LPL RESEARCH

WEEKLY ECONOMIC COMMENTARY

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GLOBAL ECONOMIC OUTLOOK REMAINS STRONG ON U.S. GROWTH PROSPECTS

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KEY TAKEAWAYS

The global growth story remains steady in 2018, with growth forecast at 3.8%.

The U.S. economy remains a primary driver, with fiscal stimulus dominating potential tailwinds.

Emerging markets are likely to support the global growth trajectory, while Europe and Japan may lag.

We believe that the global growth story will continue in 2018, with an expectation of 3.8% gross domestic product (GDP) growth for the world economy, thanks to new fiscal policies and improved business vitality. We continue to expect the U.S. economy to remain a primary driver, aided by the anticipated growth trajectory of emerging markets, while Europe and Japan may lag. Primary risks include an unexpected rise in inflation, a substantial increase in trade friction, or a policy mistake [Figure 1].

1 STEADY GLOBAL GROWTH EXPECTED FOR 2018

	2016	2017	2018 (LPL Est.)
REAL GDP (YEAR OVER YEAR, %)			
U.S.	1.5%	2.3%	**Up to 3%**
Developed ex-U.S.	1.1%	2.3%	**2.1%**
Emerging Markets	4.4%	5.0%	**4.8%**
Global	3.2%	3.8%	**3.8%**
U.S. ECONOMIC DATA			
Inflation (YoY%)	1.3%	2.1%	**2.25–2.5%**
Unemployment	4.9%	4.4%	**3.6%**

Source: LPL Research, Bloomberg 07/16/18

2018 estimates are LPL Research projections.

Inflation is measured by the Consumer Price Index.

Please see our *Midyear Outlook 2018: The Plot Thickens* publication for insights on the economy, stock and bond markets, and investments for the year ahead. This week's commentary features content from that publication.

U.S. ECONOMY PRIMED FOR BETTER GROWTH

The U.S. economy grew at a rate of 2.0% in the first quarter, in line with the initial consensus estimate of 2.0% but a slowdown from the near 3% growth of the prior three quarters. First quarter averages are historically lower, so this type of seasonal dip is not unusual. In addition, although the supportive fiscal measures had been enacted, it was a little early for them to affect growth during the quarter.

FISCAL STIMULUS REMAINS CENTRAL

While the threat of tariffs and increased oil prices may weigh on consumption and investment decisions, we believe the positive impacts of fiscal stimulus will prevail for the remainder of the year. The individual tax cuts should improve consumer spending, an important driver of economic growth, while the influence on business spending may be even more impactful. As companies experience higher profitability, this should trickle down to other elements of the economy, with profits helping to drive growth in employment, wages, consumption, and investment. Add the government spending package signed earlier this year and the benefits of increased lending capacity (from recent financial deregulation), and we're looking at significant fiscal tailwinds. We continue to believe that the combination of these forces will result in GDP growth of up to 3% for the U.S. in 2018.

LATE CYCLE BUT ROOM TO RUN

We're continuing to see a healthy labor market, with unemployment near its lowest level in 18 years (at 4.0% as of June). Underemployment (includes those who are employed part time but would like to work full time), at 7.8%, is also near previous cycle lows. A tighter labor market is often viewed as a precursor to higher wage growth and ultimately higher inflation, but sustaining inflation above the Federal Reserves's (Fed) comfort range has been elusive so far. Wages and prices, as well as market interest rates, have climbed recently, though wage growth at current levels of about 2.7% on a year-over-year basis is still well below the 4.0% pace that has typically concerned central bankers. As a result, we continue to look for inflation to climb gradually, with the Consumer Price Index finishing the year in the 2.25–2.5% range.

Manufacturing doesn't have the clout it once did in the economy as a whole, but the financial performance of manufacturing firms still has a major impact on S&P 500 Index earnings. In addition, the Institute for Supply Management (ISM) manufacturing index, which measures whether manufacturing as a whole is expanding or contracting in the U.S., hit its strongest level in over a dozen years in February 2018.

