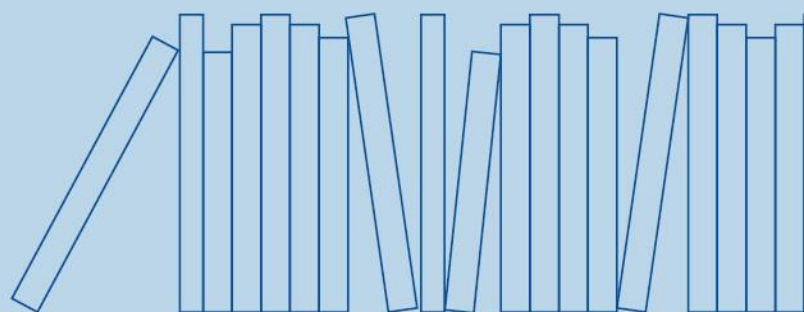


Economic Commission for Latin America and the Caribbean
ECLAC OFFICE IN WASHINGTON, D.C.



U.S. Economic Outlook

Recent developments



UNITED NATIONS



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Overview

The U.S. economic expansion remains on track and it has entered its ninth year. January marked the 103th month of growth for the U.S. economy. By May, the current economic expansion will become the second longest on record.¹ The unemployment rate sits at 4.1%, the lowest level since December 2000, suggesting the economy has reached, or nearly reached, full capacity.²

**TABLE 1:
U.S. ECONOMIC EXPANSIONS**

U.S. Expansions	Duration (Months)
1945-1948	37
1949-1953	45
1954-1957	39
1958-1960	24
1961-1969	106
1970-1973	36
1975-1980	58
1980-1981	12
1982-1990	92
1991-2001	120
2001-2007	73
2009-?	102 as of Dec 2017

Source: ECLAC, with data from the National Bureau of Economic Research (NBER) <http://www.nber.org/cycles.html>

In 2017, the U.S. economy achieved a milestone: the output gap closed. This is the first time that the output gap, or the difference between the actual GDP (based on data by the U.S. Department of Commerce's Bureau of Economic Analysis) and the potential output (calculated by the U.S. Congressional Budget Office), has not been negative since 2007. Potential GDP is the maximum amount of output an economy can turn out when it is most efficient—that is, at full capacity.

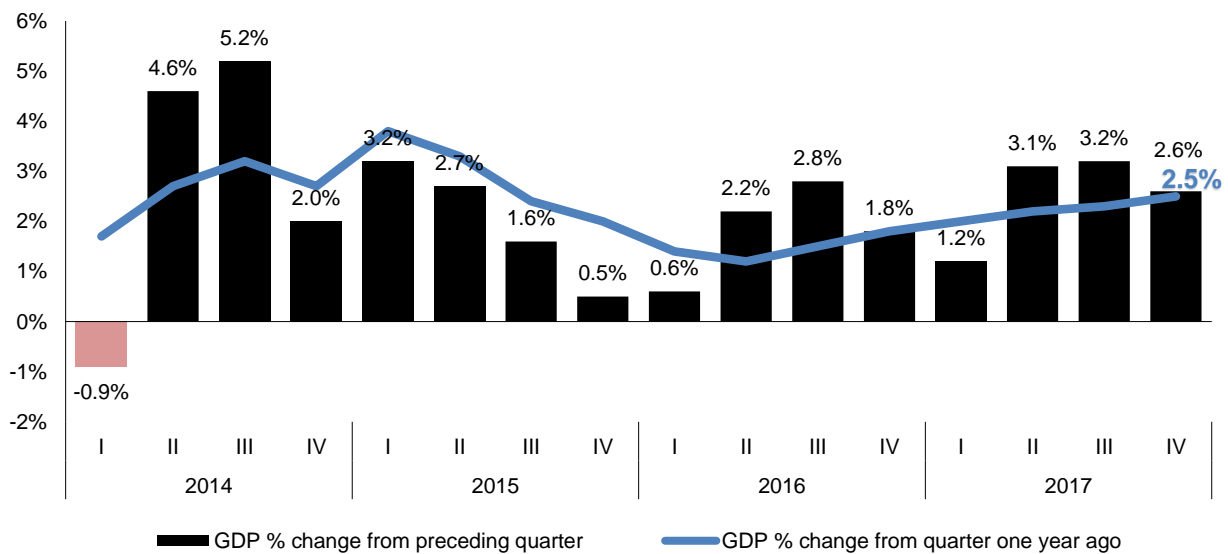
¹ The economic expansion that began in July 2009 is already the third-longest growth run in U.S. history; only the expansions of the 1960s and 1990s were longer.

