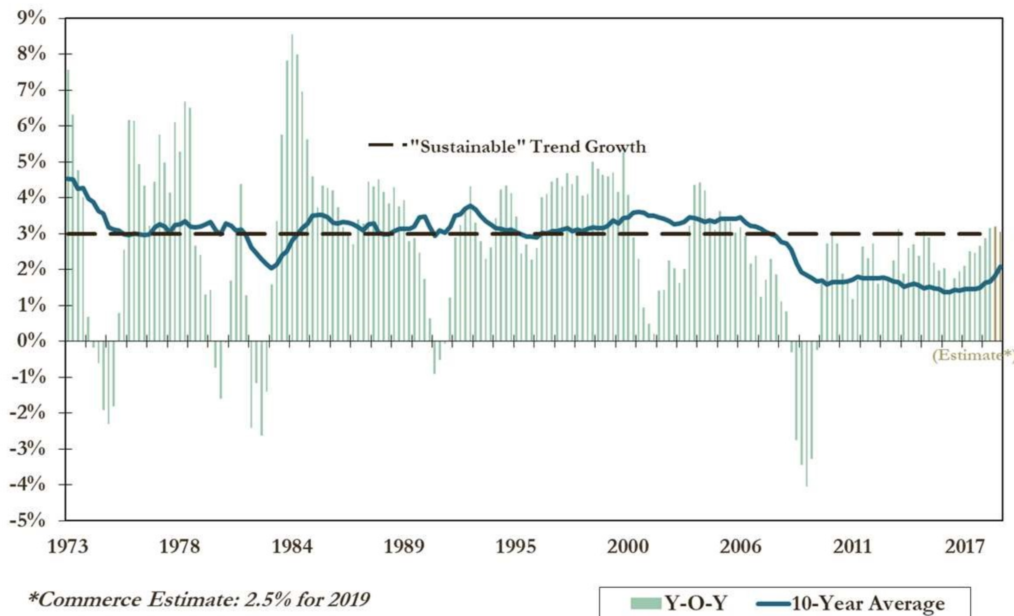
U.S. ECONOMY – 3%...FINALLY...BUT PEAKING



- The U.S. economy temporarily grew at a 3.1% pace last year, identical to the "real" (inflation-adjusted) rate of 3.1% from 1973 to 2007. But trend growth has fallen and will remain closer to the 2.2% trend post the 2007-2009 financial crisis. (Figure 5)
- The key reasons for this downshift in growth are fourfold:
  - The U.S. private sector paid back some of its debt (deleveraging)
  - Growth of the labor pool slowed (demographics)
  - Global growth fell in concert with U.S. growth (China, Europe, and Japan)
  - An aging society emphasized saving over consumption
- Temporarily, the deleveraging process has run its course. But monetary policy has just become slightly restrictive, with short-term rates now about 2.5%. Fortunately, tax policy has boosted corporate earnings, fiscal stimulus has kicked in, and household spending began to accelerate last year.
- Long-term trend economic growth is still just a function of employment growth, investment in capital stock and productivity. With long-term productivity averaging less than 1.5%, and work force growth of 0.5%, economic growth closer to 2% had become the "new" normal.
- As we came to the end of the deleveraging process last year, we expected economic growth to accelerate, and it did. But last year's 3% growth rate is unsustainable and will now likely fall back toward trend. The Federal Reserve pushed short-term rates to 2.50% in December, and financial markets tightened considerably in the fourth quarter, clouding the outlook for growth.
- Still, we do not foresee anything more than a typical late-cycle economic slowdown and believe a recession is still years away.

Source: Bloomberg, Bureau of Economic Analysis