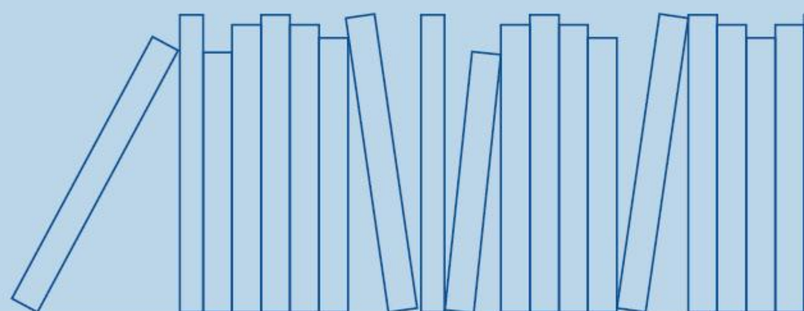
Economic Commission for Latin America and the Caribbean

ECLAC OFFICE IN WASHINGTON, D.C.

U.S. Economic Outlook

Quarterly developments



Washington, D.C., 17 November 2017

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

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Contents

Overview 5
I. Quarterly Developments 9
A. GDP Growth 10
B. Industrial production 13
C. Labor market 13
D. Inflation 16
E. Monetary policy 18
F. Financial conditions 19
G. External sector 20
II. Recent U.S. trends and Latin American and Caribbean 23
III. Looking ahead 25

Overview

The U.S. economic expansion remains on track and it has entered its ninth year. October marked the 100th month of growth for the U.S. economy. In about two years the current economic expansion will be the 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.

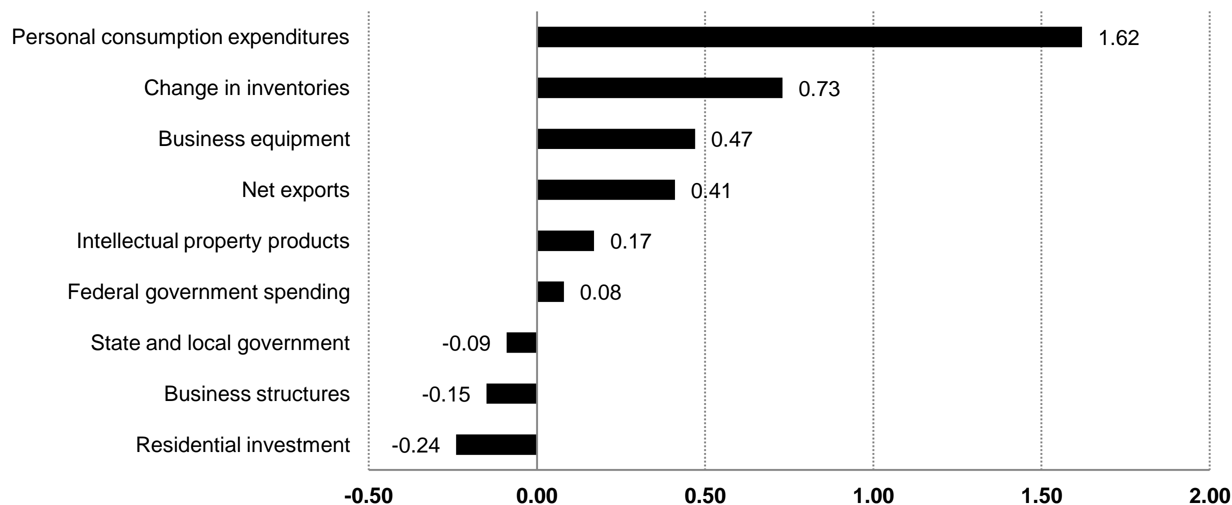
In the third quarter, the U.S. economy achieved a milestone: the output gap closed. This is the first time that the output gap, or the difference between the actual GDP (based on data by the U.S. Department of Commerce's Bureau of Economic Analysis) and the potential output (calculated by the U.S. Congressional 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.

Gross domestic product expanded at a seasonally and inflation-adjusted annual rate of 3% in the third quarter of 2017, according to the Commerce Department's advance estimate released at the end of October.[2] Following an expansion of 3.1% in the second quarter, this marks the U.S. economy's best six-month stretch since mid-2014. The third-quarter data reflected strong contributions from personal consumption, inventory investment and investment in business equipment, indicating resilient demand from consumers and businesses despite hurricane disruptions. Trade and federal government spending also made positive contributions (chart 1).

Forecasts for GDP growth in coming quarters show slightly slower growth (table 1), but no real headwinds are expected. The U.S. economy has been performing considerably better this year than in 2016, when it grew at 1.5%, in part because the economic situation has improved for much of the world, which is enjoying a rare moment of widespread expansion. Besides the global economy, demand from consumers and businesses are also supporting U.S. growth. Consumers are benefitting from a strong job market, their balance sheets are healthy and there is no shortage of credit. And businesses are being buoyed by a revival in corporate profitability, record stock prices, and low borrowing costs.

[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] This is the government's first estimate of economic output for the third quarter, and the figure will be revised twice.



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

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

	Q4 2017 (qoq)	Q1 2018 (qoq)	Q2 2018 (qoq)	Date of Forecast
What Markets Say				
Bank of America/Merrill Lynch	2.3%	2.0%	2.8%	Nov-17
J.P. Morgan	2.5%	2.0%	2.0%	Nov-17
Moody's Economy.com	2.7%	2.9%	3.3%	Nov-17
Mortgage Bankers Association	2.6%	1.9%	2.1%	Oct-17
National Association of Realtors	2.5%	2.6%	3.0%	Nov-17
National Bank of Canada	2.8%	1.5%	2.6%	Nov-17
TD Bank Financial Group	3.0%	1.9%	2.1%	Sep-17
Wells Fargo/Wachovia	2.5%	2.3%	2.5%	Nov-17
Forecasts average	***2.6%***	***2.1%***	***2.6%***	

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

Although forecasters do not envision heavy headwinds in the near future, there are reasons for caution. The labor market is at full strength, asset prices are frothy, monetary policy is tightening, and implied volatility has been low, suggesting a pervasive sense of calm in financial markets.

As widely expected, the FOMC kept its interest rate and balance sheet policies unchanged at their meeting on October 31-November 1, 2017. The statement showed the Federal Reserve has improved its assessment of the economy, noting that the labor market has continued to strengthen and that economic activity has been rising at a solid rate despite hurricane-related disruptions. Household spending was described as expanding at a moderate rate while growth in business fixed investment was said to have picked up recently. The assessment of inflation also mentioned the impact of the hurricanes, which boosted gasoline prices. Still, inflation was said to be soft. The near-term risks to the outlook were described as being roughly balanced. The Fed said it continues to expect growth to be moderate and that

inflation will return to its 2% objective in the medium term. Market analysts continue to expect an interest hike at the December meeting, assigning over 85% probability to a December hike.

The U.S. economy grew 1.5% in 2016, and growth is now expected to accelerate to more than 2% this year (table 2). U.S. consumer price inflation was 1.3% last year, but according to market projections, the CPI is expected to increase at a 2% rate on average in 2017. However, the uncertainty surrounding the economic policy and legislative landscape has continued.

Congress is currently discussing tax reform, and prospects of it becoming legislation are still uncertain. The direction of monetary policy beyond the upcoming December 12-13 meeting is also uncertain. The current Fed Chair Janet Yellen will end her term in early February and will be replaced by the new Chair selected by President Trump, Jerome Powell. Although a smooth transition is anticipated, with markets expecting Mr. Powell to stick to the Fed's gradual path towards tighter monetary policy and the slow shrinking of its US$ 4.5 trillion balance sheet, there is still uncertainty regarding how he will respond to the challenge of frothy markets and the still-subdued inflation that has kept the Federal Reserve on a cautious path. What the U.S. economic policy-mix will be next year, as well as what its domestic and global repercussions may be, are not yet clear.

