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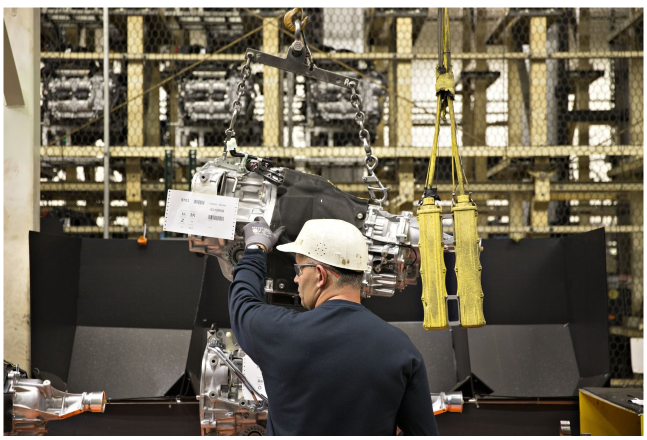
ECONOMY | ECONOMIC DATA

U.S. Economy Returns to Lackluster Growth

President Trump has set goal of generating 4% annual growth by overhauling tax code and rolling back regulations, among other measures



The U.S. is seeing the slowest economic expansion since World War II. Here, an employee moves a transmission on the assembly line at Subaru of Indiana Automotive Inc. in Lafayette, Ind., on May 25, 2016. *PHOTO: DANIEL ACKER/BLOOMBERG NEWS*

By **BEN LEUBSDORF**
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The U.S. ended 2016 on a familiar trajectory of roughly 2% economic growth, the lackluster trend that has prevailed through most of the current expansion and which President Donald Trump is seeking to double in the face of stubborn long-term headwinds.

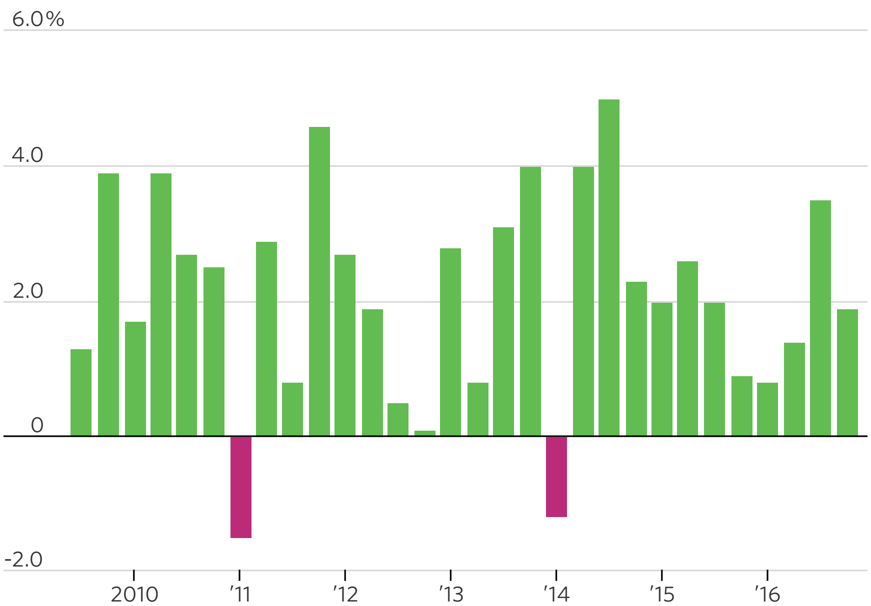
Gross domestic product, a broad measure of the goods and services produced across the economy, expanded at an inflation and seasonally adjusted annual rate of 1.9% in the fourth quarter from the previous three months, the Commerce Department said Friday. That exceeded the pace of growth in a weak first half of 2016 but marked a slowdown from a fleeting third-quarter 3.5% growth spurt.

The economy similarly grew 1.9% in the fourth quarter compared with a year earlier, matching 2015's annual growth and in line with the 2.1% average since the recession ended in mid-2009. That has made this the slowest expansion since World War II, though also one of the longest.

