Macroeconomics

May 6, 2019

The US economy: recovery or recession?

Shen Minggao
SAC no: S0260519010002
SFC CE no: ATQ771
minggaoshen@gfgroup.com.hk
+852 3719 1055

Multiple policy options to forestall recession The probability that the US will slide into recession after one year is 27.1%, based on the model developed by the New York Fed in early April, close to the level in 1990, when the economy was about to head into recession, but still lower than in 2008 before the global financial crisis. As noted in our previous reports, the US would be likely to begin a recession one year after the start of the monthly inversion of the 10-year and the one-year Treasury yields. Nevertheless, the risks could be tamed with efforts to beef up infrastructure, promote trade talks with China and cut interest rates.

The longest recovery ever The US has had long bull runs and short bear markets throughout its history. Its contractions or recessions usually end within one year, and even the longest lasted just 17 months. The current recovery began in July 2009, and the economy has been expanding for 118 months up to April 2019. This recovery is sure to continue to the third quarter and become the longest ever; how much longer it can persist hinges on how visionary US policies can be.

Shoring up infrastructure On April 30, Trump and the Democrats agreed to spend US$2trn on infrastructure including roads, bridges, highways, water networks, power grids and broadband. A recent analysis of 88 countries in the period of 1960-2000 suggests that 10% growth in infrastructure investment could lift GDP growth by 0.7-1pp.

Uncertainties to be defused by China-US trade talks A successful outcome to the China-US trade negotiations is unlikely to change the competitive landscape between the two countries, but it would lower the uncertainties of economic growth for both sides and the rest of the world. The World Economic Forum estimates that a full-blown China-US trade war could cost 0.7pp of global GDP growth in 2019, and that GDP in China/US/Europe could slow down by 0.9/0.4/0.8pp. Although the short-term US trade deficit could be narrowed by an increase in China's imports, over the long run, a smaller trade deficit will be the result of a slower US economy.

Rate cuts an alternative The Fed rarely cuts rates. Statistics since 1955 show that the Fed only cuts rates nine months after employment hits a trough on average. But this time could be different. Low inflation and other factors could prompt the Fed to take the initiative and lower interest rates earlier to avoid an outright yield inversion and counter the risks of recession. In our view, the Fed is unlikely to reduce interest rates this year, unless the uncertainties of infrastructure expansion and China-US trade talks are still looming, or unless their effects miss expectations.

Risks Policy schedule and effects miss expectations; failure to put in place necessary funds.

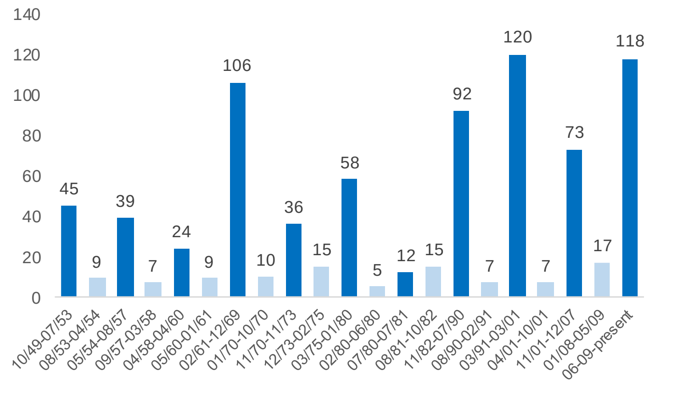
Original Chinese Report

美国经济：慢复苏，缓衰退？ 2019-05-05

Contact (Hong Kong)
Chen Jianghui
georgechen@gfgroup.com.hk
+852 3719 1030

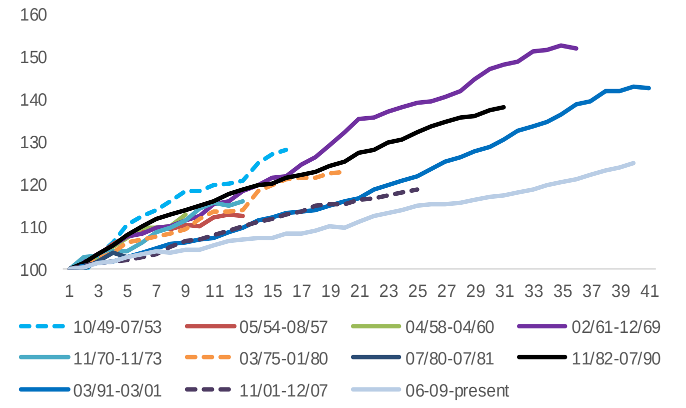
Please be sure to read the disclosures at the end of this report carefully. This is a translation of a report originally written in Chinese. The Chinese version shall prevail in the event of any discrepancy between the two versions.

