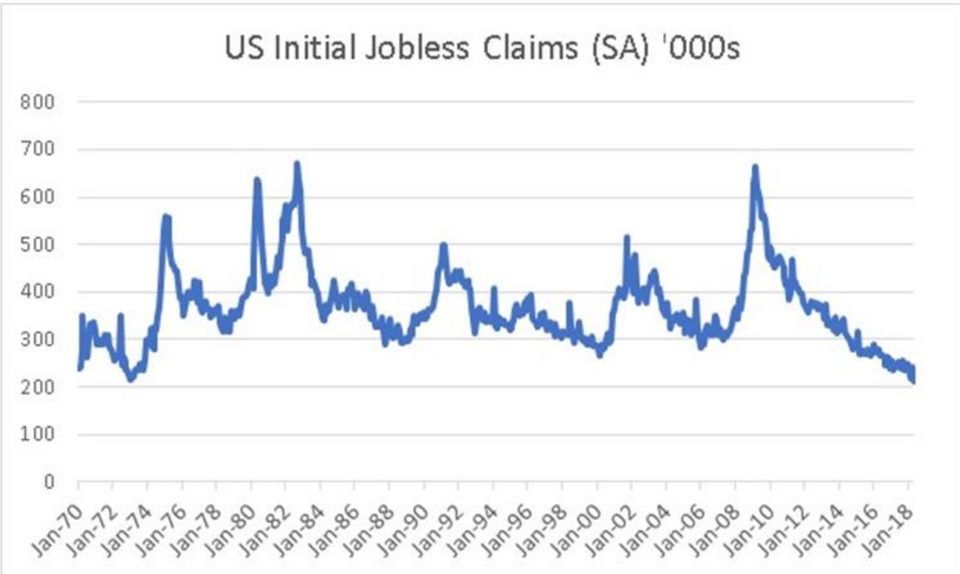
IS US GROWTH PEAKING?

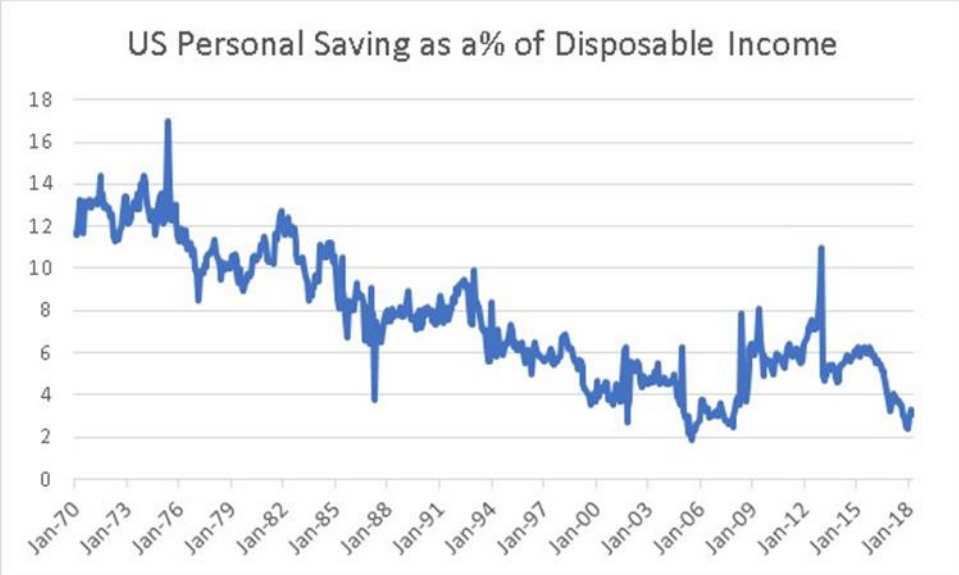
Russell Clark's
Market Views

"While currently both consumer and business confidence are strong, we have started to see some data points that US consumers are starting to pull back from consumption. This could mean that US growth is peaking."

