US 2017 Q3 GDP

30 OCTOBER 2017

NAB Group Economics

GDP grew strongly in the September quarter and, despite hurricane activity, was similar to the previous quarter's growth. The details of the report were also reasonable. The result supports our view that the economy is growing at an above trend rate. At the margin, it is likely to increase the chance that the Fed will raise rates in its December meeting.

Another strong quarter of growth

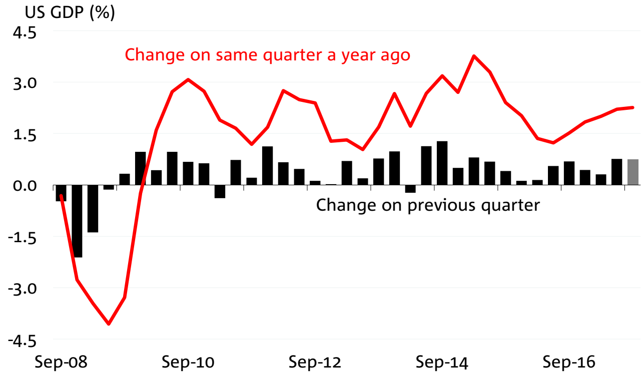
US GDP grew by 0.7% qoq, or 3.0% on an annualised basis, in the September quarter 2017. This was despite the major hurricanes that occurred during the quarter. The annual growth rate (September 2017 on September 2016) was the strongest in 2 years at 2.3% yoy. That said, this rate of growth is only marginally higher than the post-GFC average and by historical standards growth remains moderate.

The composition of growth was reasonable too. While softening, consumption and business investment growth remained solid, while there were higher contributions to growth from net exports and inventories. The inventory contribution reflected a return to a more normal level of inventory accumulation, so there is no reason to suspect a major correction soon. Final sales of domestic product, which exclude inventories, grew by a solid 0.6% qoq, despite residential investment and public demand continuing their recent soft patch.

Real consumer spending grew by 0.6% qoq, below the previous quarter's 0.8% pace. However, it is still a solid result, particularly given the initial impact on the monthly consumption data from Hurricane Harvey. The quarterly outcome suggests consumption bounced back in the September month despite another severe hurricane hitting Florida. Utilities consumption fell in the quarter; normally this would reflect seasonally mild weather but in this case it is likely the result of widespread power outages from the hurricanes. This component alone explains around half the 0.2ppt reduction in growth from the previous quarter.

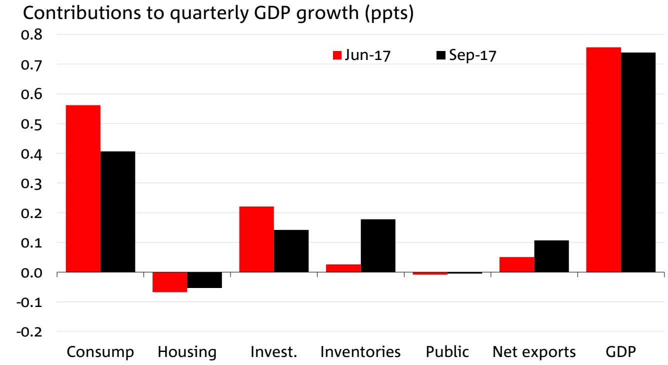
Business fixed investment increased for the sixth consecutive quarter. Growth in equipment investment was again strong while intellectual property investment (which includes research) was robust. In contrast non-residential structures investment fell, as the recent strength in mining sector investment moderated and the weakness in

Quarterly GDP growth stayed strong in Q3…



Sources: BEA, NAB. Quarterly growth rate not annualised

…helped by inventories and net exports



Sources: BEA, NAB. Data not annualised

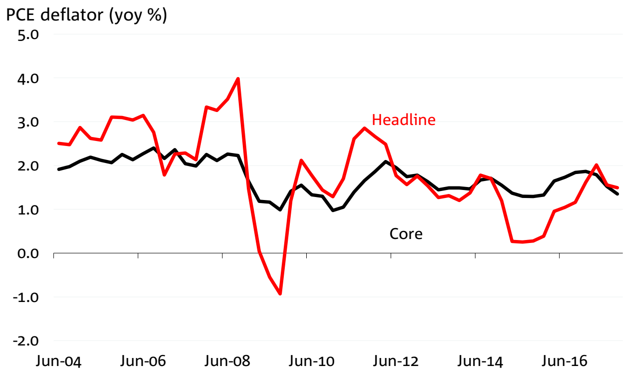
other structures investment persisted. Since mid-2016, mining structures investment has risen by more than 75%, but the easing in the rig count early in the December quarter suggests this has run out of steam.

In contrast to overall business investment, residential investment has hit a soft patch, falling in the last two quarters. The hurricanes may explain some of the September quarter weakness but it almost certainly not the only factor. Nevertheless, repairs and re-construction in hurricane affected areas might provide a boost to the sector in coming months.

The stronger contribution from net exports was driven by a fall in real goods and services imports. Exports grew a decent 0.6% qoq, but this was a bit weaker than the average over the previous year. In the September quarter, the US dollar (measured by the Fed's Broad Dollar Index), was only a little lower that a year ago, so it is hard to explain why import growth would be so sluggish when the US economy is traveling well. Hurricane activity also disrupted some ports, so it may be that the trade data has been depressed temporarily.

As expected, given the monthly data released to date, annual headline personal consumption expenditure (PCE) inflation moderated further from 1.6% yoy in the June quarter 2017 to 1.5% yoy in the September quarter. The core inflation measure, which excludes energy and food, slowed from 1.5% to 1.3%yoy.

