U.S. Economic Update, 2015Q4 GDP

by NAB Group Economics 1 February 2016

National Australia Bank

- **U.S. GDP growth slowed in the December quarter to 0.2% qoq (0.7% annualised).**
- **Most components slowed or stayed weak. The main detractors from growth were inventories and net exports. US dollar appreciation and falling energy prices are weighing heavily on some sectors.**
- **Despite these headwinds, over the last year domestic final demand has held up, and the economy is expected to growth at a moderate pace. We expect GDP growth of 2.2% in 2016 (previously 2.3%) and 2.3% in 2017, although downside risks have increased.**

Quarterly U.S. Gross Domestic Product (GDP) growth slowed further in the December quarter to 0.2% qoq or 0.7% annualised. As a result the annual growth rate (December quarter on same time last year) declined to 1.8%, its lowest level in almost two years.

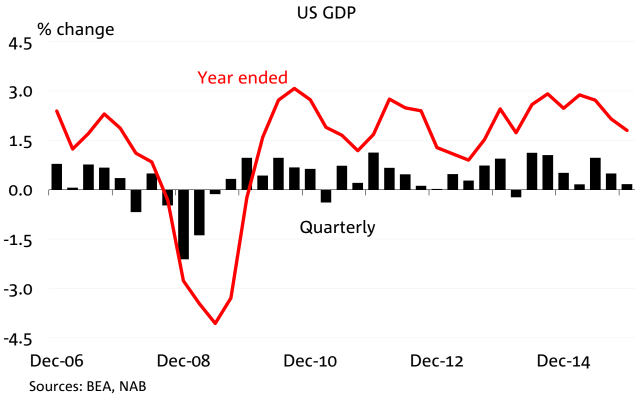
Domestic final demand has held up better, growing by 2.5% over the year to the December quarter. This reflected solid consumption growth and strong growth in residential investment. Nevertheless, growth in most of the major components of GDP slowed or remained negative in the quarter, with the exception of residential investment. Consumption growth moderated, government demand softened, business fixed investment fell, net exports weakened further, and inventories again detracted from growth.

Real private consumption growth was 0.5% qoq, slower than in recent quarters. Over the course of 2015 it grew by 2.6% and it remains the main driver of GDP growth. Consumers have benefited from the boost to household spending power from the fall in oil prices, and strong jobs growth. That, in principle, should have more than offset the effects of lower equity prices with consumer confidence remaining reasonably solid. Given this generally favourable environment the surprise is that consumption wasn't stronger – over the last two quarters the household savings rate has been rising and is at its highest level since 2012.

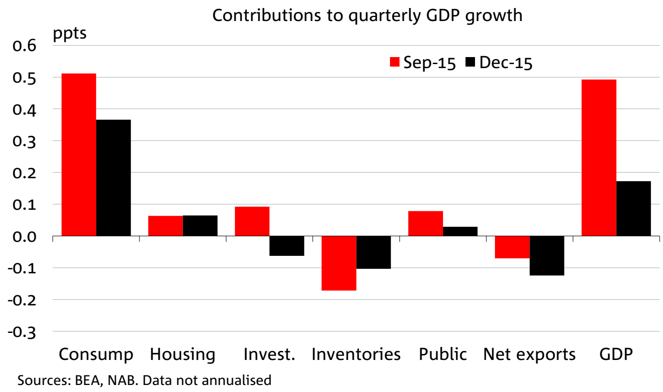
Business fixed investment declined in the December quarter, reflecting falls in both structures and equipment investment while intellectual property investment rose only modestly. The fall in structures investment was driven by another large fall in mining investment, as the sector continues to adjust to the large declines in commodity prices. Outside of mining, structures investment grew, including in the struggling manufacturing sector.

The decline in equipment investment was principally driven (but not only) by a large fall in transport equipment. This may also reflect mining sector weakness as parts of the transport sector are closely linked.

