Strong retail sales figures suggest US consumers are continuing to prop up the economy, helping partially to offset the hit to business confidence from the US-China trade conflict. (Keystone)

UBS House View - Daily US

US heading toward subpar growth, not recession

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Strong retail sales figures suggest US consumers are continuing to prop up the economy, helping partially to offset the hit to business confidence from the US-China trade conflict. Sales were up 0.7% month-on-month in July, the fifth consecutive increase and the fastest in four months.

Even more encouraging, sales in the ’control group’, which excludes volatile items and is viewed by economists as a more reliable measure of consumer demand, beat forecasts to rise by 1% in July.

The data reinforces our view that the US economy should avoid a recession in 2020. Assuming no further escalation in the trade dispute, we assign just a 25% chance that the US economy will contract for two consecutive quarters next year.

But despite the strength of the consumer side of the US economy, we do expect falling business activity to pull US growth below trend, forcing the Fed to cut rates more than we had previously expected.

- Evidence is mounting that the industrial and manufacturing side of the US economy is deteriorating. Data released yesterday showed factory output falling by 0.4% in July. Manufacturing output has now contracted in five of the past seven months. This mirrors a slowdown in manufacturing output worldwide, led by China and Germany.
- A swift resolution to the trade war remains unlikely. Although President Donald Trump has delayed the imposition of a 10% tariff on the full remaining USD 300bn of untaxed Chinese imports, we believe that this will come into effect in December. China’s announcement that it would retaliate also reduces the chances of an immediate de-escalation. Against this backdrop of uncertainty, we expect business investment to remain subdued globally. That should delay the pick-up in growth that we expected in the second half of this year. For 2020 we now expect US growth of around 1.8%, below trend.

So, while we don’t believe a recession is looming, and we remain cautiously positive on global equities, we now expect a longer period of lower rates. We now expect the
Fed to cut rates by 25 basis points three more times, at its September, December, and March meetings. We also expect only a gradual rise in the 10-year US Treasury yield, with an increase to 1.9% in 12 months, from 1.55% at present.

This environment of weak growth and central bank easing increases the appeal of income-producing strategies. We recently increased the size of our overweight in a basket of high-yielding emerging market currencies (Indonesian rupiah, Indian rupee, South African rand) against a basket of lower-yielding currencies (Australian, New Zealand, and Taiwanese dollars). We are also overweight in emerging market sovereign debt, and recommend a variety of dividend strategies in Europe and the US.

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**Content is a product of the Chief Investment Office (CIO).**