Inflation slowing despite robust growth



Sources: BEA, NAB

Assessment

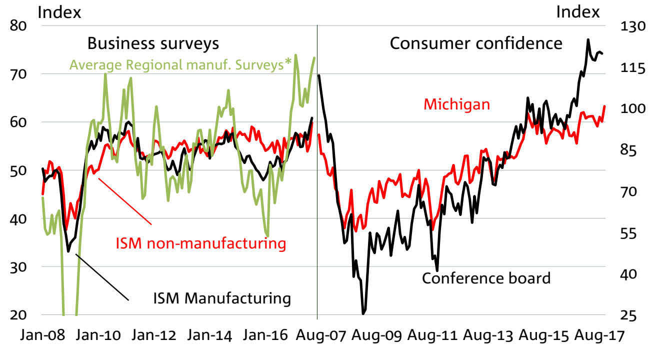
The strength in September quarter was the more impressive for occurring despite significant hurricane disruptions. As it was stronger than we had expected, our forecast for 2017 has been revised up to 2.2% (from 2.1%). However, it doesn't fundamentally alter our view of the economy and we have maintained our forecast of 2.3% for 2018.

It is worth remembering that GDP is quite volatile on a quarter-to-quarter basis. In particular, the weakness in March quarter GDP was discounted on the basis that it might reflect seasonal adjustment issues. If true, then this would mean that growth would be artificially high in the rest of the year.

Our view is that the economy is growing at an above trend level which should lead to further a decline in the unemployment rate from its already low level, providing some added inflationary pressures over time.

The main takeaway from the Q3 GDP result is additional support for this view. Importantly, given the statistical volatility noted above, it is also supported by independent data sources – business survey measures are at solid levels and consumer confidence remains relatively high.

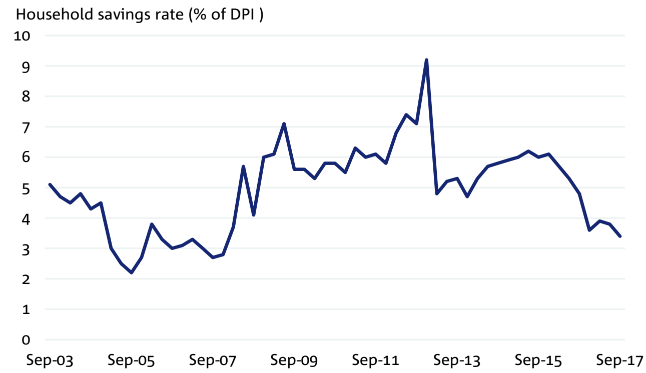
Q3 GDP result broadly consistent with surveys



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)

One issue that bears close watching is the downwards movement in the savings rate, although the rate of decline has slowed recently. The savings rate is at its lowest level since 2007 and there is a limit to how far it can fall. One possible reason for the decline is that, with confidence high and balance sheets (on average) in good shape, households have been unwinding the increase in savings that followed the GFC.

Savings rate still declining



Source: BEA

At the margin, the strong growth in September quarter GDP adds to the likelihood of the Fed raising rates in its December meeting (the chance of any change in policy at this week's meeting looks remote). One reason that the Fed has not materially changed its outlook for the fed funds rate over this year in the face of weakening inflation is that it sees future inflationary pressure from the continuing falls in the unemployment rate, a trend the strong GDP report suggests will continue.

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U.S. ECONOMIC & FINANCIAL FORECASTS

	Year Average Chng %					Quarterly Chng %									
						2016		2017				2018			
	2015	2016	2017	2018	2019	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
US GDP and Components															
Household consumption	3.6	2.7	2.7	2.4	2.0	0.7	0.7	0.5	0.8	0.6	0.6	0.5	0.6	0.6	0.5
Private fixed investment	3.9	0.7	3.6	3.2	2.7	0.4	0.4	2.0	0.8	0.4	0.9	0.8	0.9	0.8	0.7
Government spending	1.4	0.8	-0.1	0.7	1.5	0.1	0.0	-0.2	0.0	0.0	0.1	0.2	0.3	0.4	0.4
Inventories*	0.2	-0.4	-0.1	0.1	0.0	0.0	0.3	-0.4	0.0	0.2	0.0	0.0	0.0	0.0	0.0
Net exports*	-0.7	-0.2	-0.1	0.0	-0.1	0.1	-0.4	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Real GDP	**2.9**	**1.5**	**2.2**	**2.3**	**2.0**	**0.7**	**0.4**	**0.3**	**0.8**	**0.7**	**0.6**	**0.5**	**0.6**	**0.6**	**0.5**
Note: GDP (annualised rate)						*2.8*	*1.8*	*1.2*	*3.1*	*3.0*	*2.3*	*1.9*	*2.4*	*2.4*	*2.1*
US Other Key Indicators (end of period)															
PCE deflator-headline															
Headline	0.4	1.6	1.4	1.9	2.0	0.4	0.5	0.6	0.1	0.4	0.4	0.4	0.5	0.5	0.5
Core	1.3	1.9	1.4	1.9	2.0	0.5	0.3	0.5	0.2	0.3	0.4	0.5	0.5	0.5	0.5
Unemployment rate - qtly average (%)	5.0	4.7	4.2	4.0	4.0	4.9	4.7	4.7	4.4	4.3	4.2	4.1	4.0	4.0	4.0
US Key Interest Rates (end of period)															
Fed funds rate (top of target range)	0.50	0.75	1.50	2.25	2.50	0.50	0.75	1.00	1.25	1.25	1.50	1.75	2.00	2.00	2.25
10-year bond rate	2.27	2.45	2.60	3.00	3.00	1.6	2.4	2.4	2.3	2.3	2.6	2.8	2.8	3.0	3.0

Source: NAB Group Economics

*Contribution to real GDP growth

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