² Nine in 10 forecasters surveyed by the Wall Street Journal in early January said the U.S. has achieved or is approaching full employment.

2017: the year-in-review

The U.S. economy entered 2018 with healthy momentum after posting its best year of growth since 2015. Gross domestic product expanded 2.5% in the fourth quarter of 2017 compared with a year earlier (and 2.6% compared to the preceding quarter), according to the "advance" estimate released by the Bureau of Economic Analysis (the first of three estimates). Growth in 2017 was held back by a particularly slow first quarter (chart 1). Many forecasters expect growth will be supported this year by solid consumer and business confidence, stronger conditions overseas and tax cuts at home.

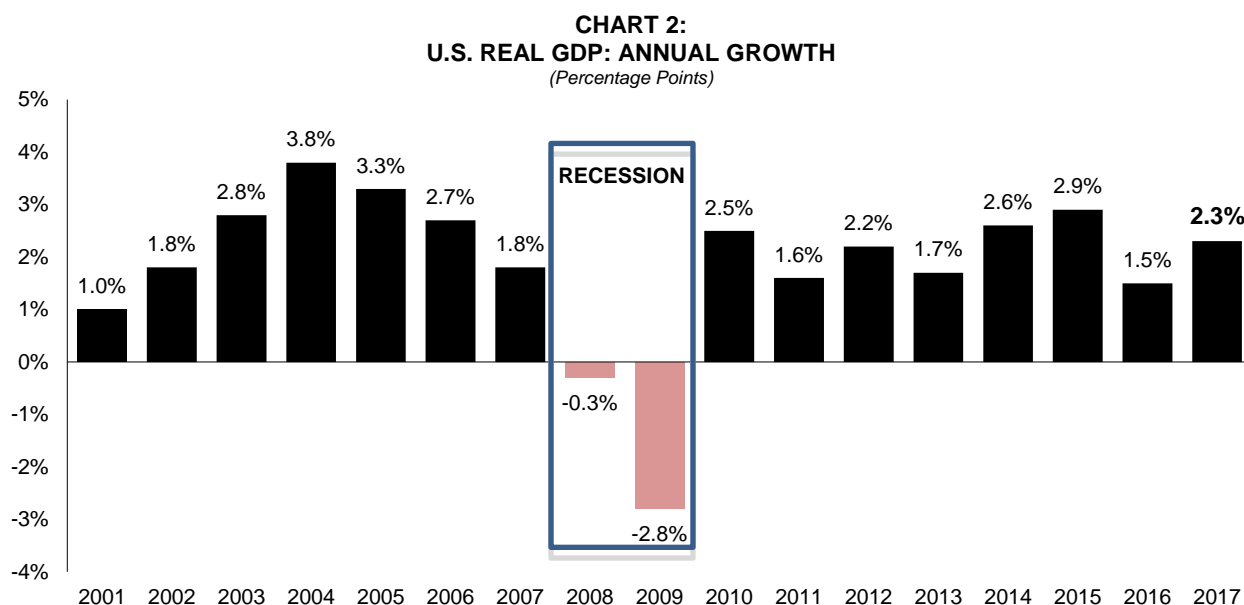
CHART 1:
U.S. REAL GDP: QUARTERLY GROWTH
(Percentage Points)



Source: ECLAC, based on data from the Bureau of Economic Analysis, U.S. Department of Commerce.

