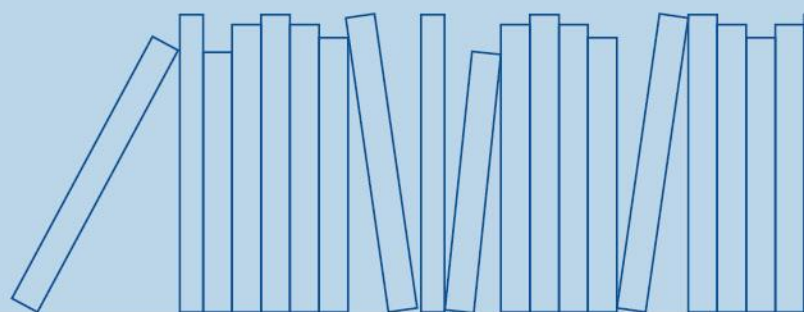


Economic Commission for Latin America and the Caribbean
ECLAC OFFICE IN WASHINGTON, D.C.



U.S. Economic Outlook

Quarterly developments



UNITED NATIONS



Washington, D.C., 1 July 2019

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This document was prepared by Helvia Velloso, Economic Affairs Officer, under the supervision of Inés Bustillo, Director, ECLAC Washington Office.

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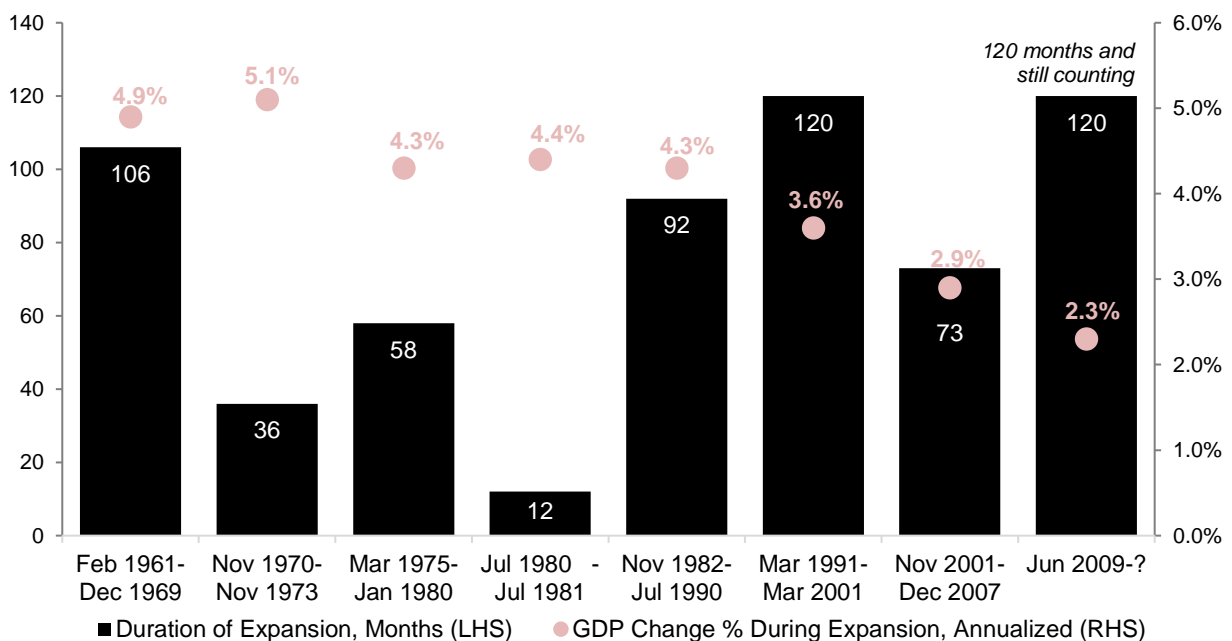
Highlights

- In the first quarter of 2019, the U.S. economy grew at an above-trend annualized rate of 3.1%, despite the government shutdown and concerns about residual seasonality. Growth was driven by exports and a buildup in inventories.
- In May, U.S. employers added just 75,000 jobs, one of the smaller gains since the recession ended in mid-2009.
- U.S. consumer price inflation moderated in May, suggesting inflationary pressures remain muted. Over the last 12 months, the all items Consumer Price Index (CPI) rose 1.8%. The core CPI was up 2.0%.
- The U.S. current account deficit fell to US\$ 130 billion in the first quarter of 2019 (2.5% of GDP), from US\$ 144 billion in the fourth quarter. Despite the decline, the current account deficit in the first quarter of 2019 is the second largest of the past decade.
- The Federal Open Market Committee (FOMC) kept the target range for the fed funds rate steady but indicated in its statement that it could soon cut it to help sustain the economic expansion.
- Trade risks and the uncertainty they create have prompted predictions of Fed rate cuts in the second half of the year. While the U.S. economy is still growing at a relatively strong pace, with unemployment at record lows, escalating trade disputes have heightened concerns about a looming downturn.
- June marks the 10th anniversary since the end of the last recession. In July, the current expansion will become the longest on record.

Overview

The current economic expansion is turning ten years old, as June becomes the 120th month of consecutive growth for the U.S. economy. It is now the longest U.S. expansion on record, tied with the March 1991 to March 2001 expansion, and on its way to break this record. However, growth has been shallower than in previous expansions (chart 1).

CHART 1:
THE CURRENT U.S. EXPANSION: LONG IN DURATION BUT LACKING VIGOR
(Number of Months, Percentage)



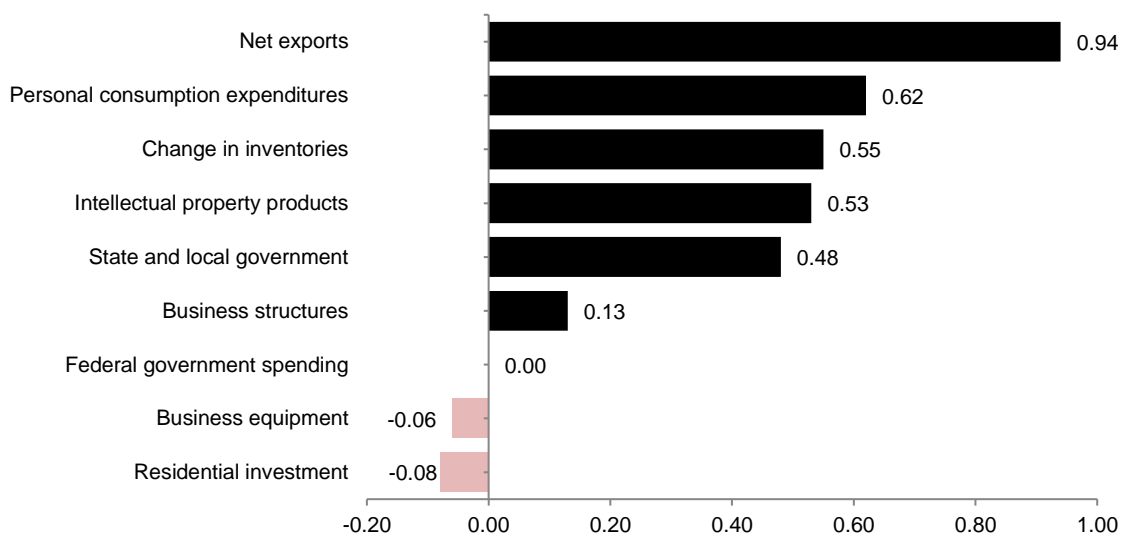
Source: ECLAC Washington Office, based on data from the National Bureau of Economic Research (NBER) and the Bureau of Economic Analysis (BEA), Commerce Department.

While the U.S. expansion is in position to keep going, risks are increasing. Among the most notable are threats of tariff-driven trade wars with China, Mexico and others that could damage business, household and investor confidence. The administration’s announcement at the end of May of possible tariffs of up to 25% on Mexico as retaliation for illegal immigration¹ – combined with growing concern over a prolonged trade war with China – alarmed bond markets, which began to fear that further escalation in trade disputes would pave the way for a material slowdown in the U.S. economy. Although the U.S. administration has recently announced a deal with Mexico to avoid the imposition of tariffs, business executives and investors are still trying to figure out how global trade may be reshaped by these policies, fearing that trade tariffs have become a more permanent policy tool.

Federal Reserve Chairman Jerome H. Powell has said that the central bank is prepared to act to sustain the economic expansion if needed, but the Fed may be in a difficult spot. Growth remains above its longer-run trend and the job market is strong, which would suggest there is no need for interest rate cuts. Moreover, the trade disputes could be resolved quickly, removing a major obstacle to continued expansion. On the other hand, if trade tensions continue to escalate and a global slowdown drags on the U.S. economy, the Fed’s recession-fighting ammunition is limited, as interest rates are still historically low. Futures-implied probability of Federal Reserve action suggest that there is a greater-than-even probability that the Fed will trim interest rates as soon as its July meeting.² At the start of May, the Fed funds futures market indicated only a 19% chance of a cut in July.

