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

# U.S. Economic Outlook

Quarterly developments

UNITED NATIONS

ECLAC

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# Highlights

- The incoming U.S. administration will be inheriting a healthy economy. The job market is posting solid gains, home sales and house prices have largely recovered from the bust, and the stock market continues to hit new highs. The current expansion has passed seven years, making it the third longest ever.

- The U.S. economy has added private sector jobs for 80 months and in November added another 178,000 jobs, with the unemployment rate falling to 4.6%, its lowest level since 2007. Since its post-crisis nadir in early 2010 the economy has created 15.6 million jobs.

- Wage growth is running ahead of inflation and consumer confidence is at its highest levels in nearly a decade. In October, U.S. personal income climbed at the fastest rate since April, highlighting the growing upward pressure on wages form a tighter job market.

- The economy expanded in the third quarter at the fastest pace in two years (3.2%). Consumption growth, a key element of U.S. economic output, was revised higher to a 2.8% pace, from the previous reading of 2.1%.

- U.S. home prices have climbed back above the record reached more than a decade ago, bringing to a close the worst period for the housing market since the Great Depression. The average home price for September was 0.1% above the July 2006 peak, according to S&P Case-Schiller U.S. National Home Price Index.

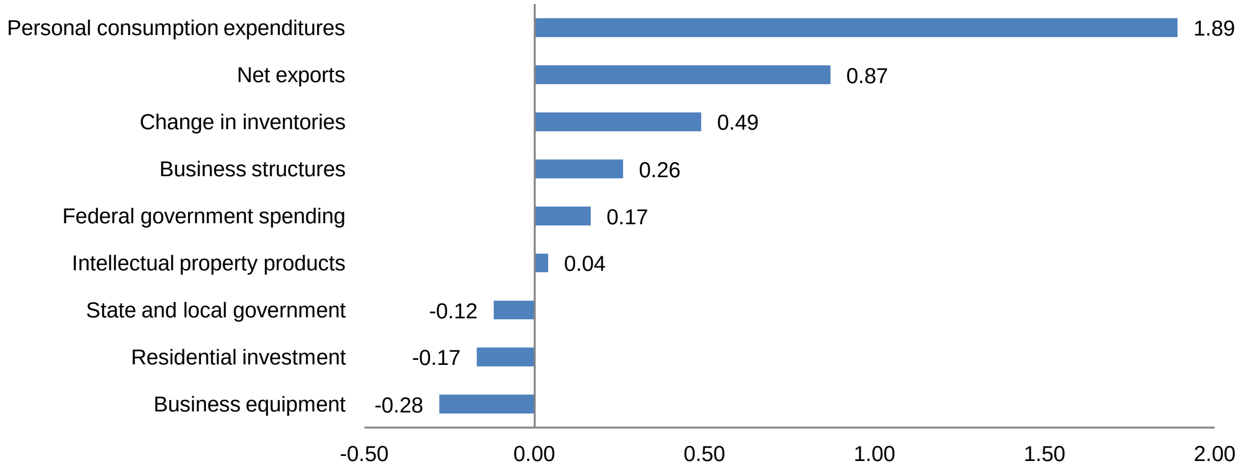
- The Federal Reserve was confident enough about the underlying strength of the U.S. economy to raise the benchmark interest rate by 25 basis points at its December 13-14 meeting, only the second increase in a tightening cycle that started a year ago. The decision to lift rates was unanimous and policymakers anticipate three rate rises in 2017. However, the outlook for next year could shift significantly based on policy changes – such as tax cuts and higher trade tariffs – that the president-elect has promised.

# Overview

According to the U.S. Department of Commerce's second estimate, GDP grew at a 3.2% annualized pace in the third quarter, up from a previous estimate of 2.9%. The revision was significantly better than the small gains of 0.8% in the first quarter and 1.4% in the second quarter, when the economy was being held back by a strong dollar and weak business investment.

Consumer spending was the main driver of growth in the third quarter, contributing 1.9%. Exports made the second largest contribution, 0.9%. Inventory investment, though still weak, improved from the second quarter to make a contribution of 0.5%. Residential investment reduced growth by 0.2%, while nonresidential fixed investment (business structures, business equipment and intellectual property) added only 0.02%. Government made a minimal contribution, with the gain in federal spending slightly more than offsetting the decline in state and local investment spending (chart 1).

**CHART 1:**
**CONTRIBUTIONS TO U.S. GROWTH: Q3 2016**
*(Percentage Points)*



Source: Bureau of Economic Analysis, U.S. Department of Commerce

Officials at the Federal Reserve increased the federal funds target rate by 25 basis points at their December meeting, only the second increase in a decade, and forecast a faster pace of tightening in the coming year. In its post-meeting statement the Fed said it was raising rates in view of “realized and expected labor market conditions and inflation” while reiterating its existing guidance that increases will be “gradual”. The Fed’s decision confirm the U.S. economy as an outlier among the world’s largest economies, which so far have been cutting rates, some into negative territory.

Nonfarm payrolls rose by a seasonally adjusted 178,000 jobs in November, right around expectations. Meanwhile, the unemployment rate dropped to 4.6%, the lowest level in nine years. Average hourly earnings were up 2.5% from a year earlier, down from October’s 2.8%, which was the strongest annual wage growth since June 2009. This decline is expected to be temporary, as other wage measures have drifted higher. Meanwhile, the labor participation rate marginally decreased to 62.7% from 62.8% in October.

Recent inflation data has been supportive of the December hike in interest rates. The headline CPI rose 0.2% in November, following an increase of 0.4% in October. It was the fourth consecutive monthly increase in inflation. Energy boosted the CPI in October and in November. Since the election there has been a decline in the bond market and an increase in long-term interest rates as markets expect fiscal stimulus measures and more inflation in the next couple of years.

### *Looking Ahead*

The U.S. economy’s 3.2% increase in third quarter is expected to be the best showing for the year. Economists believe growth has slowed to around 2% in the fourth quarter, and forecast U.S. growth will remain around 2% in the first half of next year (table 1). The anticipated change in policy direction towards more fiscal support, including tax cuts and infrastructure spending, represents an upside risk to growth. Downside risks to the growth outlook include a weak global demand and the threat of a rise in inflation and global protectionism.

**TABLE 1:**
**QUARTERLY MARKET FORECASTS FOR U.S. ECONOMIC GROWTH**

| | Q4 2016 (qoq) | Q1 2017 (qoq) | Q2 2017 (qoq) | Date of Forecast |
|---|---|---|---|---|
| National Association of Realtors | 2.1% | 1.9% | 2.0% | Nov-16 |
| Mortgage Bankers Association | 1.9% | 1.9% | 2.1% | Nov-16 |
| Bank of America/Merrill Lynch | 2.5% | 1.5% | 1.5% | Dec-16 |
| Moody's Economy.com | 3.1% | 3.0% | 3.2% | Nov-16 |
| J.P. Morgan | 2.0% | 2.0% | 2.0% | Dec-16 |
| Wells Fargo/Wachovia | 1.9% | 1.8% | 2.3% | Dec-16 |
| RGE | 2.1% | 1.8% | 2.5% | Dec-16 |
| *Forecasts average* | *2.2%* | *2.0%* | *2.2%* | |

Source: ECLAC, on the basis of several market sources.

Market projections for real GDP growth in 2016 (made mostly in November and December), now range from 1.5% to 1.8% (see table 2). On average, growth in 2016 is expected to expand at an annual pace of 1.6%. Market projections for real GDP growth in 2017 currently range from 2% to 2.9%. On average, growth in 2017 is expected to expand at an annual pace of 2.2%.

In its latest forecast the OECD said it expected the U.S. to be the best performing large advanced economy in 2017, growing 2.3%. The Federal Reserve expects the U.S. economy to grow 1.9% in 2016 and 2.1% in 2017.

The unemployment rate in November (4.6%) was below the market average projections for 2016 (4.9%) and 2017 (4.7%). Market projections for the unemployment rate in 2017 range from 4.5% to 5.0%. According to the Federal Reserve projections, unemployment will fall to 4.5% in 2017 and stay there until 2019. The Fed sees the long-term unemployment rate settling at 4.8%.