Figure 1: US economic expansion and contraction (months)



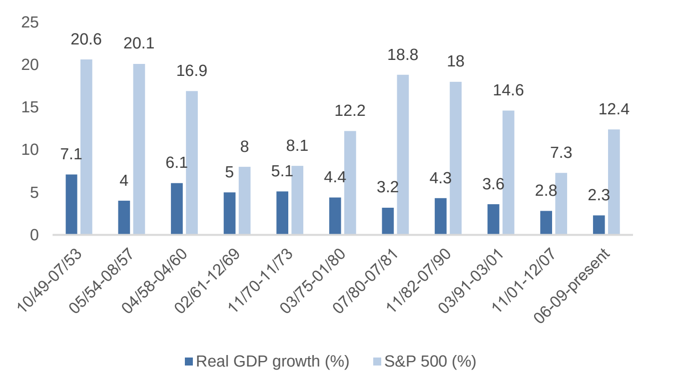
Source: Richard A. Anderson1, GF Securities Development & Research Center
Note: Dark blue indicates economic expansion, light blue denotes economic contraction

Figure 2: US economic cycle: real GDP growth (%)



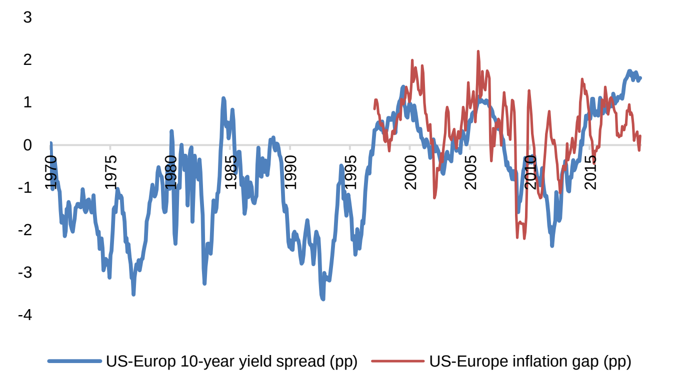
Source: CEIC, GF Securities Development & Research Center

Figure 3: Annualized average return of the S&P 500 during US economic expansion



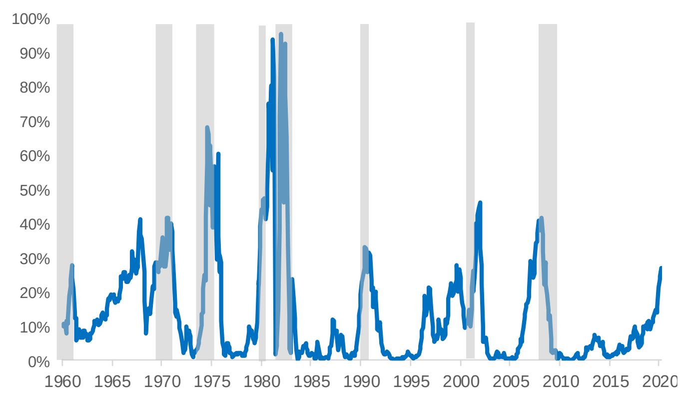
Source: Richard A. Anderson, GF Securities Development & Research Center

Figure 4: Inflation gap and yield spread between the US and Europe



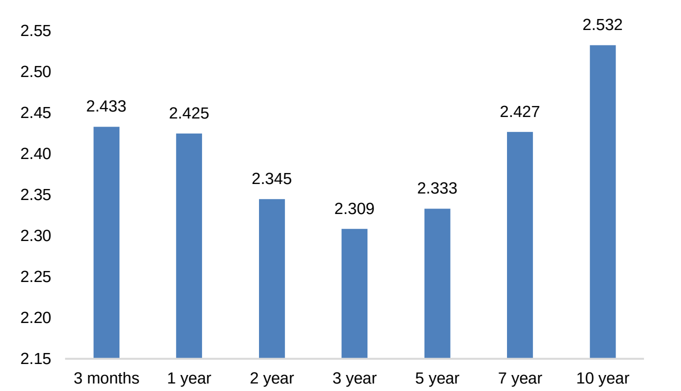
Source: CEIC, GF Securities Development & Research Center

Figure 5: New York Fed: probability of US heading into recession after 12 months



Source: New York Fed, GF Securities Development & Research Center

Figure 6: Monthly yield of US Treasuries in April 2019 (%)



Source: CEIC, GF Securities Development & Research Center

[1] Richard A. Anderson, "The Second Longest Ever Period of US Economic Expansion Continues", Aug 13, 2018.

