International > Economics

16 August 2013

United States Economic Update

- **US GDP rose by 1.7% (annualized rate) in the June quarter, an improvement on the March quarter, but still only a modest rate of growth.**
- **The stronger growth largely reflected a pick-up in business investment and a much smaller detraction from growth from public demand.**
- **We are forecasting GDP growth will strengthen in the second half of the year. As a result GDP is expected to grow by 1.5% in 2013 and 2.7% in 2014.**
- **Tapering of QE3 is expected to be announced following the September FOMC meeting (but the risk is that it will be delayed to later in the year), with the end of QE not expected until the September quarter 2014. Fed fund rate rises are not expected until 2015.**

US GDP in the June quarter grew by 0.4% qoq or at an annualised rate of 1.7%. While only a modest rate of growth, the result was above expectations and represents an acceleration of growth from the (downwardly revised) March quarter. Data since released suggest that there may be a small upwards revision when the second estimate of June quarter GDP is released late this month.

The stronger growth largely reflected a pick-up in business investment and a much smaller detraction from growth from public demand. Housing investment again grew strongly but consumption growth was weaker than in the previous quarter. Inventories again contributed to growth but there was a sizeable detraction from net exports due to a jump in import growth.

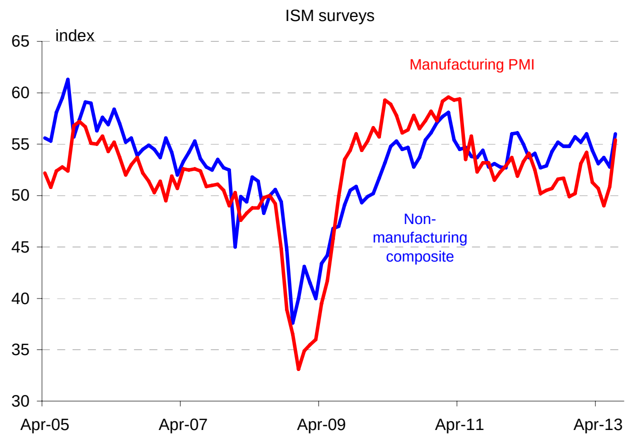
In the second half of 2013 we expect that the impact from tax increases early in the year will fade. Consumption will also be supported by the continued growth in household wealth and employment, as well as the gradual easing in lending standards by banks. This latter factor will also aid business investment, which is being underpinned by high corporate profits. Another factor that should be a positive for consumption and investment is the improvement in confidence as well as reduced uncertainty generally, with concerns about Europe currently at a relatively low ebb and signs that growth in China is stabilising.

The rapid growth in housing construction is also expected to continue, supported by low inventory and continued employment growth which will encourage more people to start a new household. However, the data for the sector have been mixed recently and the rise in mortgage interest rates means that there is downside risk to this outlook.

In contrast, subdued economic conditions in the US' major trading partners, together with the rise in the USD will constrain the export sector. However, world growth is expected to strengthen heading into 2014. Federal fiscal policy will also be a drag on growth for some time to come, although the extent of the drag may moderate towards the end of the year. Moreover, Federal spending reductions will likely be partially offset by improving conditions at the state/local government level. Interest rates remain low by historical standards, but the uncertain impact of their recent rise continues to represent a downward risk to the outlook.

Early data for the September quarter is reasonably positive. In particular, both the ISM manufacturing and non-manufacturing surveys jumped higher in July. While the regional Philadelphia and Empire State Fed surveys softened in August, they are still tracking above their June quarter average (as is industrial production despite being unchanged in July). Core retail sales also got off to a reasonably strong start in July and the four-week average of initial jobless claims reached a new post recession low early in August.