A. GDP Growth

Gross domestic product expanded at a seasonally and inflation-adjusted annual rate of 2.3% in 2017, according to the Commerce Department’s advance estimate released on January 26. This was better than the 1.5% in 2016 but in line with the average seen this cycle. A good portion of the acceleration in growth from 2016 to 2017 is attributed to energy. The boost from energy was visible in nonresidential structures and equipment spending. The latest growth – driven by solid increases in spending by consumers and businesses – capped the U.S. economy’s best year since 2015 (chart 2).



Source: ECLAC, based on data from the Bureau of Economic Analysis, U.S. Department of Commerce.

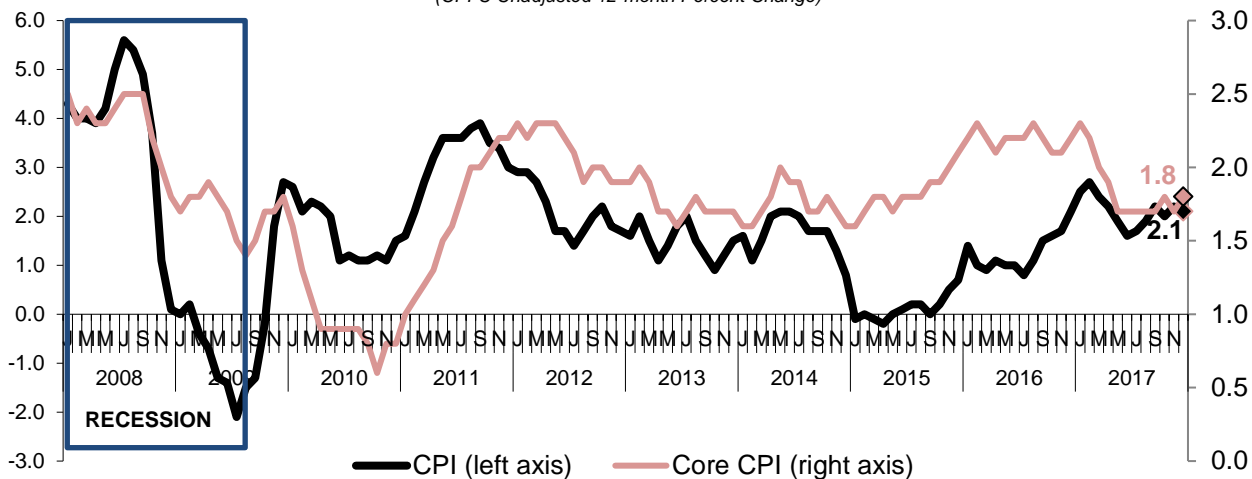
Strong GDP growth and widespread job creation both point to the broad-based nature of the expansion. Neither natural disasters nor the combative political climate have been able to disrupt the economy. Consumers have been benefiting from the strong job market, their healthy balance sheets, and improved access to credit. A revival in profitability, record stock prices, and low borrowing costs have been buoying businesses. The global economy is back on track, with all the globe’s major economies expanding in unison for the first time in a decade.

B. Inflation

Core CPI inflation in December came in stronger than expected. The Labor Department recently reported that overall consumer prices rose 0.1% in December from the previous month, but prices excluding food and energy items – the core inflation – rose 0.3%, the quickest pace in nearly a year (after being subdued for most of the year). Core prices were up 1.8% versus a year earlier, and even if inflation moderates, the annual figure should be more than 2% by April. The rise in consumer prices in December and solid growth in retail sales have bolstered expectations that inflation is firming after a long run of softness. On a year-ago basis, the headline and core CPI were up 2.1% and 1.8%, respectively (chart 2).

