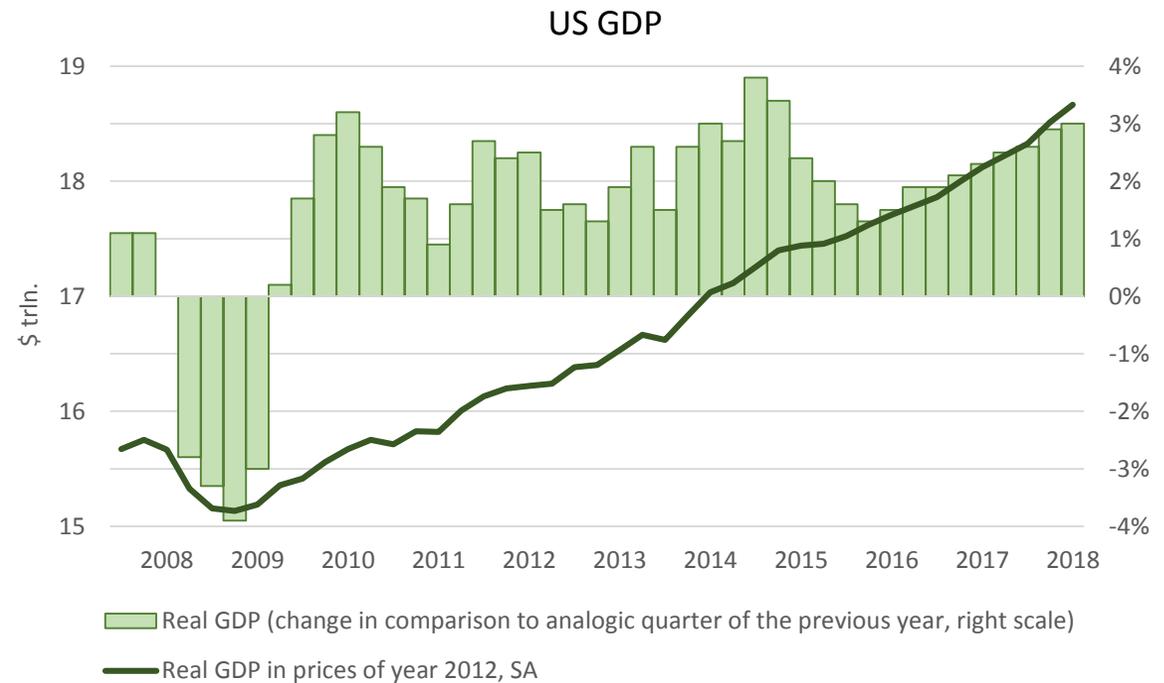


US Economy under Trump

Currently, the United States economy feels great thanks to the Fed's long, super-soft monetary policy, falling domestic energy prices and tax incentives from Donald Trump. However, it is possible that the United States has already reached the peak of the current economic cycle, and soon its economy will begin to experience signs of slowing down.

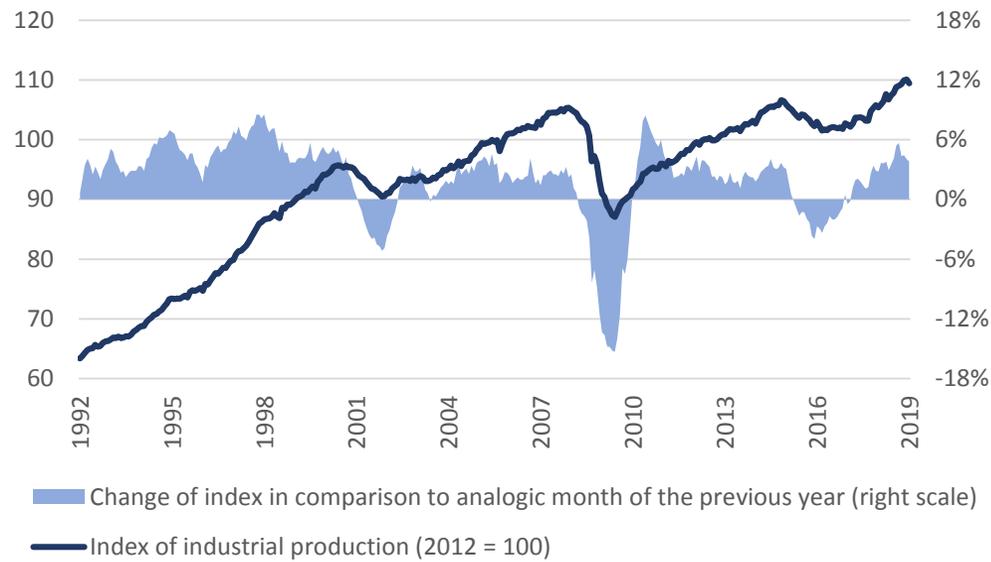
Main factors

For the first time since the 2008 crisis, US GDP has formed a tendency towards steady acceleration. For the past two years, every quarter, the economy has been growing faster than a year ago. The average growth rate exceeds 2%, which is quite good for a developed country. Key macroeconomic indicators are at historic highs.



