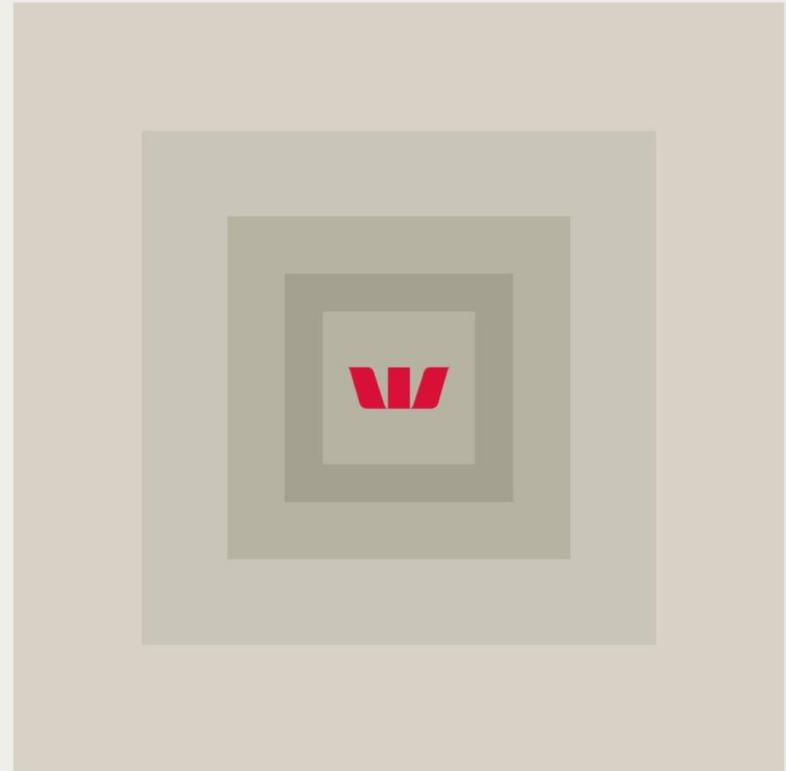


Northern Exposure

United States

October 2014



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Themes

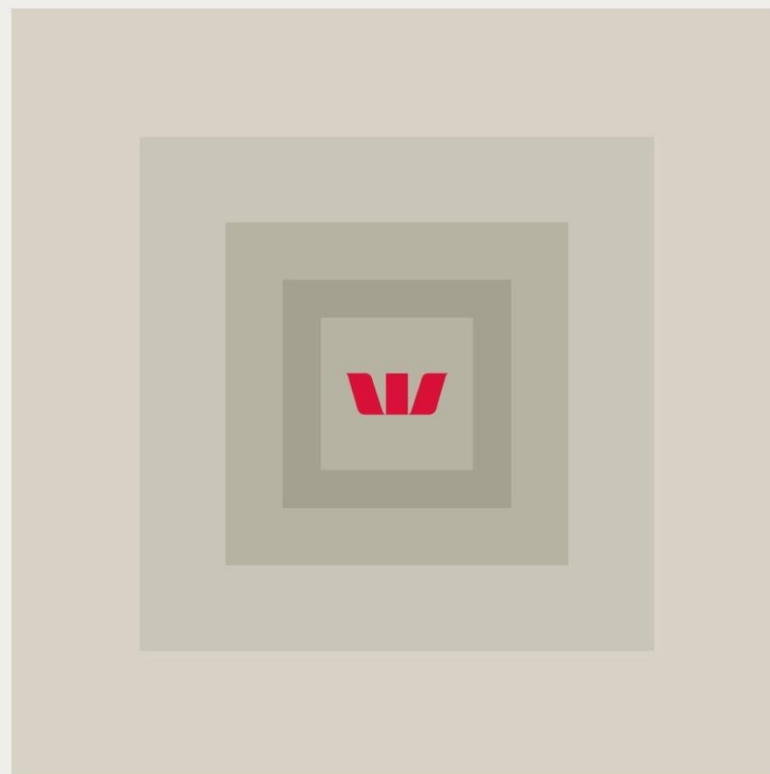
- The US labour market continued to add jobs at pace in September, with 248k positions created in the month and back revisions of +69k.
- The unemployment rate fell to just 5.9% as the participation rate continued to trend lower; 62.7% is a new 36-year low for participation.
- Despite the strong payrolls outcomes of 2014, substantial slack remains in the labour market; continued robust gains are necessary for it to dissipate over the coming 12 to 18 months.
- Labour market slack is an amorphous concept, but it is most clearly seen in: the prevalence of part-time and temporary work; the skew in job creation towards low-paid positions; and historically-low participation amongst prime-aged and young workers.
- Inflation remains benign at present, and this is expected to remain the case hence; discretionary price pressures are limited.

Themes

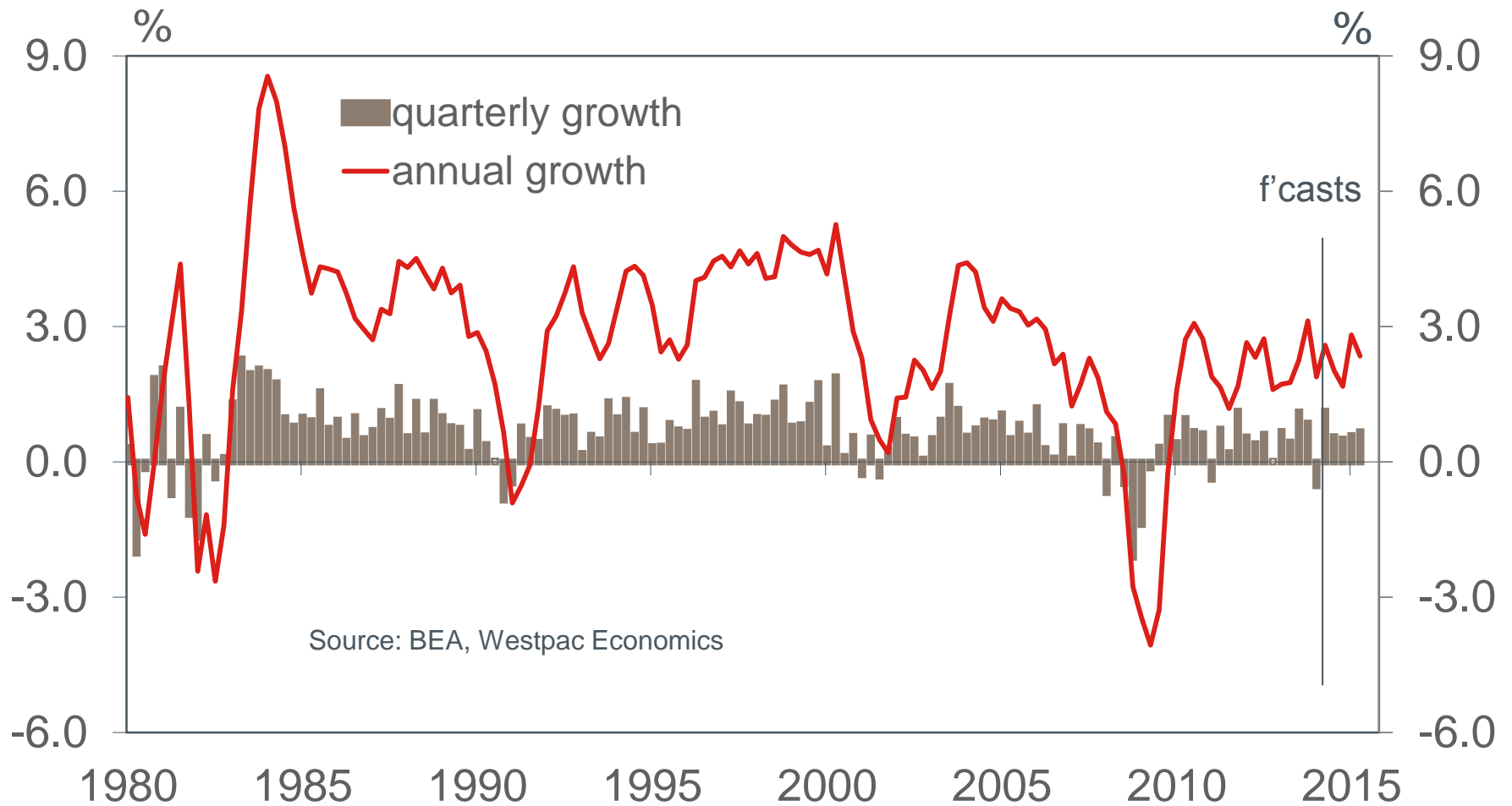
- Despite the strength apparent in job creation, the housing market remains in a fragile state.
- Mortgage approvals continue to trend down, with net mortgage credit creation at banks and the GSE's limited. Key to this weakness is previously incurred debt (mortgage; student; and auto loans) and the underutilisation of workers.
- Financial markets continue to benefit from the liquidity provided by the Federal Reserve: equities have held onto gains and volatility remains low.
- But the direct benefit received by households has been limited; by and large, this sector has chosen to not increase their market exposure.
- For the FOMC, further healing is necessary before rate normalisation can begin. The lower bound is not a comfortable place, but the consequences of an over-zealous tightening cycle would be much greater.

Growth overview

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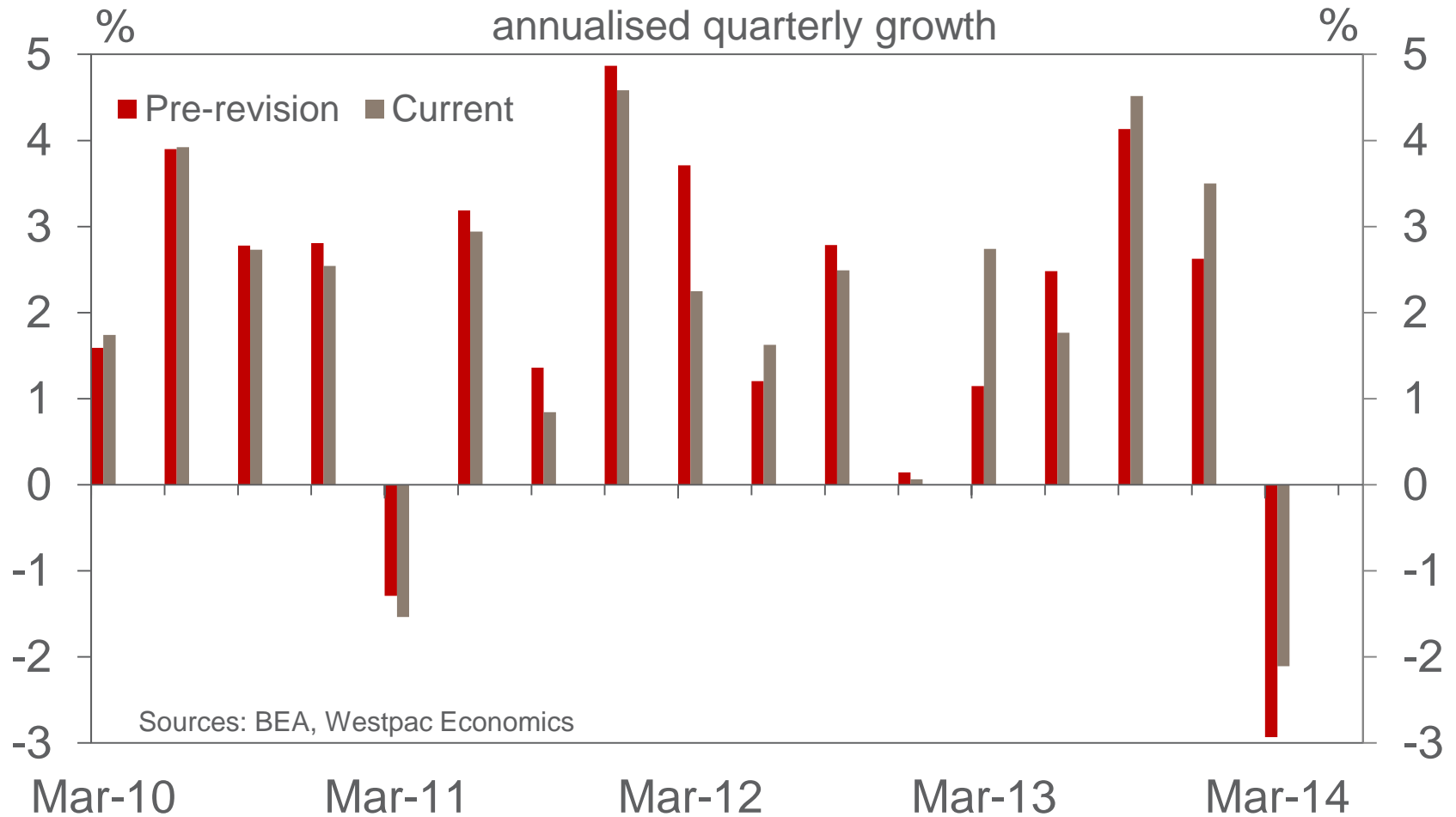
US GDP



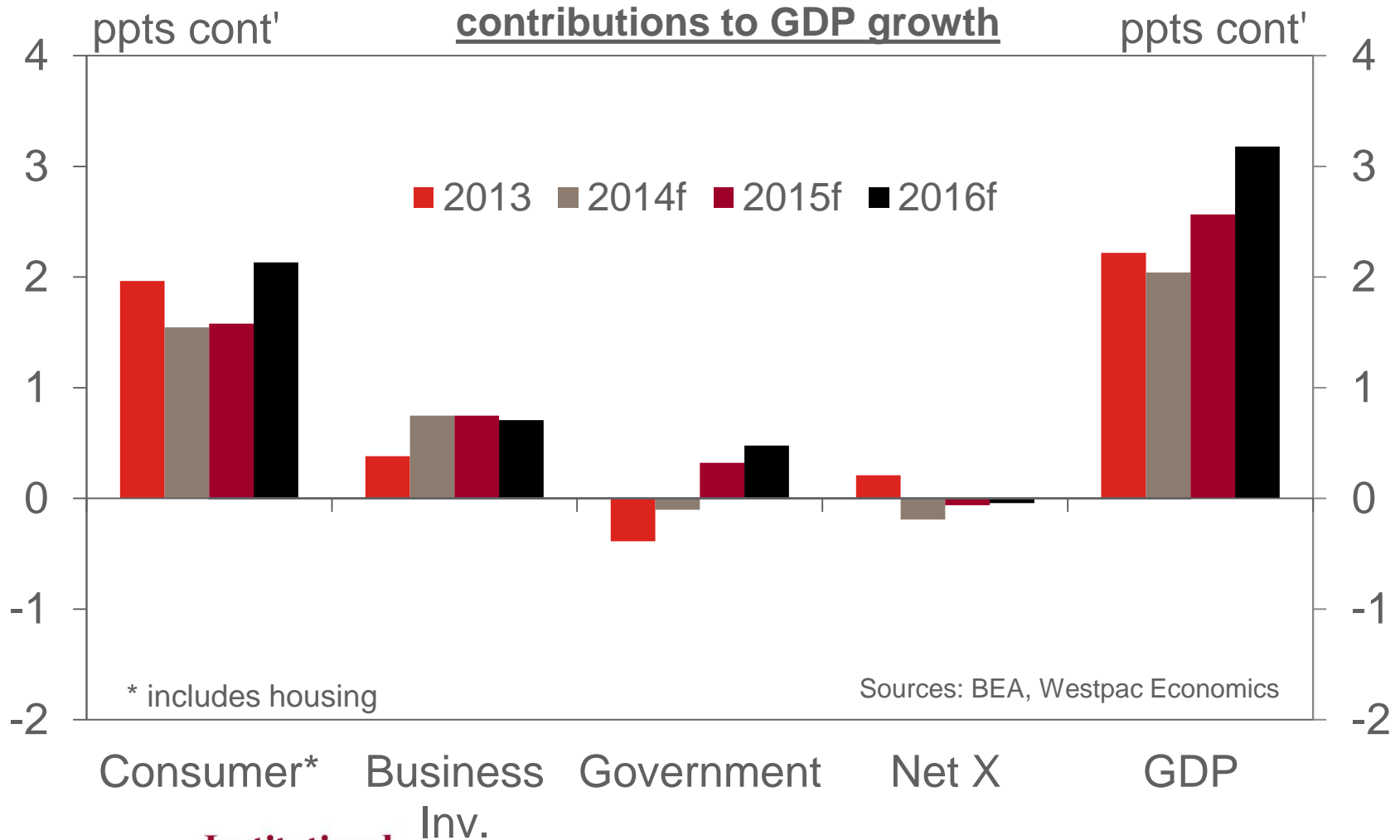
Historical overview: pre and post 2014 revisions



