Latest economic data dampen US growth prospects

By Nick Beams
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A clear divergence is emerging in estimates for future US economic growth as the Trump administration approaches its first 100 days. The stock market has enjoyed a surge since Trump's election win and indexes of consumer confidence are up on the back of his promises to stimulate the economy. Data on the real economy, however, tell another story.

The surge in the markets was largely the result of expectations that cuts in corporate and personal taxes, together with major deregulation, would provide a boost to the bottom line. The increase in profits would supposedly spark investment, leading to a lift in the US economy. Trump has said his aim is to lift annual growth to 4 percent.

But the latest data indicate that nothing like this sort of growth spurt is taking place, or is even in the pipeline.

According to Atlanta Federal Reserve estimates, gross domestic product (GDP) will show a rise of just 0.5 percent for the March quarter, well below the promises held out by Trump. The low GDP numbers continue a trend that has been in place for the past four years.

The main factors were the fall in manufacturing activity, which dropped for the first time in seven months, and a fall of 0.2 percent in retail spending in March, following a decline of 0.3 percent in February. One of the main factors was a sharp drop in auto sales, which have fallen by 10 percent since December.

The reasons for the decline in retail sales are not hard to find. Many households struggle to cope with large student loans, credit card debt and car loans under conditions of low wages growth.

Consumer prices were also significantly down in March, falling by 0.1 percent for items other than food and energy, contrary to expectations they would show an increase. It was the first fall in core consumer prices since 2010.

JPMorgan Chase chief economist Michael Feroli said the March price figures were a "huge downside miss" and would leave "lingering doubts about the popular reflation narrative."

Bank of the West economist Scott Anderson said US economic indicators were throwing off "mixed messages." He noted: "Stocks have soared along with business and consumer confidence measures since the November election in anticipation of renewed fiscal stimulus and stronger economic growth. Yet harder data on industrial production, retail sales, and even last month's employment report have so far proved disappointing."

Despite the lift in stock markets, the data on the real economy are starting to cause some concern in financial circles.

Larry Fink, the chief executive officer of BlackRock, the world's largest hedge fund, told *Bloomberg* this week that lacklustre US growth and concerns about how quickly the Trump administration would be able to carry out its economic agenda posed some risks for financial markets.

Earlier this month, Treasury Secretary Steven Mnuchin said the inability of the administration to get its changes to healthcare through Congress impacted on the proposals for changes in the tax system. The original aim was to have them through by August but that now seems highly unlikely.

In an interview on Wednesday, Fink said: "There are some warning signs that are getting darker." He pointed to the slowing auto sales and a cutback in merger and acquisition activity in financial markets as indications of increasing uncertainty over the economy.

Fink said the US economy had the lowest growth rate for any country in the G7 group of major economies. Price/earnings ratios on stocks were high, but this was based on expectations, and if they were not validated in the real economy then the market could fall by between 5 and 10 percent.

Another indication of the US economy's direction is the fall in the yield on US 10-year Treasury bonds, which is now trending toward the historically low level of 2 percent. If inflation and increased growth are anticipated, then bond yields tend to rise.

Concerns over the ability of US corporations to deal with unexpected changes in financial conditions were a feature of the *Global Financial Stability Report* issued by the International Monetary Fund (IMF) this week. It said companies with almost $4 trillion in assets, amounting to 22 percent of the total US corporate assets, would be "weak" or "vulnerable" in the face of a fiscal expansion that went wrong and led to rising interest rates.

The IMF said such a scenario could result if the Trump administration's tax cuts failed to produce a boost in the economy and led only to rising budget deficits and higher borrowing costs.

However, despite signs that prospects for economic growth are worsening rather than improving, and amid ongoing global political turbulence—not least the prospect of war—financial markets remain remarkably stable.

The Chicago Board Options Exchange Volatility Index, or Vix, known as Wall Street's "fear gauge," has remained at its lowest level its 24-year history. Last week the *Financial Times* published a major article under the headline, "The fearless market ignores perils ahead." It noted the "disconnect" between the political chaos and the calmness of the markets.

"Yet this tranquillity," it said, "is unnerving some analysts, who fear it has nurtured a panoply of trading strategies that could unravel if volatility returns to normal."

Christopher Cole, the head of a hedge fund that specialises in volatility trading, told the newspaper: "We are at an unprecedented time of low volatility, which typically presages epic downturns."

The fear is that given the state of calm on the markets, traders and their algorithmic programs are betting that any turbulence will be short-term. This ensures good profits if stability returns but can bring huge losses if it does not.

Cole likened low-volatility trades to the sirens of Greek mythology whose songs lured sailors to their death. "The siren call of risk is at its most powerful when we are at the point of maximum danger," he said.