Source: U.S. Bureau of Economic Analysis

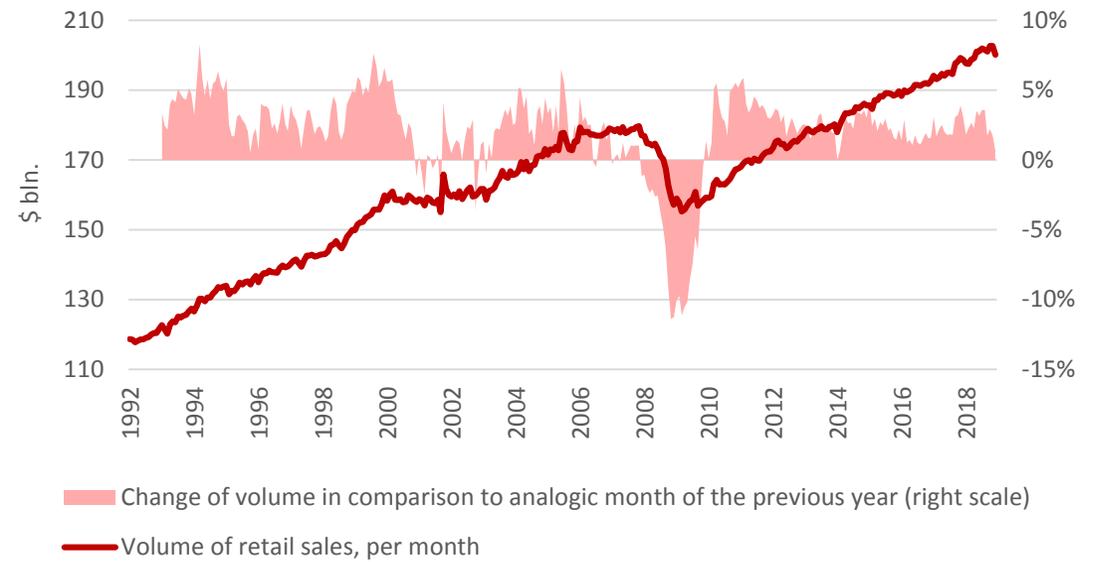
Industrial Production Index



Source: Board of Governors of the Federal Reserve System

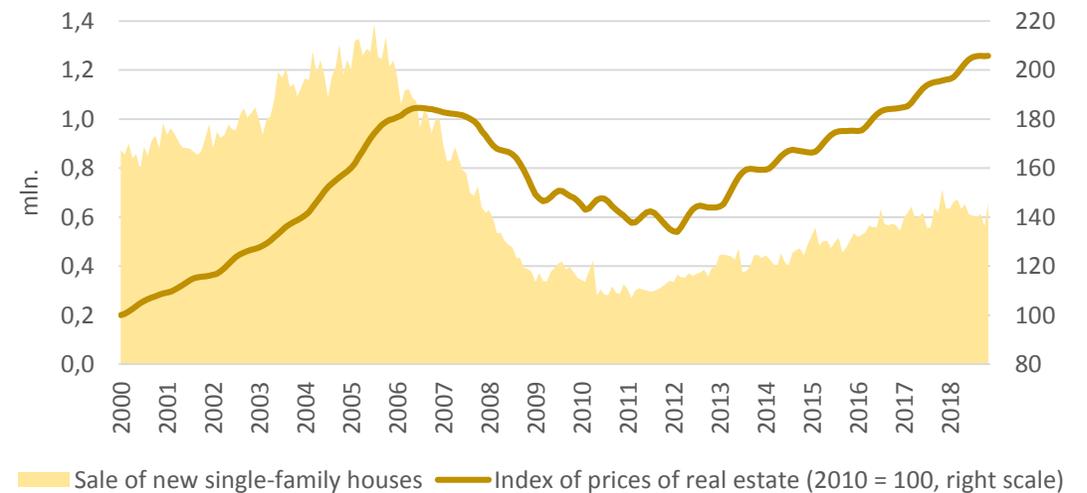
One of the few problems of the American economy remains the real estate sector - sales have not been able to fully recover from the crisis, they are limited by a strong price increase, which has already exceeded the pre-crisis values.

Retail sales



Source: Federal Reserve Bank of St. Louis

Home sales and real estate prices



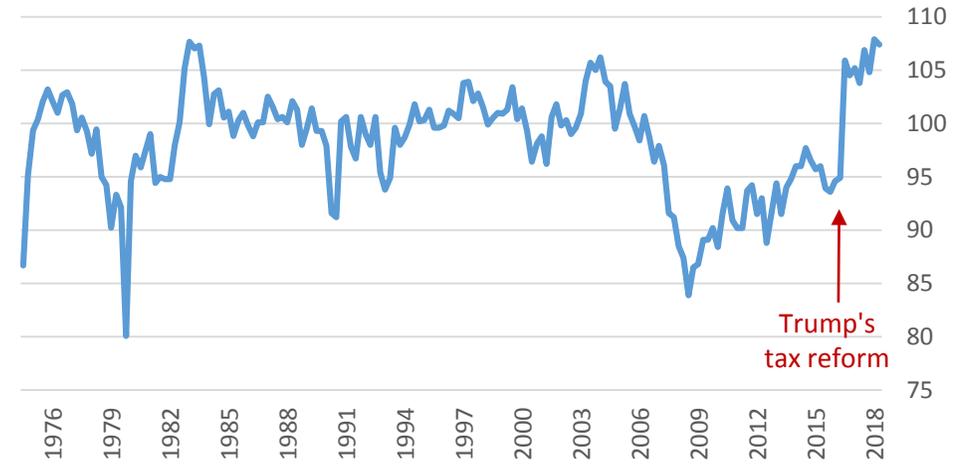
Source: U.S. Bureau of the Census, S&P Dow Jones Indices LLC

Optimism and trust

American business is very positive, in accordance with real indicators. The small business optimism index, after the announcement of tax reform by US President Donald Trump, has updated historic highs. The index of business activity in the industry is not far from the peak of 2004, in the service sector - the maximum in the entire history of calculations.