Revisions quarter by quarter

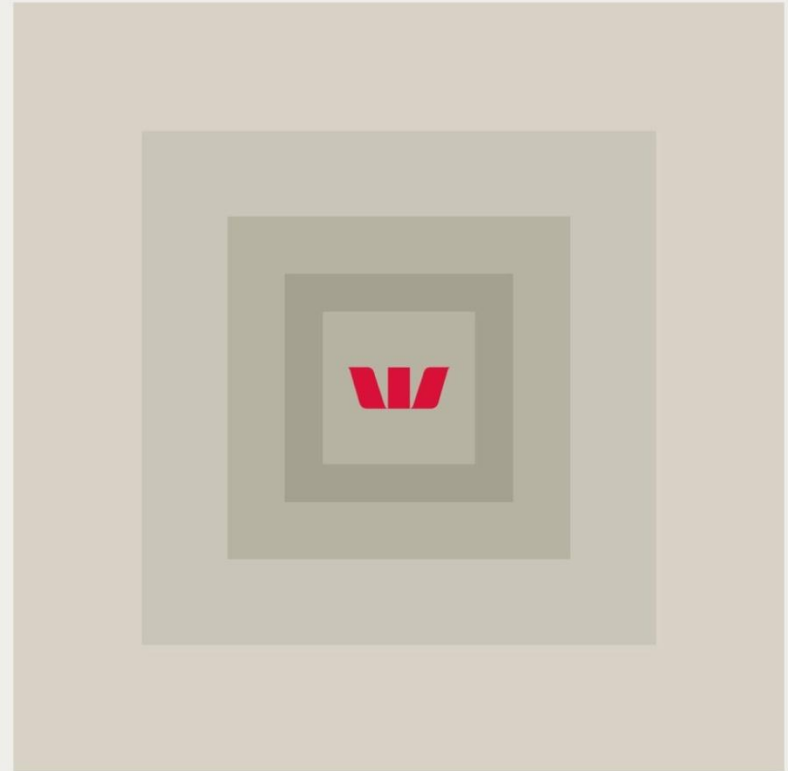


Year-average US GDP growth by sector

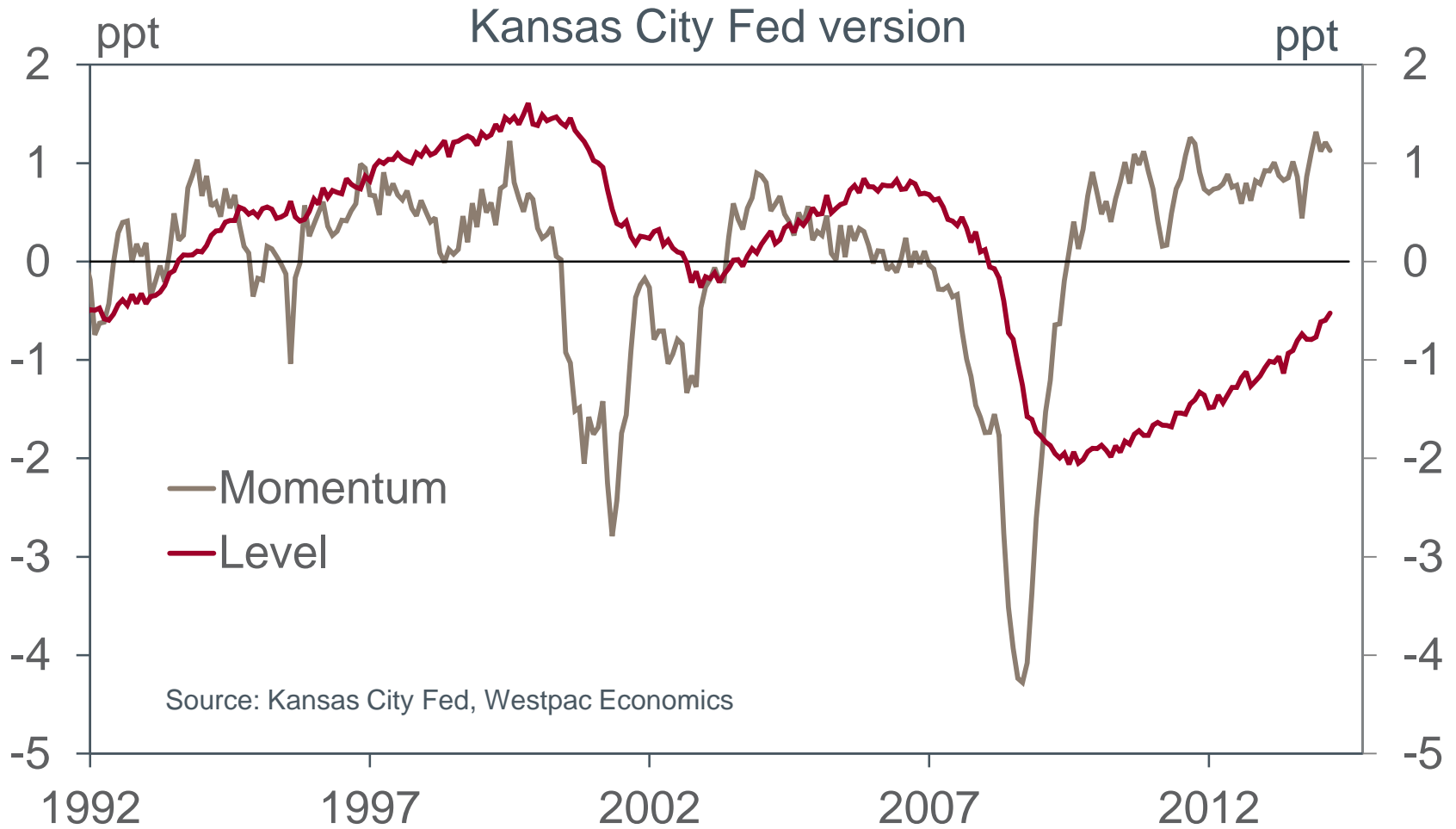


Labour market

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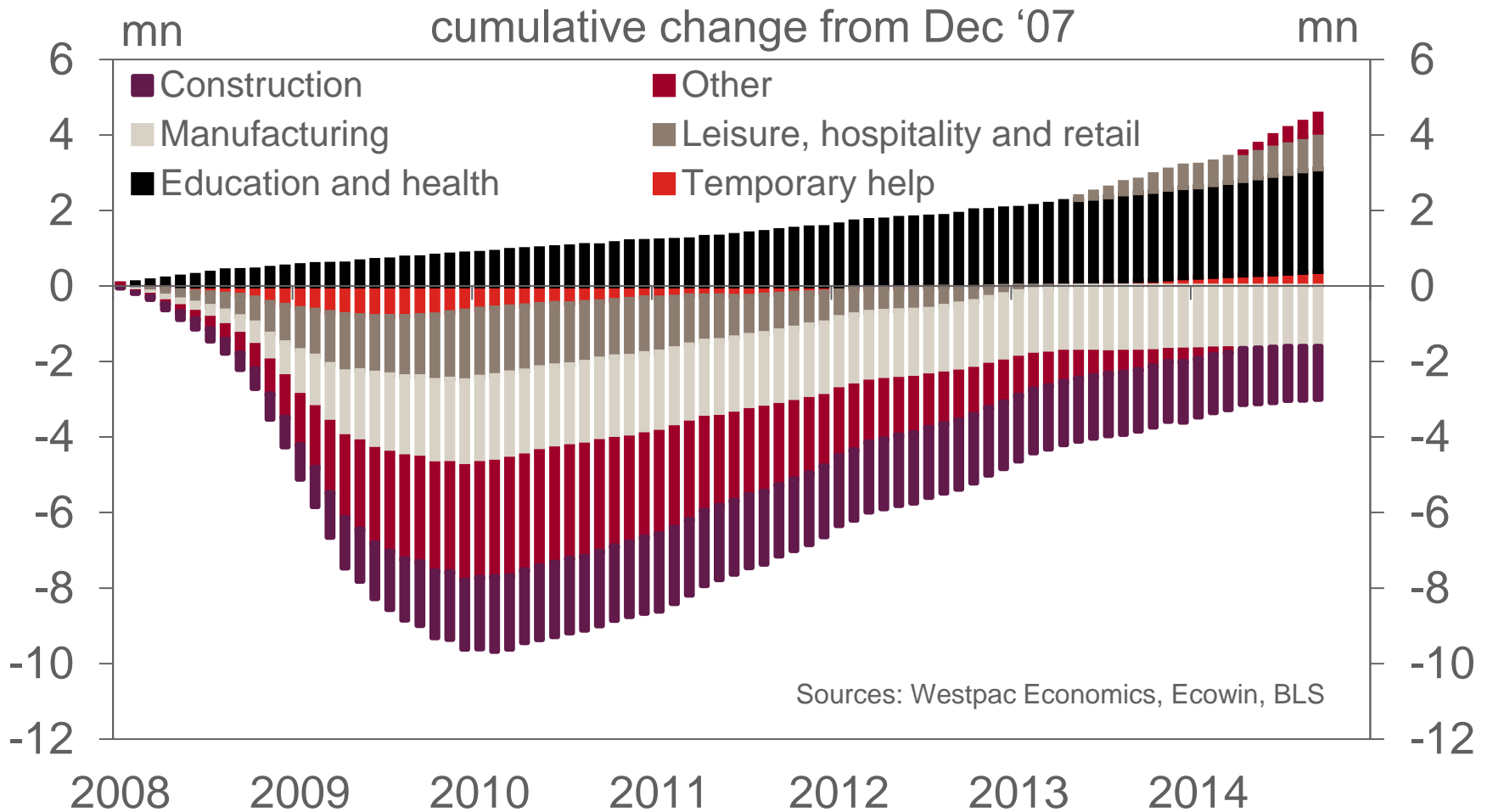
Labour market conditions indices



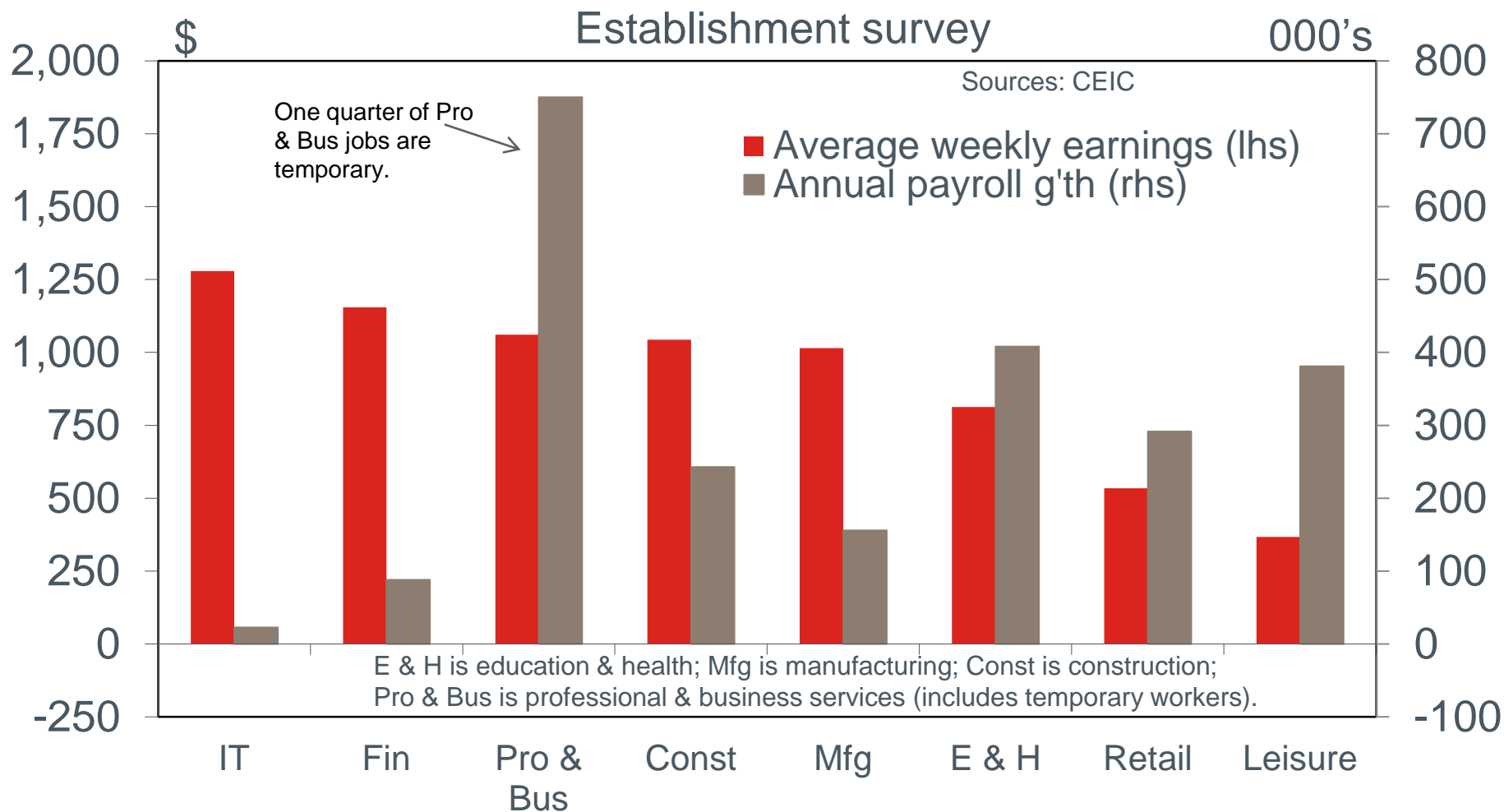
US jobs: cumulative improvement continues



