



# Intelligence MEMOS

From: Glen Hodgson  
To: Concerned Canadians  
Date: February 1, 2019  
Re: **FOUR (MACROECONOMIC) REASONS TO WORRY**

The American economy is adrift, like a huge sailing ship. When tides are high and winds are favourable, it can be headed in the right direction. But when conditions darken, the US economy will have no mooring or anchor. It could even end up crashing on the rocks again as it did in 2008.

The US is now a decade into a sustained growth cycle, and near-term economic conditions are generally positive, notwithstanding the trade war with China and the recent meltdown in share prices for many profitable and well-performing companies. Economic growth was robust in 2018, fuelled by a tax cut that advantaged firms and higher-income individuals, the consensus is for solid performance again in 2019 with output growth projected at 2.5 percent or higher, and the unemployment rate is low.

Current performance is no doubt important, but a focus on the short term deflects attention away from the underlying structural weaknesses. That can be seen in four macroeconomic fundamentals.

**First**, the United States' fiscal anchor has been lost at sea. Large deficits and mounting public debt are not a recent phenomenon to be blamed solely on Donald Trump and the previous Congress. The pattern stretches back to the early stages of the G.W. Bush administration, made much worse by the 2008-09 global financial crisis and the exceptional fiscal stimulus used to rekindle growth.

But the deep tax cuts, without comparable cuts to spending, mean federal fiscal deficits are once again rapidly growing; the Congressional Budget Office projects a fiscal deficit over US\$1-trillion in 2020. Public debt is increasing and is projected to exceed 90 percent of GDP by 2020 – triple the share when Bill Clinton left office.

Debt-service costs will inevitably absorb a larger share of the national budget. Moreover, the US fiscal framework is burdened by massive unfunded Social Security liabilities, and the sustainability of Medicare and Medicaid are at risk.

**Second**, US monetary policy is still not fully re-anchored. The United States and many other parts of the global economy have been medicated for a decade with truly exceptional monetary stimulus, or what I term “monetary morphine.” Reducing the dependency on easy money and restoring more traditional monetary conditions was never going to be easy or straightforward.

The recent sharp downward adjustment in equity prices, coupled with a decline in long-term interest rates, confirm that the US economy has not completed its withdrawal from monetary morphine. Trade and other policy turmoil simply provided an added shock. The US Federal Reserve will have to proceed carefully on its journey back to more normal interest rates if it is to avoid destabilizing confidence in the recovery.

**Third**, as Canadians know all too well, the Trump administration has made chaotic attempts on trade, but without an overarching strategy and with no consideration of the collateral damage. Mr. Trump boxed himself in on the new NAFTA and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), and US exporters now seem sure to lose market share in CPTPP signatory countries. The new NAFTA has been negotiated, but tariffs remain in place on Canadian and Mexican steel and aluminum – which makes little economic sense. And the treaty still has to run the gauntlet of confirmation by a divided Congress. Trade talks with China are now the headline, and where they are headed is unknown.

**And fourth**, climate change is the ultimate existential threat facing the United States and the world. Despite the overwhelming scientific and physical evidence, and mounting costs and risks, Washington has moved backward by announcing its withdrawal from the Paris Accord. The absence of federal leadership and co-ordination will inevitably put the United States years behind others in terms of climate-change mitigation, adaptation and seizing low-carbon growth opportunities.

It is hard for Canada to protect itself from an American economy adrift, due to deep economic integration and myriad business, social and personal networks. The least we can do is to identify and understand the many risks and implement our own strong macroeconomic, trade and climate change policies. That may not entirely prevent the malaise from spreading – but it could make Canada better equipped to deal with the consequences.

Glen Hodgson is a senior fellow at the C.D. Howe Institute.

To send a comment or leave feedback, email us at [blog@cdhowe.org](mailto:blog@cdhowe.org).

The views expressed here are those of the author. The C.D. Howe Institute does not take corporate positions on policy matters.