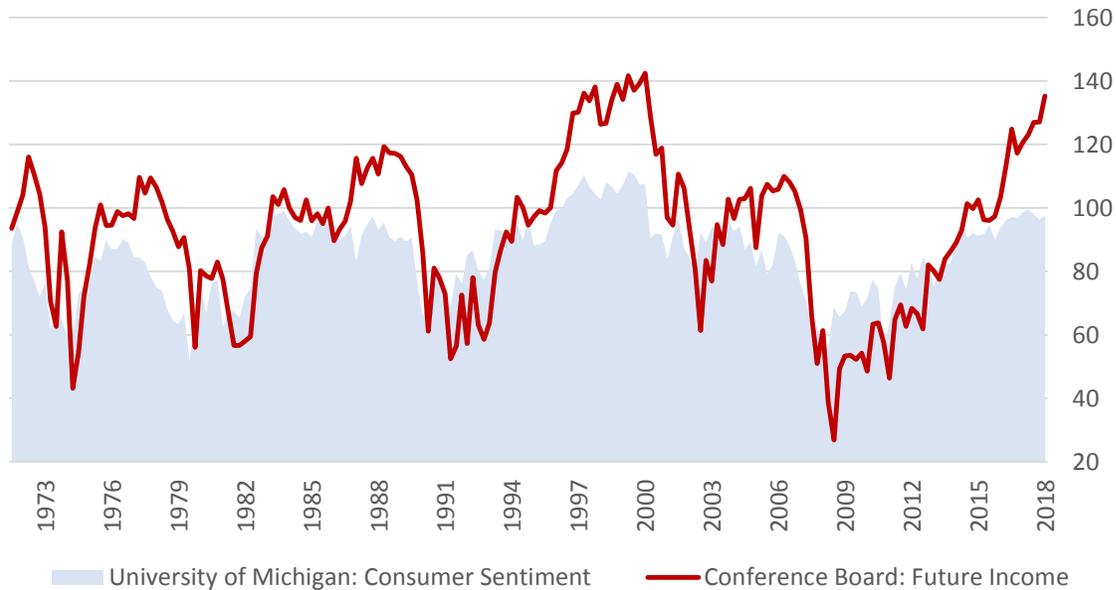
Consumer confidence indicators have not yet reached their peak, but they are not far from them. Of interest is the trend - the consumer confidence index has never grown so much for such a long time - in ten years from the historical bottom almost to its maximum.

Index of Small Business Optimism (NFIB, 1986 = 100)



Source: National Federation of Independent Business (NFIB)

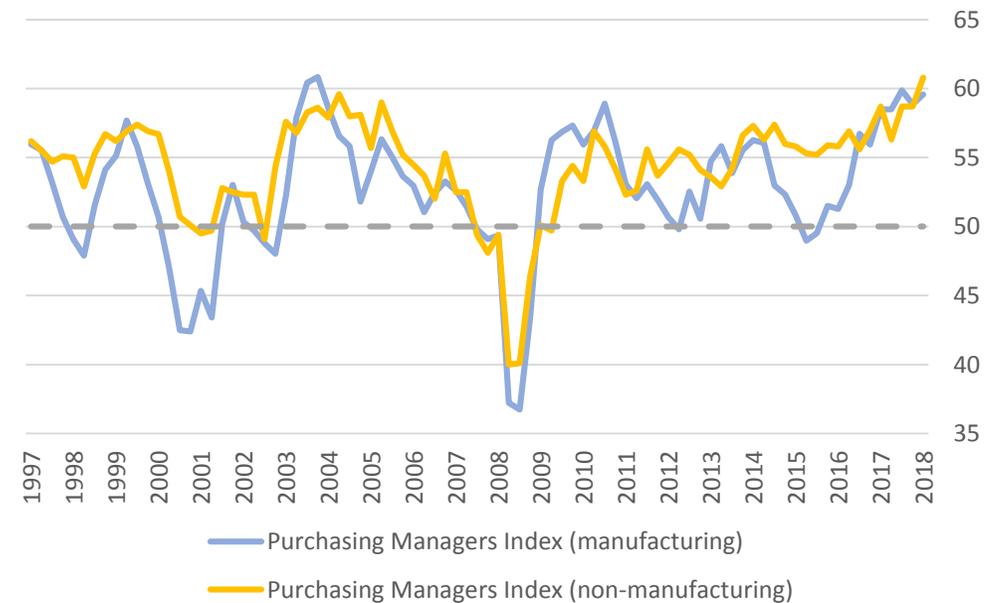
Consumer Confidence Indexes



University of Michigan: Consumer Sentiment Conference Board: Future Income

Source: University of Michigan Surveys of Consumers, The Conference Board

ISM Business Indices



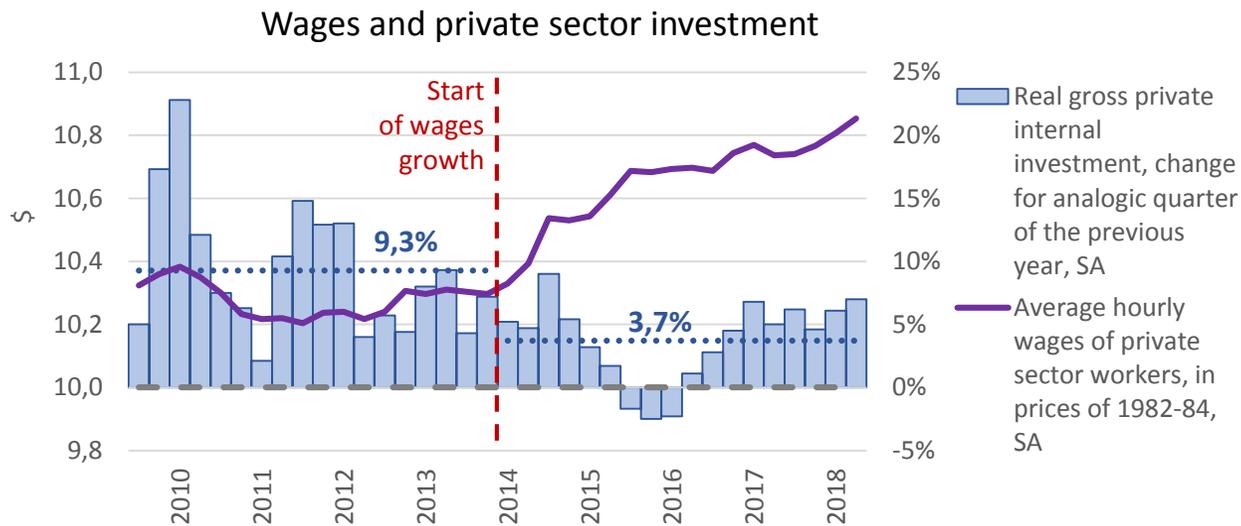
Purchasing Managers Index (manufacturing)
Purchasing Managers Index (non-manufacturing)

Source: Institute for Supply management (ISM)

