International > Economics

12 September 2013

United States Economic Update

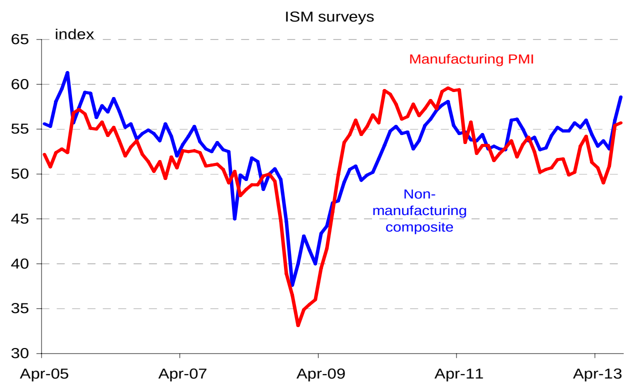
National Australia Bank

- **US GDP for the June quarter revised up from 1.7% (annualized rate) to 2.5%.**
- **While some partial indicators were soft at the start of the September quarter, business surveys point to a stronger underlying momentum in the economy.**
- **We have revised up our forecast for GDP growth in 2013 to 1.6% (from 1.5%) and expect growth of 2.7% in 2014 (unchanged).**
- **Tapering of QE3 is expected to be announced following the September FOMC meeting, but it is not a done deal. The complete end of QE asset purchases not expected until mid-2014. Fed fund rate rises are not expected until 2015.**

The U.S. statistician revised up June quarter GDP growth from its advance estimate of 1.7% qoq (annualised rate) to 2.5% qoq. This mainly reflected a better net export performance and, to a lesser extent, a higher estimate of inventory growth. As a result, while we had previously expected growth to strengthen over the second half of the year, we now expect growth in the September quarter to weaken a bit before strengthening towards the end of the year. This partly reflects the stock cycle; excluding the contribution from inventories, our forecasts imply a pick-up in growth over the course of the year.

It also reflects some weakness in partial indicators at the start of the September quarter. In July, personal consumption expenditure was essentially flat, capital goods shipments declined, and residential construction growth continued to slow down. July trade data were also a negative for GDP although this appears to be a correction to the very strong results the month before. Otherwise, we see this weakness as either largely being due to transitory factors (weather related reductions in power consumption) or temporary. Supporting this view, the ISM surveys have picked up noticeably over July and August suggesting reasonably strong underlying momentum in the economy.

ISM indicators point to strong underlying momentum



Sources: ISM

As the tax increases early in the year become a distant memory, improving household wealth, employment and confidence, as well as the gradual easing in lending standards by banks, should continue to support consumption growth. Indicators of capital expenditure intentions are also moving higher, and with profits high and growing, and banks lending standards for business loans easing, business investment is expected to strengthen. Another factor that should be a positive for consumption and investment is the general improvement in confidence as well as reduced uncertainty, with concerns about Europe currently at a relatively low ebb and increasing signs that growth in China is stabilising.

However, ructions over the funding of the Federal government and an extension of its debt limit have the potential to disrupt confidence. We expect that there will be the normal noise and last minute agreement; but there is a downside risk that events could get out of hand. This is also true of events in Middle-east, particularly if there where an escalation of U.S./Syria tensions.

With mortgage rates still low by historical standards, as is the level of home construction, we are still projecting continued strong growth in the sector. However, reflecting the weakening in some indicators we have revised down our forecast of September quarter residential investment.

The appreciation in the USD will constrain the export sector. However, we have been forecasting world growth to strengthen heading into 2014, and there are signs that this is already underway in other advanced economies. 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.