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

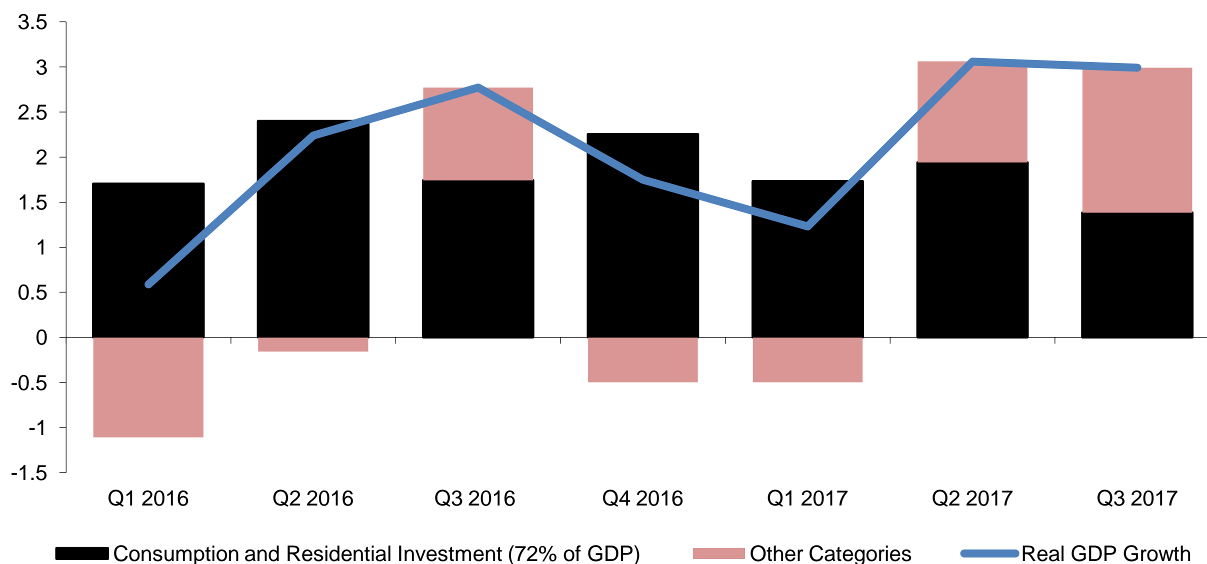
	Real GDP (% change, y/y)		CPI (% change, y/y)		Unemployment Rate (%)		FED Funds Rate (%)		
	2017	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**	**2018**	**Date of Forecast**
A. What Government Agencies Say									
FED*	2.4%	2.1%	1.5%	1.9%	4.3%	4.1%	1.4%	2.1%	*Sep-17*
CBO	2.1%	2.2%	2.3%	2.2%	4.4%	4.2%	1.0%	1.7%	*Jun-17*
OMB	2.3%	2.4%	2.6%	2.3%	4.6%	4.4%	*na*	*na*	*May-17*
B. What Markets Say									
Bank of America/Merrill Lynch	2.2%	2.4%	2.1%	2.3%	4.4%	4.0%	1.38%	2.13%	*Nov-17*
JPMorgan	2.2%	2.2%	2.1%	2.3%	4.3%	3.8%	1.40%	*na*	*Nov-17*
Moody's Economy.com	2.2%	2.9%	2.1%	2.2%	4.4%	3.8%	1.00%	1.90%	*Nov-17*
Mortgage Bankers Association	2.3%	2.0%	2.0%	2.0%	4.4%	4.1%	1.38%	2.13%	*Oct-17*
National Association of Realtors	2.2%	2.8%	2.0%	2.5%	4.4%	4.2%	1.00%	1.80%	*Nov-17*
National Bank of Canada	2.2%	2.4%	2.0%	1.9%	4.4%	4.4%	1.50%	2.00%	*Nov-17*
TD Bank Financial Group	2.1%	2.3%	1.8%	1.9%	4.4%	4.1%	1.25%	1.75%	*Sep-17*
The Economist Intelligence Unit	2.2%	2.2%	2.1%	2.2%	4.4%	4.0%	*na*	*na*	*Nov-17*
Wells Fargo/Wachovia	2.2%	2.6%	2.1%	2.1%	4.4%	4.0%	1.36%	1.90%	*Nov-17*
Market Average	***2.2%***	***2.4%***	***2.0%***	***2.2%***	***4.4%***	***4.0%***	***1.3%***	***1.9%***	
C. What International Organizations Say									
United Nations DESA (Baseline)	2.1%	2.1%	*2.3%*	*2.4%*	*4.8%*	*4.8%*	*na*	*na*	*May-17*
World Bank	2.1%	2.2%	*na*	*na*	*na*	*na*	*na*	*na*	*Jun-17*
OECD	2.1%	2.4%	2.5%	2.2%	4.6%	4.3%	*na*	*na*	*Jun-17*
IMF*	2.2%	2.3%	2.1%	2.1%	4.4%	4.1%	*na*	*na*	*Oct-17*

Source: ECLAC on the basis of 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

The U.S economy continued to grow at a steady pace in the third quarter of 2017, despite hurricane disruptions. Regarding the core of the U.S. economy – consumption and residential investment – consumer spending slowed relative to the pace in the previous quarter and the contribution of residential fixed investment to third-quarter growth was negative. On the positive side, however, nonresidential fixed investment, led by equipment, was a driver of economic growth, contributing 0.49% (chart 2).

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

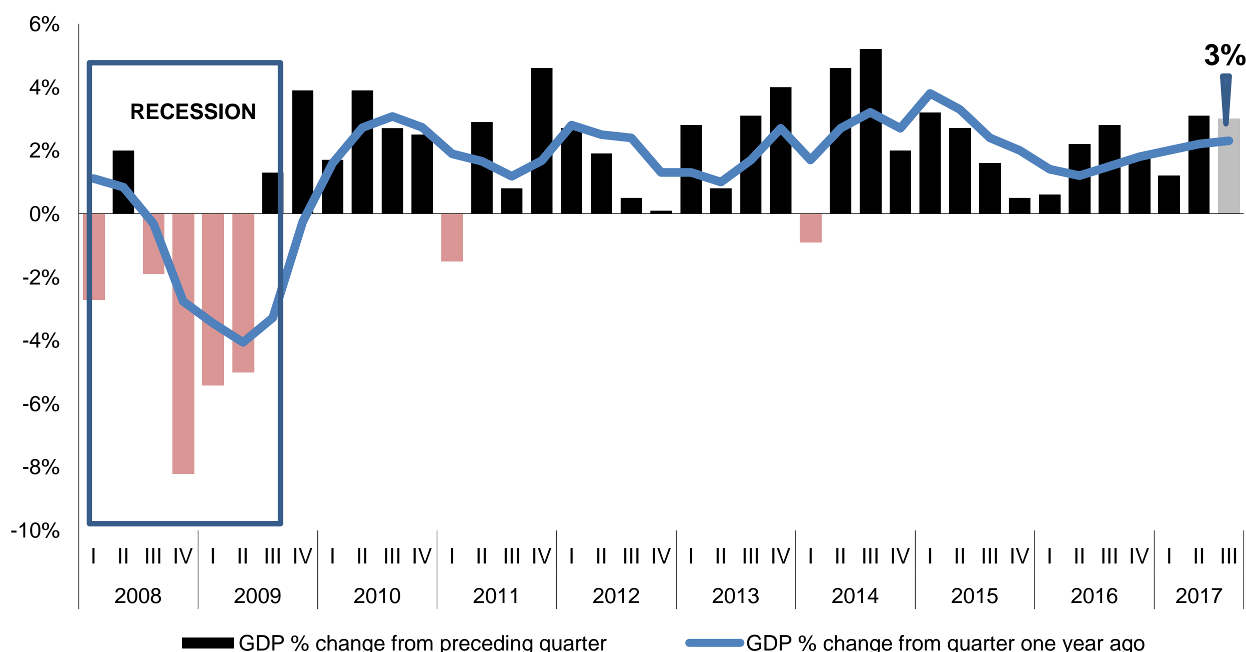


Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Department of Commerce.
Note: Contributions to growth are measured at seasonally adjusted annual rates.

