U.S. Economic Update, 2015Q1 GDP

by NAB Group Economics 30 April 2015

- **U.S. GDP growth slowed to a crawl in the March quarter.**
- **Details were weak, with the major support for growth coming from inventories.**
- **We expect the slowdown will be temporary and above trend growth to resume. However, reflecting the slower than expected March quarter outcome we have lowered our 2015 GDP growth forecast to 2.5% (from 2.7%).**

U.S. GDP growth slowed to a crawl in the March quarter, with growth of only 0.1% qoq (0.2% on an annualised basis). This mirrors the slow start to the first quarter last year which was initially reported as growing by 0.1% (annualised basis) before being revised to negative. Like last year, extreme winter weather likely had an influence, but other factors also had an influence, including plunging oil prices, strong US dollar appreciation and port disruptions.

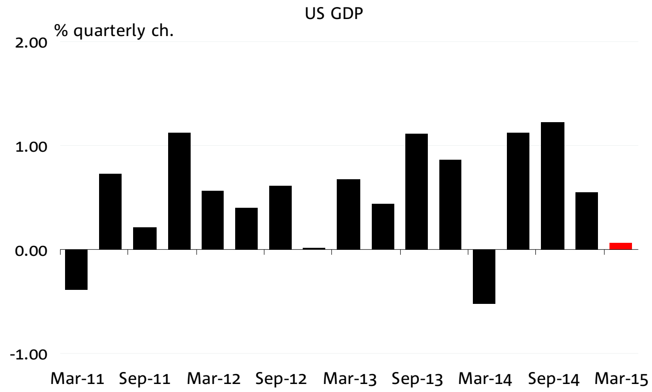
The details of the report were no better than the headline. The slowdown in growth occurred across most of the major categories, with growth in private consumption, housing and business investment, and government demand all down on the previous quarter. Exports fell and while import growth slowed, the net result being an even greater net export detraction from growth. The main factor supporting growth in the quarter was faster inventory accumulation, which is not a sustainable source of growth.

The growth in real private consumption, of 0.5% qoq was the weakest since the same time last year, and follows several quarters of strong growth. The slowdown in consumption was due to softer durable and non-durable goods consumption; indeed the latter category declined in the quarter. Services consumption held up better, as cold weather boosted power use. Health care consumption growth, while down on the previous quarter, was again strong and its annual growth rate was the highest since 2002, likely reflecting the impact of 'Obamacare'.

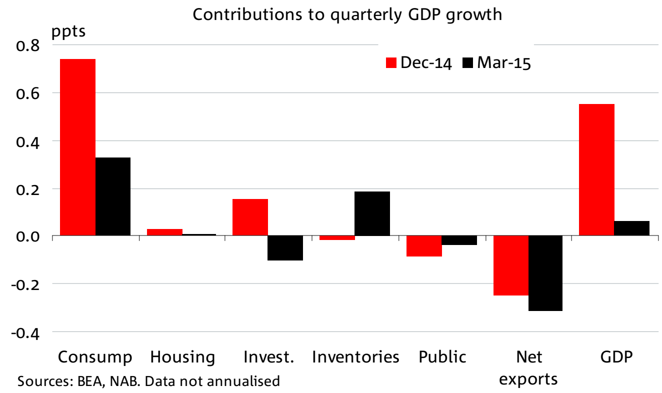
With consumer prices falling 0.5% in the quarter (due to gasoline price falls), in nominal terms consumption actually fell. At the same time there was another solid rise in household's disposable income of 1.0% qoq. As a result, the household savings rate jumped from 4.6% to 5.5%.

Business fixed investment growth declined, with equipment investment flat and non-residential structures investment falling by 6.3% qoq. While not the only source of weakness in structures investment, the mining exploration, shafts and wells category declined by 15% qoq, as energy companies cut back investment due to falling oil prices. In contrast intellectual property investment again recorded solid growth.

