February 2010

US Q4 GDP

Key points

- The initial print of US GDP growth for the December quarter 2009 came in at 1.4% (or 5.7% annualised), bettering market expectations (of 4.5% annualised). In annual terms, GDP expanded by 0.1% over the year to the December quarter, and overall in calendar 2009, fell by 2.4%.

- The strength in GDP in Q4 partly reflects a sharp reduction in the pace of de-stocking, which added 0.8ppts to quarterly growth. This is more a statement about the natural evolution of the inventory cycle rather than the underlying strength of the economy.

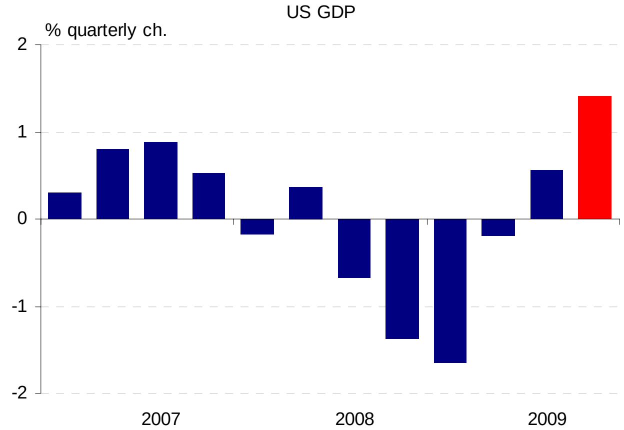
- A better gage of the underlying pulse in the economy, *final sales of domestic product* (which excludes changes in inventories), grew by 0.6% in the quarter, up from 0.4% in the September quarter. While not as spectacular as the headline result, it confirms that a modest recovery is underway in US economy.

- Importantly, key components of private demand including household consumption, equipment and software and residential investment posted solid gains in the quarter.

- Notwithstanding the stronger than expected Q4 outcome, we stand by our earlier assessment that the recovery will be sub-par by historical standards. In particular, much of the economy remains dependent on fiscal and monetary stimulus, which will not be as supportive going forward.

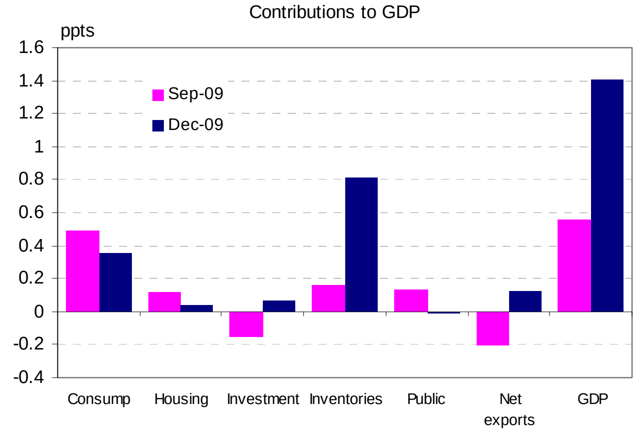
- We have revised up our forecast for US growth in 2010 to 2½% (up from 2¼% previously) to reflect the stronger starting point. We expect growth closer to trend of around 3% in 2011.

GDP growth surged in Q4...



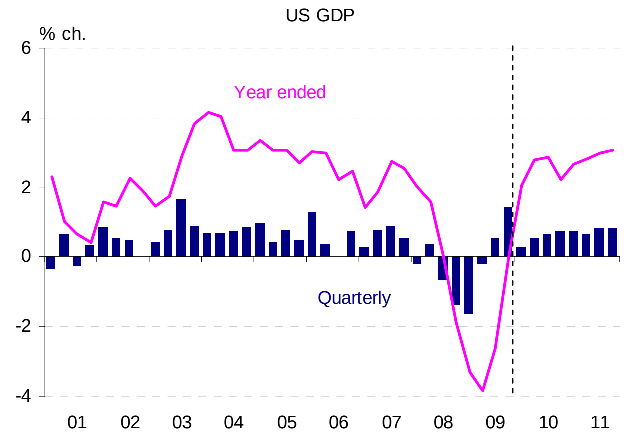
Source: US Bureau of Economic Analysis

...led by a sharp fall in the pace of de-stocking



Source: US Bureau of Economic Analysis

A more moderate expansion is likely through 2010



Source: US Bureau of Economic Analysis

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The details

The initial print of US GDP growth for the December quarter 2009 came in at 1.4% (or 5.7% annualised), bettering market expectations (of 4.5% annualised). In annual terms, GDP expanded by 0.1% over the year to the December quarter, and overall in calendar 2009, fell by 2.4%. There are a number of noteworthy points about the Q4 outcome: on the upside, it is the strongest quarterly rate of growth since the September quarter 2003 and the first time year-ended growth has moved into positive territory since the September quarter 2008; on the downside, highlighting just how deep this recession has been, the average growth rate for 2009 as a whole was the weakest since 1938.