Employment

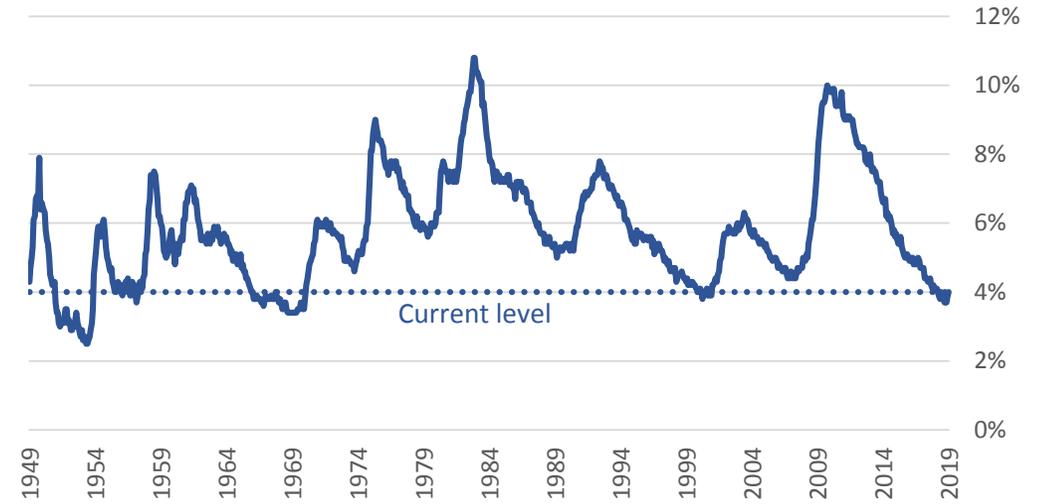
The unemployment rate is close to a twenty-year low. More accurate picture is given by applications for unemployment benefits. In contrast to the unemployment rate, they do not take into account those who do not officially have work, but at the same time they are financially safe enough not to issue a benefit. As a percentage of the number of working-age population, the number of applications filed reached a minimum in the entire history of observations, and the duration of the downward trend is also a record.

The number of unemployed able-bodied Americans is so small that it creates threats for further economic growth. The level of wages has been growing rapidly over the past four and a half years, limiting business profits and, accordingly, their investment opportunities. In 2010-2013, during the stagnation of wages, the volume of investments grew by an average of 9.3% per year, in 2014-18, during growth, by 3.7%.



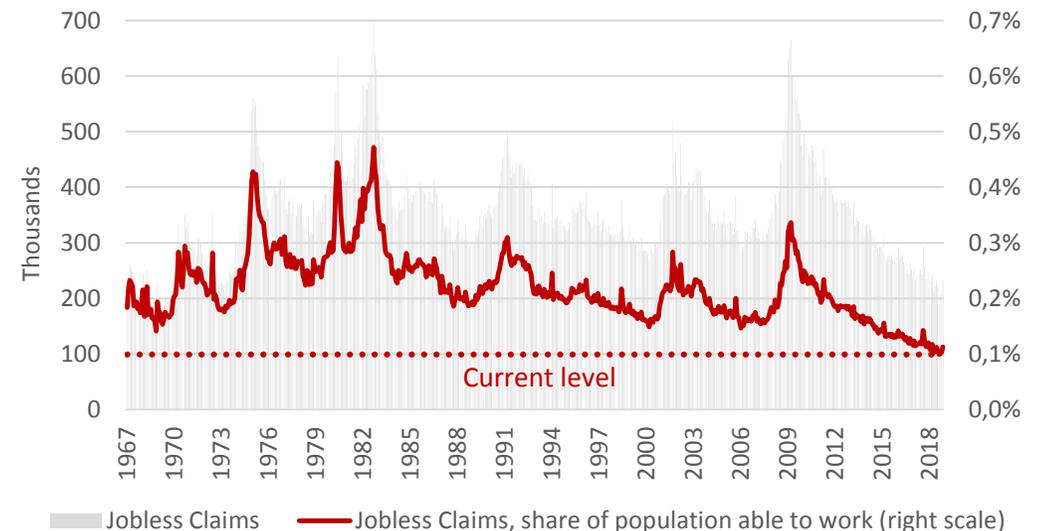
Source: U.S. Bureau of Economic Analysis, U.S. Department of Labor
The numbers on the graph show the average annual growth rate of private investment over the period selected.

Unemployment rate



Source: U.S. Bureau of Labour Statistics

Jobless Claims



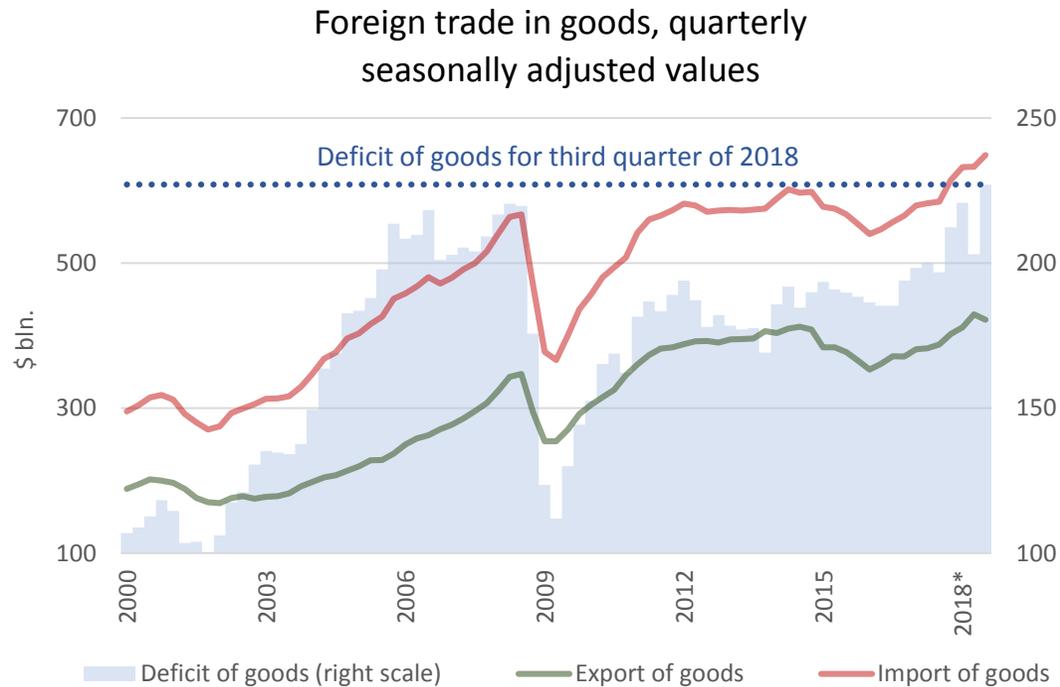
Source: U.S. Department of Labor, Organization for Economic Co-operation and Development