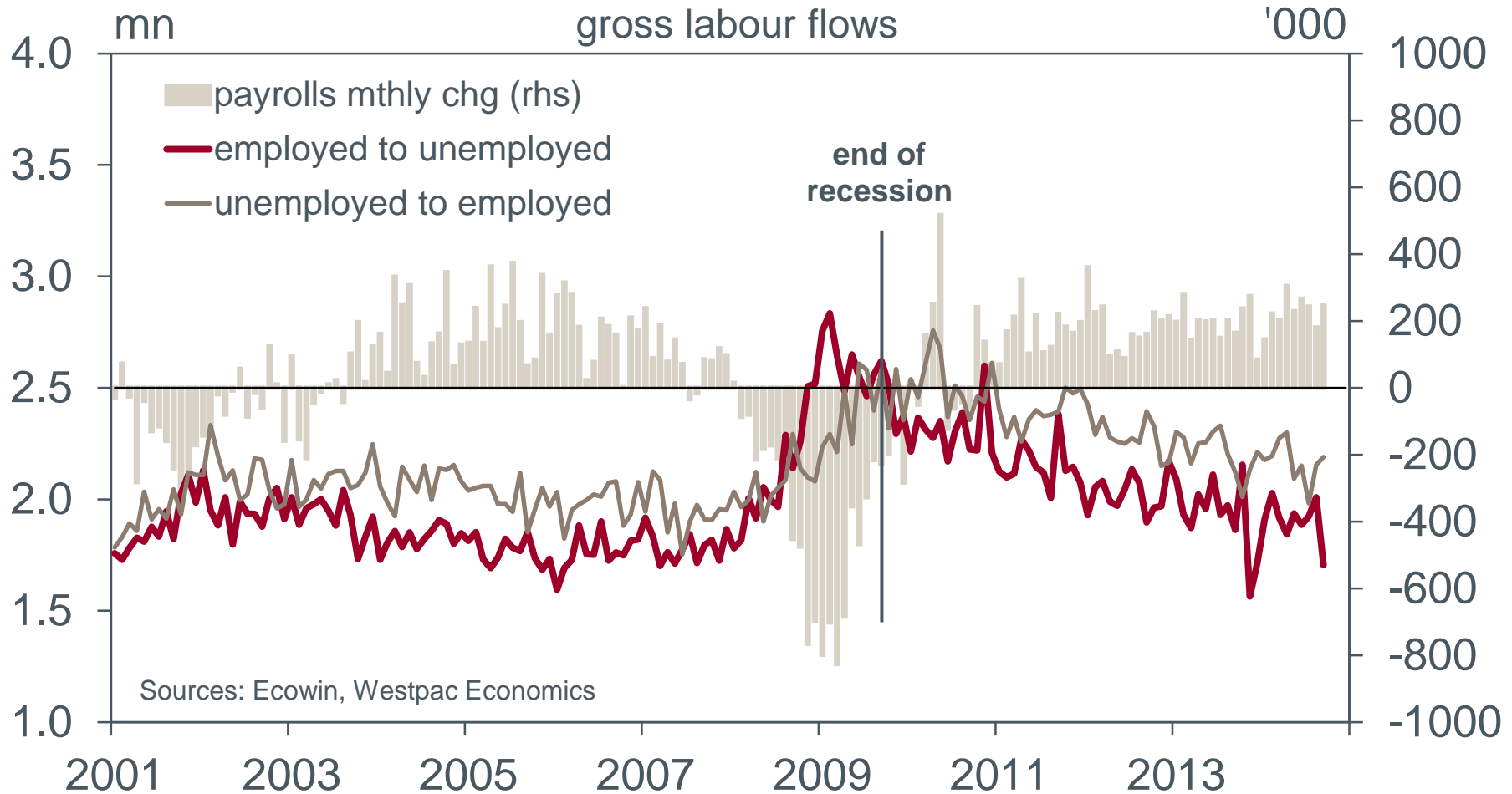
US private payrolls by industry



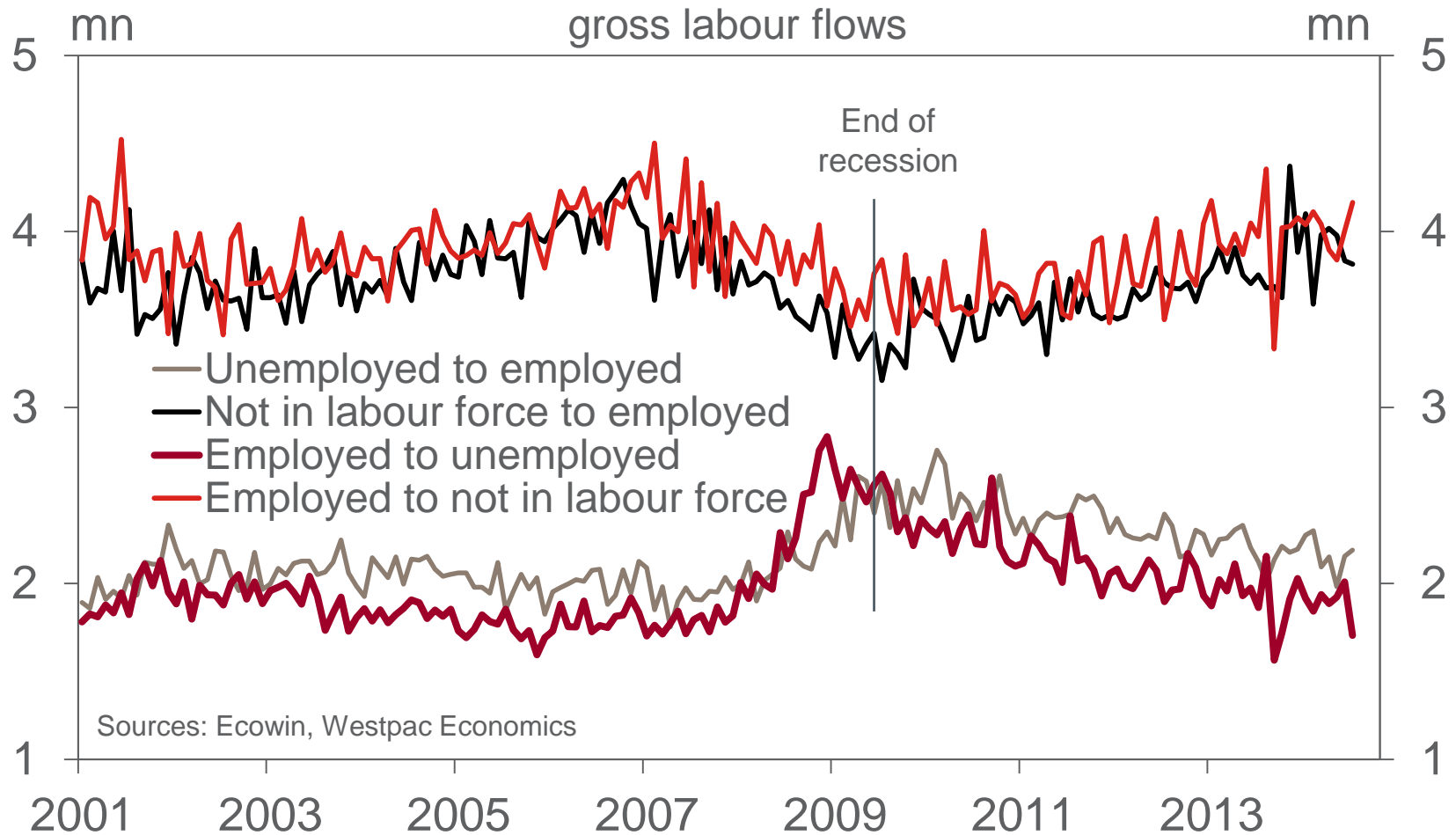
Significant hiring in low-paid sectors



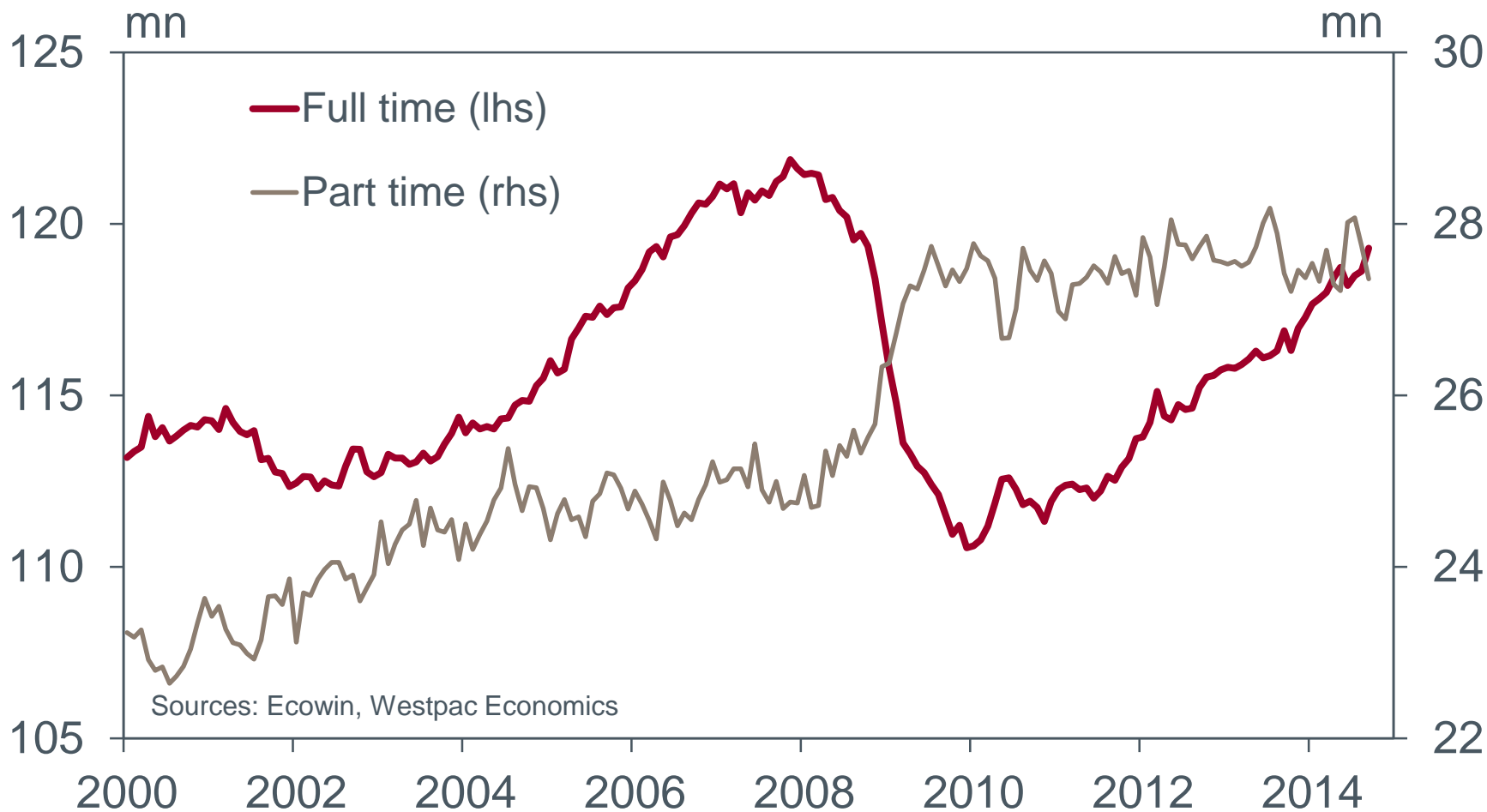
Net jobs growth mainly due to firing downtrend



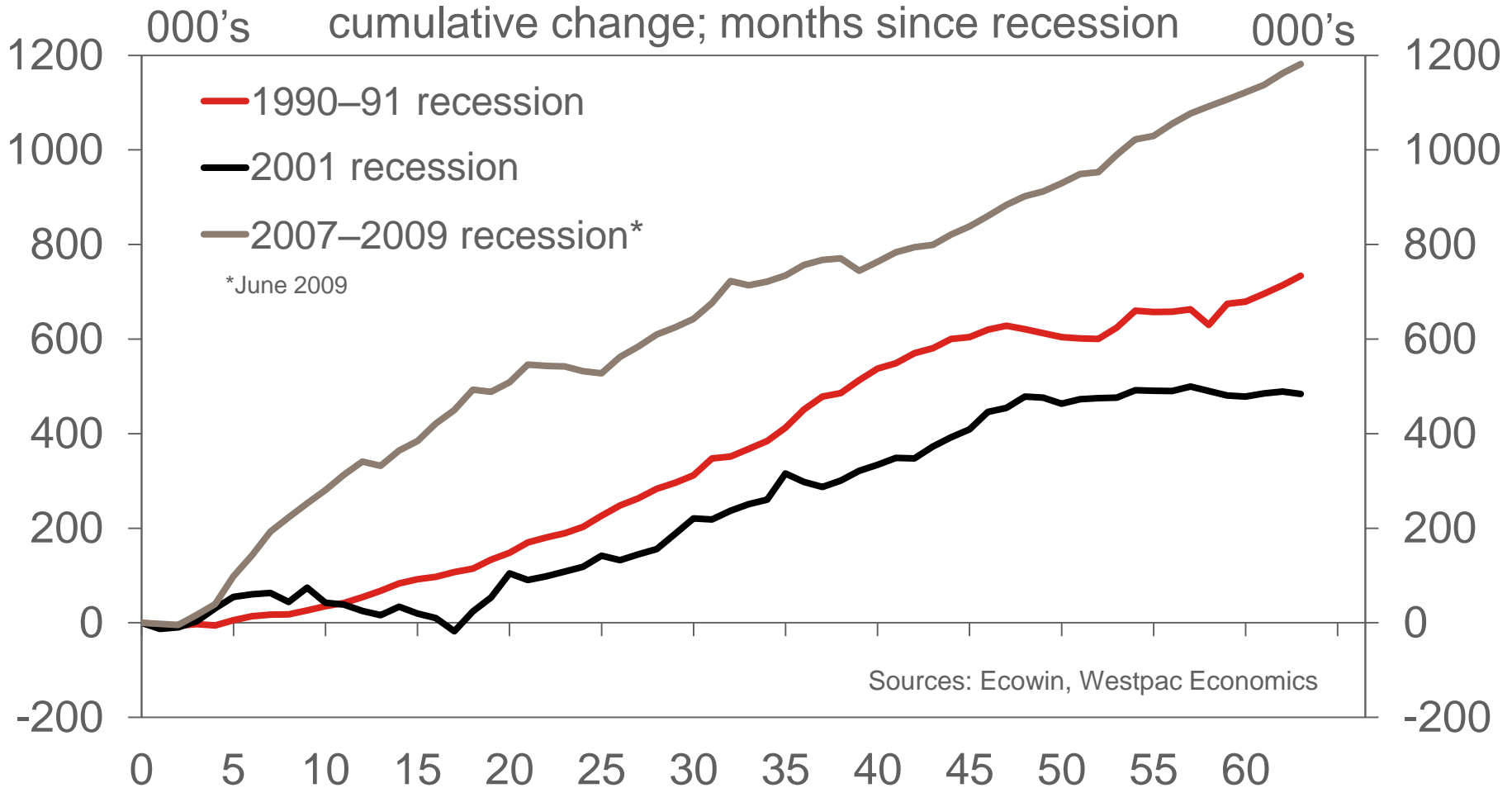
Transition in and out of labour force key



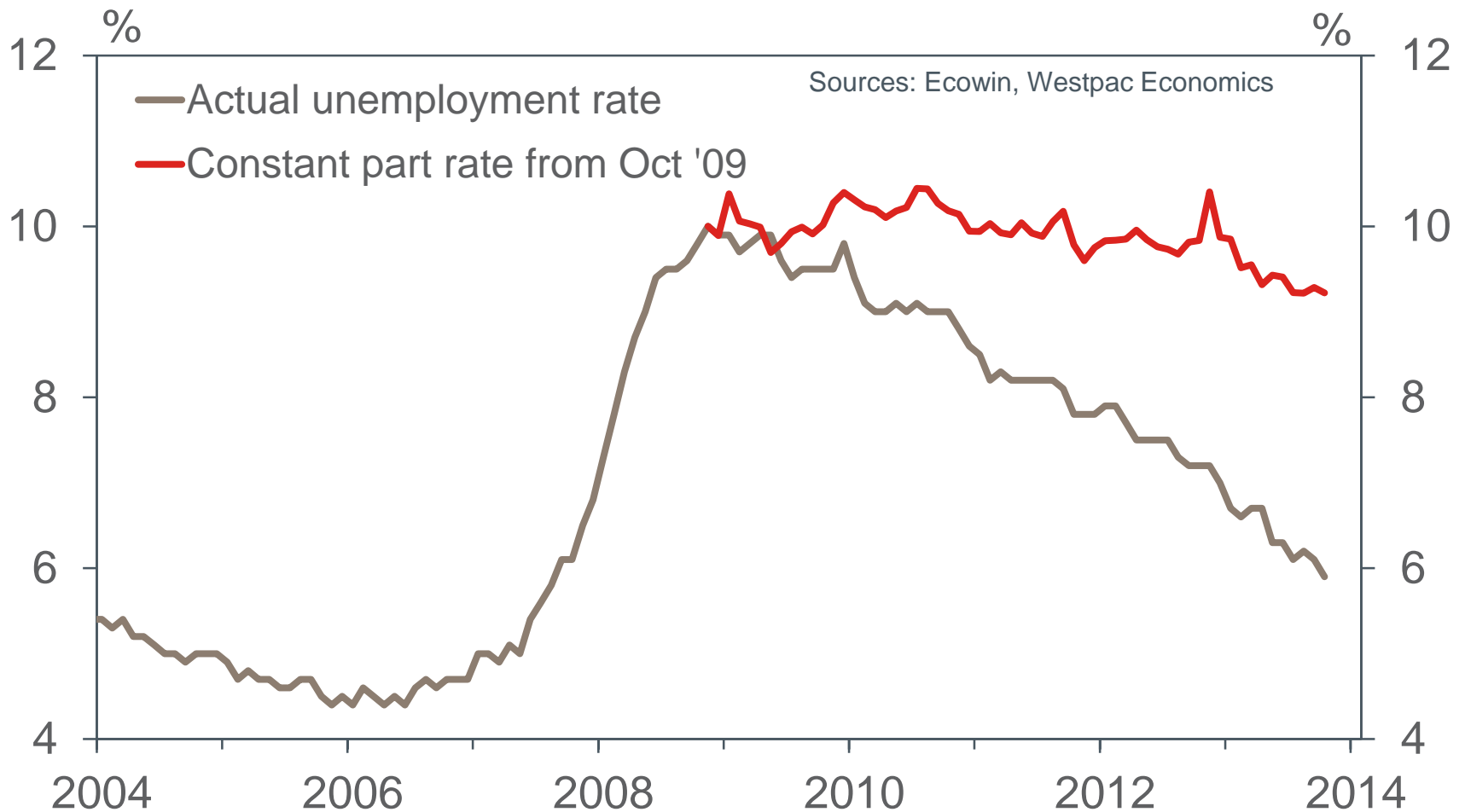
Prevalence of part-time workers persists



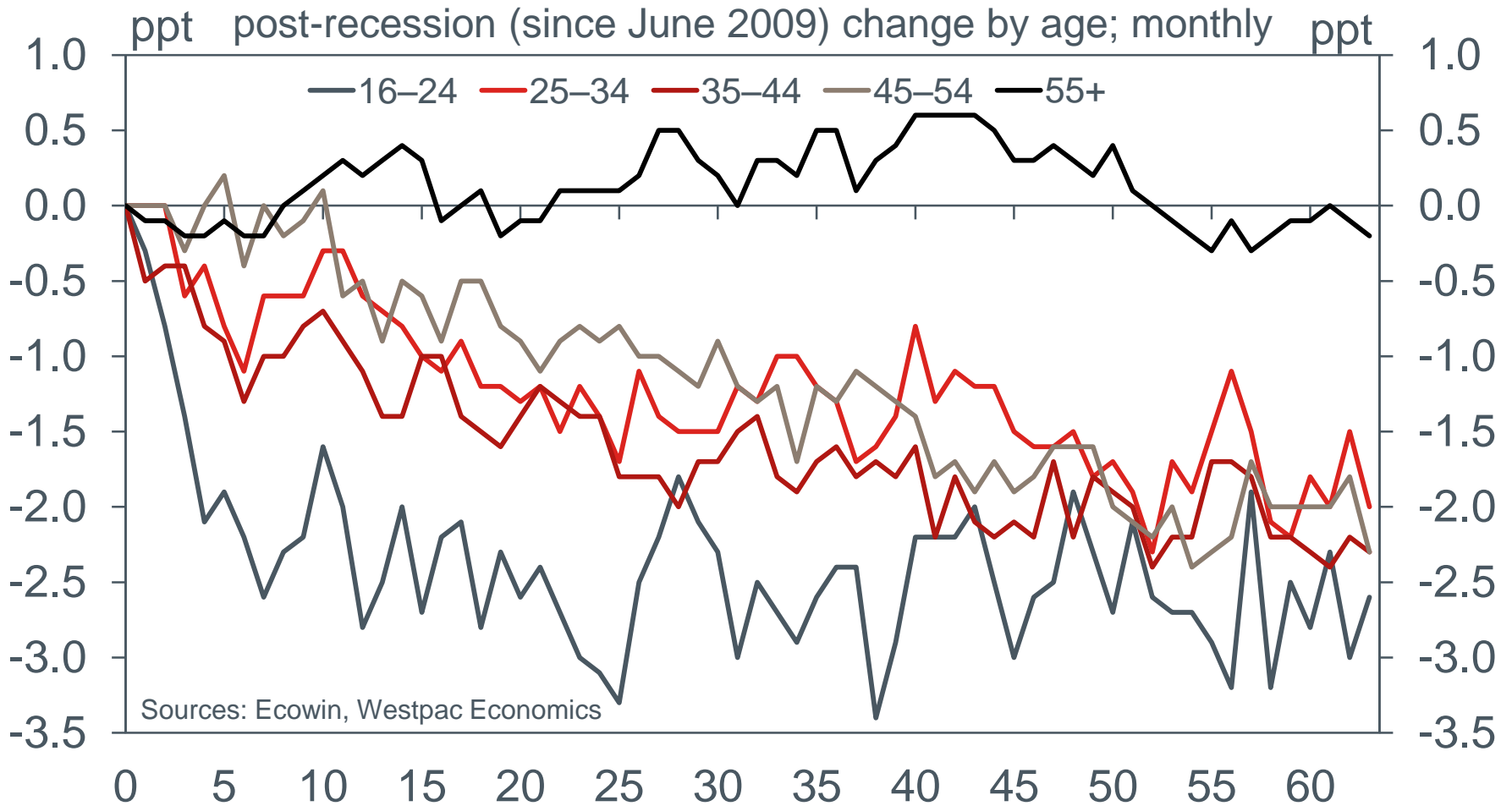
Temp hires: lower job security and less benefits



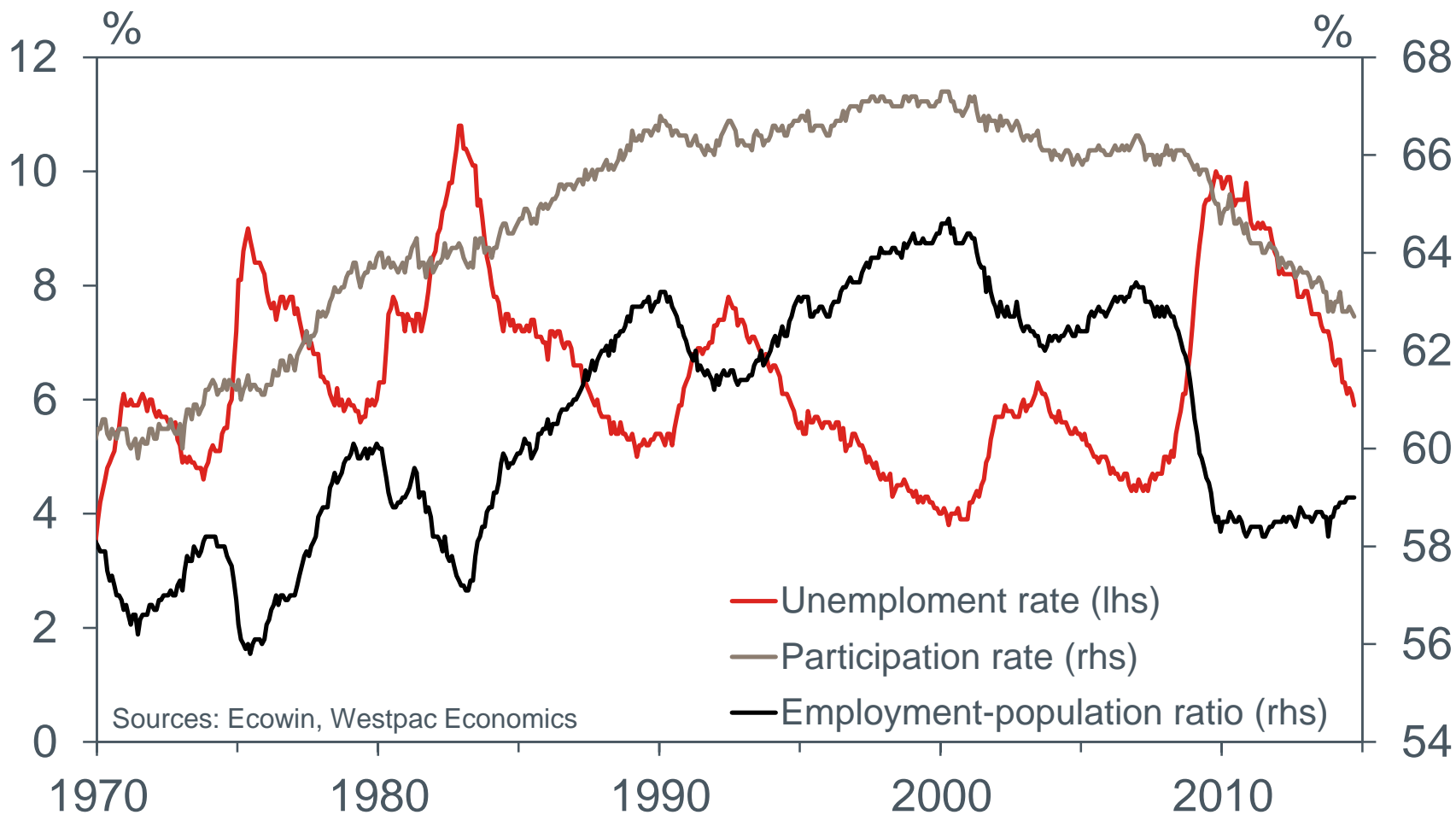
Fall in unemployment driven by part rate decline



