US ECONOMIC UPDATE SEPTEMBER 2019

National Australia Bank

Economy tracking OK but trade & other headwinds will take their toll

NAB Group Economics

The US economy still appears to be growing at a reasonable pace, but trade headwinds continue to strengthen. While consumers have been resilient, trade and other factors are weighing on business investment which is likely to result in a period of modestly below trend growth. We expect the Fed to further ease policy in Q4 2019, and with risks weighted to more action being required. The easing in policy will help stabilise growth although how the US trade policy unfolds will be important.

Available indicators point to an economy still growing at a reasonable rate, even if down on its 2018 pace. However, the repeated ramping up in US-China tariffs will take its toll and business surveys point to an underlying slowing in the economy. As a result, we expect a period of growth somewhat below trend. However, with monetary policy easing and, if as expected, the global economy stabilises in 2020, growth should eventually return to around its trend pace.

Trade headwinds keep getting stronger

Almost immediately following our last US update there was further escalation in the US-China trade and technology dispute.

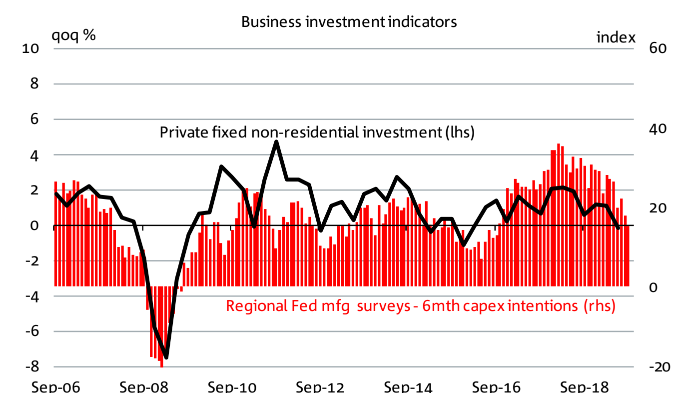
On 23 August, China announced tariffs of 5-10% on around $75b of imports from the US and re-imposed tariffs on autos and auto parts. The US responded by increasing to 15% (from 10%) the tariff increases scheduled for 1 September and 15 December on around $270b of imports from China. The US also announced that the 25% tariff already in place on around $250b of China imports would be increased to 30% on 1 October.

There was some subsequent calming of nerves as China removed some items from its tariff list and the US decided to delay the October tariff increase to 15 October. There were also hopes of a limited agreement between the US and China being reached in October, but recent comments from the US President suggest this is unlikely.

Applying the tariff rate to the amount of affected imports suggests that the US measures over September to December would raise revenue equal to around 0.25% of GDP. This would bring the total fiscal contraction from all tariff measures to 0.6% of GDP. In reality, as the US may either switch suppliers or spending to non-tariff affected goods and services, the impact will be smaller. To sum up, it is not a major fiscal contraction but nor is it trivial and it is building.

Apart from the direct impacts of the tariff measures, a concern is the impact on sentiment, especially for business investment. This is particularly in the light of a fall in US corporate margins and soft global economic growth. Regional Federal Reserve manufacturing surveys highlight the weakening in investment plans in the manufacturing sector.

Investment indicators have weakened



Recent data and outlook

The most recent data – covering industrial production, consumption (retail sales) and housing activity – have been reasonably positive.

Business surveys point to growth slowing (albeit to a still moderate pace). Weakness is most evident in the manufacturing sector (which is highly exposed to swings in both trade and capital investment). The services parts of the economy have not escaped the slowdown but, overall the surveys suggest that they have held up better than manufacturing.

Date **September 2019** | Author Tony Kelly – Senior Economist
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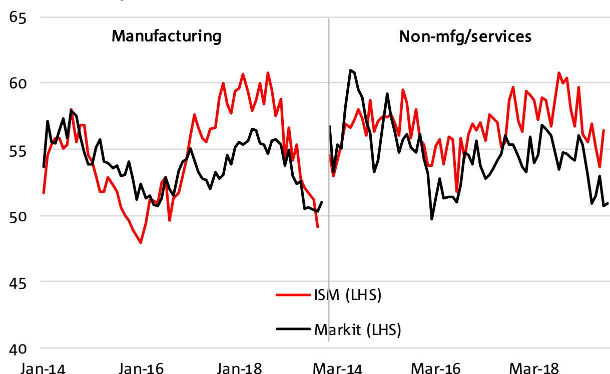
Business surveys point to an ongoing slowdown

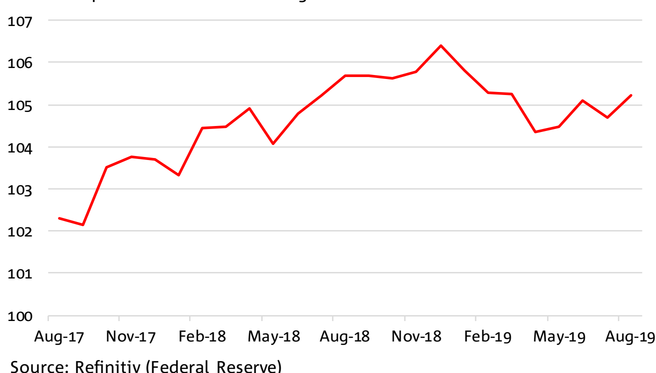
Business survey indicators



While the surveys point to growing pressure on the manufacturing sector, recent data on manufacturing industrial production suggest that activity in the sector may have bottomed out. Manufacturing industrial production has increased since April. However, with further rounds of tariff increases coming through in coming months the test will be whether this is sustained. A strike by the United Auto Workers will also place some pressure on the sector while it continues.