Despite the recent increase in market uncertainty, U.S. economic growth has been solid. Gross domestic product expanded at a seasonally and inflation-adjusted annual rate of 3.1% in the first quarter of 2019, according to the Commerce Department’s second estimate released at the end of May, driven by exports and a buildup of inventories (chart 2). Moreover, U.S. retail sales rose for a second straight month in May, suggesting that consumer sentiment remains positive.

CHART 2:
CONTRIBUTIONS TO U.S. GROWTH: Q1 2019
(Percentage)



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

¹ According to communication from the White House, a 5% tariff would be imposed on all imports from Mexico starting June 10 and tariff duties would continue to rise by 5% a month to a ceiling of 25% in October, if pending immigration issues were not resolved.

² Fed funds futures are derivatives contracts that investors use to wager on or hedge against interest movements.

However, the boost to first-quarter growth from a smaller trade gap and a buildup in inventories could dent output in the second quarter if companies draw down on their stockpiles rather than place new orders. Considering the large inventory build and the potential impact of new and proposed tariffs on businesses inventory decisions, GDP growth could become more volatile. Market projections for second-quarter growth suggest a significant slowdown from the first-quarter pace, pointing to a 1.8% growth rate on average (table 1). The Federal Reserve of Atlanta’s GDPNow model at the end of May predicted a GDP growth rate of 1.3% in the second quarter. It is currently forecasting a 1.5% growth rate (as of July 1).

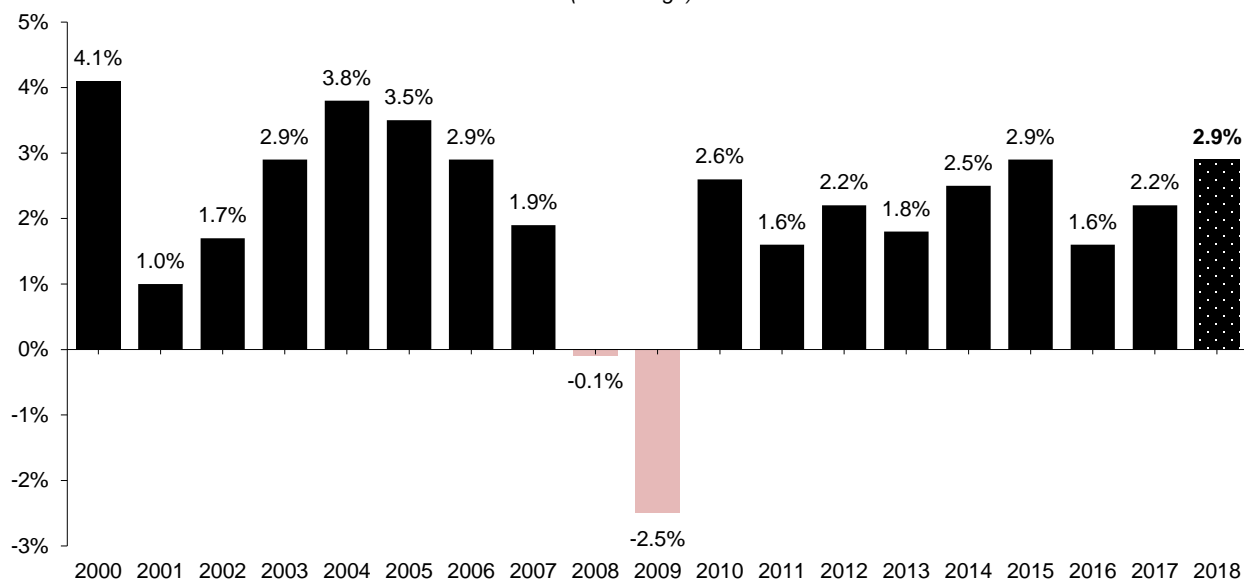
**TABLE 1:
QUARTERLY FORECASTS FOR U.S. ECONOMIC GROWTH**

	Q2 2019 (qoq)	Q3 2019 (qoq)	Q4 2019 (qoq)	Date of Forecast
<i>What Markets Say</i>				
Bank of America/Merrill Lynch	1.8%	1.7%	1.8%	May-19
J.P. Morgan	1.0%	1.5%	1.8%	May-19
Moody's Economy.com	1.7%	2.5%	2.3%	May-19
Mortgage Bankers Association	1.7%	2.3%	2.0%	May-19
National Association of Realtors	1.6%	2.0%	2.7%	Jun-19
National Bank of Canada	1.4%	2.0%	1.6%	Jun-19
TD Bank Financial Group	2.8%	2.3%	2.2%	Mar-19
Wells Fargo/Wachovia	2.4%	2.2%	2.5%	May-19
<i>Forecasts average</i>	1.8%	2.1%	2.1%	

Source: ECLAC Washington Office, based on several market sources.

Many economists expect a more muted pace of growth in 2019 due to weaker global growth and waning effects of the 2017 tax-cuts, although the U.S. economy still has strong support from low unemployment and rising incomes. On average, market projections point to growth of 2.4% in 2019 and 1.8% in 2020 (table 2), what compares with growth of 2.9% in 2018 (chart 3).

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



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

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

		Real GDP (% change, y/y)		CPI (% change, y/y)		Unemployment Rate (%)		FED Funds Rate (%)		Date of Forecast
		2019	2020	2019	2020	2019	2020	2019	2020	
A. What Government Agencies Say										
	FED*	2.1%	1.9%	1.8%	2.0%	3.7%	3.8%	2.4%	2.6%	Mar-19
	CBO	2.7%	1.9%	2.1%	2.6%	3.5%	3.7%	na	na	Jan-19
	OMB	3.2%	3.1%	2.1%	2.3%	3.6%	3.6%	na	na	Mar-19
B. What Markets Say										
	Bank of America/Merrill Lynch	2.5%	1.8%	1.7%	1.9%	3.6%	3.4%	2.38%	na	May-19
	Capital Economics	2.0%	1.4%	1.5%	1.8%	4.0%	4.6%	2.13%	1.63%	Apr-19
	JPMorgan	2.3%	na	1.9%	na	3.6%	na	2.00%	na	May-19
	Moody's Economy.com	2.6%	1.7%	2.0%	2.1%	3.6%	3.4%	2.44%	2.69%	May-19
	Mortgage Bankers Association	2.3%	1.5%	2.0%	2.0%	3.6%	3.7%	2.38%	2.38%	May-19
	National Association of Realtors	2.2%	2.0%	1.3%	1.8%	3.8%	4.1%	2.40%	2.40%	Jun-19
	National Bank of Canada	2.5%	1.9%	1.8%	2.0%	3.7%	3.6%	2.50%	2.75%	Jun-19
	TD Bank Financial Group	2.4%	2.0%	2.0%	2.1%	3.7%	3.7%	2.50%	2.50%	Mar-19
	The Economist Intelligence Unit	2.2%	1.7%	2.2%	1.4%	4.0%	4.6%	na	na	May-19
	Wells Fargo/Wachovia	2.7%	2.1%	1.9%	2.3%	3.7%	3.6%	2.50%	2.44%	May-19
	Market Average	2.4%	1.8%	1.8%	1.9%	3.7%	3.9%	2.4%	2.4%	
C. What International Organizations Say										
	United Nations DESA (Baseline)	2.3%	2.1%	na	na	na	na	na	na	May-19
	World Bank	2.5%	1.7%	na	na	na	na	na	na	Jan-19
	OECD	2.6%	2.2%	na	na	na	na	na	na	Mar-19
	IMF*	2.3%	1.9%	na	na	na	na	na	na	Jan-19

Source: ECLAC Washington Office based on official and market sources.