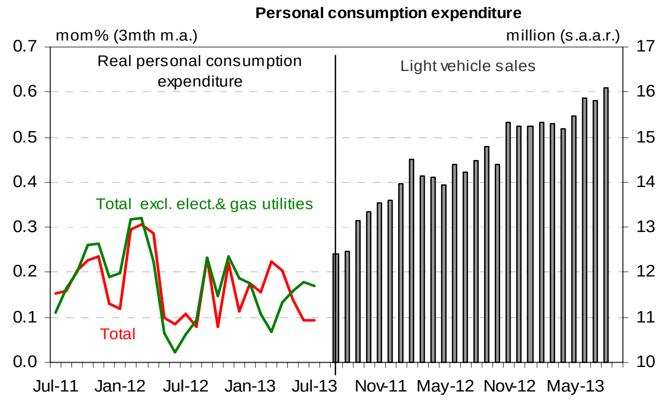
In terms of monetary policy, we expect tapering of the QE program will probably be announced after the Fed's September FOMC meeting, but it is by no means a done deal. Once tapering starts, if the economy turns out as we expect, QE will end by mid-2014. An increase in the Fed Funds rate, however, is 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 1.6% (revised up from 1.5%) in 2013 and of 2.7% in 2014. The change to the forecast for 2013 reflects the BEA's upwards revision to the June quarter GDP estimate, partially offset by revisions to the September quarter due to the weakness in some partial indicators in July (particularly for housing).

Consumption

Private consumption got off to a slow start in the September quarter, with real personal consumption expenditure basically unchanged in July. As with the June quarter, a factor constraining consumption was lower power usage likely reflecting unseasonable weather. Excluding electricity and gas utility consumption, personal consumption growth has strengthened in recent months, consistent with the view that growth should pick-up as the impact of the start of year tax increases fades. Supporting this outlook, August motor vehicles sales increased 1.8% mom, continuing their upward trend since April.

Recent softness in total consumption deceiving



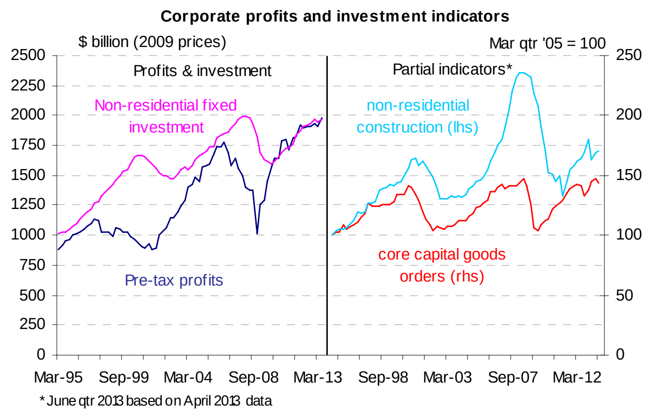
Sources: Bureau of Economic Analysis, Autodata

Moreover, consumer confidence has been trending up as has household wealth (due to increasing stock market and house price growth) which should continue to support consumption growth. However, still modest income growth as well as some pressure on real incomes from recent rises in gasoline prices (in seasonally adjusted terms) will continue to limit the pace of consumption growth.

Business investment

Short and longer-term indicators generally point to continued growth in business fixed investment. Core (excluding defence and aircraft) capital goods orders in July fell for the first time in five months but have been running ahead of shipments, pointing to a pick-up in the latter. Private non-residential construction rose in July, continuing the general, albeit modest, recovery since a dip at the start of the year.

Indicators of future business investment generally positive



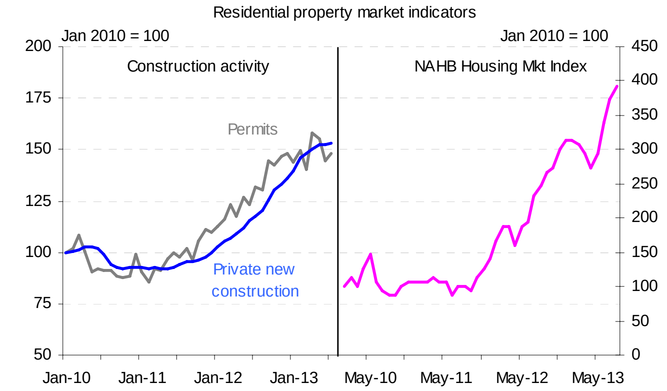
Source: Census Bureau, Philadelphia, Richmond, Dallas, Kansas City and New York federal reserves, NAB.

Longer term indicators are, if anything, more positive, with credit conditions improving and already high corporate profits, rising further in the June quarter. Corporate profits in the June quarter rose by 3.9% qoq, the strongest quarterly increase since end-2011, with reasonably consistent growth across domestic/overseas and financial/non-financial operations. Reinforcing this message, capex intentions, as measured by an average of the various Fed regional surveys, continued their improvement in August to be at their highest level in over a year. With policy uncertainty almost back at pre-recession levels, improvement in other advanced economies underway, the conditions are set for a strengthening in the pace of US business investment.

