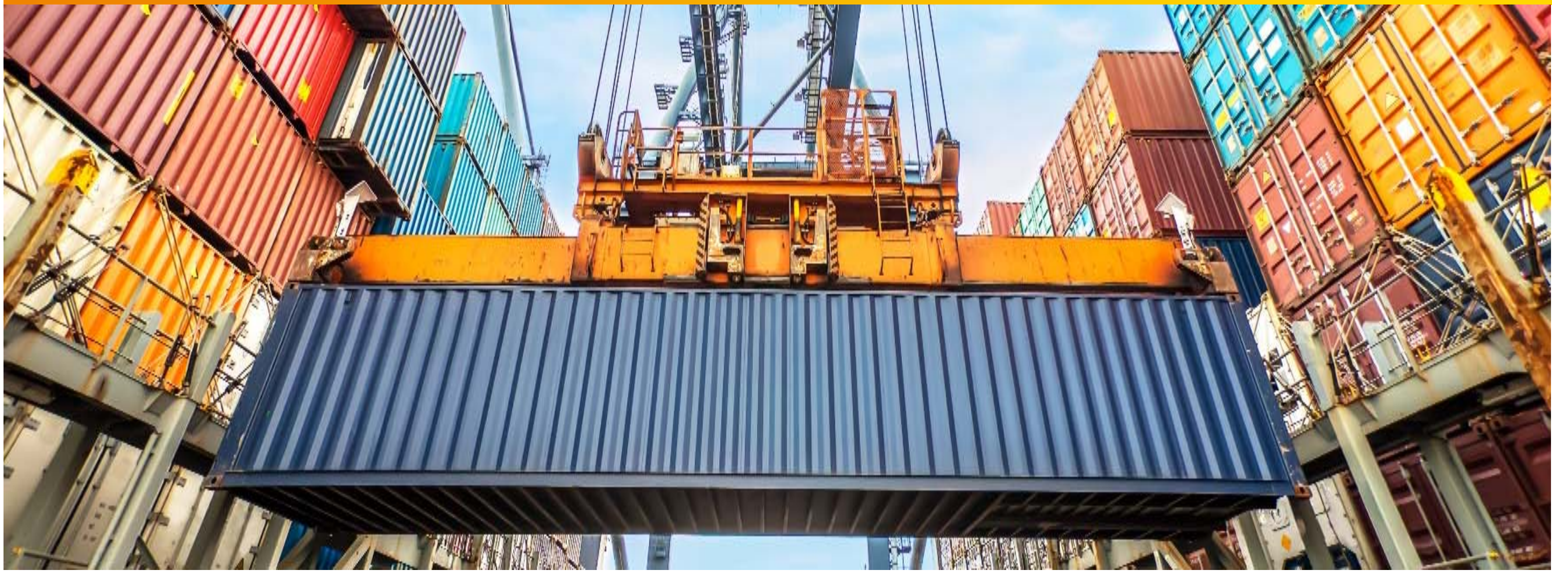
Wayne Best
Chief Economist
wbest@visa.com

Chief Economist Newsletter

November 2018



Strong growth for the U.S. economy, but will it last?

Key Takeaways:

- **Consumer spending, jobs and confidence should fuel U.S. economic growth through 2019**
- **Indirect effects of potential trade war could undermine economic growth**
- **Tariff impact will depend on each state's exports and trading partners**