Q4 2009 GDP

	QoQ (%)	QoQ cont. (ppts)	YoY (%)
Consumption	0.5	0.4	1.1
Fixed investment	0.9	0.1	-14.1
Structures	-4.1	-0.1	-24.7
Equip & software	3.2	0.2	-8.7
Residential	1.4	0.0	-12.1
Ch. in inventories		0.8	
Public Demand	0.0	0.0	1.6
GNE	1.2	1.3	-0.9
Net exports		0.1	
Exports	4.2	0.5	-1.7
Imports	2.5	-0.4	-7.7
GDP	**1.4**	**1.4**	**0.1**

Source: US Bureau of Economic Analysis

The strength in GDP in Q4 partly reflects a sharp reduction in the pace of de-stocking, which added 0.8ppts to quarterly growth. This says more about the natural evolution of the inventory cycle than anything about the underlying strength of the economy: businesses have already run inventories down to record lows over the past few years and simply cannot continue to reduce them much further, or at least not at the pace that they have been; in national accounting terms, this translates to positive growth.

A better indication of the underlying pulse in the economy, *final sales of domestic product* (which excludes changes in inventories), grew by 0.6% in the quarter, up from 0.4% in the September quarter. While not as spectacular as the headline result, it confirms that a modest recovery is underway in US economy.

One of the more encouraging aspects of the Q4 report was a 0.5% lift in household consumption. This was the second consecutive quarter of *solid* growth and came despite the impact of the withdrawal of the 'cash for clunckers' fiscal incentive which underpinned a small fall in consumption of durable goods (not to mention double-digit unemployment). Consumption of non-durables and services both increased at the strongest quarterly pace in a number of years.

Elsewhere, fixed investment grew for the first time since the June quarter 2007, supported by various fiscal incentives. Investment in equipment and software was particularly strong, growing 3.2% in the quarter underpinned by tax breaks included in the fiscal stimulus package, while residential investment increased by 1.4% in the quarter on the back of the first homebuyer tax credit. Partly offsetting this however was a 4.1% fall in non-residential structures investment, which is now down almost 25% over the year.

Public demand continues to track well below its long-run average growth rate, presumably reflecting the impact of constraints on finances at all levels of government. Meanwhile, net exports contributed marginally to GDP growth in the quarter, with a strong rise in exports (+4.2%) only partly offset by a more modest rise in imports (+2.5%).

Assessment

Whichever way you cut it this was a good economic report card. Movement in stocks aside, key components of private demand – particularly household consumption –posted solid gains, confirming that the recovery is now well and truly in train.

But we do need to be careful about extrapolating last quarter's outsized gains going forward: there were enough clues in the Q4 report to suggest that our earlier assessment that the recovery will be sub-par by historical standards remains intact.

For starters, while the current low level of stocks virtually guarantees that it will continue to exert a positive influence on growth through 2010, it will probably not be as large as was the case in Q4.

Also, much of the economy remains dependent on government aid, which is temporary. Household incomes continue to be propped up by a combination of tax cuts and unemployment and welfare benefits, some of which is scheduled to recede or expire. Against this backdrop, and with unemployment likely to continue rising till around the middle of the year, growth in household consumption looks to be constrained in the near term.

The outlook for business investment looks similarly tepid. Investment in equipment and software will ease from the rate in Q4 as the stimulus from fiscal measures recedes, while prospects for a turnaround in non-residential structures looks remote in the near term with low levels of resource utilisation, falling commercial property prices and uncertain demand weighing on the sector. In contrast residential investment looks to have bottomed, though a meaningful recovery from almost four years of recession in that industry will not occur till significant inroads have been made into the unemployment rate, probably not till 2011.

Public finances at all levels of government remain severely impaired and pressure to rein in discretionary spending will likely see public demand continue to track below its long-run average rate through 2010. Meanwhile, external demand will have a broadly neutral impact on growth through 2010 as solid growth in exports is offset by the impact of the recovering domestic economy on growth in imports.

We have revised our forecasts for US growth up following the stronger than expected result in Q4 though but the broad outlook for a sub-trend recovery in 2010 building to more normal rates of growth in 2011 remains. GDP growth is now expected to be 2½% in 2010 (up from 2¼% previously) and around 3% in 2011.

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