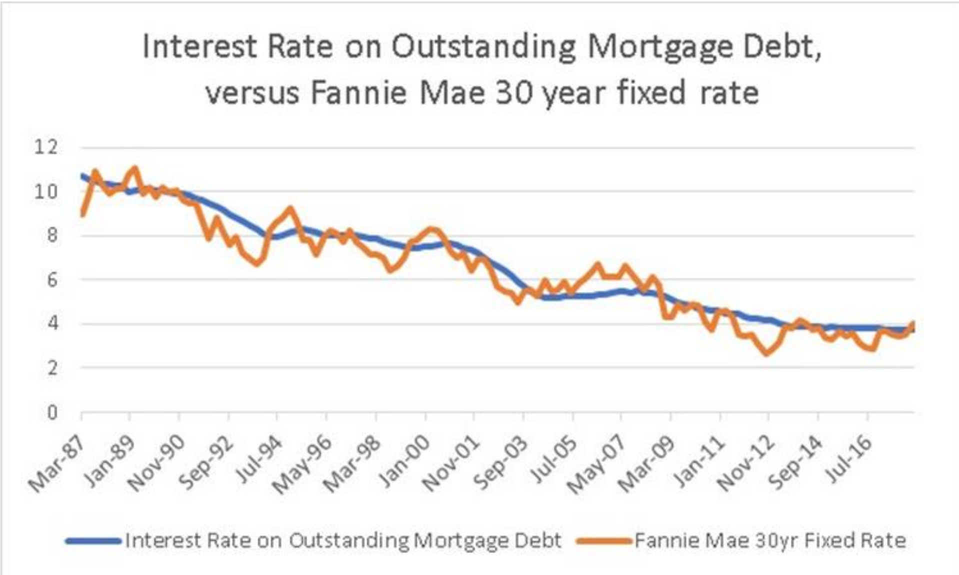
Predicting the end of the current US economic expansion has been a fool's errand for the past few years. US initial jobless claims issued by the US Department of Labor, which has been historically a good lead indicator of US economic weakness, with an attractive mean reversion feature, has continued to fall to levels not seen since the early 1970s. Given the nearly 50% increase in population since then, the levels of initial jobless claims today are truly extraordinary.



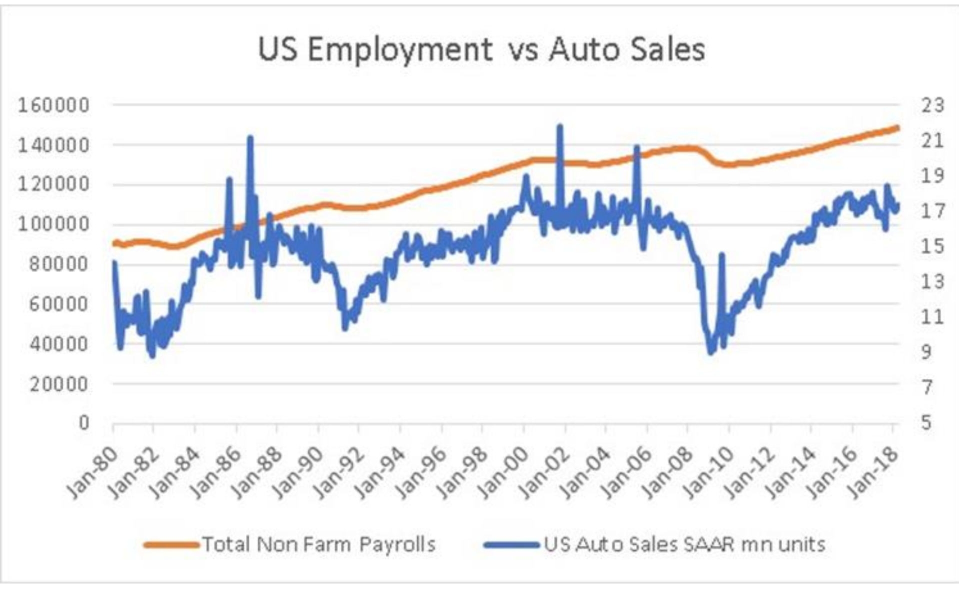
The US is a consumption driven economy, making up nearly 70% of GDP. Consumption tends to be fairly stable but does have cyclical elements to it. One aspect is the savings rate. That is how much of current earnings people are choosing to save. As the saving rate rises, there is less consumption and vice versa. After the financial crisis, savings rate increased, but has now fallen back to close to all-time lows. This heightens the negative effect of any shock, as consumers will quickly lift savings rates.