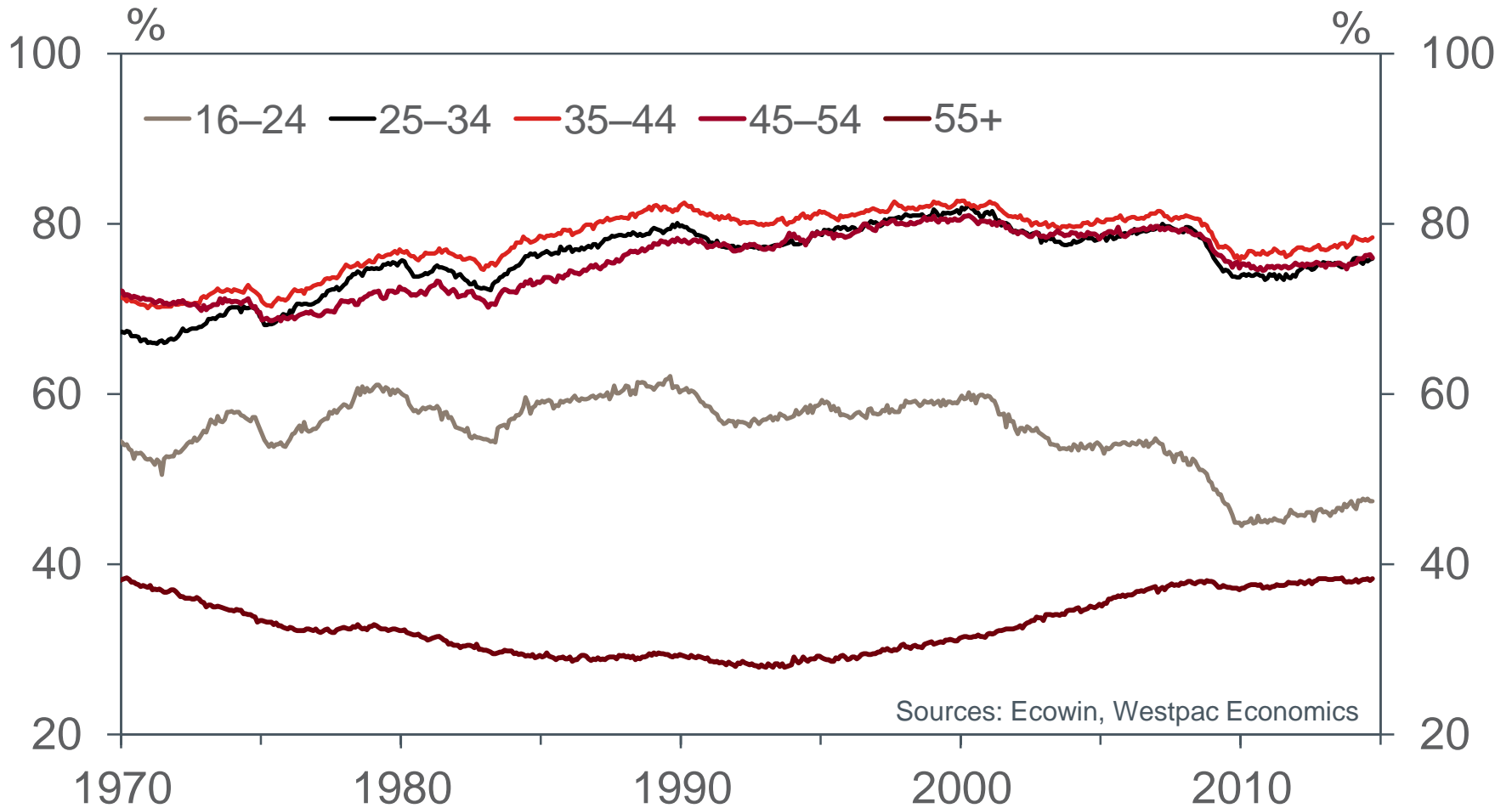
Participation rate for prime workers near lows



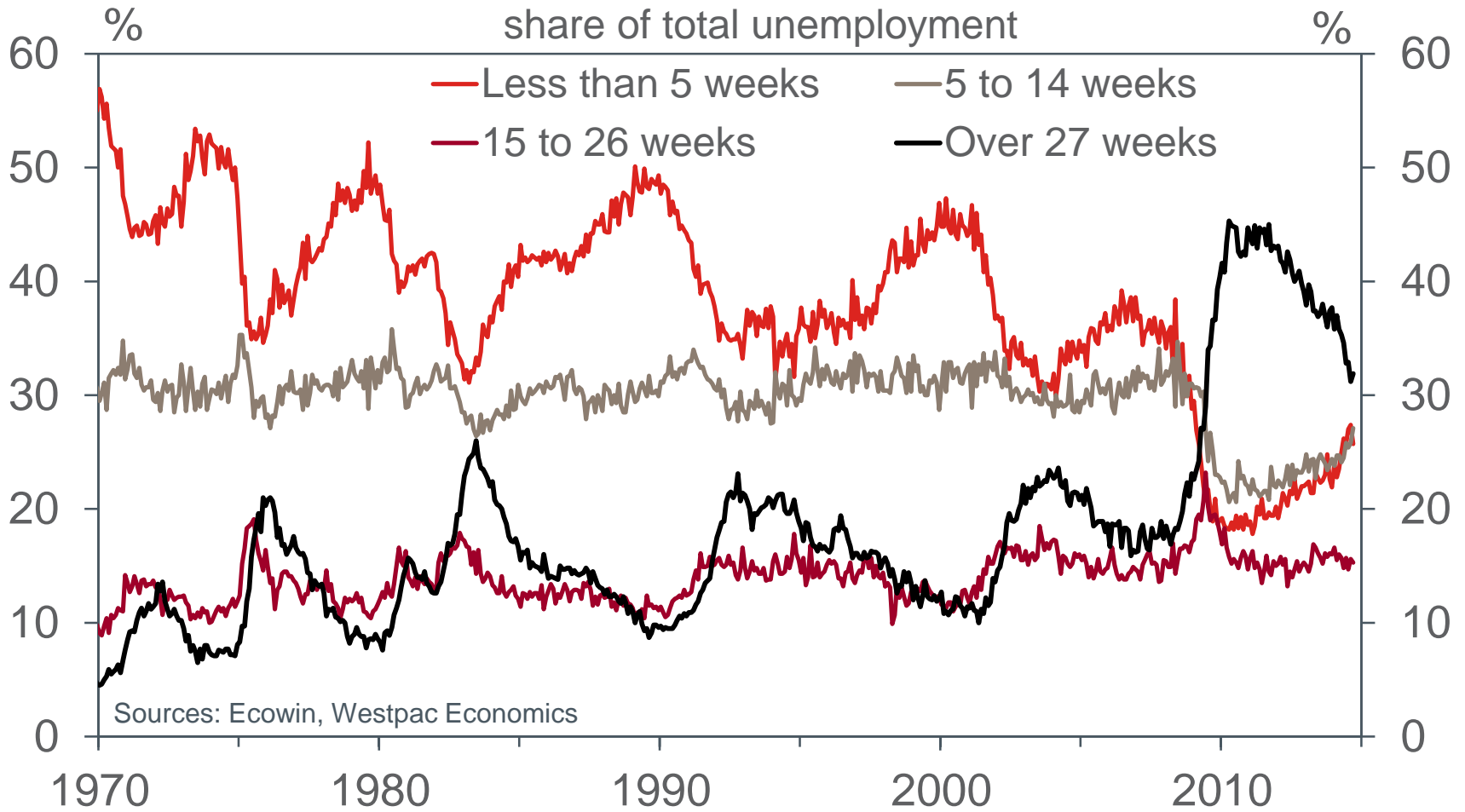
US employment to population ratio still near low



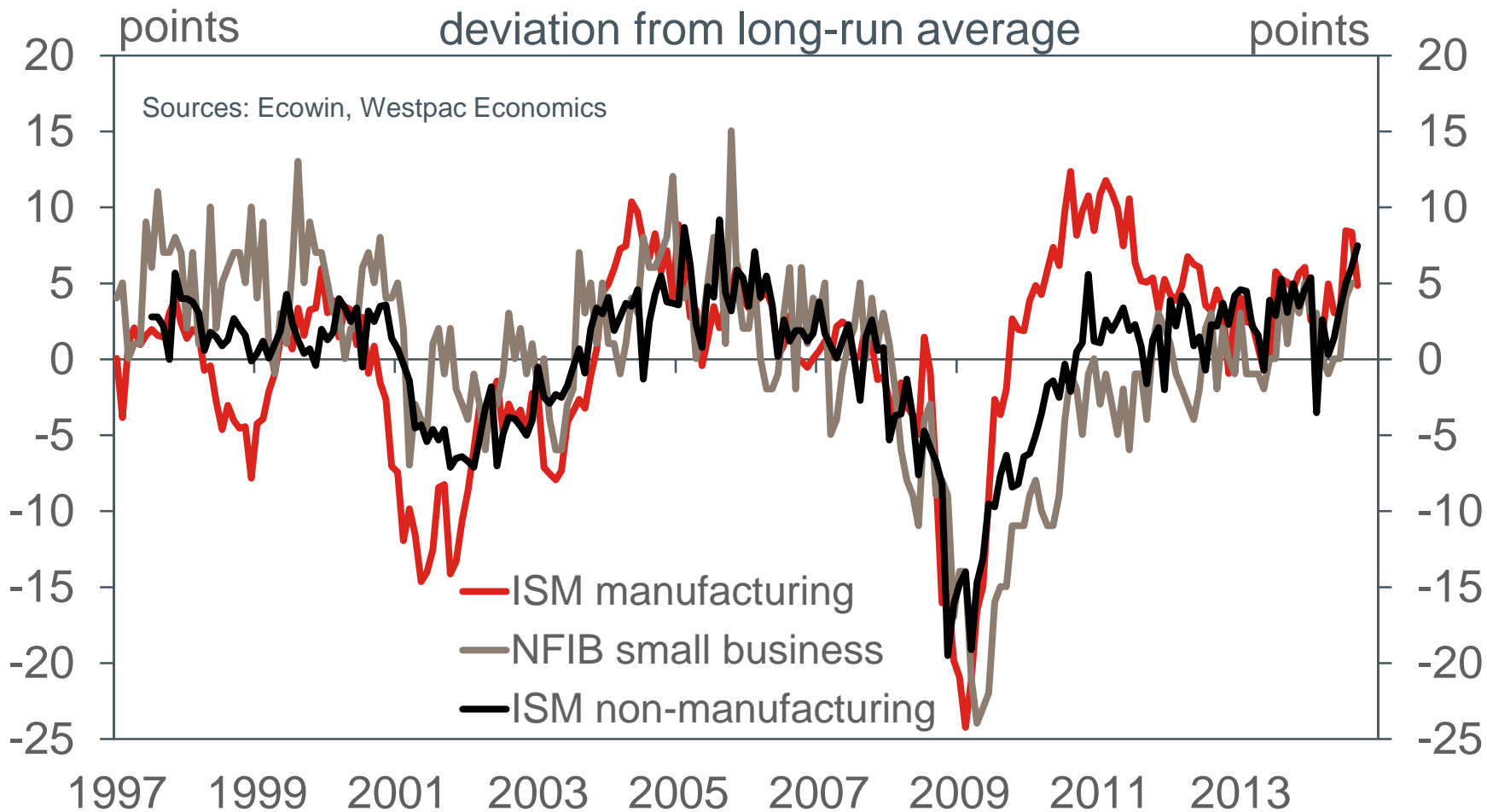
Employment to pop'n ratio, weak among young



