29 April 2013

US Economic Update – US GDP, 2013 Q1

National Australia Bank

- **US GDP rose by 2.5% (annualized rate) in the March quarter. Underlying trend is modest growth.**
- **Growth in the quarter was largely driven by private consumption and a positive contribution from inventories. Fixed investment was weaker than the previous quarter but continues to grow. Public demand and net exports both detracted from growth.**
- **We expect GDP will grow by 2.1% in 2013 (previously 2.4%) and 2.9% in 2014. The downwards revision in 2013 reflects the lower than expected March quarter outcome, and a softer projection for the June quarter.**

US GDP in the March quarter grew by 0.6% qoq or at an annualised rate of 2.5%. This was much stronger than the growth in the December quarter but below market, and our own, expectations. The stronger growth largely reflected a pick-up in consumption expenditure, as well as a faster rate of inventory accumulation (mainly, but not solely, due to the farm sector as the affects of the drought start to wane). While weaker than in the previous quarter, housing investment continues to grow rapidly and business investment is also rising. Public demand again declined, largely driven by another large fall in defence spending. In the December quarter weather conditions (Hurricane Sandy and mild winter) likely had a negative impact, but the reverse was probably true in the March quarter (rebound from the Hurricane and colder weather leading to greater power consumption).

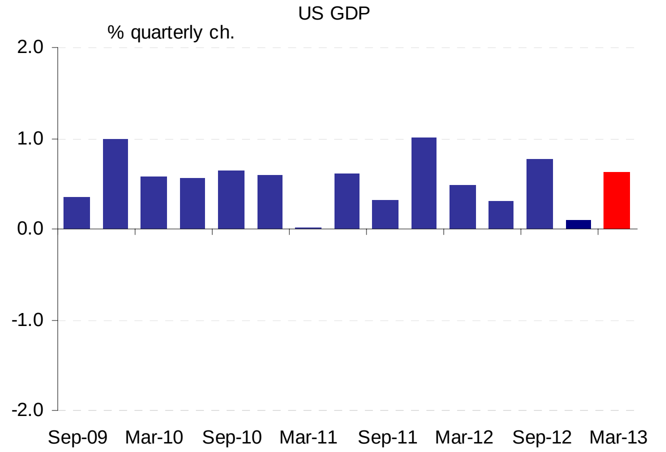
Overall, the GDP results suggest an economy growing at a modest pace; GDP has been volatile recently but has averaged 0.5% qoq over the last three quarters.

Private consumption grew at its fastest pace in over two years, despite the tax increases that came into effect at the start of the year. This reflected a pick-up in services consumption which recorded its fastest growth rate since 2005. This reflected a turnaround in the 'housing and utilities' services category. Swings in this category are often driven by weather related changes in utilities consumption and after detracting 0.2 percentage points from consumption growth in the previous quarter it added the same amount in the March quarter. This is consistent with a move from seasonally mild weather conditions at the end of 2012 to colder weather in the March quarter and unwinding of any Hurricane Sandy effects.

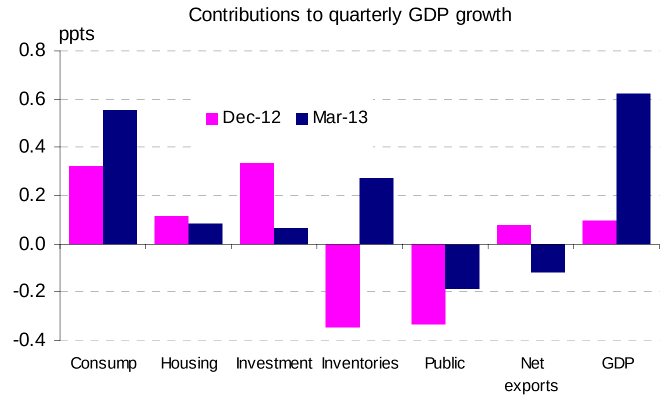
The combination of strong consumption growth, tax increases, and a slowdown in income growth largely resulting from the shifting of income into 2012 (to avoid tax increases) meant that there was a large decline in the savings rate from 4.7% (December quarter) to 2.6% (March quarter). The fall is exaggerated by the bring-forward of income for tax-related purposes but, even allowing for this, the savings rate has declined.

Business fixed investment grew by 0.5% qoq, well down on the 3.1% growth of the previous quarter but this still represents the second consecutive quarter of growth after a mid -2012 decline. The growth was entirely attributable to equipment & software investment as investment in structures fell. That said, the advance

GDP growth rebounds in March quarter



…led by consumption and inventories



Q1 2013 GDP Details

	QoQ (%)	QoQ cont. (ppts)	YoY (%)
Consumption	0.8	0.6	2.0
Fixed investment	1.0	0.1	5.8
Structures	-0.1	0.0	4.0
Equip & software	0.8	0.1	4.1
Residential	3.0	0.1	13.0
Ch. in inventories		0.3	
Public Demand	-1.0	-0.2	-2.1
GNE	0.0	0.8	1.7
Net exports		-0.12	
Exports	0.7	0.1	1.8
Imports	1.3	-0.2	0.8
GDP	0.6	0.6	1.8

Source: US Bureau of Economic Analysis estimate for structures investment in the December quarter was also negative but the final estimate was a positive 3.9% qoq so the scope for revisions to the advance estimate for this component of GDP needs to be recognised. The bottom line is that the accounts confirm that business investment is growing again despite concerns about the impact of fiscal restraint and events abroad.