A. GDP Growth

According to the first estimate released by the U.S. Department of Commerce on 27 October 2017, the U.S. economy grew at an annual rate of 3% in the third quarter, following an increase of 3.1% in the second quarter (chart 3).[3] Growth was strong despite hurricane disruptions, and it was supported by steady spending from businesses and households.[4] Personal consumption expenditures, private inventory investment, nonresidential fixed investment, exports and federal government spending made positive contributions to growth in the third quarter that were partly offset by negative contributions from residential fixed investment, and state and local government spending. Imports, which are a subtraction in the calculation of GDP, decreased.

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

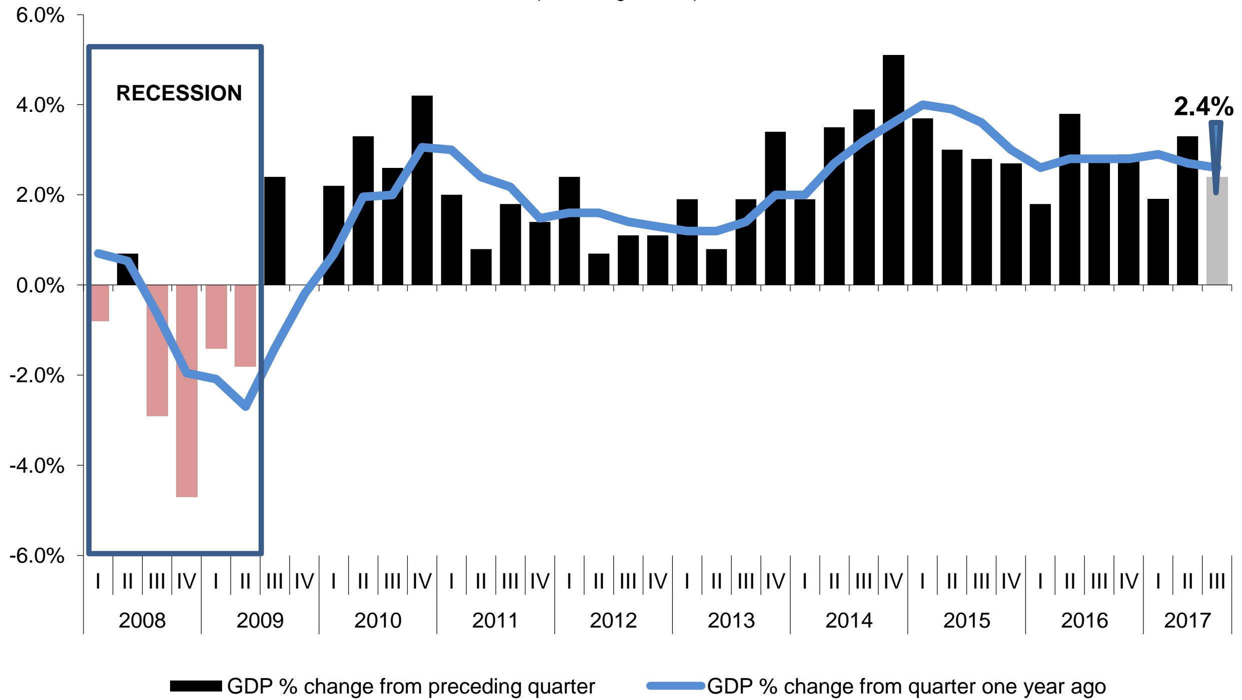


Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Department of Commerce.

The largest component of GDP, real personal consumption expenditures, grew 2.4% in the third quarter, following an increase of 3.3% in the second quarter (chart 4). Despite slowing down from the second quarter, consumer spending was the biggest driver of growth in the third quarter, contributing 1.62% to growth. This was down from the 2.24% contribution in the second quarter. 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.

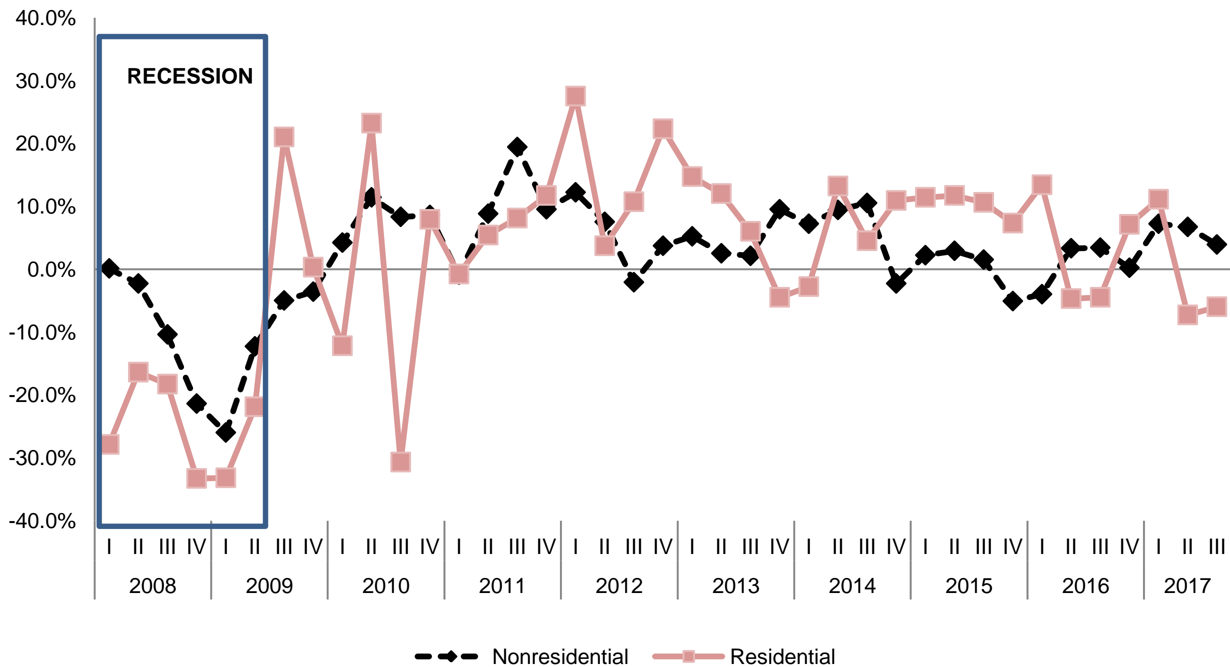
[3] The second quarter's growth rate was the quickest pace since the beginning of 2015.
[4] The Bureau of Economic Analysis (BEA) of the U.S. Department of Commerce noted that hurricanes impacted the data by disrupting production, including energy and agricultural production in several states, and increasing activity of emergency services and rebuilding, but the overall impact was not quantified.

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.

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.