It would be easy to perceive the recent peak in manufacturing growth to be a negative for the economy, but even when you're past the peak, growth can still be steady. History has also shown that a peak in ISM manufacturing does not typically mean the end of stock gains or that a recession is around the corner. As shown in

Figure 2, on average over the last five economic cycles, expansions have continued for nearly four years following an ISM manufacturing peak, during which the S&P 500 has cumulatively gained an average of nearly 57%.

EMERGING MARKETS TO PLAY KEY SUPPORTING ROLE

Looking at developed international, Bloomberg-based consensus expectations for European growth, after climbing sharply in late 2017 and early 2018, have been modestly declining over the last several months as European and Japanese data came in below heightened expectations in recent months. We still believe both Europe and Japan will see growth in 2018, but our expectation of 2.1% growth for developed international remains below consensus expectations.

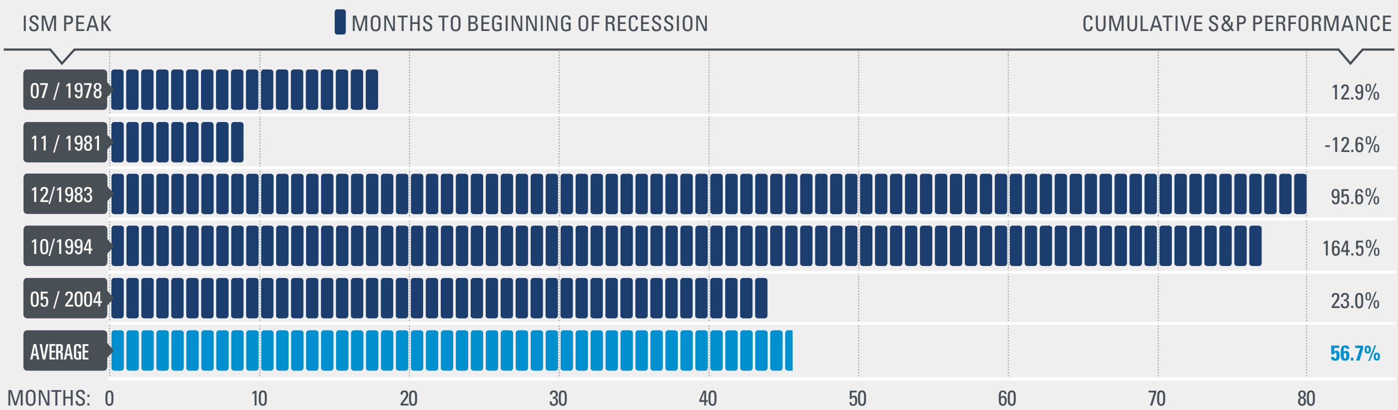
From our perspective, the emerging economies still appear to have a more sustainable growth trajectory. Though the possibility of a more aggressive Fed, tariffs, and the potential for a trade war with China have weighed on investor sentiment and could take a toll on emerging markets, we don't expect these factors to derail their growth trajectory. We continue to expect the U.S. and China will successfully navigate trade issues and ultimately reach an agreement, particularly once the crucial intellectual property policy issues are addressed.

Despite these challenges, we expect that the powerful demand trajectory driven by 6 billion emerging market consumers, along with innovative businesses embracing dynamic global output changes, should result in emerging market economic growth approaching 5.0% in 2018.

CONCLUSION

Coordinated global growth in 2017 helped produce the best year for overall global growth since 2011. We expect the global economy to grow at a similar pace in 2018, with accelerating growth in the U.S. offsetting slower but still solid growth in Japan, Europe, and emerging markets. Trade and the gradual removal of central bank support remain risks, but we believe that supportive fiscal policy, in the U.S. in particular, should more than compensate and help keep the economy on a steady path. ■

2 A PEAK IN MANUFACTURING DOESN'T MEAN STOCK MARKET GAINS ARE OVER



Source: LPL Research, Bloomberg 07/16/18

IMPORTANT DISCLOSURES

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