Market projections for CPI inflation in 2016 range from 1.2% to 1.3%, reflecting the effect of declining oil prices at the beginning of the year, and for 2017 they range from 2.1% to 2.6%. On average, CPI inflation is expected to be around 1.2% in 2016, substantially higher than the 0.1% increase in 2015, and 2.4% in 2017.

Inflationary pressure, which has been slowly building in the labor market, may become a more serious problem with a change in U.S. policy towards more fiscal stimulus – including tax cuts and infrastructure spending – at a time when unemployment rate is already at low levels, forcing the Federal Reserve to raise rates more rapidly.

In recent years, financial markets were consistently expecting interest rates to be raised at a slower pace than the Fed's own projections. The Fed has repeatedly overestimated the pace at which it would be able to tighten policy, and spent 2016 rethinking the economy's long-term growth and gradually revising down its estimates for future interest rates. Since the November elections, however, market views have been changing significantly, with investors now expecting a more aggressive Fed going forward. Fed policymaker's forecasts released following the December meeting suggest three rate increases next year (to a rate of 1.4% by year's end), a slightly faster pace than previously projected.

## TABLE 2:
## ANNUAL FORECASTS FOR U.S. ECONOMIC GROWTH

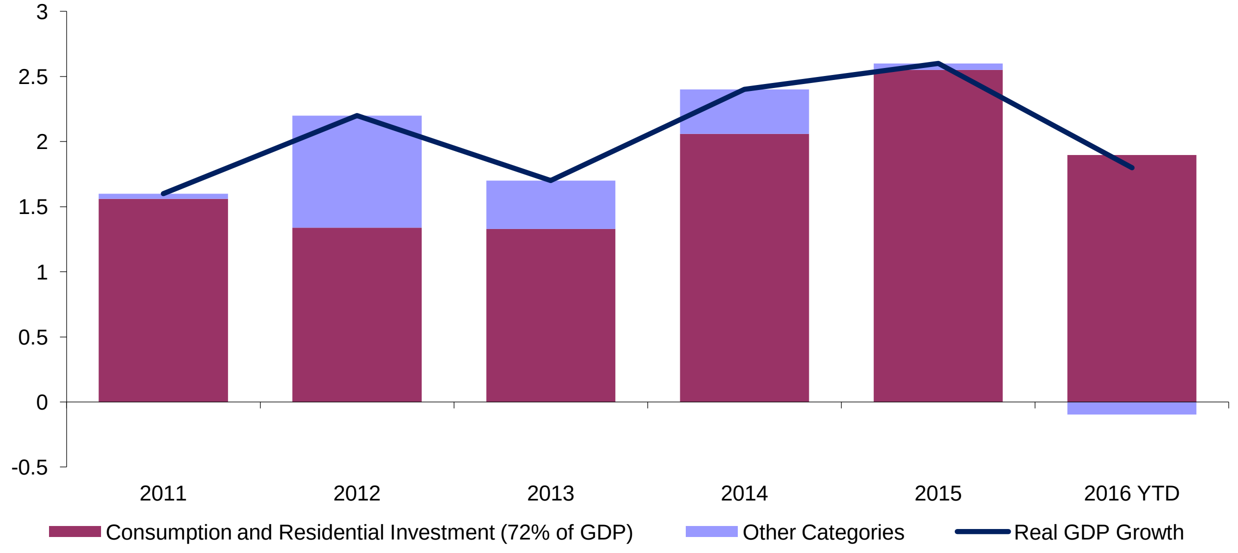
| | **Real GDP** | | **CPI** | | **Unemployment Rate** | | **FED Funds Rate** | | |
|---|---|---|---|---|---|---|---|---|---|
| | **(% change, y/y)** | | **(% change, y/y)** | | **(%)** | | **(%)** | | |
| | **2016** | **2017** | **2016** | **2017** | **2016** | **2017** | **2016** | **2017** | Date of Forecast |
| ***A. What Government Agencies Say*** | | | | | | | | | |
| **FED*** | 1.9% | 2.1% | 1.5% | 1.9% | 4.7% | 4.5% | 0.6% | 1.4% | *Dec-16* |
| **CBO** | 1.9% | 2.4% | 1.4% | 2.4% | 4.8% | 4.5% | *na* | *na* | *Aug-16* |
| Administration (Office of Management and Budget) | 2.6% | 2.6% | 1.5% | 2.1% | 4.7% | 4.5% | *na* | *na* | *Jul-16* |
| ***B. What Markets Say*** | | | | | | | | | |
| National Bank of Canada | 1.6% | 2.2% | 1.2% | 2.1% | 4.9% | 5.0% | 0.75% | 1.25% | *Nov-16* |
| TD Bank Financial Group | 1.5% | 2.1% | 1.3% | 2.6% | 4.9% | 4.7% | 0.55% | 0.90% | *Sep-16* |
| National Association of Realtors | 1.5% | 2.1% | 1.2% | 2.5% | 4.9% | 4.7% | 0.4% | 0.8% | *Nov-16* |
| Mortgage Bankers Association | 1.8% | 2.0% | 1.3% | 2.5% | 4.9% | 4.6% | 0.625% | 1.375% | *Nov-16* |
| Bank of America/Merrill Lynch | 1.6% | 2.0% | 1.3% | 2.3% | 4.9% | 4.6% | 0.62% | *0.87%* | *Dec-16* |
| Credit Suisse | 1.5% | 2.3% | 1.2% | 2.2% | 4.9% | 4.6% | *na* | *na* | *Sep-16* |
| Moody's Economy.com | 1.6% | 2.9% | 1.2% | 2.5% | 4.9% | 4.8% | 0.4% | 1.0% | *Nov-16* |
| The Economist Intelligence Unit | 1.6% | 2.3% | 1.2% | 2.1% | 4.8% | 4.5% | *na* | *na* | *Dec-16* |
| JPMorgan | 1.6% | 2.1% | 1.3% | 2.5% | 4.9% | 4.6% | *na* | *na* | *Dec-16* |
| Wells Fargo/Wachovia | 1.5% | 2.1% | 1.2% | 2.4% | 4.9% | 4.7% | 0.56% | 1.00% | *Dec-16* |
| Roubini Global Economics | 1.5% | 2.2% | 1.3% | 2.2% | *na* | *na* | 0.63% | 1.38% | *Dec-16* |
| ***Market Average*** | ***1.6%*** | ***2.2%*** | ***1.2%*** | ***2.4%*** | ***4.9%*** | ***4.7%*** | ***0.6%*** | ***1.1%*** | |
| ***C. What International Organizations Say*** | | | | | | | | | |
| United Nations DESA (Baseline) | 2.2% | 2.5% | *na* | *na* | *na* | *na* | *na* | *na* | *May-16* |
| World Bank | 1.9% | 2.2% | *na* | *na* | *na* | *na* | *na* | *na* | *Jun-16* |
| OECD | 1.5% | 2.3% | 1.2% | 1.9% | 4.9% | 4.7% | *na* | *na* | *Nov-16* |
| IMF | 1.6% | 2.2% | 0.8% | 1.2% | 4.9% | 4.8% | *na* | *na* | *Oct-16* |

Source: ECLAC on the basis of official and market sources.
Note: *FED forecast for core PCE inflation, the FED's preferred measure.

# I. Quarterly developments

The U.S. economy in the third quarter grew at the fastest pace in two years, but year-to-date it is still growing at a lower rate than in the previous two years. Consumption and residential investment represent 72% of U.S. GDP and have been the core of the U.S. economy. Consumption has remained resilient this year so far, although it has grown at a lower rate than in the previous two years, but residential investment has subtracted from growth. Also subtracting from growth this year is investment in business equipment and inventories, although inventory investment made a positive contribution in the third quarter (chart 2).