Influence of the trade war

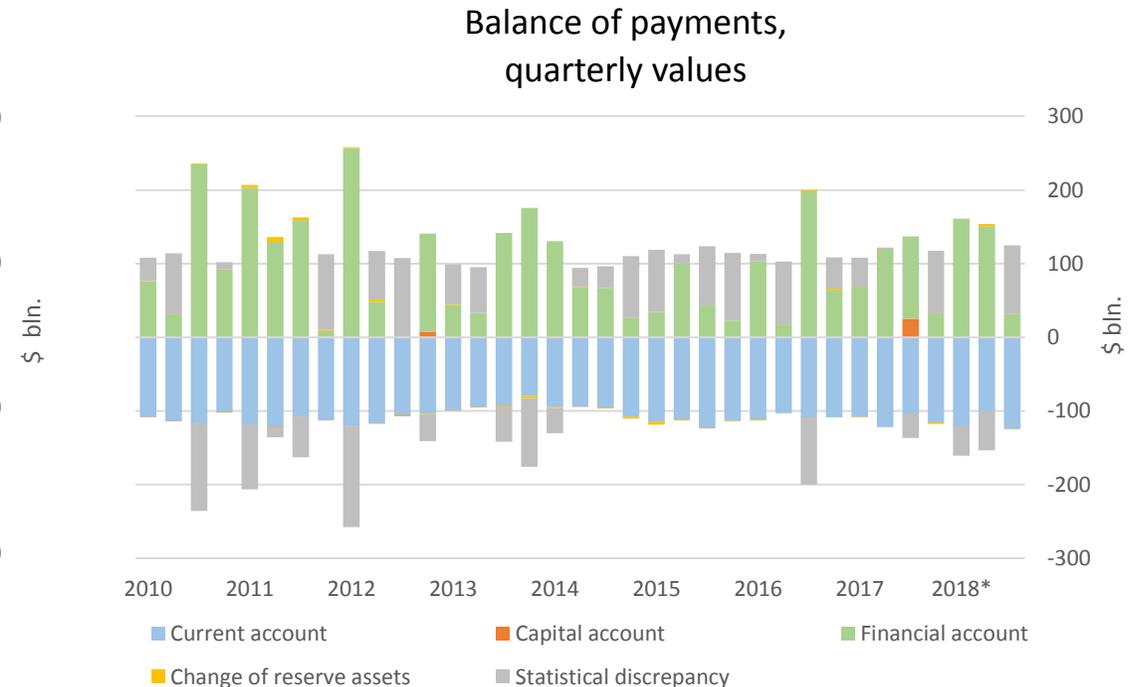
The trade war unleashed by Donald Trump influences the US economy. After Trump announced the imposition of import duties, mainly Chinese, companies stepped up foreign trade, trying to buy more goods before the tariff increase. As a result, the US trade deficit in the third quarter of 2018 reached a new historical maximum in absolute terms.

A high trade deficit reduces GDP, reflecting negative net exports, but this event is most likely a one-time event. Regardless of whether Trump continues to raise tariffs or not, this will no longer have the same effect on the activity of importers as in 2018.

The balance of payments of the USA as a whole has changed little. Due to the increased surplus of the United States in trade in services, the current account deficit grew slightly, much weaker than the commodity deficit, and is still balanced by mostly foreign investment (financial account).



Source: U.S. Bureau of Economic Analysis
* last value for the third quarter of 2018

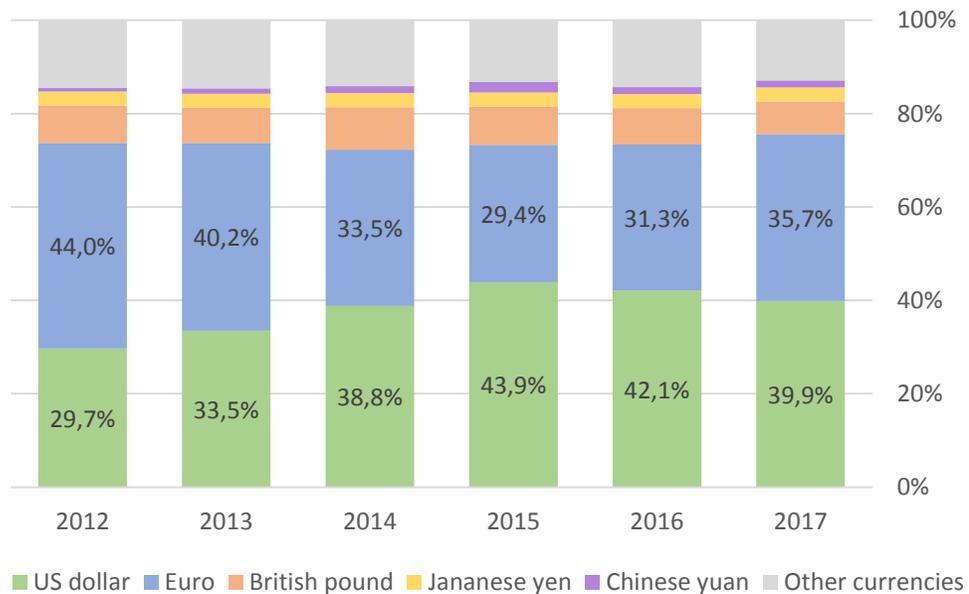


Source: U.S. Bureau of Economic Analysis
* last value for the third quarter of 2018

To close the current account deficit with foreign investments is allowed to the United States, in particular, by the continued dominance of the dollar in the global financial market. While there are no serious competitors for the dollar - the eurozone is fragmented and includes countries with bad debts, Japan cannot get out of many years of stagnation, the economies of Great Britain and Switzerland have insufficient capacity, and the Chinese yuan has non-transparent pricing and restrictions on capital movement.

