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American Exceptionalism Should Endure

Reflections on the U.S. elections are ongoing and will likely dominate the media for some time to come. That said, the polls are closed, and all eyes are focused on what the ramifications of the incoming Trump administration will be for the U.S. economy. Most commentators believe that the prospect of higher tariffs, massive deportations and broadly based lower taxes are inflationary. We caution, however, that bold campaign proposals are usually watered down before they become actual policies. What's more, it is a mistake to view a president's agenda in a vacuum. Higher tariffs invite retaliation by trading partners, leading to unintended consequences that could result in higher business costs, lower profits and eventually job cutbacks.

That said, aside from inducing heightened volatility in the financial markets – investors always loath uncertainty – the full impact of Trump's signature proposal, higher tariffs, would not be felt until late 2025 and 2026. In the meantime, the incoming administration will be inheriting an economy that is still heavily influenced by policies put into effect during the Biden regime – both good and bad – as well as the legacy of the Federal Reserve's policies in recent years. While many fear that tensions with other nations will escalate, the U.S. economy is still the envy of the world, having emerged from the Covid recession much stronger and, despite domestic angst over prices, with lower inflation.

Barring sudden external shocks, that outperformance should continue. The tailwinds driving the U.S. economy are numerous and still powerful. The increase in productivity last year is not a flash in the pan, but something that should endure. That, in turn, enhances the economy's growth potential and helps curb inflation. Consumers still have a good deal of spending firepower ignited during the post-covid years, and the fiscal measures unleashed during the Biden administration, such as the Chips Act, are poised to launch a boom in business capital spending. To be sure, the economy faces risks. The prospect of a contentious political environment could heighten policy uncertainty among traders, risking a severe correction in financial markets. That could take a toll on household wealth and undercut business confidence, resulting in less investment spending and reduced hiring, if not outright job cuts. Perhaps the only thing that is certain is the heightened uncertainty that will linger until the policies of the new administration come into clearer focus.

U.S. Outperforms

The last 15 years can generally be characterized as American exceptionalism. U.S. per capita GDP growth was the third strongest among advanced economies in 2023 and is poised to be among the best performers this year. Even putting the prospect for expansionary fiscal policy aside, US exceptionalism will endure next year despite heightened policy uncertainty and volatility in the financial market. The key drivers for growth in the U.S. next year are consumer spending and business investment in equipment, with strong tailwinds for both.

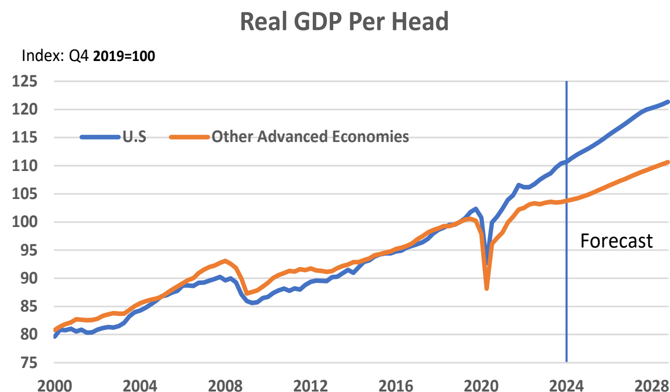
As noted, the recent upsurge in productivity growth isn't a flash in the pan. Thanks to strong business spending on research and development, continued advances and broader applications of artificial intelligence and the ongoing efforts to cut labor costs, that trend should continue. Together with the increase in the labor force, stronger productivity growth will keep the US economy's potential growth rate elevated next year.

The Trump administration's stance on immigration and trade may well be a drag on GDP growth down the road, but it won't be a major factor in 2025, helping ensure that the U.S. economy's outperformance will continue. Another reason the US economy has outperformed other advanced economies is because of the aggressive expansion in its fiscal policy during the pandemic. Importantly, not all of the deficit spending went toward stimulus payments, which

clearly juiced consumer spending over the past three years. While most of those funds have been spent, the bipartisan infrastructure bill, Inflation Reduction Act, and CHIPs Act will continue to support business investment, and support productivity growth for years to come.

Big Lift from Business Investment

No doubt, consumers have been the main engine



of growth in recent years, thanks to the stimulus payments and accelerated wage growth linked to an historically tight job market. A lesser but growing adjunct to consumer spending should kick in next year and sustain the U.S. economy's exceptional growth on the world stage. Simply put, the strong growth in investment on nonresidential structures, particularly in manufacturing, will be a tailwind for equipment spending next year. There is a roughly two-year lag between an increase in factory construction and the associated boost to equipment investment. The equipment cycle will kick in next year and into 2026 as real investment in manufacturing structures this year is on track to be the largest in the post-war era.

