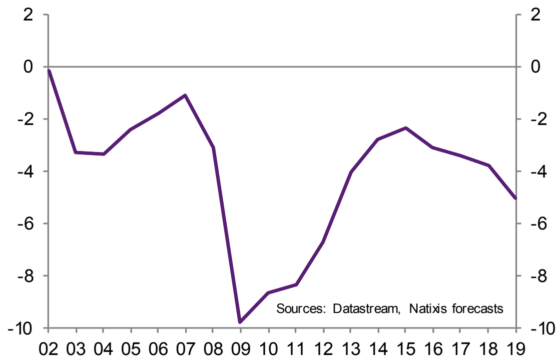
But what mechanisms could cause growth to fall below potential growth in the United States?

Pronounced boost to demand and activity in the United States

Demand and activity in the United States are being boosted by:

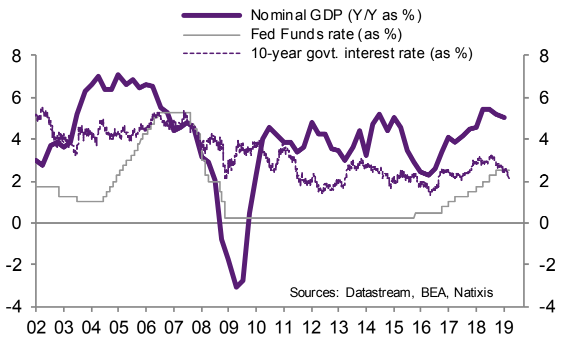
- **Expansionary fiscal policy (Chart 5);**

Chart 5
United States: Fiscal deficit (as % of nominal GDP)



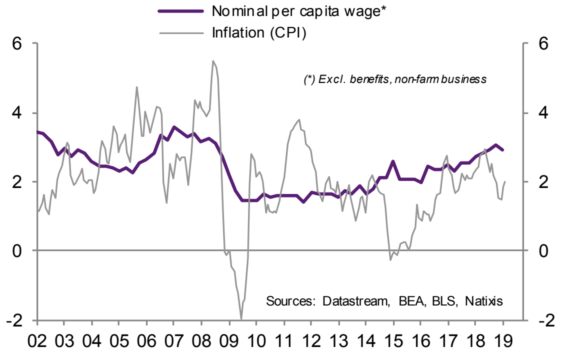
- **Expansionary monetary policy (Chart 6);**

Chart 6
United States: Nominal GDP, Fed Funds rate and interest rate on 10-year Treasuries



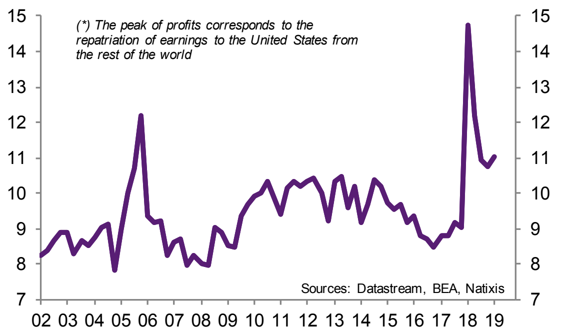
- **Real wage growth (Chart 7);**

Chart 7
United States: Nominal per capita wage and inflation (Y/Y as %)



- **The high level of corporate profitability (Chart 8).**

Chart 8
United States: Profits after tax, interest and dividends (as % of nominal GDP)

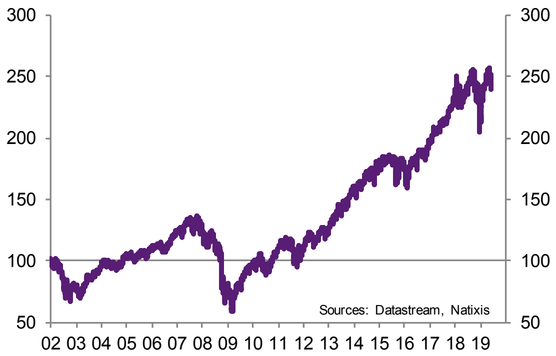


It would therefore be normal to conclude that growth is capable of remaining at the level of potential growth in the United States, given the extent of this demand stimulus.

So what factors could lead growth to slow below potential growth in the United States?

1. **A negative wealth effect linked to a fall in the equity market?** US equities have levelled out since 2017 **(Chart 9A).**

Chart 9A
S&P stock market index (2002:1 = 100)



Has this led to a rise in household savings or a fall in corporate investment?