**CHART 2:**
**CONTRIBUTIONS TO U.S. REAL GDP GROWTH**
*(Percentage Points)*

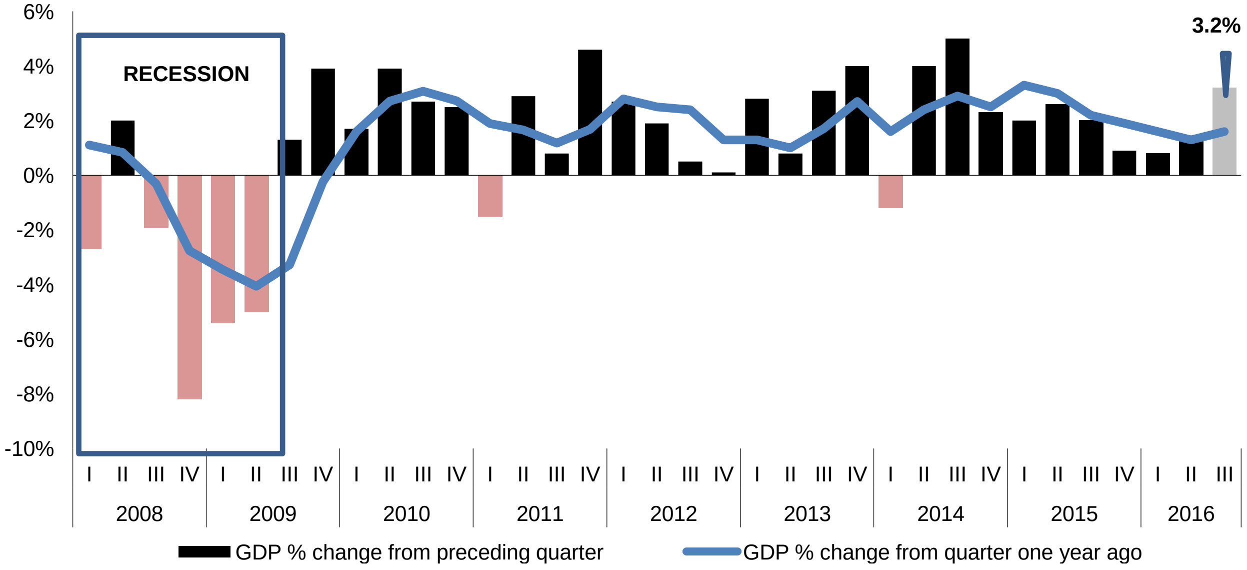


Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Department of Commerce.
Note: Contributions to growth are measured at seasonally adjusted annual rates.

## A. GDP Growth

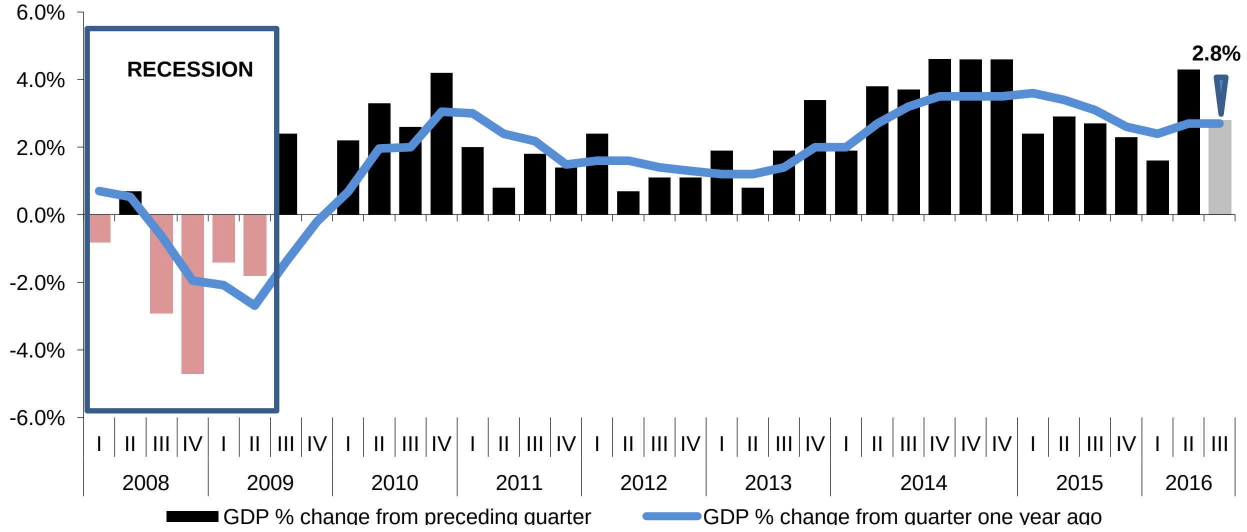
The second estimate for third-quarter GDP growth, released by the U.S. Department of Commerce on 29 November 2016, was an upward revision to 3.2% from a previous 2.9% estimate, and an improvement over the 1.4% rate of the previous quarter (chart 3). Consumer spending, net exports, private inventory investment, and federal government spending made positive contributions to growth in the third quarter, while residential fixed investment and state and local government spending subtracted from growth.

**CHART 3:**
**U.S. REAL GDP: QUARTERLY GROWTH**
*(Percentage Points)*



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

**CHART 4:**
**PERSONAL CONSUMPTION EXPENDITURE: QUARTERLY GROWTH**
*(Percentage Points)*



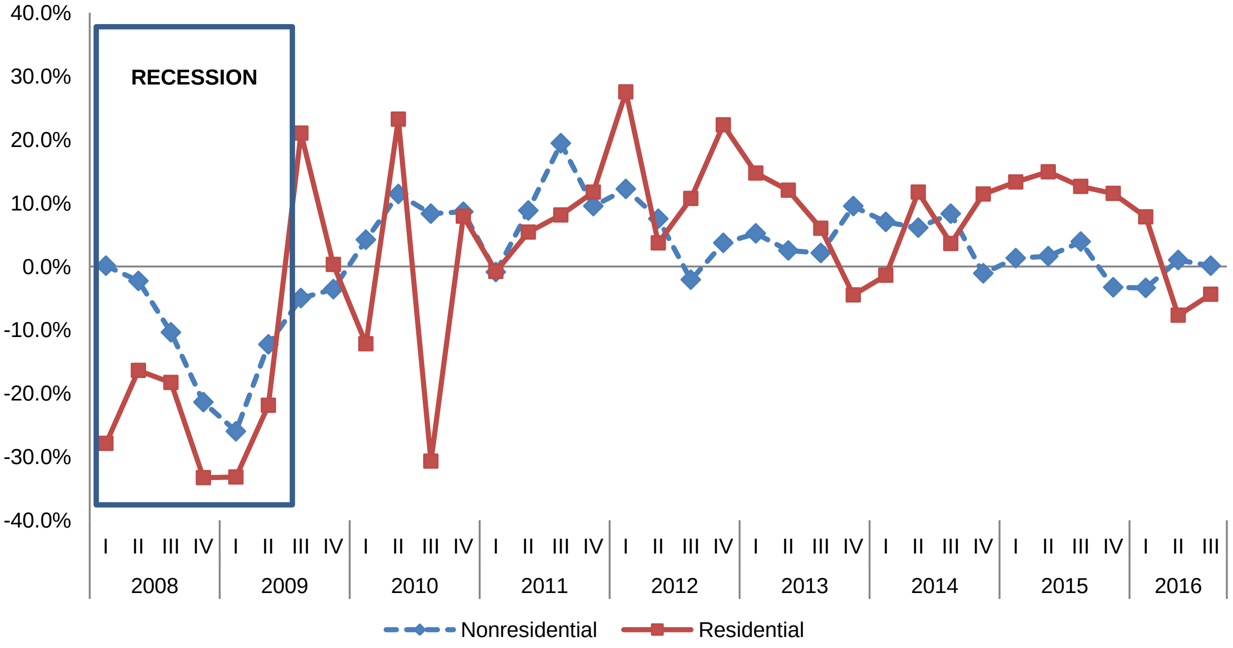
Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Department of Commerce.

