more give, less take

U.S. Economic Update, 2014Q3 GDP

by NAB Group Economics 31 October 2014

National Australia Bank

- **GDP grew by 3.5% qoq (annualised rate) in the September quarter, a strong above trend result.**
- **While we expect that growth may slow in the December quarter, it should still be consistent with around 3% annualised growth in the second half of 2014. This is more than sufficient to maintain the improvement in the U.S. labour market.**
- **We continue to forecast growth of 2.2% in 2014 and 3.0% in 2015.**

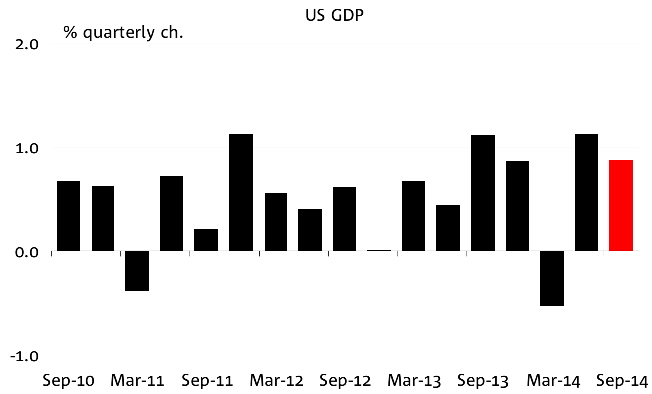
GDP grew by 3.5% qoq (annualised rate) in the September quarter, a strong above trend result. Growth was reasonably broad based with consumption, housing and business investment, net exports and government spending all contributing to growth; only inventories detracted from growth. While the relatively strong boost from government and net exports may be difficult to sustain, this is counterbalanced by less risk of a large inventory correction in the next quarter.

Consumption growth was only a modest 0.4% qoq in the September quarter. June quarter growth was boosted by the rebound in goods consumption following the weather affected first quarter so some slowdown was to be expected. Services consumption continues to be sluggish, although in the last two quarters this has been partly due to a weather related fall in utility consumption. The household savings rate has now risen in each of the last three quarters (from 4.4% in the December quarter 2013 to 5.5% in the September quarter) so, despite strong gains in household wealth and a gradual pick-up in confidence, households are continuing to show a degree of caution in their spending decisions.

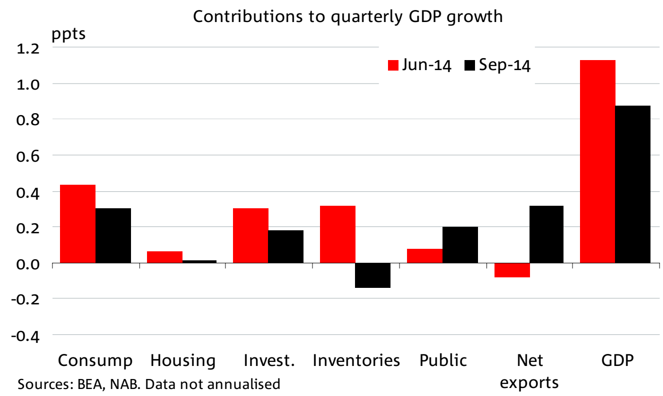
Non-residential fixed (business) investment growth also slowed in the quarter – as with consumption, the June quarter strength was in part due to a bounce back from the poor start to the year – but was a still reasonable 1.3% qoq. Non-residential structures investment grew for the sixth consecutive quarter on the back of strong growth in manufacturing structures (as in the previous quarter) and continued strength in mining related investment flowing from the U.S. energy boom. Equipment investment also rose, but information processing equipment investment declined and is slightly down on year ago levels. Intellectual property investment growth remained steady.

Residential investment also grew for the second consecutive quarter, but at a slower rate than in the June quarter. This reflected the first decline in investment in new (permanent site) structures since mid-2011. Leading indicators of activity such as building permits reacted quickly to the steep rise in mortgage rates in mid-2013 but the impact on actual construction has come through more slowly. In contrast, 'Other structures' investment – which includes home improvements and ownership transfer costs (e.g. real estate commissions) – grew, consistent with the upturn in existing home sales over the last half-year.

