34. THE UNITED STATES OF AMERICA

Trade tensions and policy uncertainty weigh on growth

The US economy is forecast to slow down as persistent economic tensions with China and elevated policy uncertainty hurt the outlook for private investment. At the same time, recent monetary policy easing is set to cushion the economic downturn while tailwinds from the sizeable fiscal stimulus implemented last year fade out.

Weaker investment dynamics are slowing growth

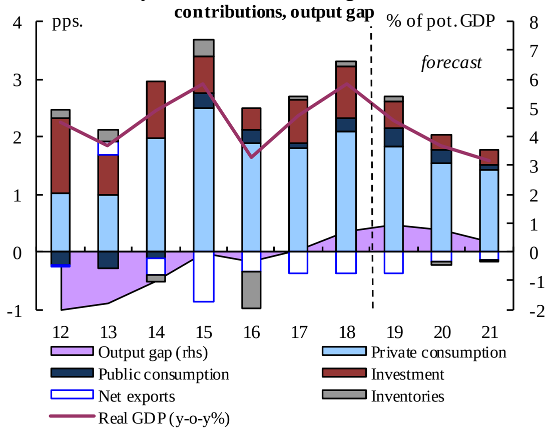
The US economy has gradually slowed after a period of above potential activity in 2018. In 2019-Q2, the pace of real GDP growth moderated to 0.5% q-o-q (from 0.8% q-o-q in 2019-Q1) as business investment weakened against the backdrop of intensifying US-China economic tensions and broader trade policy uncertainty. Furthermore, the slump in the manufacturing sector also extended to the US, where recently PMIs have been close to contractionary territory. Still, robust consumer spending underpinned by progressively tightening labour market conditions has been a stabilising force for the US economy in the first half of the year.

Going forward, economic activity is set to moderate further. The intensification of economic tensions with China in the context of a mature economic cycle and a weakening manufacturing sector have darkened the US economic outlook just as the growth impulse from the fiscal stimulus has been fading. Recent policy easing by the US Federal Reserve aimed to cushion some of the negative impact on the economy, but lower borrowing costs are not expected to be sufficient to offset the negative shock on business investment. Resilient private consumption is expected to remain the main driver of economic activity over the forecast horizon supported by easier financing conditions, real disposable income growth and strong household balance sheets. Thus, the US economy is expected to grow by 2.3% in 2019 before slowing further below potential growth to 1.8% and 1.6% in 2020 and 2021, respectively, on the back of weakening investment activity.

Employment growth passed its peak

Job creation has been moderating after buoyant activity in 2018. Growth of total nonfarm payroll employment averaged 167,000 per month in 2019 compared with an average monthly gain of 223,000 in 2018. At the same time, growth in average hourly earnings slipped below 3% in 2019-Q3, suggesting that demand-side factors rather than supply-side constraints are causing jobs growth to slow. Nevertheless, the unemployment rate has continued to edge down so far in 2019, recently reaching 3.5%. Job creation is expected to slow further over the forecast horizon because of elevated policy uncertainty and a protracted weakness in the manufacturing sector. Against this, the unemployment rate is expected to stabilise at around 3.7% over the forecast horizon, also reflecting the expected slowing growth of the labour force due to the retirement of the baby boom generation. As wage pressures soften and domestic demand slows, consumer price inflation is forecast to pick up only modestly over the next two years, reflecting mainly the direct impact of recently implemented and announced tariff hikes.

Graph II.34.1: **US - Real GDP growth and contributions, output gap**



A rotation in the macroeconomic policy mix

US macroeconomic policies are set to remain supportive to the economy over the next two years underpinned by a rotation in the policy mix to more accommodative monetary policy and from an expansionary to a broadly neutral fiscal stance.

The US Federal Reserve's monetary policy stance has shifted markedly since the spring against the backdrop of intensifying economic tensions with China, subdued underlying inflation and a number of external risks to the US economic outlook. The

Fed cut its benchmark interest rate by a total of 50bps over the summer while financial market expectations for further policy easing remain high. The accommodative policy stance is expected to cushion the slowdown in economic activity, supporting particularly the interest rate sensitive housing sector as well as consumer spending.

In addition, the Trump administration and congressional leaders recently eliminated the risk of a "fiscal cliff" in 2020 by reaching a budget deal to raise discretionary government spending and suspend the US debt ceiling over the next two years. The US fiscal stance is set to turn broadly neutral over the forecast horizon, in line with the policy assumptions in the spring. The general government budget deficit is forecast to remain above 6½% of GDP.

