King of the Hill

The US economy continues to strongly outperform Europe, as it confounds fears that it could enter recession this year. US data have come in well ahead of expectations to date in 2023. This has seen US GDP rise by 0.5% and 0.6% in the first two quarters of the year. By contrast, Eurozone data have disappointed. GDP has been weak, flat-lining in the first quarter and rising by 0.3% in second. Meanwhile, although the UK has avoided recession, GDP growth has been very anaemic at an estimated 0.1% in each of the first two quarters of 2023.

As a result, US GDP was 2.6% higher in the second quarter than a year earlier, much stronger than the 0.6% annual growth rate seen for the Eurozone and estimated 0.3% rise in the UK. Indeed, US GDP is now 6.2% above its end 2019 pre-COVID level. Eurozone GDP is 2.7% higher, held back somewhat by a weak performance by Germany, while UK GDP is still some 0.5% below its pre-COVID end 2019 level.

The outperformance of the US economy in recent years can be put down to a number of factors; the less restrictive COVID measures imposed on the economy, expansionary fiscal policy both during and after the pandemic, being better insulated from the energy price shock with the economy now a net energy exporter, as well as a less severe inflation shock – the annual CPI rate in the US stood at 3.0% in June, well below the rates of 5.5% in the Eurozone and 7.9% in the UK. Not surprisingly, the war in Ukraine has also had also proved more of a headwind for the European economy than the US.

However, the US outperformance is nothing new - in 2018 and 2019 before COVID hit, US GDP rose by 5% in total, double the level of increase in Europe. The reality is that the US has been outperforming the European economy for many decades and continues to do so, reflecting stronger labour force and productivity growth.

Labour force growth in the US is currently running at 1.8% year-on-year, boosted by continuing high levels of immigration. Indeed, the number of foreign-born workers in the US has risen to almost 20% of the workforce. Productivity is also higher, partly because employees in the US work significantly longer hours than those in Europe. Greater levels of investment, more benign regulatory environment, higher spending on education and research, more use of technology, as well as deeper, more efficient capital markets that result in lower funding costs, also help boost US productivity growth.

The surprising strength of the US economy in 2023 is reflected in the 17.5% rise in the S&P 500 stock market index year-to-date. By contrast, the main Euro area stock market index is up by just 7%, while the FTSE indices in the UK are broadly flat. It is also reflected in the continuing strength of the dollar.

Overall, the US economy appears to be emerging in good shape from a very testing period that has included a global health pandemic, inflation shock and substantial monetary tightening. In this regard, the icing on the cake would be if the US Fed is able to bring an end its rate hiking cycle before the ECB and Bank of England, even though the US economy is growing more strongly and has a lower unemployment rate.

Oliver Mangan,
Chief Economist,
AIB

AIB Customer Treasury Services
DUBLIN / CORK
aib.ie/fxcentre

Customer Treasury Services NI
BELFAST
aibni.co.uk/fxcentre

Customer Treasury Services GB
LONDON
aibgb.co.uk/fxcentre

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