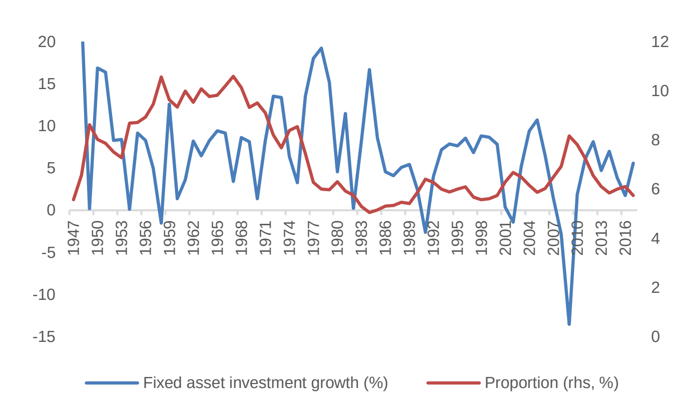
Please be sure to read the disclosures at the end of this report carefully.

Table 1: US Treasuries yield spread (pp)

	3 month-10 year	1 year-10 year	2 year-3 year	1 year-2 year	1 year-3 year	1 year-5 year	2 year-5 year
1978-08		-0.10	0.04	-0.06	-0.02	-0.02	0.04
1978-09		0.22	0.16	0.07	0.23	0.21	0.14
1980-09		0.01	0.00	-0.05	-0.05	-0.10	-0.05
1980-10		0.74	0.08	0.40	0.48	0.63	0.23
1988-12	-0.76	-0.11	-0.02	-0.10	-0.12	-0.10	0.00
1989-01	-0.53	-0.04	-0.02	-0.13	-0.15	-0.10	0.03
1989-02	-0.33	0.08	0.05	-0.12	-0.06	-0.02	0.10
1989-03	-0.22	0.21	0.07	-0.11	-0.04	0.06	0.17
1989-04	-0.22	0.19	0.05	-0.09	-0.04	0.07	0.16
1989-05	-0.12	0.12	0.04	-0.04	0.00	0.07	0.11
1989-06	0.15	0.16	0.04	0.03	0.07	0.15	0.11
2000-03	-0.39	-0.03	0.00	-0.31	-0.31	-0.28	0.02
2000-04	-0.17	0.16	0.05	-0.25	-0.21	-0.11	0.14
2000-05	-0.45	-0.11	0.04	-0.48	-0.44	-0.36	0.12
2000-06	-0.24	0.08	0.06	-0.31	-0.25	-0.13	0.18
2000-07	0.09	0.03	0.06	-0.26	-0.19	-0.10	0.16
2000-08	0.45	0.36	0.05	-0.05	0.01	0.12	0.17
2000-09	0.38	0.33	0.07	0.04	0.11	0.19	0.15
2005-12	-0.50	-0.11	0.01	-0.05	-0.04	-0.04	0.01
2006-01	-0.08	0.03	0.04	0.05	0.09	0.10	0.05
2018-12	-0.42	-0.18	0.00	-0.02	-0.02	-0.03	-0.01
2019-01	-0.29	-0.13	0.02	0.04	0.06	0.04	0.01
2019-02	-0.24	-0.13	0.02	0.05	0.07	0.06	0.02
2019-03	-0.12	-0.08	0.04	0.08	0.12	0.12	0.04
2019-04	-0.10	-0.11	0.04	0.08	0.12	0.09	0.01

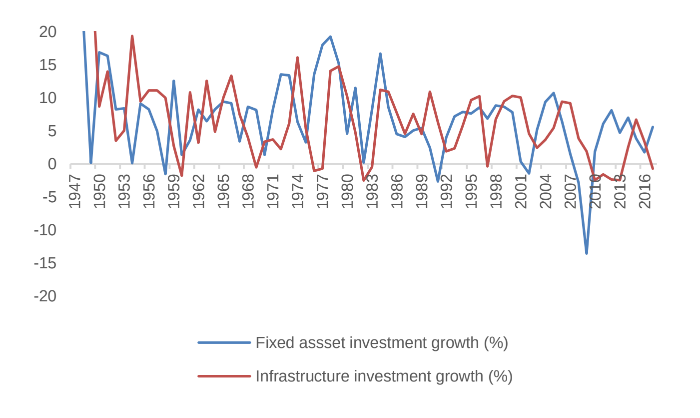
Source: CEIC, GF Securities Development & Research Center