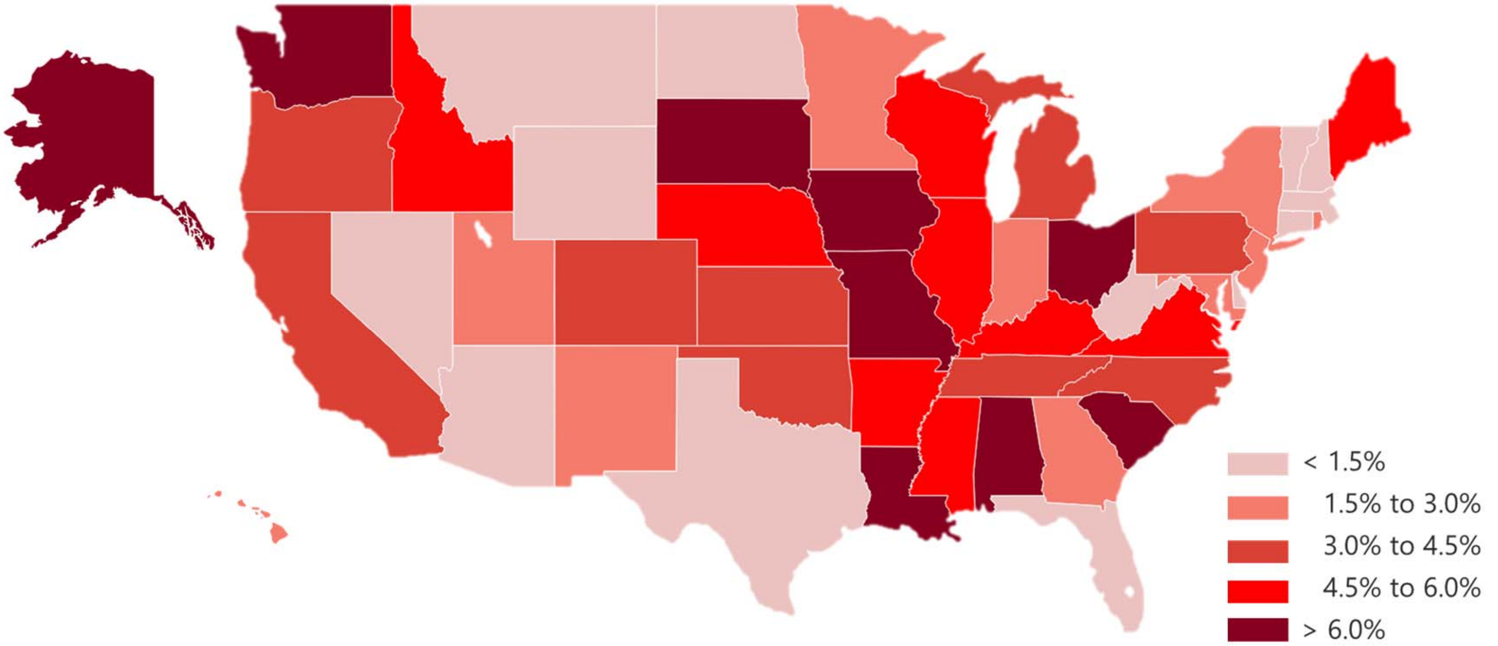
Strong economic growth is likely to continue in the near term, with consumer confidence climbing and income growth slowly but surely accelerating. Robust consumer spending and employment are also fueling this trend. If this keeps up, the U.S. economy could even break a record next summer for the longest uninterrupted growth streak since records have been kept. However, the expansion will not go on forever. In the short term, the continued threat of a trade war is the wild card in the equation that could disrupt the economy's current positive trajectory. Long term, other economic events could also be the linchpins that push the country into a recession.

The direct impact of a trade war is generally felt by consumers when goods subject to newly enacted tariffs cost more as a result. Currently, the percentage of personal consumption expenditure represented by imports from all trading partners is still a relatively low 18 percent.[1] When broken down by specific trading partners it becomes even less consequential. The portion represented by imports from China, for example, is still fairly low at 4 percent[2] of the total. However, the impact will be unevenly felt across different income groups, as imports from China are more prevalently consumed by less affluent Americans.

Strong growth for the U.S. economy, but will it last? (cont.)