ISM indicators strengthen early in the September quarter



Sources: ISM

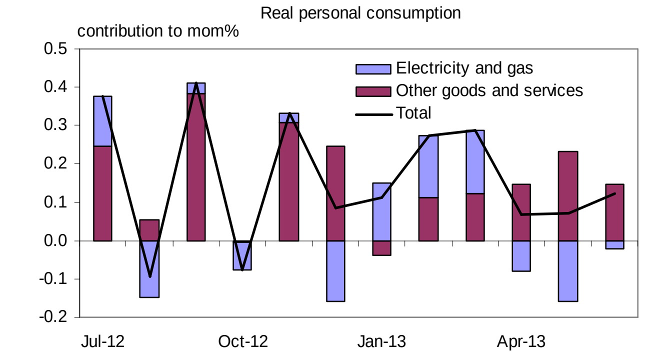
In terms of monetary policy, we expect tapering of the QE program will probably be announced after the Fed's September FOMC meeting, but there is a not insignificant chance it will be delayed until later in the year. Once tapering starts, if the economy turns out as we expect, QE will end by around the September 2014 quarter. An increase in the Fed Funds rate, however, is not in prospect until 2015.

In summary, we expect that the drawn-out recovery will continue, but with the pace of growth strengthening further over the rest of this year. We are forecasting GDP growth of 1.5% in 2013 and of 2.7% in 2014.

Consumption

Private consumption growth slowed down to a modest 0.4% qoq in the June quarter. The monthly growth rates were 0.1% mom in each month of the quarter, a notable slowdown from the previous quarter. However, the March quarter strength was exaggerated by high power consumption which fluctuates in line with unseasonable weather. Excluding this factor, consumption growth, if anything, strengthened through the June quarter consistent with a fading impact from the start of the year income tax increases. Consistent with this, while retail sales only grew by 0.2% mom in July, core retail sales (sales excluding auto dealers, gasoline and building materials), which feed into GDP estimates, rose by a strong 0.5% mom. While auto sales (as reported by Autodata) declined in the same month, they were still above their June quarter average.

Power usage masking underlying trends



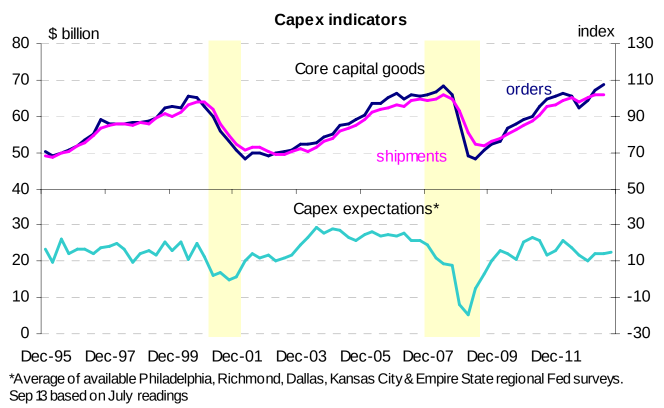
Sources: Bureau of Economic Analysis

Moreover, consumer confidence has been improving and wealth continues to rise (due to increasing stock market and house price growth) which should continue to support consumption growth. A downside risk comes from the jump in gasoline prices (in seasonally adjusted terms) and smaller increases in July and early August.

Business investment

Business fixed investment grew by 1.1% qoq, rebounding from a 1.2% decline in the previous quarter. The turn around was largely due to a strong rise in non-residential structures investment, which increased by 1.7% qoq, following a large decline (-7.2% qoq) the previous quarter. The volatility largely reflects changes in 'power and communication' investment, but mining investment also grew strongly in the June quarter. Equipment investment also strengthened (from 0.4% to 1.0% qoq) and the new intellectual property products category (which includes software and research and development) rose 1.0% qoq, similar to the previous quarter.

