THE GLOBE AND MAIL

January 20, 2016

U.S. economy could start feeling tremors of global market instability

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Concerns brewing as persistent market turbulence coincides with news the American economy was slowing in late 2015

After another punishing day on global stock and commodity markets, there is growing anxiety in some quarters that the financial turmoil could undermine the broader U.S. economy.

The United States has been an island of stability in a world of bad news, churning out jobs and registering steady if unspectacular growth. Now some economists and investors fear that a bout of extended instability in financial markets threatens to weaken the country's economy.

"It would be foolhardy not to be very concerned," said Joseph LaVorgna, chief U.S. economist at Deutsche Bank in New York. "Markets have a way of bringing about an economic outcome that people didn't think was possible."

Mr. LaVorgna noted that data indicate the U.S. economy was already decelerating at the end of last year. At the start of this month, before the market tumbled, he lowered his forecast for GDP growth in 2016 to 1.5 per cent. Now he thinks that figure is optimistic: The U.S. dollar has strengthened further, which hurts exports, and the cost of issuing corporate debt has risen rapidly, constraining investment.

Economists don't see signs of significant weakness in the U.S. economy in the latest data. They add that financial markets aren't always a good barometer for what's happening in the world of goods and services. At the same time, they say, there are several ways that market upheaval can trigger broader turbulence.

"Our concern would be if investor sentiment, which is quite sour right now, spills over into consumer sentiment," said Kathy Bostjancic, head financial market economist at Oxford Economics in New York. "The more the sell-off intensifies and the longer it goes on, the greater the risk that it dampens consumer confidence and business confidence."

Investors are grappling with a toxic brew of plunging oil prices, a slowing Chinese economy and fears about global growth. None of these factors in themselves would tip the U.S. into recession, economists assert. A plunging oil price, while bad for energy companies and the banks who lend to them, is good for U.S. consumers. And the United States is less dependent on trade than other major economies as a source of economic output.

Still, policy-makers are watching closely. Dennis Lockhart, president of the Federal Reserve Bank of Atlanta, said earlier this month that he didn't believe the market volatility posed an imminent threat to the U.S. economy. "If the volatility continues for several weeks, I may have to revise my view," he said on Jan. 11. "It is a matter of how long it lasts."

However, the Fed has few tools at its disposal to calm spooked markets – another factor that may be unnerving investors, who realize policy-makers are unable to ride to the rescue. In December, the Fed raised its benchmark interest rate for the first time in nine years to between 0.25 per cent and 0.5 per cent. It could postpone any further interest-rate increases in light of the market turmoil. But with rates already so low, rate cuts aren't likely to be effective.

On Wednesday, new data releases appeared to confirm a slowdown in the pace of growth in the U.S. economy at the end of 2015. Housing starts fell in December and consumer prices dropped from a month earlier.

Some economists say the U.S. is still well-positioned to power through the latest upheaval in markets. "We have been hearing more and more of the 'R' word," said **Bernard Baumohl of the Economic Outlook Group**. "But when you look deeper into the U.S. economy, what you see is that the chance of a recession is really very remote."

Mr. Baumohl believes the U.S. will continue to expand at an annual rate of about 2 per cent as consumers benefit from rising incomes, job growth and an improving housing market. "I don't see that an $18-trillion economy is suddenly going to stop cold as a result of what's going on in China and certainly not the fall in oil prices."

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