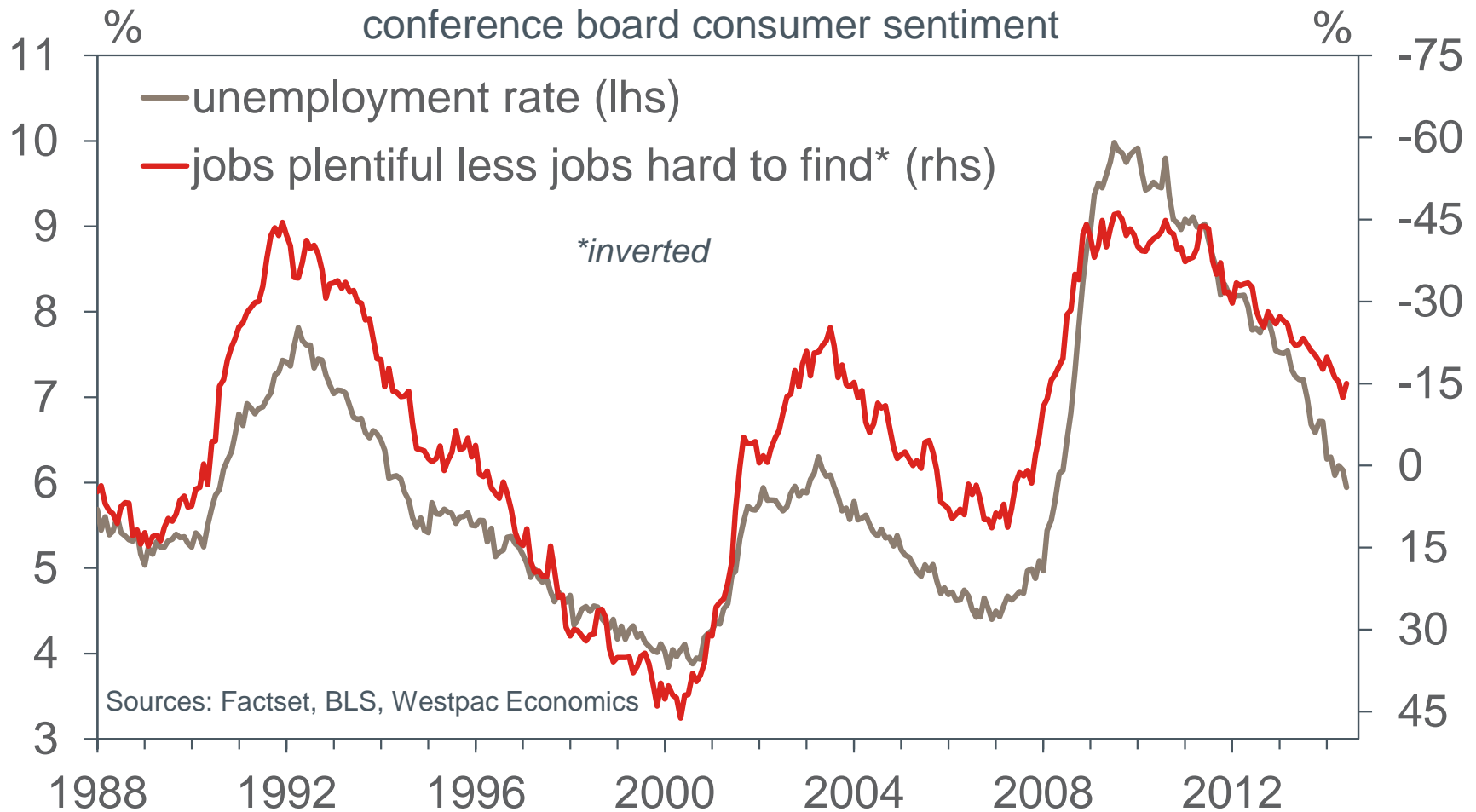
Long-term unemployment trending down



Employment indicators jumped *after* payrolls

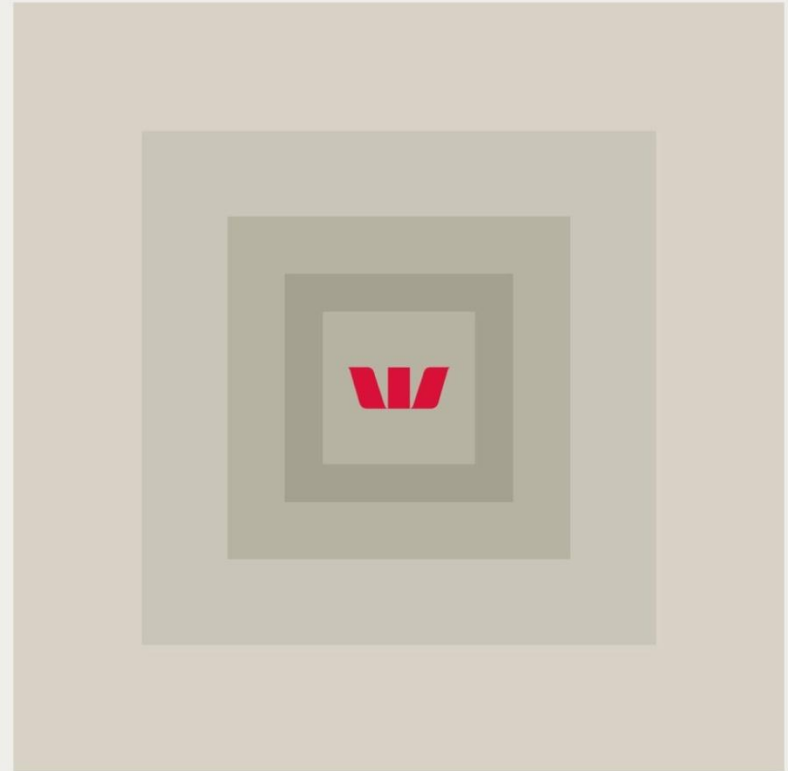


Consumers still uncertain about job prospects

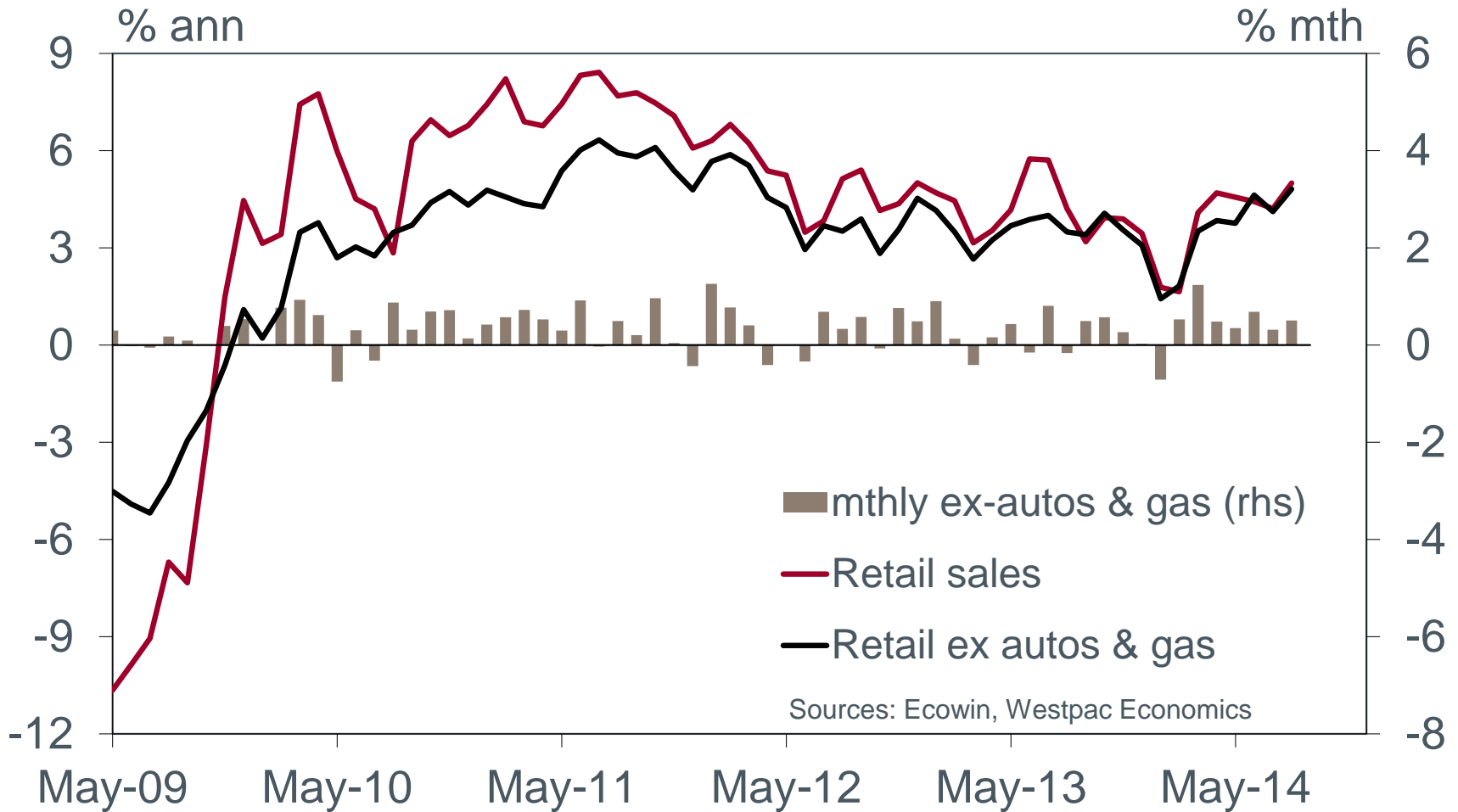


Consumer spending & incomes

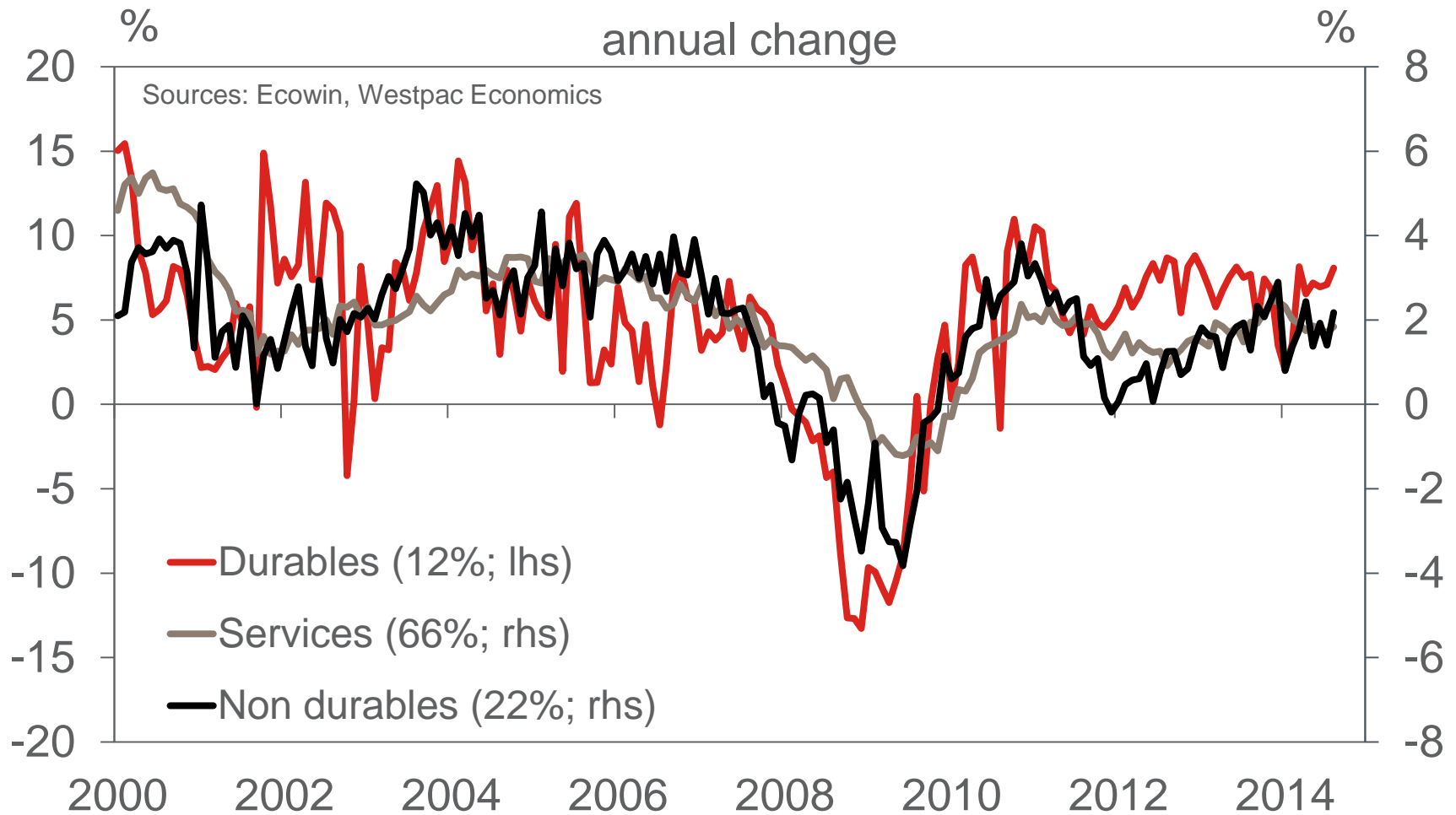
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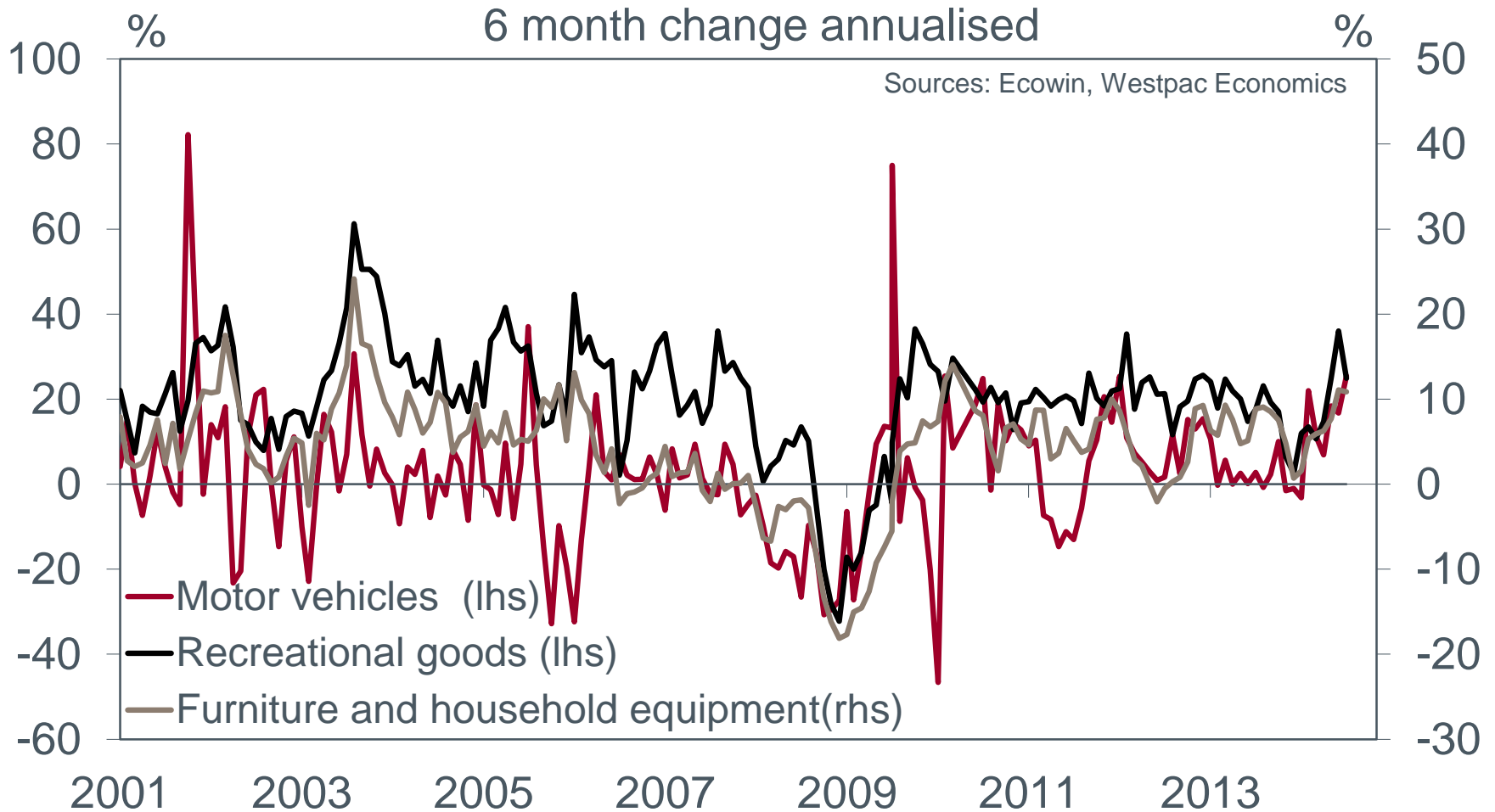
US retail sales: continue to struggle to get going



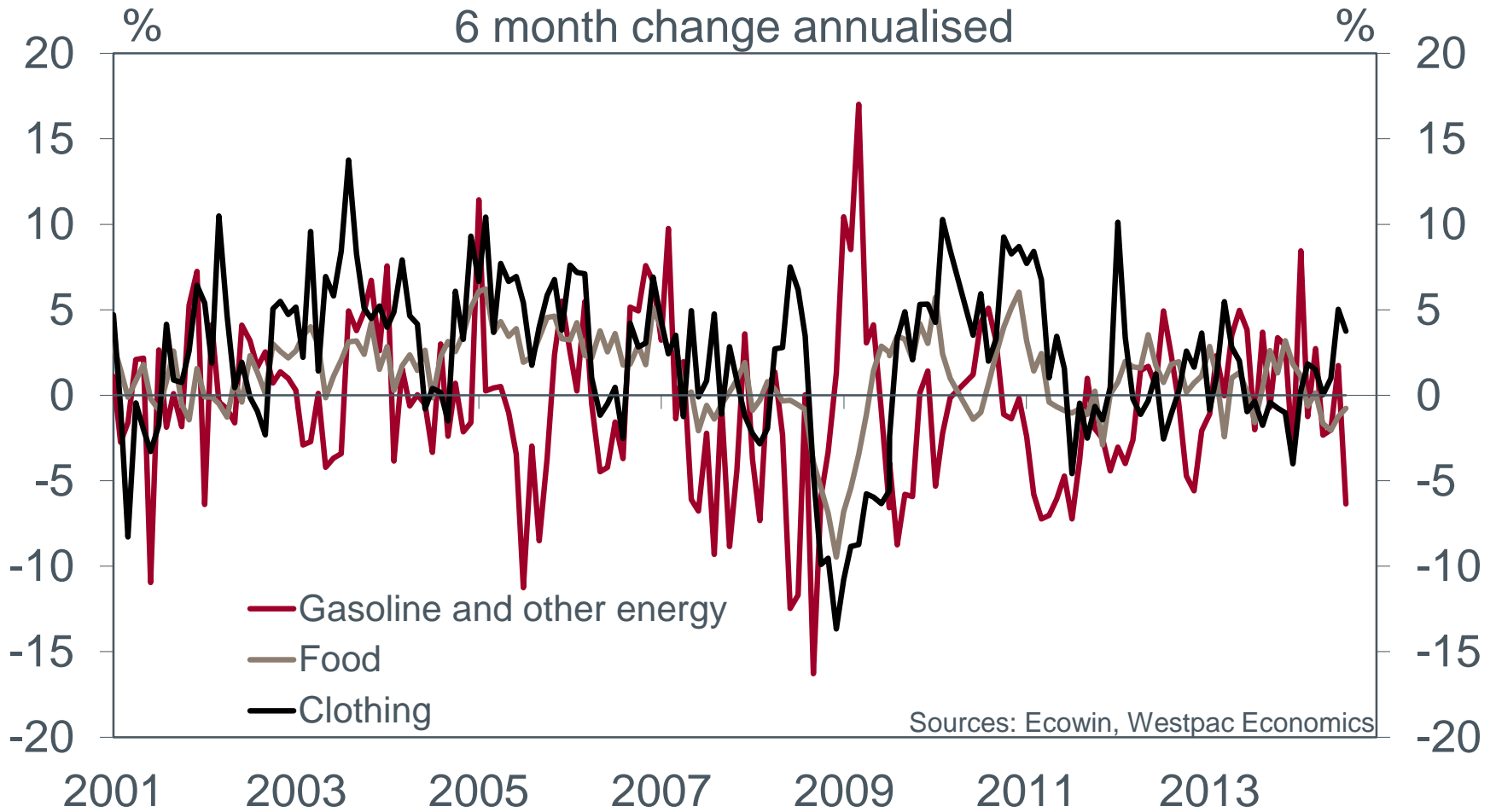
Consumption: durables remain driving force



