more give, less take

U.S. Economic Update, 2015Q3 GDP

by NAB Group Economics 30 October 2015

National Australia Bank

- **U.S. GDP growth slowed in the September quarter to a rate of 0.4% qoq (1.5% annualised).**
- **The details were more positive and there appears to be still solid underlying momentum in the economy.**
- **We have lowered our forecast slightly for 2015 – to 2.4% from 2.5%.**

U.S. GDP growth slowed in the September quarter to 0.4% qoq or 1.5% annualised, continuing the recent volatility in quarterly GDP growth rates.

While growth in most of the major categories slowed, the details were more positive. A large part of the slowdown was due to an inventory correction which will be transitory. Consumption growth remained strong, as did housing investment, while business fixed investment and government demand continued to expand. As a result, domestic final demand remained strong, growing at a 2.9% annualised rate in the quarter.

The major surprise was that the net exports detraction from growth was only minimal, with both export and import growth slowing in the quarter.

Real private consumption slowed to a still strong 0.8% qoq from 0.9% the previous quarter. Over the last year it has grown by 3.2%, and is the main driver of domestic demand. Its strength reflects the boost to household spending power from the fall in oil prices, the improving labour market and higher confidence. Durable goods consumption continues to show the strongest growth, but non-durables consumption has strengthened, as has services.

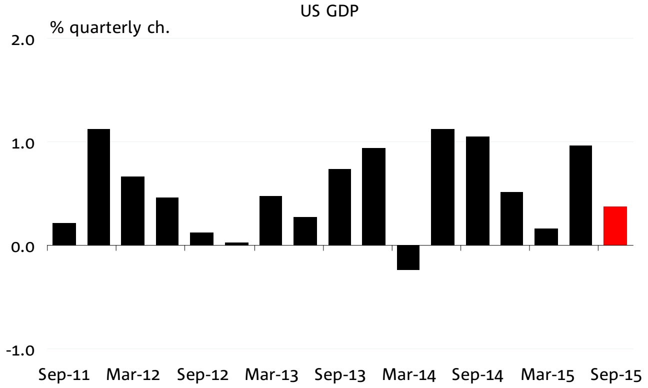
Business fixed investment growth grew modestly in the September quarter, weighed down by further falls in mining investment. Equipment investment recorded its strongly quarterly growth since the same quarter a year ago, but intellectual property investment was soft and structures investment declined.

The fall in structures investment reflected another large decline in mining & exploration investment of 15% qoq, and it has fallen 45% over the last three quarters. Outside of mining investment, structures investment grew solidly.

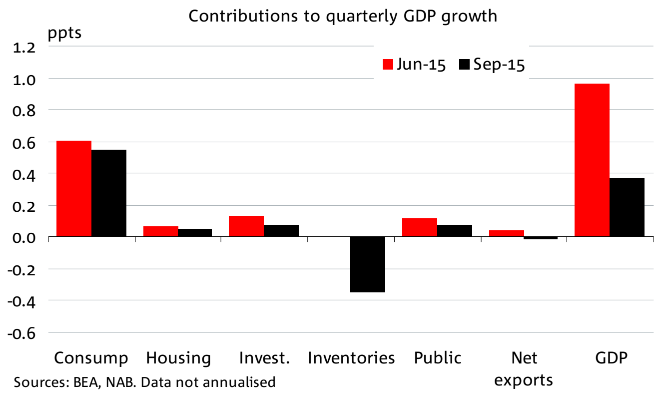
Residential investment growth, while down on the previous quarter, was still a solid 1.5% qoq, and over the last year it grew by a strong 8.9%. Growth in the quarter was centred on new construction, with the 'other structures' category (mainly home improvements and ownership transfer costs) only showing modest growth.

Inventory accumulation slowed noticeably in the September quarter, and as a result it significantly detracted from growth. Inventory movements have largely transitory affects, with little net impact over time. As a result of the correction in the quarter, ratios of non-farm inventories to sales declined. That said, they still look elevated and the inventory correction may not be fully over (see chart next page). Consistent with this, October regional surveys continued to show weakness in the manufacturing sector.

Slowdown in GDP growth in Q3



...largely due to an inventory correction



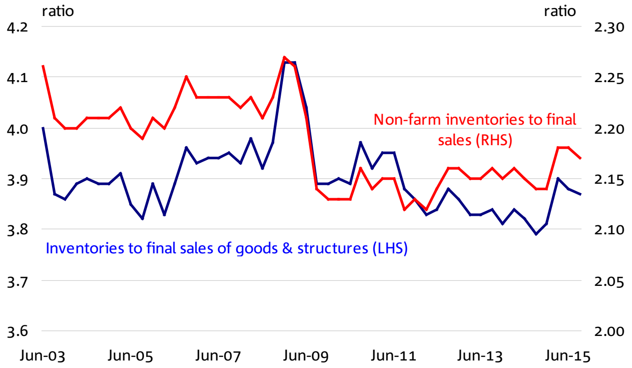
Sources: BEA, NAB. Data not annualised

2015 Q3 GDP detail

	QoQ (%)	QoQ cont. (ppts)	YoY (%)
Consumption	0.8	0.5	3.2
Fixed investment	0.7	0.1	3.4
Structures	-1.0	-0.03	-0.4
Equipment	1.3	0.1	0.7
Intellectual property	0.4	0.02	6.1
Residential	1.5	0.05	8.9
Ch. in inventories		-0.3	
Public Demand	0.4	0.1	0.7
Net exports		-0.01	
Exports	0.5	0.1	1.5
Imports	0.4	-0.1	5.5
GDP	0.4	0.4	2.0

Source: BEA, NAB. Data not annualised.