The largest component of GDP, real personal consumption expenditures, grew 2.8% in the third quarter, following an increase of 4.3% in the second (chart 4). Consumer spending was a driver of growth, contributing 1.9%. This was down from the unsustainable 2.9% contribution in the second quarter, but upwardly revised. Stronger and higher-quality job growth in recent years, low borrowing costs and record low debt service burdens, rebounding housing prices, and lower oil prices have supported consumer spending. The fact that U.S. consumers have been able to spend without dipping into their savings is a positive sign. The saving rate has remained above 5% during the economic recovery and has been higher than 5.5% for more than two years. The saving rate held steady at an upwardly revised 5.9% level in the third quarter.

Real residential investment declined at a 4.4% pace (subtracting 0.17% from third-quarter growth), following a decline of 7.7% in the previous quarter (chart 5). Yet, the housing sector may provide a boost to the U.S. expansion in coming quarters. Homebuilding has improved, but it is still low given the demand for new housing, and the housing vacancy rate, including homes that are for sale and rent, is falling fast, according to Moody's. Home prices have recovered the ground lost during the housing crisis and in September were 0.1% above their July 2006 peak according to S&P Case-Schiller U.S. National Home Price index released in November. Home-price growth has outpaced income gains, however, making it more likely that the current rate of appreciation is unsustainable. Moreover, raising mortgage rates could also begin to pose headwinds for further price growth.

Real nonresidential fixed investment, which represents overall business spending, remained basically unchanged, increasing at a 0.1% annual rate in the third quarter after an increase of 1% in the previous quarter (it contributed 0.02% to third-quarter growth). Investment in equipment fell 4.8% (it subtracted 0.28% from third-quarter growth), after declining 2.9% in the second quarter. Investment in nonresidential structures increased 10.1% after a decline of 2.1% in the previous quarter (it added 0.26% to third-quarter growth). Investment in intellectual property products (including software, R&D, entertainment, literary and artistic originals) increased 1% (contributing 0.04% to third-quarter growth).

**CHART 5:**
**GROSS PRIVATE DOMESTIC INVESTMENT: QUARTERLY GROWTH**
*(Percentage Points)*



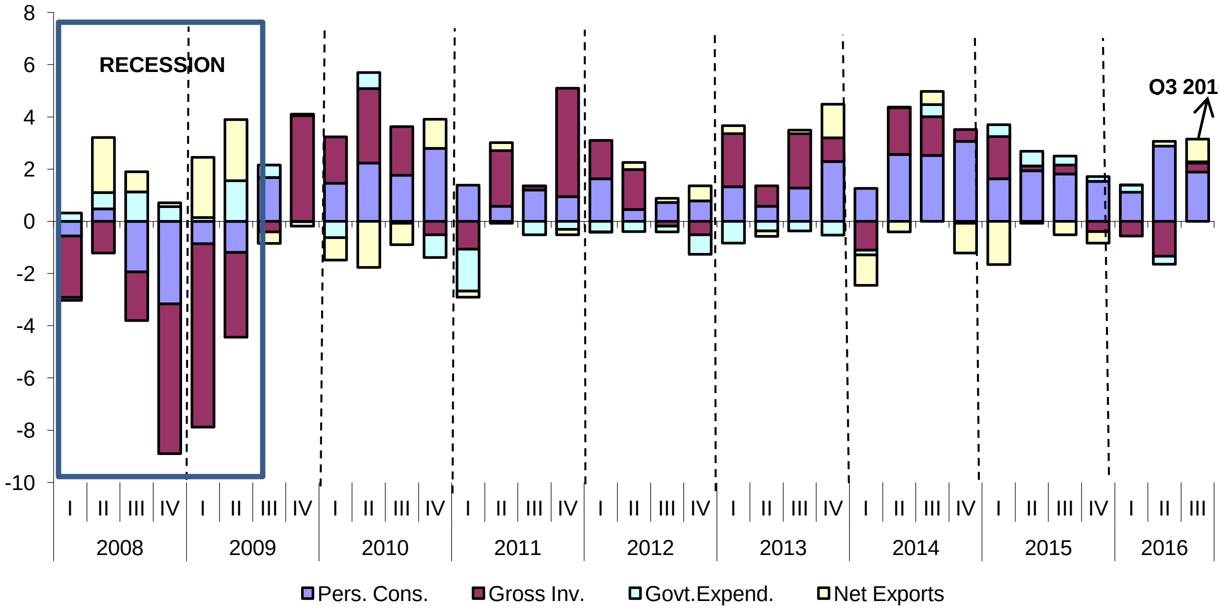
Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Department of Commerce.

The change in private inventories contributed to growth for the first time in a year and a half, as the inventory correction appears to have mostly run its course. It added 0.49% to the third quarter change in real GDP, after subtracting 1.16% from growth in the previous quarter. Overall, gross private domestic investment increased at a 2.1% annual rate in the third quarter, adding 0.34% to third-quarter GDP growth (with -0.15% due to business fixed investment – -0.17% from residential and 0.02% from nonresidential – and 0.49% due to inventories). Real final sales – GDP excluding the change in inventories – expanded at a healthy 2.7% pace, up from the 2.6% pace in the previous quarter.

Total government consumption was a slight positive to growth in the third quarter. Overall, government spending increased by 0.2% and added 0.05% to growth. State and local government spending decreased 0.1%, and federal outlays increased 2.5% (national defense spending increased 2.1%, while nondefense spending increased 3%).

Finally, net exports added 0.87% to growth in the third quarter. Exports increased 10.1% and imports 2.1%, as the dollar stabilized against major currencies and global conditions improved (chart 6).

**CHART 6:**
**CONTRIBUTIONS TO REAL GDP GROWTH**
*(Percentage Points)*



Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Department of Commerce.
Note: Contributions to growth are measured at seasonally adjusted annual rates.

Although GDP growth appears set to moderate in the fourth quarter, prospects remain bright. Consumer spending remains robust and should continue to support growth, as nominal income increased 4.5% at an annual rate in the third quarter. In addition, the housing sector is stronger, while the increased likelihood of a fiscal stimulus such as more spending on infrastructure or reduced taxes also supports the near-term outlook. U.S. business, consumer and investment confidence has improved since the presidential election. Risks have likely increased as well, and now include the possibilities of higher inflation and reduced trade.

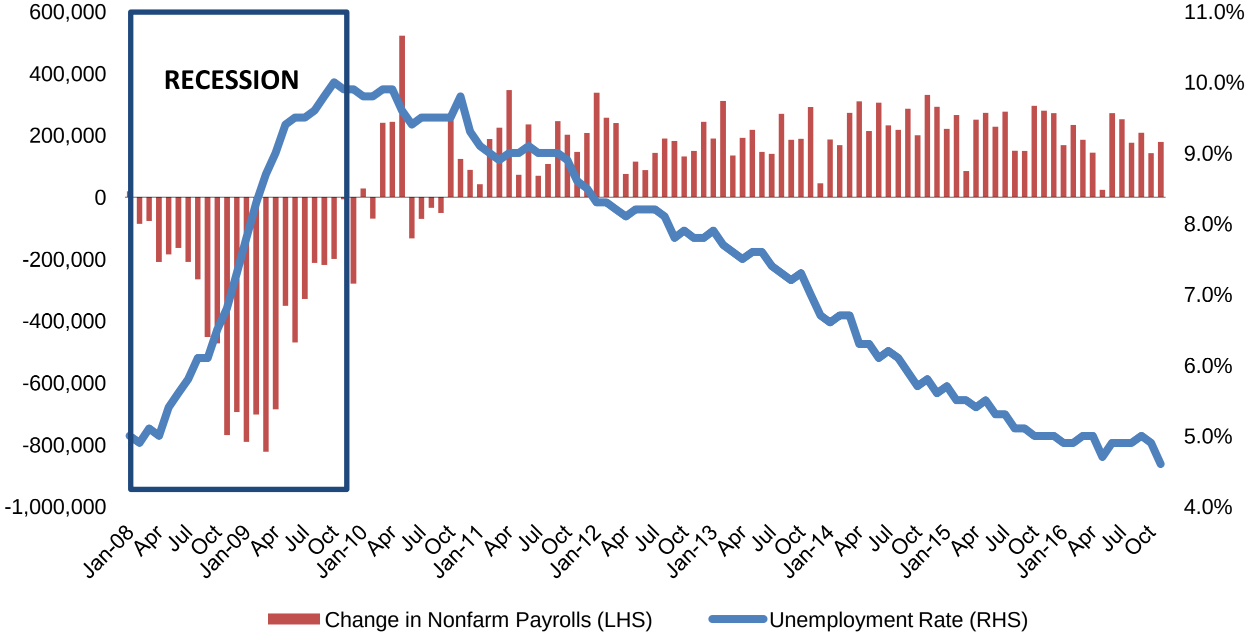
## C. Labor market

The U.S. economy added 178,000 jobs in November, meaning that it has added 15.6 million jobs since early 2010. September's nonfarm payrolls were revised up to a gain of 208,000 and October's were revised down to 142,000, a net decrease of 2,000.

