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Daily Observations

September 17, 2018

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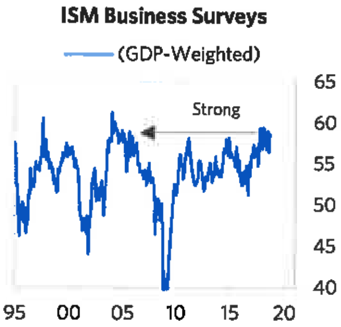
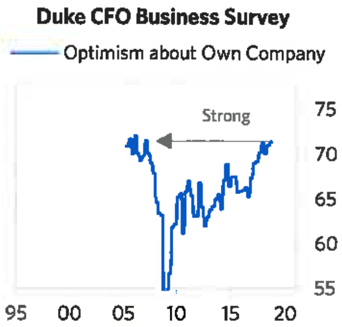
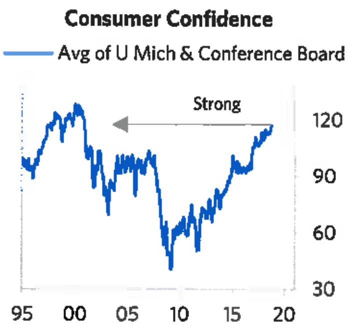
The Fed's Tightening Clearly Hasn't Slowed the US Expansion Yet, Increasing the Odds of More Tightening Ahead

While the Fed has been tightening gradually for some time, the US economy has shown few signs of slowing. The past week's stats are one of the clearest indications to date that the expansion is strong and self-reinforcing in a way that's increasingly likely to prompt more tightening. Businesses and consumers are about as confident as they've ever been (comparable to the tech bubble); they've been boosting actual spending and production about as quickly as we've seen during this expansion; and businesses are planning to meet this demand by boosting investment, hiring, and wages in a way that's likely to reinforce the expansion further. Another indication of the strength of the economy is that initial unemployment claims (a proxy for the firing rate) are meaningfully lower than in any other expansion since the 1940s. The fact that the economy has remained this strong makes sense when you look at the underlying drivers—the Fed tightening hasn't flowed through to a downturn in asset prices, this tightening has been coming at a time when there has been a lot of momentum in the domestic and global economies, and the economy has been buoyed by a meaningful fiscal stimulus. Of course, it takes some time for changes in monetary policy to flow through to asset markets and the economy, but the strength we're still seeing makes it more likely that the Fed's tightening cycle has some legs; and the more that growth surprises to the upside, the more tightening we'll get. Given that not much tightening is priced in, particularly beyond the next year, this creates increased risks to asset prices and the economy.

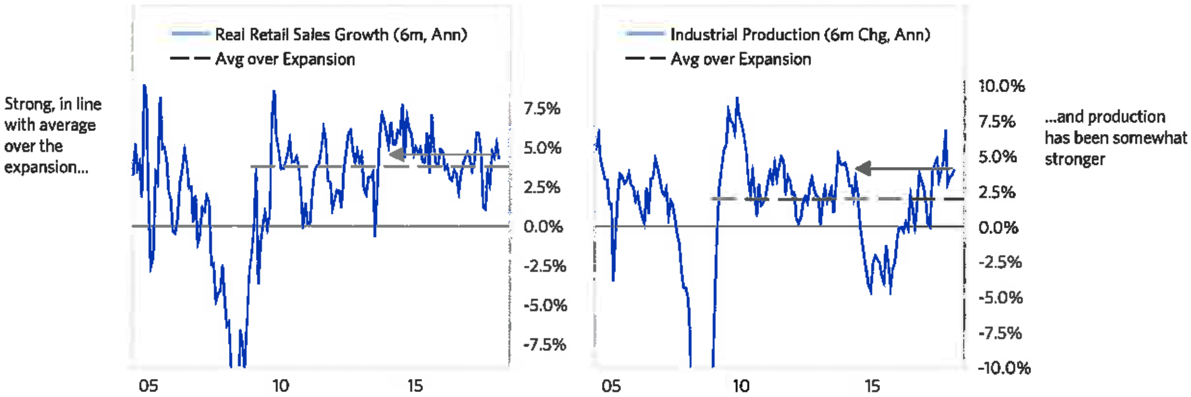
Below, we walk through how broadly strong US growth rates continue to be. We start by looking at various measures of business and consumer sentiment, which reflect a combination of growth and levels of activity. Across measures, sentiment is very strong and appears to be flowing through to spending (as we show further below).





