Economic Outlook: Trade Trauma & Election Drama

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Big questions for 2020

Are we going into recession?

Will the global trade war flare up again?

Will the coronavirus hit growth?

Is the bull market over?

Where are interest rates headed?

Who's going to win the US election? How will it affect the policy path?
Will the coronavirus hit growth?

More widespread than SARS [2003], but less virulent and we’re more prepared

Mostly affecting China, but China in 2020 has much larger share of global GDP than in 2003 (USD: 4.3% vs 16.9%, PPP: 8.7% vs 19.7%)

BMO cut 2020:Q1 GDP growth to 4.8% y/y from 5.9% y/y

Hit to global commodity prices, tourism/travel, supply chains

Fed’s Monetary Policy Report [February 7, 2020]:

“Downside risks to the economic outlook seem to have receded... Labor market conditions and economic growth in the United States have been resilient to the global headwinds in 2019, and conflicts over trade policy diminished somewhat toward the end of the year. Economic growth abroad also shows signs of stabilizing, though the coronavirus outbreak presents a more recent risk.”
Global economy lost steam

Real GDP\(^1\)
2019:Q3 (y/y % chng)

<table>
<thead>
<tr>
<th>Country</th>
<th>Current</th>
</tr>
</thead>
<tbody>
<tr>
<td>China(^2)</td>
<td>6.0</td>
</tr>
<tr>
<td>India</td>
<td>4.6</td>
</tr>
<tr>
<td>US(^2)</td>
<td>2.3</td>
</tr>
<tr>
<td>South Korea(^2)</td>
<td>2.2</td>
</tr>
<tr>
<td>Japan</td>
<td>2.2</td>
</tr>
<tr>
<td>Australia</td>
<td>1.9</td>
</tr>
<tr>
<td>Russia</td>
<td>1.7</td>
</tr>
<tr>
<td>Canada</td>
<td>1.7</td>
</tr>
<tr>
<td>Brazil</td>
<td>1.2</td>
</tr>
<tr>
<td>UK</td>
<td>1.1</td>
</tr>
<tr>
<td>Eurozone(^2)</td>
<td>1.0</td>
</tr>
<tr>
<td>Mexico(^2)</td>
<td>-0.1</td>
</tr>
</tbody>
</table>

OECD Leading Indicator
(index : sa : amplitude adjusted)

Trade war hurt, but policymakers’ pivots helping

\(^1\) Sorted by current • \(^2\) 2019:Q4

Source: BMO Economics
Casualties of trade war

World trade volume\(^1\)
(y/y % chng)

Manufacturing PMIs
(50+ = increasing)

Capex clipped

\(^1\) CPB World Trade Monitor, Netherlands Bureau for Economic Policy Analysis • \(^2\) ISM • \(^3\) CFLP • \(^4\) Markit • \(^5\) Jibun/Markit

Source: BMO Economics
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Markets initially took the global trade war in stride... tax cuts helped

Beginning in 2017, antidumping and countervailing duty investigations along with investigations under Sections 201, 232 and 301 of US trade laws were ramped up

To date, 198 AD/CVD investigations have been initiated... most result in duties

February 2018... Section 201 (safeguard) tariffs

Solar panels (30%, mostly from China), washing machines (20%-50%, mostly from South Korea) ⇒ No retaliation

March 2018... Section 232 (national security) tariffs

Steel (25%), aluminum (10%)
⇒ Canada, China, EU, India, Mexico & Turkey retaliate

July-August 2018... Section 301 (unfair trade practices) tariffs

25% on $50 bln of Chinese goods ⇒ China retaliates

Section 301 then became the auspices to wage a full-blown trade war with China... markets were not amused
Trade war worries whipsawed market... now at record high owing to US-China deal

United States  (as of February 10, 2020)

S&P 500

Shaded areas represent periods of equity selloffs

Source: BMO Economics
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Powell’s pivot provided support to both stocks and bonds

United States  (as of February 10, 2020)

Stocks and bonds

Shaded areas represent periods of equity selloffs • ¹ (lhs: 1941-43 = 10) • ² (rhs: %)

Source: BMO Economics
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Yield curve flirted with inversion... Fed easing reversed

10-year Treasury spreads – United States (ppts)

Less reliable recession signal than before:
- Lower longer-run policy rates
- Reduced inflation risk
- Legacy of QE
- Negative global bond yields

But still a decent signal of slower growth ahead

Left panel: monthly averages • Right panel: daily closes

Source: BMO Economics
US economy slowing but remains far from recession

United States

Real GDP (% chng)

Contributions to real GDP growth (y/y % chng)

Source: BMO Economics
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Job growth affected by demand and supply factors

United States

Payroll employment
(000s : m/m chng)

November 2019: 6.8 mln job vacancies vs 5.8 mln unemployed

Unemployment rate
U6 rate

Source: BMO Economics
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Choppy wage gains

United States

Wages (y/y % chng)

Secular disinflation forces trumping cyclical inflation pressures:

- Demographics (aging population)
- Technology (automation, digitalization, AI)
- Globalization (supply chain management)

Source: BMO Economics

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Healthy balance sheets despite record-high debt

Households – United States

Debt

% of PDI\(^1\)\(^2\)

$ trlns\(^3\)

Net worth (% of PDI\(^1\))

Debt service (% of PDI\(^1\))

Prudently-paced growth  Record-high stocks  Borrowing capacity

\(^1\) [PDI] personal disposable income · \(^2\) (lhs) · \(^3\) (rhs)

Source: BMO Economics

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Eroding affordability hurt housing demand... but now rebounding

United States

New and existing home sales (mlns)

30-yr mortgage rate (percent)

Home price index (y/y % chng)