The U.S. labor market figures released on February 2, 2018, showed hourly wage growth of 2.9% in January 2018, the highest annual rise since 2009 and significantly exceeding expectations of a 2.7% increase. This has raised the possibility of higher U.S. inflation and interest rates, sending major stock indexes to their biggest one-day decline in years.

CHART 3:
U.S. DOMESTIC PRICES: MONTHLY EVOLUTION
(CPI-U Unadjusted 12-month Percent Change)



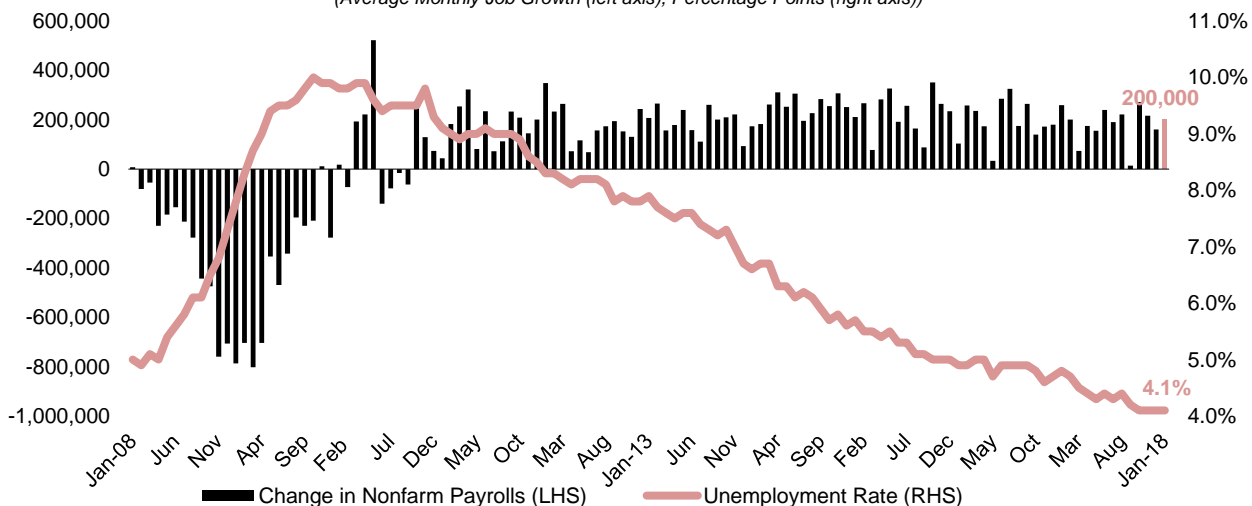
Source: ECLAC, based on data from the U.S. Bureau of Labor Statistics.

C. Labor market

Last year ended on a somewhat disappointing note, but the labor market remained healthy. Job gains slowed to 148,000 in December 2017, somewhat less than the monthly average of 171,000 for the year. The economy created over 2 million jobs during 2017, a very strong pace. The unprecedented 87 months of steady gains are notable and this streak is expected to continue in 2018. The unemployment rate remained at 4.1%, but the rate may fall below 4% in 2018 as the labor market's expansion persists into the year.

According to the job figures released in early February, this year has started on a strong note. U.S. nonfarm employment increased by a net 200,000 in January 2018, better than the consensus expectation for a 180,000 increase. The trend remains solid. Job growth has averaged 180,000 per month over the past six months and 176,000 over the past 12 months. This is more than sufficient to push the unemployment rate lower over time.

CHART 4:
THE U.S. LABOR MARKET
(Average Monthly Job Growth (left axis); Percentage Points (right axis))



Source: ECLAC, based on data from the U.S. Bureau of Labor Statistics.