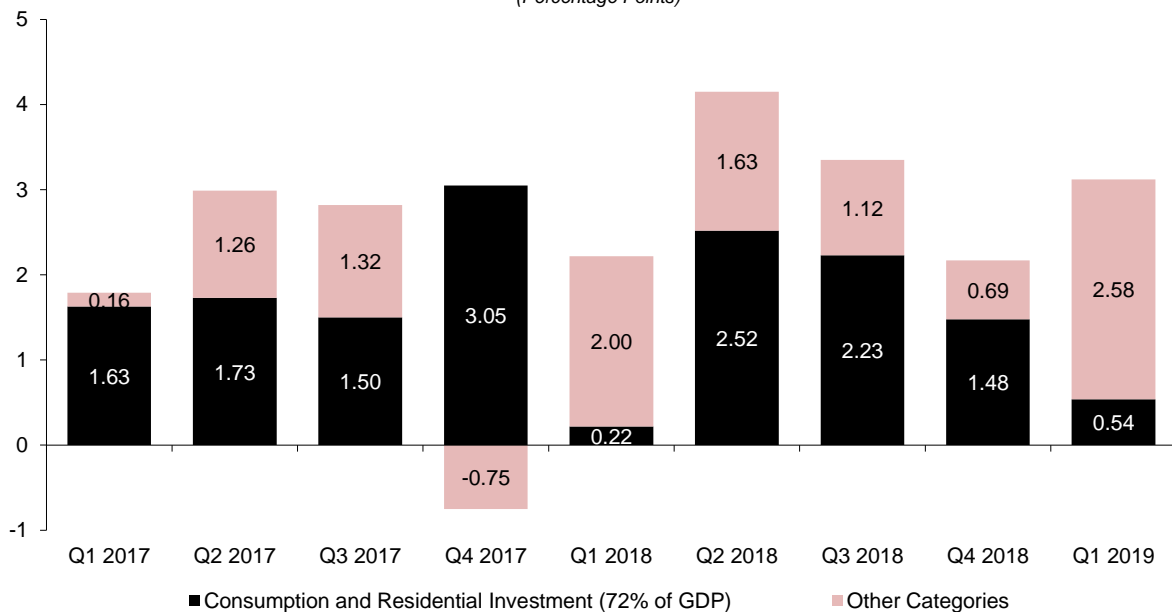
Note: FED: Federal Reserve; CBO: Congressional Budget Office; OMB: Office of Management and Budget (U.S. Administration's forecasts).

*Forecast for PCE inflation.

I. Quarterly Developments

U.S. growth improved in the first quarter of 2019 relative to the fourth quarter of last year and to the first quarter a year before. The contribution of the core of the U.S. economy – consumption and residential investment – lowered considerably in the first three months of 2019, held back by the slowdown in consumer spending, which contributed 0.62% to growth compared to a contribution of 1.66% in the fourth quarter of 2018, while residential investment subtracted -0.08% from first-quarter growth (chart 4).

CHART 4:
CONTRIBUTIONS TO U.S. REAL GDP GROWTH
(Percentage Points)

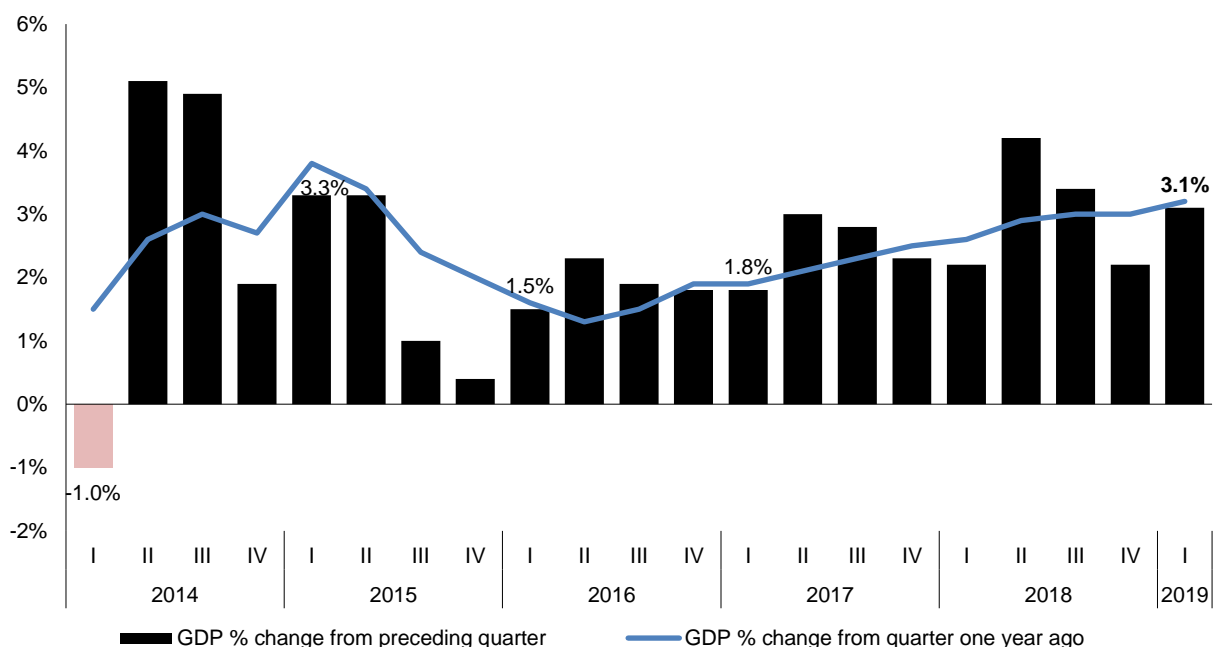


Source: ECLAC Washington Office, based on data from the Bureau of Economic Analysis, U.S. Department of Commerce.
Note: Contributions to growth are measured at seasonally adjusted annual rates.

A. GDP Growth

According to the third and final estimate released by the U.S. Department of Commerce on 27 June 2019, the U.S. economy grew at an annual rate of 3.1% in the first quarter, following an increase of 2.2% in the previous quarter. This was the fastest first-quarter growth since 2015 (chart 5). Growth is expected to slow in the second quarter. As of July 1, the Federal Reserve Bank of Atlanta's *GDPNow* model is predicting a GDP growth rate of 1.5% in the second quarter. The U.S. government will release its initial estimate for second-quarter GDP on July 26.

CHART 5:
U.S. REAL GDP: QUARTERLY GROWTH
(Percentage Points)



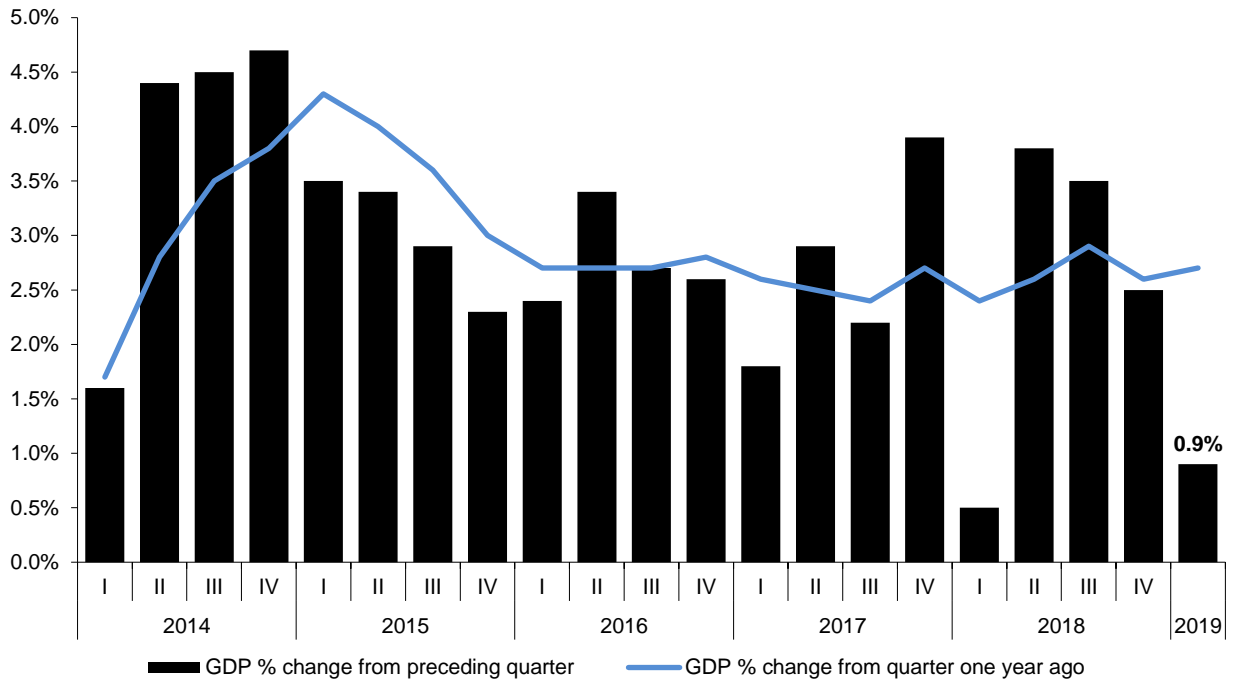
Source: ECLAC Washington Office, based on data from the Bureau of Economic Analysis, U.S. Department of Commerce.