The average gains for 2016 year-to-date are 180,000 payroll jobs a month, down from the better than 200,000 pace in 2014 and 2015, but still healthy given the longevity of the recovery and the overall unemployment rate. In the third quarter, average gains were 212,000 payroll jobs a month.

The unemployment fell to 4.6% in November from 4.9% in October (chart 7). This was the lowest level since 2007, adding to growing evidence that the U.S. economy is emerging from the shadow of the 2008 global financial crisis.

**CHART 7:**
**THE U.S. LABOR MARKET**
*(Average Monthly Job Growth (left axis); Percentage Points (right axis))*

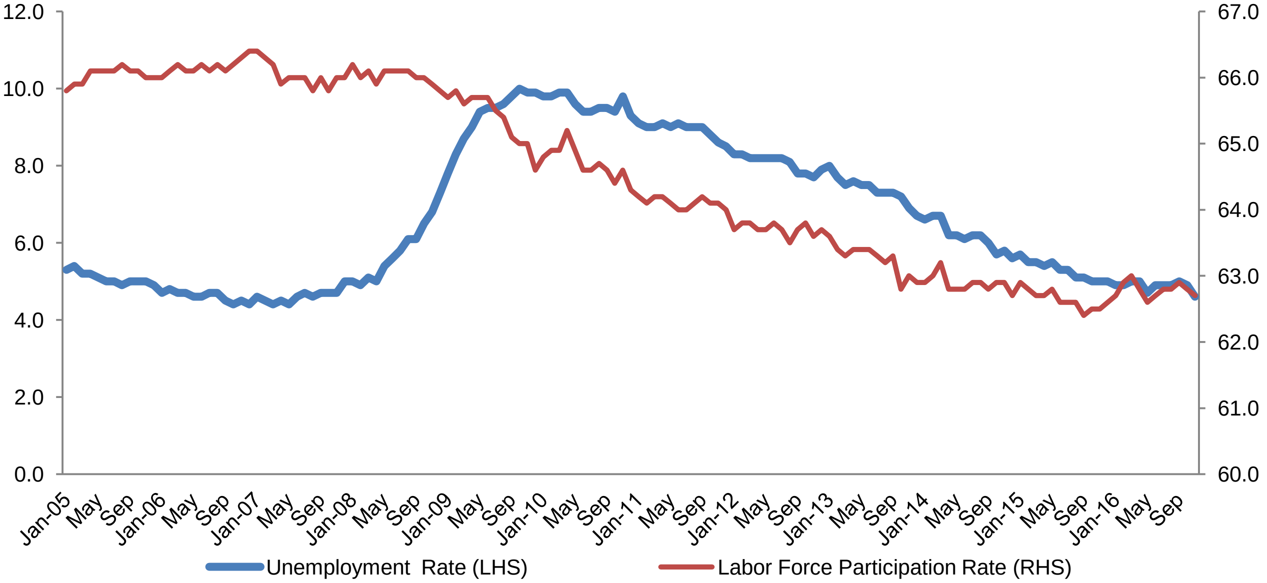


Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics.

However, the drop came more from a decline in the labor force than from an increase in household employment. Labor force participation moved down to 62.7% from 62.8% in October, meaning that more than 400,000 Americans dropped out of the labor force in November (chart 8). A broad measure of unemployment and underemployment, which includes those who have stopped looking and those in part-time jobs who want full-time positions, was 9.3% in November, down from 9.5% in October and the lowest since April 2008, but still elevated. The rate averaged 8.3% in the two years before the recession.

Average hourly earnings fell 0.1% in November, slowing the wage gain over the last 12 months to 2.5% from October's 2.8%, which was the strongest annual wage growth since June 2009 but still below the rates of more than 3% before the financial crisis. This decline is seen as largely a seasonal blip in hiring patterns and should prove temporary as other measures of wage growth have drifted higher.

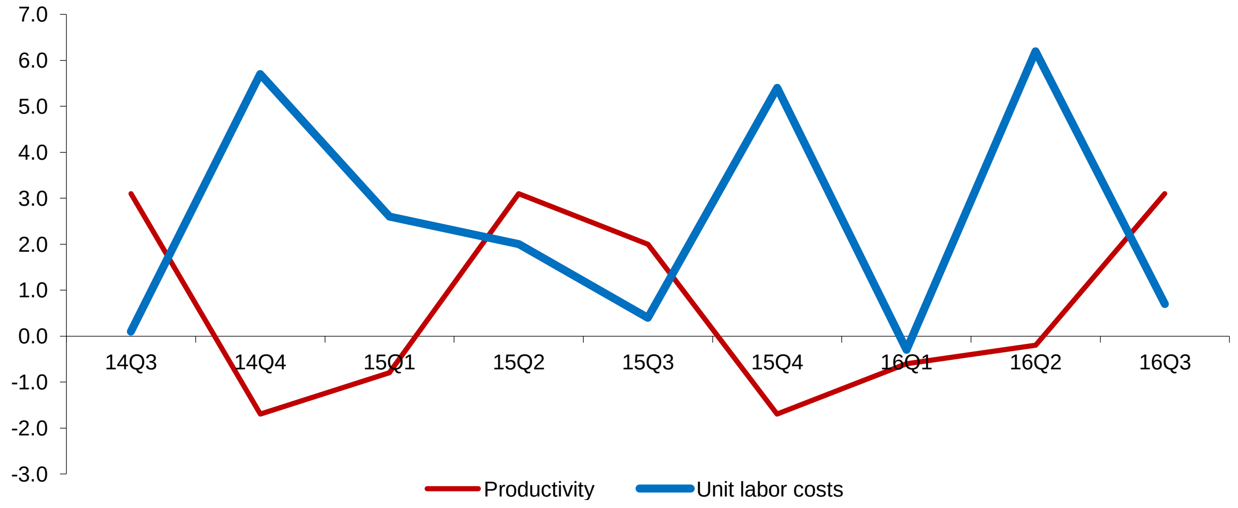
**CHART 8:**
**U.S. UNEMPLOYMENT RATE AND LABOR FORCE PARTICIPATION**
*(Percentage Points)*



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

Productivity growth rose 3.1% at an annual rate in the third quarter, following a decline in each of the prior three quarters (chart 9). Productivity is volatile, but the increase leaves it unchanged on a year-ago basis. Unit labor costs were revised higher and are now shown to have risen 0.7% at an annual rate, stronger than the 0.3% gain in the advance estimate. On a year-ago basis, unit labor costs were up 3% in the third quarter. The gain in third quarter unit labor costs reflects a 3.8% gain in hourly compensation and a 3.1% increase in productivity (table 3).