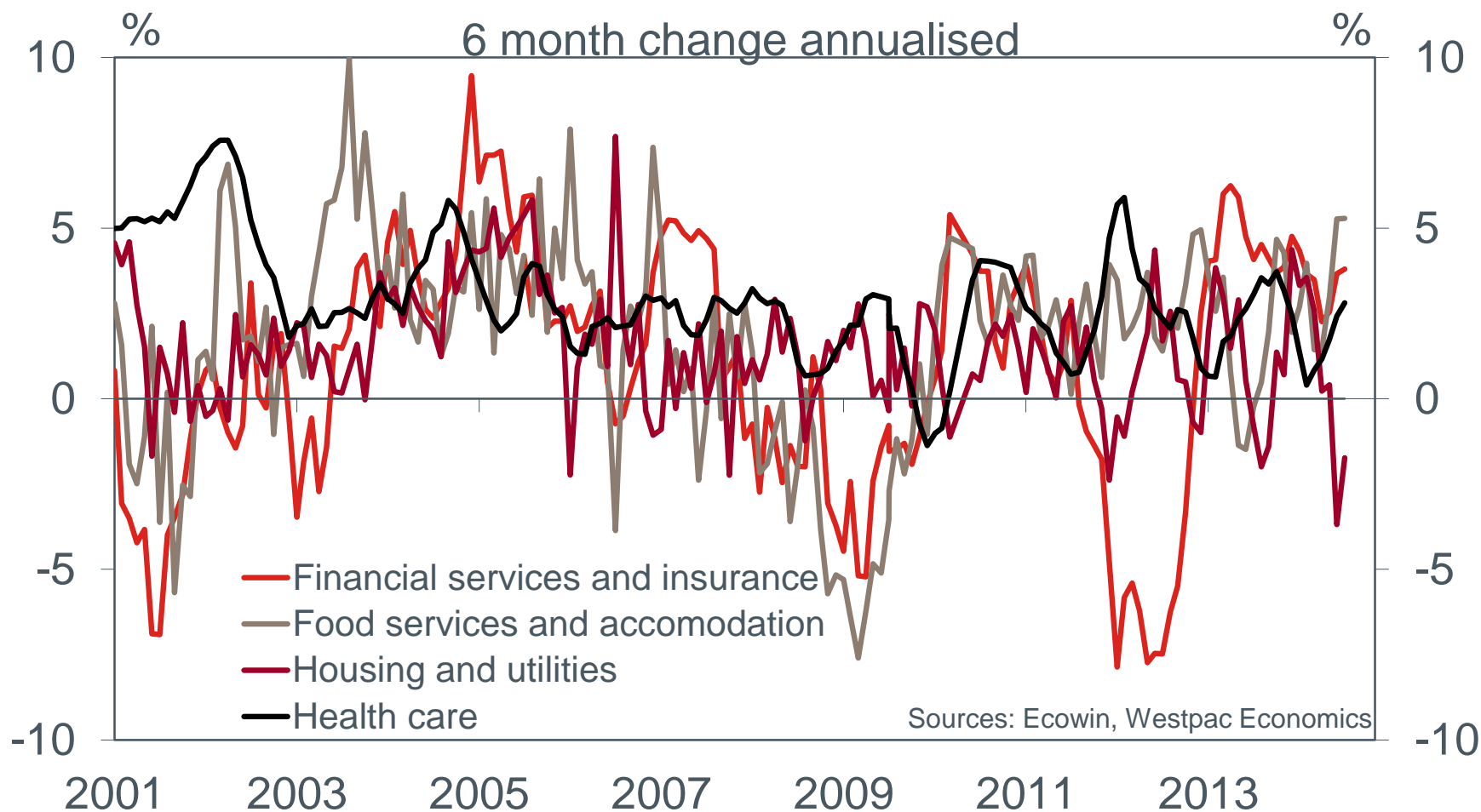
Durables personal consumption



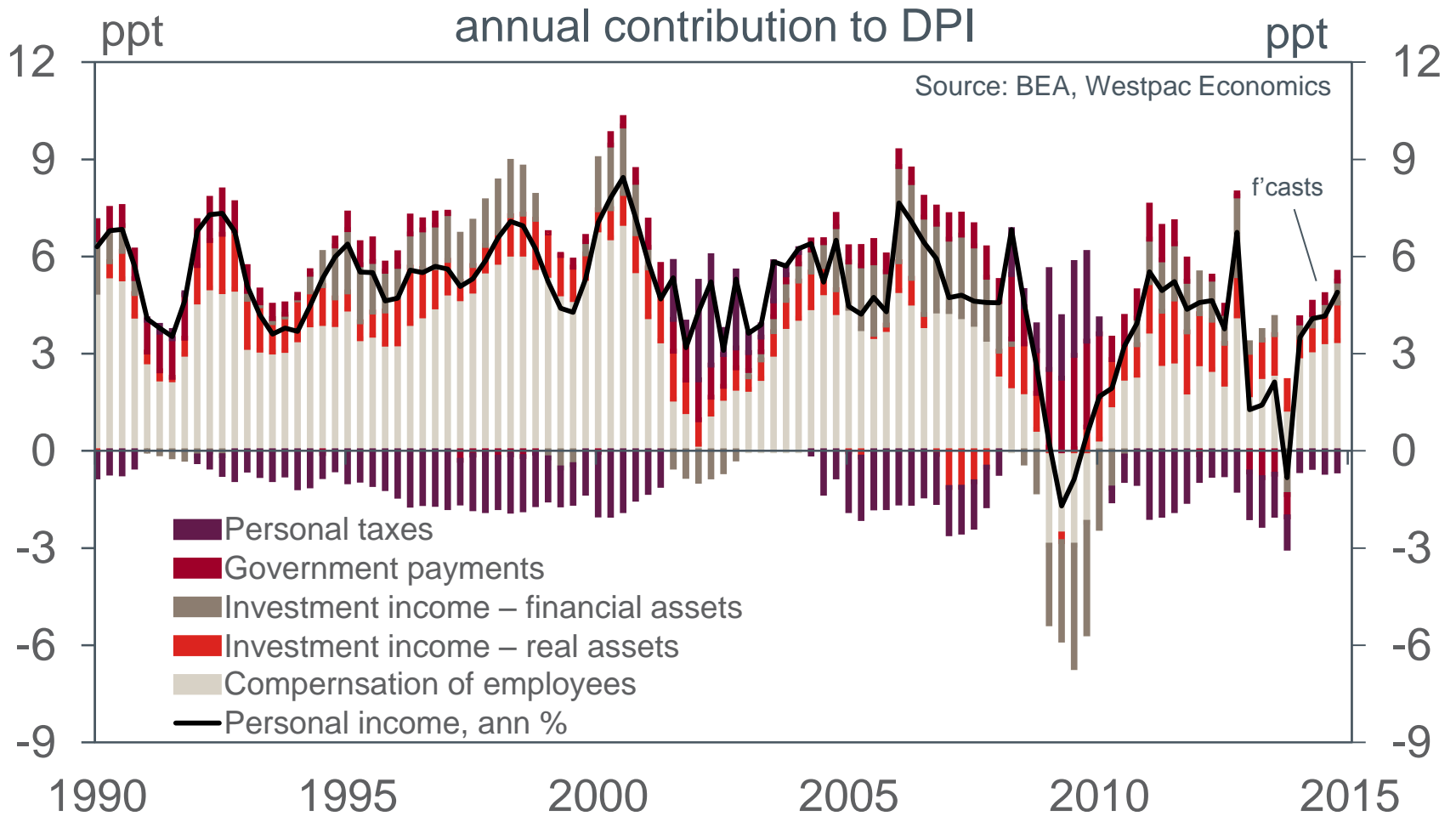
Non-durables personal consumption



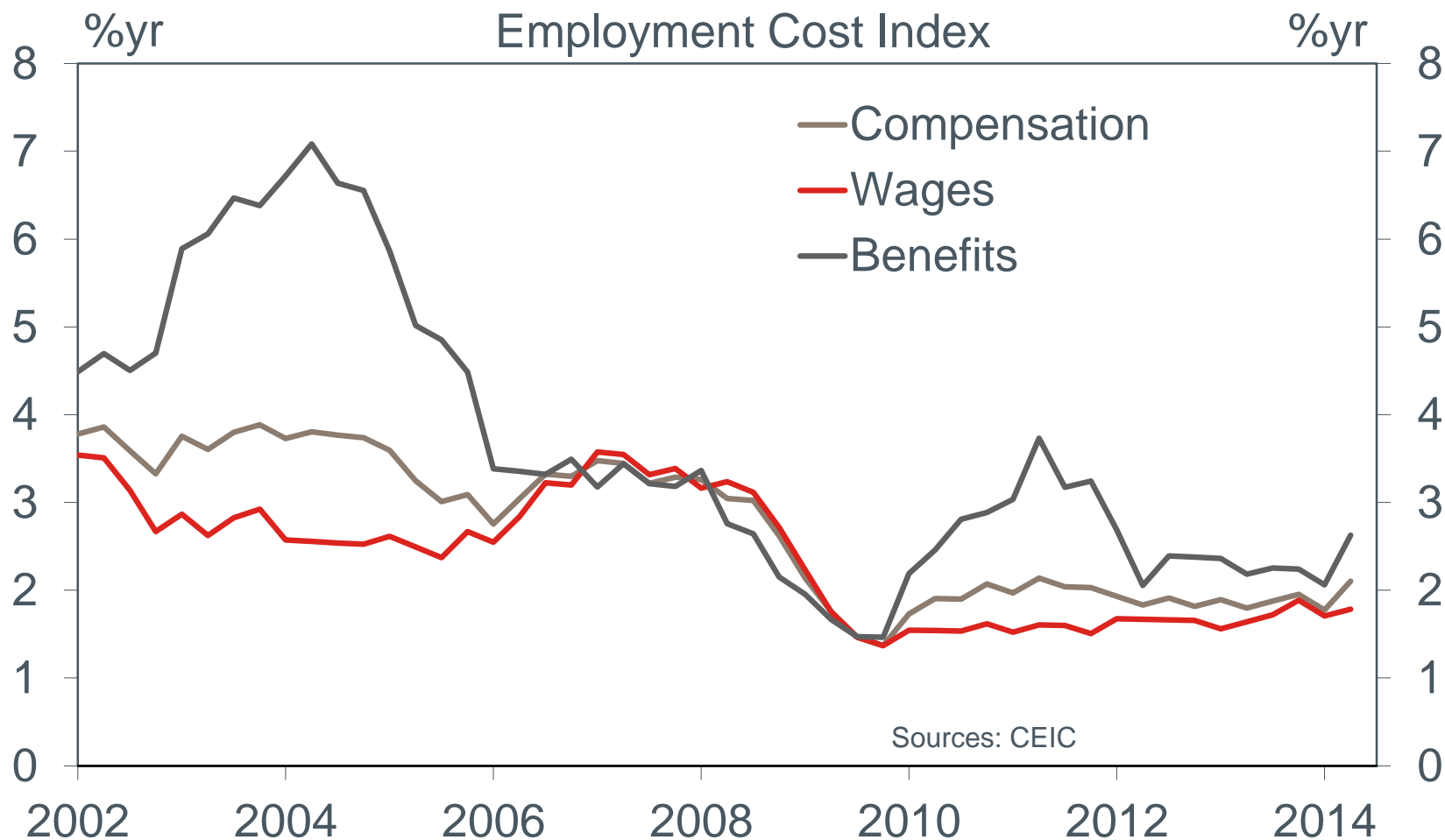
Services personal consumption



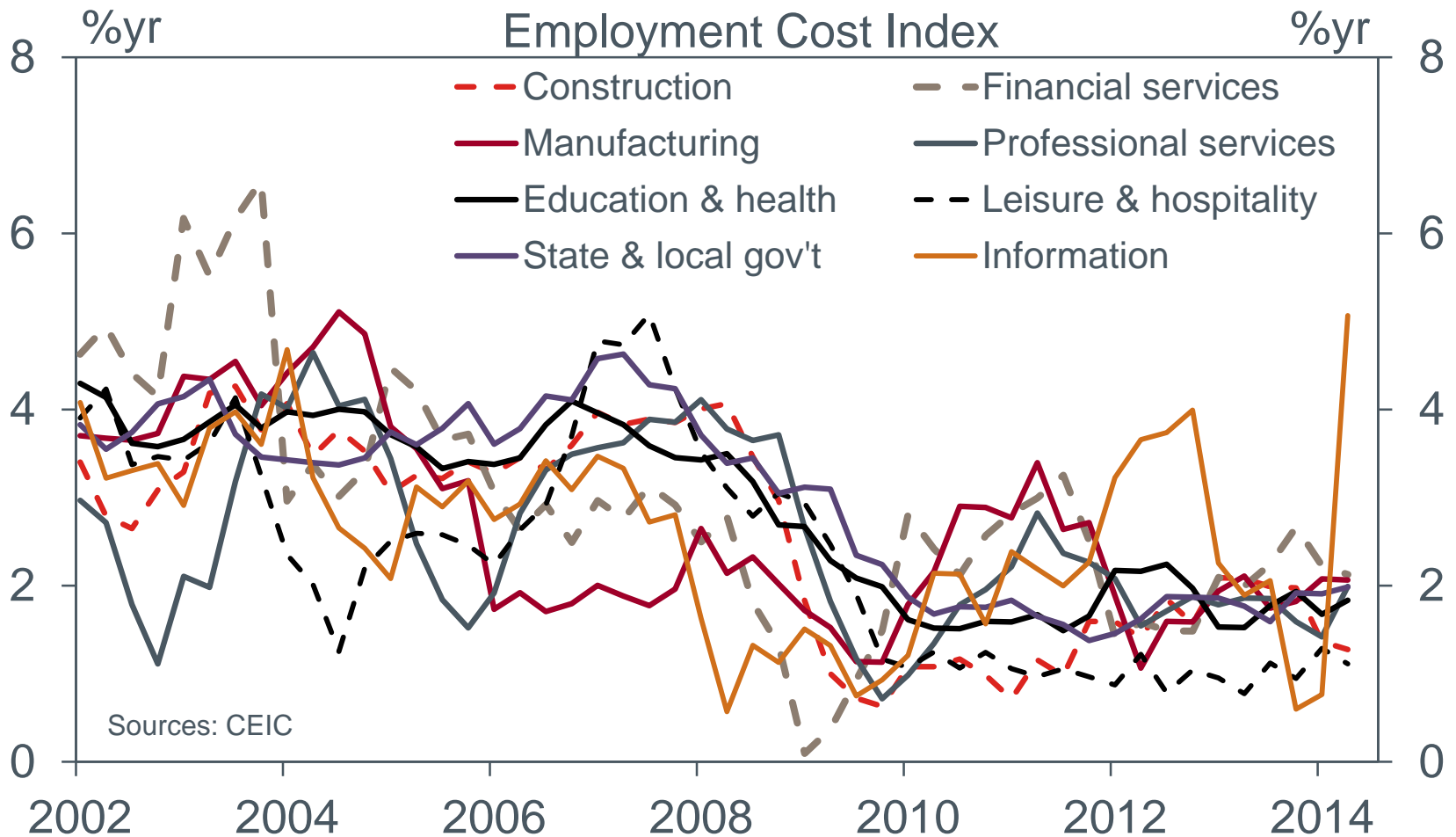
Household income supported by investment income



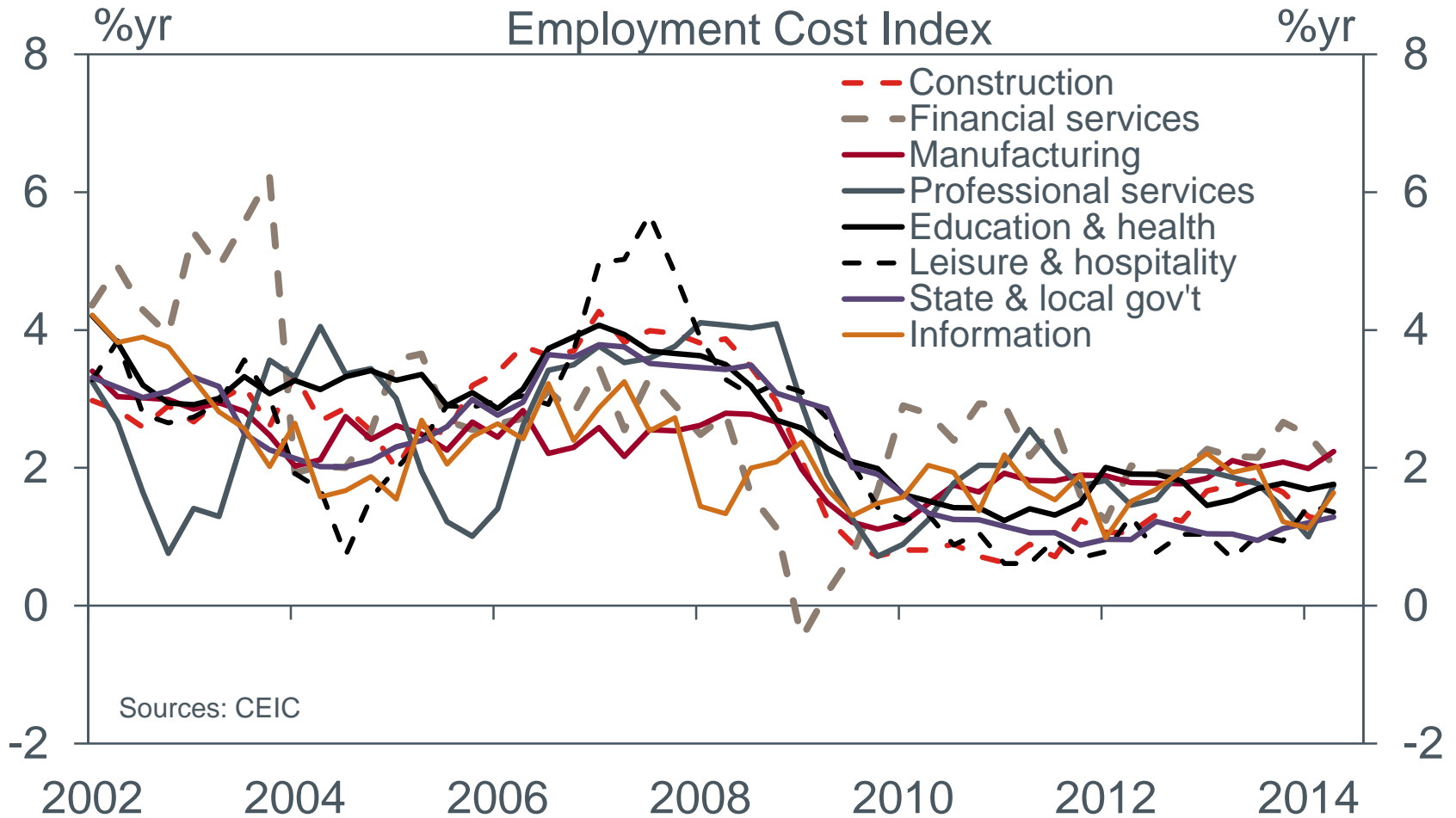
Nominal wages and benefits for civilian workers



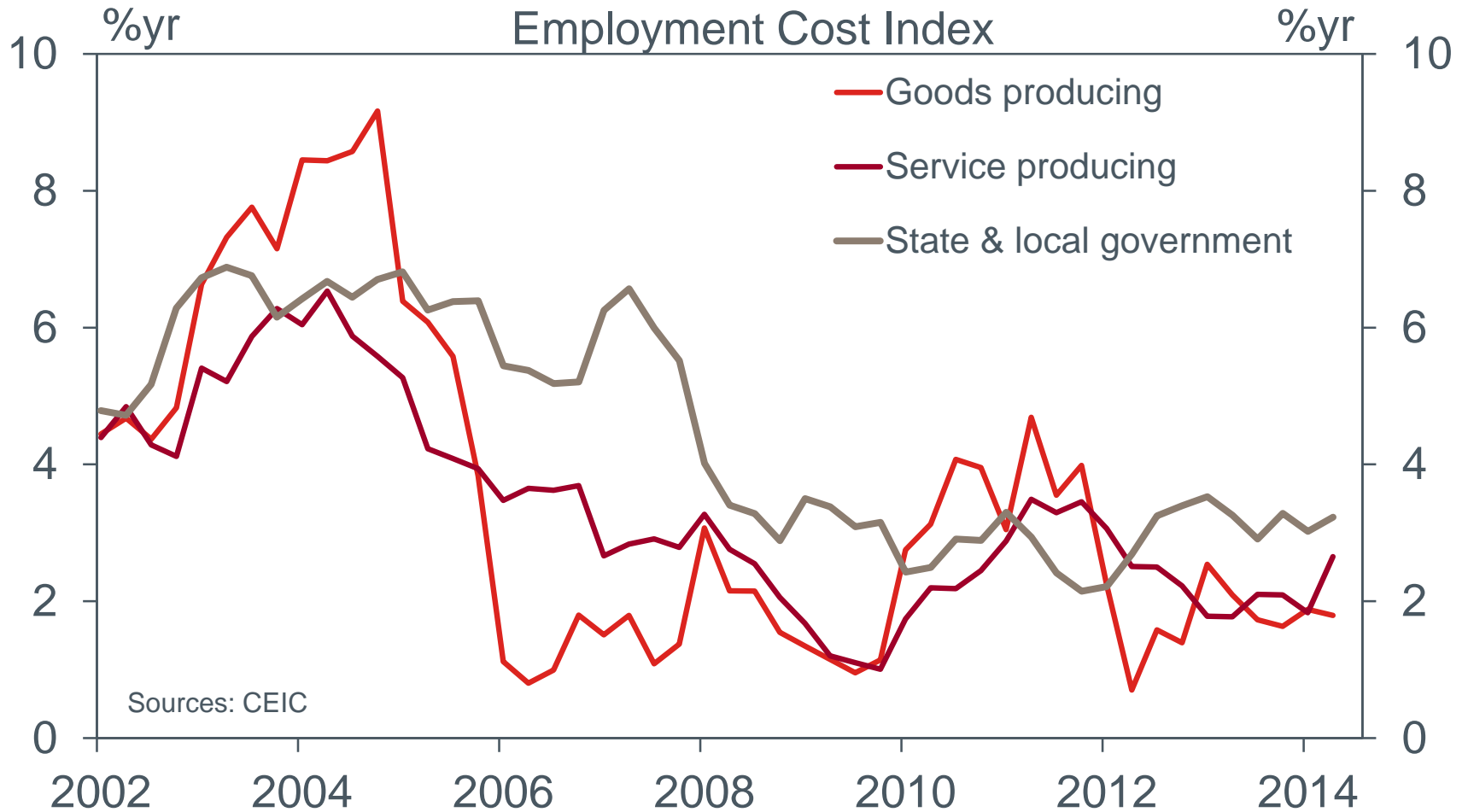
Growth in total compensation by industry



