ODDO BHF

MARKET *view*

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The recession that isn't happening: don't underestimate the growth potential of the US economy

“In the future, a temporary slowdown in economic activity is possible, but a recession seems unlikely. To what extent the outcome of the presidential election will influence future economic developments is so far unknown.”

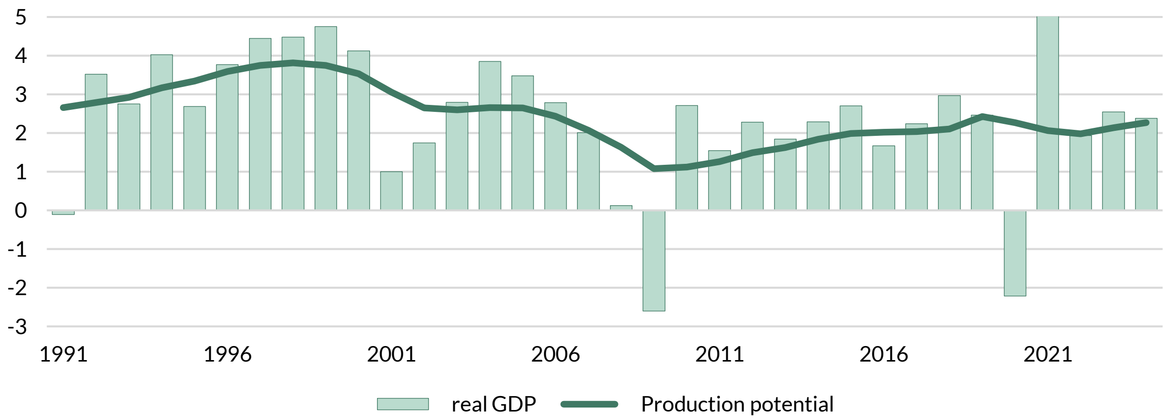
When the Covid pandemic shut down the global economy in Spring 2020, it ended the longest expansion phase in US history, which lasted 42 quarters. **For more than ten years, there had been repeated warnings that the next recession was imminent. But the US economy remained on a growth trajectory**. Despite a few weak quarters and even a few with negative growth (Q1 2011, Q1 2014), the US economy grew by an average of 2,5% per year between mid-2009 and the end of 2019. Only the outbreak of the coronavirus pandemic – an external shock – could end this long-lasting expansion.

For several months now, experts and market participants have been discussing the risk of a recession in the US again. Some observers, including well-known institutions, have upgraded the risk of recession. The regular Bloomberg surveys among experts indicate a median probability of 30%. The New York Fed's estimation model, which is based on the steepness of the yield curve, goes as far as to indicate a recession probability of almost 60% over a 12-month horizon. And the so-called Sahm Rule, which is derived from the rise in the unemployment rate, triggered a recession alert in July 2024.

However, we believe that the risk of a ‘real’ recession in the US is low. Real in this case means that there is a significant contraction in economic activity in the US as defined by the National Bureau of Economic Research. The US economy is broadly diversified, less dependent on international influences than the European economy for instance, and highly innovative. In addition, potential growth (ie. the growth opportunities with full utilization of production capacities) is significantly higher than in Europe at 2 to 2.5%, so that the ‘normal’ distance from the null line is greater (see Fig. 1). The US economy therefore appears to be less at risk of a recession than the European economy, for example.

However, not everything is running smoothly in the US. One weak point, for example, is the construction sector, where the trend has been on a downward path since Spring 2022. Building permits and housing starts, which have somewhat slipped again in recent months, are more than 20% below the level seen at the beginning of 2022. **A second weak point is the manufacturing sector. Industrial production has barely budged over the past two years**, and incoming orders do not yet show any sign of a sustained improvement.