Figure 7: US: proportion of infrastructure investment and fixed asset investment growth



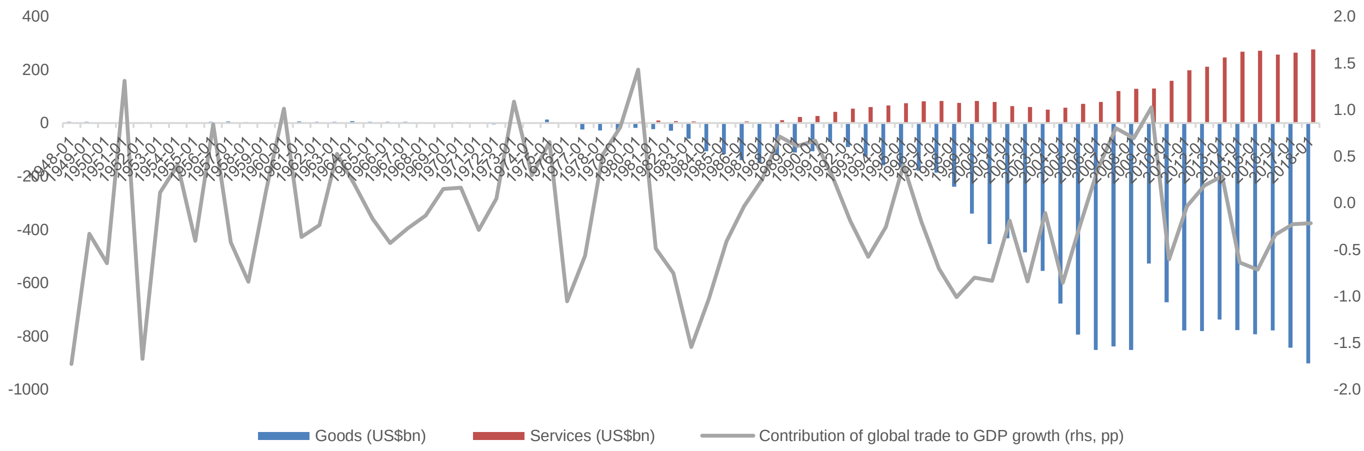
Source: Wind, GF Securities Development & Research Center

Figure 8: Growth of fixed asset investment and infrastructure investment



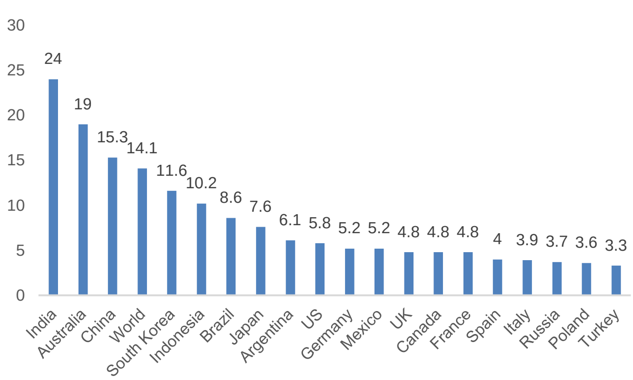
Source: Wind, GF Securities Development & Research Center

Figure 9: US trade surplus/deficit in goods and services and their contribution to GDP growth



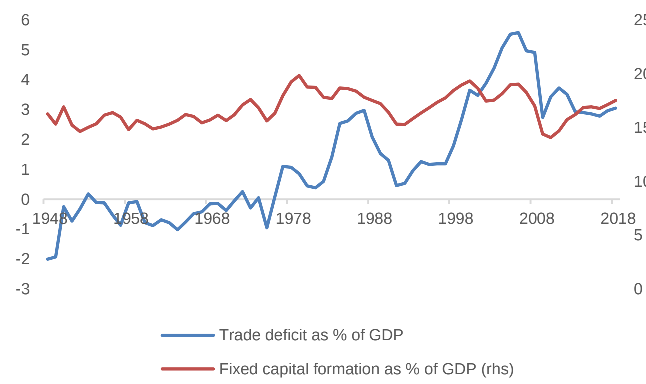
Source: CEIC, GF Securities Development & Research Center

