US: Signs of a slowdown?

The US has had a great 2018 but will face more headwinds in 2019. Worryingly, there are already some signs of a slowdown coming through in the data, in particular, the housing market

Source: Shutterstock

Headwinds are intensifying

The US economy has performed really well this year with a robust jobs market and massive tax cuts helping to generate the strongest year of GDP growth since 2005. But maintaining this momentum in 2019 will be hard, given the headwinds of the lagged effects of the strong dollar and higher interest rates along with the fading support from the fiscal stimulus and intensifying trade protectionism at a time of softer global growth. Housing and investment numbers suggest that this slowdown may already be underway.

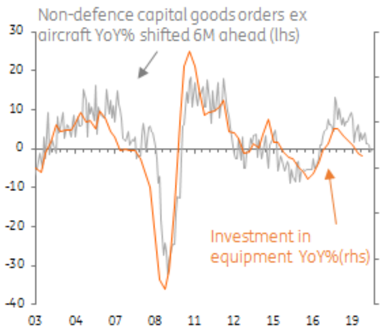
Housing affordability weighing on activity

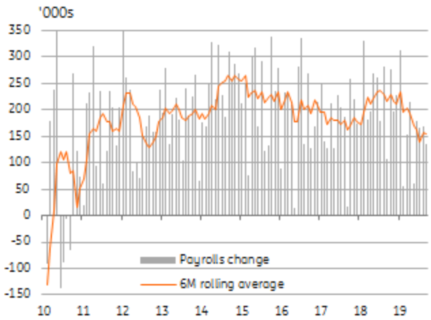
The housing market has been the area where this moderation in activity has been most noticeable. This should be understandable given 30-year mortgage rates are close to 5.2% right now – the highest for eight years – while house prices have been rising progressively. The S&P/Case-Shiller national average index is up 54% from the 2012 lows. Wage growth is picking up, but at 3.1% it remains well behind annual house price growth of 5.5% year on year as of August.

This combination of high prices and high borrowing costs have resulted in home purchases mortgage applications falling nearly 13% over the past four months while for refinancing the downturn is over 40% since January.

We have seen home sales drift lower over the past 18 months on all of the main transaction measures and this is finally translating into weaker homebuilder sentiment. Indeed, the National Association of Home Builders index dropped eight points on Monday. This is the biggest drop since 2014 and takes the index back to the level seen in August 2016. With building permits down 8% since March, this suggests that home construction activity will be a drag on growth in 2019.

Housing figures point to slowdown





Capex concerns

The other area that is starting to cause a little concern is the corporate investment. President Trump had suggested that by lowering tax rates and encouraging companies to bring back overseas profits, this would stimulate investment and job creation in the US economy. The number of jobs in the US is certainly up, but the story on investment isn't as obvious.

The Federal Reserve has long been known to follow a key component within the durable goods report – non-defence capital goods orders excluding aircrafts. Aircraft orders tend to lead to big swings in the headline reading, as we saw today with a 21.4% decline in this component contributing strongly to a 4.4% drop in total orders. Defence orders can also be very volatile, so this "core" measure provides a better measure of what is going on in corporate America.

As the second chart below shows, it tends to lead investment spending and has historically had a very strong relationship. It isn't a good story right now with three consecutive monthly declines suggesting that the boost to corporate cashflows is not leading to stronger investment. Instead, a significant amount of those tax cuts appear to have been used to fund share buybacks and special dividends. Moreover, the uncertainty relating to protectionism may be making business more cautious.

Durable goods orders signal capex slowdown

	2019	2020	2021	2022	Longer run
Change in real GDP (Dec Fed forecast)					
Previous projection (September)	2.2	2.0	1.9	1.8	1.9
Unemployment rate (Dec Fed forecast)					
Previous projection (September)	3.7	3.7	3.8	3.9	4.2
Core PCE inflation (Dec Fed forecast)					-
Previous projection (September)	1.8	1.9	2.0	2.0	-
Federal funds rate (Dec Fed forecast)					
Previous projection (September)	1.9	1.9	2.1	2.4	2.5

Source: Macrobond, Bloomberg, ING

Caution from the Fed?

We are certainly not suggesting the US is on the verge of a pronounced slowdown – we see GDP growth of 2.4% in 2019 and 1.8% in 2020, but some signs warrant caution on the US outlook. There are still positives for the US such as good momentum and robust wage growth, but looking at the situation all together it is understandable why Fed officials sound more mixed on the outlook.

For now, we are forecasting a December rate rise with three more rate rises next year, but the balance of risks does appear to be shifting towards a more modest rate hike path making it look as though two rate hikes are more likely than four.

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