FIGURE 1: US PUBLIC DEBT OVER TIME



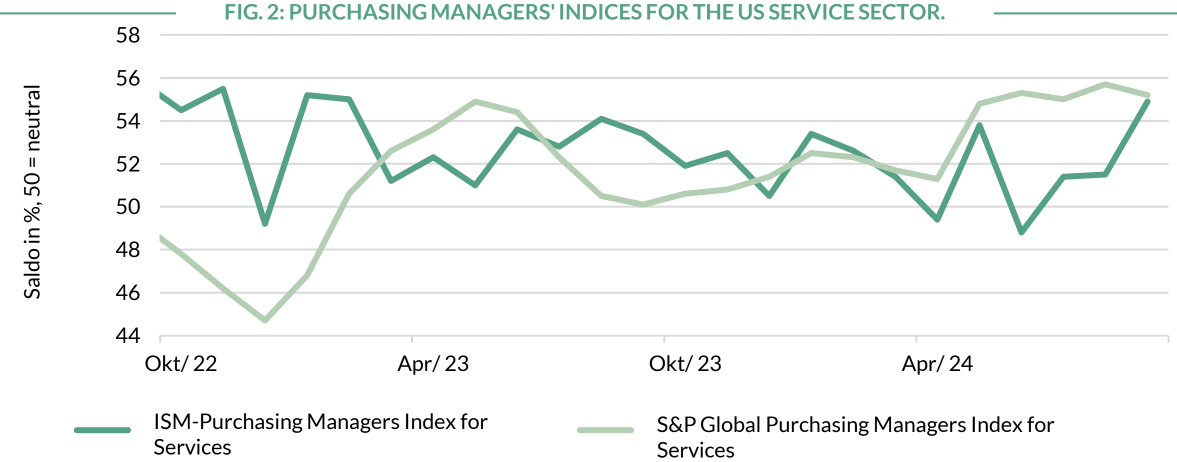
Source: European Commission (AMECO) / Datastream; 01/01/1991-31/12/2024 (2024 forecast)

The "new orders" component of the ISM survey even shows a decline reaching contraction criteria for the last six months, to 46.1 (neutral: 50.0) in September.

However, a further weakening in these areas is not likely to push the US economy into recession. These sectors' overall economic weights are too low to be singlehandedly accountable: the construction sector (excluding real estate services) generated just under 4% of total economic output in the second quarter of 2020, while the manufacturing sector generated around 10%. By comparison, financial services alone accounted for more than 20%. Overall, most indicators point to a robust trend in the service sectors, which is far more central to the economy's health. The purchasing managers' indices for the service sector, both the ISM Survey and the S&P Global survey, show a level of around 55 for September (Fig. 2). In addition, the new orders indicator shot up steeply in September to 59.4. This is consistent with the employment trend, which picked up again in September. The service sector showed somewhat more volatility over the summer months, but the available data do not suggest any significant weakening.

Accounting for almost 70% of gross domestic product (GDP), it is above all consumption that determines the ups and downs of the US economy on the demand side. In the second quarter, private consumption rose sharply by 2.8% (quarter-on-quarter, extrapolated to an annual rate). For the third quarter at least, the result could remain similarly good, as far as can be seen from the available figures on personal consumer spending. So far, there is little sign of consumer restraint.

FIG. 2: PURCHASING MANAGERS' INDICES FOR THE US SERVICE SECTOR.



Source: LSEG Datastream, 01/01/2022-30/09/2024

In the future, this development could possibly slow down. **It is often pointed out that the 'extraordinarily' high savings, due to the generous transfer payments during the 2020/21 coronavirus crisis, have largely been used up.** The savings rate could therefore rise. However, this is offset by the relieving effects of recent interest rate cuts, and above all, by the wealth effects from the 2023/24 stock markets' high price gains.

Regardless of the macroeconomic matter, stock markets continue to soar. The S&P 500 reached new highs in mid-October. Analysts have gradually scaled back their expectations for earnings growth over the course of the third quarter. At 4.1% year-on-year (according to Factset, blended earnings), 'official' expectations for earnings growth are now quite modest. However, companies tend to 'understate' in the run-up to reporting. For example, the latest reports from US banks (dated 11 October) were stronger than observers had expected; the largest US bank, JP Morgan, claimed that consumers were in 'fine and on strong footing'. Taking the average positive surprise as a reference, earnings growth in the past quarter could also end up in the region of 7%. Most importantly, earnings growth is expected to rebound strongly in the fourth quarter, analysts have it. According to Factset, estimates for Q4 currently stand at 14.2% and for the calendar year 2025 at 14.9%.

In our view, the US economy is likely to have grown quite solidly in the third quarter of 2024 as well. In the future, a temporary slowdown in economic activity is possible, but a recession seems unlikely. To what extent the outcome of the presidential election will influence future economic developments is so far unknown. Both election programs contain some economically explosive material. However, Congress is an essential piece of the equation, as it will also be (partially) re-elected at the same time as the presidential election. 'Shared' responsibility would clearly make it more difficult to implement the major political programs. **If politics or other external factors do not interfere, the current expansion phase could continue for a few more years.**

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