MarketWatch

GDP, other vital signs show U.S. economy stable, even if Fed not convinced

Central bank unlikely to raise interest rates in July

By Jeffrey Bartash July 24, 2016

Higher consumer spending and a rebound in hiring show the economy snapped back to life in the spring and a report card on the nation's growth this week is likely to offer undeniable proof. But that doesn't mean U.S. growth is strong enough to satisfy the Federal Reserve.

The Fed is expected to stand pat and leave its benchmark short-term interest rate near zero after bank VIPs meet on Tuesday and Wednesday to survey the economic landscape. Yet before and after the two-day meeting, a score of indicators including second-quarter GDP are forecast to show the U.S. remains on a stable growth path.

What most worries the Fed is weak corporate investment amid a squeeze on profits and the unsettled nature of the global economy in the wake of the shock vote by Britain a month ago to exit the European Union. The central bank seems to want more time to gauge the fallout before raising its short-term rate.

Then there's the election. Companies have a pretty good idea what a President Hillary Clinton would do. They are not so certain about an unpredictable Donald Trump. "Why invest billions of dollars into capital and labor when this election brings so much uncertainty about the return on those investments," said **Bernard Baumohl, chief global economist at the Economic Outlook Group.**

On Tuesday, the latest report on demand for big-ticket items such as new cars or heavy machinery is forecast to decline again in June. These orders for durable goods have fallen slightly in the past 12 months if the volatile transportation sector — airplanes and autos — is stripped out.

Nor is there much hope of a big rebound in business investment. The presidential election has muddied the waters at home, the Brexit vote has clouded the global picture and U.S. corporate profits have shrunk, especially among energy producers.

“Profits have been under pressure and that is not a good harbinger for capital investment or hiring going forward,” said Sam Bullard, senior economist at Wells Fargo Securities in Charlotte, N.C.

Aside from durable goods, though, other reports are expected to point to improving home sales, low layoffs, fairly high consumer confidence — and much stronger second-quarter growth.

Economists polled by MarketWatch predict GDP will jump to a 2.5% annual rate, more than double the tepid 1.1% pace in the first quarter. Consumers led the way, boosting purchases at retail stores and buying more cars and homes.

The faster pace in the spring, however, probably won’t be matched in the second half of the year, economists say. The U.S. has repeatedly experienced slow growth early in the year, a pickup in the spring and then more moderate activity as the year winds down. The U.S. is forecast to expand about 2% in 2016 — virtually the same as the past five years.

“It’s an OK pace. It’s not fantastic,” said Gus Faucher, senior economist at PNC Financial Services. “It keeps the economy moving forward.”

The halting nature of the recovery helps explain the economic angst that’s given rise to the Trump candidacy on the Republican side and the surprisingly popular run by socialist turned Democrat Bernie Sanders. While the economy is stable, the U.S. is likely to fail to reach the 3% growth mark for the 11th straight year.

That’s the worst stretch in modern times and a big disappointment for an economy that’s historically grown 3.3% a year. The lower growth rate during the seven-year-old recovery translates into fewer jobs, slower income growth and less opportunity for millions of Americans.

“There is a big difference between a 3% economy and 2% economy,” Bullard said. And that’s exactly why the Fed is hesitant to raise interest rates.

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