MUFG Asset Management

Global Fixed Income Thematic Viewpoint

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Analysing the US Macro-Economy: Is the US Economy Really That Strong?

The US economy is slowing down. Both demand and labour supply are decreasing, so while the unemployment rate has not yet deteriorated significantly, it is likely to rise gradually. Inflation driven by tariff impacts may not rise as much as markets anticipate, and we expect inflationary pressures to diminish due to slowing domestic demand. Longer term we forecast a decline in the global economy driven by de-globalisation and the impact of US tariff policies, leading to inflation levels around 3%. But, for now, let's step away from that long-term view and focus on the economy over the next six months

Signs of so-called crowding out are emerging in the commercial real estate market, where rising interest rates are exerting downward pressure on the real economy, together with the adverse effects of tariffs began to show in summer macroeconomic indicators. As we discuss below, these themes are now beginning to emerge.

First, the US real GDP figures released on 30 July. The number was +3.0% against a forecast of +2.7%, with personal consumption expenditure rebounding quarter-on-quarter. While the market interprets this as a not-too-bad figure, the underlying details are worse than they appear.

As a quick reminder, GDP can be expressed as private final demand (consumption + investment) + government spending + net exports (exports - imports) + inventory changes. The relatively robust figures this time are primarily attributable to tariff-related import and export factors. Referring to the formula above makes it clear: the previous quarter saw a 0.5% year-on-year decrease due to increased imports from last-minute demand, while this quarter recorded a 3.0% year-on-year increase due to the rebound effect. The impact of imports is just under 2%.

However, one might well ask: 'But consumer spending accelerated, rising by +0.5% quarter-on-quarter and +1.4% quarter-on-quarter!' However, per the formula above, GDP is susceptible to fluctuations in government spending and trade, making it necessary to examine private final demand (consumption + investment) to gauge the fundamental strength of the US economy.

Looking at this, private final demand has declined from +3.4% in the third quarter of 2024 to +2.9%, then to +1.9%, and now to +1.2%. The US potential growth rate, that is, growth at the level of production capacity neutral to the economy, is estimated to be just under 2%, meaning the current 1.2% falls below this. This likely indicates that demand has been falling below supply capacity since around April.

Furthermore, regarding the employment statistics, not only was July's figure weak, but May and June were revised downwards by a total of over 250,000. There are three implications here.

First, the employment statistics are preliminary figures based on sample surveys, with the initial release estimated using 60–70% of the data. When the economy deteriorates, employment does not decline across all industries, but rather starts with sectors sensitive to economic conditions, resulting in a mixed pattern of data strength. This leads to a significant difference between the initial survey and the revised figures. Furthermore, companies that can respond to the initial survey in time tend to be large firms with well-established systems and this explains why the initial sample data is relatively favourable. As a result, when the economy deteriorates, the revised figures tend to deteriorate sharply, as seen during the Lehman Shock and the COVID-19 pandemic. Put another way, the current situation is a phenomenon typically observed during economic downturns.

The second issue is seasonal adjustment. Seasonal adjustment models are a simple regression analysis method that incorporates time series correlations and trends using ARIMA (Autoregressive Integrated Moving Average) models, an area where I have extensive personal experience. Why, in this day and age, are we resorting to such antiquated, traditional statistical processing? I suspect it is to eliminate arbitrariness and avoid the kind of sceptical scrutiny directed at Mr. Trump. This model is revised annually in January, recalculating the model based on five years' worth of data. This inevitably includes the entire COVID-19 period, casting significant doubt on the model's accuracy. While a post-COVID revision appears to have been conducted, the Bureau of Labour Statistics' insufficient communication on this point to both the government and the market was a potential factor in Mr. Trump's dismissal of the Director, Erika McEntarfer in August. In other words, the likelihood of data manipulation is low.

Furthermore, on 9 September 2025, alongside the model revision, a revision of the underlying data is also scheduled in what is known as a benchmark revision. Consequently, September 2025 is likely to be a month of unprecedented uncertainty, with the benchmark revision, monthly employment statistics, and other factors coming into play.

The third factor is the impact of illegal immigration. Firstly, it is important to grasp the scale of employment data, which is a highly variable indicator, so the following points should be briefly noted.