**CHART 9:**
**U.S. NONFARM BUSINESS SECTOR: PRODUCTIVITY VS UNIT LABOR COSTS**
*(Percentage Change from Previous Quarter at Annual Rates)*



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

**TABLE 3:**
**U.S. PRODUCTIVITY AND COSTS**

**Productivity and costs: Revised third quarter 2016 annual averages**
(Seasonally adjusted annual rates)

| Sector | Productivity | Output | Hours | Hourly compensation | Real hourly compensation | Unit labor costs |
|---|---|---|---|---|---|---|
| | | | Percent change from preceding quarter | | | |
| Nonfarm business | 3.1 | 3.6 | 0.5 | 3.8 | 2.2 | 0.7 |
| Business | 3.5 | 3.9 | 0.3 | 4.1 | 2.4 | 0.6 |
| Manufacturing | 0.4 | 0.6 | 0.3 | 3.7 | 2.0 | 3.3 |
| Durable | 3.0 | 2.7 | -0.3 | 4.2 | 2.5 | 1.2 |
| Nondurable | -3.0 | -1.9 | 1.1 | 2.8 | 1.2 | 6.0 |

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

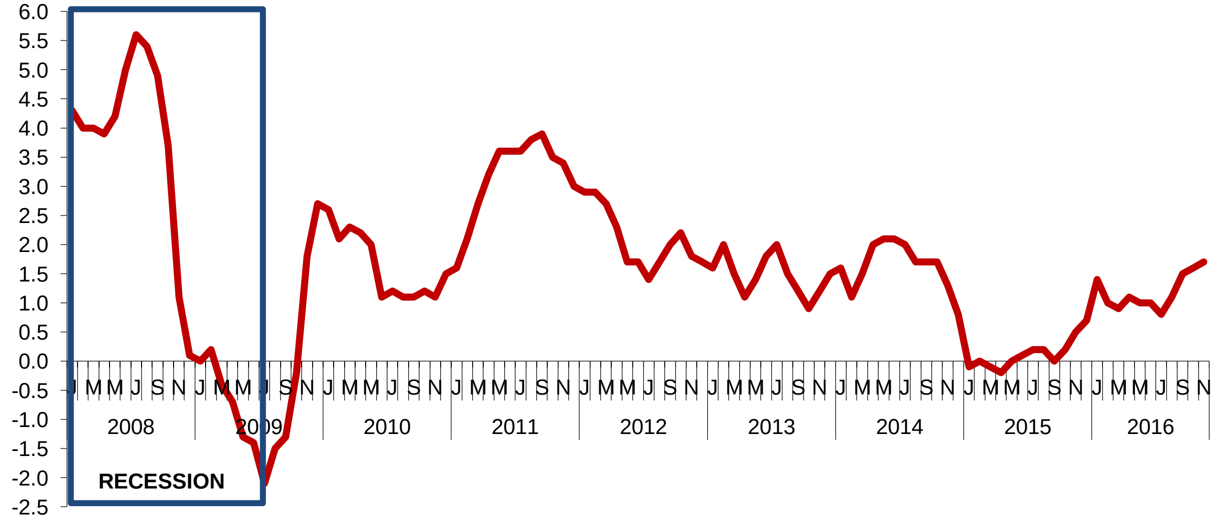
The recovery that began in mid-2009 has been long by historical standards but also weak, with annual growth averaging just 2.1%. A marked slowdown in productivity gains since the IT-fueled boom of the 1990s and early 2000s plus the deceleration in labor-force growth as the baby boom generation begins to retire and workforce participation declines, help explain the recent tepid growth trend.

## D. Inflation

U.S. consumer prices edged up in November for the fourth consecutive month, the latest sign of firming U.S. inflation amid a rise in energy prices. The Consumer Price Index for All Urban Consumers (CPI-U) increased 0.2% from a month earlier. Prices rose last month for gasoline, rent and used cars, but fell for groceries and clothing. Over the last 12 months, the all items index rose 1.7% before seasonal adjustment (chart 10), the strongest annual gain in any 12-month period since October 2014.

The energy CPI increased 1.2% following increases of 3.5% in October and 2.9% in September. Fuel oil prices increased 2.5%, and gasoline rose 2.7%, the third consecutive monthly increase. Food prices remained tame, unchanged for the fifth consecutive month.

**CHART 10:**
**U.S. DOMESTIC PRICES: MONTHLY EVOLUTION**
*(CPI-U Unadjusted 12-month Percent Change)*

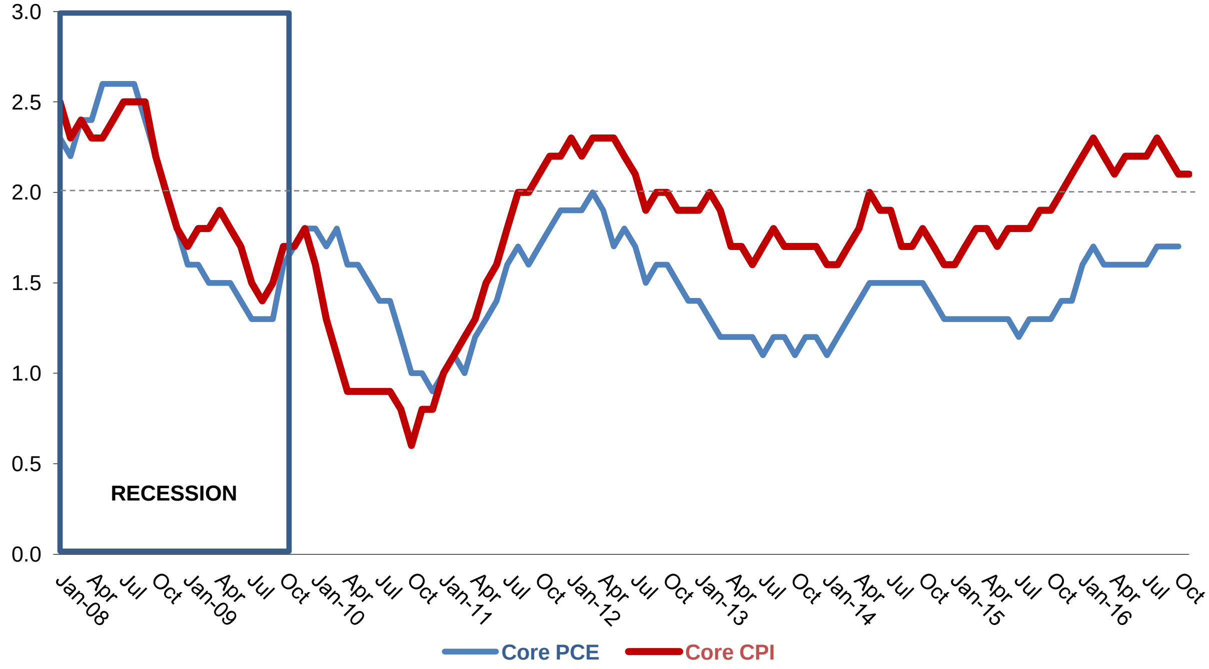


Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics.

Excluding food and energy, the CPI rose 0.2% in November, a modest acceleration from the 0.1% increase in each of the prior two months. The core CPI was up 2.1% on the year for the second straight month, marking the twelfth consecutive month that annual core inflation matched or exceeded 2%.

The most closely watched measure by the Federal Reserve – the Personal Consumption Expenditure (PCE) core price index– increased at an annualized 1.7% in the third quarter. In October, the latest data available, the core PCE advanced at 1.7%, lower than the Federal Reserve's threshold of 2%. October marked the 54th consecutive month in which prices have fallen short of the Fed's 2% annual target (chart 11). Thus as measured by the PCE index, U.S. inflation has undershot the central bank's 2% annual target for the past 4 ½ years.

**CHART 11:**
**U.S. CORE CONSUMER PRICE INDICES**
*(Year-over-year Percentage Change)*



Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics (BLS), Department of Labor and the Bureau of Economic Analysis (BEA), U.S. Department of Commerce.

## E. Monetary policy

The Federal Open Market Committee (FOMC) raised the federal funds rate target range by a quarter-point to 0.50%-0.75% in its last meeting of the year, which took place on December 13-14. The decision to raise the target rate was unanimous. The increase had already been priced in by the markets, so their focus was on what policy would look like in 2017 and beyond. The key question is what the pace of future rate increases will be. In its post-meeting statement, the Fed reiterated its existing guidance that increases will be gradual.

