US ECONOMIC UPDATE NOVEMBER 2019

The waiting game

NAB Group Economics

While we wait to see if the US-China agree to a "Phase One" trade deal, early data for Q4 continue to show a slowing in growth. Household spending is still growing (but more slowly) and, while housing investment is improving, business investment is under pressure. Trade disputes have been weighing on activity and while a trade deal would boost sentiment, it is unclear whether it would remove the uncertainty that has been leading US businesses to reduce investment.

It's a waiting game at present. We are waiting on a "Phase One" trade deal between the US and China. We are waiting for the President's next step on auto tariffs. We are waiting to see if the Congress will ratify the US-Mexico-Canada trade agreement (USMCA) ahead of next year's elections. The Fed is waiting to see what it should do next on monetary policy. Business is waiting to see if it should start investing again. Last week Congress couldn't wait any longer to fund the government so did some 'kicking the can down the road' – providing funding but only for one month.

We are all waiting on data to get a solid reading on how Q4 growth is tracking. For most of the indicators that will feed into the Q4 GDP estimates we still only have October data at best.

The limited data we do have for Q4 is on the soft side. The Atlanta Fed's GDPNow nowcast of Q4 GDP of only 0.4% annualised growth (well below our current 1.5% projection). However, there are some temporary negative factors and more broadly recent trends appear unchanged:

- Household spending is still growing (but the rate of growth is decelerating)
- Housing investment is growing again
- Business investment is under pressure

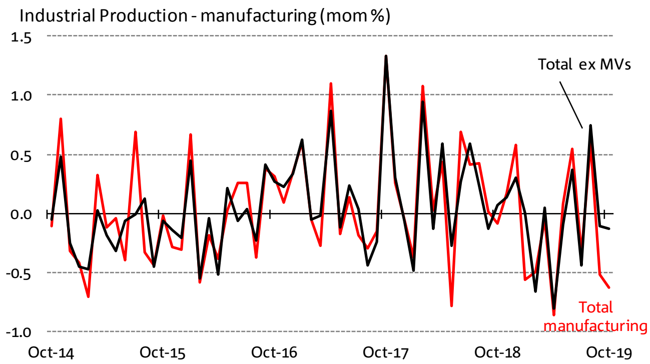
Most notably, after a small decline in September, retail sales grew again in October. Looking through the month-to-month volatility, growth appears to have slowed. In contrast, the Q3 rebound in residential investment looks to be continuing with housing starts, permits and sales of existing homes all up in October.

Household related activity will continue to be supported by healthy household balance sheets, positive consumer sentiment, low interest rates, jobs growth (albeit slowing) and real wage gains.

In contrast, business investment declined in the last two quarters and early indicators point to further weakness in Q4. September forward capital goods orders were negative, production of business equipment declined in October (although these may also reflect weak overseas demand) and the number of oil rigs (an indicator of mining sector investment) declined through to mid-November.

Industry specific factors have also been at play in the aviation (Boeing) and auto sectors (GM auto workers strike). There was a 12% fall in motor vehicle and parts production over the last two months; in contrast other manufacturing production has shown some improvement since the first half of 2019. The strike ended in late October, so a rebound in manufacturing production is likely in November.

Auto sector disrupted by GM labour strike



Source: Refinitiv (Federal Reserve). 'MVs' = motor vehicles.

Business surveys illustrate the slowdown that has been underway in the US economy. This is particularly so for the manufacturing sector which is relatively highly traded and more exposed to a business investment downturn than other sectors. While the ISM survey in October is at a level consistent with further slowing in GDP growth, the

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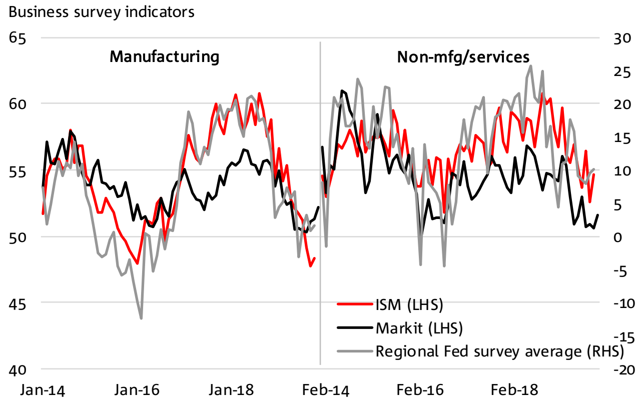
pick-up in the flash Markit surveys for November suggests activity might be stabilising.

