US 2017 Q4 GDP JANUARY 2018

NAB Group Economics

US GDP grew solidly for the third consecutive quarter to end 2017. The composition of GDP growth was also positive with consumption strong and business investment accelerating. We have lifted our forecast for 2018 GDP growth from 2.4% to 2.7%, but still expect growth to slow in 2019 as the Fed returns monetary policy to a more neutral setting, this year's fiscal stimulus impacts fade and capacity constraints bite.

A solid end to the year

US GDP grew solidly for the third consecutive quarter to end 2017. GDP growth in the December quarter was 0.6% qoq, or 2.6% on an annualised basis. Despite a slow start, growth over the year (December 2017 on December 2016) was 2.5% yoy, the fastest annual pace since mid-2015.

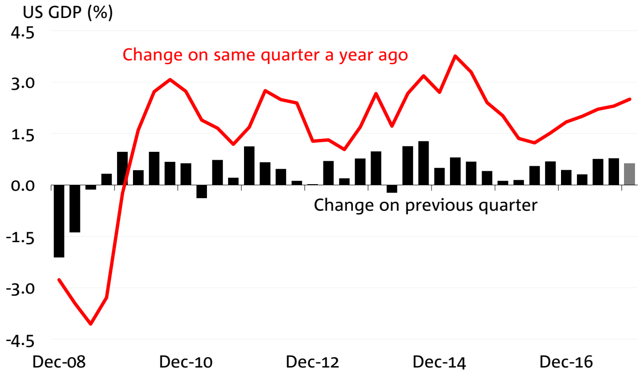
The composition of GDP growth was also positive. Consumption growth was strong, business investment growth strengthened, while residential investment turned positive. The major drags came from net exports and also inventories, with the latter basically reversing the previous quarter's gains. Inventories are not high relative to sales so a return to more normal levels of inventory accumulation is a possible upside for the March quarter 2018.

As a result, final sales to domestic purchasers – a measure of domestic final demand – grew strongly in the quarter, rising by 1.1% qoq.

This included strong growth in real consumer spending of 0.9% qoq. The strength may in part reflect some bounce back from the Hurricane affected September quarter. The savings rate has also declined over the last three quarters and is now at its lowest level since 2005.

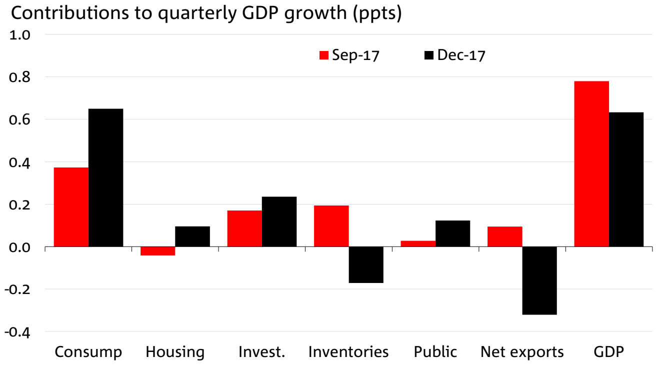
Business fixed investment increased for the seventh consecutive quarter and the quarterly growth rate, of 1.7% qoq, was the equal highest recorded over this stretch. Equipment investment growth was again strong while intellectual property investment (which includes research) was robust. In contrast non-residential structures investment only recorded a small rise, as mining sector investment growth slowed further and non-mining structures investment again fell (although the fall was more modest than in recent quarters).

A solid end to 2017



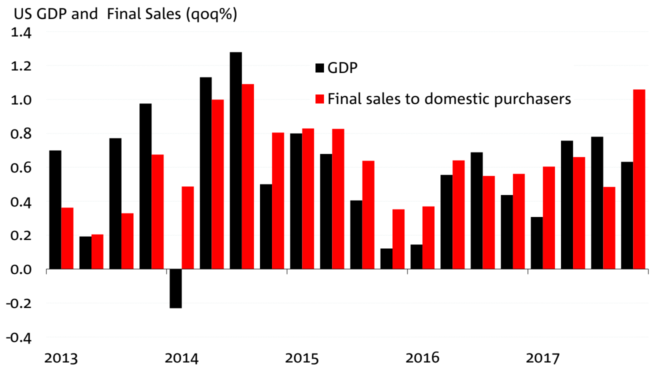
Sources: BEA, NAB. Quarterly growth rate not annualised

...despite detractions from inventories & net exports



Sources: BEA, NAB. Data not annualised

...as domestic demand very strong



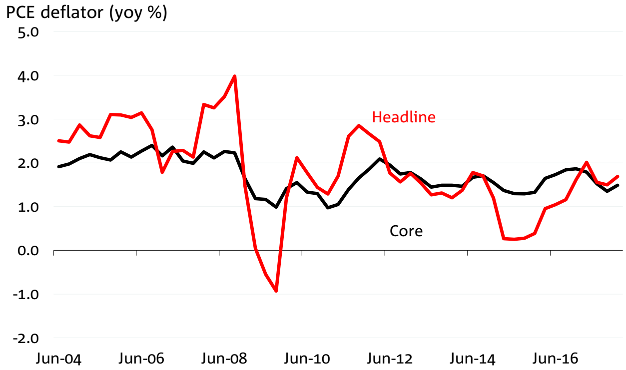
Sources: BEA, NAB

After declining in each of the prior two quarters, residential investment bounced back strongly in the December quarter, rising 2.8% qoq. Multi-family (apartment) investment, however, again fell and investment in this category looks to have peaked for now given the upwards trend in the apartment vacancy rate since late 2016. Compared to December 2016, residential investment was up 2.3% pointing to a modest underlying trend.