Housing

As we have noted in recent months, there continue to be mixed signals on the strength on housing construction. Building permits and starts increased in July but this was entirely due to the volatile multi-family category and permits are below their June quarter average. Private new residential construction continues to grow but at a much slower pace than that experienced through 2012 and for much of 2013. There was also a large fall in new home sales in July. One obvious culprit is the rise in mortgage interest rates since April. However, not all indicators have turned down, with the National Association of Home Builders Housing Market Index in August reaching its highest level since late 2005. Other possible factors affecting the industry – and which may explain the difference in the indicators – are extremely wet weather in the South and supply constraints in the industry.

Recent housing data still mixed



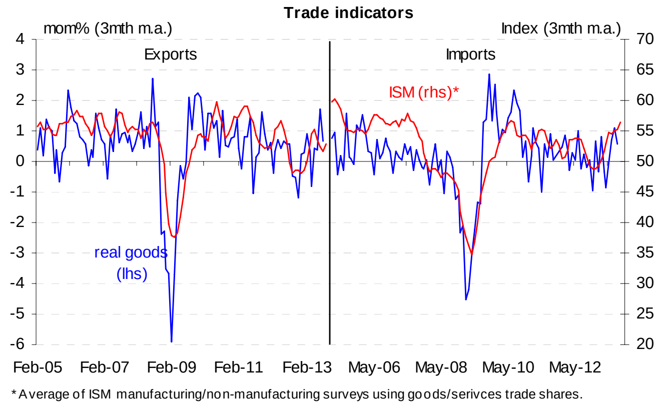
Sources: Census Bureau, National Association of Home Builders

While mortgage rates are not likely to move back to their previous lows, we do not see them rising much further over the next year either given our projections for long-term Treasury yields. With mortgage rates still relatively low by historical standards, as is the level of home construction, we are still projecting continued strong growth in the sector, although we have revised down our forecast for the September quarter. One factor cushioning September quarter residential investment is existing home sales, which in July were tracking 6.6% above their June quarter level; ownership transfer costs are capitalised and included as part of residential investment.

Trade

Much of the upwards revision to the advance estimate of June quarter GDP was attributable to net exports. In the advance GDP estimate, net exports detracted 0.2 ppts from quarterly growth, but in the second estimate this was revised to essentially zero.

Trade has picked up over 2013



Sources: ISM, Census Bureau

In July real goods exports fell and imports rose, but these movements partially reversed even larger movements in the opposite direction in June. Overall, trade flows – both exports and imports – have improved over 2013, and the ISM surveys suggest this is continuing, particularly for imports. Strength in imports can be an indicator that U.S. demand is strong (the other possibility, at least for a short period of time, is that it reflects an inventory build-up).

Over the last few years net exports, on average, have made a small positive contribution to growth; we don't expect to see this over the forecast horizon given our forecast for stronger domestic demand combined with ongoing appreciation in the currency. However, there are increasing signs of a turnaround in other advanced economies and we also expect some improvement in emerging economy growth in 2014, which will provide some support to net export performance.

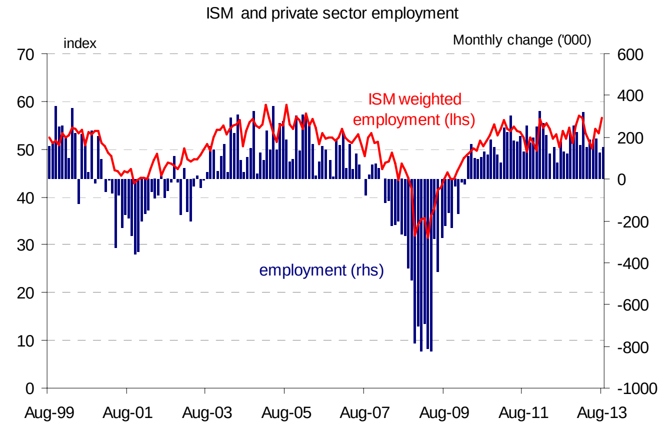
Labour market

The unemployment rate fell for the second consecutive month in July, and is now 7.3%, consistent with an on-going recovery in the labour market. Despite the fall, the reaction to the employment report was quite mixed, as downward revisions to past months suggest that the rate of non-farm employment growth has slowed recently.