Indicators suggest business investment growth to pick up

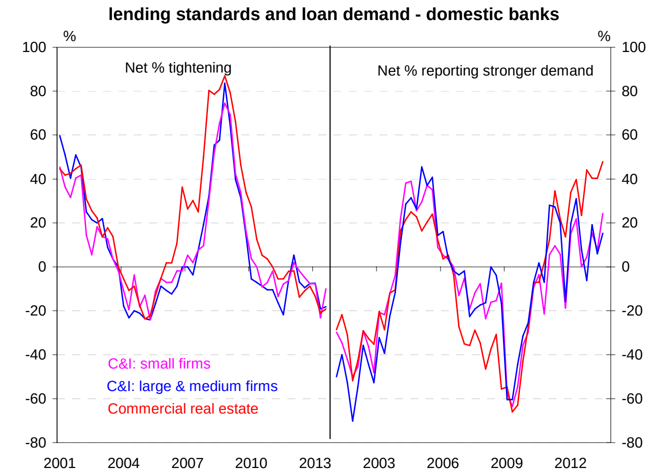


Source: Census Bureau, Philadelphia, Richmond, Dallas, Kansas City and New York federal reserves, NAB.

Partial indicators are also consistent with continuing growth in business investment. Core (excluding defence and aircraft) capital goods orders rose again in June and are running ahead of shipments, pointing to stronger growth ahead. Capex intentions, as measured by the various Fed regional surveys, have also slowly tracked higher since the latter part of 2012/early 2013. Lastly, non-residential construction, notwithstanding a small decline in June, has trended up since the large fall at the start of the year.

The recent spike in interest rates, and how business reacts, represents a downside risk. However, we expect business investment growth will remain positive. Lending rates are still low by historical standards and the recently released Fed Reserve Senior Loan Officer Opinion Survey shows lending standards continue to be eased and loan demand is positive.

Credit conditions improving for business



Source: Federal Reserve Senior Loan Officer Opinion Survey

Moreover, market and policy uncertainty which, when elevated, can lead to a deferral of investment plans, is better than last year and the still high level of corporate profits should continue to underpin business investment.

The pace of business inventory accumulation also picked up in the June quarter, leading to another positive contribution to GDP growth. However, more recently released data on inventories suggests that the advance GDP estimate inventory contribution will be reduced when the second estimate is released. Farm inventories again rose consistent with the overall easing in drought conditions in the United States.

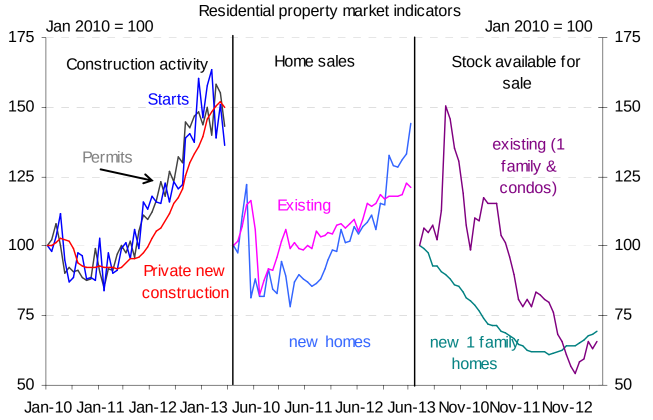
Housing

Housing continued to be the stand-out sector in the June quarter, growing by 3.2% qoq to be almost 15% higher than a year ago. Notwithstanding the strong growth, it is still off a low base, and the level of activity still remains very low by historical standards.

However, there continue to be some mixed signals emerging on whether this rate of growth will be maintained, which is a concern particularly in the light of the recent rise in mortgage interest rates, the effects of which are unlikely to have fully flowed through yet. Building permits and starts fell sharply in June, private new residential construction in the same month recorded its first decline since September 2011, and mortgage purchase applications have fallen (although these could be for purchases of existing homes).

In the case of the permits – a leading indicator for the other measures – the decline has been driven by the volatile multi-family category and single home permits are still trending up. Moreover, new (singe family) home sales jumped even higher in June, and in August the National Association of Home Builders index moved to its highest level since late 2005.