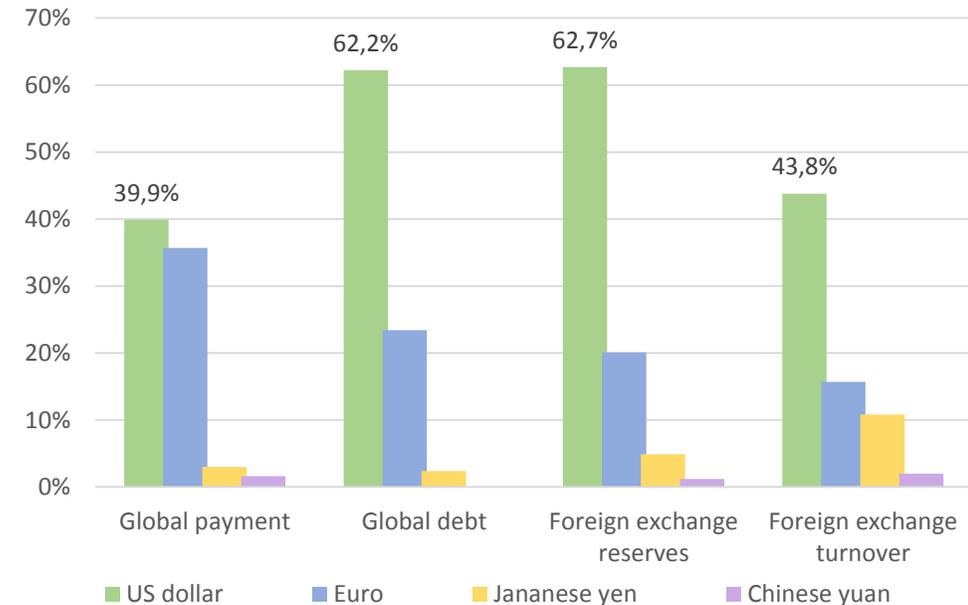
The share of the US dollar in international settlements in 2017 was almost 40%, having increased from 2012 by a quarter. The high proportion of the euro, exceeding in 2012-13 even a dollar, should not be misleading, as it includes calculations between members of the eurozone. More indicative is the data of the global debt, more than 60% denominated in dollars, and foreign exchange reserves of central banks, where the share of the dollar also exceeds 60%. The role of the US dollar as a world currency remains unshakable.

Share of currencies in international settlements



Source: Society for Worldwide Interbank Financial Telecommunications (SWIFT)

The international role of currencies, 2017



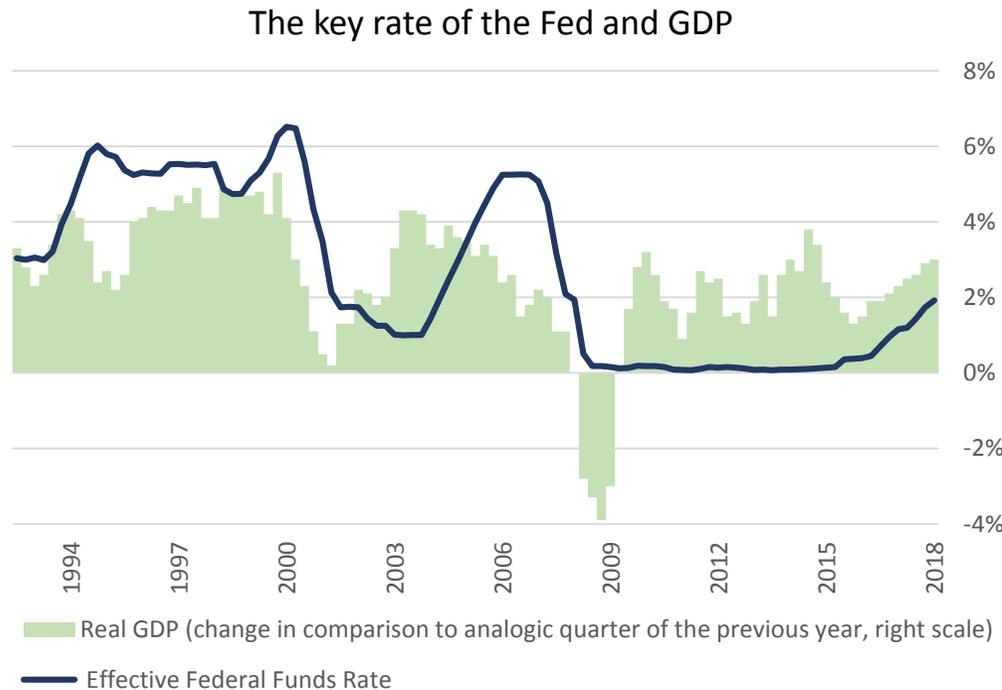
Source: Society for Worldwide Interbank Financial Telecommunications (SWIFT)