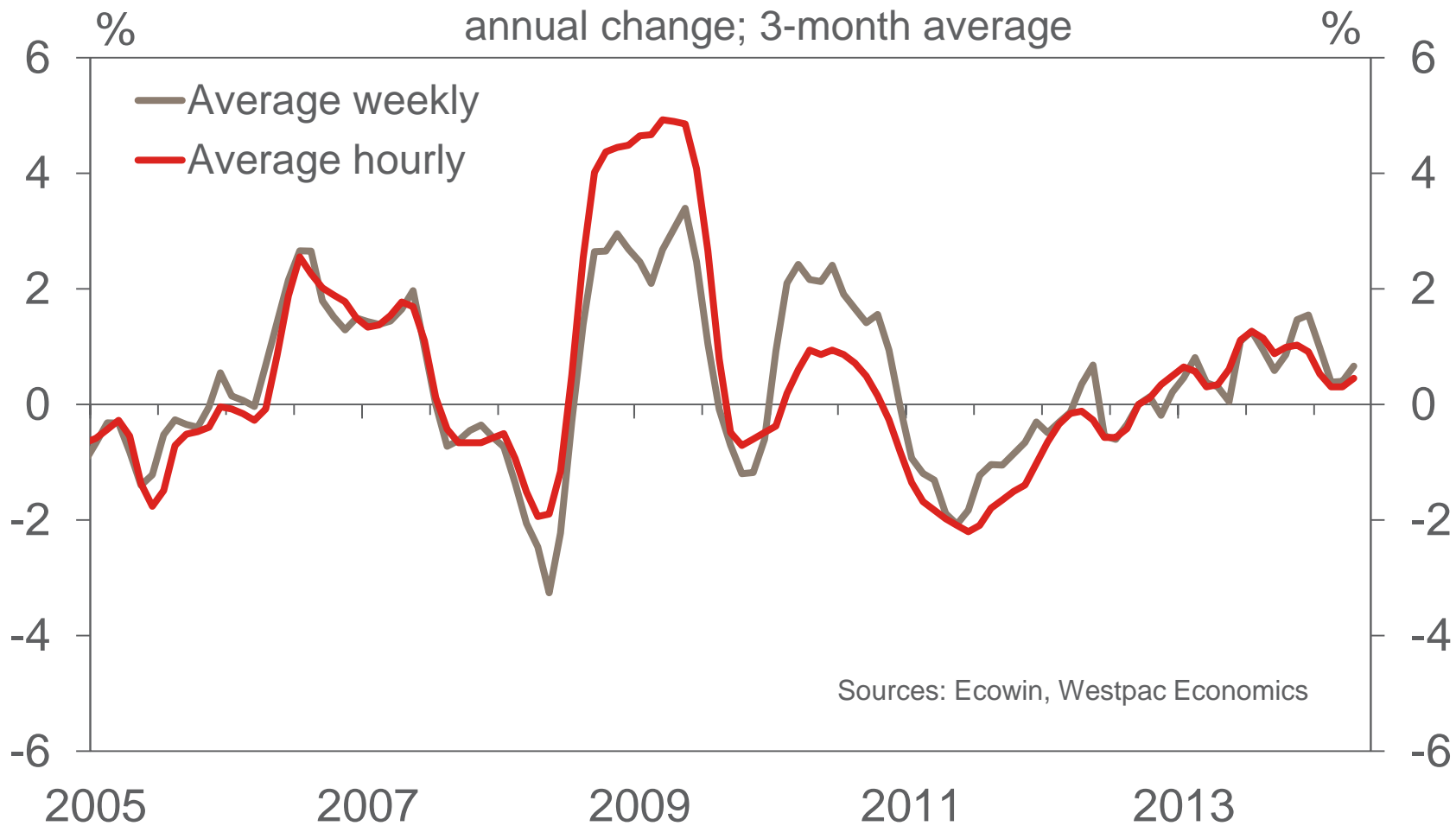
Wages by industry



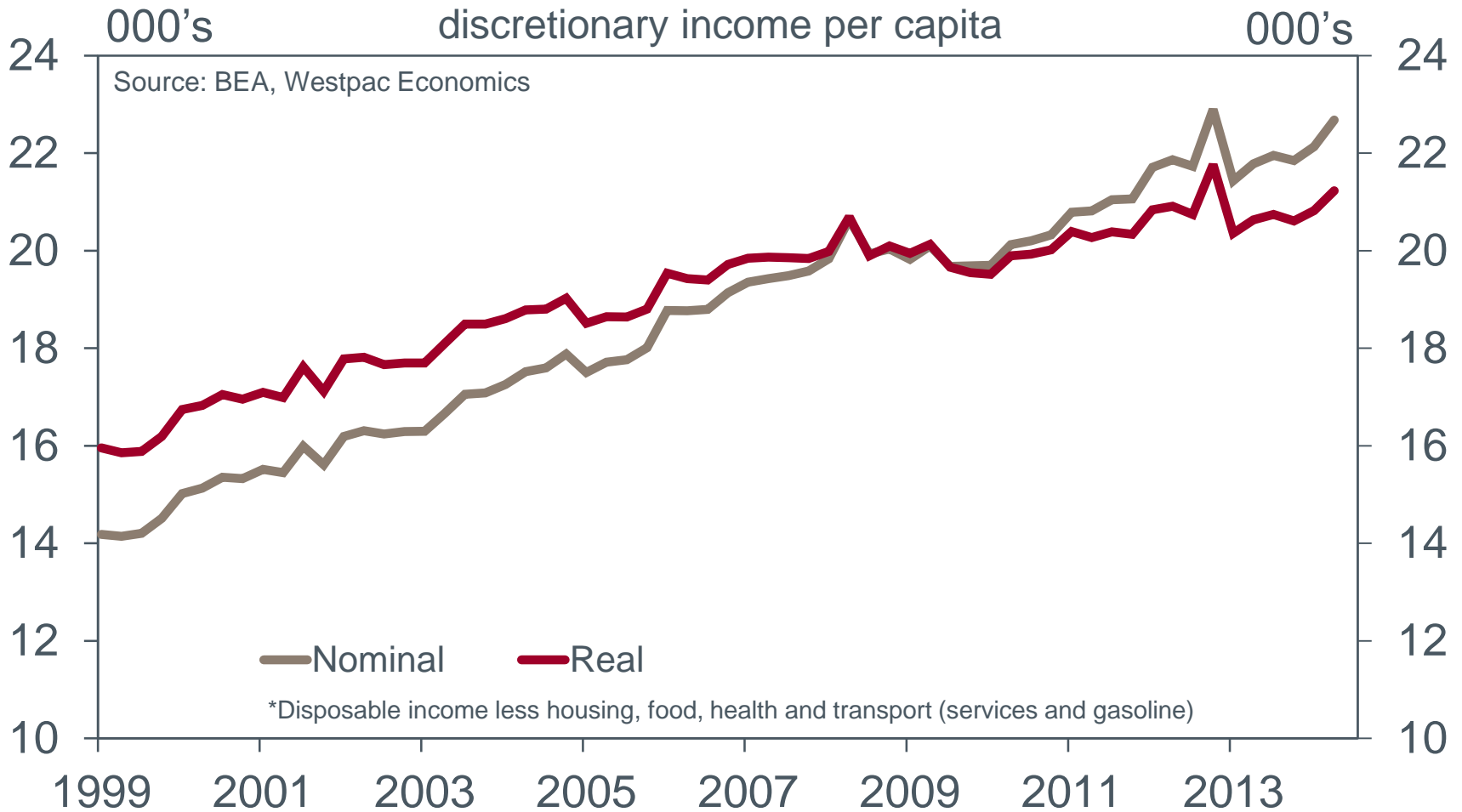
Benefits by industry



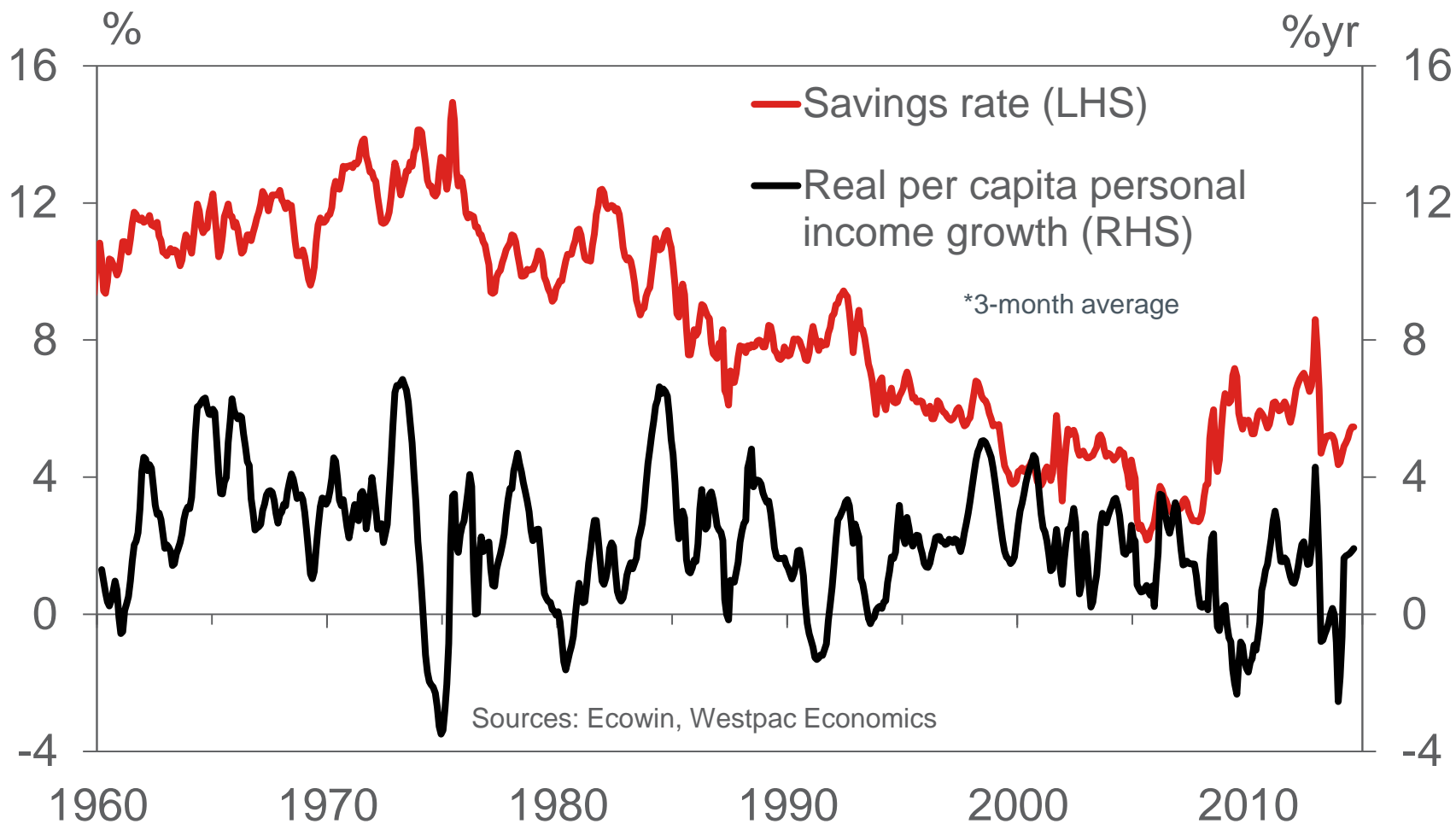
Real wages growth weak



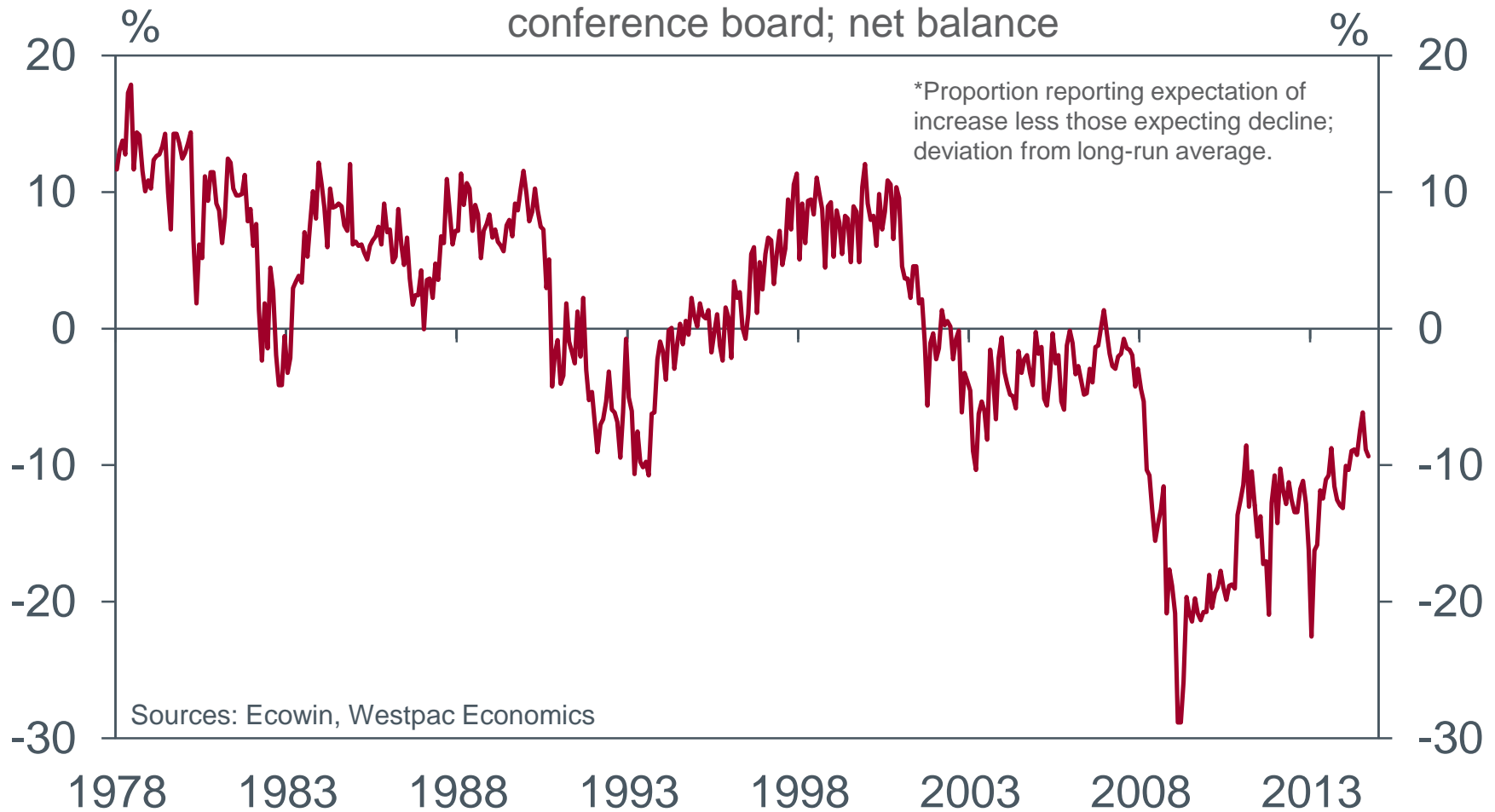
Discretionary income, starting to pick up