The increase in real GDP growth in the first quarter reflected positive contributions from personal consumption expenditures, private inventory investment, exports, state and local government spending, and nonresidential fixed investment, which were partially offset by a negative contribution from residential fixed investment. Imports, which are a subtraction in the calculation of GDP, decreased.

The largest component of GDP, real personal consumption expenditures (PCE), grew only 0.9% in the first quarter of 2019, after increasing 2.5% in the fourth quarter of 2018 (chart 6). Still, consumer spending was the second biggest driver of growth, contributing 0.62% to growth in the first quarter. This was a smaller contribution than in the fourth quarter, when PCE contributed 1.66% to growth.

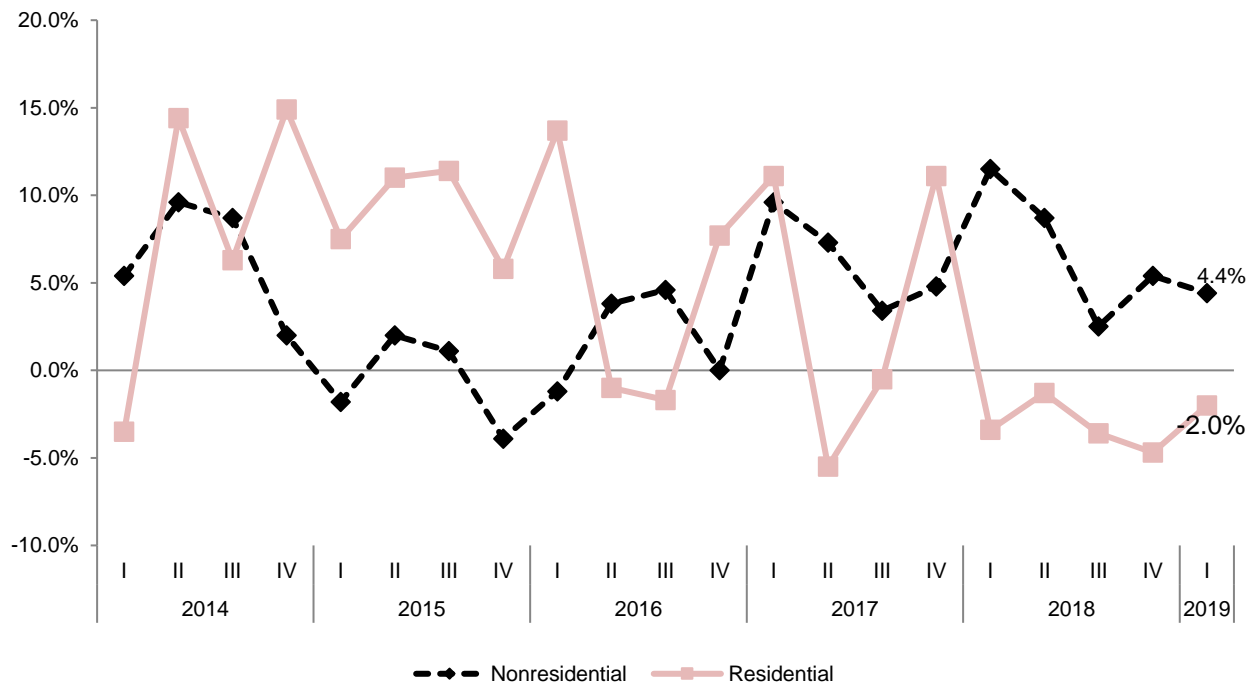
Fixed investment added 0.53% to growth in the first quarter. The change in private inventories added 0.55% to the first quarter change in real GDP, after adding 2.33% and 0.11% in the third and fourth quarters of 2018, respectively, and it was the third biggest driver of growth in the first quarter. Overall, gross private domestic investment increased at a 6% annual rate, adding 1.08% to first-quarter GDP growth (with 0.53% due to business fixed investment – 0.61% from nonresidential and -0.08% from residential – and 0.55% due to inventories).

CHART 6:
PERSONAL CONSUMPTION EXPENDITURE: QUARTERLY GROWTH
(Percentage Points)



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

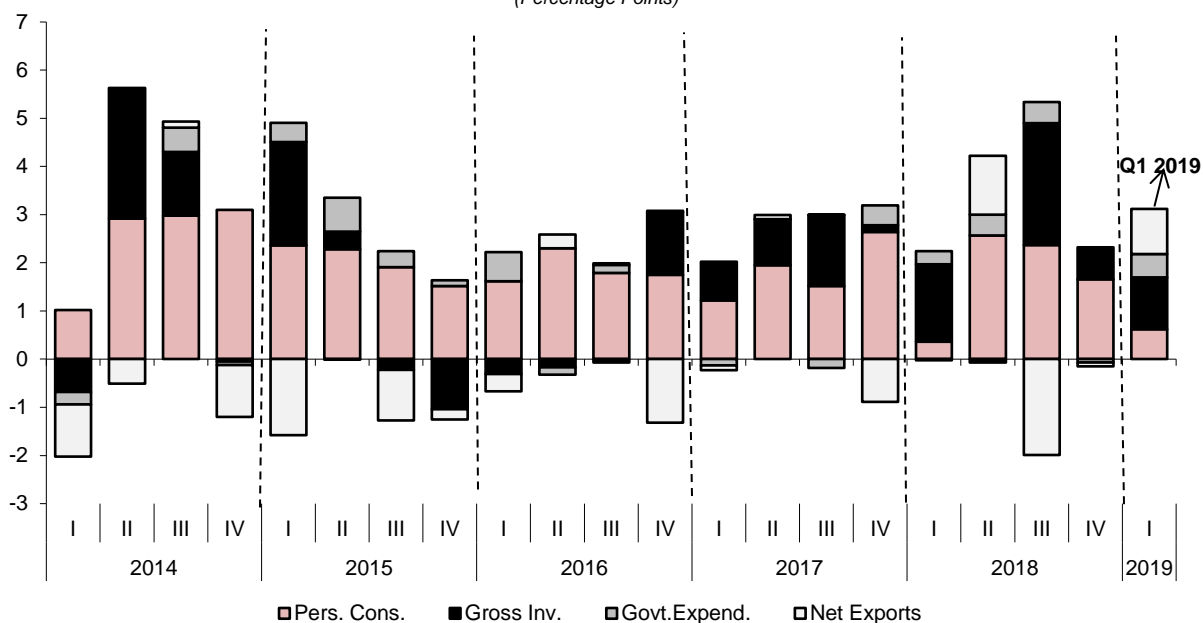
CHART 7:
GROSS PRIVATE DOMESTIC INVESTMENT: QUARTERLY GROWTH
(Percentage Points)



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

Overall, government spending increased 2.8% and added 0.48% to growth in the first quarter. State and local government spending increased 4.6% and federal outlays showed no increase (0%) in the first quarter (national defense spending increased 4%, while nondefense spending fell (-5.8%)). Finally, net exports were the biggest driver of growth, contributing 0.94% to growth in the first quarter. Exports increased 5.4% and imports declined 1.9%, adding 0.65% to and 0.30%, respectively, to first-quarter growth (chart 8).

**CHART 8:
CONTRIBUTIONS TO REAL GDP GROWTH**
(Percentage Points)



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

The first-quarter numbers show that the U.S. economy continues to grow at a steady pace. The economy grew at an above-trend pace despite the partial government shutdown and residual seasonality temporarily reducing growth. Real GDP growth has slowed from the middle of last year, when it was driven by deficit-financed tax cuts, but looks to be settling near the pace of just over 2% that has prevailed throughout much of this nearly record-long expansion. The U.S. economy has also received a little help from the Federal Reserve's hard pivot away from interest rate hikes since the beginning of the year. The Fed increased the federal funds rate four times last year, a quarter-percentage point each time, and as recently as late last year was on track to raise rates several more times this year and early next year. Now, no rate hikes are expected this year and few, if any, are expected next year. This boosts the outlook for rate-sensitive sectors of the economy, including housing.

B. Industrial production

U.S. industrial production rose in May, a welcome sign of strength in the sector following a spate of weak readings this year. Industrial production, a measure of factory and utility output, rose a seasonally adjusted 0.4% in May from April, according to data from the Federal Reserve (table 3). From a year earlier, industrial production rose 2% in May, while capacity utilization increased by 0.2% to 78.1%. Manufacturing output rose a modest 0.2%. In the first four months of the year it had decreased about 0.4% a month on average. The manufacturing industry's output accounts for about 75% of the total industrial output.