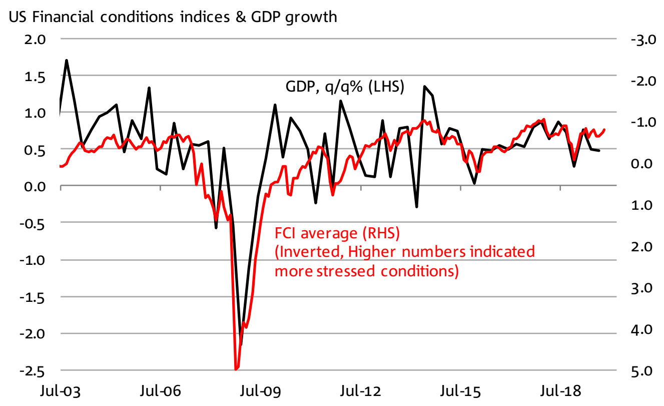
Business surveys point to growth easing



Our forecasts currently anticipate that GDP growth will slow to around 1.5% (annualised) over the next two quarters, before starting to gradually strengthen partly due to the lagged impact of monetary easing.

However, as we noted in last month's update, our US macro models currently suggest that there is some upside risk to near-term forecasts. Similarly, broad based measures of financial conditions are not at levels that point to a further slowdown in growth.

Financial conditions consistent with growth

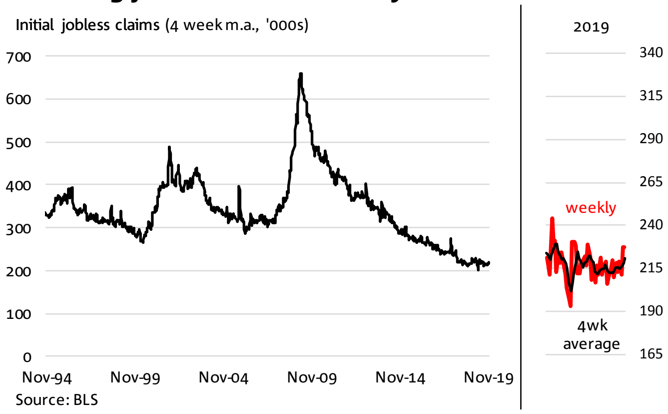


Sources: BEA, Bloomberg, Datastream. 'FCI' is an average of Goldman Sachs & Bloomberg FCIs, Chicago Fed NFCI, Kansas & St Louis Fed Stress indices

There remain a range of risks around the forecasts. One is that compression in business margins, concerns over the outlook and negative spill overs from the manufacturing sector have a bigger than expected impact on the economy. A rapid slowdown in employment growth could constrain consumer spending reinforcing headwinds on the economy.

In this light an increase in initial jobless claims over the last two weeks has been given some attention. Jobless claims are not only timely but can lead movements in other indicators such as the unemployment rate. However, they can be volatile week-to-week (which is why a 4-week average is often used), particularly around holiday periods (there was a public holiday on 11 November). The recent lift can be seen in the right-hand panel of the chart below – even just by this year's standards it is too soon to be reading much into it. A further, sustained increase, would be needed to signal a turning point.

Watching jobless...but too early to be alarmed



Trade developments and impacts

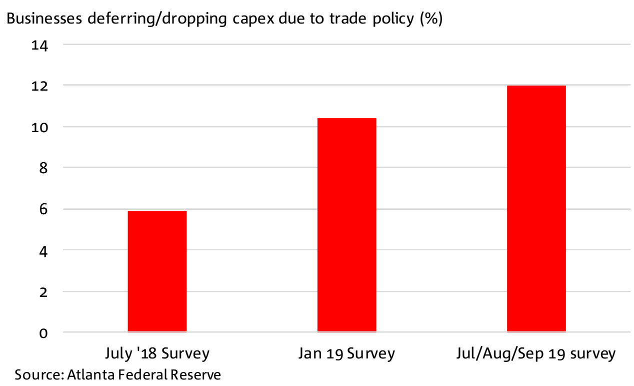
Our forecasts are based on no change to existing (or announced) tariffs. Therefore, an initial trade deal would provide some upside risk to our forecast.

It appears, at a minimum, for a deal to be concluded that the US would need to remove the tariffs scheduled for December. News reports have also, at times, raised the prospect of existing tariffs being wound back.

How much of a boost would come from a deal is less clear. The fiscal impact of the December tariffs (15% on around $160b of imports from China) is only around 0.1% of US GDP. Even if the September tariffs were rolled back this only rises to 0.2%. However, as reflected in the lift to financial markets from the prospect of a deal, it would clearly lift sentiment.

Less clear is whether it would remove the uncertainty facing businesses as to the nature of future trading arrangements. One possible reaction from business to this uncertainty is to postpone or cancel investment projects. A survey of businesses by the Atlanta Federal Reserve shows businesses have indeed being doing exactly this because of the trade dispute. Moreover, the impact has been rising over time, as illustrated in the chart below.