The final three months of 2016 saw solid consumer spending, a pickup in business investment, a rebound for home construction and stronger spending by state and local governments. A widening in the foreign-trade deficit weighed on growth, offset in part by a buildup in business inventories.

Settling Down

U.S. GDP, quarterly change at an annualized rate



Note: All figures are adjusted for inflation and seasonality.
Source: Commerce Department

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"With a business-friendly administration and Congress, are we witnessing a return to animal spirits as we head into the new year?" asked Beth Ann Bovino, U.S. chief economist at S&P Global Ratings. "That remains to be seen, but it does suggest some promise."

The latest data underscored the obstacles to stronger growth facing Mr. Trump, who has said he will raise the pace of expansion to 4% a year. Friday's report also provided fodder for Republicans arguing that stronger growth is needed and possible. "Americans spoke loudly and clearly in November telling the world that President [Barack] Obama's 'new normal' was unacceptable," said Rep. Pat Tiberi (R., Ohio), chairman of Congress's Joint Economic Committee. "That's why Republicans are ready to unleash America's economic potential."

Mr. Trump has argued the U.S. can achieve stronger growth by overhauling the tax code, boosting infrastructure spending, rolling back federal regulations and cutting new trade deals that narrow the foreign-trade deficit.

Economic forecasters are predicting slightly stronger growth in the next few years compared with pre-election estimates. But many remain skeptical of the potential for a significant shift in the long-term growth picture.

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Federal Reserve Chairwoman Janet Yellen last week pointed to "a variety of forces depressing both supply and demand," including slow growth in the size of the labor force and sluggish worker productivity. She said she expected they would continue to restrain growth for years to come. The nonpartisan Congressional Budget Office this week reiterated that it thinks U.S. economic growth will remain modest over the coming decade due to long-term forces, namely the slower workforce growth produced by baby-boomer retirements.

"A combination of across-the-board tariffs, corporate tax reform and lower tax rates, and infrastructure spending—the whole package could boost growth," said Michael Gapen, chief U.S. economist at Barclays. "The real question is, does that turn out to be a short-term boost, or does it improve productivity growth and rates of potential growth at the same time?"

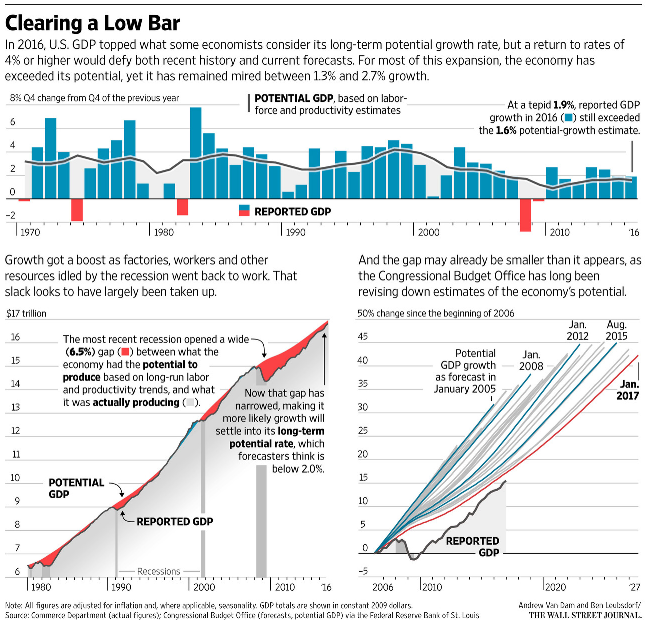
He said the economy's underlying growth rate is likely in the range of 1.5% to 2%, and it's "not totally impossible" to raise that trend.

"Certainly the details matter," Mr. Gapen said, and "the timing matters" too.

For now, many businesses seem hopeful about the possibility of stronger economic growth, but aren't counting on an imminent boom.