**TABLE 3:
U.S INDUSTRIAL PRODUCTION**

	Total Industrial Production		Capacity Utilization Rate
	Index 2012=100	Percentage Change From Previous Period	Total Industry (%)
2018 Q4	110.3	3.9	79.4
October	109.9	0.2	79.3
November	110.5	0.5	79.6
December	110.6	0.0	79.5
Annual	108.6	3.9	78.7
2019 Q1	109.7	-2.2	78.6
January	110.1	-0.4	79.0
February	109.5	-0.6	78.4
March	109.6	0.1	78.4
2019 Q2	na	na	na
April	109.2	-0.4	77.9
May	109.6	0.4	78.1

Source: ECLAC Washington Office, based on data from U.S. Federal Reserve, Industrial Production and Capacity Utilization
Note: Quarterly changes are at annual rates. Annual changes are calculated from annual averages.

U.S. manufacturers have faced higher costs for many components and metals because of U.S. tariffs on goods from China and a strong dollar that makes U.S. exports more expensive. Though manufacturing accounts for a small share of GDP, the sector is highly sensitive to shifts in global demand, making it a bellwether for the broader U.S. economy.

The ISM manufacturing index unexpectedly fell from 52.8 in April to 52.1 in May, the lowest reading since October 2016, as manufacturers confronted renewed trade tensions and slowing growth abroad. New orders increased from 51.7 to 52.7, but production, inventories and supplier deliveries all declined. Manufacturing is unlikely to quickly turn around, but even with the recent declines, the ISM manufacturing survey remains above its expansionary threshold of 50 and well above the recessionary threshold of 42.9.

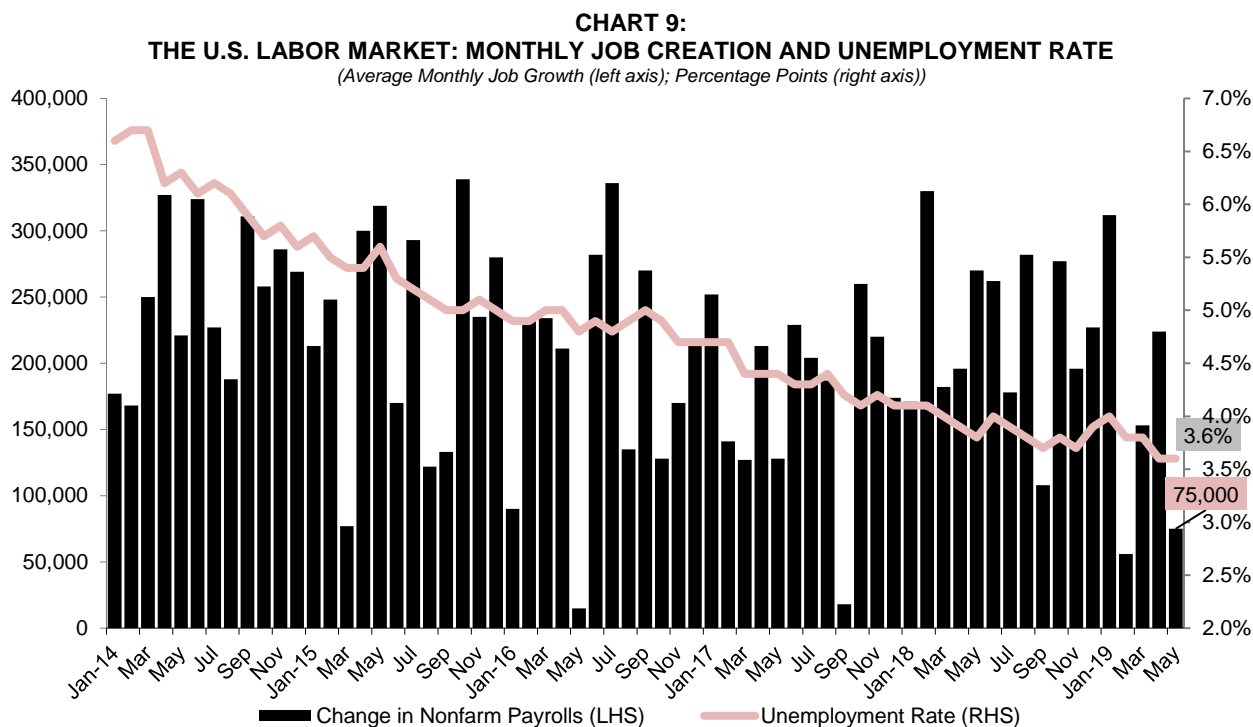
According to another survey, the Empire State Manufacturing Index, June showed the sharpest one-month decline in the top-line general business conditions index in its nearly two decade history. The index fell more than 26 points to -8.6, its first negative reading since late 2016. Demand indexes and labor market indicators followed suit, signaling that trade tensions may be taking a significant toll. This was much more than the decline the market was expecting (from 17.8 to 11). Breaking the index down, almost all of the sub-indexes declined, and the employment index registered its first negative result in two years.

C. Labor market

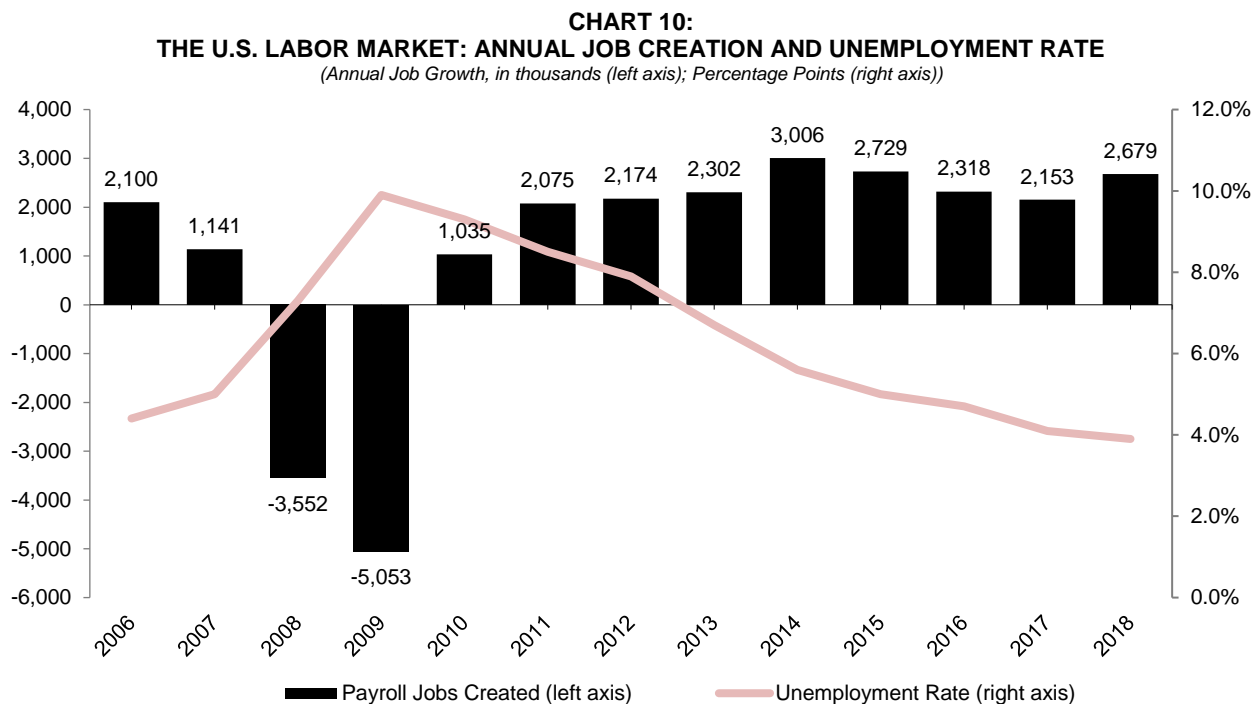
The U.S. economy added 75,000 jobs in May (chart 9), slowing significantly from a month earlier. May hiring was far lower than the median 185,000 predicted by economists. Employment gains in March and April were also revised lower, meaning 75,000 fewer jobs were added than previously reported. The slowdown signals companies are taking a more cautious approach at a time of cooling global growth and rising trade tensions. The May employment report adds to signs the U.S. economy was cooling even before the recent escalation in trade tensions, and should contribute to intensify the debate over whether the Fed will lower interest rates to sustain a decade-long expansion and counter the drag from trade disputes.

Trend job growth has also slowed, averaging 164,000 over the past five months, compared to an average of 223,250 in 2018. The average jobs growth for the first quarter of 2019 was 174,000 a month. Last year 2.7 million jobs were created (chart 10), while 820,000 jobs were created from January to May 2019.

The unemployment rate held steady at 3.6%, its lowest level since 1969, as did the participation rate at 62.8%. Average hourly earnings were up 3.1% on a year-ago basis in May, drifting down since hitting a post-recession peak of 3.4% in February (chart 11).