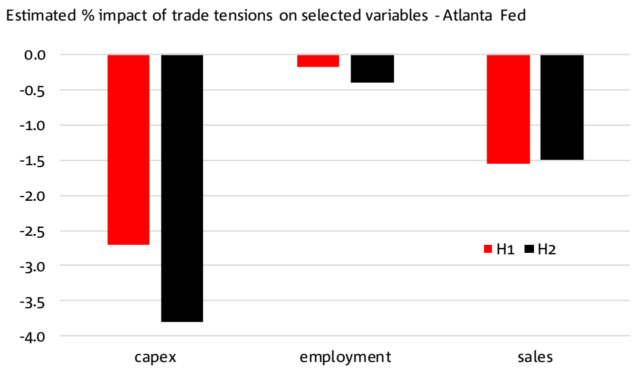
Impact of trade war on investment rising



Survey details indicate the impact on capex has been most pronounced in manufacturing, followed by construction and transport/warehousing; in contrast, there has been a much smaller impact on service sector capex.

Based on the survey responses, the Atlanta Fed also estimated the impact on capital expenditure as well as sales and employment. While the largest impact has been on the investment side, sales and jobs have also been hurt. Moreover, the size of the impact on investment and jobs is expected to be greater in the second half of this year than in the first.

Biggest impact on capex; but hits jobs and sales too



Source: Atlanta Federal Reserve

Based on what has been reported about a possible “Phase One” deal many of the more difficult issues would remain (intellectual property monitoring and enforcement, and China’s industrial policy). More generally, unless the deal establishes a clear – and credible – framework for addressing remaining issues (and what this mean for tariffs that remain in place) businesses may still be tempted to postpone investment where possible.

Monetary policy

The Fed has cut the federal funds rate by a total of 75bps since the middle of the year. However, following the October meeting rate cut, the Fed indicated that it thinks interest rates are now at the appropriate level to support growth and inflation.

Our expectation that there might be some further slowing in growth suggests that there is a risk that the Fed may re-assess and again cut rates, perhaps in early 2020. However, the Fed has indicated that there needs to be a ‘material’ change in the outlook for it to cut again. While no benchmark has been provided for assessing what constitutes ‘material’, a small deviation in growth from what is expected is unlikely to be sufficient given the inherent volatility in the data.

As a result, we continue to expect no further change in the fed funds rate this year and next, but note that the risk to this projection is that they undertake further cuts. In contrast, with inflation below target and not showing signs of accelerating, and some (if not many) Fed members willing to tolerate a period of above target inflation to lift inflation expectations, a rate hike over the next year looks like a remote possibility.

Federal Government shutdown avoided…for now

While Congress earlier this year passed a two-year budget deal (including a suspension of the debt limit) detailed spending bills were still required to ensure funding for Federal government operations. This has not yet happened.

To avoid a government shutdown, last week the Congress passed a continuing resolution which provides funding through to 20 December 2019. Given the current tempestuous US political environment, there is still the near-term risk of a Federal government shutdown.

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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	0.7	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**
Private fixed investment	4.6	1.3	0.5	2.0	1.3	0.2	0.7	0.8	-0.4	-0.3	**0.1**	**0.2**	**0.3**	**0.4**	**0.5**
Government spending	1.7	2.3	2.1	1.8	0.6	0.5	-0.1	0.7	1.2	0.5	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**
Inventories*	0.1	0.2	-0.1	0.0	-0.4	0.6	0.0	0.1	-0.2	0.0	**-0.1**	**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	0.0	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Real GDP	**2.9**	**2.3**	**1.7**	**1.8**	**0.9**	**0.7**	**0.3**	**0.8**	**0.5**	**0.5**	**0.4**	**0.4**	**0.4**	**0.4**	**0.5**
Note: GDP (annualised rate)					*3.5*	*2.9*	*1.1*	*3.1*	*2.0*	*1.9*	*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	2.0	1.8	0.5	0.4	0.3	0.1	0.6	0.4	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**
Core	1.9	1.7	2.0	1.9	0.5	0.4	0.4	0.3	0.5	0.5	**0.4**	**0.5**	**0.5**	**0.5**	**0.5**
Unemployment rate - qtly average (%)	**3.8**	**3.6**	**3.7**	**3.6**	**3.9**	**3.8**	**3.8**	**3.9**	**3.6**	**3.6**	**3.6**	**3.6**	**3.6**	**3.6**	**3.7**
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	2.5	**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	2.0	**1.5**	**1.5**	**1.6**	**1.7**	**1.8**

Source: NAB Group Economics

*Contribution to real GDP growth

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