

## US: Beware of the risks

Financial markets remain in a positive mood, but with the headlines on trade looking less encouraging and the global backdrop and strong dollar acting as headwinds for growth, we are less sanguine on the economic outlook. We continue to forecast sub-consensus growth of 1.4% and expect the Federal Reserve to cut rates twice more in the first half of 2020



Source: Shutterstock

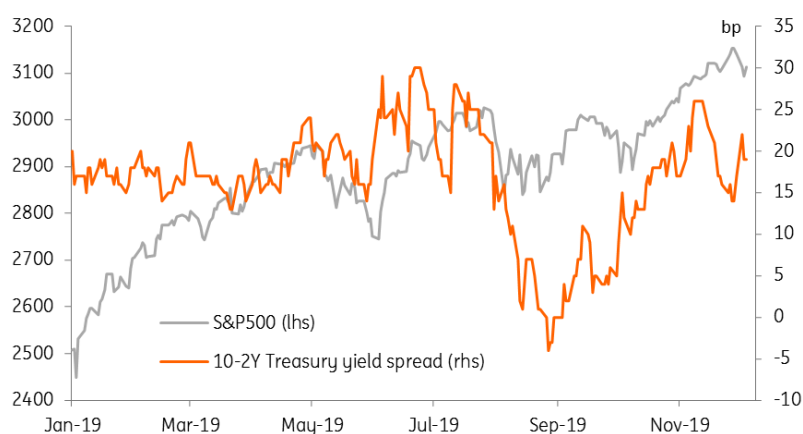
### Markets accentuate the positive

Just four months ago equities were selling off, the yield curve was inverted - historically a strong predictor of recession - and activity data was starting to soften. Since then we have had three interest rate cuts from the Federal Reserve totalling 75 basis points and there has been talk of a

phase one trade deal with China. With the economic data seemingly having stabilised we have seen a major turnaround in market sentiment with the yield curve re-steepening and equities rising more than 10% from those August lows.

There has been a shift in sentiment at the Federal Reserve too, with officials suggesting that after their “insurance” policy easing, the economy is in a good place and they are happy to wait and see the effects of those rate cuts in July, September and October. The market agrees, pricing in just one more rate cut in this cycle (and not until late 2020).

## US equities versus the 10-2Y yield curve



Source: Macrobond, ING

## But we can't eliminate the negative...

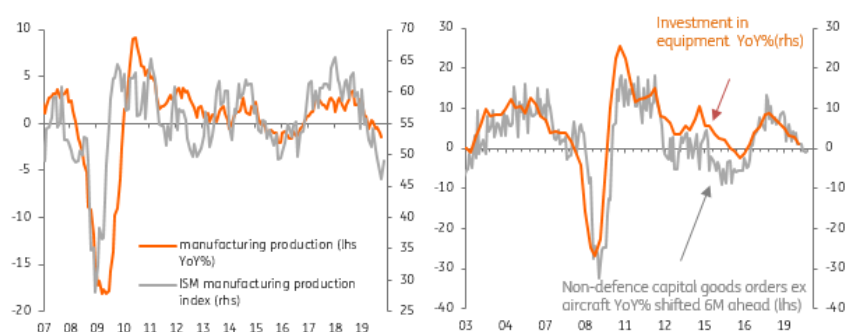
We are less sanguine. Instead, we see significant threats to this narrative and prefer to stay on the softer side of consensus, predicting 2020 GDP growth of 1.4% versus the 1.8% the market expects. We also see the risks skewed towards two further 25bp interest rate cuts in the first half of 2020. After all, global activity remains subdued, inflation is benign and the latest news on trade is hardly encouraging, so we struggle to see where meaningful upside momentum is going to materialise from.

Regarding trade policy, via a tweet, President Trump promised to restore tariffs on steel and aluminium imports from Brazil and Argentina in response to his perception that they have generated “massive depreciation of their currencies, which is not good for our farmers”. At the same time tensions are escalating with France and the EU. The US has threatened tariffs on \$2.4 billion of French exports to the US in retaliation for a digital tax imposed by France (replicated elsewhere) that is primarily raising revenues from American tech companies.

Additionally, the prospects for a phase one trade deal with China, which was initially announced all the way back in October, are looking less positive. President Trump suggested that he has no deadline and would be prepared to wait until after the 2020 election. This implies a diminished prospect that some of the already enacted tariffs will be rolled back and raises the threat that another wave of 15% tariffs on \$156 billion of consumer goods from China will go ahead as scheduled on 15 December. With China likely to respond in kind, trade looks set to remain a major

headwind for growth in 2020 by disrupting supply chains, hurting profitability and damaging sentiment.

