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ECONOMY

Strong Economic Growth Boosts U.S. in Trade Battles

Latest figures contrast with data showing slowed growth in Mexico, Europe and China

By Josh Zumbrun July 31, 2018

China, Europe and Mexico's economies showed fresh signs of stumbling Tuesday while the U.S. powered ahead, boosting Washington's hand as it jockeys with them over trade.

U.S. economic reports Tuesday showed wages and salaries grew in the second quarter at their fastest pace in nearly a decade while consumption in June also registered solid growth. Meantime, overall U.S. economic output expanded at a 4.1% annual rate in the quarter, its best three-month increase since 2014.

By contrast, other data out Tuesday showed Mexico's economy contracted in the second quarter; the eurozone economy notched 1.4% growth, its slowest rate in three years; and a measure of manufacturing in China fell to a five-month low.

The Chinese economy "faces some new problems and new challenges," China's Politburo said in a statement after a meeting Tuesday. Without referencing tariffs or the trade conflict with the U.S., it added, "there are obvious changes in the external environment."

The Trump administration has heralded economic strength as a source of leverage in its quest to force rivals to make concessions to the U.S. on trade. Those talks are entering a new phase, with a renewed push to renegotiate the North American Free Trade Agreement, including the participation of Mexico's incoming presidential administration, and an agreement to hold off on tariffs against Europe after a Washington visit last week by European Commission President Jean-Claude Juncker.

The U.S. and China, meanwhile, are making little progress in behind-the-scenes efforts to restart formal trade talks.

"I would expect to see this divergence in economic growth between the U.S. and others continue the rest of 2018," said **Bernard Baumohl, chief global economist of the Economic Outlook Group**, though he cautioned that the U.S. would likely slow as well by 2019, especially as the boost from last year's tax cuts begins to fade.

The first round of U.S. tariffs has begun to reverberate globally, and the economic effects are likely to become more apparent if they remain in place—and as other countries retaliate. But for many U.S. trading partners, the tariffs may be just one of many challenges they face.

The eurozone entered 2018 on a high, having racked up its most rapid expansion in a decade during 2017. But growth slowed sharply in the first three months of this year, a setback that policy makers and many economists initially attributed to unusually cold weather and labor strikes in Germany and France. The failure of the economy to rebound in the second quarter shows other forces may be at work.

“It seems like excuses are running out,” said Bert Colijn, an economist at ING Bank. “Factors with a longer shelf life seem to have brought eurozone GDP growth down to a lower cruising speed for the moment.”

The difference between U.S. and European growth in the second quarter was the widest since 2014’s second half, when Europe faced Greece’s debt crisis. Business optimism in Europe has waned, but trade is just one factor. Stock markets have faced turbulence from uncertainty over Britain’s plans to leave the bloc next year, and from a new Italian government that has been skeptical of the euro. In a sign of stumbling optimism, Germany’s DAX stock index is down 0.9% this year, compared with a 5.4% rise by the U.S.-based S&P 500 index.

Analysts cautioned that some of the U.S. strength in recent months might be a temporary result of companies positioning themselves in response to tariff threats. U.S. GDP growth was boosted in the second quarter by a burst of exports, particularly soybeans, as trade partners moved to book purchases before retaliatory tariffs from China take effect.

“What happened in the second quarter was the rush by exporters to ship goods before the tariffs take their punishing toll,” said Mr. **Baumohl**.

Europe, on the other hand, experienced a slowdown in exports, which economists attributed in part to uncertainty over trading relationships with the U.S. and U.K.

A similar story played out in Mexico, where economic output contracted in the second quarter after a robust first quarter, according to data from Mexico’s National Statistics Institute released Tuesday.

Mexico’s economic output shrank by a 0.3% seasonally adjusted annualized rate, following a first quarter in which output expanded at an annualized rate of 4.6%.

After a strong start to the year, private investment in Mexico likely was negative in the second quarter, said independent economist Jonathan Heath. He noted the uncertainty that emerged during the quarter over negotiations with the U.S. and Canada to redraw Nafta. Mexico also faced unease following the July 1 presidential election won by leftist candidate Andrés Manuel López Obrador.

The trade tensions are being felt in Beijing as well, where they are adding to longer-standing challenges for China's economy.

China's official manufacturing purchasing managers index fell to a five-month low of 51.2 from June's 51.5, data released by the National Bureau of Statistics showed Tuesday. The reading was slightly below economists' expectations, though still above the 50 mark that is a demarcation of contracting activity. A subindex measuring production dropped to 53.0 from 53.6, while the new-orders index fell to 52.3 from 53.2.

China's growth rates have been slowly declining for years, not just because of recent trade-related changes, as the government attempts to shift away from credit-fueled and export-led growth toward more domestic consumption.

It remains unclear how long the U.S. can maintain strong performance when so much of the world has stuttered. American growth has been energized by tax cuts and government spending increases.

The administration has pledged that its tax cuts will create a lasting boost to growth, but many economists believe the effects are more likely to be a temporary stimulus that will fade in coming years.

"Difficult to say the divergence will be brief, because in the short term fiscal policy will be clearly in favor of the U.S.," said Marco Valli, head of macro research at UniCredit Bank in Milan. "That said, when the fiscal boost ebbs, it's very unlikely the U.S. could meaningfully decouple" from the rest of the world and maintain higher growth rates.

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