Charts 9B and **C** show **a stable savings rate and a high level of investment.**

Chart 9B
United States: Net household savings rate (as %)

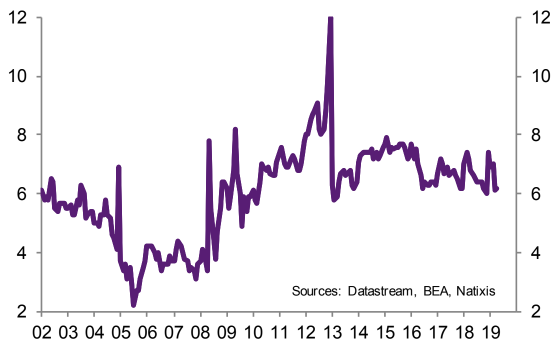
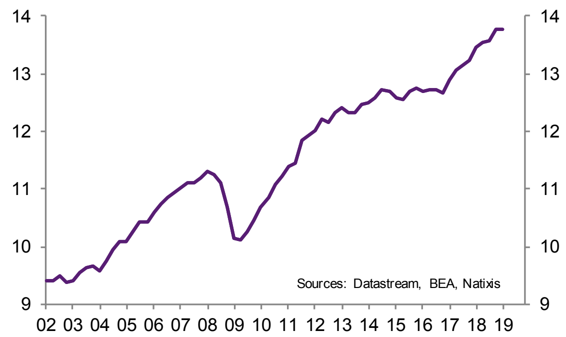


Chart 9C
United States: Productive investment (as % of real GDP)



2. **Is the global trade slowdown affecting US exports?**

Charts 10A and **B** show that US exports have indeed slowed.

Chart 10A
United States: Global trade and exports (in volume terms, Y/Y as %)

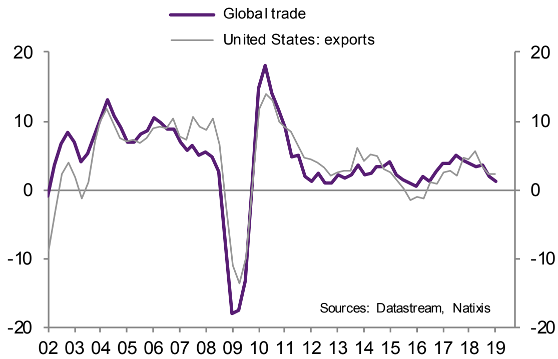
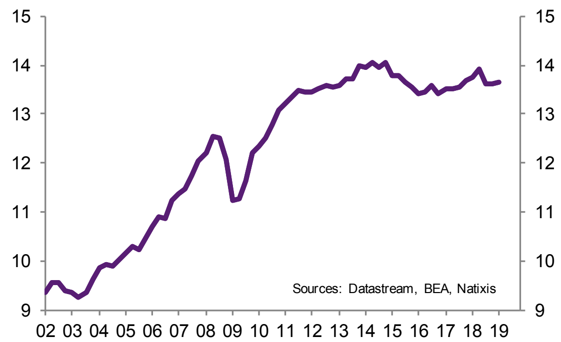


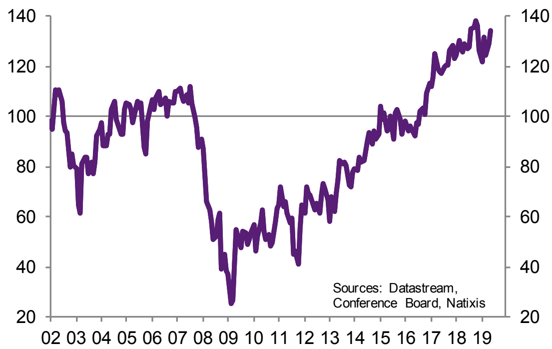
Chart 10B
United States: Exports (as % of real GDP)



3. A loss of confidence due to geopolitical tensions and the trade war?

The trade war between the United States and China worsened between September 2018 and May 2019. The growth outlook **(Chart 3)** is middling. **Consumer confidence (Chart 11)**, on the other hand, is high; the household savings rate (**Chart 9B** above) is stable;

Chart 11
United States: Consumer confidence (index)



Conclusion: Could growth conceivably become much lower than potential growth in the United States?

At full employment, US growth is at best equal to potential growth, which is quite high (2.7% per year). Demand in the United States is being boosted strongly by expansionary fiscal and monetary policies, real wage growth and high corporate profitability.

So are there other mechanisms that could weaken US growth?

- Not wealth effects;
- Possibly the slowdown in global trade and in exports;
- Not, for the time being, a loss of confidence.

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