GDP growth slows further in Q4



...with most components slowing or still negative



2015 Q4 GDP detail

	QoQ (%)	QoQ cont. (ppts)	YoY (%)
Consumption	0.5	0.37	2.6
Fixed investment	0.1	0.01	3.1
Structures	-1.3	-0.04	-3.6
Equipment	-0.6	-0.04	2.4
Intellectual property	0.4	0.02	4.1
Residential	2.0	0.06	9.0
Ch. in inventories		-0.10	
Public Demand	0.2	0.03	1.3
Net exports		-0.12	
Exports	-0.6	-0.08	-0.8
Imports	0.3	-0.04	3.4
GDP	0.2	0.17	1.8

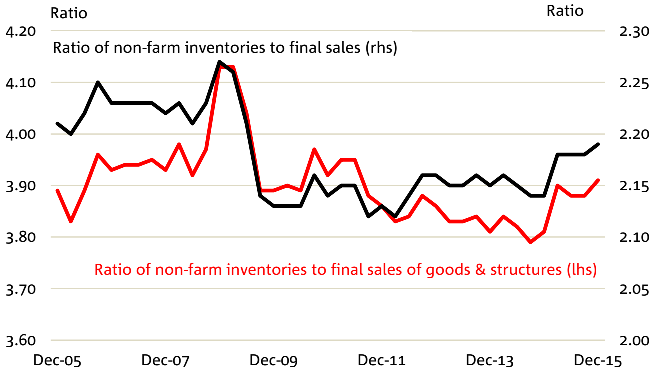
Source: BEA, NAB. Data not annualised.

Quarterly residential investment growth was unchanged at 2.0% qoq, and was up by 9% over the year. While still strong, new construction growth slowed in the quarter but growth in 'other structures' (mainly home improvements and ownership transfer costs) strengthened.

Inventory accumulation slowed for the second quarter in a row. As a result it again detracted from GDP growth.

Inventory movements have largely transitory affects, with little net impact over time, but this correction may still have further to run. While the rate of inventory growth has slowed, it is still enough to increase the ratio of inventories to sales. This is unlikely to continue given that the longer term trend is for lower inventories.

Inventory correction not over

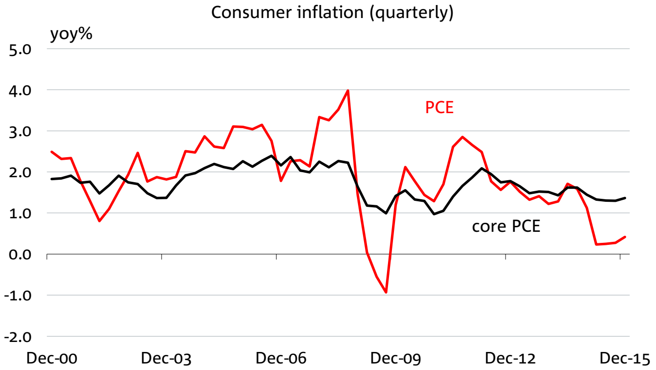


Source: BEA, NAB

Exports declined in the December quarter, and were also below the level of a year ago. This likely reflects the impact of the strong appreciation of the US dollar and the lacklustre global economy. Import growth also slowed in the December quarter, but over the last year grew by 3.4% - faster than the rate of domestic demand as importer competitiveness has gained from the dollar's rise. As a result, net exports again detracted from GDP growth and over the course of 2015 took 0.6ppts off growth. This headwind is likely to continue for some time, although if the pace of USD appreciation slows (as we expect) then it should lose some of its force.

Government consumption and investment increased by a modest 0.2% qoq. Overall, the trend is one of gradually strengthening public demand. The annual growth rate is now at its highest level in over five years.

Inflation still low but has bottomed out



Sources: BEA, NAB

Inflation picked up slightly in the December quarter, but remains well below the Fed's long-term 2% target. The personal consumption expenditure (PCE) deflator grew by 0.4% yoy in the December quarter, from 0.3% in the previous quarter. Similarly core (ex energy and food) PCE price growth ticked up 0.1ppt to 1.4% yoy. Inflation has been held down by falling oil prices and the rising dollar.

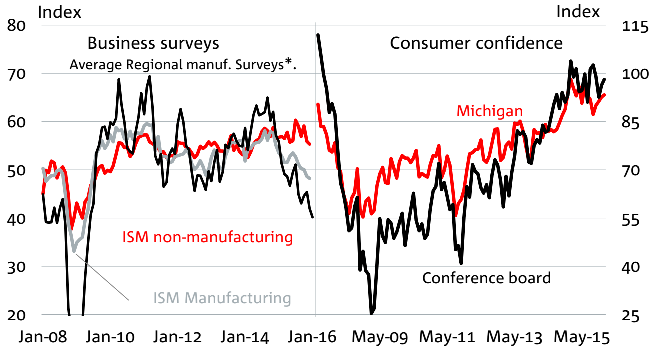
Assessment

While the advance estimate of December quarter's GDPsuggests a slowing economy, the annual growth rate is still within the bounds of what has been seen in the recovery from the 2007-09 recession.