GDP growth in Q3 – a strong, above trend, result



Growth broad based



2014 Q3 GDP detail

	QoQ (%)	QoQ cont. (ppts)	YoY (%)
Consumption	0.4	0.3	2.3
Fixed investment	1.2	0.2	5.1
Structures	0.9	0.0	7.9
Equipment	1.8	0.1	7.7
Intellectual property	1.0	0.0	4.5
Residential	0.5	0.0	-1.0
Ch. in inventories		-0.1	
Public Demand	1.1	0.2	0.4
Net exports		0.3	
Exports	1.9	0.2	4.6
Imports	-0.4	0.1	3.2
GDP	0.9	0.9	2.3

Source: BEA, NAB. Data not annualised.

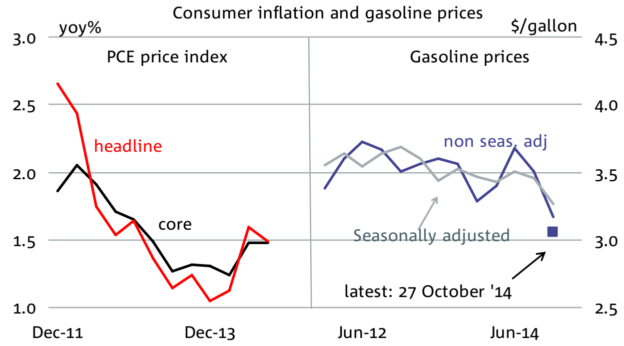
Exports grew strongly for the second quarter in a row, rising by 1.9% qoq, seemingly at odds with recent concerns about the strength of the global economy. In contrast, despite the strong growth in the U.S., imports declined, although this followed a large increase in the previous quarter. As a result, net exports made a strong contribution to growth.

One of the major surprises was the strength in Government consumption and investment, which grew by 1.1% qoq, well above the previous quarter's 0.4%. This largely reflected a spike in national defence spending. A possible explanation is that it reflects the operations against ISIS but it is not certain.

Inventory accumulation in the September quarter was still solid by historical standards, but as it was slower than in the previous quarter its contribution to growth was negative (-0.1 ppt).

The personal consumption expenditure (PCE) price index – the Federal Reserve's preferred inflation measure – slowed a little to 1.5% yoy in the September quarter. The large decline in oil prices – if sustained – means that inflation is likely to decline even further in the December quarter. Annual core inflation (which excludes food and energy prices) was steady, growing by 1.5%.

Oil prices weighing on headline Inflation



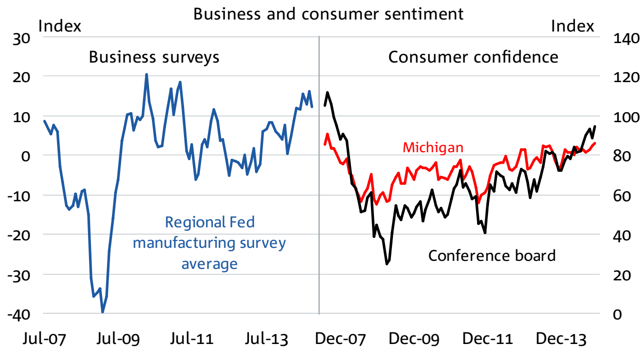
Sources: BEA, EIA, BLS, NAB. Quarterly data; gasoline price for Dec. '14 quarter equal to October average. Seasonal adjustment of gasoline by NAB using CPI seasonal factors.

Assessment

The September quarter GDP outcome is a strong result, as it shows growth is well above the economy's long-term potential growth rate (which we consider to be around 2%). While we expect that growth may slow in the December quarter – as the boost from net exports and government spending are unlikely to be repeated and may even be unwound to some extent – it should still be consistent with solid (around 3% annualised) growth in the second half of 2014. Growth of this magnitude is more than sufficient to continue the improvement in the labour market. This is supported by the continued downwards trend in initial jobless claims (the latest data were also released overnight). Overall, we continue to forecast growth of 2.2% in 2014 and 3.0% in 2015.

While October business manufacturing survey measures of activity softened a little, they remain at solid levels. Manufacturing is one of the more trade exposed sectors in the economy, and so at this stage global growth concerns and US dollar appreciation don't appear to be having a major impact.