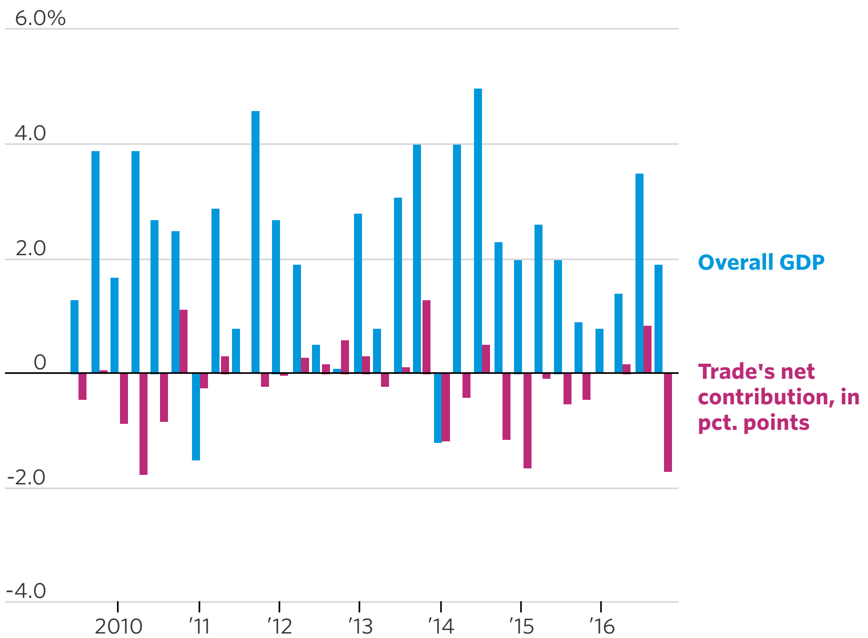
"I don't think there's any secret that the overall mood seems to be modestly better" early in 2017, Illinois Tool Works Inc. Chief Executive Scott Santi told analysts this week. "Whether that translates into anything meaningful in terms of demand, that remains to be seen."

One unknown is how long the Fed would let the economy run hot if the



Trade Drags

Net trade (exports minus imports) pulled down GDP growth in the fourth quarter.



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Source: Commerce Department

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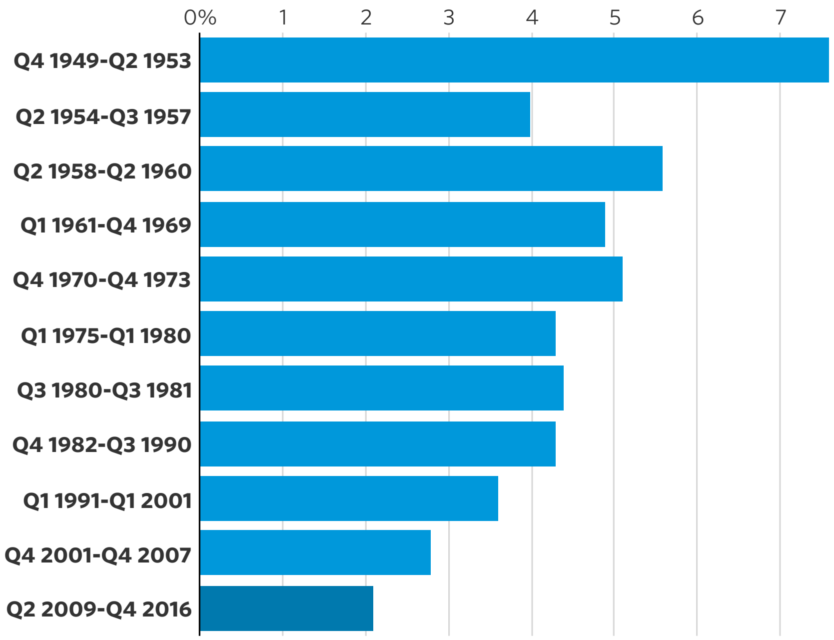
growth rate does pick up. Fast growth rates in the 1980s came as the Fed was cutting interest rates after bringing inflation under control; now, the Fed is gradually raising interest rates with unemployment low and inflation showing signs of rising. The 1990s economic boom rested on soaring growth in worker productivity which held inflation down; the U.S. and other advanced economies now face a puzzling productivity slowdown.