Fed Monetary Policy

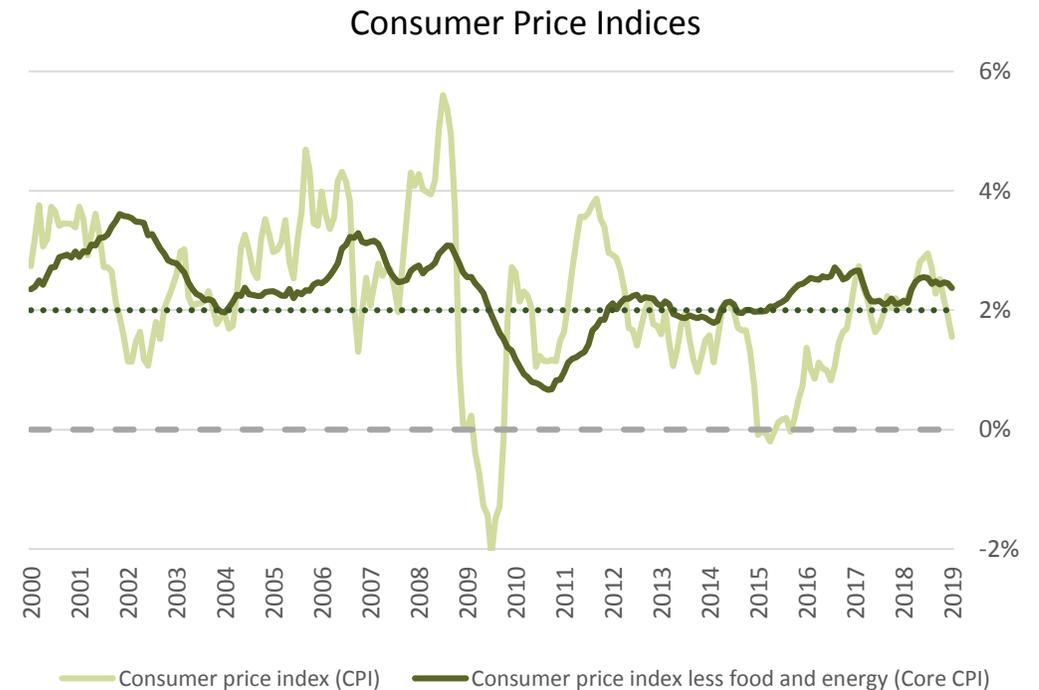
In periods of economic growth, the US Federal Reserve raises the stakes in part because of the desire to prevent the economy from overheating, but mainly to get to the point of slowing down the economy at a high enough rate that could be significantly reduced.

The US economy recovered fairly quickly after the 2008 crisis, but the Fed kept the rate around zero until 2016, considering the growth of the economy to be too volatile. Since 2017, monetary policy has been steadily tightening, reflecting the Fed's view of the strength of the economy and the fears of its imminent slowdown

The inflationary pattern is favorable for the Fed rate increase - the consumer price index, with the exception of volatile energy and food prices (core CPI) has been steadily staying above the target level of 2% for four years.



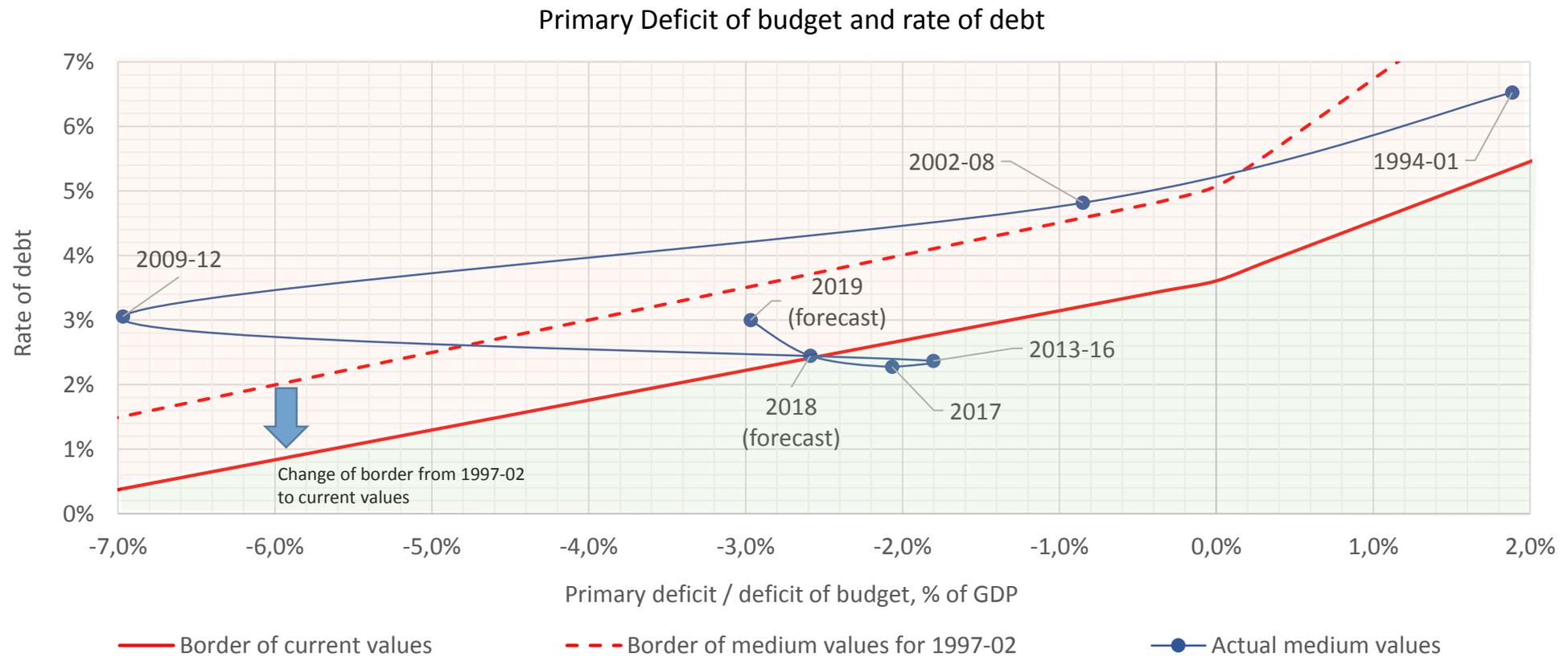
Source: Board of Governors of the Federal Reserve System, U.S. Bureau of Economic Analysis



Source: Organization for Economic Co-operation and Development

The beginning of the cycle of raising the key rate can have unpleasant consequences for the debt burden of the US economy. Previously, we built a US government debt sustainability model (link to a review about US debt), which showed that in the event of an increase in interest rates, the US economy would become so-called “red zone”, in which, while maintaining current trends, the US national debt will double the volume of GDP.

18. Furthermore, thanks to the Trump reform, the corporate income tax rate has dropped dramatically, which should significantly reduce fiscal revenues. According to official forecasts, the primary budget deficit will only grow over the coming years. Thus, the increase in the key rate and the growth of the primary budget deficit should push the US economy into the “red zone” by 2019.