Business and consumer sentiment positive



Sources: Philadelphia, Dallas, Kansas City, Richmond, New York Federal Reserves, Conference Board, University of Michigan/Thomson Reuters. Data are to October 2014.

Moreover, consumer confidence, as measure by both the Conference Board and University of Michigan, hit a recovery high in October. Rising confidence, coupled with strong employment growth and ongoing improvement in household balance sheets should underpin solid future consumption growth. While dependent on how long they are maintained, the recent fall in gasoline prices (and associated softer inflation readings) are also a plus for household budgets.

We expect residential investment to grow over time as activity returns to more normal levels, supported by low vacancy rates and on-going employment growth. Business investment is also expected to remain positive, supported by a high level of profits and improving credit conditions.

At the same time, fiscal headwinds have faded and monetary policy remains accommodative. While the Fed's October meeting statement (released last Wednesday U.S. time) announced the end of its monthly asset purchase program (QE) we expect the fed funds rate will remain at its current, near zero, level until mid-2015. This view is based around continuing above-trend economic growth leading to further falls in the unemployment rate and a gradual rise in the core inflation rate.

While there is little noticeable impact so far, risks around the growth outlook are centred on the impact of the recent US dollar appreciation, coupled with global economic growth concerns – particularly in the Euro-zone. In any event, we expect the US dollar will continue to appreciate over time (but are factoring in a more gradual pace) which, coupled with solid U.S. growth, will put pressure on net exports.

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US Economic & Financial Forecasts

	Year Average Chng %				Quarterly Chng %									
					2013		2014				2015			
	2013	2014	2015	2016	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
US GDP and Components														
Household consumption	2.4	2.2	2.6	2.6	0.5	0.9	0.3	0.6	0.4	**0.7**	**0.7**	**0.7**	**0.7**	**0.7**
Private fixed investment	4.7	5.2	7.4	6.3	1.6	1.5	0.0	2.3	1.2	**2.0**	**1.9**	**1.8**	**1.7**	**1.6**
Government spending	-2.0	-0.1	0.6	0.8	0.0	-1.0	-0.2	0.4	1.1	**-0.3**	**0.0**	**0.1**	**0.2**	**0.2**
Inventories*	0.0	0.0	-0.1	0.0	0.3	-0.1	-0.3	0.3	-0.1	**-0.1**	**0.0**	**0.0**	**0.0**	**0.0**
Net exports*	0.2	-0.1	0.0	-0.1	0.1	0.3	-0.4	-0.1	0.3	**-0.1**	**-0.1**	**0.0**	**0.0**	**0.0**
Real GDP	**2.2**	**2.2**	**3.0**	**2.8**	**1.1**	**0.9**	**-0.5**	**1.1**	**0.9**	**0.6**	**0.7**	**0.7**	**0.7**	**0.7**
Note: GDP (annualised rate)					*4.5*	*3.5*	*-2.1*	*4.6*	*3.5*	*2.5*	*2.7*	*2.9*	*2.9*	*2.9*
US Other Key Indicators (end of period)														
PCE deflator-headline														
Headline	1.0	1.3	2.0	2.0	0.4	0.3	0.3	0.6	0.3	**0.1**	**0.4**	**0.5**	**0.5**	**0.5**
Core	1.3	1.5	1.9	2.0	0.4	0.3	0.3	0.5	0.3	**0.4**	**0.5**	**0.5**	**0.5**	**0.5**
Unemployment rate - qtly average (%)	7.0	5.8	5.2	4.8	7.3	7.0	6.7	6.2	6.1	**5.8**	**5.6**	**5.5**	**5.3**	**5.2**
US Key Interest Rates (end of period)														
Fed funds rate (top of target range)	0.25	0.25	1.00	2.50	0.25	0.25	0.25	0.25	0.25	**0.25**	**0.25**	**0.50**	**0.75**	**1.00**
10-year bond rate	3.03	2.50	3.50	3.00	2.61	3.03	2.72	2.53	2.49	**2.50**	**3.00**	**3.25**	**3.50**	**3.50**

Source: NAB Group Economics

*Contribution to real GDP

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