GDP growth slowed to a crawl in Q1



Details even less positive



Sources: BEA, NAB. Data not annualised

2015 Q1 GDP detail

	QoQ (%)	QoQ cont. (ppts)	YoY (%)
Consumption	0.5	0.3	3.0
Fixed investment	-0.6	-0.1	4.7
Structures	-6.3	-0.18	-1.0
Equipment	0.0	0.0	5.6
Intellectual property	1.9	0.1	8.1
Residential	0.3	0.0	4.2
Ch. in inventories		0.2	
Public Demand	-0.2	0.0	0.8
Net exports		-0.3	
Exports	-1.8	-0.2	3.0
Imports	0.5	-0.1	5.5
GDP	0.1	0.1	3.0

Source: BEA, NAB. Data not annualised.

Residential investment grew by a modest 0.3%, down from the almost 1% growth rates of recent quarters. An improvement in the 'other structures' category (which includes home improvements and ownership transfer costs) was offset by a slowdown in new dwelling construction growth. Construction activity was potentially affected by the extreme winter weather.

Both the trade data and the inventory data were likely affected by west coast port disruptions in the first half of the quarter. The slowdown in trade was driven by declines in goods trade, with services exports and imports growing by 1.5% qoq or more. Goods exports declined 3.5% while goods imports rose by only 0.2% qoq. With trade data only available to February, to achieve the reported quarterly goods outcomes requires a much greater bounce back in March month imports than exports. While this remains to be proven, export orders indicators from the ISM surveys suggest that export growth is softening, likely due to the appreciation of the dollar.

Inventory accumulation was its strongest in over four years. This may have been in part caused by the disruption to supply chains from the port strikes. That said, with strong consumption growth widely forecast due to the boost to household incomes from plunging oil prices, there may also be an element of unexpected inventory build-up. With the ratio of inventories to final sales now well above recent levels, a slowdown in inventory accumulation in coming quarters appears likely.

For the second consecutive quarter, government consumption and investment declined. However, this quarter the fall was due to a decline in state & local spending (the first fall since the March quarter last year), with Federal government demand up slightly.

Assessment

While the slowdown in GDP growth in the first quarter of 2015 was not unexpected, it was still more than we had expected. It starkly contrasts with hopes that growth would move to an even more solid footing this year as fiscal and other headwinds continued to fade, and the (on-balance) positive impact of the fall in oil prices.

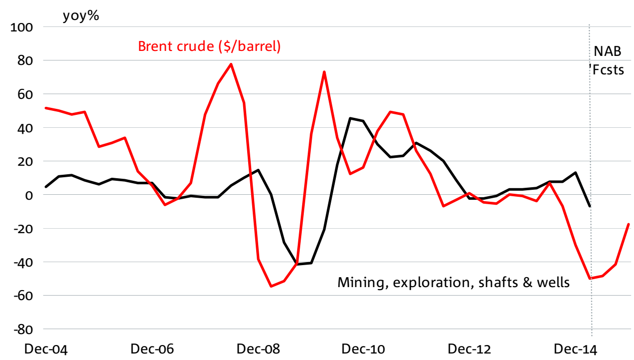
However, economic data are volatile; the falls in GDP in the March 2011 and 2014 quarters, and the flat December 2012 outcome, ultimately did not signal any fundamental change in economic circumstances. The annual growth rate (March quarter on same time last year) was 3.0%, its highest rate since mid-2010. We expect that, like these previous episodes, the growth slowdown will prove to be temporary.

That said, there are several cross-currents affecting the economy, benefiting some sectors of the economy and hurting others, and with uneven timing. This is particularly true of the more than 50% plunge in oil prices between June 2014 and January 2015 (Brent crude), and the 13% appreciation of the dollar (as measured by the Fed's Broad dollar index) since July last year.

While households – the major beneficiaries – did initially increase spending, the modest consumption growth in the March quarter was a surprise. Solid income growth, rising wealth, easing credit conditions, declining prices and improving confidence would normally suggest further strong consumption growth. Given these sound fundamentals, we expect that consumption growth will return to a more solid footing over the rest of the year.

At the same time, the major direct negative from the fall in oil prices was always going to be in the energy sector. This is clearly shown in the large decline in mining related structures investment in the quarter. While oil prices have started to edge back-up, given the lag with which investment reacts, further declines in mining related investment are likely.