Moreover, the participation rate fell and is now at a new post-recession low. The BLS' estimate of discouraged workers (those who want a job but who are not looking and so not counted as unemployed) has trended down since the end of the recession. However, the underlying factors (such as demographics) that are likely to drive workforce participation down for many years to come are dominating any return of discouraged workers.

We have previously noted that the pace of jobs growth has been strong relative to GDP growth; non-farm employment increased by 1.6% over the year to the June quarter, the same pace as GDP growth (implying little or no productivity growth). However, other indicators suggest that the recent slowdown may be more the normal statistical noise than anything real. Annual employment growth was still 1.6% yoy in August, equal to its average since late 2011. Moreover, the ISM manufacturing and non-manufacturing survey employment measures have improved recently and initial jobless claims in August moved to a new post-recession low.

Recent employ. slowdown not matched by other indicators



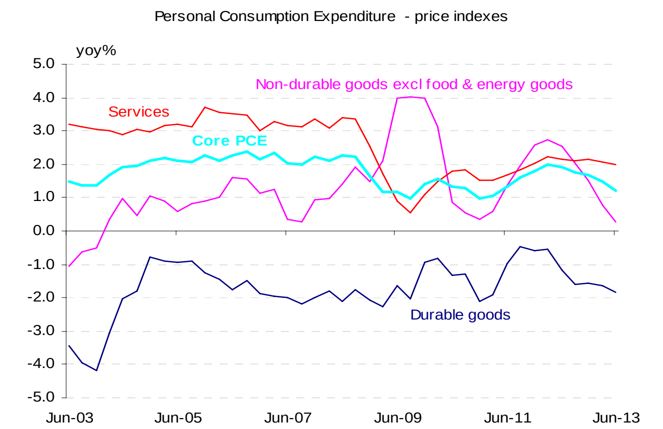
Source: Bureau of Labor Statistics, ISM, NAB. ISM manufacturing & non-manufacturing surveys were weighted by the manufacturing/non-manufacturing share of private non-farm employment since mid-1997.

Inflation

Inflation remained quite subdued in July growing by 1.4% on a headline basis and 1.2% on a core (ex food and energy) basis since the same time last year.

The current weakness in core inflation reflects a downturn in goods prices (ex gasoline and other energy goods) that started around mid-2012. Services price inflation has been much more stable, although still below pre-recession levels. International trade is relatively far more important for goods than services. As a result, the appreciation of the dollar of around 7-8% since the June quarter 2011 is a factor driving goods prices. Moreover, given weakness in world economic growth in 2012 and so-far in 2013, spare capacity worldwide – and not just in the U.S. – has probably also played a role. Non-energy & food commodity prices – again reflecting globally supply and demand conditions – are also important (e.g., the cotton price – which affects clothing prices – is down 60% since its 2011 peak). While we expect the U.S. dollar to continue to appreciate – which will exert downward pressure on goods prices – world economic growth is expected to strengthen which will work in the other direction.

Recent inflation slowdown driven by goods prices

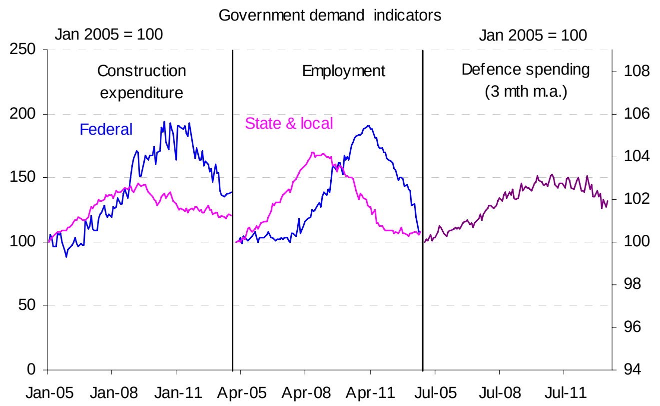


Sources: Bureau of Economic Analysis, NAB. Note data are quarterly.

Public demand

As we noted in last month's update, public demand again fell in the June quarter, but by a much smaller amount than at the start of the year. However, the advance GDP estimate of a small increase in spending at the state/local level has been revised away. Nevertheless partial indicators suggest the drag from state/local government sectors is receding.

