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The US economy – quo vadis?

Market Comment, March 2024

Contrary to the consensus view of almost all economists, the US was able to present a fairly pleasing economic picture in 2023. This was made possible by the level of excess savings, which is still benefiting from the cheques sent out by the US government to counteract the coronavirus pandemic and which was revised upwards by the US authorities at the end of the third quarter of 2023. It is now likely that these savings are slowly waning, as US consumers have failed to hold back on spending in recent quarters. As things stand, however, the US economy is clearly outperforming its EU counterpart, thanks to greater investment growth and the solid consumption seen to date, among other factors.

Over a period of many quarters now, the US economy has succeeded in delivering positive news underpinned by better-than-expected figures. There are many reasons for this. Firstly, distortions induced by the US government's fiscal policy during the coronavirus crisis have seen demand amongst US consumers remain massively above the historical trend. In particular, greater travelling activity, similar to that seen in Europe, and attendance at music and sporting events, among other things, have been responsible for the robust performance posted by the economy's service sectors up until now. While manufacturing in the US put in a less dynamic performance in 2023, this was still clearly better on the whole than that of European industry. Notably, the difference between German and US industrial production has become more marked in recent months. Over the coming quarters, however, it is unlikely that the challenges facing US industry will be any easier. Although rising military spending is providing support, greater tensions in terms of trading with China would have a detrimental effect.

To the surprise of almost all global economists and contrary to the market consensus view, the US economy maintained 2023 a solid rate of growth relative to the previous year at 2.5%. This was also the primary reason for the unexpectedly positive developments on the equity market in 2023. Two other factors played a role in the good economic performance on the other side of the pond last year. Firstly, the official third-quarter revisions in terms of the income situation revealed that the excess savings of US households accumulated thanks to the distribution of cheques by the government were higher than expected. Secondly, high government spending, especially on alternative energies, provided a further boost to investment growth, although this was accompanied by a significant increase in debt and the budget deficit. Economic growth in the US thus came in above expectations in 2023, a performance that also had a positive impact on other global equity markets.

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> Gérard Piasko, Chief Investment Officer

While a certain slowdown in economic growth is possible over the coming quarters, this is by no means certain. On the one hand, savings will tend to provide less support to consumption during 2024 than they did in 2023. On the other hand, the further rise in US market interest rates in 2023 is putting the brakes on the US economy. Although the financing environment for consumers has changed as a result of the hikes in key interest rates, the so-called wealth effect is underpinning private consumption via higher equity prices.

The US housing market, which has historically proven to be particularly sensitive to interest rates, remains fragile and the valuation of US real estate remains vulnerable, as it is by no means favourably priced relative to the past. Finally, the more restrictive lending policies adopted by banks could weigh on the US economy more in 2024 than they did last year despite the fact that they are by no means as restrictive as they were around six months ago.

The potential for a decline in supply growth also has positive sides, as it could reinforce the fall in headline inflation, thus impacting real income (inflation-adjusted). A further important factor will be the development of core inflation, i.e. inflation excluding energy and food prices. Rents, which remain stubbornly high, and prices for services are currently only allowing for a relatively slow decline in core inflation. The US labour market is also important here, as unemployment remains low by historical standards. This means that the wage pressure in the US labour market has not yet really dissipated, a fact that, alongside the development of headline inflation, will influence the interest rate policy of the US Federal Reserve. Whether the financial markets' very optimistic expectations in terms of interest rate cuts will prove justified will be determined in no small part by how these factors develop.

Conclusion: By historical standards, there is currently an above-average level of uncertainty when it comes to both the development of the US economy and the interest rate policy of the US Federal Reserve. A balanced investment policy with a focus on quality in both the equity and bond spaces remains the order of the day.

Gérard Piasko

Gérard Piasko is Chief Investment Officer and head of the investment committee of private bank Maerki Baumann. Before he was for many years Chief Investment Officer of Julius Baer, Sal. Oppenheim and Deutsche Bank.

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