Inventories to sales



Source: BEA

Both export and import growth slowed in the September quarter. The June quarter was itself boosted by the end to west coast port disruptions early in the year, making the quarterly numbers, volatile at the best of times, not a reliable guide to the underlying trend. Exports over the last year have managed to grow by 1.5% qoq despite the strong appreciation of the U.S. dollar and a lacklustre world economy. Import growth has, however, been stronger, again reflecting the U.S. dollar appreciation (which improves the competitiveness of importers) and reasonably strong U.S. domestic demand.

Government consumption and investment increased by a modest 0.4%, with growth strongest at the state & local level. A fall in defence spending held back federal government demand. Over the last year government demand rose by only 0.7% but is trending up as the effects of fiscal restraint fade.

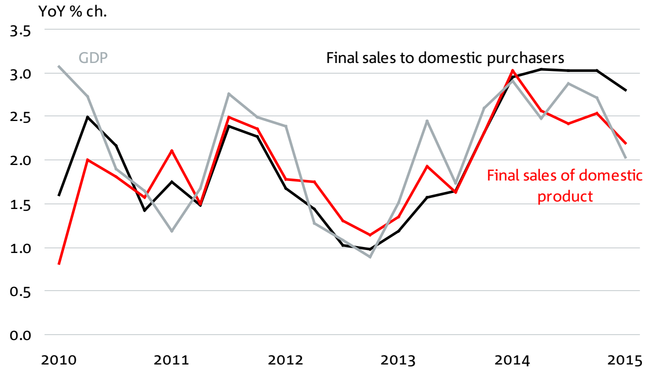
Assessment

While growth slowed appreciably, the strength in the June quarter was itself due to a bounce back from weakness at the start of the year. Moreover, a large part of the slowdown in growth was due to an inventory correction and there appears to be still solid underlying momentum in the economy.

In particular, domestic final demand (measured by 'final sales to domestic purchasers') is growing reasonably strongly, having risen by 2.8% over the year to the September quarter (compared to 2.0% for GDP).

However, notwithstanding a better result in the September quarter, net exports is dragging on the economy as the tradeable sector faces a loss of competitiveness from a higher dollar and with a lack lustre world economy providing little impetus to exporters. This can be seen in the gap between 'final sales to domestic purchasers' and 'final sales of domestic product' in the following chart.

Solid domestic demand but net exports a headwind



Sources: BEA, NAB

With further U.S. dollar appreciation expected, this is likely to continue to be the case over the next year.

However, we expect that the economy will continue to grow at a solid pace given the strong underlying momentum in consumption and residential investment. The drag on business investment from lower oil prices should slow as prices stabilise, although investment from businesses exposed to the U.S. dollar (particularly in manufacturing) will continue to come under pressure. Easing lending standards are also likely to continue to be a positive factor.

Moreover, the headwind from fiscal policy seems well and truly past. This week's federal budget deal (still subject to Senate approval, but this appears almost certain to be given) not only provides a small fiscal boost, but also removes the tail risks around government shutdowns and default at least until 2017.

While our outlook for the economy is essentially unchanged, due to the slightly lower than expected September quarter result the forecast for 2015 has been lowered from 2.5% to 2.4%.

The GDP result probably has relatively few implications for the monetary policy debate going on within the Federal Reserve. The result was broadly in line with expectations, and labour market (as well as inflation) indicators are more likely crucial right now. The latest initial jobless claims data – also out overnight – continue to trend down and are at very low levels by historical standards. This suggests the labour market continues to improve, although the Fed will want to see this confirmed in upcoming employment reports.

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US Economic & Financial Forecasts

	Year Average Chng %			2015				2016			
	2014	**2015**	**2016**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
US GDP and Components											
Household consumption	2.7	3.2	2.8	0.4	0.9	0.8	**0.7**	**0.7**	**0.7**	**0.6**	**0.6**
Private fixed investment	5.3	4.3	5.9	0.8	1.3	0.7	**1.6**	**1.7**	**1.6**	**1.5**	**1.3**
Government spending	-0.6	0.8	1.5	0.0	0.6	0.4	**0.3**	**0.4**	**0.4**	**0.4**	**0.4**
Inventories*	0.0	0.1	-0.2	0.2	0.0	-0.3	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Net exports*	-0.2	-0.6	-0.4	-0.5	0.0	0.0	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.1**
Real GDP	**2.4**	**2.4**	**2.5**	**0.2**	**1.0**	**0.4**	**0.6**	**0.7**	**0.6**	**0.6**	**0.6**
Note: GDP (annualised rate)				*0.6*	*3.9*	*1.5*	*2.5*	*2.7*	*2.6*	*2.6*	*2.4*
US Other Key Indicators (end of period)											
PCE deflator-headline											
Headline	1.1	0.6	2.0	-0.5	0.5	0.3	**0.2**	**0.4**	**0.5**	**0.5**	**0.5**
Core	1.4	1.3	1.8	0.2	0.5	0.3	**0.3**	**0.4**	**0.5**	**0.5**	**0.5**
Unemployment rate - qtly average (%)	5.7	5.0	4.6	5.6	5.4	5.1	**5.0**	**4.8**	**4.7**	**4.6**	**4.6**
US Key Interest Rates (end of period)											
Fed funds rate (top of target range)	0.25	0.50	1.50	0.25	0.25	0.25	**0.50**	**0.75**	**1.00**	**1.25**	**1.50**
10-year bond rate	2.17	2.50	2.75	1.92	2.35	2.04	**2.50**	**2.50**	**2.50**	**2.75**	**2.75**

Source: NAB Group Economics

*Contribution to real GDP

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