US 2016 Q2 GDP

AUGUST 2016

GDP growth soft again in the June quarter but underlying trend better

NAB Group Economics

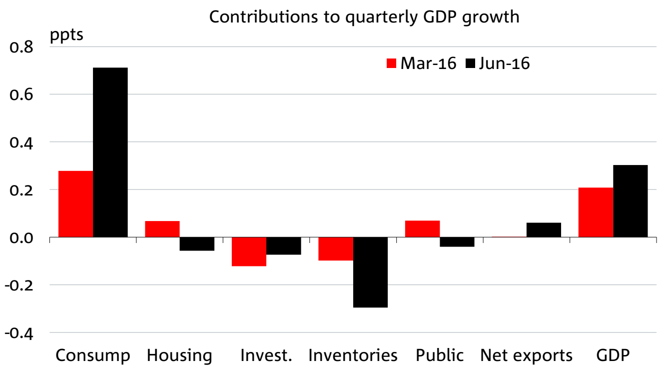
US GDP growth remained soft in the June quarter. Consumption grew strongly, but business and residential investment, as well as government demand, all detracted from growth. In particular, business cut back on inventories, continuing the recent inventory correction. However, domestic demand continues to grow at around the average pace seen since the last recession, suggesting a stronger underlying economy than the headline GDP number indicates, although weak productivity growth remains a concern.

JUNE QUARTER 2016 GDP

In the June quarter 2016, US GDP grew by an annualised 1.2% qoq. This was a little stronger than the 0.8% qoq growth recorded in the March quarter, but still a relatively soft rate of growth and below expectations.

Growth was driven by strong household consumption, while business fixed investment, inventories, public demand and housing investment detracted from growth. Net exports did, however, make a small contribution to growth.

Strong consumption offsets other weakness



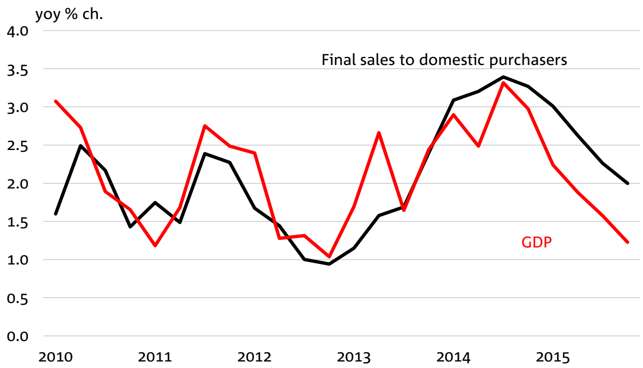
Sources: BEA, NAB. Data not annualised

The pace of inventory accumulation has slowed over each of the last five quarters, causing a drag on growth over this period. In the June quarter inventories actually declined, taking 1.2% (annualised) off quarterly GDP growth.

Over the last year final sales to domestic purchasers (which excludes both inventory changes and net exports, and therefore measures domestic demand), have been much stronger than GDP, growing by 2.0% yoy, compared to 1.2% yoy. While final sales growth is off the peak seen in early 2015, it is broadly in line with the average growth rate experienced in the recovery.

Real private consumption grew by a strong 1% qoq. This is only the third time in over nine years that the 1% mark being achieved. Durable goods consumption rebounded after falling in the previous quarter, services consumption strengthened, including the 'house and utilities' component which normally indicates some weather related impact. Non-durables consumption rose particularly quickly despite a fall in gasoline consumption as oil prices rises start to bite.

