Good outlook for the US economy, with the permission of investment

- The US economy continues to grow at a steady pace, although business investment has shown a marked slowdown in 2019.
- For the time being, this slowdown should not be cause for concern, since it is occurring after a period of strong growth spurred by the tax reform of 2017.
- In addition, the strength of the labour market, the negotiations currently underway with China and the Fed's accommodative shift will favour the continuity of the expansion in 2020.

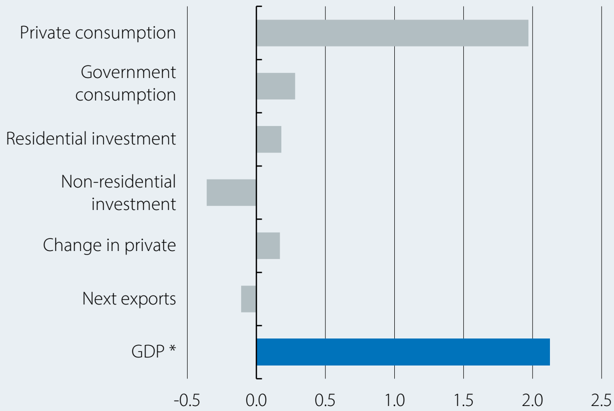
Since last July, the US has been in the longest expansionary phase in its history. Perhaps for this same reason, fears have arisen that the next recession is just around the corner. However, the latest data show that the country's GDP remained strong in Q3. In particular, US economic activity grew by 0.5% quarter-on-quarter (2.1% year-on-year), slightly above the forecast and the country's potential. But how much longer will this strength in the US economy's growth last?

The breakdown of the GDP growth seen in recent quarters, by components of demand, shows a mixed picture that deserves some attention. Private consumption has remained the main pillar of US growth. At the other end of the spectrum, in Q3, business investment (non-residential) contracted again for the second consecutive quarter, driven by the fall in investment in structures and equipment (see first chart).

Focusing on investment, its recent weakness must be taken in context, as it follows the strong performance shown in 2018. In particular, late 2017 saw the implementation of a sharp cut in corporation tax, as well as changes in the accounting standards relating to tax deductions for investment costs.[1] These acted as a spur for investment, which grew above the historical average throughout 2018 (see second chart). In this regard, it is somewhat natural for 2019 to be a year marked by much more contained levels of investment. Nevertheless, it is worth mentioning that the rise in investment following the tax changes was lower than most analysts had predicted. Similarly, the slowdown during 2019 has been somewhat greater than expected. Without a doubt, the trade disputes between the US and China which began in 2018 have weighed down on companies' appetite for investment since then.[2] That said, we could see an improvement in this mood thanks to the negotiations currently underway between the two countries. Despite some of the future investment indices developed by

Components of GDP in Q3 2019

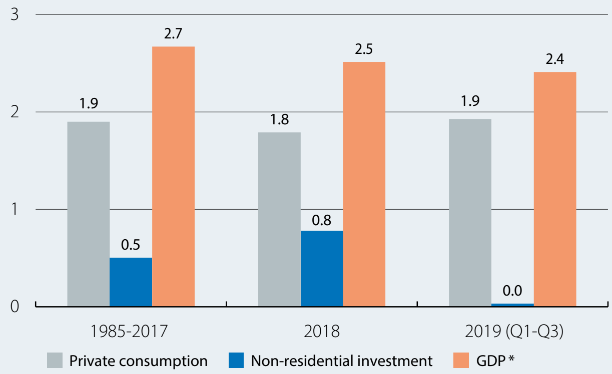
Contribution to annualised quarter-on-quarter growth (pps)



Note: * Annualised quarter-on-quarter change (%).
Source: CaixaBank Research, based on data from the Bureau of Economic Analysis.

US: GDP, consumption and investment

Contribution to annualised quarter-on-quarter GDP growth (pps)



Note: * Annualised quarter-on-quarter change (%).
Source: CaixaBank Research, based on data from the Bureau of Economic Analysis.

the various Federal Reserves not showing such an improvement (see third chart), at least for the time being, we believe that it could nevertheless materialise in 2020.