2018 tax changes magnified impact

Source: BMO Economics
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Relatively lean supply

United States (mlns)

Homes for sale

Housing starts

Sources: BMO Economics • 1 Joint Center for Housing Studies, Harvard University
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Peak car = Ride sharing + Electric vehicles + Aging population + Autonomous driving

United States

Light weight vehicle sales\(^1\) (mlns of units: saar)

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\(^1\) Autos + light trucks • \(^2\) February 2016 = 17.585 mln

Sources: BMO Economics • [magazine cover] Bloomberg Businessweek, March 4, 2019
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Businesses became more cautious

Real business fixed investment – United States  (y/y % chng)

Some capex in response to labor shortages

Source: BMO Economics
Construction spending topped $1.3 trillion in 2019

United States (y/y % chng)

Private

Residential (39.5%)

Nonresidential (35.3%)

Public

Residential¹ (0.5%)

Nonresidential² (24.7%)

¹ (lhs) • ² (rhs)

Source: BMO Economics

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Technological change pumping productivity gains

United States (y/y % chng)

Business sector labor productivity

Source: BMO Economics
Budget deal to avoid mini “fiscal cliff” and lift debt ceiling boosts spending

Federal budget deficit – United States

Largest non-recession-related deficits ever

Source: BMO Economics

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Legacy of trillion-dollar deficits

United States  (fiscal years)

Debt held by the public

Consequences:

Constrains fiscal flexibility

Causes interest payments to increase
(even if rates don’t rise)

Risks a fiscal crisis

Reduces total savings in the economy
(less available for investment...
more reliance on foreign savings)

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1 (lhs)  2 (rhs)

Source: BMO Economics
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Relatively stable total trade deficit (% of GDP)

United States

Goods and services trade balance

Source: BMO Economics

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Three “extreme” aspects of America’s trade deficit

Trade balance – United States (US$ blns : 12-mnth ms)

<table>
<thead>
<tr>
<th>Services¹</th>
<th>Petroleum goods²</th>
<th>Non-petroleum goods²</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="image" alt="Graph of Services" /></td>
<td><img src="image" alt="Graph of Petroleum goods" /></td>
<td><img src="image" alt="Graph of Non-petroleum goods" /></td>
</tr>
</tbody>
</table>

¹ BoP basis • ² Census basis

Source: BMO Economics
Deficits with China and EU are the major culprits

United States  (US$ blns : 12-mnth ms)

Goods trade balance

Source: BMO Economics
Let’s make a deal

Trans Pacific Partnership (TPP):
Withdrawed signature January 2017

Korea:
Renegotiated deal signed September 2018

Canada & Mexico (USMCA):
Renegotiated deal signed November 2018, Congress ratified January 2020
Mexico ratified June 2019... Canada to ratify within weeks

Japan:
New limited deal signed October 2019

China:
“Phase one” deal signed January 2020... on to “phase two”

In the works:
EU, UK
Slowing but still growing

United States

Real GDP (% chng)

Dampening factors:
- Slower global growth amid increased trade restrictions
- Labor shortages and other supply constraints
- Boeing’s suspension of 737 MAX production
- Coronavirus concerns

Supporting factors:
- Low interest rates
- Higher federal government spending
- Strong household balance sheets
- US-China trade deal... USMCA

Longest economic expansion in history should continue
Jobless rate hits its nadir as inflation stays restrained

United States

**Unemployment rate**
(Percent)

- FOMC longer-run projections:
  - Median: 4.1%
  - Lowest: 3.5%
  - Current: 3.6%

**PCE price index**
(y/y % chng)

- Total:
  - Target: 2.0%
  - Current: 1.6%

- Core:
  - Current: 1.6%

Source: BMO Economics

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A “mid-cycle adjustment”

United States

Interest rates (%: as of February 10, 2020)

<table>
<thead>
<tr>
<th></th>
<th>Fed funds</th>
<th>Treasury</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current</td>
<td>1.50-1.75</td>
<td>1.56</td>
</tr>
<tr>
<td>End-2020</td>
<td>1.50-1.75</td>
<td>2.00</td>
</tr>
<tr>
<td>End-2021</td>
<td>1.50-1.75</td>
<td>2.20</td>
</tr>
</tbody>
</table>

“Monetary policy is in a good place”

Further rate cuts require “material reassessment of our outlook”

Rate hikes require “significant” and “persistent” inflation pickup

[history] weekly averages • [forecast] monthly averages

Source: BMO Economics
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The Fed is studying changes to its monetary framework... Due mid-2020

United States

Since an inflation target was adopted in January 2012, allowing a 0.1%-range around 2% core PCE inflation, the Fed has...

- Achieved the target 19% of the time (1.9% to 2.1%)
- Come up short 81% of the time (<1.9%)
- Never exceeded the target (>2.1%)

The Fed refers to the target as being “symmetric” but note the complete lack of symmetry

Options:
- Employ additional inflation metrics
- Move to history-dependent (average) inflation targeting
Uncertainties and risks persist

Trade tensions:
“Phase one” deal compliance... progress of “phase two” talks
US-EU, US-WTO skirmishes

Climate change:
Extreme weather events

Global issues:
Iran, Brexit, Hong Kong, North Korea, coronavirus

US election
Who will face Donald Trump on November 3?

Latest national polls say...

1. Joe Biden
2. Bernie Sanders
3. Elizabeth Warren
4. Michael Bloomberg
5. Pete Buttigieg
6. Amy Klobuchar
7. Andrew Yang
8. Tom Steyer

Iowa results
Buttigieg
Sanders
Warren
Biden
Klobuchar

New Hampshire
Today!

Super Tuesday
March 3

Source: BMO Economics
Q and A

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