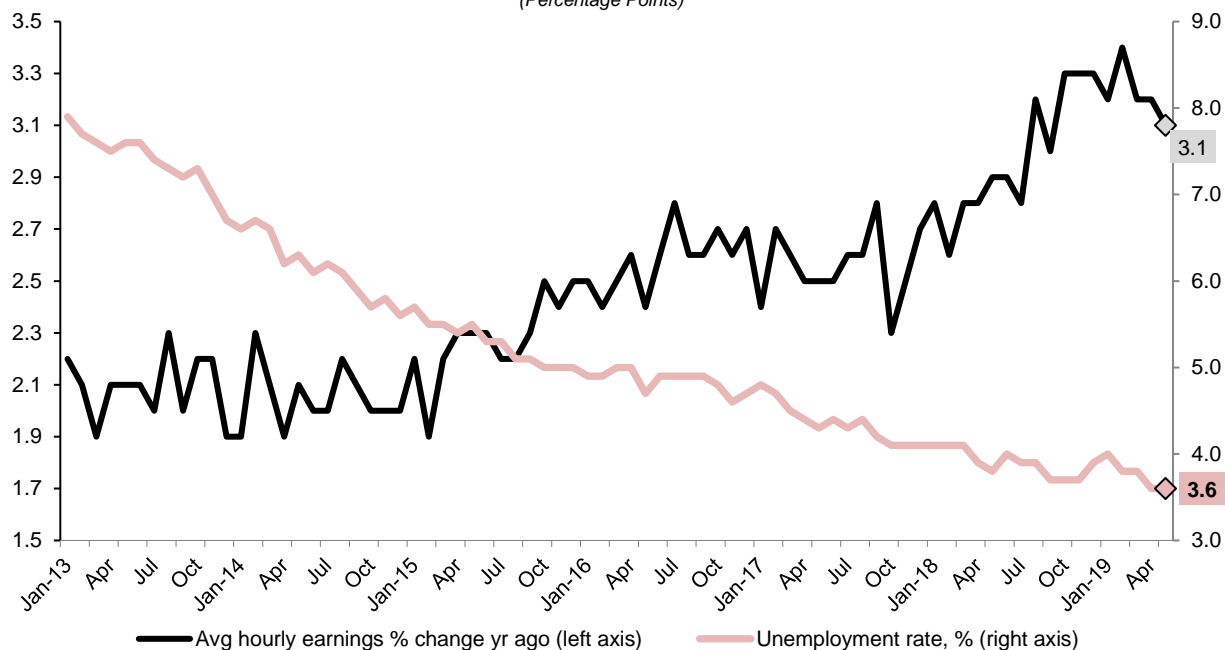


Source: ECLAC Washington Office, based on data from the U.S. Bureau of Labor Statistics.



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

CHART 11:
U.S. UNEMPLOYMENT RATE AND AVERAGE HOURLY EARNINGS
(Percentage Points)



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

Nonfarm productivity increased 3.4% at an annualized rate in the first quarter of 2019 (table 4). Productivity growth is very volatile from quarter to quarter and year to year. Still, trend productivity growth is showing some signs of improvement.³ Through the first quarter, productivity growth is now averaging more than 1% over the past five years. Trend productivity growth had been consistently running south of 1% since 2014.

TABLE 4:
U.S. PRODUCTIVITY AND COSTS

Productivity and costs: Revised first-quarter 2019 annual averages (Seasonally adjusted annual rates)							
Sector	Percentage change from:	Labor Productivity	Output	Hours Worked	Hourly compensation	Real hourly compensation	Unit labor costs
Nonfarm business	Previous quarter	3.4	3.9	0.5	1.8	0.9	-1.6
	A year ago	2.4	3.9	1.5	1.5	-0.1	-0.8
Business	Previous quarter	3.5	3.9	0.4	1.9	1.0	-1.5
	A year ago	2.4	3.9	1.4	1.6	-0.1	-0.8
Manufacturing	Previous quarter	0.4	-2.0	-2.4	2.4	1.5	2.0
	A year ago	0.8	1.6	0.7	0.9	-0.8	0
Durable	Previous quarter	-0.6	-2.8	-2.2	2.1	1.1	2.7
	A year ago	1.0	2.4	1.5	0.4	-1.3	-0.6
Nondurable	Previous quarter	1.6	-1.1	-2.6	3.1	2.2	1.5
	A year ago	1.1	0.6	-0.5	1.6	0	0.5

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

³ However, according to Moody's, it's possible that the partial government shutdown in January may have contributed to the larger than expected gain in productivity growth because of compositional issues. Productivity growth was also strong in the quarter in which the 2013 government shutdown occurred.

On a year-ago basis, productivity was up 2.4% in the first quarter. Unit labor costs fell 1.6% at an annualized rate in the first quarter (previously down 0.9%). This leaves them down 0.8% on a year-ago basis (chart 12). According to Moody’s Analytics, of the various wage measures that feed into its wage tracker, unit labor costs remain the outlier.

CHART 12:
U.S. NONFARM BUSINESS SECTOR: PRODUCTIVITY VS UNIT LABOR COSTS
(Percentage change from same quarter a year ago)



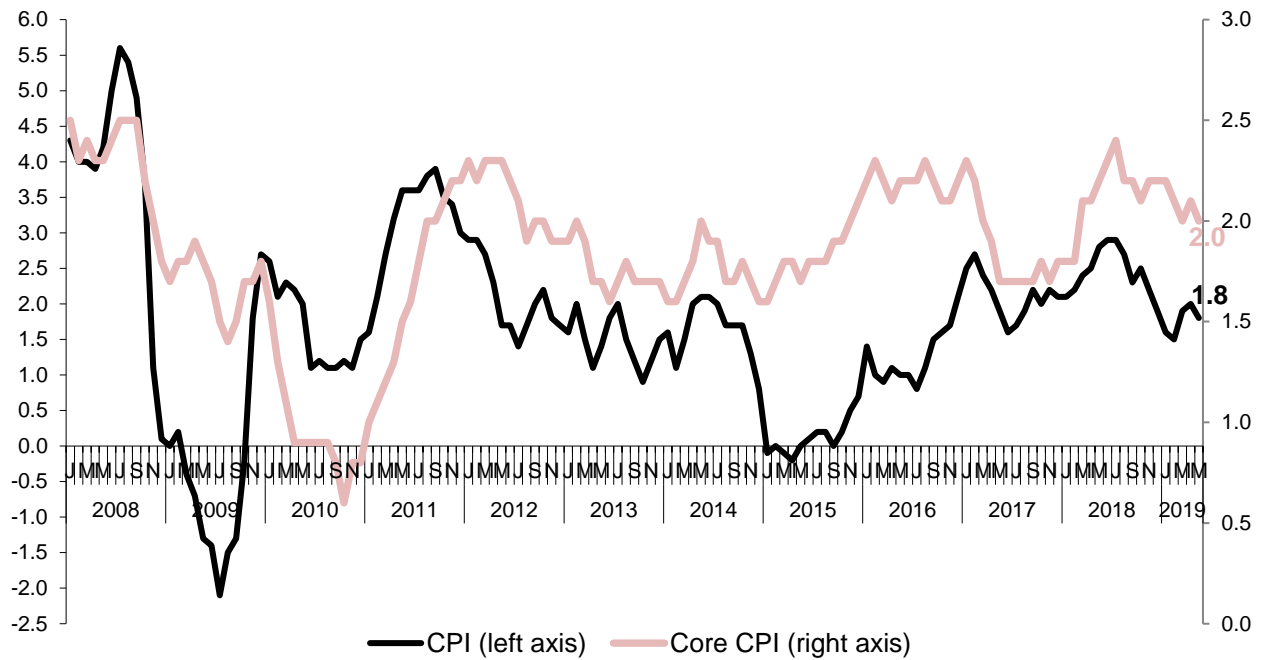
Source: ECLAC Washington Office, based on data from the U.S. Bureau of Labor Statistics.

D. Inflation

U.S. inflation slowed in May, restrained by weakening price pressures almost across the board, particularly for gasoline and other energy products. The May reading suggests inflationary pressures remain muted, potentially reinforcing calls for the Federal Reserve to cut interest rates this year. In May 2019, the Consumer Price Index for All Urban Consumers (CPI-U) increased 0.1% on a seasonally adjusted basis, after posting a 0.3% gain in April. The CPI for energy was down -0.6% in May, while food prices were up 0.3%. The index for all items less food and energy increased 0.1% for the fourth consecutive month. The all items index increased 1.8% for the 12 months ending in May. The index for all items less food and energy rose 2.0% over the last 12 months (chart 13). Core inflation has fallen from its recent high of 2.4% in July 2018, despite the strong labor market delivering wage gains for workers.