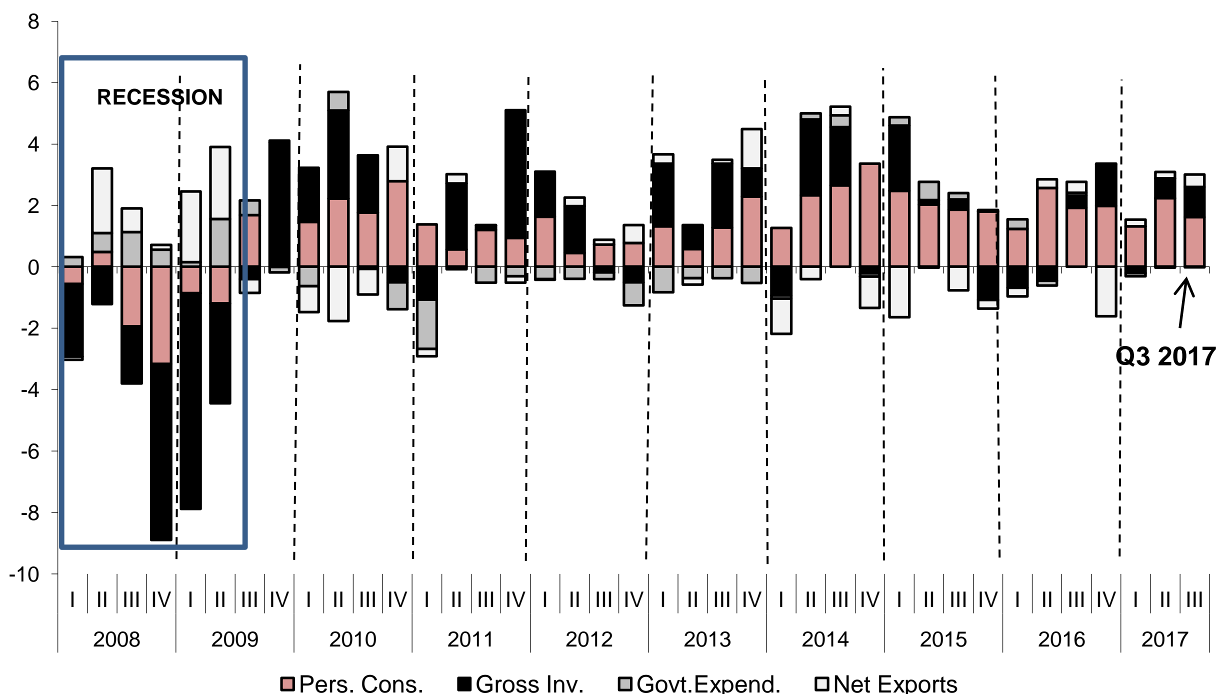
Fixed investment contributed 0.25% to growth in the third quarter, led by equipment investment. Real residential investment fell at a 6% pace (subtracting 0.24% from third-quarter growth), following another decline of 7.3% in the previous quarter (chart 5). Real nonresidential fixed investment, which represents overall business spending, increased at a 3.9% annual rate in the third quarter (adding 0.49% to third-quarter growth), following a bigger increase of 6.7% in the previous quarter.

With respect to the components of nonresidential fixed investment, investment in structures decreased 5.2% (subtracting 0.15% from third-quarter growth), following an increase of 7% in the second quarter. Investment in equipment increased 8.6% (contributing 0.47% to third-quarter growth), after increasing 8.8% in the second quarter. Investment in intellectual property products – including software, R&D, entertainment, literary and artistic originals – increased 4.3% (contributing 0.17% to third-quarter growth), following a smaller increase of 3.7% in the second quarter.

The change in private inventories contributed 0.73% to the third quarter change in real GDP, after adding 0.12% to growth in the previous quarter. Overall, gross private domestic investment increased at a 6% annual rate in the third quarter, adding 0.98% to third-quarter GDP growth (with 0.25% due to business fixed investment – +0.49% from nonresidential and -0.24% from residential – and 0.73% due to inventories).

Total government consumption was a negative to growth in the third quarter. Overall, government spending declined 0.1% and subtracted 0.02% from growth in the third quarter. State and local government spending declined 0.9% and federal outlays increased 1.1% in the third quarter (national defense spending increased 2.3%, while nondefense spending declined 0.5%). Finally, net exports added 0.41% to growth in the third quarter. Exports increased 2.3% and imports declined 0.8% (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.

B. Industrial production

Industrial production rose 0.3% in September (table 3), bringing the monthly change back into positive territory after a sizable drop in August. Production increase was broad based, with gains even in utilities and mining, which were expected to have suffered in the aftermath of Hurricanes Harvey and Irma. Manufacturing production gained a weaker than expected 0.1%, however. Capacity utilization rose 0.2%.

Data points to a healthier sector this year, but there have been mixed readings. The Federal Reserve's industrial production index hit a 9-year high in April, though it has gradually declined in recent months. An Institute for Supply Management manufacturing gauge hit its highest level in 13 years in September, but has dialed back in October.

TABLE 3:
U.S INDUSTRIAL PRODUCTION

	Total Industrial Production		Capacity Utilization Rate
	Index 2012=100	Percentage Change From Previous Period	Total Industry (%)
2017 Q1	**103.7**	**1.5**	**75.8**
January	103.5	-0.3	75.7
February	103.7	0.2	75.8
March	103.9	0.2	75.9
2017 Q2	**105.1**	**5.6**	**76.6**
April	105.0	1.1	76.6
May	105.0	0.0	76.5
June	105.2	0.2	76.6
2017 Q3	**104.7**	**-1.5**	**76.1**
July	105.1	-0.1	76.5
August	104.3	-0.7	75.8
September	104.6	0.3	76.0

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

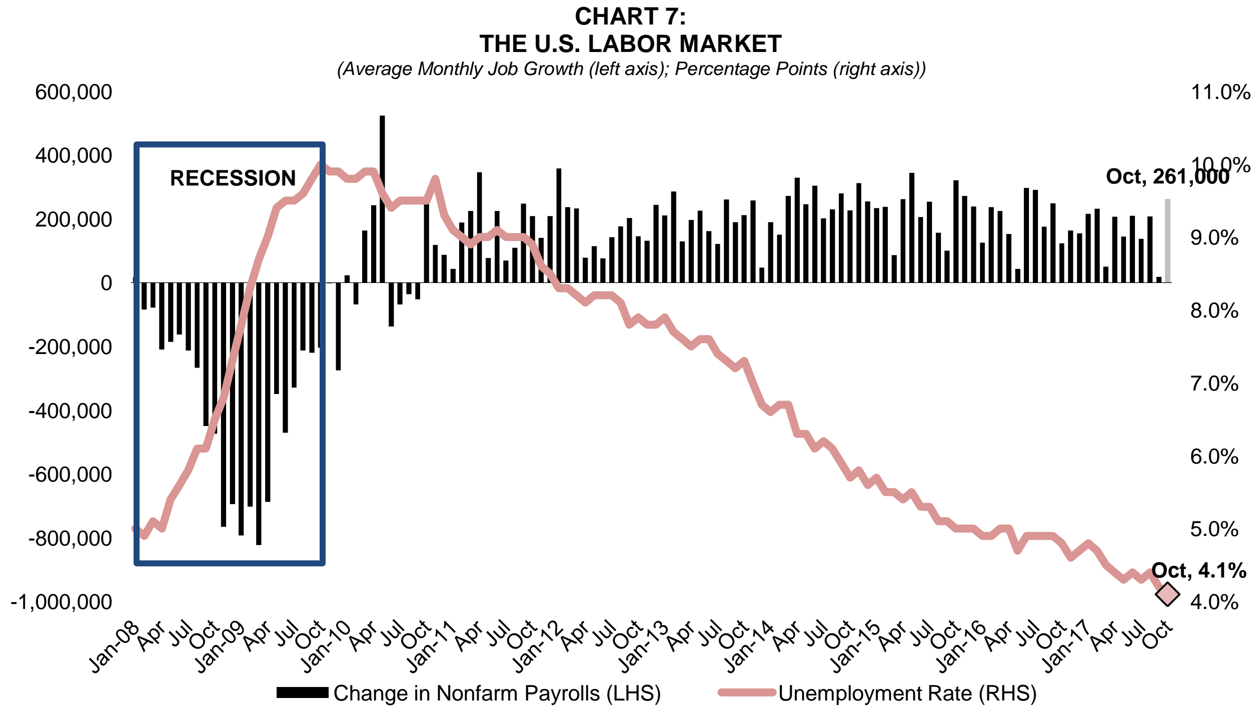
Global energy and commodity prices have rebounded amid growth in many economies around the world, which has led to an improvement in U.S. manufacturing this year. Much of the progress has come even though important parts of President Trump's manufacturing agenda haven't come to fruition, business leaders say, as global conditions have been supportive. While the sector overall has improved, progress has been uneven among industries and companies. Some have posted significant gains while others have continued to struggle. Among 70 manufacturing sub-industries tracked by the U.S. Labor department, 19 have see robust employment increases of 2.5% or more since October 2016, the month before the election. But over the same period, 22 industries have seen employment decline, including motor vehicles and parts manufacturing and aerospace.