D. Exchange rates and external sector

The U.S. dollar weakened in 2017 against a broad index of currencies as challenges to the U.S. policy agenda and the promise of accelerating economic growth overseas propelled investor funds into the yen, euro and many emerging-market currencies. On one hand, the prospect of tighter monetary policy is expected to support a modest appreciation in the U.S. dollar in 2018-19. On the other hand, many analysts believe the dollar's decline is likely to be accelerated in 2018 by the passage of the U.S. tax bill, which is widely expected to expand the U.S. fiscal deficit.

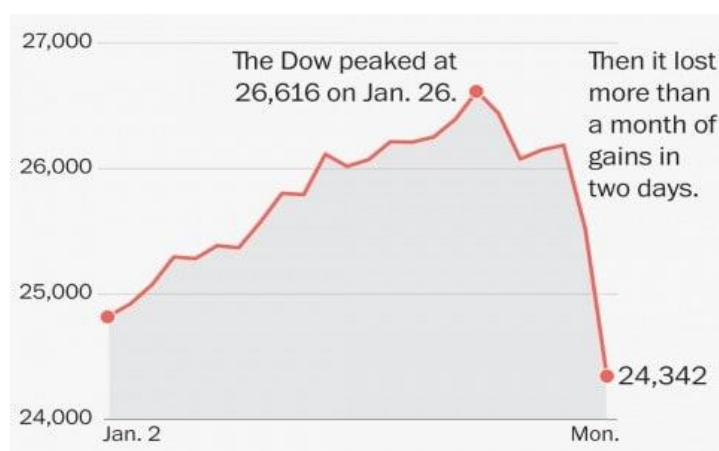
The current account is expected to remain in deficit as the strong dollar (by historical standards) and structural imbalances, such as the shift of low-cost manufacturing to Asia and Latin America ensure a wide trade deficit. The structural current-account deficit has narrowed, however, as higher oil and gas production has reduced the U.S. dependence on energy imports. Nevertheless, as the world largest oil consumer, the U.S. remains a net importer.

E. Financial conditions

The Dow Jones Industrial Average climbed 25% higher in 2017, getting closer to 25,000 and making it its best year since 2013. The index breezed through milestones. It had taken the Dow 14 years to climb from 10,000 to 15,000, but just three and a half years to reach 20,000 in 2017. The S&P 500 and Nasdaq also had their best years since 2013. The broader S&P 500 was up 19% in 2017, and the Nasdaq jumped an impressive 28%. The stock market's rise led to increased wealth and encouraged consumers to spend more and save less of their paychecks, driving the personal saving rate below 3%, the lowest since 2007.

Both U.S. and global stocks have hit all-time highs this year, supported by a strong rise in earnings per share, better-than-expected global economic growth, still low interest rates, and the U.S. corporate tax cut from 35% to 21%, as tax cut legislation was passed in late 2017. Successive U.S. market records (on January 26, 2018, for example, the Dow set its highest closing record at 26,616) and low volatility contributed to a strong market performance on a risk-adjusted basis up until last week, with the good stock market performance boosting consumer and business confidence.

CHART 5:
DOW JONES INDUSTRIAL AVERAGE, 2018
(Index, Tuesday, January 2 to Monday, February 5)



Source: Dow Jones Industrial Average Market Index and Washington Post.

However, U.S. stocks sold off sharply following the release on February 2 of January's U.S. jobs figures, which showed wages growing faster than expected. The faster-than-expected increase in wages raises the possibility of higher U.S. inflation and interest rates. The concern is that the Federal Reserve will accelerate interest rate hikes and slow the economy. If interest rates on safe assets go up, there will be less value on risky assets as a result.

The stock market lost nearly US\$ 1 trillion in value in the first five days of February. On Monday, February 5, the Dow was down more than 1,000 points (its largest point loss since 2008) or 4.6%, the S&P 500 dropped 4.1%,³ and the NASDAQ fell 3.8%. Moreover, the VIX – the Chicago Board Options Exchange (CBOE) Volatility Index – jumped 117% in its largest-ever percentage increase for a single day. The sudden return of volatility nearly wiped out the assets of some popular exchange-traded products that allow investors to bet on continued calm.⁴ Stocks rebounded the next day, and the VIX index – after briefly hitting 50, almost its highest this decade – fell back to a more manageable 29.9. However, another round of wild price swings during the day raised new questions about whether volatility is emerging as a threat to the nearly nine-year old bull market.