Recent housing data mixed



Sources: Census Bureau, National Association of Realtors

So while there is some downside risk we continue to believe that other important factors, such as house price expectations (rising), household confidence in the economy (rising), low inventories of new homes and employment growth (which will support household formation), will continue to support strong growth in the housing sector. Indeed recent research by a Fed economist suggests that there could be a substantial increase in the number of households as the labour market recovers.[1]

Trade

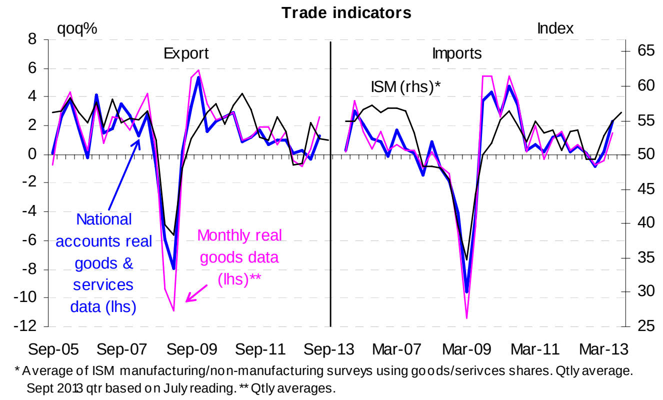
The advance GDP estimates allowed for a pick-up in both export and import growth after weakness in recent quarters. Exports were estimated to have grown by 1.3% qoq after a small decline the previous quarter. Imports were estimated to have recovered even more strongly, rising 2.3% qoq after falling over the two previous quarters. As a result, net exports made their largest detraction from GDP growth since 2010.

However, trade data released since the advance GDP estimates suggests a much stronger net export performance in the June quarter. Real goods imports declined 3% mom in June while exports rose by around the same amount. By itself, this suggests a revision to June quarter GDP of around 0.2% qoq (0.8% annualized rate) suggesting a fairly neutral net export contribution to growth.

However, we still expect net exports will come under pressure from the continued weakness in the global economy and the appreciation of the USD. This is also suggested by the ISM trade indicators. While the export indicators are still above the lows of the second half of 2012, they have come off a bit recently and are weaker than the import indicator.

[1] Paciorek A., The Long and the Short of Household Formation, Finance and Economics Discussion Series, Federal Reserve Board, April 2013

Net exports under pressure, but likely overstated in Q2 GDP



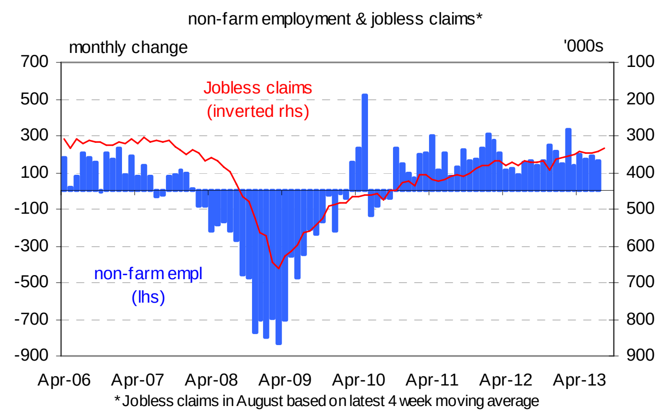
Sources: ISM, Census Bureau, Bureau of Economic Analysis

Labour market

The U.S. labour market continued its slow, but steady, improvement in July. That said, the July employment report was a little disappointing even though the unemployment rate fell to 7.4% from 7.6%. While non-farm employment grew by a solid 162,000 this was below the almost 200,000 pace experienced in the first half of the year. Moreover, there was a small fall in the participation rate and average weekly hours (private non-farm) fell and imply overall hours worked fell. Around 75% of the net employment growth this year has been in part-time jobs; this may be partly attributable to the budget cuts (which have seen agencies cut the length of the working week of employees rather than lay-off staff) and impending changes to health care (some of which have now been delayed).

However, as we noted for a while now, the monthly variation in the data should not be over emphasised. The annual growth rate (current month on same month a year ago) has been around 1.6-1.7% yoy for a while now, consistent with on-going solid jobs growth which should slowly bring down the unemployment rate. Moreover, the four-week average of initial jobless claims has reached a post-recession low, consistent with on-going improvement in the labour market.