C. Labor market

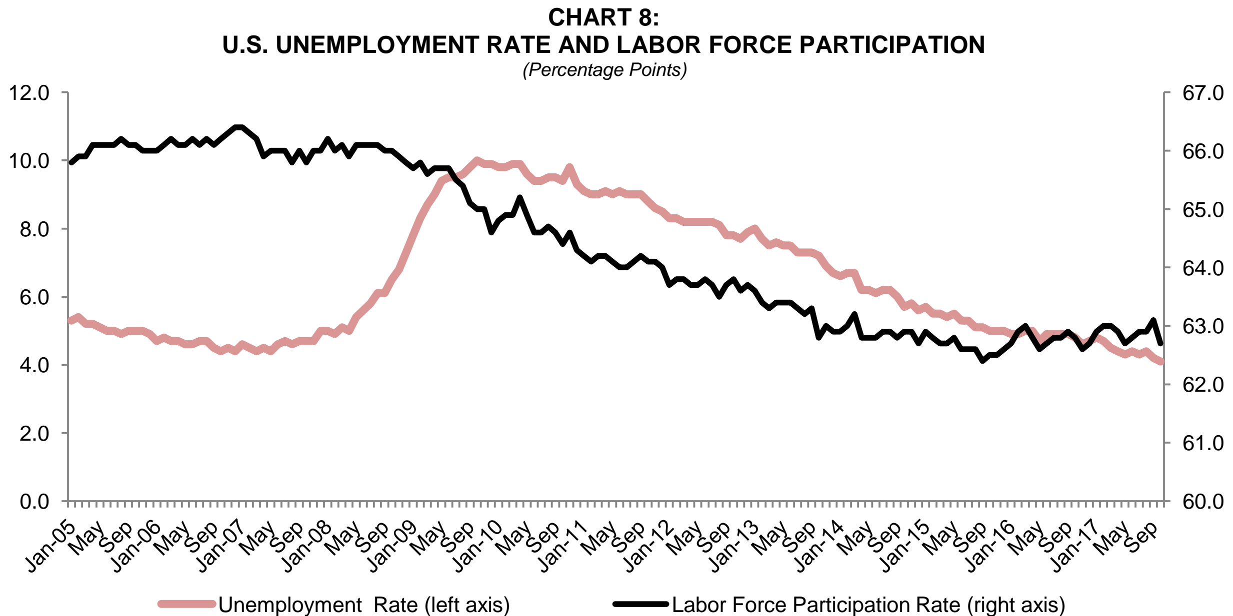
The U.S. economy added 261,000 jobs in October, while the figures for the prior two months were revised higher. The revision to September payrolls turned a loss of 33,000 jobs (the earlier estimate) into a gain of 18,000. August payroll gains were also revised up, from 169,000 to 208,000 (an addition of 39,000 jobs). Employers have added on average 169,000 monthly this year, lower than the 187,000 average monthly gain in 2016. In the past four months (from July to October), the monthly average was 156,000 jobs. The slowing trend is due in part to the tightening labor market, which is either at or approaching full employment.

The average jobs growth for the third quarter of 2017 was 121,000 a month, and in October the job market rebounded from the third quarter's hurricane-induce slowdown.

The unemployment rate fell to 4.1%, its lowest level since December 2000, but for the wrong reasons (chart 7). The labor force dropped by 765,000 and the labor force participation rate fell from 63.1% to 62.7%. Wage growth missed forecasts, falling by 1 cent an hour over the month and growing by 2.4% over the year, down from 2.8% in the previous month. Average hourly earnings were unchanged in October after rising 0.5% in September.



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



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

Nonfarm productivity increased 3% in the third quarter of 2017. Nonfarm business output increased 3.8% and employee hours were up 0.8% from the preceding quarter. Hourly compensation increased 1.5% in the third quarter of 2017, and unit labor costs also increased 0.5% (table 4, chart 9). On a year-ago basis, unit labor costs were down 0.1% in the third quarter while productivity increased 1.5%. The tighter job market is expected to put upward pressure on unit labor costs. These costs should rise as the economy reaches full employment. In theory, this should provide an incentive for businesses to invest more aggressively in productivity enhancements. However, this is not assured.

Productivity growth in the third quarter was solid, but the long-term trend remains unfavorable and highlights the poor run productivity has been on over the past five years. Productivity increased at an average annual rate of 0.6% from 2011 to 2016, well below the long-term rate of 2.1% from 1947 to 2016. Among the possible reasons for depressed productivity growth are measurement issues, labor mismatching, weak business formation, regulation, low labor costs, an aging population, and the availability of credit.

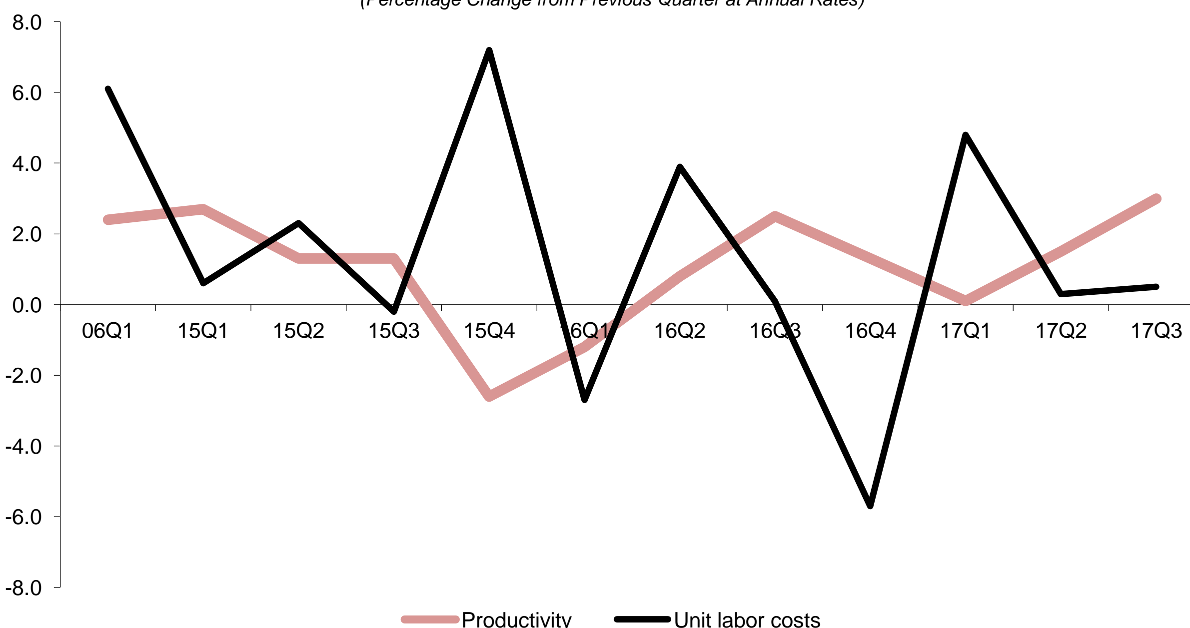
TABLE 4:
U.S. PRODUCTIVITY AND COSTS

Revised first 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	3.0	3.8	0.8	3.5	1.5	0.5
Business	3.6	3.8	0.1	4.1	2.0	0.4
Manufacturing	-5.0	-2.1	3.1	0.9	-1.1	6.2
Durable	-5.7	-3.4	2.5	0.5	-1.4	6.7
Nondurable	-4.6	-0.7	4.1	1.6	-0.4	6.5