The trade war impacts will also affect different areas of the country in different ways. Nearly half of the country's states have 4 percent or more of their total exports that will be affected by the new tariffs. This is especially pronounced in much of the central region of the United States (as shown in the chart below). Some tariffs affect multiple states that produce similar goods, such as soybeans in North Dakota, Illinois, Ohio, Louisiana and others, or passenger vehicles in states like Oregon, Kentucky, Michigan, Georgia and Alabama. Other tariffs impact individual states—Maine lobster, Alaskan salmon and Hawaiian macadamia nuts, for examples. These tariffs could affect job growth disproportionately throughout the country.

Share of total exports impacted by new tariffs



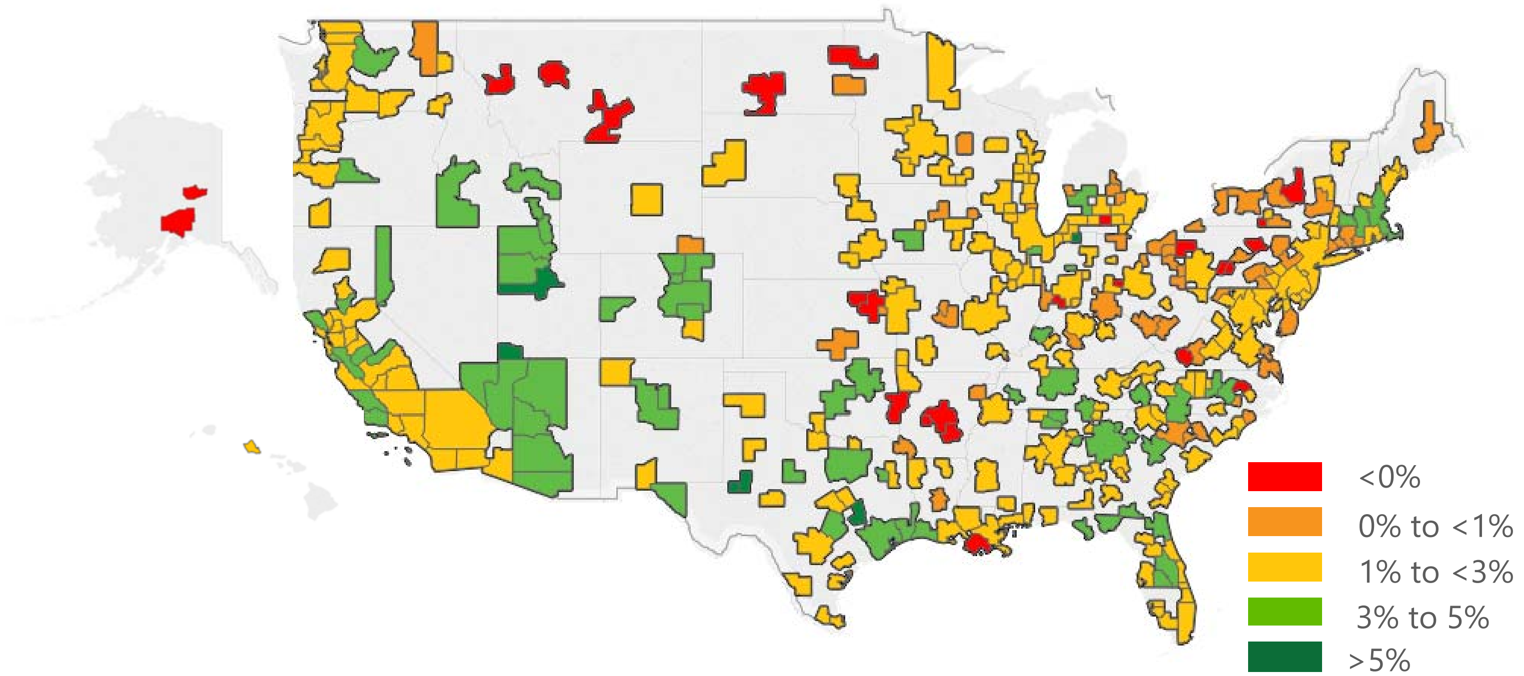
Source: Visa Business and Economic Insights analysis of U.S. Chamber of Commerce and U.S. Census data as of July 2018.
* Download associated data file for actual growth rates: exports-tariffs.xlsx.