What's more, companies are in a good position to fill these new structures with the necessary equipment. Strong profits, healthy balance sheets, lower borrowing costs and easier lending conditions indicate that businesses will have the necessary funds to finance the expenditures. In addition to these positive fundamentals, the fiscal environment should also give a hefty boost to capital spending. Republicans swept the White House and Congress on Election Day, and the outlook for equipment spending is sensitive to the fiscal policies that a GOP trifecta will enact.

The party's agenda includes reviving full expensing of qualified business equipment, which would lend meaningful support to capital investment. It appears that Republicans are only in favor of repealing most electric vehicle tax credits granted under the Inflation Reduction Act (IRA), while leaving the remainder of the clean energy tax credits untouched. In August, 18 House Republicans sent a letter to House Speaker Mike Johnson opposing a full repeal of the IRA's clean energy tax credits, citing the investments in the energy sector since its passage. The IRA will benefit business investment most directly through its tax incentives for domestic production of solar panels, wind turbines, battery components, and critical minerals. The climate law will also have positive spillover effects for electrical equipment spending as new renewable energy supply is connected to the existing power grid.

Consumers Still Chugging Along

Like fine wine, the American consumer gets better with time. A few months ago, most economists thought that households were running out of fuel, having spent their stimulus checks and exhausted the savings cushion built up during the pandemic and its immediate aftermath. Many believed the pullback in spending risked putting the economy on the cusp of a recession late this year. Indeed, the jumbo half-percent rate cut by the Fed in September, followed by a smaller quarter-point cut in early November were aimed at preventing such an occurrence by lowering borrowing costs for consumers and, more broadly, easing the growth-dampening brake that high interest rates were imposing on the overall economy.

While many felt the Fed's move was overdue, the recession risk implied by an exhausted consumer turned out to be a false alarm. Revised data revealed that households had more income and savings than previously thought and were more than willing to

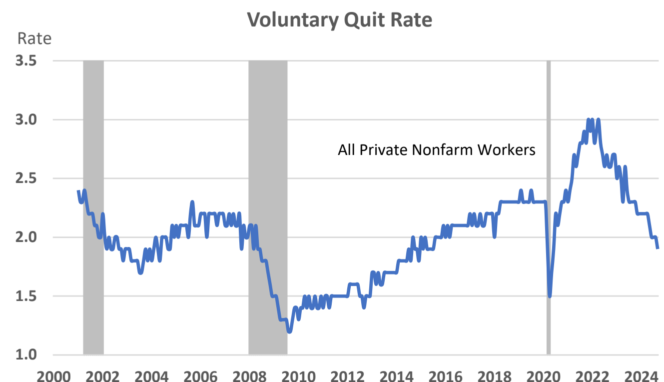
spend those funds. Instead of rolling over in the waning months of the year, consumer spending jump-started what is shaping up to be a festive holiday shopping season. Retail sales in September and October were much stronger than expected, and economists are upgrading their growth forecasts for the fourth quarter. The widely followed Atlanta Federal Reserve GDP tracking model is pegging a growth rate of 2.6 percent (as of November 16) for the quarter, which would be almost spot-on with the above-trend 2.8 percent pace in the second quarter.

But unlike the support for business, the fiscal environment is not shaping up as well for consumers. True, lower taxes would put more money in people's pockets. But we suspect that lawmakers will be mostly focused on extending the tax reductions that are due to expire in 2025 rather than implementing additional tax cuts. Meanwhile, consumers, particularly low- and mid-income households, are vulnerable to tariffs, which are inflationary and will bite into real disposable income. Importantly, the higher deficits that are certain to occur will keep market interest rates higher than otherwise and may well slow the Federal Reserve's rate-cutting campaign. Investors are already pricing in fewer rate cuts next year earlier than expected.

Warning Signs

The biggest risk that could throttle the economy's growth engine next year would be a collapse in the job market. That's not likely to happen unless, as noted earlier, some confidence shattering external shock sends tremors through the business community. Barring that the fundamentals supporting a healthy labor market remain intact. Consumers are still spending, propelled by rising wages and strong balance sheets. Businesses are still hiring as both profits and sales are holding up well. And while tariffs may be a drag on growth down the road, they are giving a jolt to activity over the near term, as many companies are stepping up orders from abroad before tariffs kick in.