U.S. Treasury prices have also been hit by expectations that the U.S. deficit will rise because of the recent tax cuts, which are expected to lead to more government borrowing. Higher yields and rising interest rates typically mean higher borrowing costs for companies and can reduce the relative attractiveness of stocks. Longer term, tighter monetary policy can constrain economic growth, which has underpinned much of the climb in stocks over the past year. A slowing economy would likely turn the bull market toward bearish.

F. Policy trends

At the end of 2017, the Republican Congress passed the biggest reform in the U.S. tax code since the 1980s, the Tax Cuts and Jobs Act of 2017 (TCJA). While struggling during most of the year to implement its policy agenda, the tax changes represent a high-water mark for the Trump administration. The administration also moved forward with deregulation during 2017, especially in environment, energy and finance.

Fiscal policy

The signature feature of the tax reform agreed in late 2017 is a permanent lowering of the corporate tax rate from 35% to 21%. The reform also includes cuts in individual tax rates, a bump in the standard deduction and a larger child tax credit, among other things, but they are set to expire at the end of 2025, as are the proposed tax cuts for "pass-through" entities (businesses that pay taxes through the individual income tax code).

The real impact of the tax cuts remains to be seen, but expectations are that growth this year will be supported by them. An increase in government borrowing is anticipated – the tax legislation does not increase revenues and is not financed by a reduction in spending – which raises concerns about the long-term fiscal outlook. Structural shifts such as the retirement of baby boomers, an increase in federal subsidies for health insurance, an ageing population and higher interest rates on the federal debt are expected to put upward pressure on the deficit. According to the *Economist Intelligence Unit*, the fiscal deficit is expected to widen from an estimated 3.5% of GDP in 2017 to 4.3% in 2019. Supporters of the legislation, however, argue that the reform will be paid for by its positive impact on economic growth.

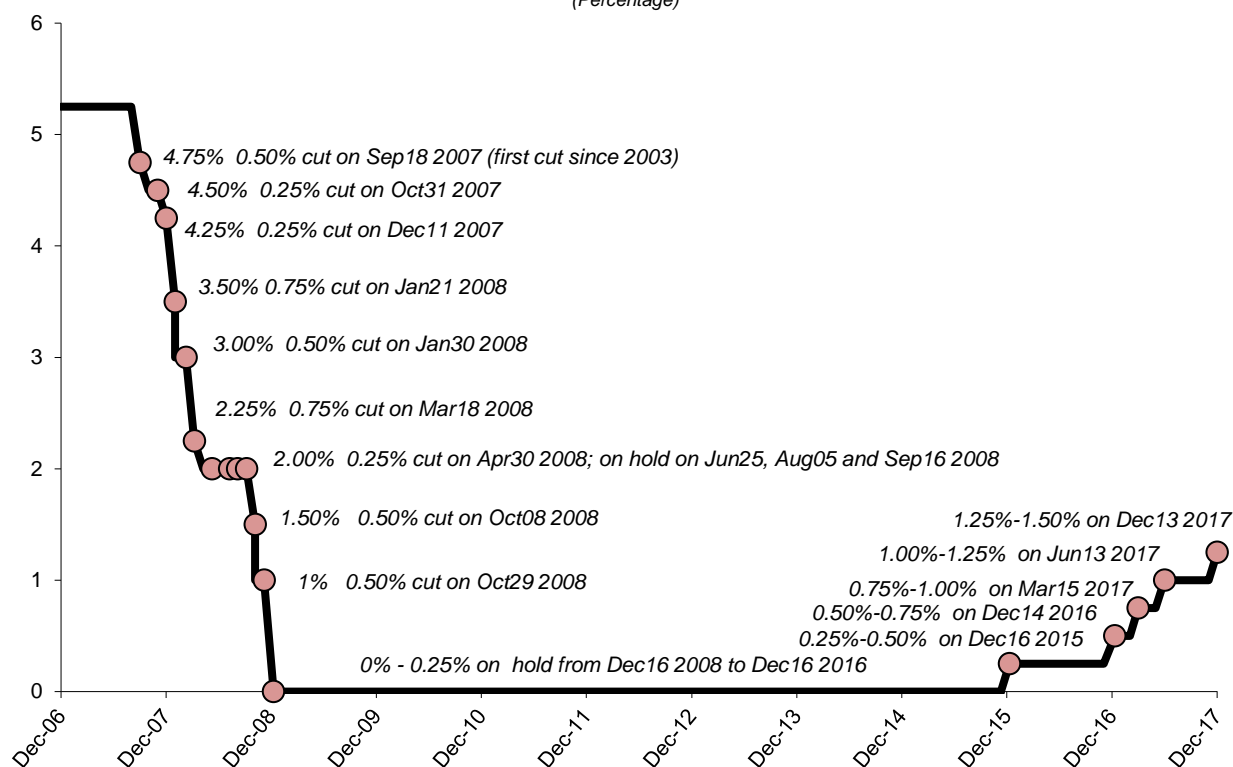
³ In January 2018, the S&P 500 saw its 10th consecutive monthly gain, the longest streak in 59 years.

