The current economic expansion in the USA is on the verge of becoming the longest on record.[1] Specifically, the duration of this period of sustained growth, largely underpinned by the expansionary stance of economic policies, is now nine years.[2] However, the high recent GDP growth (with annualised quarter-on-quarter rates above 3.5% in the middle two quarters of 2018), which has taken the output gap into positive territory (see Chart 1) and reduced the unemployment rate to 3.7% of the labour force (its lowest level for the last 50 years), has given rise to a less balanced composition of aggregate demand, with a higher weight of consumption and a certain fall-off in investment, perhaps signalling a certain exhaustion of the cycle. Looking forward, it is expected that the more restrictive stance to be adopted by demand-side policies will contribute to raising the likelihood of a change of cycle in the US economy. This box analyses the foreseeable behaviour of fiscal and monetary policy and their effect on expected US growth in the next few years.

In the monetary arena, against a background of gradually rising inflation (see Chart 2) and progressive improvement in the labour market, the Federal Reserve has raised its policy rate by 200 bp since December 2015 (see Chart 3) and may further raise it by another 125 bp up to the end of 2020, according to the median of the projections of the Federal Open Market Committee (FOMC) members. Furthermore, in October 2017, the Federal Reserve began to downsize its balance sheet, and is expected to continue to do so gradually over the coming years. Although the Federal Reserve expects inflation to remain around the target of 2% in the near future, the scant slack in the labour market and the effects of the tariff increases pose upside risks to the baseline price scenario, the materialisation of which would prompt additional tightening of monetary policy and further toughening of domestic and global financial conditions.[3]

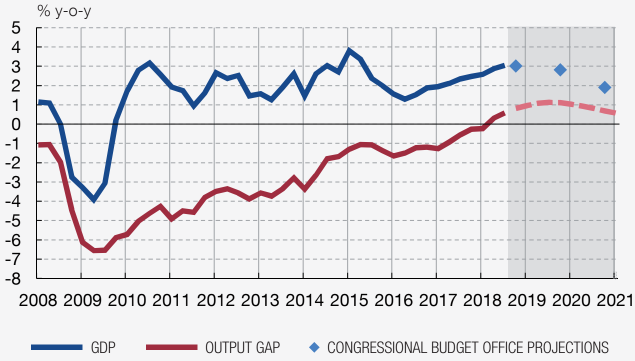
1 See the business cycle dating published by the National Bureau of Economic Research since the middle of the 19th century.

2 The average duration of expansions in the USA since 1945 is approximately five years.

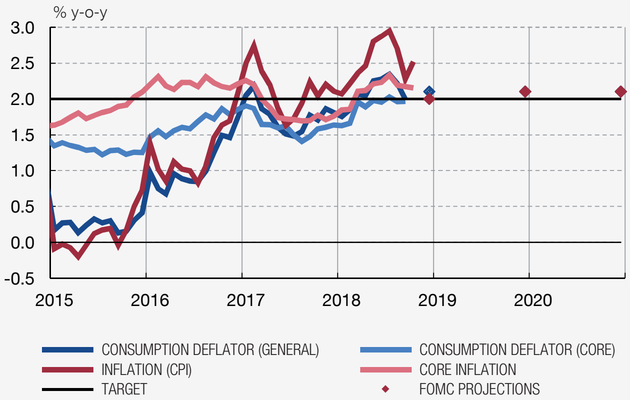
3 Specifically, it is estimated that a tightening in financial conditions of 1 standard deviation may clip as much as 1.6 pp from the annual growth of the USA, See Hatzius, J. and S. Stehn (2018), "The case for a financial conditions index", Goldman Sachs Global Economics Paper.

Chart 1
CYCLICAL POSITION AND ROLE OF DEMAND POLICIES

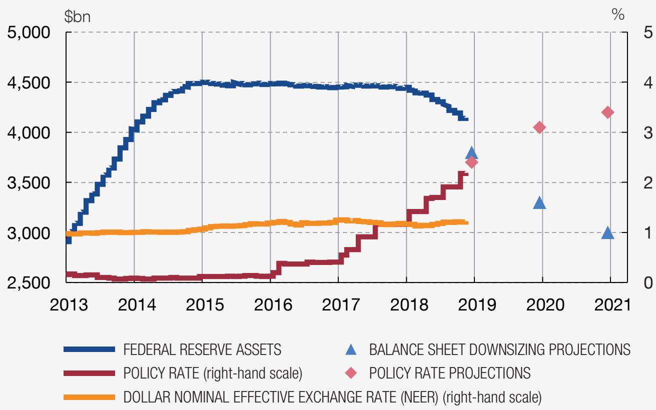
1 GDP AND OUTPUT GAP



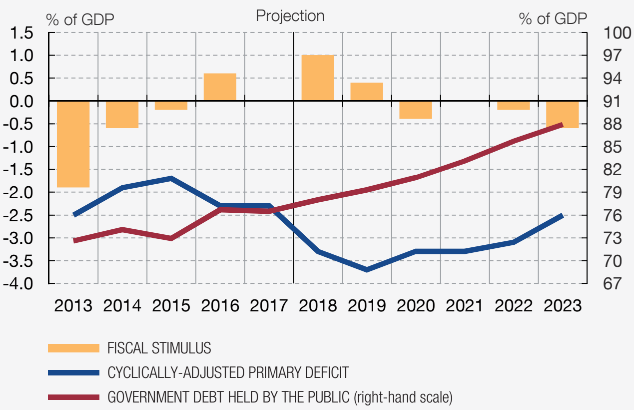
2 CPI, PERSONAL CONSUMPTION EXPENDITURE (PCE) PRICE INDEX AND TARGET INFLATION



3 MONETARY POLICY



4 FISCAL STIMULUS AND PUBLIC DEBT



SOURCES: Bureau of Economic Analysis, Congressional Budget Office, Bureau of Labor Statistics, Federal Reserve and Bloomberg.

As regards fiscal policy, it is estimated that the stimulus derived from the expansionary measures adopted in late 2017 and early 2018 will have a positive impact on GDP growth of 0.6 pp in both 2018 and 2019.[4] As this fiscal stimulus peters out after 2020 (see Chart 4), activity will tend to slow, falling back towards its trend growth rate in the medium term, slightly below 2%, according to the projections of the Congressional Budget Office.

Lastly, it should be noted that the protectionist about-face of the current US administration will continue to be another key factor in the US economic outlook. The imposition of trade tariffs is a prerogative of the president and it is unlikely that the outcome of the mid-term elections will alter the protectionist trade policy agenda. If the threats made were to be carried out, the trade conflict could trim nearly 0.5 pp from US GDP growth in 2019, according to estimates by the main international organisations.[5]

In short, the loss of support for expansionary demand-side policies against a background of high uncertainty due to trade tensions, points to a slowdown in US economic activity in the coming years to growth rates more in line with potential. Moreover, in the event of a hypothetical recession in the medium term, the room for manoeuvre of demand-side policies is now more constrained than in previous recessions. Firstly, monetary policy faces a setting of lower natural interest rates and a higher likelihood of hitting the policy rate floor. Secondly, the action of automatic stabilisers and the application of a discretionary expansionary fiscal policy would be partially limited by the severe fiscal imbalances built up in recent years.

4 *An Update to the Economic Outlook: 2018 to 2028.*

5 See for example, IMF (2018), *World Economic Outlook,* October 2018; and OECD (2018), *Economic Outlook,* November 2018.