The U.S. workforce, with a labour participation rate of around 60%, numbers approximately 170 million people. Given a population growth rate of approximately 1% in 2025, a monthly increase of around 140,000 employed individuals is considered reasonable. A range of 150,000 to 200,000 is seen as healthy, 50,000 to 100,000 indicates an economic slowdown, and below 50,000 raises concerns about recession. Considering this, the revised figures for May (19,000, previously 144,000), June (14,000, previously 147,000), and July (73,000) clearly demonstrate how poor the numbers are. Currently, the figures are so significantly lower than before that the market is in a state of uncertainty, wondering whether this signals an economic slowdown or merely a statistical fluctuation.

Now, let's move on to the topic of illegal immigration. It is estimated that there are approximately 15.4 million illegal immigrants in the United States, with roughly half of whom, or about 8.6 million, are employed. The question here is whether illegal immigrants are included in the employment statistics. The answer is that immigrants are fundamentally included in employment statistics, as there is no question asking whether they are immigrants. However, a significant number of cases are excluded from the statistics due to factors such as cash-in-hand day labour or refusal to respond. Interpreting data from this becomes a black box, necessitating the comparison of multiple datasets and an exercise of imagination.

Since the second Trump administration took office, the Immigration and Customs Enforcement (ICE) has been actively cracking down on immigrants, with an estimated 300,000 deportations per year. Furthermore, according to local news reports, there are cases of individuals avoiding workplaces out of fear of apprehension, as well as legal immigrants whose family members have been deported, leading them to return to their home countries. This has resulted in many Los Angeles immigrant neighbourhoods becoming deserted. Taking this into account, the withdrawal of undocumented immigrants from the labour market may be more widespread than expected.

Since the beginning of 2025, the labour participation rate has declined from 62.6% to 62.2%. This indicates that over 1 million workers have exited the labour market in the past six months. As the labour participation rate remained unchanged in 2024, something significant is occurring in 2025 and this may be down to the return of President Trump. I believe that a significant number of the workers who have exited the labour market include the immigrants mentioned earlier, but I will explore this further later.

The labour participation rate is calculated by subtracting the private non-institutional population of 267 million (excluding prisoners and military personnel) from the labour force of 170 million. Meanwhile, the unemployment rate is calculated by dividing the number of unemployed people (approximately 7.2 million) by the labour force of 170 million. The number of unemployed has risen by approximately 400,000 since the beginning of the year, but the unemployment rate has risen by only 0.1%, which is solely due to a decline in the labour participation rate, meaning the labour force - the denominator – has shrunk alongside the number of unemployed. This means that the decline in labour demand and the decrease in labour supply are offsetting each other, creating a mechanism where the unemployment rate appears stable. Fed Chair Powell has also pointed out this possibility.

Employment statistics also break down the number of employees by race. Whilst the number of Hispanic employees, who share the same ethnicity as immigrants, has remained largely flat, the number of black employees, who statistically tend to be to be lower paid workers, has decreased significantly. The relative resilience in the number of legally employed Hispanic workers is understandable, as the reduced influx of illegal immigrants increases demand for legal immigration. Examining wage data from the Federal Reserve Bank of Atlanta reveals that while wages for highly skilled workers remain comparatively high, those for low-skilled workers are currently weakening. This suggests that the decline in black employment may stem from a simultaneous drop in labour demand itself, coinciding with reduced labour supply from low-skilled workers due to the trend of excluding illegal immigrants.

Viewed in this light, it becomes clear that the decline in private final demand and the softening of labour demand has occurred at almost the same time. This further supports the accuracy of the employment statistics. Until now, employers have believed US employment to be robust, leading to practices such as "ghost listings" – job postings without any real intention to hire, which have become problematic in the US – and efforts to suppress layoffs. However, as this softening of the labour market becomes recognised, it could accelerate the deterioration of employment going forward.

Importantly, personal credit card delinquency rates are near their highest levels since the Lehman crisis and the previously robust housing market is also showing signs of softening.

Stock prices have risen in anticipation of demand for generative AI and associated AI data centre construction. However, in the current economic environment, a clear monetisation strategy for the significant capital investments required will be essential for further stock price increases.

Predicting the timing of a stock market correction is extremely challenging. However, historically speaking, a P/E ratio of 25 in these high-interest-rate environments is a rare level. We believe the prudent strategy is to maintain a longer duration focus in countries with relatively high interest rates, keep credit weightings low, and prepare for the inevitable correction.