Employment data a bit weaker but jobless claims at new low

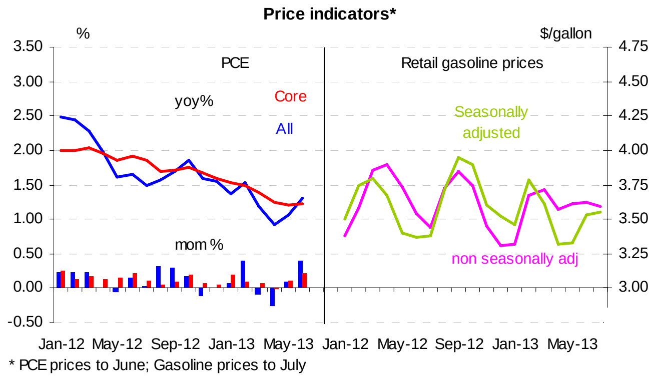


Source: Bureau of Labor Statistics, Department of Labor

Inflation

Inflation remains quite soft although, as we flagged last month, the downward trend in annual inflation has come to an end for now. Boosted by rising energy costs, the headline personal consumption expenditure (PCE) price index rose 0.4% mom in June to be 1.3% higher on a year ago (up from 1.1% yoy in May). However, it was not just energy costs as the core (ex energy and food) PCE inflation rose by 0.2% mom for the first time since January. The separate CPI measure rose in July by 0.2% mom both on headline and core basis, again consistent with the notion that the downward trend in inflation is over.

Inflation still subdued but downward trend has come to an end



Sources: Bureau of Economic Analysis, Energy Information Administration, NAB

We expect annual inflation to remain subdued, and well below the Fed's 2% objective over this year and into early next year, as the appreciation of the USD and the still large amounts of slack in the economy and weakness in the global economy constrain goods inflation.

Public demand

Public demand again fell in the June quarter, but by a much smaller amount than at the start of the year. This reflected a small increase in state and local government demand (+0.1% qoq), and a much smaller decline in Federal government spending. Defence spending only declined by 0.1% qoq, after falling almost 9% over the two previous quarters. Defence spending has not only been affected by the 'sequester' budget cuts, but also by the winding down of overseas military operations. The June quarter results suggests that the latter factor might be receding, although the sequester is yet to fully play out.

Indeed, Federal employment recorded another, albeit small, decline in July. While Federal fiscal policy is likely to be a continuing headwind for a while to come, some relief is coming from the state & local governments. In July, combined state and local government employment rose for the sixth consecutive month.

A looming issue, and a risk to our forecast, is that the debt limit on the Federal Government will soon need to be increased (probably by October/November). If this is not done in a timely or orderly manner, it could lower confidence and have a negative impact on the economy. Around the same time appropriation bills (or a 'continuing resolution') will need to be passed to fund Government (if this doesn't occur then there will be a Government shutdown).

Monetary Policy

In his post June meeting press conference the Fed Chairman raised the prospect of QE tapering (a reduction in the size of Fed asset purchases in 'measured steps') starting later this year in the context of continuing job gains, economic growth that picks-up over the next few quarters and inflation moving back towards 2%.

The June GDP result, combined with revisions to previous quarters, suggests an upwards trend to GDP growth this year although off a lower base. The July employment report showed yet another solid month's worth of employment growth and a further decline in the unemployment rate; these are probably the two main labour market indicators although some other measures of the labour market (e.g. the employment to population ratio) have been weaker. While, inflation was weaker in the June quarter and remains well below the Fed's long-term objective, monthly growth in the PCE price index (the Fed's preferred measure) strengthened in May and June. The Fed will also want to see these trends continued in partial data released before the September meeting.