Weakness in GDP reflects inventory correction



Sources: BEA, NAB

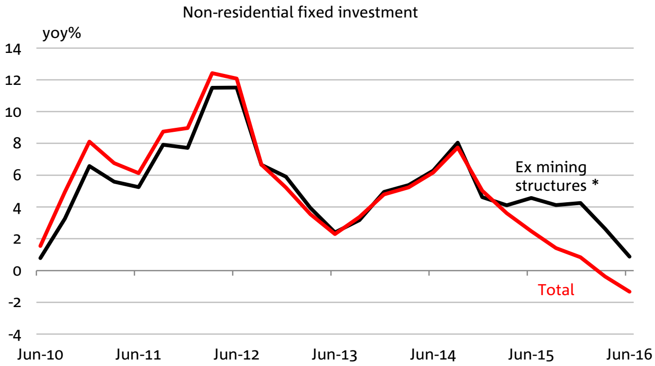
Household disposable income growth also strengthened in the quarter. But the combination of stronger real consumption and price growth meant that the savings rate fell, although it still lies within the post-2007-09 recession band.

In contrast, residential investment turned down in the quarter. This followed a period of strong growth and so it was still 6% higher than a year ago.

Date **1 August 2016** | Author **Antony Kelly** – Senior Economist – International

Business fixed investment fell for the third consecutive quarter, and is below year ago levels. There was another large fall in mining related investment. Mining structures investment fell 19% and is now over 60% below its end 2014 level. However it is not just a mining story. Excluding mining structures investment (the mining equipment detail is not yet available, but it is much smaller), other investment has also softened as the chart below illustrates.

Business investment weakened further

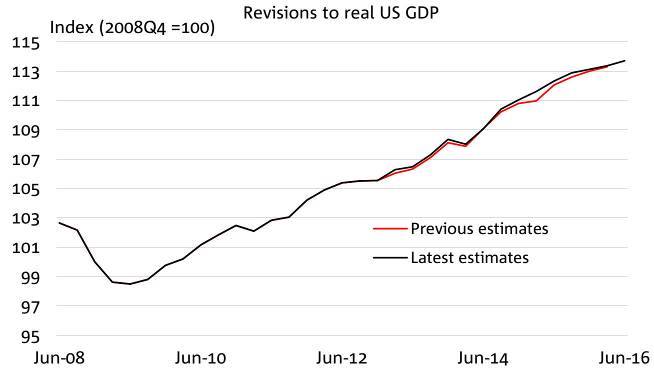


Source: BEA, NAB. *Mining exploration, shafts, and wells

With exports growing for the first time in a year, and imports again falling, net exports made a small contribution to growth. This is despite lingering effects from past rapid US dollar appreciation and below trend global growth. While weakness in imports can be sign of weak domestic demand, the fall this time around has coincided with the broader inventory correction.

Government consumption and investment also declined, its first fall in six quarters. Fiscal policy appears to be generating a mild tailwind but, given quarter-to-quarter volatility, the odd negative quarterly result is not a major surprise.

Historical revisions marked down recent growth, but overall story since recession unchanged



Sources: BEA, NAB

As normal, the June quarter GDP report included historical revisions. The overall picture since the 2007-09 recession is largely unchanged – annual average growth between June 2009 and March 2016 was unchanged at 2.1%. However, growth starting from June quarter 2015 was marked down. Over the year to the March quarter 2016, GDP growth was revised from 2.1% to 1.6%.

Implications

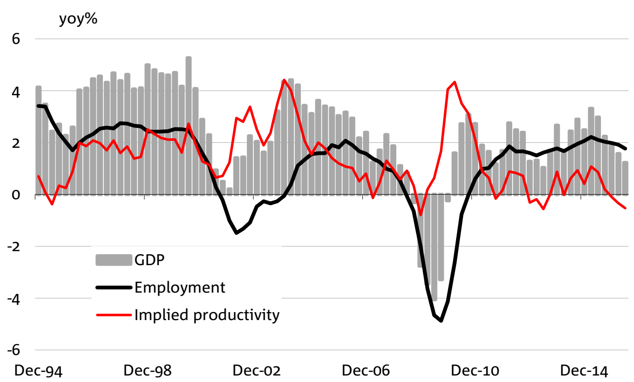
While below expectations, allowing for the inventory correction – which is likely reaching its end – the underlying pace of the US economy remains in line with that seen over recent years.