Businesses also continue to increase inventories. However, while the pace picked up on the previous quarter, the increase in non-farm inventories was actually smaller than the average over the last year. The big turnaround was in the farm sector which after experiencing large reductions in stocks in previous quarters, due to the drought, is estimated to have added to inventories in the March quarter. Drought conditions are still widespread but have softened recently. Overall, while the pace of inventory accumulation is unlikely to pick-up any further next quarter, it is not obvious either that there will be a large slow down.

Housing continues to be the stand-out sector, growing by 3.0% qoq to be 13% higher than a year ago. While the level of activity still remains very low by historical standards this is still one of the most rapidly growing sectors of the economy.

Net exports made their largest detraction from growth since the December quarter 2011. Exports rebounded to grow by 0.7% qoq after a similar decline the previous quarter. However, imports recovered even more strongly, rising 1.3% qoq, their fastest quarterly growth rate in 2½ years. A fair degree of caution is warranted in interpreting advance GDP trade estimates as they are based on only two months data, but the broad trend of strengthening trade flows in 2013 is consistent with the trade indicators from the ISM surveys.

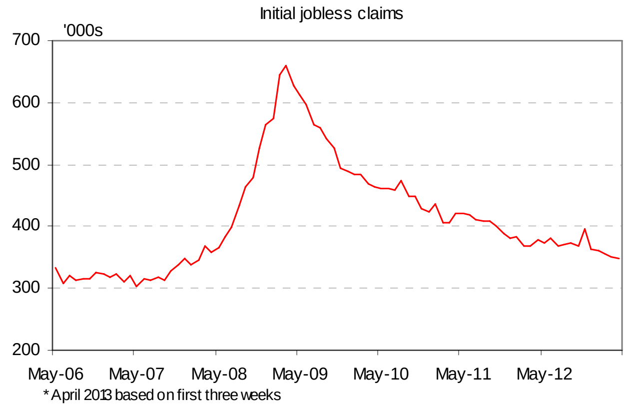
One of the surprises of the advance March quarter estimate was the extent of the weakness in government demand. Government demand decline 1.0% qoq after a 1.8% qoq decline in the previous quarter. Again, the fall was led by Federal defence spending, down a further 3% in the quarter (after a 6% decline in the previous quarter). The 'sequester' automatic budget cuts only started in March and should take a while to filter through to actual spending, although the decline in defence spending may also reflect a winding down of overseas operations, as well as other cuts specified in the 2011 Budget Control Act.

Inflation remains quite soft. The personal consumption expenditure (PCE) price index was 1.2% higher than the same quarter a year ago. Core inflation was only slightly higher at 1.3% yoy. Both measures are, therefore, well below the Fed's 2% long-term goal.

Assessment

As anticipated, GDP growth rebounded from its weak December quarter result in the March quarter. While the advance estimate was below market – and our – expectations it is not by enough to warrant a major reconsideration of the outlook. The strong data releases earlier in the quarter that gave rise to the heightened expectations have been matched more recently by weaker data (for example for non-farm employment and retail sales). Whether the recent weak data are a portent of things to come or simply a correction to earlier strength is the big question; we lean towards the latter. While the ISM business surveys softened in March they are still consistent with moderate growth. Moreover, the weekly initial jobless claims continue to trend down, pointing to continuing jobs growth and suggesting that there has been no major change to business confidence.

Jobless claims improvement consistent with moderate growth



We expect GDP growth will soften a little in the June quarter. Households are probably still adjusting to the higher taxes that kicked in at the start of the year, although they are getting some respite from lower petrol prices which have fallen over 10% (seasonally adjusted) since February). Given the large decline in the savings rate, households are likely to slow the pace of consumption growth. While we don't expect to see an inventory 'correction', growth in inventories is unlikely to pick-up further which will mean that the contribution to growth in the March quarter will not be repeated.

Nevertheless, the continued growth in household wealth and employment, as well as low interest rates from the Fed's ultra-loose monetary policy will support continued consumption growth. Corporate profits continued to rise at the end of 2012 and, together with easing credit standards for business loans, this will underpin growth in business investment. The rapid growth in housing construction will continue, supported by rising new-home sales and low new-home inventories and mortgage interest rates. The world economy is likely to improve in the second half of 2013 and into 2014 supporting exports, notwithstanding the recent appreciation in the US dollar. Federal fiscal policy, however, will be a drag on growth for some time to come.