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

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

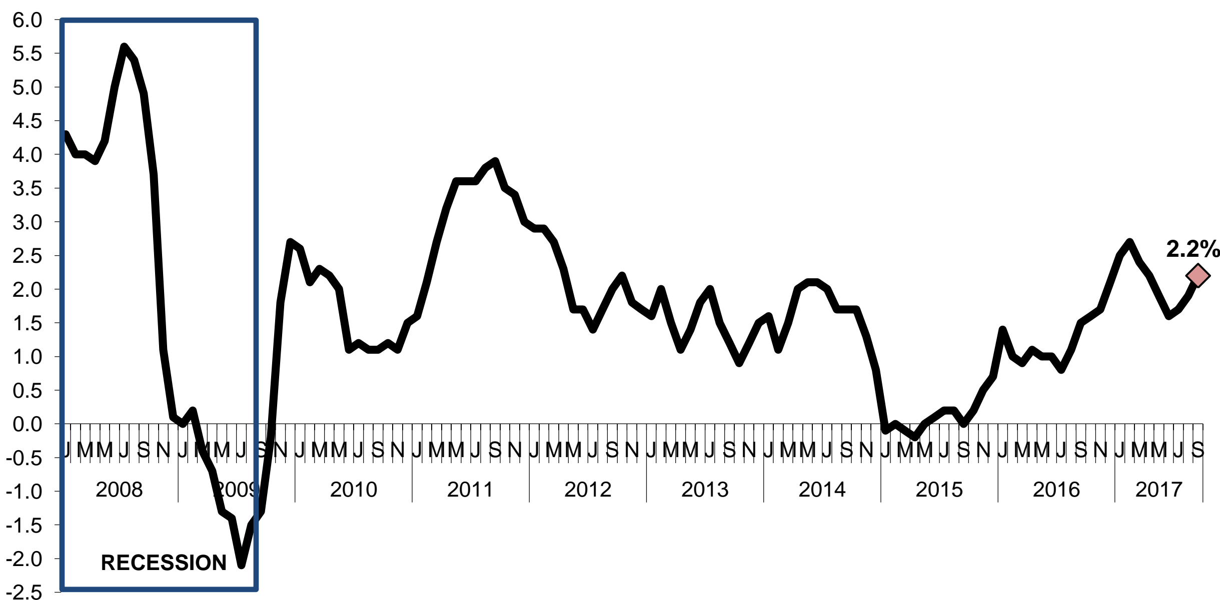


Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics.

D. Inflation

In September, the Consumer Price Index for All Urban Consumers (CPI-U) rose 0.5% on a seasonally adjusted basis, after posting a 0.4% gain in August and a 0.1% gain in July. The gain in September puts the CPI up 4.3% annualized over the prior three months, noticeably higher than the 2% in August. Over the last 12 months, the all items index rose 2.2% (chart 10), a bigger increase than the 1.9% rise for the 12 months ending in August.

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



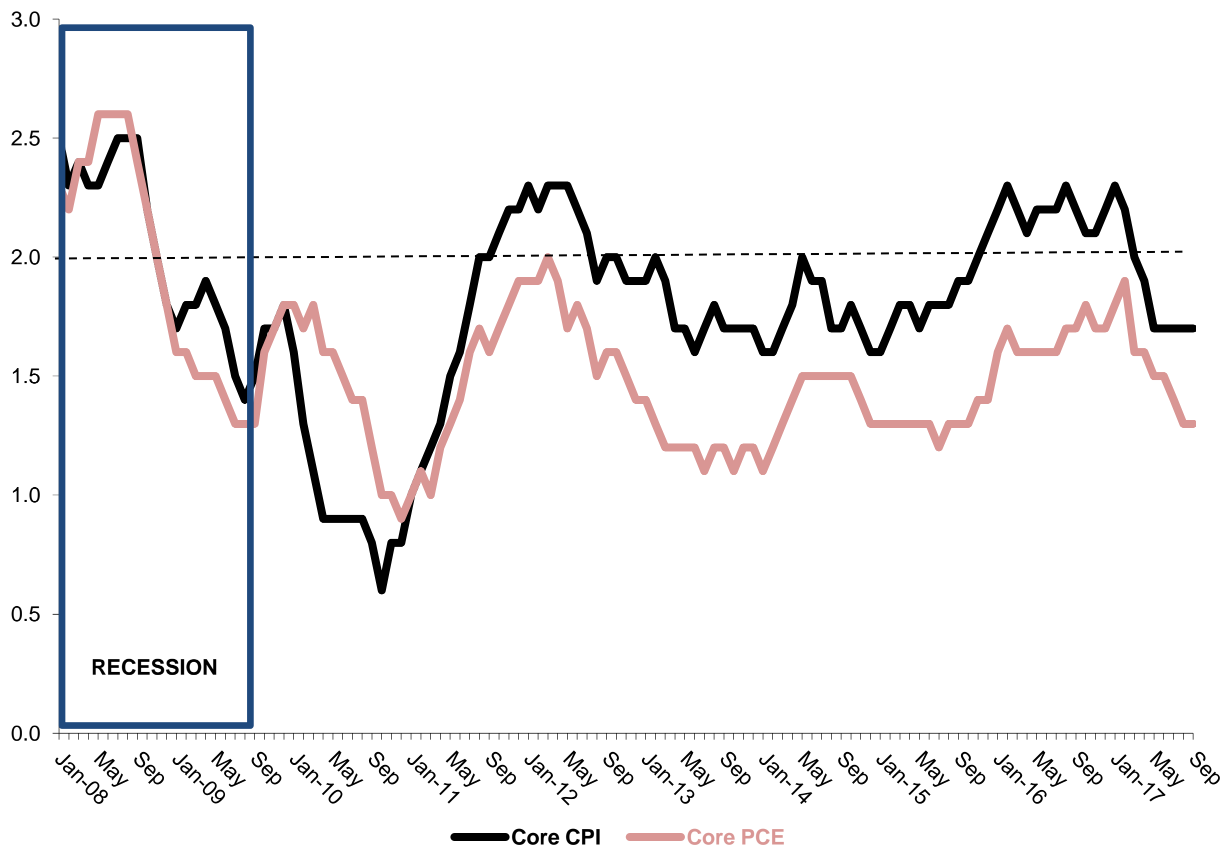
Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics.

The acceleration in inflation was mainly due to an increase in energy prices. The energy CPI rose 6.1% as gasoline prices jumped 13.1%. Food prices rose 0.1% in September, matching the gain in August. Excluding food and energy, the CPI increased 0.1%, continuing a weak trend. The core CPI was up 1.7% on the year. Core inflation appears to have moderated, as year-over-year growth was weaker than the 2.2% gain in February 2017.

The most closely watched measure by the Federal Reserve – the Personal Consumption Expenditure (PCE) core price index– increased at an annualized 1.3% in the third quarter, a small improvement over the second quarter's 0.9%. September marked the 65th consecutive month in which prices have fallen short of the Fed's 2% annual target (chart 11).

PCE, which is published by the U.S. Commerce Department's Bureau of Economic Analysis, is derived from retail-sales data collected in business surveys, and in this data, medical care tends to carry the greatest weight. The CPI, on the other hand, is derived from consumer purchases reported in household surveys. Typically, consumers report spending more on shelter than anything else, giving that category more weight in the CPI. Since shelter costs have been rising, the core CPI has been been increasing faster than the core PCE.

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.