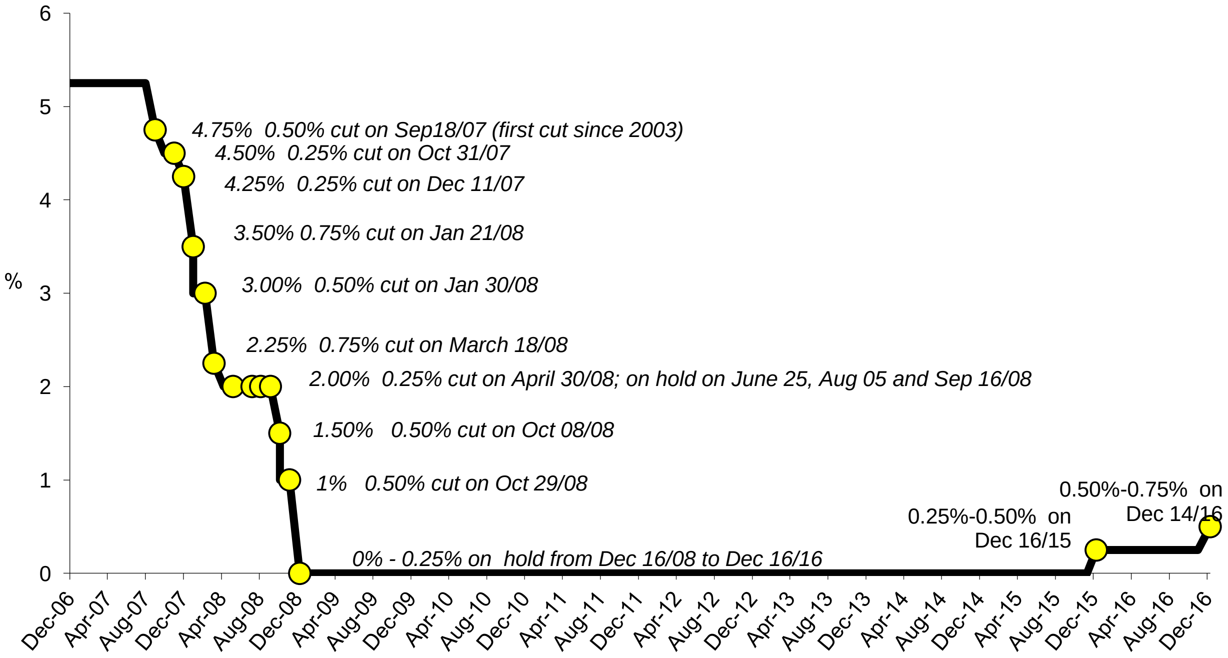
Policymakers' projections suggest three increases in interest rates next year, a little faster pace than it was projecting before. The median projection is three 25-basis point rate increases in 2017 compared with two in the September projections. The new rate projections also added another 25-basis point rate hike in 2018 and 2019. The Fed's estimate of the long-term equilibrium fed funds rate was raised from 2.875% to 3%.

When interest rates were raised for the first time in December 2015, Fed officials predicted no fewer than four rate increases in the course of 2016, and it has delivered only one. However, market expectations of the U.S. growth and inflation outlook have been changed by the prospects of a fiscal stimulus by the next administration, prompting speculation that a steeper pace of Fed tightening may be needed next year.

Recent data suggest the Fed is already closing in on its employment and inflation goals. November’s 4.6% unemployment rate is below the Fed policymakers’ median estimate of its long-run rate. And inflation as measured by the personal consumption expenditures price index excluding food and fuel is at 1.7%, not far from the Fed’s 2% target.

There is much uncertainty about which policies the incoming administration will actually adopt and how much they will actually impact the economy and inflation. There is thus substantial scope for a “surprise” in the rates market if the optimistic assumptions about new policies are not borne out by events.

**CHART 12:**
**U.S. FEDERAL FUNDS TARGET RATE**
*(Percentage)*



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

## F. Financial conditions

Since the U.S. elections investors have embraced a view that the incoming administration’s promise to use fiscal policy to reinvigorate the U.S. economy will both boost growth and fan inflation. That has been good for stocks, but bad for bonds, which have sold off sharply.

In the third quarter the Dow Jones Industrial Average, the S&P 500, and NASDAQ gained 2.89%, 3.54%, and 8.19%, respectively. Since the elections in November the stock-market indices have kept up a record-breaking streak of gains. The end isn’t in sight just yet. The Russell 2000, composed of U.S. small companies typically worth US$ 300 million to US$ 2 billion, in November notched the sharpest monthly jump since 2011, with a gain of 11%.

The yield on the 10-year Treasury note, as of December 6, was approaching 2.5%, compared to an average of 1.8% in October (table 4). The surge since July has pushed the 10-year yield up by a full one percentage point. Rising rates can reflect optimism about economic prospects, yet over time they can also slow growth by making borrowing more expensive for consumers and businesses. If growth does not accelerate as investors expect, higher rates could actually slow growth.

Rising labor costs coupled with a 4.6% unemployment rate suggests yields could rise further. The higher Treasury yields go, the stronger the dollar is likely to become, widening the trade deficit and weighing on the economy.

**TABLE 4:**
**U.S. STOCK PRICES AND TREASURY SECURITY YIELDS**

| | **STOCK PRICES** | | | | **U.S. TREASURY SECURITY YIELDS** | | |
|---|---|---|---|---|---|---|---|
| | **Monthly Stock Prices** | | | | **Monthly Yields** | | |
| | **Dow Jones** | **S&P 500** | **Nasdaq** | | **3-year** | **10-year** | **30-year** |
| **2015** | | | | **2015** | | | |
| January | 17,542.26 | 2,028.18 | 4,673.70 | January | 0.90 | 1.88 | 2.46 |
| February | 17,945.41 | 2,082.20 | 4,854.26 | February | 0.99 | 1.98 | 2.57 |
| March | 17,931.75 | 2,079.99 | 4,938.01 | March | 1.02 | 2.04 | 2.63 |
| April | 17,970.51 | 2,094.86 | 4,985.95 | April | 0.87 | 1.94 | 2.59 |
| May | 18,124.71 | 2,111.94 | 5,029.94 | May | 0.98 | 2.20 | 2.96 |
| June | 17,927.22 | 2,099.28 | 5,073.04 | June | 1.07 | 2.36 | 3.11 |
| July | 17,795.02 | 2,094.14 | 5,082.14 | July | 1.03 | 2.32 | 3.07 |
| August | 17,061.59 | 2,039.87 | 4,934.62 | August | 1.03 | 2.17 | 2.86 |
| September | 16,339.95 | 1,944.40 | 4,748.00 | September | 1.01 | 2.17 | 2.95 |
| October | 17,182.28 | 2,024.81 | 4,879.04 | October | 0.93 | 2.07 | 2.89 |
| November | 17,723.77 | 2,080.62 | 5,082.51 | November | 1.20 | 2.26 | 3.03 |
| December | 17,542.86 | 2,054.08 | 5,040.54 | December | 1.28 | 2.24 | 2.97 |
| **2016** | | | | **2016** | | | |
| January | 16,305.25 | 1,918.60 | 4,610.71 | January | 1.14 | 2.09 | 2.86 |
| February | 16,299.90 | 1,904.42 | 4,463.21 | February | 0.90 | 1.78 | 2.62 |
| March | 17,302.14 | 2,021.95 | 4,754.48 | March | 1.04 | 1.89 | 2.68 |
| April | 17,844.37 | 2,075.54 | 4,892.17 | April | 0.92 | 1.81 | 2.62 |
| May | 17,692.32 | 2,065.55 | 4,788.24 | May | 0.97 | 1.81 | 2.63 |
| June | 17,754.87 | 2,083.89 | 4,856.23 | June | 0.86 | 1.64 | 2.45 |
| July | 18,341.18 | 2,148.90 | 5,023.99 | July | 0.79 | 1.50 | 2.23 |
| August | 18,495.19 | 2,177.48 | 5,217.04 | August | 0.85 | 1.56 | 2.26 |
| September | 18,267.40 | 2,157.69 | 5,254.15 | September | 0.90 | 1.63 | 2.35 |
| **October** | 18,184.55 | 2,143.02 | 5,255.99 | October | 0.99 | 1.76 | 2.50 |