A surprise in recent quarters has been the weakness in trade flows, particularly imports. The December quarter, reversed this pattern. Export growth strengthened to 1.7% qoq, but not by as much as imports, which grew by 3.3% qoq. This was the strongest quarterly import growth rate in over seven years. While the strength of domestic demand undoubtedly boosted imports, their strength looks exaggerated and may reflect catch-up given past weakness and possibly also Hurricane disruptions in the September quarter.

There was also a bounce back in inflation, partly reversing some of the recent weakness. Headline personal consumption expenditure (PCE) inflation grew by 0.7% qoq, resulting in a small uptick in the annual growth rate to 1.7% yoy (from 1.5% in the September quarter). The strength in December quarter inflation was partly due to rising energy prices, but core (ex energy and food) inflation also accelerated, rising by 0.5% qoq, up from the average of 0.3% in the prior two quarters.

Signs of a turnaround in inflation



Sources: BEA, NAB

Assessment

While GDP growth in the December quarter was only a bit stronger than we had expected, the composition of growth was better, with the slowdown in inventory accumulation, and what looks like exaggerated weakness in net exports, unlikely to persist.

As a result we have lifted our forecast for 2018 GDP growth from 2.4% to 2.7%. A risk around this is the recent tendency for the March quarter growth rate to be relatively weak, although if due to seasonal adjustment issues it would imply higher growth over the rest of the year.

Growth of 2.7% for 2018 is above our assessment of the economy's longer term potential growth rate. The expectation for above trend growth reflects the current momentum in the economy as well as the fiscal stimulus from the recently enacted tax cuts which kicked in at the start of 2018.

The continuing fall in the savings rate raises concerns over the sustainability of the recent strong growth in consumption. While we expect growth to moderate from its December quarter pace we don't anticipate a major correction. The fall in the savings rate in part probably reflects the gains in household wealth and the stock market has accelerated into 2018. Moreover, personal income tax cuts will improve household finances, although recent increases in oil prices work the other way.

The increases in oil prices, however, will support business investment. Businesses were also beneficiaries of the tax cuts, which may provide some additional spur to investment.

Above trend growth should lead to further declines in the unemployment rate. The Fed will continue to tighten policy in this environment– subject to inflation showing signs of moving back to the 2% target growth rate. While annual headline and core inflation remains below the Fed's 2% target, the upturn at the end of the year lends some support to the Fed's assessment that the soft inflation readings seen earlier in 2017 will be temporary and that inflation will gradually move towards its target level.

Into 2019, as monetary policy becomes less benign, the impact of this year's fiscal stimulus fades and as capacity constraints start to bite, we expect GDP growth to moderate to 2.0%.

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U.S. ECONOMIC & FINANCIAL FORECASTS

	Year Average Chng %					Quarterly Chng %									
						2017				2018				2019	
	2015	2016	2017	2018	2019	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
US GDP and Components															
Household consumption	3.6	2.7	2.7	2.8	2.1	0.5	0.8	0.5	0.9	**0.7**	**0.6**	**0.6**	**0.5**	**0.5**	**0.5**
Private fixed investment	3.9	0.7	4.0	4.4	3.0	2.0	0.8	0.6	1.9	**1.0**	**1.0**	**1.0**	**0.9**	**0.7**	**0.6**
Government spending	1.4	0.8	0.1	0.9	1.0	-0.2	0.0	0.2	0.7	**0.0**	**0.2**	**0.2**	**0.3**	**0.3**	**0.3**
Inventories*	0.2	-0.4	-0.1	0.1	0.0	-0.4	0.0	0.2	-0.2	**0.1**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**
Net exports*	-0.7	-0.2	-0.2	-0.3	-0.1	0.1	0.1	0.1	-0.3	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Real GDP	**2.9**	**1.5**	**2.3**	**2.7**	**2.0**	**0.3**	**0.8**	**0.8**	**0.6**	**0.7**	**0.7**	**0.6**	**0.5**	**0.5**	**0.4**
Note: GDP (annualised rate)						*1.2*	*3.1*	*3.2*	*2.6*	*2.6*	*2.7*	*2.4*	*2.1*	*1.8*	*1.8*
US Other Key Indicators (end of period)															
PCE deflator-headline															
Headline	0.4	1.6	1.7	2.1	1.8	0.6	0.1	0.4	0.7	**0.6**	**0.5**	**0.5**	**0.4**	**0.4**	**0.4**
Core	1.3	1.9	1.5	2.0	2.1	0.5	0.2	0.3	0.5	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**
Unemployment rate - qtly average (%)	5.0	4.7	4.1	3.6	3.6	4.6	4.3	4.3	4.1	**3.9**	**3.8**	**3.7**	**3.6**	**3.6**	**3.6**
US Key Interest Rates (end of period)															
Fed funds rate (top of target range)	0.50	0.75	1.50	2.25	2.50	1.00	1.25	1.25	1.50	**1.75**	**2.00**	**2.00**	**2.25**	**2.50**	**2.50**
10-year bond rate	2.27	2.45	2.50	2.75	2.75	2.4	2.3	2.3	2.5	**2.5**	**2.6**	**2.6**	**2.8**	**2.8**	**2.8**

Source: NAB Group Economics
*Contribution to real GDP growth

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