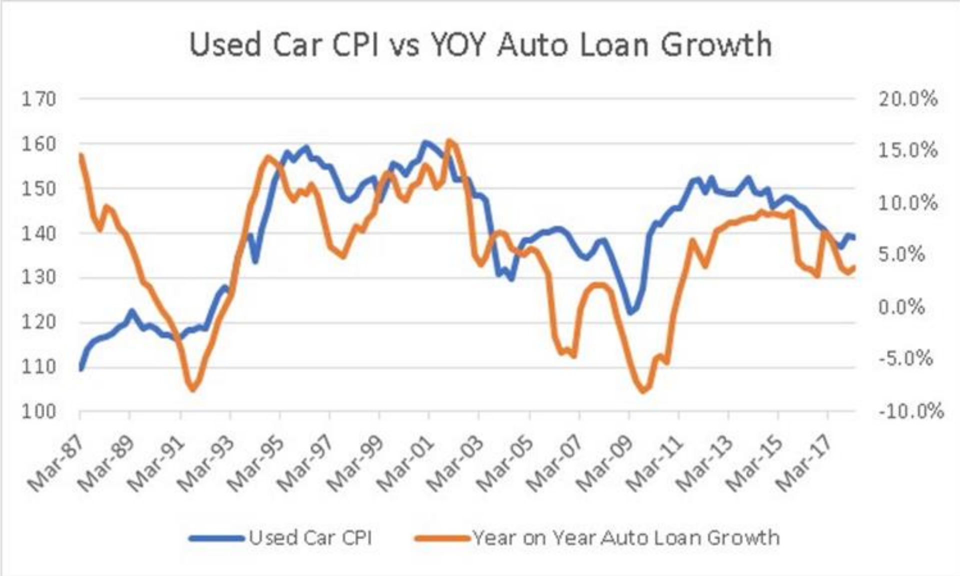
US consumption has also been boosted by ever falling mortgage rates. In fact, the US has not been able to sustain growth with offered mortgage rates above the interest rate on outstanding debt for a sustained period. The Bureau of Economic Analysis provides us with the data on outstanding mortgage interest rates. 2005 and 2007 saw a prolonged period of higher rates, however it was common for mortgages to have much lower teaser rates in this period. Recently Fannie Mae offered rate moved to 4.2%, compared to 3.76% on outstanding debt.



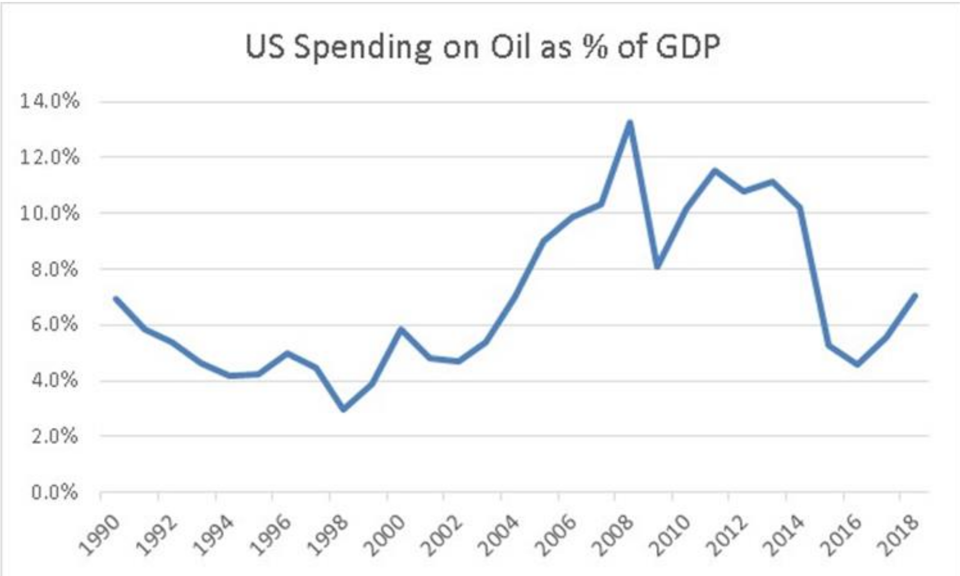
While housing is a significant driver of domestic growth in the US, the automotive industry also tends to be a large driver of activity, with some estimates that the total industry drives roughly 3 to 3.5% of GDP. Auto sales have tended to flatline before any decline in payrolls.