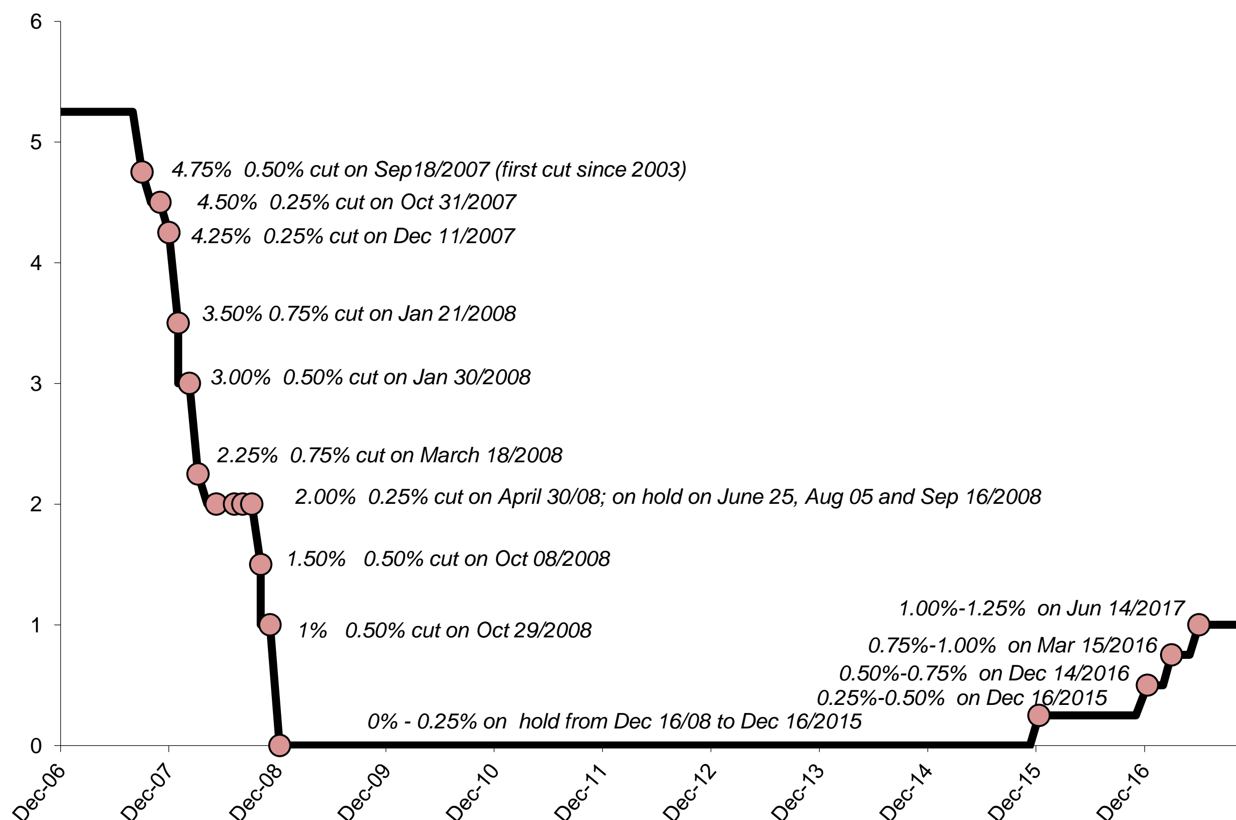
In October, the latest CPI data available, the consumer price index rose 0.1%. A 0.3% increase in the CPI for shelter was the main factor in the gain in the headline index. The energy CPI slid 1% as a result of a 2.4% decline in gasoline prices. Food prices were unchanged, after rising 0.1% in September. Excluding food and energy, the core CPI rose 0.2%. October's gain leaves the core CPI up 1.8% annualized over the prior twelve months, an acceleration from the 1.7% in September. The pick-up in core consumer prices followed a significant rise in core producer prices, which were up 2.3% year on year in October.

Economists and investors have been playing close attention to inflation since it has consistently underwhelmed even as the labor market has tightened. Although the labor market is strong, the Federal Reserve cannot ignore the deceleration in inflation, which is not consistent with a full-employment economy. However, policymakers have signaled that they expect to raise rates in December amid expectations that a low unemployment rate and steady growth will begin to put more upward pressure on prices. Robert Kaplan, President of the Federal Reserve Bank of Dallas, said recently that despite stubbornly low inflation in the U.S., he was increasingly concerned that historically low unemployment rates – which hit a 17-year record in October – required heightened vigilance.

E. Monetary policy

The Federal Open Market Committee (FOMC) continues to balance evidence of a resilient economy against persistently weak inflation. In its October 31-November 1 meeting, the Committee kept the key interest rate at 1 to 1.25% (chart 12), signaling that "gradual" rate rises lie ahead, even if it did not offer any explicit indications as to when the next move will come. The FOMC highlighted that core inflation remained "soft" and upgraded slightly the characterization of economic growth to "solid" from a pace seen as advancing "moderately." Overall the statement did not change the near-term rate hike expectations with the market continuing to assign over 85% probability to a December hike.

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



Source: ECLAC, on the basis of 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 ends in February, and a new Chair selected by President Trump, Jerome Powell, will take office then. In replacing Ms. Yellen, President Trump is breaking with precedent. The previous three Fed chairs were reappointed, in each case by a president of the opposite political party. Mr. Powel, a former lawyer and private equity executive, will be the first non-economist chair in almost four decades.

The Fed under Ms. Yellen's leadership has sharply reduced unemployment while maintaining controll 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 interest rate three more times next year, as well as continuing to pare back its massive balance sheet of Treasury notes and bonds.

President Trump will have the opportunity to reshape the Federal Reserve further through appointments in coming months, including the appointment of the next the President of the Federal Reserve Bank of New York. William C. Dudley, the current President of the New York Fed, is stepping down before the end of his 10-year term expires in January 2019. His successor will be responsible for regulating some of the world's largest banks.

F. Financial conditions

Both U.S. and global stocks have hit all-time highs this year. Successive U.S. market records and low volatility – the VIX hit a record low in the first week of November and the Bank of America MOVE index of interest rate volatility also hit a multi-decade low – have contributed to a strong market performance on a risk-adjusted basis.[5] The past few months have been the quietest (meaning lowest daily change in the S&P 500 index) for the U.S. stock market in more than half a century.[6]

U.S. Stock markets performed well in the third quarter of 2017, with the Dow Jones Industrial Average, the S&P 500, and NASDAQ gaining 4%, 2.4%, and 3.3%, respectively. Year-to-date (January to October), the Dow Jones Industrial Average, the S&P 500, and NASDAQ have gained 17%, 14% and 22%, respectively (table 5). The good stock market performance has boosted consumer and business confidence.

TABLE 5:
U.S. STOCK PRICES AND TREASURY SECURITY YIELDS

	STOCK PRICES			U.S. TREASURY SECURITY YIELDS		
	Monthly Stock Prices			Monthly Treasury Yields		
2017	Dow Jones	S&P 500	Nasdaq	3-year	10-year	30-year
January	19,908.15	2,275.12	5,561.42	1.48	2.43	3.02
February	20,424.14	2,329.91	5,764.70	1.47	2.42	3.03
March	20,823.06	2,366.82	5,864.96	1.59	2.48	3.08
April	20,684.69	2,359.31	5,912.17	1.44	2.30	2.94
May	20,936.81	2,395.35	6,124.88	1.48	2.30	2.96
June	21,317.80	2,433.99	6,224.29	1.49	2.19	2.80
July	21,581.25	2,454.10	6,294.67	1.54	2.32	2.88
August	21,914.08	2,456.22	6,311.40	1.48	2.21	2.80
September	22,173.41	2,492.84	6,428.08	1.51	2.20	2.78
October	23,036.24	2,557.00	6,603.01	1.68	2.36	2.88

Source: ECLAC, on the basis of data from Economic Indicators, U.S. Government Publishing Office (GPO).

[5] The Chicago Board Options Exchange (CBOE) Volatility Index shows the market's expectation of 30-day equity volatility and is constructed using the implied volatilities of a wide range of S&P 500 index options. The gauge formally known as the Merrill Lynch Option Volatility Estimate Index (MOVE) is a yield curve weighted index of the normalized implied volatility on 1-month Treasury options which are weighted on the 2, 5, 10, and 30 year contracts. The Move index is the Treasury market equivalent of the more famous VIX index of equity market volatility.

[6] Since election day last year, the daily change in the S&P 500 has been only 0.31%. Over the last half century, the index has moved by an average of 0.72% each day, more than double the volatility seen this year, according to a Financial Times analysis of historic returns for the S&P 500 dating back to its inception in 1927.