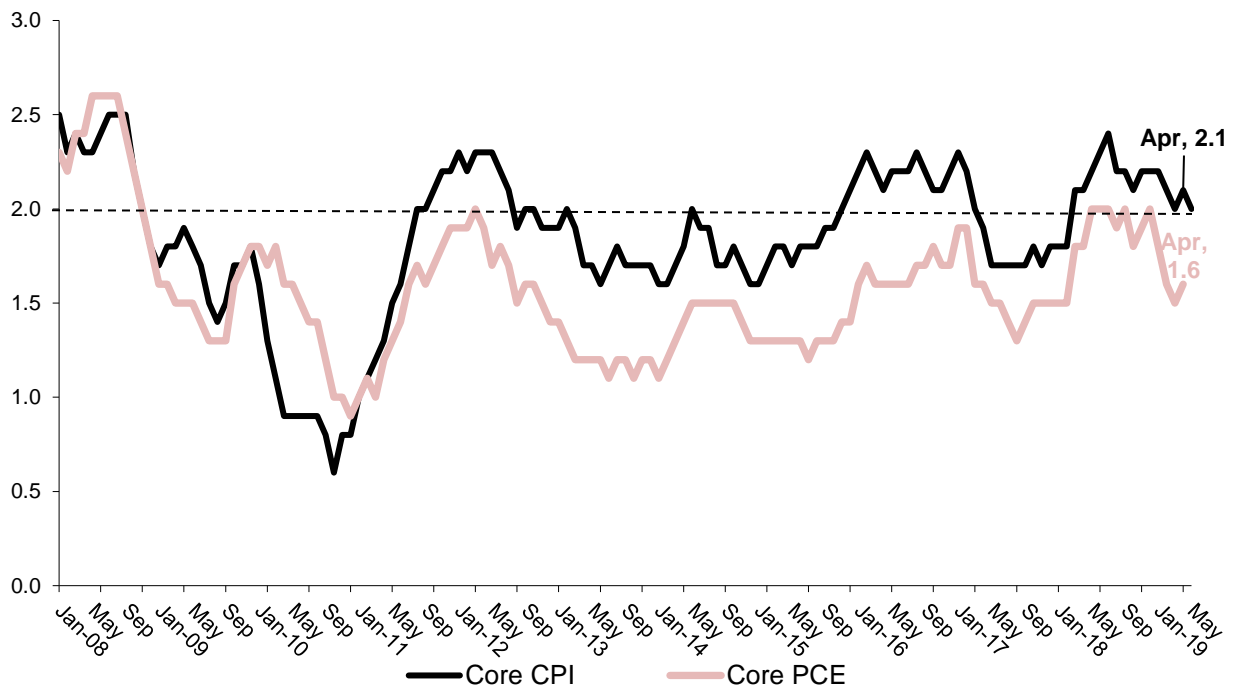
The most closely watched measure by the Federal Reserve – the Personal Consumption Expenditure (PCE) core price index– increased at an annualized 1.0% in the first quarter. In April, the last monthly reading available, the core PCE advanced at 1.6% (chart 14). Year-over-year growth in the core PCE deflator was 0.5% below the core CPI, equal to the historical average according to Moody’s.

CHART 13:
U.S. DOMESTIC PRICES: MONTHLY EVOLUTION
(CPI-U Unadjusted 12-month Percent Change)



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

CHART 14:
U.S. CORE CONSUMER PRICE INDICES
(Year-over-year Percentage Change)



Source: ECLAC Washington Office, based on 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.

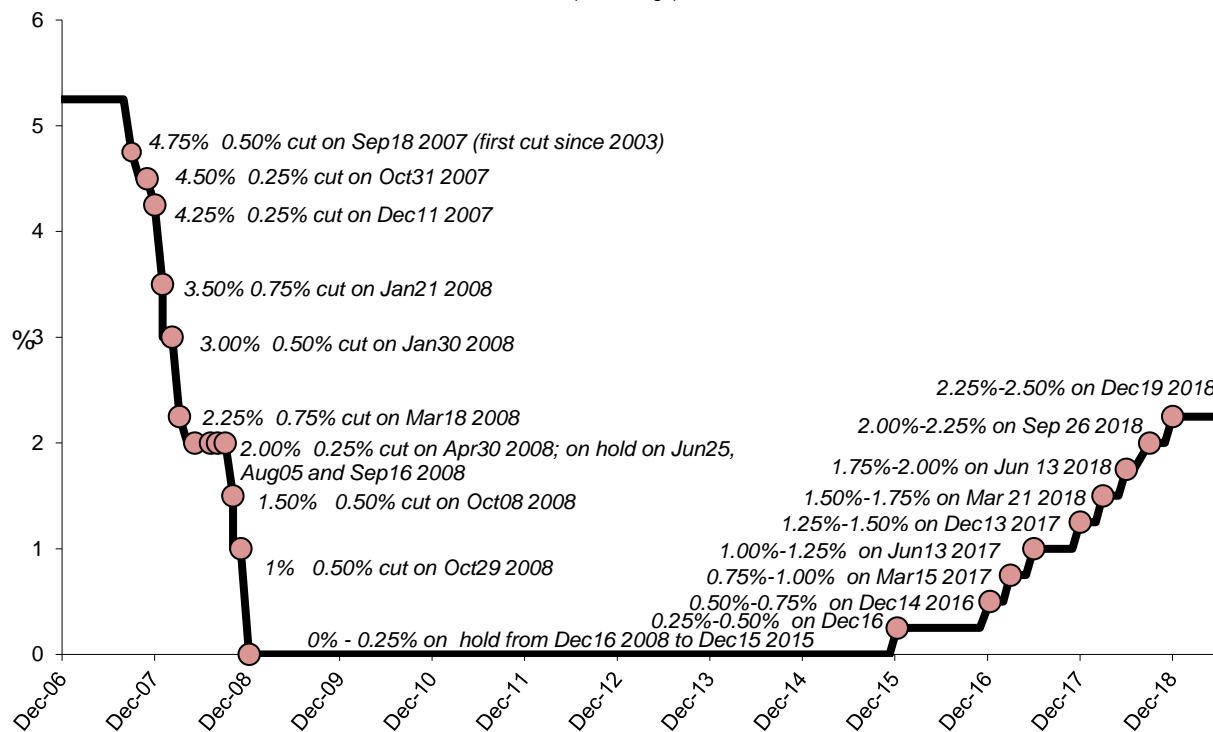
E. Monetary policy

After the Federal Reserve spent the past three-and-a-half years normalizing interest rates following the vast monetary stimulus of the post-crisis decade, a possible reverse of course is anticipated. Last December, the Fed put the plans for further tightening on hold, in what was described as a pivot towards a more “patient” approach to interest rate hikes, after equity markets dropped sharply. Yet as recently as March, Fed officials were still expecting to resume rate rises in 2020, according to the dot plots.

During the Federal Open Market Committee (FOMC) meeting on June 18-19, officials had to weigh the impact of trade disputes and guide the markets towards their next move. The Federal Open Market Committee (FOMC) kept the target range for the fed funds rate steady but indicated in its statement that it could soon cut it. The statement was dovish, and the dot-plot was even more so, sifting down substantially. Seven members now expect two rate cuts to be warranted in 2019 (and one additional member expects one rate cut this year). The core PCE forecast for this year was downgraded to 1.8% from 2%. In the statement, FOMC officials removed the “patient” language. Regarding financial markets’ reaction, Treasury notes and equities rallied, while the U.S. dollar depreciated among most currencies. A rate cut by the July 31st meeting is now fully priced in, although a slim majority of the FMOC still expects no rate cut in 2019. One of the Fed’s biggest challenges is that incoming economic data has not offered a crystal-clear case for a particular course of action.

Fed officials are looking at the current situation through the frame of the 1990s. Alan Greenspan, then Chair of the Fed, cut rates in two cycles, first in 1995 and then in 1998 during the Asian financial crisis, to help sustain the U.S. expansion. According to the Fed vice-chairman, Richard Clarida, in a recent interview, “in past episodes, in the 1990s, we did have insurance cuts by the Fed,” he said, adding that “that has been in the monetary policy toolkit in the past.”

CHART 15:
U.S. FEDERAL FUNDS TARGET RATE
(Percentage)



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

F. Financial conditions

Following the FOMC statement, 2- and 10-year Treasury bond yields fell, with 10-year bond yields at 2.03%, the lowest level since the end of 2016. Equities also went up slightly. The market is now pricing a rate cut in the next FOMC meeting at the end of July.

