



Economics

US: Despite Q1 lull and dollar appreciation, trend growth will continue to improve

- The economy is projected to grow 2.4% in Q1 2015, nearly the same pace as the previous quarter. The inability of the economy to sustain a 3%-plus growth rate in the first quarter is due to several transitory factors, which we expect to dissipate in Q2. Consequently, similar to last year, we expect economic activity to rebound over the next couple of quarters. The biggest risk to growth is from an appreciating dollar. However, we believe that most of the dollar strength will be offset by the fall in energy prices, which will significantly boost real income. At the same time, the outlook for interest rates is much more benign, as the timing and glide path of the fed funds rate has been significantly reduced. This, too, will help offset some of the projected weakness in net exports. Therefore, financial conditions have not tightened enough for us to mark down our full-year GDP forecast. Moreover, to the extent that monetary policymakers are projecting less tightening than before, recent dollar appreciation, which has been on a torrid path, is likely to moderate.
- Given the lags between changes in the trade-weighted dollar and net exports, the economy has yet to meaningfully feel the impact of the appreciating dollar. If its current level is maintained or if the dollar appreciates further, net exports are poised to be a significant drag on economy activity. At the same time, the strong dollar will weigh further on import prices and hence consumer goods inflation. Based on the appreciation to date, we estimate the rise in the dollar is worth roughly 50 basis points of monetary tightening. However, overall economic activity may not be meaningfully compromised because a stronger dollar will keep interest rates lower than would otherwise be the case, which should help housing-related spending. Additionally, to the extent that the rising dollar has helped dampen inflation both through lower energy prices and eventually even lower goods prices, real wage growth will be lifted. This is a meaningful tailwind for consumers, who dominate US aggregate demand. Ultimately, the appreciating dollar may simply alter the composition of real GDP growth and not the trajectory of growth. This is why we have not changed our longer-run forecasts for the economy.
- The economy has generated 3.3 million jobs over the past 12 months, the strongest pace since March 2000, when interest rates were much higher. In 2000, the fed funds rate was 6.0% and inflation-adjusted fed funds, using the headline personal consumption expenditures deflator, was 3.13% at that time. Even with a strengthening dollar and the expectation of a rising fed funds rate, monetary policy will remain highly accommodative for the foreseeable future.

Figure 1: Macro-economic activity & inflation forecasts: US

Economic activity (% qoq, %a)	2014				2015				2014 % yoy	2015F % yoy	2016F % yoy
	Q1	Q2	Q3	Q4	Q1F	Q2F	Q3F	Q4F			
GDP	-2.1	4.6	5.0	2.2	2.4	4.0	3.2	3.1	2.4	3.3	3.1
Private consumption	1.2	2.5	3.2	4.4	3.9	3.4	3.3	3.3	2.5	3.6	3.1
Investment (inc. inventories)	-6.9	19.1	7.2	3.7	-5.3	10.2	9.1	8.3	5.8	4.8	7.7
Gov't consumption	-0.8	1.7	4.4	-1.9	2.0	2.6	2.6	3.0	-0.2	1.8	2.9
Exports	-9.2	11.0	4.6	4.5	1.0	0.0	-3.0	-4.0	3.2	1.6	-1.6
Imports	2.2	11.3	-0.9	10.4	-1.0	3.0	4.0	4.0	4.0	3.5	4.6
Contribution (pp): Stocks	-1.2	1.3	-0.1	-0.1	-0.9	0.7	0.2	0.0	0.0	0.0	0.0
Net trade	-1.6	-0.3	0.7	-1.0	0.3	-0.5	-1.0	-1.2	-0.2	-0.3	-0.9
Industrial production	n.a	4.1	4.5	3.9							
Unemployment rate, %	6.6	6.2	6.1	5.7	5.5	5.2	4.9	4.7	6.2	5.1	4.5
Prices & wages (% yoy)											
CPI	1.4	2.1	1.8	1.2	0.5	0.1	0.5	1.4	1.6	0.6	2.6
Core CPI	1.6	1.9	1.8	1.7	1.6	1.6	1.8	2.0	1.7	1.7	2.5
Producer prices	1.6	2.8	2.4	0.7	-1.0	-1.8	-1.0	1.3	1.9	-0.6	3.8
Compensation per empl.	3.1	1.8	2.4	2.5	1.6	2.7	2.9	3.4	2.5	2.7	4.2
Productivity	0.6	1.1	1.2	-0.1	1.5	1.1	0.5	1.3	0.7	1.1	1.3

Source: National authorities, Deutsche Bank Research