Oil price plunge affecting mining investment



Sources: BEA, ICIS Pricing, NAB

Moreover, other businesses that supply inputs to the mining sector, particularly those in the manufacturing sector may also be cutting investment plans. The bigger issue is whether (and when) businesses that benefit from the oil price falls (through lower input costs, higher sales) ramp-up investment spending. Easing bank lending standards also remain a positive for investment.

The manufacturing sector is also relatively more exposed to the strengthening US dollar than the service sector (where competition from abroad is less of a factor). The ISM manufacturing survey has softened over recent months, and regional Federal Reserve manufacturing surveys suggest that this continued into April. However, the service sector (a much bigger part of the economy) has held up much better.

There is also still considerable scope for a pick-up in residential investment, as it remains at relatively low levels, and fiscal headwinds have largely ended. Moreover, despite the likely prospect of monetary policy tightening later this year interest rates are low. The Federal Reserve, in its April meeting statement (also released yesterday) indicated that it also viewed the growth slowdown as reflecting, in part, 'transitory factors'. We expect that the Fed will start lifting rates in September; the GDP outcome does not change this expectation as it was based on an expectation of an improvement in the data flow in coming months.

As a result, we expect the economy will resume growing at an above trend in coming quarters. However, at this stage we do not expect a bounce back in growth comparable to that in 2014, in part because of the different stages of the inventory cycle (with inventories likely to detract from growth in coming quarters). As a result we have reduced our forecast for GDP growth in 2015 to 2.5% (previously 2.7%), but left have our 2016 forecast unchanged at 2.7%.

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US Economic & Financial Forecasts

	Year Average Chng %				Quarterly Chng %									
					2014				2015				2016	
	2013	2014	2015	2016	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
US GDP and Components														
Household consumption	2.4	2.5	3.1	2.8	0.3	0.6	0.8	1.1	0.5	**0.9**	**0.8**	**0.7**	**0.7**	**0.6**
Private fixed investment	4.7	5.3	4.2	6.6	0.0	2.3	1.9	1.1	-0.6	**1.4**	**1.9**	**1.7**	**1.7**	**1.6**
Government spending	-2.0	-0.2	0.8	1.4	-0.2	0.4	1.1	-0.5	-0.2	**0.6**	**0.3**	**0.3**	**0.3**	**0.3**
Inventories*	0.0	0.0	0.1	-0.2	-0.3	0.3	0.0	0.0	0.2	**-0.2**	**-0.1**	**-0.1**	**-0.1**	**0.0**
Net exports*	0.2	-0.2	-0.5	-0.3	-0.4	-0.1	0.2	-0.2	-0.3	**0.0**	**-0.1**	**-0.1**	**-0.1**	**-0.1**
Real GDP	**2.2**	**2.4**	**2.5**	**2.7**	**-0.5**	**1.1**	**1.2**	**0.5**	**0.1**	**0.7**	**0.7**	**0.7**	**0.6**	**0.6**
Note: GDP (annualised rate)					*-2.1*	*4.6*	*5.0*	*2.2*	*0.2*	*3.0*	*2.9*	*2.6*	*2.6*	*2.6*
US Other Key Indicators (end of period)														
PCE deflator-headline														
Headline	1.0	1.1	0.8	2.2	0.3	0.6	0.3	-0.1	-0.5	**0.3**	**0.4**	**0.5**	**0.5**	**0.5**
Core	1.3	1.4	1.4	1.9	0.3	0.5	0.3	0.3	0.2	**0.4**	**0.4**	**0.4**	**0.5**	**0.5**
Unemployment rate - qtly average (%)	7.0	5.7	5.2	4.8	6.6	6.2	6.1	5.7	5.6	**5.4**	**5.3**	**5.2**	**5.1**	**5.0**
US Key Interest Rates (end of period)														
Fed funds rate (top of target range)	0.25	0.25	0.75	1.75	0.25	0.25	0.25	0.25	0.25	**0.25**	**0.50**	**0.75**	**0.75**	**1.25**
10-year bond rate	3.03	2.17	2.50	3.00	2.72	2.53	2.49	2.17	1.92	**2.25**	**2.50**	**2.50**	**2.75**	**2.75**

Source: NAB Group Economics

*Contribution to real GDP

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