These considerations reinforce our view that the September meeting is the likely date for a start to tapering to be announced, particularly given that even some Dovish Fed members are not pushing back publicly on this possibility. However, given the still modest level of economic growth, weakness in some labour market indicators and the still low annual inflation rate, there is a not insignificant risk that the start to tapering will be pushed out to later in the year. Concerns of how the debt limit debate will proceed may also be a factor the Fed takes into account.

The Fed Chairman has also indicated that, if the economy developed as expected, that tapering would lead to the asset purchase program ending in mid-2014 when unemployment would be around 7%. Our forecast is for the unemployment rate to reach this level in the September quarter 2014. Given that the unemployment rate has been declining faster than might be expected given the level of GDP growth, the risk is probably more weighted to the QE program ending sooner than this date rather than later.

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	2.2	2.0	2.4	0.4	0.4	0.6	0.4	**0.5**	**0.6**	**0.6**	**0.6**	**0.6**	**0.6**
Private fixed investment	6.2	8.3	5.2	8.6	0.7	2.8	-0.4	1.5	**2.1**	**2.2**	**2.1**	**2.1**	**2.0**	**2.0**
Government Spending	-3.2	-1.0	-2.2	-0.6	0.9	-1.7	-1.1	-0.1	**-0.3**	**-0.2**	**-0.1**	**-0.1**	**-0.1**	**-0.1**
Inventories*	-0.2	0.2	0.0	0.0	0.1	-0.4	0.2	0.1	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Net Exports*	0.1	0.1	-0.1	-0.2	0.0	0.2	-0.1	-0.2	**0.0**	**-0.1**	**-0.1**	**0.0**	**0.0**	**0.0**
Real GDP	**1.8**	**2.8**	**1.5**	**2.7**	**0.7**	**0.0**	**0.3**	**0.4**	**0.6**	**0.7**	**0.7**	**0.7**	**0.7**	**0.7**
US Other Key Indicators (end of period)														
PCE deflator-headline		(yoy%)												
Headline	2.6	1.7	1.3	1.7	0.4	0.4	0.3	0.0	**0.6**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**
Core	1.8	1.7	1.4	2.0	0.4	0.3	0.3	0.2	**0.4**	**0.4**	**0.5**	**0.5**	**0.5**	**0.5**
Unemployment Rate (%)	8.7	7.8	7.3	6.8	8.0	7.8	7.7	7.6	**7.4**	**7.3**	**7.2**	**7.1**	**7.0**	**6.8**
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	3.00	2.75	1.72	1.72	1.96	2.30	**2.75**	**3.00**	**2.75**	**2.50**	**2.50**	**2.75**

Source: NAB Group Economics

*Contribution to real GDP

** History are quarterly averages, projections are end quarter

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

not purport to contain all matters relevant to any particular investment or financial instrument. The Information is not intended to be relied upon and in all cases anyone proposing to use the Information should independently verify and check its accuracy, completeness, reliability and suitability obtain appropriate professional advice. The Information is not intended to create any legal or fiduciary relationship and nothing contained in this document will be considered an invitation to engage in business, a recommendation, guidance, invitation, inducement, proposal, advice or solicitation to provide investment, financial or banking services or an invitation to engage in business or invest, buy, sell or deal in any securities or other financial instruments.

The Information is subject to change without notice, but the NAB Group shall not be under any duty to update or correct it. All statements as to future matters are not guaranteed to be accurate and any statements as to past performance do not represent future performance.

The NAB Group takes various positions and/or roles in relation to financial products and services, and (subject to NAB policies) may hold a position or act as a price-maker in the financial instruments of any company or issuer discussed within this document, or act and receive fees as an underwriter, placement agent, adviser, broker or lender to such company or issuer. The NAB Group may transact, for its own account or for the account of any client(s), the securities of or other financial instruments relating to any company or issuer described in the Information, including in a manner that is inconsistent with or contrary to the Information.

Subject to any terms implied by law and which cannot be excluded, the NAB Group shall not be liable for any errors, omissions, defects or misrepresentations in the Information (including by reasons of negligence, negligent misstatement or otherwise) or for any loss or damage (whether direct or indirect) suffered by persons who use or rely on the Information. If any law prohibits the exclusion of such liability, the NAB Group limits its liability to the re-supply of the Information, provided that such limitation is permitted by law and is fair and reasonable.

