TCM INSIGHTS

PERSPECTIVE AND OUTLOOK—OVERSEAS SLUGGISHNESS

A consistent theme among pessimists is that slower global growth is a headwind for the U.S. economy. Their stance is that a softening of Europe and China would significantly hinder any further U.S. expansion.

The prevailing theory is that a struggling global economy naturally hinders U.S. exports. Superficial data exists to support this idea. Over the past year, real GDP expanded 1.5% in the European Union, the slowest pace since 2013. China's real GDP is up 6.4% from a year ago, the slowest in decades. Japan's real GDP expanded 2.1% in the first quarter of 2019 (annualized), but this expansion is slower compared to annualized growth numbers from 2017 and 2018. Some of this is to be expected, however, as Japan's population is shrinking, meaning its GDP growth will remain consistently lower than the U.S.

Conversely, real GDP growth in the U.S. has been accelerating. Last month's reporting revealed that real GDP increased 3.2% (annualized) in the first quarter of this year, up over 3% from a year ago. The upcoming report could reveal a small downward revision, but growth should remain around 3%.

Current real GDP growth numbers reveal a strengthening from the average annualized growth rate of 2.2% seen during the Plow Horse recovery from mid-2009 through early 2017. Equally impressive is the increase in productivity growth, which averaged 1.1% annualized during the Plow Horse era but grew 2.4% in the past year. These statistics contradict the theory that slowing global growth will cause U.S. growth to slow as well.

The Rest of the World

Excitement and optimism about U.S. growth should not be interpreted as rejoicing over a foreign slowdown. Rather, the data is revealing a decoupling of the U.S. economy from the rest of the world. Domestic growth is the result of more favorable economic policies that have reduced competitive disadvantages that U.S. businesses previously faced.

Despite these changes in the global economic landscape, the outlook for foreign markets remains positive. Significant pessimism is already priced in to foreign markets, making them very attractive as a broad, undervalued asset class.

Why does the U.S. economy continue to exhibit such strength relative to the overall global economy? Historically speaking, the pessimistic theory would make sense. When foreign countries have less purchasing power, logically they would be more limited on how many U.S. imports they could purchase. But current U.S. growth has accelerated due to policy changes, such as lower tax rates and deregulation.

These same policy changes that have accelerated growth in the U.S. have slowed growth abroad. Lower taxes and deregulation have made the U.S. a much more attractive place to do business, making foreign nations relatively less hospitable toward economic activity. Future data will likely reveal that businesses are gradually shifting resources toward the U.S. in response to these policy changes, meaning less activity for foreign trading partners.

China has also been affected by these shifts. For two decades, the White House has turned a blind eye toward China's reckless attitude regarding intellectual property. This attitude created a huge competitive advantage for China. Current policy changes are signaling an end to such advantages.

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