We have seen similar, or lower, quarterly growth rates in recent years and each time GDP growth has rebounded. Still solid domestic demand, underpinned by household consumption and residential investment is likely to continue to provide substantial support to the economy. Households continue to benefit from falling gasoline prices and strong job gains. Moreover, fiscal policy has become more expansionary, offsetting some of the impact from the Fed's move to a tighter monetary policy.

However, there are clear risks to this outlook. The stronger dollar and low oil prices are negatively affecting some sectors of the economy. Moreover, it is adding to the pressure on share prices coming from concerns over the global economy, which could eventually affect consumer confidence. The recent slower GDP growth could also affect job gains. The ISM indicators out this week will provide a guide to the strength of the economy. If the regional Fed manufacturing surveys are a guide, the pressure on the manufacturing sector may have intensified early in 2016.

Consumer confidence holding up, but manufacturing remains under pressure



Sources: ISM, Conference Board, Univ.of Michigan/Thomson Reuters, Richmond, Dallas, Kansas City, Philadelphia & New York Federal Reserves (*simple average of survey results plus 50) & Chicago ISM

At this stage our view is that the economy will grow at a moderate pace, and by enough to further bring down unemployment and contribute to gradual rises in inflation. That said, we have revised down our forecasts for 2016 from 2.3% to 2.2% due to: the December quarter result being a bit below our expectation (0.7% compared to an expected 0.9% qoq), the composition being slightly less favourable than expected (we expected more of an inventory correction in the December quarter) and recent weakness in data on capital goods orders.

Like us, the Fed will also be looking to see whether the growth slowdown is permanent or temporary. This consideration, together with the tightening in financial conditions this year (dollar appreciation, wider spreads, lower share prices), means a further increase in the fed funds rate at the March FOMC meeting is unlikely. We don't expect another Fed funds rate hike until the June quarter (with June more likely than April), but this is dependent of an improvement in activity indicators in line with our forecasts.

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US Economic & Financial Forecasts

	Year Average Chng %				Quarterly Chng %							
					2015		2016				2017	
	2014	2015	2016	2017	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
US GDP and Components												
Household consumption	2.7	3.1	2.8	2.4	0.7	0.5	**0.8**	**0.7**	**0.6**	**0.6**	**0.6**	**0.6**
Private fixed investment	5.3	4.0	4.2	5.0	0.9	0.1	**1.2**	**1.4**	**1.5**	**1.3**	**1.2**	**1.1**
Government spending	-0.6	0.8	1.4	1.6	0.4	0.2	**0.3**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**
Inventories*	0.0	0.2	-0.3	0.0	-0.2	-0.1	**-0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Net exports*	-0.2	-0.7	-0.4	-0.3	-0.1	-0.1	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.1**
Real GDP	**2.4**	**2.4**	**2.2**	**2.3**	**0.5**	**0.2**	**0.6**	**0.6**	**0.6**	**0.6**	**0.6**	**0.5**
Note: GDP (annualised rate)					*2.0*	*0.7*	*2.5*	*2.5*	*2.4*	*2.4*	*2.3*	*2.2*
US Other Key Indicators (end of period)												
PCE deflator-headline												
Headline	1.1	0.4	1.4	2.3	0.3	0.0	**0.0**	**0.2**	**0.5**	**0.6**	**0.5**	**0.6**
Core	1.4	1.4	1.7	2.0	0.3	0.3	**0.3**	**0.4**	**0.5**	**0.5**	**0.5**	**0.5**
Unemployment rate - qtly average (%)	5.7	5.0	4.6	4.4	5.1	5.0	**4.9**	**4.8**	**4.7**	**4.6**	**4.5**	**4.5**
US Key Interest Rates (end of period)												
Fed funds rate (top of target range)	0.25	0.50	1.25	2.50	0.25	0.50	**0.50**	**0.75**	**1.00**	**1.25**	**1.50**	**1.75**
10-year bond rate	2.17	2.27	2.75	3.00	2.04	2.27	**2.50**	**2.75**	**2.75**	**2.75**	**3.00**	**3.00**

Source: NAB Group Economics

*Contribution to real GDP

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