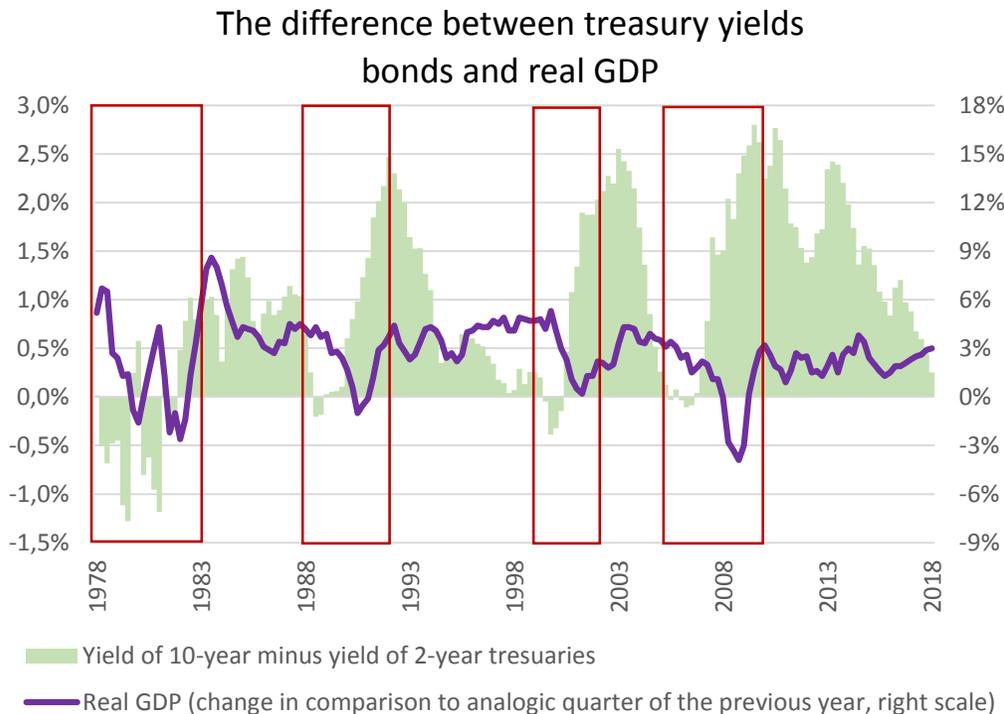
Source: Bureau of Economic Analysis, Office of Management and Budget, расчёты Standard Capital

Waiting for recession

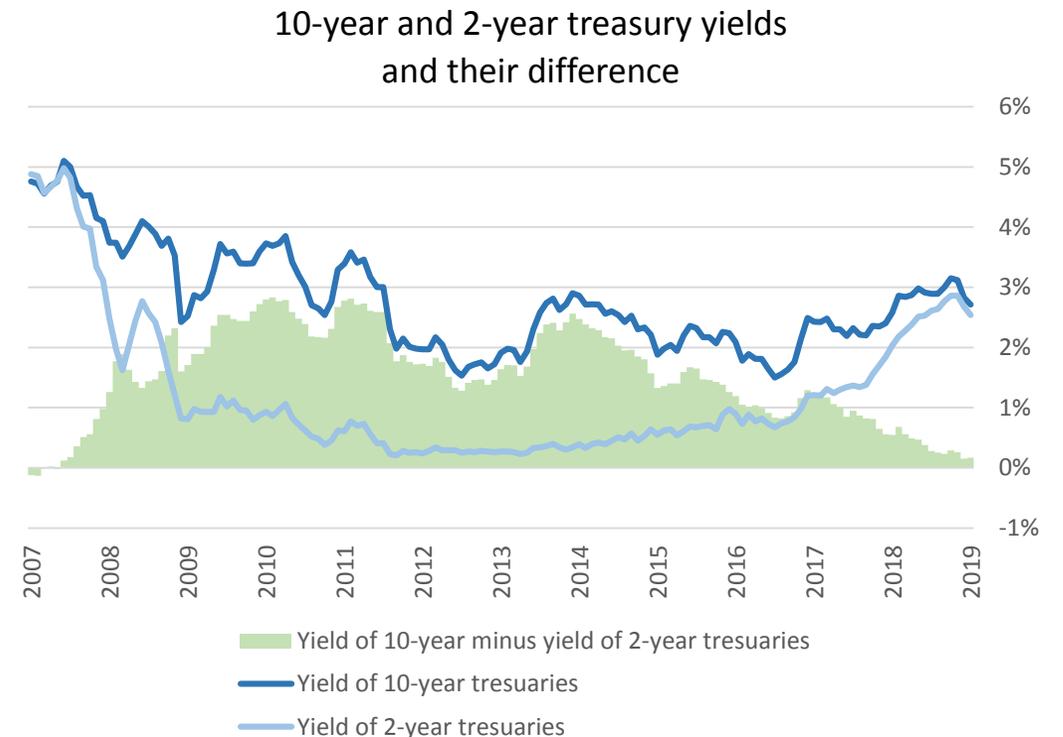
One of the most accurate harbingers of economic recession in the United States is the difference between the yield of bonds with different maturities. If investors believe that a crisis will come in the future and, accordingly, the Fed will be forced to lower the key rate, the spread between long-term and short-term securities will be reduced. If the spread becomes negative, then with a high degree of probability the economy will begin to decline.

This is clearly visible on historical data. The difference between 10-year and 2-year treasury bonds went into negative territory only a few times over the past forty years and after some time, on average, about a year, followed by GDP.

The current situation gives rise to well-founded concerns in the imminent recession. The difference in profitability has fallen to a minimum in the last decade. The last time it reached the same level at the end of 2007, shortly before the financial crisis.



Source: Board of Governors of the Federal Reserve System,
U.S. Bureau of Economic Analysis



Source: Board of Governors of the Federal Reserve System

The current state of the US economy looks very positive, many macroeconomic indicators such as industrial production, retail sales, employment, optimism of the population and business have reached record levels. But crises in a market economy are inevitable, and it is possible that right now the economy is experiencing the highest point of the current business cycle.

Investors and the Fed have already begun to prepare for the economic downturn. Among the risk factors for the US economy, there is an increase in the cost of servicing the public debt, an uncertain situation with the completion of trade disputes with China and political upheavals associated with the anomalously tough opposition of Congress and President Donald Trump.

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