This document is intended for clients of the NAB Group only and may not be reproduced or distributed without the consent of NAB. The Information is governed by, and is to be construed in accordance with, the laws in force in the State of Victoria, Australia.

Analyst Disclaimer: The Information accurately reflects the personal views of the author(s) about the securities, issuers and other subject matters discussed, and is based upon sources reasonably believed to be reliable and accurate. The views of the author(s) do not necessarily reflect the views of the NAB Group. No part of the compensation of the author(s) was, is, or will be, directly or indirectly, related to any specific recommendations or views expressed. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Global Markets Division of NAB.

For distribution by WealthHub Securities: Where you have received this document via the nabtrade service (nabtrade), it is distributed to you by WealthHub Securities Limited ABN 83 089 718 249 AFSL No. 230704 (“WealthHub Securities”). WealthHub Securities is a Participant of the Australia Securities Exchange and a wholly owned subsidiary of National Australia Bank Limited ABN 12 004 044 937 AFSL No. 230686 (“NAB”). NAB doesn’t guarantee the obligations or performance its subsidiaries, or the products or services its subsidiaries offer. Any material provided to you by WealthHub Securities will contain factual information or general advice. This factual information or general advice does not take into account your particular objectives, financial situation and needs, and a statement of advice will not be provided. WealthHub Securities will not give you any legal, tax, financial or accounting advice or any advice or recommendation regarding the suitability or profitability about your transactions. Before you make a decision about whether to acquire a financial product, you should obtain and read the Product Disclosure Statement available at nabtrade.com.au and consider the appropriateness of the information having regard to your particular circumstances. You agree that you will not solely rely on the information provided by WealthHub Securities or elsewhere on nabtrade.com.au when making investment and/or financial decisions. WealthHub Securities does not provide personal advice to online retail clients. WealthHub Securities receives commission from dealing in securities and from its authorised representatives. Introducers of business may directly share in this commission. WealthHub Securities and its associates may hold shares in the companies that it distributes research/information on.

The value of investments and future returns may rise or fall and, at times, returns may be negative. Past performance is not a guarantee of future performance. Please note, this material has not been verified by WealthHub Securities. WealthHub Securities does not make any representation or warranty as to the timeliness, reliability, accuracy or completeness of the material, nor does it accept any responsibility arising in any way for errors in, or omissions from, that material.

United Kingdom: If this document is distributed in the United Kingdom, such distribution is by National Australia Bank Limited, 88 Wood Street, London EC2V 7QQ. Registered in England BR1924. Head Office: 800 Bourke Street, Docklands, Victoria, 3008. Incorporated with limited liability in the State of Victoria, Australia. Authorised and regulated by the Australian Prudential Regulation Authority. Authorised in the UK by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

USA: If this document is distributed in the United States, such distribution is by nabSecurities, LLC. This document is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of nabSecurities to create legal relations on the basis of information provided herein.

Hong Kong: In Hong Kong this document is for distribution only to "professional investors" within the meaning of Schedule 1 to the Securities and Futures Ordinance (Cap. 571, Laws of Hong Kong) ("SFO") and any rules made thereunder and may not be redistributed in whole or in part in Hong Kong to any person. Issued by National Australia Bank Limited, a licensed bank under the Banking Ordinance (Cap. 155, Laws of Hong Kong) and a registered institution under the SFO (central entity number: AAO169).

New Zealand: This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. To the extent that any information or recommendations in this publication constitute financial advice, they do not take into account any person’s particular financial situation or goals. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication. National Australia Bank Limited is not a registered bank in New Zealand.

Japan: National Australia Bank Ltd. has no license of securities-related business in Japan. Therefore, this document is only for your information purpose – and is not intended as an offer or solicitation for the purchase or sale of the securities described herein or for any other action.