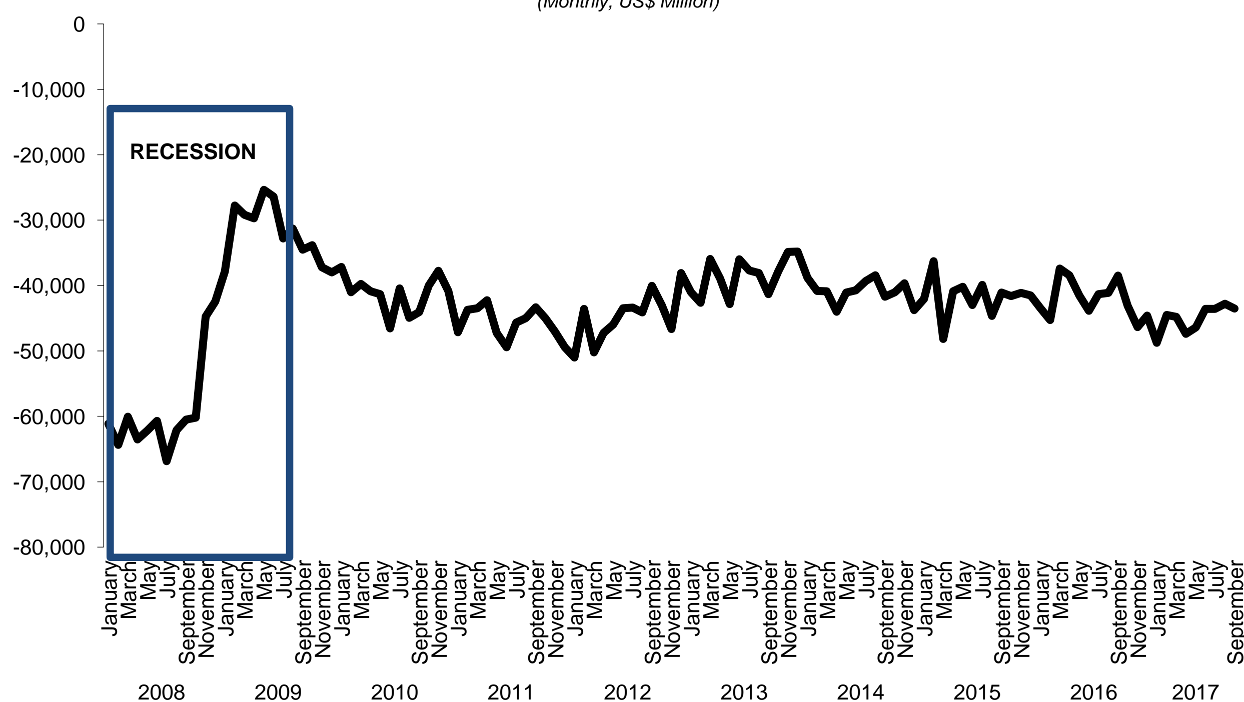
There are good supports for market strength. Earnings per share have risen strongly for the year, global economic growth is running better than expected, interest rates remain low as the European Central Bank and Bank of Japan continue to provide stimulus, and there are expectations of a cut in the U.S. corporate tax, although optimism about the boost to the economy from tax cuts has diminished more recently. Analysis by the Minneapolis Federal Reserve finds that markets are assigning a low probability to a large move in the S&P 500. Probabilities derived from option pricing on S&P 500 index futures indicate that the chances of either a 20% increase or a 20% decrease are less than 8%.

Low equity volatility is largely a product of the supportive global economic environment, but that should arguably spur investors to increase the probability of higher interest rates. However, volatility is also low in bond markets, as the MOVE index attest. This shows the extent to which investors expect interest rates to remain more or less stable in the current range for a very long time. At the start of the year, most analysts said the 10-year Treasury yield would climb above 3% by the end of 2017. Now, the mean forecast is for that to first happen in early 2019. U.S. Treasury futures suggest that it will not happen for at least another five years. Year-to-date (January to October), 3-year Treasury yields increased 13%, but 10-year and 30-year Treasury yields declined by 5.2% and 7.4%, respectively (table 5). If inflation finally does materialize, then Treasury bonds may be vulnerable to a sell-off.

G. External sector

The U.S. trade deficit widened modestly in September, the latest data available, increasing by US$ 700 million to US$ 43.5 billion. Even with the monthly increase, the deficit remained below trend relative to the preceding year. The goods deficit increased US$ 600 million, while the services surplus declined US$ 200 million. Exports and imports both increased, with imports sustaining the larger gain.

CHART 13:
U.S. BALANCE ON GOODS AND SERVICES TRADE
(Monthly, US$ Million)



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

Despite September's increase in the trade deficit, the details were largely positive. There has been a steady upward trend in exports, which have risen for three consecutive months and are up 10% from their trough in January 2016. The depreciation of the U.S. dollar and stronger global economic growth globally are major forces behind this recovery.

The real broad trade-weighted U.S. dollar has weakened since the beginning of the year, retracing about half of the more than 20% appreciation that occurred from summer 2014 to late 2016. The dollar has softened in recent months against most major currencies, including the Euro, Japanese Yen, Canadian Dollar and Chinese Yuan. This support for exports may moderate in coming months, however, as the dollar is expected to stabilize.

Recent gains in imports have almost exclusively been in capital goods, which have surged more than 9% since the start of the year. Imports of capital goods rose sharply to an all-time high in September. This increase in capital spending is good news, as stronger equipment spending should be key to improving the U.S. workforce's productivity.

The U.S. accumulated a trade deficit of US$ 405 billion in the first nine months of 2017, compared with a deficit of US$ 371 billion in the same period last year.

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

Debt sales by issuers from Latin America and the Caribbean have boomed since the beginning of 2017. Total debt issuance in the region as of 2 November 2017 – US$ 131 billion – has already surpassed the US$ 129 billion total issuance in 2016 as a whole, reflecting strong investor appetite for higher-yielding bonds and an improvement in the region's economic fundamentals. Bonds from the region offer more yield than government bonds in advanced economies, in which rates continue to be historically low. Most of the LAC issuance year-to-date has been denominated in U.S. dollar and that could pose challenges for some issuers if U.S. interest rates rise faster than expected or the dollar resumes its ascent.

Uncertainty regarding the path of U.S. interest rates next year may pose a problem for the region. The Federal Reserve raised interest rates two times in the first half of this year, and has signaled that it can raise interest rates again in December. When the Federal Reserve increases the federal funds rate, it normally reduces inflationary pressure and works towards an appreciation of the dollar. When the dollar rises, so does the cost of servicing dollar debts. Faster monetary tightening from the Fed may unsettle LAC issuers used to abundant dollars and may induce portfolio adjustments.

The implications of fewer dollars, particularly for emerging markets, are starting to be pondered as Fed officials began shrinking the central bank's US$ 4.5 trillion balance sheet in October. As the Fed slows its purchases of Treasuries and other securities, the dollars effectively given out around the world through those deals will start to disappear, and this could have a hard impact on emerging markets.

III. Looking ahead

At a 3% rate, U.S. economic growth was solid in the third quarter despite hurricane disruptions, especially following growth of 3.1% in the second quarter. Market projections for real GDP growth in 2017 (made mostly in October and November), now range from 2.1% to 2.3% (see table 2). On average, growth in 2017 is expected to expand at an annual pace of 2.2%. Market projections for real GDP growth in 2018 currently range from 2% to 2.9%. On average, growth in 2018 is expected to expand at an annual pace of 2.4%.

The U.S economy's current growth is broad-based and supported by several factors. U.S. consumers have been supportive of growth, as they benefit from a strong job market, healthy balance sheets and plenty of credit. U.S. businesses have also been supportive of growth, as they benefit from higher profitability, record stock prices and low borrowing costs. More importantly, a synchronous upturn across major world economies has also been very supportive of growth in the United States.

There seems to be no major headwinds in the near future, although there are risks, especially regarding government policy. Fiscal policy is uncertain, as policymakers continue to discuss tax reform, and the lack of tax cuts could be a negative for the outlook. The markets are increasingly worried that the new tax package will not deliver on all its promises. The direction of U.S. monetary policy beyond December is also more uncertain. With a new Chair expected to start next year and other important positions to be filled, including the appointment of the next the President of the Federal Reserve Bank of New York, there are some questions with respect to how monetary policy will be conducted next year, although markets expect a smooth transition and continuity. Nonetheless, market reaction to any surprises in monetary policy next year remains a concern.

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