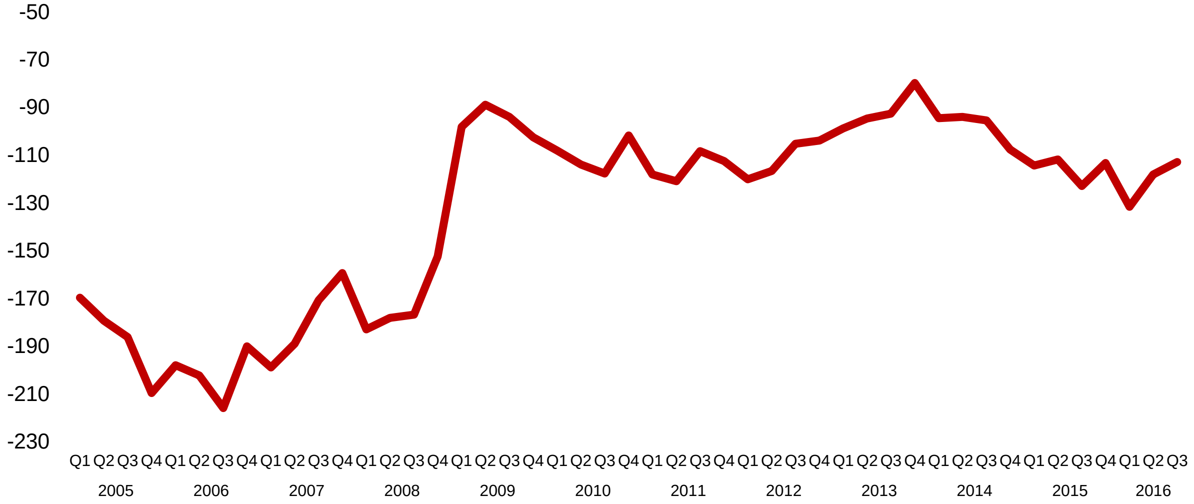
Source: Economic Indicators, U.S. Government

## G. External sector

The U.S. current account deficit, the broadest measure of net exports to the rest of the world because it includes income payments and government transfers in addition to foreign trade, narrowed from a revised US$ 118.3 billion in the second quarter of 2016 (2.6% of GDP) to US$ 113 billion in the third (2.4% of GDP). It was the third straight quarter of improvement in the current account, with the deficit falling to its lowest level since the second quarter of 2015 (chart 13). Trade in goods was exceptionally strong over the quarter. Record soybean exports significantly boosted total exports, and other goods categories also fared well.

The third quarter’s improvement came in the face of a strong U.S. dollar. The Fed’s tightening of monetary policy should strengthen the dollar, which is negative for exporters and positive for imports, as imported goods become relatively cheaper in the domestic market. The stronger dollar also lowers the value of repatriated assets from overseas investments. It may also encourage transfer payments abroad as remittances based in U.S. dollars gain in value.

**CHART 13:**
**U.S. BALANCE ON CURRENT ACCOUNT**
*(Quarters, Seasonally Adjusted, US$ Billion))*



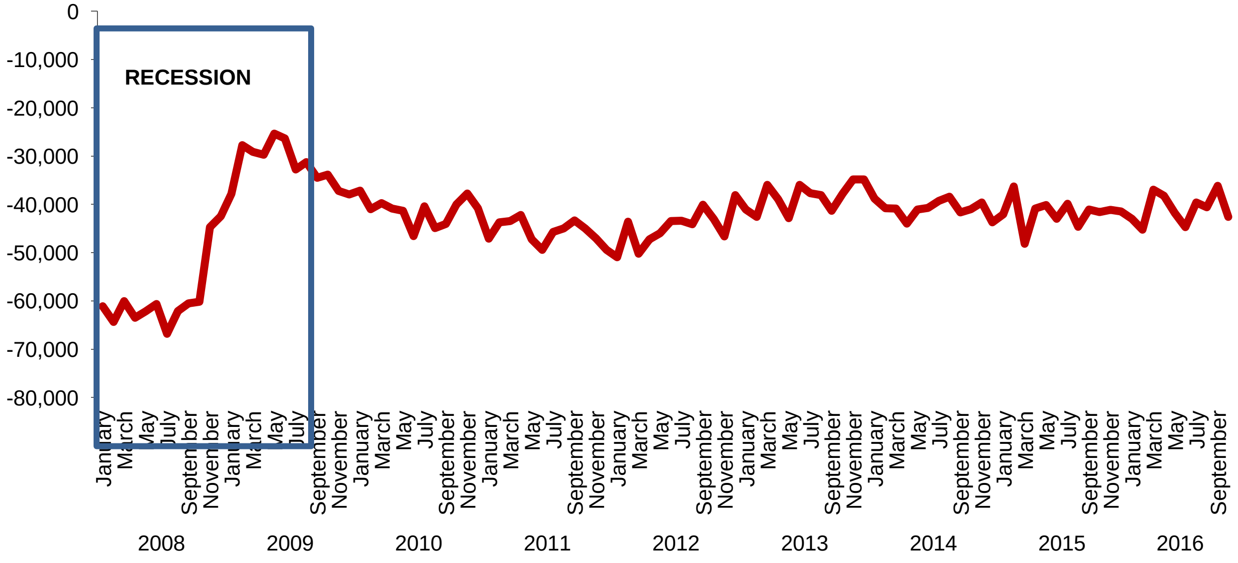
Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Commerce Department.

Although trade added significantly to third quarter GDP growth, it will likely be a weight this quarter. The U.S. trade deficit widened to US$ 42.6 billion in October, the latest data available, from a revised US$ 36.2 billion in September (chart 14). It was a significant increase (18%) from the previous month.

Exports of goods and services fell 1.8% in October, while imports climbed 1.3%. Export weakness was concentrated in food, and a payback for the surge in soybean exports in the third quarter is behind the slide. Record soybean exports had pushed down the trade deficit over the previous three months, but that trend is unwinding. Goods imports were also unusually high in October, hitting their highest level in just more than a year.

The U.S. accumulated a trade deficit of US$ 409 billion in the first ten months of 2016, compared with a deficit of US$ 418 billion in the same period last year.

**CHART 14:**
**U.S. BALANCE ON GOODS AND SERVICES TRADE**
*(Monthly, US$ Million)*



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

# II. Recent trends and emerging market economies

The low rate backdrop of developed markets, including the U.S., has made emerging markets' yield story attractive. However, the potential adoption of pro-growth and inflation-inducing policies – including tax cuts and infrastructure spending – at a time when the U.S. economy is close to full employment is expected to affect the low interest rate environment that the world has gotten used to and shake financial markets out of a decade-long period where low interest rates became the norm.

Emerging markets have arguably benefited from central bank policy in developed economies driving yields lower, but now may be at risk from higher U.S. interest rates and a strong U.S. dollar. From the election to mid-December the trade-weighted dollar was up by more than 3%. Moreover, after the Federal Reserve signaled at the end of its December meeting that it expects to raise interest-rates quicker than previously anticipated, the U.S. dollar surged to its highest level in 14 years, hitting emerging market currencies and pushing the euro closer to parity. Increases in U.S. interest rates at a faster pace to curb inflation would widen the gulf between U.S. monetary policy and the rest of the world, which would likely keep the recent dollar rally going and keep long-term interest rates rising.

According to the Bank for International Settlements (BIS) in its just released quarterly review, 10% of dollar-denominated corporate debt in emerging markets is set to mature next year. Emerging market countries and corporations have increased their dollar debt for more than a decade and now may face a spike in servicing costs and elevated debt burdens. In the economic literature, connections between sustained periods of dollar strength and bouts of financial instability have been drawn by several authors, thus there is some uneasiness in emerging markets regarding what the impact of U.S. future policies may be.

The effect that dollar strength may have on the competitiveness of the U.S. companies, and the possibility of more protectionist measures, is another concern. The growing strong dollar poses a threat to the incoming administration's promise to reduce the trade deficit, and the possibility that it could lead to more protectionist measures as a result is a concern.

So far, credit and equity market reactions in emerging market economies have been more muted than during the taper tantrum of 2013, however. Moreover, there are upside risks as well. If U.S. economic growth indeed accelerates as a result of the expected fiscal stimulus, emerging market economies could benefit.

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