Manufacturing production showing signs of life

Industrial production: manufacturing index

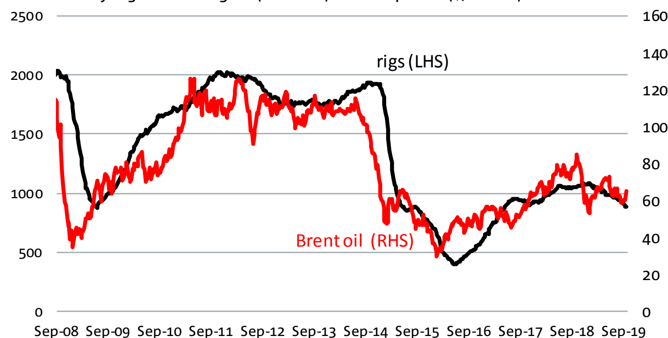


Source: Refinitiv (Federal Reserve)

Industry specific factors are also reducing investment. The decline in oil prices since October 2018 has seen investment in the capital-intensive mining sector decline. The rise in oil prices since the recent disruptions to Saudi production may help stabilise investment but does not appear sufficiently large to cause it to move higher at this stage.

Oil prices have weighed on investment

U.S. rotary rigs - oil and gas (number) and oil prices ($/barrel)



Sources: Baker Hughes Incorporated, Datastream

While business investment has weakened, consumer spending has been holding up better, helping to sustain growth in the economy. Indicators so far in Q3 point to another robust quarter of household consumption growth. July consumption was 0.7% higher than its Q2 average, and August retail trade data point to further growth in that month. Consumer confidence remains solid, and the household balance sheet is in good shape.

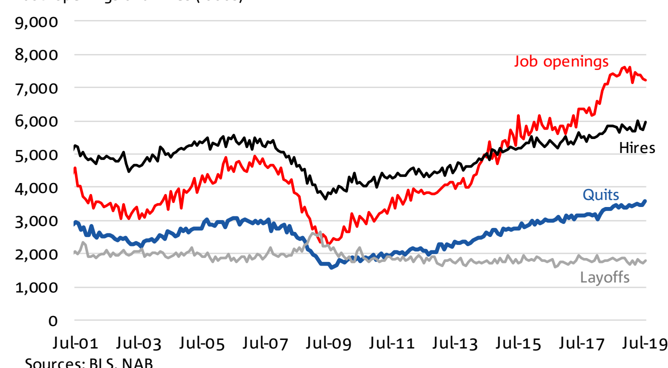
Strength in the labour market is another factor supporting household consumption. Unemployment is low, wages growth has gradually accelerated over time – and is above the inflation rate – while the number of people employed continues to rise.

That said, employment growth has been slowing – from a little under 2% y/y at the end of last year to under 1.4% y/y in August. The unemployment rate has also been tracking sideways suggesting that there will be little further acceleration in wages.

The risk is that with businesses facing weaker conditions, declining margins and uncertainty about the future they will cut back on hiring as well as fixed investment. Data available to July indicates that there has been some decline in job openings – but they are still at high levels – and growth in hiring has slowed. However, at this stage layoffs have not lifted and voluntary departures ('quits') are still trending up (something normally associated with a healthy labour market).

Labour market flows

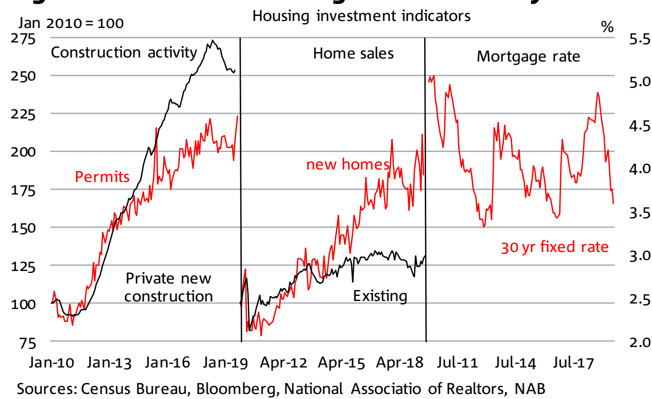
Job openings and hires ('000s)



Sources: BLS, NAB

The shift in the Fed policy stance since early this year – and the accompanying falls in mortgage rates – is one factor that will help to support growth in the economy. One sector where this is already starting to be seen is housing. Permits – a leading indicator of construction – have increased recently, as have sales (both for new and existing homes).

