CUSTOMER TREASURY SERVICES

Economist's Weekly Market View

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# Will US economic outperformance last

The US economy has registered a stout performance over the past year. This is despite an aggressive pace of rate hikes from the US Federal Reserve, leading many commentators to become more confident of a "soft landing" for the economy.

One reason for the stronger US performance is that it has been less exposed to the fallout from the War in Ukraine and associated big jump in energy prices, which has had a bigger impact on the main European economies. Another has been the expansionary stance of US fiscal policy.

In GDP terms, the US economy expanded by 2.3% year-on-year over the first three quarters of 2023. By comparison, both the Eurozone and UK economies grew by just 0.6% over the same period.

Aside from robust GDP growth numbers, another area where the US economy has posted a strong outturn is job creation. Non-farm payrolls expanded by 266,000 per month in quarter 3, compared to an already healthy average of 257,000 in the first half of the year.

Meanwhile, various inflation metrics for the US economy show that price pressures have eased over the course of this year, albeit some stickiness has persisted in core indicators. The Fed's preferred measure of underlying inflation, core-PCE, fell to 3.7% in September. The Fed expects core inflation to move slowly down towards its 2% target over the next couple of years.

More recent data though, have hinted at some softening in activity levels in the US economy. Survey activity indicators have been more mixed in the fourth quarter. There have also been some tentative signs of a softening in labour market conditions. Payroll numbers for October undershot expectations, with a gain of just 150,000. The weekly jobless claims numbers have moved upwards recently too. The unemployment rate has been edging higher as well, rising to 3.9% in October.

At the same time, retail sales data for October suggest some moderation in household spending at the start of the fourth quarter after a very strong increase in the previous quarter. Meantime, business investment metrics and the housing market remain subdued.

The US economy faces a number of challenges over the coming quarters. The impact of high inflation and significant monetary policy tightening are still working their way through the economy. Credit lending conditions have tightened significantly. The post-pandemic accumulation of savings that boosted consumption has been reduced. Meanwhile, the supportive impact from fiscal policy is likely to wane.

The IMF sees growth slowing from 2.1% this year to 1.5% in 2024. The Fed is also projecting much slower growth next year. A downturn in the economy is not foreseen, though.

Overall, forecasters and markets need to be careful about being overly confident on a soft landing for the US economy given the numerous headwinds it faces. In this regard, futures contracts have moved recently to price in significant rate cuts in the US in 2024-25 suggesting they may be beginning to hedge their bets on the health of the economy next year.

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