⁴ In the years since the financial crisis, shorting volatility has become a popular and profitable strategy for investors while yields have plunged around the world and stocks have moved steadily upwards. The increase in volatility in February, therefore, has led to sharp losses for this popular trade.

Monetary policy

The Federal Reserve raised its policy rate in December for the third time in 2017, to a range of 1.25% – 1.50% (chart 6). This is expected to be followed by three rate rises in each of 2018 and 2019. The Fed is also engaging in another form of monetary tightening by shrinking its balance sheet. The value of the assets owned by the Fed rose from US\$ 870 billion in mid-2008 to US\$ 4.4 trillion in mid-2014, owing to the Fed's post-financial crisis quantitative easing (QE) programs. This has helped to keep U.S. bond yields historically low.

CHART 6:
U.S. FEDERAL FUNDS TARGET RATE
(Percentage)



Source: ECLAC, based on data from the U.S. Federal Reserve.

The direction of U.S. monetary policy beyond December is more uncertain. The term of current Fed's Chair Janet Yellen has ended, and the new Chair selected by President Trump, Jerome Powell, took office on February 5. As he was sworn amid a shaky spell for stock markets, Mr. Powell vowed to maintain the resilience of the financial system.⁵

The Fed under Ms. Yellen's leadership has sharply reduced unemployment while maintaining control of inflation, coming as close to achieving its congressional mandate as at any time in its history. It is expected that under Mr. Powell's leadership, the Fed will continue on its projected path of raising its

⁵ In replacing Ms. Yellen, President Trump broke with precedent. The previous three Fed chairs were reappointed, in each case by a president of the opposite political party. Mr. Powell, a former lawyer and private equity executive, is the first non-economist chair in almost four decades.

interest rate three more times this year, as well as continuing to pare back its massive balance sheet of Treasury notes and bonds.

The new Fed Chair might confront some difficult trade-offs in the next year or two, however, such as maintaining price stability or financial resilience. The economy is close to “full” employment, thus it may be hard for the Fed to support stock markets if the current setback deepens further. Given its commitment to price stability, the central bank could potentially drive yields up further, to the detriment of the economy and of stock markets. Market analysts have been using an analogy to describe the situation that the Federal Reserve will likely face this year—the Fed will be looking to step on the brakes as the fiscal stimulus will be pushing on the accelerator.



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