Signs of life in the housing market activity



Sources: Census Bureau, Bloomberg, National Associatio of Realtors, NAB

Overall, we expect year-average GDP growth of 2.2% in 2019. This incorporates a slowdown in growth in H2 2019 to a level a bit below trend leading to year-average growth of 1.6% in 2020. However, as monetary easing starts to kick in, we expect growth to stabilise and then return to around our estimate of the potential growth (around 1¾%).

We assume no worsening or improvement in current trade disputes, and there are obvious risks around this assumption. With a range of other geo-political risks (Brexit, oil supply disruptions in the Middle East), and global growth continuing to slow, overall risks remained weighted to the downside.

Fed policy

The Fed reduced the target range for the federal funds rate by 25bps at its September meeting. This follows a 25bp cut in July.

The median individual meeting projection (the 'dots') was for no change in the fed funds rate from now through to the end of 2020.

However, we still expect at least one more rate cut – most likely in October or December this year – and with a greater risk that further rate cuts will be required rather than fewer (i.e. no more).

A sizable minority of Fed members (7 out 19 for 2019 and 8 our 19 for 2020) did see one more cut as being appropriate if the future unfolds as they expect. This is like the June meeting projections, where the median view did not have any rate cuts in 2019 (although a sizable minority did) and we have since had two. As the Fed Chair noted, in the current environment it is hard for anyone to have 'hardened expectations' so depending on how the data and events unfold Fed views will change.

The Fed Chair, in his post-meeting press conference, also expressed the view that it would be a mistake to "…hold onto your firepower until a downturn gains momentum…". When coupled with his comments on the need to sustain the expansion, and that the Fed is willing to be aggressive if the economy weakens further, it suggests a Fed ready to ease policy further.

In this context, it is relevant that we are also expecting somewhat slower GDP growth than the (median) Fed member. If realised, this would add to the case for a further easing in policy. Generally benign inflation (and the desire of at least some Fed members to have a period of above target inflation) as well as a range of geo-political risks – particularly traded related – are also supportive of further monetary easing.

CONTACT THE AUTHOR

Tony Kelly
Senior Economist
Antony.Kelly@nab.com.au

U.S. ECONOMIC & FINANCIAL FORECASTS

	Year Average Chng %				Quarterly Chng %										
					2018			2019				2020			
	2018	2019	2020	2021	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
US GDP and Components															
Household consumption	3.0	2.6	2.3	1.9	1.0	0.9	0.4	0.3	1.1	**0.8**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**
Private fixed investment	4.6	1.4	0.6	2.0	1.3	0.2	0.7	0.8	-0.3	**-0.1**	**0.0**	**0.2**	**0.3**	**0.4**	**0.5**
Government spending	1.7	2.2	2.0	1.8	0.6	0.5	-0.1	0.7	1.1	**0.4**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**
Inventories*	0.1	0.1	-0.2	0.0	-0.4	0.6	0.0	0.1	-0.2	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Net exports*	-0.4	-0.3	-0.2	-0.1	0.2	-0.6	-0.1	0.2	-0.2	**-0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Real GDP	**2.9**	**2.2**	**1.6**	**1.8**	**0.9**	**0.7**	**0.3**	**0.8**	**0.5**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**	**0.5**
Note: GDP (annualised rate)					*3.5*	*2.9*	*1.1*	*3.1*	*2.0*	*1.7*	*1.5*	*1.5*	*1.6*	*1.7*	*1.8*
US Other Key Indicators (end of period)															
PCE deflator-headline															
Headline	1.9	1.5	2.1	2.0	0.5	0.4	0.3	0.1	0.6	**0.4**	**0.5**	**0.6**	**0.5**	**0.5**	**0.5**
Core	1.9	1.7	2.0	2.0	0.5	0.4	0.4	0.3	0.4	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**
Unemployment rate - qtly average (%)	**3.8**	**3.7**	**3.8**	**3.8**	**3.9**	**3.8**	**3.8**	**3.9**	**3.6**	**3.7**	**3.7**	**3.7**	**3.8**	**3.8**	**3.8**
US Key Interest Rates (end of period)															
Fed funds rate (top of target range)	2.5	1.8	1.8	1.8	2.0	2.3	2.5	2.5	2.5	**2.0**	**1.75**	**1.75**	**1.75**	**1.75**	**1.75**
10-year bond rate	2.7	1.5	1.8	1.9	2.9	3.1	2.7	2.4	2.0	**1.5**	**1.5**	**1.5**	**1.6**	**1.7**	**1.8**

Source: NAB Group Economics

*Contribution to real GDP growth

Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Dean Pearson
Head of Behavioural & Industry Economics
+(61 3) 8634 2331

John Sharma
Economist
+(61 3) 8634 4514

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Australian Economics and Commodities

Gareth Spence
Senior Economist
+(61 0)436 606 175

Phin Ziebell
Economist – Australia
+61 (0) 475 940 662

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(613) 9208 2929

International Economics

Tony Kelly
Senior Economist
+(61 3) 9208 5049

Gerard Burg
Senior Economist – International
+(61 3) 8634 2788

Global Markets Research

Ivan Colhoun
Global Head of Research
+61 2 9237 1836

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