Summary Assessment of U.S. Outlook & Risks

November 9, 2019

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- Based on information as of October 2019, we expect a moderate slowdown in 2019 with GDP growth of 2.4% growth, followed by 1.9% in 2020. We expect inflation to reach 2.75% by December of this year, due to higher oil prices, record-low unemployment, creeping wage costs, and higher tariffs. On the external front, we expect modest growth in Europe; Asia is cruising at a slower but more sustainable pace, with China expected to grow 6.2% in 2019; and South America is still struggling to achieve a sustainable healthy recovery. We do not expect any additional declines in the Fed Funds rate during the next six months. However, the long-end of the yield curve, in particular, the yield on the 10-year TB, is likely to edge up in the short-run by about 50 bps; and more if there is a downgrade of Federal debt.

- The ***risks*** to the U.S. forecast ranked by likelihood of occurrence are:

  - A unique aspect of the current cycle is that this record-length expansion is facing cross signals from the bond and equity markets. Given the recent drop in the 10-year Treasury, the fixed income market is calling for an imminent recession; whereas the equity market continues to lift the S&P500 index to record levels, meaning that investors are expecting business cash flows to continue to grow. Curiously, at the same time, investors, analysts, and the media following the equity markets have been fixated on the U.S. – China trade disputes as the prime determinant of what will happen to the U.S. economy. It appears the markets are over-reacting to anything said by either side. This has resulted in increased volatility in equities. Nevertheless, protracted trade policy battles are a risk to the medium-term outlook.

  - ***Larger fiscal deficits (short-term) and higher inflation (short- to medium-term):*** While this is the longest economic expansion in 100-plus years, the U.S. Federal deficit is once again on a trillion-plus dollars range and ballooning. As we have explained in past reports, it is surprising that the rating agencies have not yet downgraded Federal debt by a notch. It could appear as if they are hesitating for fear that it would disrupt the financial markets; in such a case, they are overvaluing their clients' bonds.

  - ***Political division and policy impasse:*** A divisive political environment combined with the approach of the 2020 presidential and congressional elections could discourage investment. The impeachment inquiry could also distract attention from economic / financial / global challenges.

  - ***Financial market turbulence and crisis of confidence:*** Political tensions, unmet expectations, and increased market volatility, could trigger greater market anxieties and fears of a trade war, resulting in a sharp market contraction which could trigger an economic downturn.

  - ***Monetary policy***: The Fed has had to stop its Normalization plan after facing a trade-off between supplying more liquidity to the economy, or reducing the size of its balance sheet. We think the ability of the Fed to respond to a downturn in the economy is a significant risk in the medium-term.