ECONOMIC RESEARCH

The NewsLine

January 25, 2016

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USA

An incongruous end to 2015

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At the end of this week the Bureau of Economic Analysis will publish the initial estimate for GDP in the final quarter 2015. The general expectation is that growth will be disappointing. A weak outcome does not necessarily presage ongoing subdued economic activity. In the current cycle we have seen a number of quarters in which the rate of expansion in GDP was close to zero or even lower. And the underlying weakness of demand-side indicators contrasts starkly with the very dynamic development on the labor market. A more coherent picture of the shape of the US economy at the end of last year will possibly only emerge in the course of data revisions.

Following a solid performance in the two middle quarters of the year, the US economy probably expanded at an annualized quarterly rate of only around 1% in the final quarter 2015. A significant drag probably came from the ongoing cutbacks in inventory investment. Although this also resulted in a more moderate expansion in imports, the persistent weakness of exports suggests that foreign trade again made a negative contribution to growth. And the ongoing slide in energy-sector investment curbed the expansion of private fixed nonresidential investment. In addition, the trend in public-sector construction spending points to a more subdued increase in government spending. Private consumption has also lost steam. This was in part due to temporary factors, with relatively mild temperatures curtailing energy demand. The marked drop in industrial production was largely due to the decline in utilities output.

The evidence for clearly subdued economic growth is hard to reconcile with the sharp acceleration in jobs growth seen in the fourth quarter. With the upward revisions for October and November and the increase of 292,000 in

December, an average of 284,000 jobs a month were created in the nonfarm sector – a good 100,000 more than in the preceding quarter. What is more, the increase in jobs in December was broad-based. Aggregate hours worked in the private sector rose by 0.5% on the preceding quarter or – looking solely at nonsupervisory employees – by a strong 0.7%. Although employment reacts to changes in economic activity with a time lag, our calculations show the highest correlation between the rate of change in hours worked and the contemporaneous and preceding period's rate of change in real gross value added of the nonfarm business sector. Accordingly, assuming annualized growth of only 1% in real output, one would expect to see only a marginal increase in hours worked.

Dips in labor productivity on a quarterly comparison are nothing unusual for the current cycle. However, it should also be borne in mind that the data available so far possibly understate economic activity. Hefty discrepancies between the labor market data and demand-side indicators are evident for instance in the construction sector, where aggregate hours worked in the fourth quarter rose by more than 3% on the preceding quarter (not annualized). This was the steepest increase since mid-2014. But at the same time (nominal) construction spending in October and November was only 0.4% up on the level seen in the third quarter. Against this backdrop, a subsequent upward revision of this demand component looks very likely.

For the current quarter there are no "hard" indicators available as yet. However, initial survey results for January support our view that that US economy can notch up growth of 2½% (annualized rate). For instance, the consumer sentiment index compiled by der University of Michigan improved further despite the sharp swings on the financial markets. This underpins our expectation that the spending leeway fueled by solid real income gains will also be exploited in the coming months. At the same time, the upbeat sentiment still prevailing among homebuilders and the fact that, at the end of 2015, building permissions were a good 8% higher than housing starts, suggest that residential construction is set to remain on an upward path. Housing starts remain well below their longer-term average. Finally, we should bear in mind that government spending this year is poised to make the first tangibly positive contribution to growth since 2009, with Congress having agreed to raise the federal budget spending ceiling in early November.

Against this backdrop, the rebound in the purchasing managers' index (Markit) for the manufacturing sector is a positive. According to provisional figures, a brighter assessment of new orders and production contributed to the recovery. Domestic demand is evidently providing the sector with adequate

support despite the ongoing adjustment in the energy sector and the awkward external backdrop with the steep rise in the effective exchange rate of the US dollar. Nonetheless, any further appreciation would make life very difficult.

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