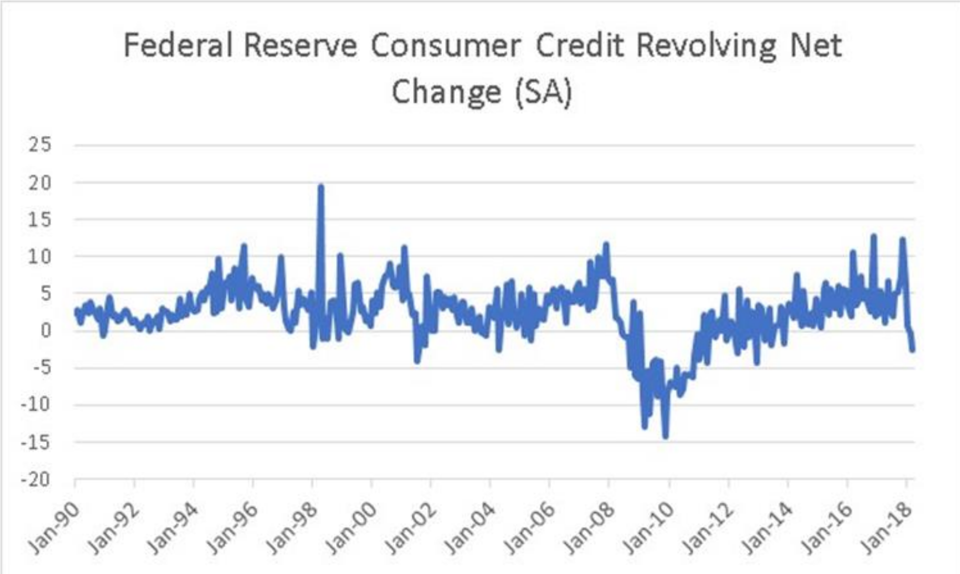
A good lead indicator for auto lending and hence auto sales has been CPI for used cars. As used cars are the collateral used for car loans, any decline in used car prices tends to impact auto lending and hence auto sales.



US consumption is also tightly correlated to oil prices. Unlike most other developed countries, the US lightly taxes oil, and has a relatively undeveloped public transport network. This means that higher oil prices tend to have a negative effect on US consumption. Taking US oil consumption from the BP Statistical Report, and using average WTI oil prices in previous years, and spot for the current year, we can see that oil spending has risen from a low of nearly 4% of GDP to 7.1% of GDP at current prices. While this is still lower than the level of spending we have seen from 2004 to 2014, the rise in spending is equivalent to the increase we saw in 1998 to 2000, and in 2006 to 2007, both periods that preceded a US recession.



While current both consumer and business confidence is strong, we have started to see some data points that consumers are starting to pull back from consumption. The recently released Federal Reserve report on consumer credit show the first pullback in revolving credit since 2012.



Mortgage rates have risen to a level that has previously caused growth to slow. The US savings rate is close to all time lows. Used car prices are falling, which has been a good lead indicator on auto loan growth. Spending on oil has increased by 2% of GDP from recent lows. US revolving credit has seen a large fall recently. All signs point to a peak in US consumption, and likely US growth.

INFORMATION

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