Figure 10: GDP growth loss when returning to 1990 average tariff rates (%)



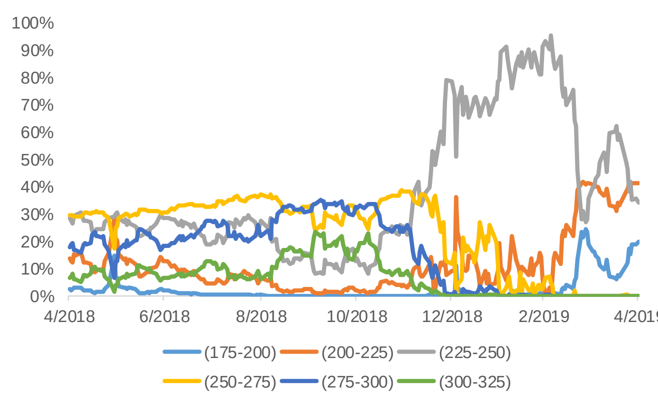
Source: Quartz, GF Securities Development & Research Center

Figure 11: Proportion of US trade deficit and fixed capital formation in GDP



Source: CEIC, GF Securities Development & Research Center

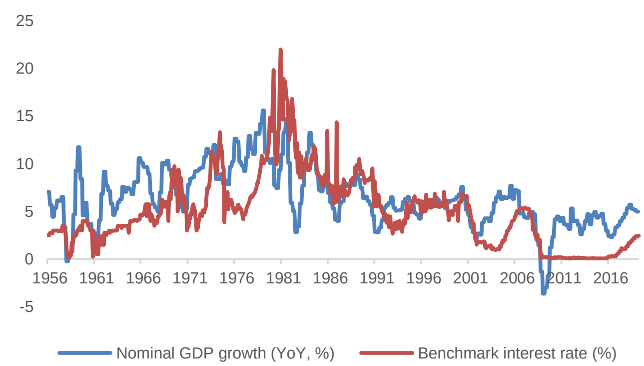
Figure 12: Expected benchmark interest rate set by the US Fed at the end of 2019



Source: CEIC, GF Securities Development & Research Center

Note: The current benchmark interest rate is in a range of 225-250.

Figure 13: Benchmark interest rate and nominal GDP



Source: CEIC, GF Securities Development & Research Center

Rating definitions

Company ratings	
Buy	Stock expected to outperform benchmark by more than 15%
Accumulate	Stock expected to outperform benchmark by more than 5% but not more than 15%
Hold	Expected stock relative performance ranges between -5% and 5%
Underperform	Stock expected to underperform benchmark by more than 5%

Sector ratings	
Positive	Sector expected to outperform benchmark by more than 10%
Neutral	Expected sector relative performance ranges between -10% and 10%
Cautious	Sector expected to underperform benchmark by more than 10%

Legal Disclaimer

This report has been prepared by GF Securities Co. Ltd or its affiliates. GF Securities Co. Ltd and its affiliates are referred to as "GF Securities" hereinafter. According to the laws, regulations and regulatory requirements in different countries and regions, this report is distributed by the subsidiaries/operating bodies of GF Securities with relevant lawful and compliant operation qualifications in these countries and regions.

GF Securities (Hong Kong) Brokerage Limited ("GF Securities (Hong Kong)") is licensed by the Securities and Futures Commission of Hong Kong to conduct Type 4 Regulated Activity "Advising on Securities". It is regulated by the Securities and Futures Commission of Hong Kong, and is responsible for the distribution of this report in Hong Kong.

GF Securities Co. Ltd is qualified to conduct securities advisory business as approved by the Chinese Securities Regulatory Commission. It is regulated by the Chinese Securities Regulatory Commission, and is responsible for the distribution of this report in China (except Hong Kong, Macau and Taiwan).

Information about the qualifications of the research analyst(s) who is(are) the author(s) of this report as registered analysts with the Securities Association of China and information about their licenses issued by the Securities and Futures Commission of Hong Kong are disclosed in the section where research analyst names are shown.

This is a summary of a report originally written in Chinese. Please contact us for more information of the original report. The Chinese version shall prevail in the event of any discrepancy between the two versions.