In the first quarter of 2019, the Dow Jones Industrial Average, the S&P 500, and NASDAQ gained 8%, 9%, and 12%, respectively. In the first five months of the year they gained 8%, 11% and 14.5%, respectively (table 5). U.S. Treasury security yields have declined, especially short-term maturities. In the first five months of 2018, 3-year Treasury yields fell 19%, while 10-year and 30-year Treasury yields declined 15% and 12%, respectively.

TABLE 5:

STOCK PRICES				U.S. TREASURY SECURITY YIELDS			
Monthly Stock Prices				Constant Maturities			
Dow Jones				Monthly Yields			
	Industrial	S&P 500	Nasdaq		3-year	10-year	30-year
2018	Average			2019			
December	23,805.55	2,567.31	6,814.29	December	2.67	2.83	3.1
2019				2019			
January	24,157.80	2,607.39	6,979.66	January	2.52	2.71	3.04
February	25,605.53	2,754.86	7,430.08	February	2.48	2.68	3.02
March	25,722.62	2,803.98	7,629.37	March	2.37	2.57	2.98
April	26,401.58	2,903.80	7,993.15	April	2.31	2.53	2.94
May	25,744.79	2,854.71	7,804.82	May	2.16	2.40	2.82

Source: Economic Indicators, U.S. Government

There seems to be a divergence in views inside the bond market. While government bond yields suggest that the global economy may be in worse shape and could soon be in even deeper trouble, junk bonds, which should be acutely sensitive to any signs of economic trouble, have hit a new record high. Even triple C-rated debt has returned over 8% this year. Some argue that government bonds, credit and equities are not really differing and instead are all pricing in the likelihood of an economic slowdown that will force central banks, led by the Federal Reserve, to ease policy, forestalling a full recession.

G. Fiscal policy

According to the Treasury Department, government tax revenue continued to rise in May thanks to a strong labor market, but not enough to offset higher federal outlays. The U.S. budget gap widened in May as a result, as government spending outpaced tax collection. The budget deficit has increased 39% during the first eight months of the fiscal year. The U.S. government ran a US\$ 739 billion deficit from October 2018 through May 2019, compared with US\$ 532 billion the same period a year earlier.

The Treasury Department says that about half of the increase in deficit was due to a shift in the timing of certain federal payments, which made the deficit appear larger. If not for that, the deficit would have risen just 19% in the first eight months of fiscal 2019, which started October 1.

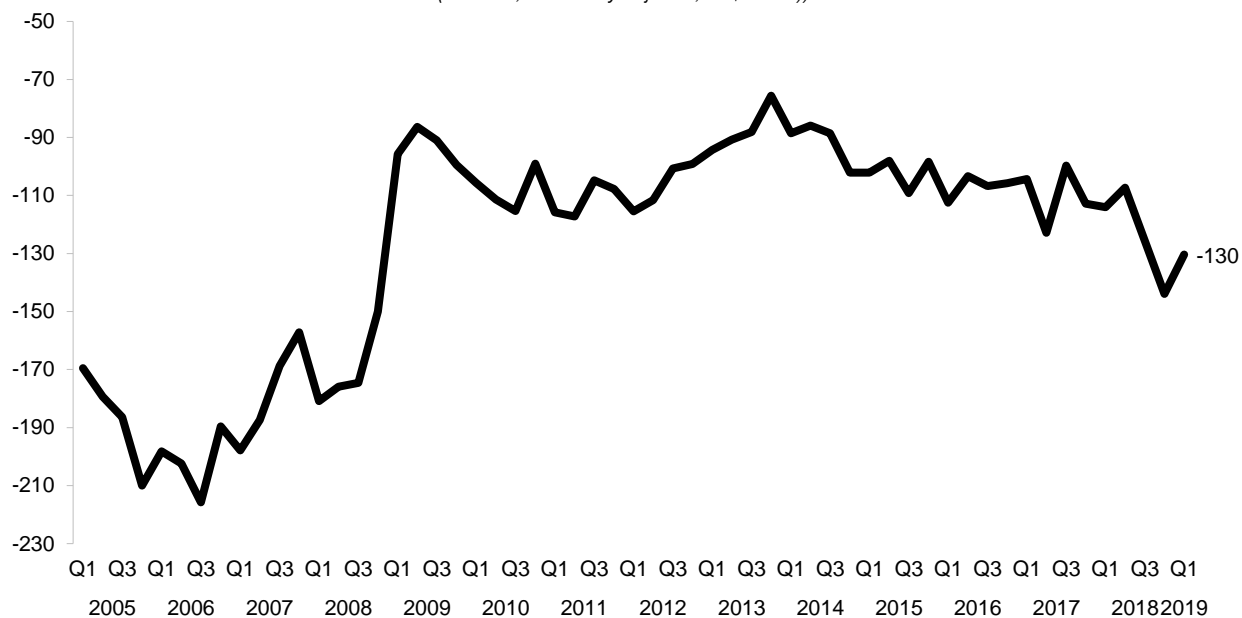
Deficits typically shrink when the economy is strong as more people find jobs and see their wages rise, lowering spending on safety-net programs such as unemployment insurance and boosting tax receipts. However, the 2017 tax cuts constrained revenues last year and a two-year congressional budget deal increased federal spending, pushing annual deficits toward US\$ 1 trillion. For the 12 months ended in May, the deficit totaled US\$ 985.3 billion, or 4.7% as a share of GDP, the highest since May 2013.

H. 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, fell to US\$ 130.4 billion in the first quarter of 2019, from US\$ 143.9 billion in the fourth quarter. The quarterly decline in the current account deficit was mainly driven by a US\$ 15.8 billion decrease in goods deficit, the largest component of the current account, reflecting lower imports and slightly higher exports. Despite the decline, the current account deficit in the first quarter of 2019 is significantly greater than the US\$ 116.1 billion deficit a year earlier and is the second largest of the past decade (chart 16). As a percentage of GDP, the deficit decreased to 2.5% from 2.8% in the fourth quarter.

Higher deficits are, in part, the result of the advanced business cycle and strong U.S. economy. During good economic times, both consumers and business demand more imported goods, driving up the goods deficit. However, there remain considerable uncertainties surrounding trade policies, and trade tensions may continue to escalate, adding to economic costs.

CHART 16:
U.S. BALANCE ON CURRENT ACCOUNT
(Quarters, Seasonally Adjusted, US\$ Billion)



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

II. Recent U.S. trends and Latin American and Caribbean

Markets are pricing in Fed rate cuts this year, and expectations are that the first one could be delivered as early as in July. These developments have been supportive of emerging market and Latin American and Caribbean assets. In general, these assets have held much better since mid-May. These mechanics are expected to remain at work in coming weeks, on the assumption that there will be no further escalation in trade disputes and that the Fed will indeed deliver a rate cut in the second half of the year. Emerging market and Latin American and Caribbean assets have also been benefiting from falling U.S. real yields, which have curbed the U.S. dollar. Gains for the emerging market currencies against the dollar are now lending support to emerging market dollar-denominated credit.

Investors have said that U.S. tariffs on Mexican imports would likely thin out the deal pipeline in the bond market and have a negative impact on bonds in Latin America and the Caribbean. In particular, the threat has muted market expectations in Mexico, with large loans, IPOs and M&A deals expected to face setbacks.

III. Looking ahead

While economic growth was strong in the first quarter and the labor market has continued to add jobs, recent declines in business activity have suggested the economy is losing momentum, weighed by trade tensions and slowing global growth. Investors see global growth prospects at risk from increasingly uncertain trade developments. According to Capital Economics, an economic research company, after incorporating a further escalation in the U.S.-China trade dispute in their baseline forecasts and combined with previous measures, the trade dispute is likely to leave global GDP 0.5% lower than it would have otherwise been by the end of 2020.

Despite the strength of the U.S. economy concerns over economic growth are spreading, while global uncertainties and the lack of inflationary pressures are leading investors to pricing in interest rate cuts by the Federal Reserve this year, beginning as early as next month. Investors are also seeking the safety of U.S. government bonds on the biggest scale since the financial crisis.

Economists in the Wall Street Journal's latest monthly survey put the probability of a recession in the next 12 months at 30.1%, the highest level since late 2011, with nearly two-thirds naming trade or tariffs as the biggest downside risk to their forecast. Another worrying sign is that most of the U.S. yield curve is "inverted": that is, when long-term Treasury yields are lower than short-term ones. That has historically presaged economic downturns, and the New York Fed's own curve-derived model indicates that there is almost a 30% chance of a recession over the next 12 months. Activity in bond markets is likely to continue to be dominated by safe haven bids in the near future.

Regarding near-term challenges, Congressional leaders are negotiating a funding deal that includes an effort to lift stiff budget caps, avoid a shutdown and potentially raise the debt ceiling by the end of August. A bipartisan agreement would avert another government shutdown in the fall.



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