The impact of the tariffs also depends on the trading partner and how much the exports figure into each state's total economic output. European Union tariffs, for example, affect Rhode Island, Tennessee and Florida most, while Mexico's tariffs affect states from Texas on up to South Dakota, according to Visa Business and Economic Insights' analysis of U.S. Chamber of Commerce and U.S. Census data. China's tariffs affect a broader array of states, including the west coast and pacific northwest states, while nearly half of all state economies would be impacted by Canadian tariffs should a full-blown trade war transpire with the largest U.S. trading partner.

The good news is that the "economic health" of much of the country's consumers is fairly strong, with only small pockets of stagnant or declining employment and retail sales growth, according to Visa Metro Insights (as shown in the map below). This means that most areas are likely to be able to weather the tariff impact, for now. In addition, negotiations to create the new United States-Mexico-Canada Agreement are a step in the right direction, but the trade deal still needs to be ratified by Congress and that likely won't happen until next year. Nevertheless, it appears conditions have returned to a relative status quo among the three North American trading partners.

Strong growth for the U.S. economy, but will it last? (cont.)

Growth of consumer economic health*
(by Metropolitan Statistical Area, 2Q2018)



Sources: Visa Business and Economic Insights; Visa Metro Insights. *Measures employment and retail sales growth. Download associated data file for actual growth rates: economic-health-metro.xlsx.

Potential trade war adds uncertainty to the outlook

The indirect impacts of the tariffs may prove to be a bigger issue. Fear of a trade war could lead to indecision and a deceleration of investment among businesses, as well as a drop in consumer confidence. U.S. GDP under a trade war could drop more than 1 percent below current GDP estimates.[3] However, this is still unlikely to push the U.S. economy into a recession. Investor angst is being stoked by uncertain monetary policy, geopolitical concerns that may affect trade and the global economy, as well as rising interest rates. This could lead to a continued period of stock market volatility and in turn impact consumer spending. It appears, the *fear* of a trade war would have a larger impact on the economy than the trade war itself.

Currently, the economy is expanding at an impressive pace. In 1H2018, tax cuts helped to boost disposable income and drive a surge in consumer spending. Very low jobless claims filings and a high number of job openings in September—at 7.0 million[4]—are signaling a tighter labor market, although job growth to-date is still holding steady. GDP growth, while strong now, is expected to gradually slow in 2019/2020, but there are some risks that could lead to a further deceleration beyond what is forecast. A more rapid labor market tightening, combined with recently-enacted tariffs, may put further pressure on inflation and lead to more rate hikes from the Federal Reserve. Consumers would likely pull back on their credit demand and spending, particularly if prices begin rising faster than income.

Potential trade war adds uncertainty to the outlook (cont.)

Economists will also look for signs of a looming recession. Certain economic indicators have historically led recessions by several months, such as initial fillings for unemployment insurance benefits, upward unemployment rate movement, a spike in oil prices and an inverted yield curve,* which successfully identified every downturn in the last 60 years. Other indicators may be more telling today. Economists, for example, will watch closely for a change in the Conference Board's Leading Economic Indicators—a weighted average of 10 top economic indicators that has dipped below zero prior to seven of the past eight recessions—especially if it coincides with an inverted yield curve and higher-term corporate bond risk premiums. This confluence of trends may be more likely to foretell a contraction on the horizon in the current economic climate. For now, consumers appear ready to start the holiday shopping season with gusto as their spending-fueled economic activity continues.

Sources

[1] Visa Business and Economic Insights analysis; U.S. Census Bureau; U.S. Bureau of Economic Analysis; Oxford Economics
[2] U.S. Chamber of Commerce, U.S. Census Bureau
[3] Oxford Economics
[4] IHS Markit
* Occurs when long-term treasury yields are lower than short-term treasury yields

Forward-looking statements and disclaimer

For more information, please visit
Visa.com/EconomicInsights or **Visa.com/TravelInsights**.