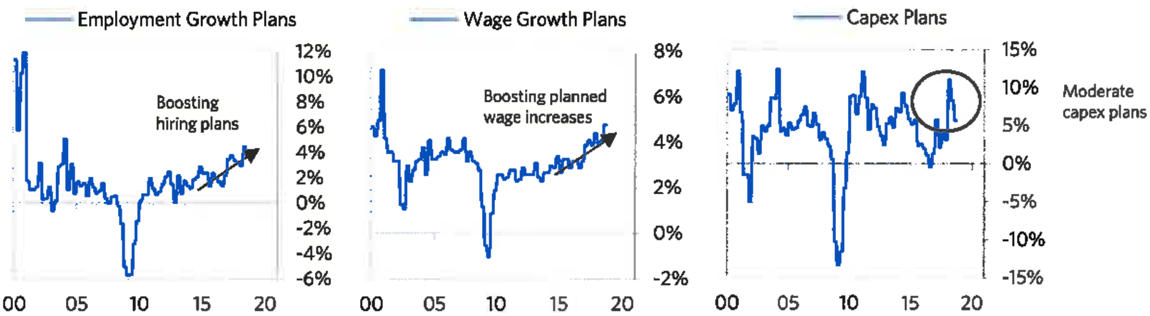


Households and businesses haven't just been confident; they've also been increasing actual activity about as quickly as at any point during the expansion in response to a combination of stimulative conditions. While rates have been rising, asset prices have continued to rally, income growth has been strong, and households have been enjoying the benefit of lower taxes. In line with this, household spending continued to grow at a reasonably strong pace through the end of August (it was weak on the month but revised up for July). Business production has been even stronger, as businesses also benefited from the pickup in domestic investment and the strength in external demand.



In response to this strong demand, businesses have also been reinforcing the expansion through increased hiring and investment, and the latest surveys of business plans suggest they'll continue. As the charts below show, businesses are planning to boost hiring and wages more quickly than they have in years. Capex plans ticked down last quarter but remain moderate.

Duke CFO Business Survey: Planned Spending Growth



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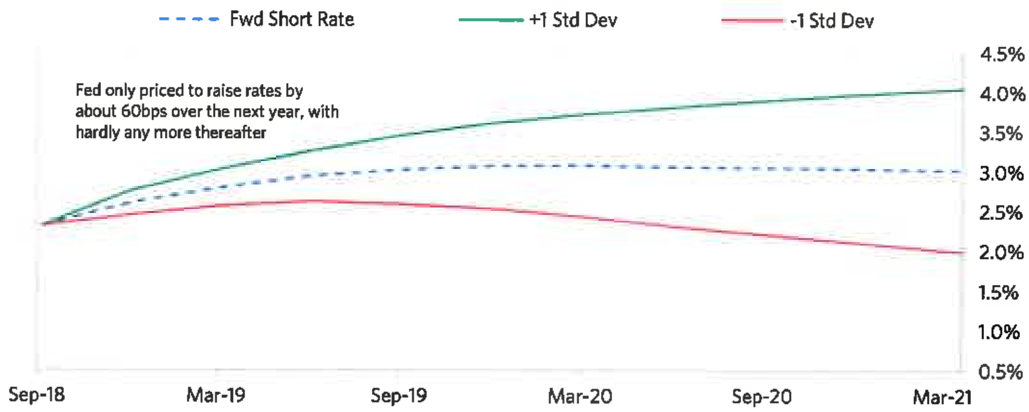
Plus, businesses have hardly been firing anyone. This is another reflection of the strong conditions they've been facing and how they've been responding in a way that supports the expansion.

With capacity tight by traditional measures and inflation near its target, the Fed has increasingly been tightening into economic strength and is planning to continue. However, at this point, there's very little tightening priced into forward interest rate markets, particularly after the next year, with a pretty tight range of discounted outcomes. This creates risks to asset markets and the economy.

Discounted Forward Short Rate



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