That said, it would be a mistake to ignore emerging signs of weakening labor conditions. There are far fewer job openings than earlier this year, workers are choosing to stay put rather than quit for jobs elsewhere, reflecting less confidence of finding one, and while layoffs are low, unemployed workers are taking longer to find a job. Simply put, under the hood of the historically low unemployment rate, conditions are starting to stagnate. That's not necessarily a bad thing; the job market had been overheated and a cooling off is needed to help bring down inflation. If the Fed gets the signs right and keeps the job market from further weakening without stoking an inflation rebound, the U.S. economy's exceptionalism will endure. But the Fed will take a back seat to policy makers in the White House and on Capitol Hill in coming months, and the hope is that they can avoid a messy rollout of policies that would upend what is looking like a bright future for the U.S. economy.



Key Economic & Financial Indicators

FINANCIAL INDICATORS*

	October	September	August	July	June	May	April	12-Month Range High	Low
Prime Rate	8.00	8.30	8.50	8.50	8.50	8.50	8.50	8.50	8.00
3-Month Treasury Bill Rate	4.51	4.72	5.20	5.24	5.24	5.25	5.24	5.27	4.51
5-Year Treasury Note Rate	3.91	3.50	4.16	4.32	4.32	4.50	4.56	4.56	3.50
10-Year Treasury Note Rate	4.10	3.72	4.25	4.31	4.31	4.48	4.54	4.54	3.72
30-Year Treasury Bond Rate	4.38	4.04	4.46	4.44	4.44	4.62	4.66	4.66	4.04
Tax-Exempt Bond Yield	4.00	3.83	3.94	3.94	3.94	4.00	3.87	4.00	3.36
Corporate Bond Yield (AAA)	4.95	4.68	5.12	5.13	5.13	5.25	5.28	5.28	4.68
Conventional 30-Year Mortgage Rate	6.43	6.18	6.85	6.92	7.06	7.06	6.99	7.44	6.18
Dow Jones Industrial Average	42494	41491	40086	40086	38904	39129	38401	42494	34705
S&P 500 Index	5792	5621	5538	5538	5415	5235	5112	5792	4460
Dividend Yield (S&P)	1.28	1.31	1.31	1.31	1.33	1.36	1.39	1.54	1.28
P/E Ratio (S&P)	25.9	26.1	25.6	25.8	25.6	24.7	24.1	26.1	22.0
Dollar Exchange Rate (vs. Major Currencies)	123.8	122.1	123.7	123.7	124.0	122.2	122.5	124.0	120.2

*Monthly Averages

ECONOMIC INDICATORS

	October	September	August	July	June	May	April	12-Month Range High	Low
Housing Starts (Thousands of Units)	1311	1353	1379	1262	1329	1315	1377	1568	1262
New Home Sales (Thousands of Units)		738	709	726	672	672	736	738	611
New Home Prices (Thousands of Dollars)		426	411	427	414	414	415	436	411
Retail Sales (% Change Year Ago)	2.8	2.0	2.0	2.9	2.0	2.6	2.8	5.0	0.2
Industrial Production (% Change Year Ago)	0.0	-0.7	0.0	-0.5	0.9	0.0	-0.8	0.9	-1.2
Operating Rate (% of Capacity)	77.1	77.4	77.9	77.6	78.2	78.1	77.7	78.4	77.1
Inventory Sales Ratio (Months)		1.38	1.38	1.37	1.38	1.38	1.37	1.38	1.36
Real Gross Domestic Product (Annual % Change)		2.8			3.0			3.2	1.6
Unemployment Rate (Percent)	4.1	4.1	4.2	4.3	4.1	4.0	3.9	4.3	3.7
Payroll Employment (Change in Thousands)	12	223	78	144	118	216	108	310	12
Hourly Earnings (% Change Year Ago)	4.0	3.9	3.9	3.6	3.8	4.0	3.9	4.3	3.6
Personal Income (% Change Year Ago)		5.5	5.7	5.9	5.8	5.9	5.9	6.0	5.2
Savings Rate (Percent of Disposable Income)		4.6	4.8	4.9	5.2	5.2	5.3	5.5	4.40
Consumer Credit (Change in Blns. Of Dollars)		6.0	7.6	27.3	3.2	9.6	1.5	27.3	-24.0
Consumer Prices (% Change Year Ago)	2.6	2.4	2.5	2.9	3.0	3.3	3.4	3.5	2.4
CPI Less Food & Energy (% Change Year Ago)	3.3	3.3	3.2	3.2	3.3	3.4	3.6	4.0	3.2
Wholesale Prices (% Change Year Ago)	2.4	1.9	2.0	2.4	3.0	2.6	2.3	3.0	0.8

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