

Q&A

Capex Drought May Sap U.S. Growth in 2016, Says Top Forecaster Barraud

Policy uncertainty, the strong dollar and lack of capital expenditure may weigh on U.S. growth next year, according to **Christophe Barraud**, chief economist at **Market Securities**.

Paris-based Barraud — Bloomberg's top-ranked forecaster of the U.S. economy since the fourth quarter of 2014 — spoke with Bloomberg Brief Editor Ben Baris on October 12. His comments have been edited and condensed.

Q: What is your outlook for the U.S. through year-end?

A: I believe that growth will reach 2.4 percent this year, unchanged from 2014. U.S. GDP is likely to be subdued in the second half, negatively impacted by a widening trade deficit and a slowdown in inventories. Fortunately, on the positive side, personal consumption expenditures will remain a key support for the U.S. economy and the main driver in a context where interest rates are historically low, credit standards are easing, gasoline prices fell significantly and the employment situation keeps improving.

Q: What is your biggest concern about the U.S. through next year?

A: GDP [growth] will be close to 2.0 percent, which is the five-year average from 2010-2014. Nevertheless, risks are skewed to the downside due to several factors like monetary policy uncertainty from the Federal Reserve, the potential contraction in both manufacturing (global slowdown, high U.S. dollar) and oil (low prices), presidential elections (fiscal policy uncertainty) and a less favorable global environment (lower growth, currency war). My main concern is about capex, private non-residential investment. For several years, most S&P 500 companies have accumulated high amount of cash and favored buybacks and dividend payments at the expense of capex. However, the growth of capital stock is one of the key drivers of a country's GDP, productivity and employment. Business spending on equipment, machinery and buildings initiate a positive economic feedback loop, leading to more potential growth.

Q: What do economists and investors fear that they shouldn't?

A: Worries about domestic consumption seem to be a bit exaggerated. My guess is that consumption expenditures will remain a bright spot for the U.S. economy. The employment situation has progressively returned to equilibrium so wage pressures should intensify in coming months. Medicare/Medicaid programs and low gas prices should offer some relief to purchasing power. Moreover, in a context where rates will remain historically low, credit will gain traction and keep on supporting high spending items like autos. Finally, housing prices will remain well oriented and should support expenditures through the wealth effect.

Q: What should most worry the Fed?

A: Low inflation — even slight deflation — seems transitory and reflects declines in energy prices and, to a lesser extent, weakness of non-energy imports prices. I'm confident that inflation will rebound, as slack in the labor market has diminished significantly and rents have already risen by more than 3 percent year over year. The global slowdown is the most important issue, and is likely to persist because of cyclical and structural factors. Demographics in developed countries are less supportive, with a slowdown in labor-force growth. Productivity is unlikely to improve sharply due to a lack of investment in recent years.

Q: When will the Fed raise rates? How would this affect growth prospects?

A: Since the September FOMC meeting,

the central bank has lost a part of its credibility and could add more uncertainty if it delays the liftoff until 2016. In the meantime, if it comes earlier than expected, it should result in a higher U.S. dollar and weigh negatively on exporters, especially in the manufacturing sector.

Separately, in a context where global growth has slowed, politicians are putting pressure on central banks to devalue and gain market share instead of implementing structural reforms. I would not be surprised if several central banks like the ECB, SNB, BOJ or Riksbank ease their monetary policy in coming months, making the task more difficult for the Fed.

For me the window for a liftoff in 2015 is almost closed and the beginning of 2016 seems to be the base-case scenario.

Q: How do you feel about China and other emerging markets?

A: Concerning China, I think the bottom will be reached in the fourth quarter, since Chinese officials are accelerating public spending in infrastructure, lifting several restrictions in the housing sector and easing monetary policy. Seven percent GDP [growth] will no longer be a sustainable target, but I'm not very worried, given that the long-term growth story is still on track with a low urbanization rate, low equipment rate in the auto sector and high foreign-exchange reserves.

At the opposite end, several emerging countries with high current-account deficits like Malaysia and South Africa seem vulnerable to global slowdown, low commodities prices and monetary-policy uncertainty.

AT A GLANCE



Source: Olaf Blecker/
Bloomberg Markets

Favorite book: "The Crimson Rivers" by Jean-Christophe Grange.

Favorite movie: GoldenEye. It also spawned one of the most legendary video games ever.

What would you be doing if not in your current role: I am a foodie. I would probably open a restaurant in a city with sunny weather, maybe in the south of France or in Spain.

Hobbies: Sports in general, football (OGC Nice) and tennis are my favorites. I like watching horse racing and wrote my PhD thesis on sports betting. I am also keen on wine tasting and learning more about wine varieties. **Twitter:** @C_Barraud