## Industrial output and capex continue to weaken



Source: Macrobond, ING

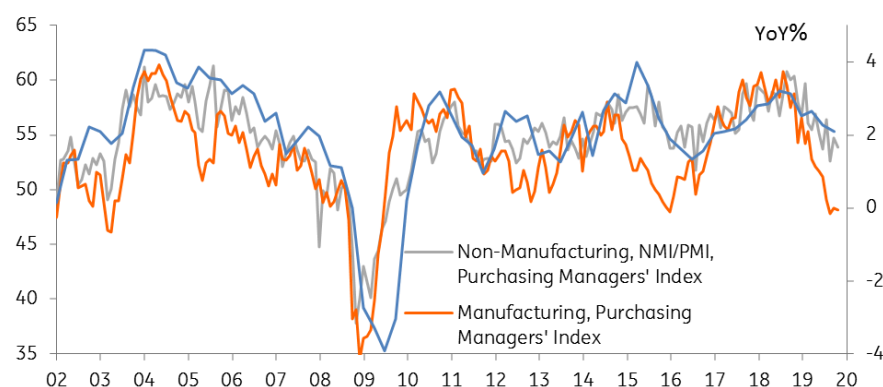
## Slowdown set to continue, but recession avoided

Domestically, the economy's growth rate is slowing. Payrolls growth that averaged 233,000 per month in 2018 is now averaging 168,000 while the ISM manufacturing index has been in contraction for four consecutive months. Moreover, the production sub-component is at levels consistent with output falling 5% year-on-year.

Capital expenditure fell in both 2Q and 3Q with lead surveys, such as the durable goods report, suggesting a third consecutive contraction in the fourth quarter. With trade worries set to linger and firms seemingly willing to "wait and see" given divergent political policies and priorities of the respective presidential candidates, we are doubtful of a major rebound in capex in 2020.

There has also been evidence of a slowing in service sector output and in consumer spending despite confidence holding up relatively firmly. Retail sales have been disappointing in recent months with auto sales also looking like they have peaked. This may be temporary, but with the economic news looking subdued, politics remaining divisive and mortgage rates on the rise again the outlook is, at best, uncertain. Consequently, we suspect 4Q GDP and 1Q 2020 GDP will come in below the 2.1% rate of 3Q19, especially if firms begin to run down some of the inventories they have built up in recent quarters.

## ISM business surveys point to GDP slowdown



ISM surveys ask major US companies what they are seeing in terms of output, order, employment, inventories, supplier delivery times and comes up with an aggregate index of performance. #>50 = expansion #<50 = contraction

Source: Macrobond, ING

## Downside risks for interest rates

With the inflation backdrop looking benign, the Federal Reserve is able to offer more support to the economy with a couple more interest rate cuts. Recent comments suggest a strong reluctance at present, but with the trade backdrop looking less favourable, the key ISM series on a downward trend and the global backdrop and strong dollar hurting export performance and business confidence, we think they will. It is probably going to be later than we had previously been thinking, straddling 1Q and 2Q 2020 rather than concentrated in 1Q. We also see downward risk for longer-dated Treasury yields, targeting 1.40% for the 10-year yield in the first half of next year.

## Election uncertainty continues

In terms of politics, the impeachment process against the President is gaining pace with the House of Representatives having published its report which concluded that Trump had abused his position to pursue “personal and political interest above the national interests of the US” in regard to dealings with Ukraine. The Democrat-controlled House looks set to vote in favour of impeachment, which will lead to a trial in the Senate. Nonetheless, with 20 Republican Senators required to vote in favour to get a two-thirds majority for conviction this looks highly unlikely given none have hinted at voting in favour so far. As such Donald Trump will get to stand for re-election.

The field of Democrat candidates remains sizeable with fifteen still in the race. In terms of noted names, early front runner Kamala Harris has dropped out while former New York mayor Michael Bloomberg has entered the fray. Former Vice President Joe Biden remains the lead, but he is closely followed by the more progressive (and interventionist) Elizabeth Warren and Bernie Sanders, according to recent polling.

Opinion polling suggests the election will be close, but that a centrist Democrat is more likely to defeat President Trump than a progressive. If this is the case we will likely see more emphasis on infrastructure spending versus tax cuts from Trump as the key policy thrust, with more regulatory oversight of tech industries and a focus on greener energy to boot. Another four years under Donald Trump would likely result in broader use of tariffs as a tool for generating trade “wins”. Under a centrist Democrat, we suspect that the US would be prepared to work more closely with Europe to get a re-orientated global trade policy with less emphasis on tariffs as the starting point.

Please click on this [link](#) for a collection of our latest views on US politics.

## Author

**James Knightley**

Chief International Economist, US

[james.knightley@ing.com](mailto:james.knightley@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.