Important Notices

GF Securities Co. Ltd and its affiliates may be seeking or building business relationships with companies mentioned in this report. Therefore, investors should consider the impact on the independence of this report by GF Securities Co. Ltd and its affiliates due to potential conflicts of interests. Investors should not make any investment decisions based solely on the contents of this report.

The research analyst(s) primarily responsible for the content of this research report, in whole or in part, certifies that with respect to the company or relevant securities that the analyst(s) covered in this report: (1) all of the views expressed accurately reflect his or her personal views on the company or relevant securities mentioned herein; and (2) no part of his or her remuneration was, is, or will be, directly or indirectly, in connection with his or her specific recommendations or views expressed in this research report.

The remuneration for the production of this report by research staff is determined based on various factors including the quality of research, client review and workload, and it is also affected by factors including GF Securities' overall revenue, part of which is generated from GF Securities' investment banking business.

This report is distributed solely to clients or designated institutions authorized by GF Securities, and is not distributed publicly. It can only be used by the targeted recipients who have the obligation to maintain confidentiality. GF Securities does not view any persons who have received or read this report through other means as its clients.

This report is distributed to a certain client based on the conclusion that this client is deemed to be able to assess investment risks independently, execute investment decisions independently and assume corresponding risks independently.

The contents of this report is for reference only. Information contained or opinions expressed in this report does not constitute an offer or inquiry. Customers should not substitute their independent judgment with this report or make decisions based on this report.

This report is published solely for information purpose and does not constitute an offer to buy or sell any securities or a solicitation of an offer to buy, or recommendation for investment in, any securities. The research report is intended solely for use of the clients of GF Securities. The securities mentioned in the research report may not be allowed to be sold in certain jurisdictions. No action has been taken to permit the distribution of the research reports to any person in any jurisdiction that the circulation or distribution of such research report is unlawful. No representation or warranty, either express or implied, is made by GF Securities as to their accuracy and completeness of the information contained in the research report. GF Securities accepts no liability for all loss arising from the use of the materials presented in the research report, unless is excluded by applicable laws or regulations. Please be aware of the fact that investments involve risks and the price of securities may be fluctuated and therefore return may be varied, past results do not guarantee future performance. Any recommendation contained in the research report does not have regard to the specific investment objectives, financial situation and the particular needs of any individuals. The report is not to be taken in substitution for the exercise of judgment by respective recipients of the report, where necessary, recipients should obtain professional advice before making investment decisions.

GF Securities may have issued, and may in the future issue, other communications that are inconsistent with, and reach different conclusions from, the information presented in the research report. The points of view, opinions and analytical methods adopted in the research report are solely expressed by the analysts but not that of GF Securities or its affiliates. The information, opinions and forecasts presented in the research report are the current opinions of the analysts as of the date appearing on this material only which may subject to change at any time without notice. The salesperson, dealer or other professionals of GF Securities may deliver opposite points of view to their clients and the proprietary trading division with respect to market commentary or dealing strategy either in writing or verbally. The proprietary trading division of GF Securities may have different investment decision which may be contrary to the opinions expressed in the research report. GF Securities or its affiliates or respective directors, officers, analysts and employees related to research report business may have rights and interests in securities mentioned in the research report. Recipients should be aware of relevant disclosure of interest (if any) when reading the report.

This Research report may contain and/or describe/present factual historical information on prices of Futures contracts (the "information"). Please note that this information is solely for the purpose of forming part of the argument/grounds/evidence in our research methodology/analysis to support our conclusion on our view of the relevant industry/company mentioned. It does not, by any means (express or implied) to be associated with or constituted as SFC Type 5 Regulated Activity (Advising on futures contracts).

Disclosure of Interests

(1)GF Securities (Hong Kong) do not have any investment banking relationship with the companies mentioned in this research report in the past 12 months.

Copyright © GF Securities

Without the prior written consent obtained from GF Securities, any part of the materials contained herein should not (i) in any forms be copied or reproduced or (ii) be re-disseminated.

	Guangzhou	Shenzhen	Beijing	Shanghai	Hong Kong
Address	35/F, GF Securities Tower, 26 Machang Road, Tianhe District	31/F, Taiping Financial Building, 6001 Yitian Road, Futian District	18/F Yuetan Building, 2 North Yuetan Road, Xicheng District	16/F, IFC, 8 Century Avenue, Pudong New District	Room 1401-1410, 14/F, Wing On Centre, 111 Connaught Road Central, Hong Kong
Postal Code	510627	518000	100045	200120	
Service Email	gfyf@gf.com.cn				