The 1980s and 1990s also benefited from rising labor-force participation among women, a trend that has since plateaued, and broader labor-force participation has been declining because of retiring baby boomers and a decadeslong decline in the share of men who work.

Not So Fast

Average annual change in GDP, by expansion



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Friday's report gave the first comprehensive look at the U.S. economy's year-end performance. Household spending, which accounts for the majority of total activity, rose at a healthy 2.5% annual rate in the final three months of the year, led by robust spending on durable goods like motor vehicles.

A broad measure of businesses' capital expenditures, fixed nonresident investment, rose for the third consecutive quarter, lifted by rising spending on equipment and research-and-development projects.

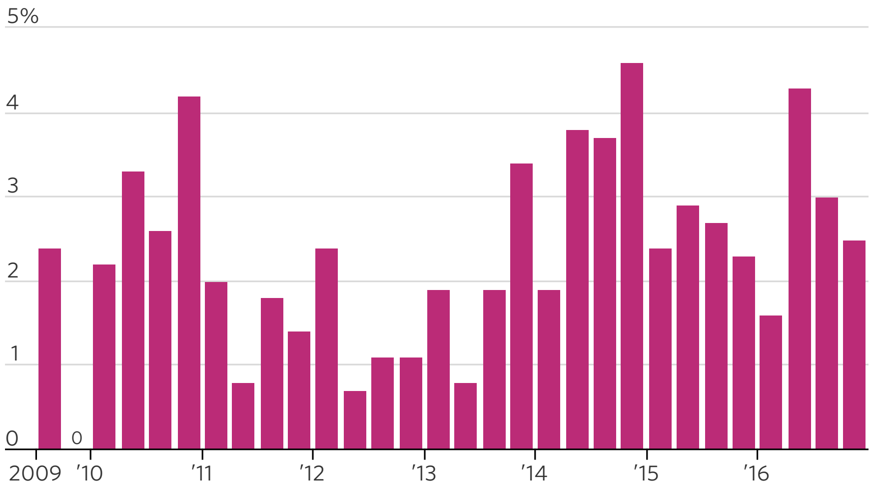
Energy companies had scaled back spending on new wells and equipment as oil prices plunged starting in 2014, but investment has started to rebound as prices have stabilized in recent months. In 2014, Hess Corp. was operating 17 rigs in North Dakota's Bakken Shale formation, but pulled back on its drilling activity as prices plunged. Now, "with the recovery in oil prices to the mid-$50s, we plan to increase our rig count from the two rigs we currently have operating to six rigs by the end of this year," Chief Operating Officer Greg Hill told analysts Wednesday.

Net exports subtracted 1.7 percentage points from the fourth quarter's GDP growth rate, reflecting a drop in exports and a large rise in imports. It was the largest trade-related drag on overall growth since the second quarter of 2010, but it may be temporary. It came after a surge in soybean exports had helped narrow the overall trade gap in the third quarter.

Another volatile category, private inventories, added a full percentage point to last quarter's growth rate.

Slower Spending

Consumer spending, typically a major driver of U.S. economic growth, grew more slowly in the fourth quarter than in recent quarters.



Source: Commerce Department

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A bright spot was the housing sector. Residential investment grew at a 10.2% annual pace in the final three months of 2016, rebounding after two straight quarters of decline.

"After several years of strong job formations and low unemployment, supported by favorable demographics, there are signs that housing demand is now being bolstered by an improving economy and recent gains in consumer sentiment," Atlanta-based home builder PulteGroup Inc. Chief Executive Ryan Marshall told analysts Thursday.

Mortgage rates have risen since the Nov. 8 election, though they remain low by historical standards. Mr. Marshall played down worries that higher borrowing costs could crimp buyer demand headed into the spring buying season.

"Coming off such a low starting point, it is certainly reasonable to expect that housing demand can continue to expand—especially if the rise in rates truly reflects increased expansion of the U.S. economy," he said.

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