Weak trade activity ahead

Despite increasing exports of petroleum products, total US exports are forecast to nearly stagnate in 2019, and recover only modestly thereafter, weighed down by protectionist trade policies, a struggling manufacturing sector and subdued global demand. Import growth is also expected to be weaker than forecast earlier as domestic demand slows on the back of weaker investment dynamics. The current account deficit is forecast to remain contained at around 2½% of GDP over the forecast horizon.

Risks to the outlook remain elevated

Given weak business confidence and subdued manufacturing activity, any further intensification of the US-China economic confrontation could also dampen activity in the services sector, increasing the risk of a sharper slowdown of the economy and the labour market. Bilateral trade tensions could spread to other US trade partners, notably the EU. Furthermore, tensions between market expectations of a more aggressive monetary policy easing and the possible more cautious reaction of the Fed to incoming economic data, should the strength of the labour market be confirmed and inflation rebound, could trigger financial market volatility at times when some US asset valuations appear stretched. On the upside, any material de-escalation of trade tensions could lower policy uncertainty, which combined with favourable borrowing costs, could provide the basis for a pick-up in business confidence, investment and trade.

Table II.34.1:

Main features of country forecast - UNITED STATES

	2018			Annual percentage change						
	bn USD Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP	20580.2	100.0	2.0	1.6	2.4	2.9	**2.3**	**1.8**	**1.6**
Private Consumption	13998.7	68.0	2.3	2.7	2.6	3.0	**2.6**	**2.2**	**2.1**
Public Consumption	2904.3	14.1	1.1	1.8	0.6	1.7	**2.3**	**1.7**	**0.6**
Gross fixed capital formation	4260.8	20.7	1.8	1.9	3.7	4.1	**2.2**	**1.1**	**1.1**
of which: equipment	1376.0	6.7	3.9	-0.9	4.8	6.7	**2.4**	**1.0**	**0.9**
Exports (goods and services)	2510.2	12.2	4.0	0.0	3.5	3.0	**0.3**	**1.5**	**1.6**
Imports (goods and services)	3148.5	15.3	3.8	2.0	4.7	4.4	**2.2**	**2.0**	**1.8**
GNI (GDP deflator)	20848.1	101.3	2.2	1.6	2.5	3.0	**2.4**	**1.9**	**1.6**
Contribution to GDP growth: Domestic demand			2.1	2.5	2.6	3.1	**2.6**	**2.0**	**1.7**
Inventories			0.0	-0.5	0.0	0.1	**0.0**	**0.0**	**-0.1**
Net exports			-0.1	-0.3	-0.3	-0.3	**-0.3**	**-0.1**	**-0.1**
Employment			-	1.7	1.2	1.6	**1.1**	**1.0**	**0.5**
Unemployment rate (a)			6.3	4.9	4.4	3.9	**3.7**	**3.7**	**3.7**
Compensation of employees / f.t.e.			3.0	0.9	3.1	3.3	**3.3**	**2.9**	**2.5**
Unit labour costs whole economy			1.6	1.0	2.0	2.0	**2.1**	**2.0**	**1.5**
Real unit labour cost			-0.4	-0.1	0.1	-0.4	**0.4**	**0.2**	**-0.2**
Saving rate of households (b)			11.3	12.2	12.3	12.4	**12.4**	**12.2**	**11.9**
GDP deflator			2.0	1.0	1.9	2.4	**1.7**	**1.8**	**1.7**
Consumer-price index			-	1.3	2.1	2.4	**1.8**	**2.1**	**2.0**
Terms of trade goods			-0.2	0.4	0.3	0.7	**0.5**	**0.0**	**0.0**
Trade balance (goods) (c)			-4.9	-4.2	-4.3	-4.4	**-4.3**	**-4.4**	**-4.4**
Current-account balance (c)			-3.3	-2.3	-2.3	-2.4	**-2.5**	**-2.5**	**-2.5**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-3.3	-2.3	-2.3	-2.4	**-2.5**	**-2.5**	**-2.5**
General government balance (c)			-6.2	-5.4	-4.3	-6.6	**-6.7**	**-6.7**	**-6.7**
Cyclically-adjusted budget balance (d)			-	-	-	-	**-**	**-**	**-**
Structural budget balance (d)			-	-	-	-	**-**	**-**	**-**
General government gross debt (c)			78.3	106.8	106.0	104.3	**106.7**	**109.4**	**112.3**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.

(*) Employment data from the BLS household survey.