On the other hand, in April, Democrats and Republicans came to an agreement on the need to allocate 2 billion dollars to improve the country's infrastructure (roads, bridges, broadband, etc.). Undoubtedly, an increase in public spending on infrastructure of this scale could also

1. Tax Cuts and Jobs Act of 2017.
2. See E. Kopp, D. Leigh, S. Mursula and S. Tambunlertchai (2019). «US Investment Since the Tax Cuts and Jobs Act of 2017». Nº 19/120. International Monetary Fund.

give a significant boost to private investment. To date, however, these good intentions have not yet materialised in an infrastructure spending package, so a shift in the trend in investment in 2020 driven by this agreement appears less and less likely.

Finally, it should be noted that investment in intellectual property products has not only endured the uncertainty over trade and global geopolitics, but in the last two years it has even maintained a higher than usual growth rate (8% since 2018, versus the historical average of 6%). As such, investment in intellectual property products is less subject to the effects of uncertainty, especially in a country like the US, which has highly developed legislation on the matter.[3] Furthermore, the contrast between the strong performance of investment in intellectual property products and that of investment in structures suggests another possible explanation: the transition towards an economy that is increasingly focused on services and knowledge requires a lower level of investment, and one with a different composition (see fourth chart).

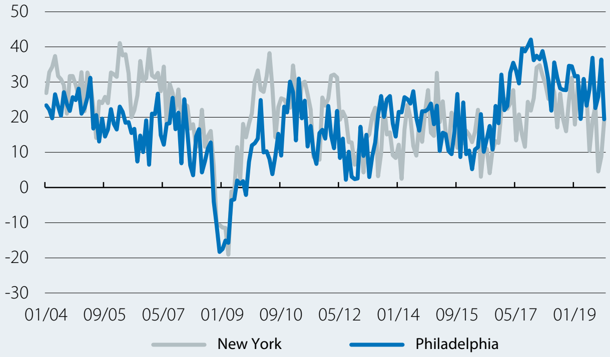
In short, the moderation in investment is something to be monitored, although it does not yet seem to be cause for concern. In addition, the strength of the labour market, with an unemployment rate at its lowest levels since the late 1960s and a higher than expected rate of job creation in an economy with full employment, will help to keep private consumption at high levels. Finally, the trade negotiations currently underway with China and the Fed's accommodative shift in recent months (see fifth chart) are two other factors that will favour the continuity of the expansion in 2020, with growth that we estimate at around 1.8%.

Clàudia Canals

3. See D. Czarnitzki and A.A. Toole (2011). «Patent protection, market uncertainty, and R&D investment» The Review of Economics and Statistics, 93(1), 147-159.

*Future capital expenditures index **

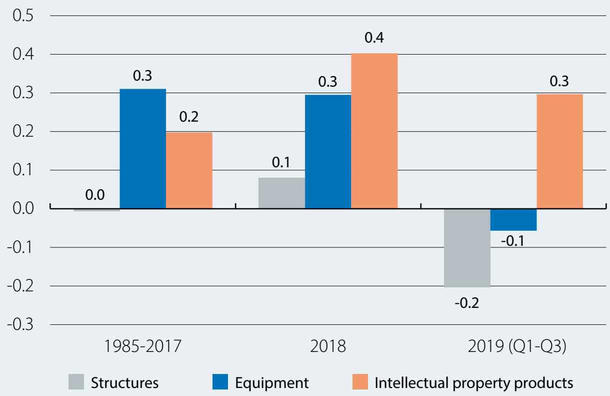
Level



Note: ** Diffusion index (expected capital expenditure over the next six months) by the Philadelphia Fed (includes the states of Pennsylvania, New Jersey and Delaware) and by the New York Fed (which comprises the state of New York). The index is calculated as the percentage of respondents who report an increase, minus the percentage who report a reduction. The index can take values of between +100 and -100. The mid-point (0) indicates that the same percentage of companies report an increase and a reduction in future investment.*
Source: *CaixaBank Research, based on data from the Federal Reserve Banks of Philadelphia and New York.*

US: non-residential investment

Contribution to annualised quarter-on-quarter GDP growth (pps)



Source: *CaixaBank Research, based on data from the Bureau of Economic Analysis.*

*US: reference interest rate **

(%)

Note: ** Fed funds rate. Upper limit of the range marked.*
Source: *CaixaBank Research, based on data from the Federal Reserve.*