As a result of the statistician's revisions to recent growth estimates, as well as the weaker than expected June quarter result, we have lowered our 2016 GDP growth forecast from 1.8% to 1.5%. However, we have left our forecasts for 2017 and 2018 unchanged at 2.1% and 1.9% respectively.

A concern over the outlook, reinforced by the June quarter GDP report, is the disappointing productivity performance of recent years. With the labour market tightening – the unemployment rate is around the Fed's estimate of its long-term sustainable rate – the capacity to grow simply by taking on extra staff is likely to be increasingly constrained, turning the focus to productivity to sustain growth.

The large fall in oil prices and significant US dollar appreciation that occurred between late 2014 and early 2016, placed the capital intensive (high labour productivity) energy and manufacturing sectors under stress. The resulting structural shifts in the composition of output make discerning underlying productivity trends from aggregate measures difficult. Nevertheless, with our forecasts incorporating some improvement in labour productivity, recent trends, if sustained, represent a downward risk to the outlook.

Weak productivity growth a concern



Sources: BEA, BLS, NAB

However, generally there is little monetary policy can do to address poor productivity. That said, continued low productivity may have implications for how high the federal funds rate may go in the tightening cycle (and how quickly it will move). However, with inflation, and wages, edging up and the unemployment rate close to the Federal Reserve's target, increases in the federal funds rates are likely assuming (as we do) that the economy holds up.

At the margin, weak GDP growth will do little to make the Fed more confident about the outlook. So while there has been some speculation recently that a September rate hike might be in play, the June quarter GDP report reinforces our view that December is the more likely date.

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U.S. ECONOMIC & FINANCIAL FORECASTS

	Year Average Chng %					2016				2017			
	2014	2015	2016	2017	2018	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
US GDP and Components													
Household consumption	2.9	3.2	2.5	2.2	1.9	0.4	1.0	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**
Private fixed investment	5.5	4.0	0.6	3.0	3.2	-0.2	-0.8	**0.6**	**0.9**	**0.9**	**0.9**	**0.9**	**0.8**
Government spending	-0.9	1.8	1.1	1.3	1.6	0.4	-0.2	**0.3**	**0.3**	**0.4**	**0.4**	**0.4**	**0.4**
Inventories*	-0.1	0.2	-0.4	0.1	0.0	-0.1	-0.3	**0.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Net exports*	-0.1	-0.7	-0.2	-0.2	-0.1	0.0	0.1	**-0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Real GDP	**2.4**	**2.6**	**1.5**	**2.1**	**1.9**	**0.2**	**0.3**	**0.6**	**0.5**	**0.6**	**0.5**	**0.5**	**0.5**
Note: GDP (annualised rate)						*0.8*	*1.2*	*2.5*	*2.1*	*2.2*	*2.1*	*2.1*	*2.0*
US Other Key Indicators (end of period)													
PCE deflator-headline													
Headline	1.2	0.4	1.4	2.2	2.3	0.1	0.5	**0.4**	**0.4**	**0.5**	**0.5**	**0.6**	**0.6**
Core	1.6	1.4	1.8	2.0	2.2	0.5	0.4	**0.4**	**0.4**	**0.5**	**0.5**	**0.5**	**0.5**
Unemployment rate - qtly average (%)	5.7	5.0	4.7	4.4	4.4	4.9	4.9	**4.8**	**4.7**	**4.6**	**4.5**	**4.4**	**4.4**
US Key Interest Rates (end of period)													
Fed funds rate (top of target range)	0.25	0.50	0.75	1.50	2.25	0.50	0.50	**0.50**	**0.75**	**0.75**	**1.00**	**1.25**	**1.50**
10-year bond rate	2.17	2.27	1.75	2.25	2.25	1.77	1.47	**1.50**	**1.75**	**1.75**	**2.00**	**2.00**	**2.25**

Source: NAB Group Economics
*Contribution to real GDP

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