In summary, we expect that the drawn-out recovery seen to-date will continue. Overall, we expect GDP growth of 2.1% (previously 2.4%) in 2013 and 2.9 in 2014 (unchanged). The revision to 2013 reflects the base effect of a lower than expected March quarter, and lower expected June quarter growth as no contribution to growth from inventories is now expected.

antony.kelly@nab.com.au

US Economic & Financial Forecasts

	Year Average Chng %				Quarterly Chng %									
					2012		2013				2014			
	2011	2012	2013	2014	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
US GDP and Components														
Household Consumption	2.5	1.9	2.3	2.6	0.4	0.5	0.8	**0.5**	**0.6**	**0.6**	**0.7**	**0.7**	**0.7**	**0.7**
Private fixed investment	6.6	8.7	7.5	9.0	0.2	3.3	1.0	**2.3**	**2.4**	**2.3**	**2.2**	**2.1**	**2.0**	**2.0**
Government Spending	-3.1	-1.7	-2.6	-0.7	1.0	-1.8	-1.0	**-0.6**	**-0.4**	**-0.2**	**-0.1**	**-0.1**	**-0.1**	**-0.1**
Inventories*	-0.2	0.1	0.1	0.0	0.1	-0.3	0.3	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Net Exports*	0.1	0.1	0.0	-0.1	0.1	0.1	-0.1	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Real GDP	**1.8**	**2.2**	**2.1**	**2.9**	**0.8**	**0.1**	**0.6**	**0.5**	**0.7**	**0.7**	**0.7**	**0.7**	**0.7**	**0.7**
US Other Key Indicators (end of period)														
PCE deflator-headline		(yoy%)												
Headline	2.5	1.6	1.0	1.9	0.4	0.4	0.2	**0.1**	**0.3**	**0.4**	**0.4**	**0.5**	**0.5**	**0.5**
Core	1.7	1.5	1.2	1.9	0.3	0.3	0.3	**0.3**	**0.3**	**0.3**	**0.4**	**0.5**	**0.5**	**0.5**
Unemployment Rate (%)	8.7	7.8	7.5	7.1	8.0	7.8	7.7	**7.7**	**7.6**	**7.5**	**7.4**	**7.3**	**7.2**	**7.1**
US Key Interest Rates (end of period)														
Fed Funds Rate	0.25	0.25	0.25	0.3	0.25	0.25	0.25	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**
10-year Bond Rate	1.98	1.72	2.50	3.25	1.72	1.72	1.96	**1.90**	**2.25**	**2.50**	**2.50**	**2.75**	**3.00**	**3.25**

Source: NAB Group Economics

***Contribution to real GDP**

Global Markets Research

Peter Jolly
Global Head of Research
+61 2 9237 1406

Australia

Economics

Rob Henderson
Chief Economist, Markets
+61 2 9237 1836

Spiros Papadopoulos
Senior Economist
+61 3 8641 0978

David de Garis
Senior Economist
+61 3 8641 3045

FX Strategy

Ray Attrill
Global Co-Head of FX Strategy
+61 2 9237 1848

Emma Lawson
Senior Currency Strategist
+61 2 9237 8154

Interest Rate Strategy

Skye Masters
Head of Interest Rate Strategy
+61 2 9295 1196

Rodrigo Catril
Interest Rate Strategist
+61 2 9293 7109

Credit Research

Michael Bush
Head of Credit Research
+61 3 8641 0575

Ken Hanton
Senior Credit Analyst
+61 2 9237 1405

Equities

Peter Cashmore
Senior Real Estate Equity Analyst
+61 2 9237 8156

New Zealand

Stephen Toplis
Head of Research, NZ
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Markets Economist
+64 4 474 6923

Mike Jones
Currency Strategist
+64 4 924 7652

Kymberly Martin
Strategist
+64 4 924 7654

UK/Europe

Nick Parsons
Head of Research, UK/Europe,
and Global Co-Head of FX Strategy
+ 44 207 710 2993

Gavin Friend
Markets Strategist
+44 207 710 2155

Tom Vosa
Head of Market Economics
+44 207 710 1573

Simon Ballard
Senior Credit Strategist
+44 207 710 2917

Derek Allassani
Research Production Manager
+44 207 710 1532

Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Tom Taylor
Head of Economics, International
+61 3 8634 1883

Rob Brooker
Head of Australian Economics
+61 3 8634 1663

Alexandra Knight
Economist – Australia
+(61 3) 9208 8035

Vyanne Lai
Economist – Agribusiness
+61 3 8634 0198

Dean Pearson
Head of Industry Analysis
+(61 3) 8634 2331

Robert De Iure
Senior Economist – Property
+(61 3) 8634 4611

Brien McDonald
Economist – Industry Analysis
+(61 3) 8634 3837

Gerard Burg
Economist – Industry Analysis
+(61 3) 8634 2778

John Sharma
Economist – Sovereign Risk
+(61 3) 8634 4514

James Glenn
Economist – Asia
+(61 3) 9208 8129

Tony Kelly
Economist – International
+(61 3) 9208 5049