Cutbacks continuing at Federal level



Sources: Census Bureau, Bureau of Labor Statistics, Thomson Reuters

Federal fiscal policy is likely to be a continuing headwind for a while to come, notwithstanding attempts by the White House to reverse the sequester. However, the worst of the defence spending cutbacks appear to be over. Defence spending has not only been affected by the 'sequester' budget cuts, but also by the winding down of overseas military operations. Recent data suggest that the latter factor is fading.

At the Federal fiscal level there are two looming issues which have the capacity to be disruptive and affect broader confidence. Firstly, there is the need to pass a 'continuing resolution' to fund the government by the start of October (if this doesn't occur then there will be a partial Government shutdown). Secondly, an increase in the Federal Government's debt limit on the Federal Government will be needed by mid October/early November. If these are not done in a timely or orderly manner (relative to the low standards of the past), it could lower confidence and have a negative impact on the economy.

Monetary Policy

Our view for a while has been that the Fed would begin tapering of its QE program (i.e. a reduction in the size of Fed asset purchases in 'measured steps') following its September meeting (which ends 18 September). However, we also see the risk of tapering being delayed as reasonably high. The recent data have not fundamentally changed that view.

On the face of it, the reduction in the unemployment rate from 7.6% at the time of the last FOMC meeting to 7.3% in August should have significantly increased the prospect of a September start to tapering. The Fed Chairman has indicated that he expects the unemployment rate to be around 7.0% when the asset purchases are stopped. So if they are to reduce the purchases in a series of steps they will need to start soon.

However, the weakness in other aspects of the report – the slowdown in non-farm employment growth and the fall in workforce participation rate may cause doubts, as may continuing below target inflation, and the slow start to the quarter for some partial indicators of activity. The strength in business surveys will, however, provide some comfort about the underlying direction of the economy.

Nevertheless, in terms of the labour market, the Fed's forward guidance on the fed funds rate, and its discussion of tapering, has always centred on the unemployment rate. This is because the Fed sees it as the single best measure of labour market conditions. While abrupt declines in workforce participation (leading to a fall in the unemployment rate) may cause them to hesitate, persistent falls in the participation rate, as we have been seeing, are another matter. Put simply, the general view of the Fed is that monetary policy cannot fix supply side issues, which is what a decline in workforce participation is. Given these considerations the most likely start for tapering remains September.

The Fed Chairman has also indicated that, if the economy developed as expected, tapering would lead to the asset purchase program ending in mid-2014 when unemployment would be around 7%. Our forecasts have a similar timing.

In terms of the fed funds rate, the Fed's forward guidance is that this will not occur until the unemployment rate reaches 6.5% or lower, or one-to-two year ahead inflation is forecast to be above 2.5% or inflation expectations start to rise beyond their normal levels. With the unemployment rate continuing to decline faster than might normally be expected given the pace of GDP growth, the risk is that it will happen earlier (in the first half of 2015) than our current expectation of late 2015. The Fed has been reinforcing the point that reaching 6.5% unemployment won't automatically trigger an increase in the fed funds rate. However, it is hard to see them delaying much beyond that point given the risks of such a loose monetary policy at that stage of the economic cycle. The key may be where inflation is at; if it persists at well below 2% (not our central forecast) then the Fed may well delay raising rates even when the unemployment threshold is reached.

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	1.9	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	4.8	8.3	0.7	2.8	-0.4	1.5	1.6	2.1	2.2	2.1	2.0	2.0
Government Spending	-3.2	-1.0	-2.3	-0.6	0.9	-1.7	-1.1	-0.2	-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	-0.1	0.0	0.2	-0.1	0.0	0.0	0.0	-0.1	0.0	0.0	0.0
Real GDP	**1.8**	**2.8**	**1.6**	**2.7**	**0.7**	**0.0**	**0.3**	**0.6**	**0.5**	**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	1.2	1.7	0.4	0.4	0.3	0.0	0.6	0.4	0.4	0.4	0.4	0.5
Core	1.8	1.7	1.3	1.9	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	7.2	6.7	8.0	7.8	7.7	7.6	7.3	7.2	7.1	7.0	6.8	6.7
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	2.90	3.00	2.75	2.70	2.75	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.