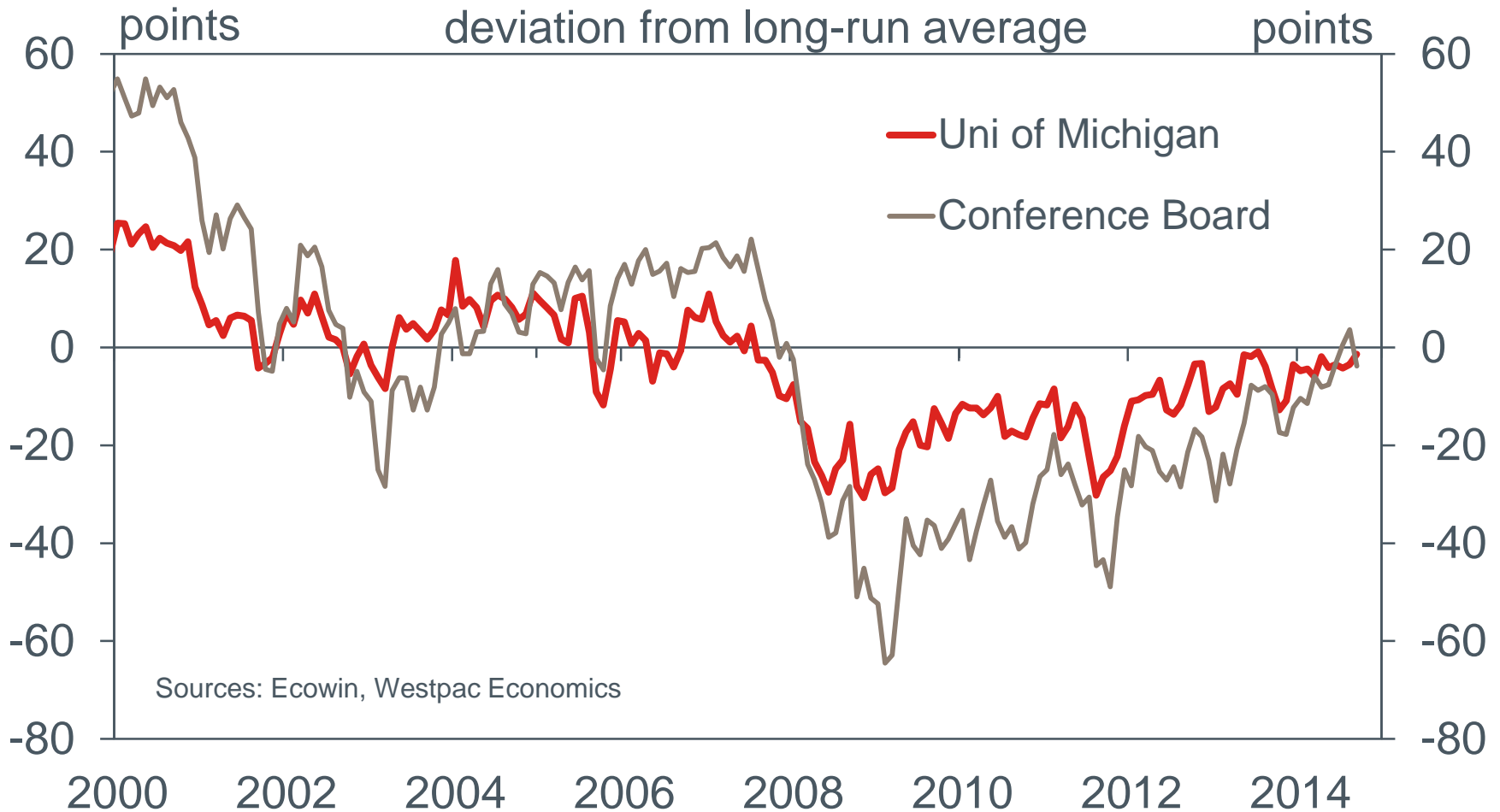
Savings rate ticking higher again



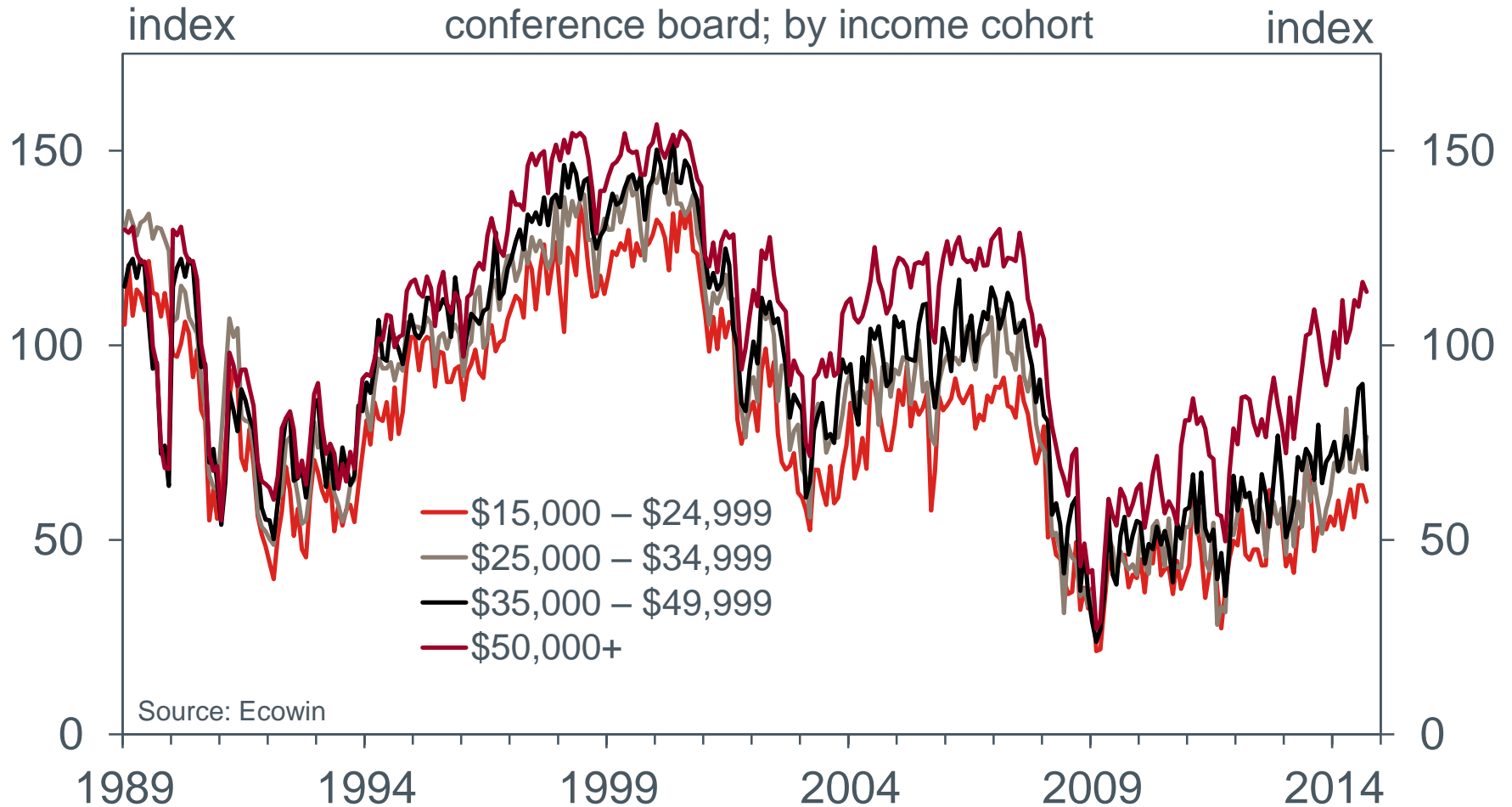
Household income expectations



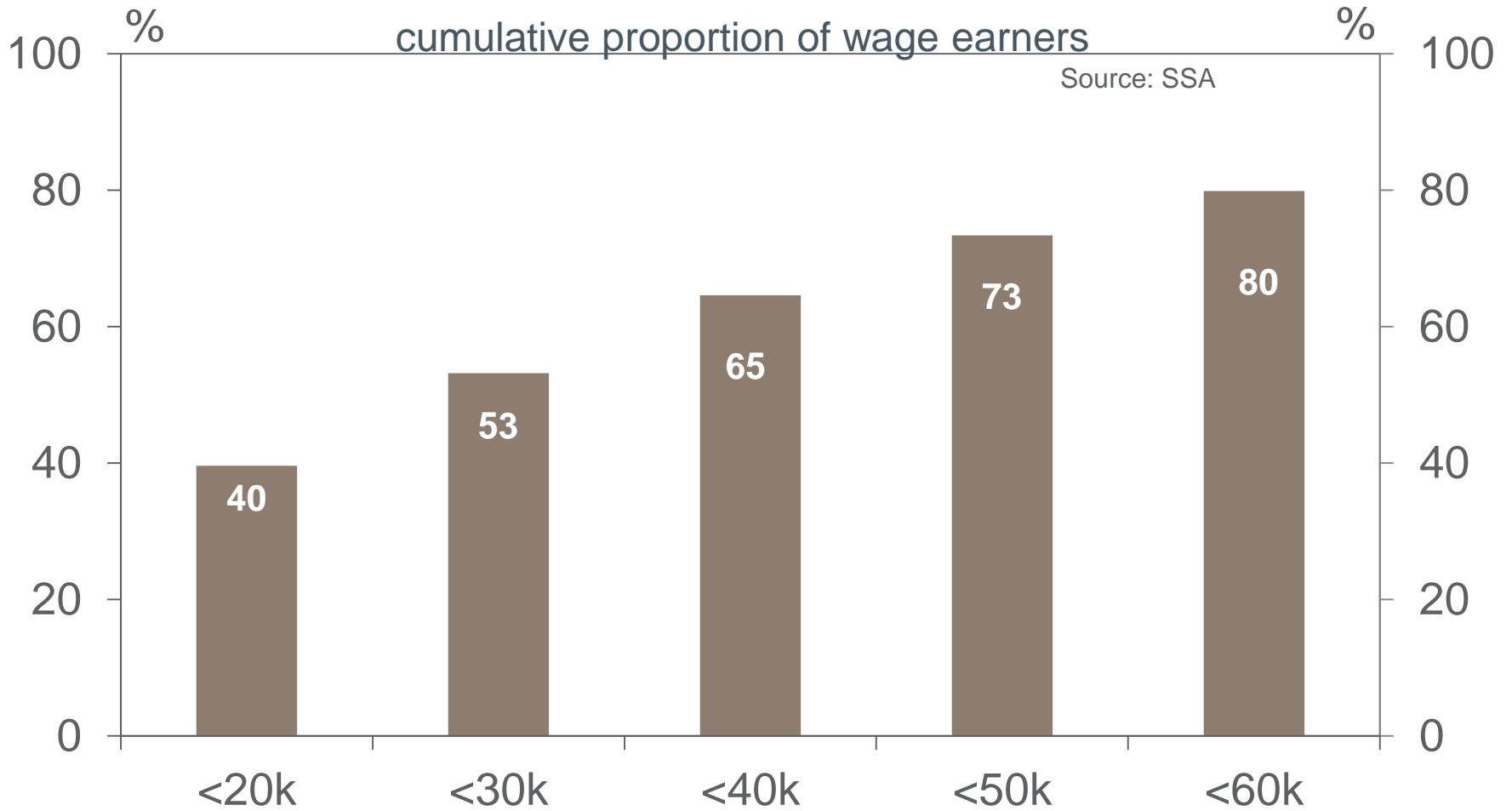
Consumer sentiment trending higher



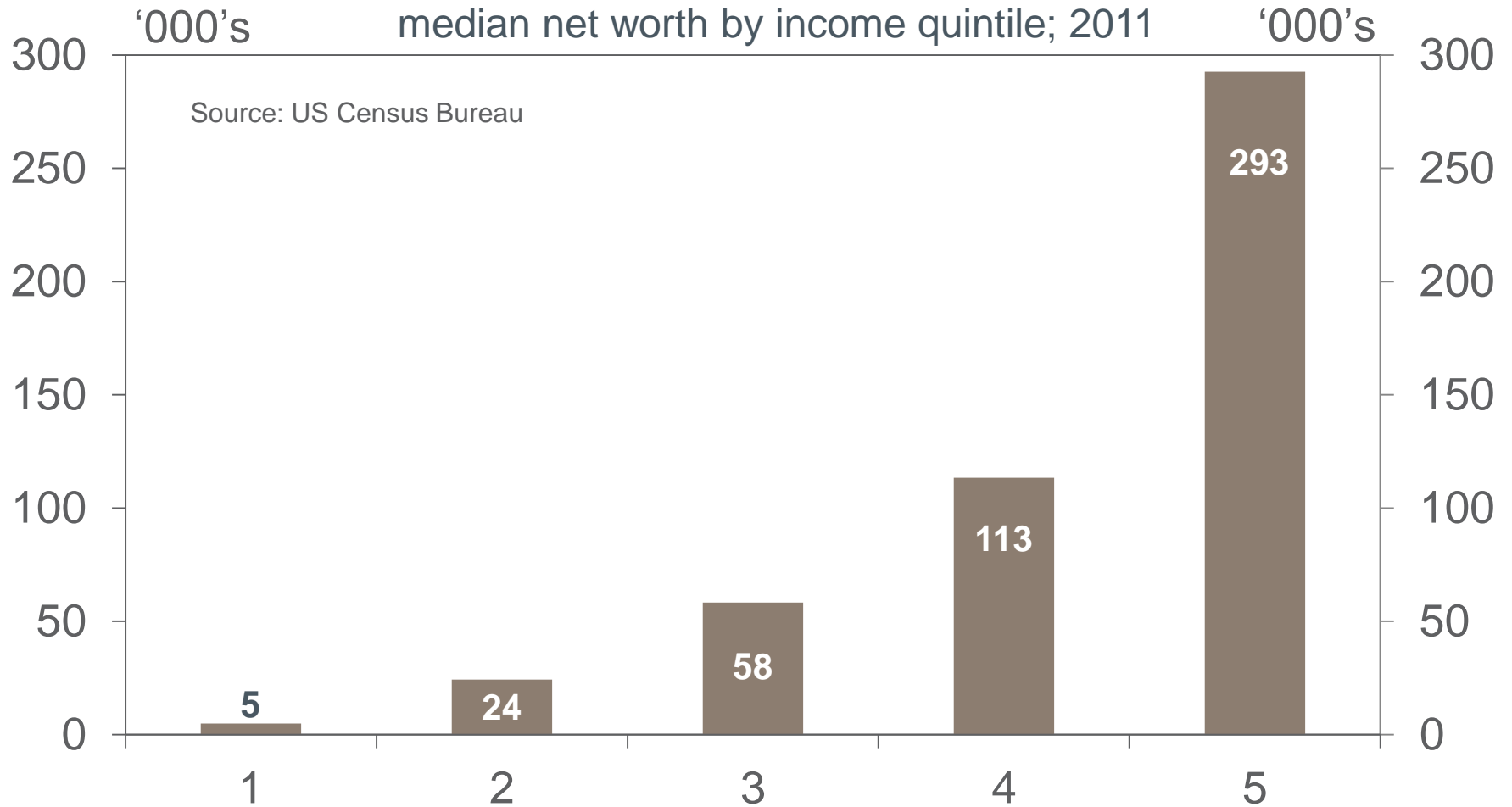
Consumer confidence: weaker amongst lower paid



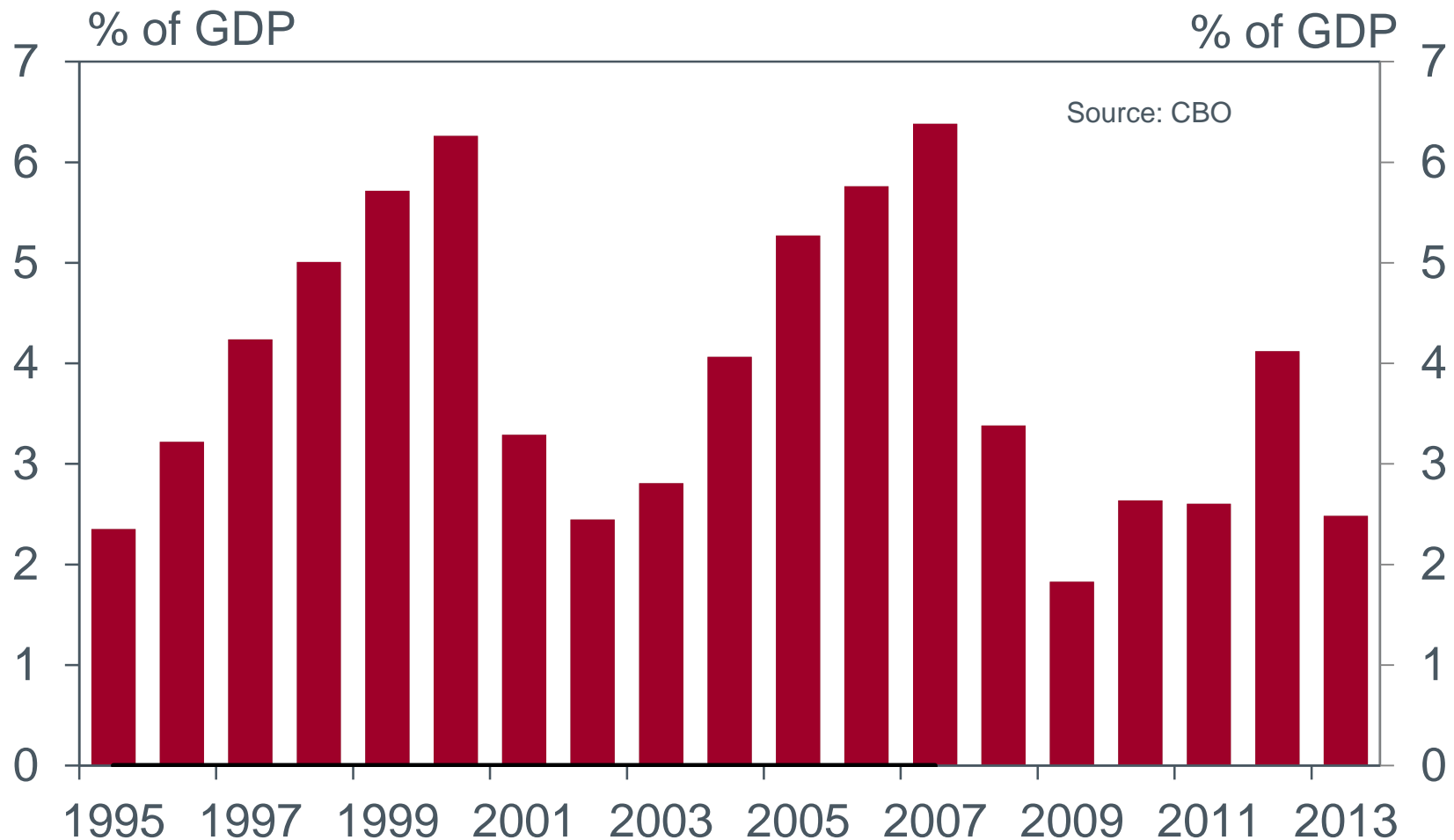
Who make up bulk of wage earners



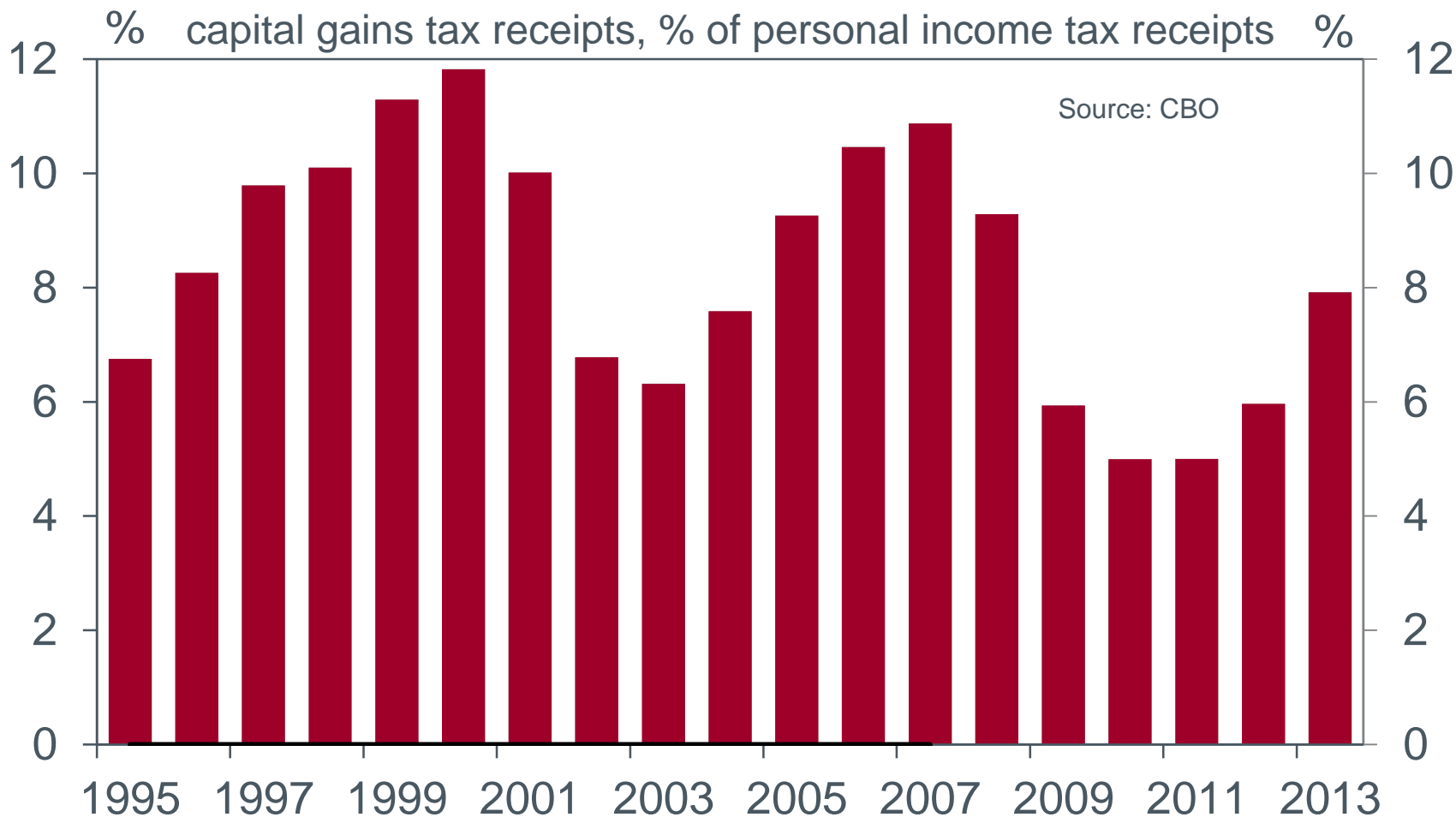
Wealth disparity substantial



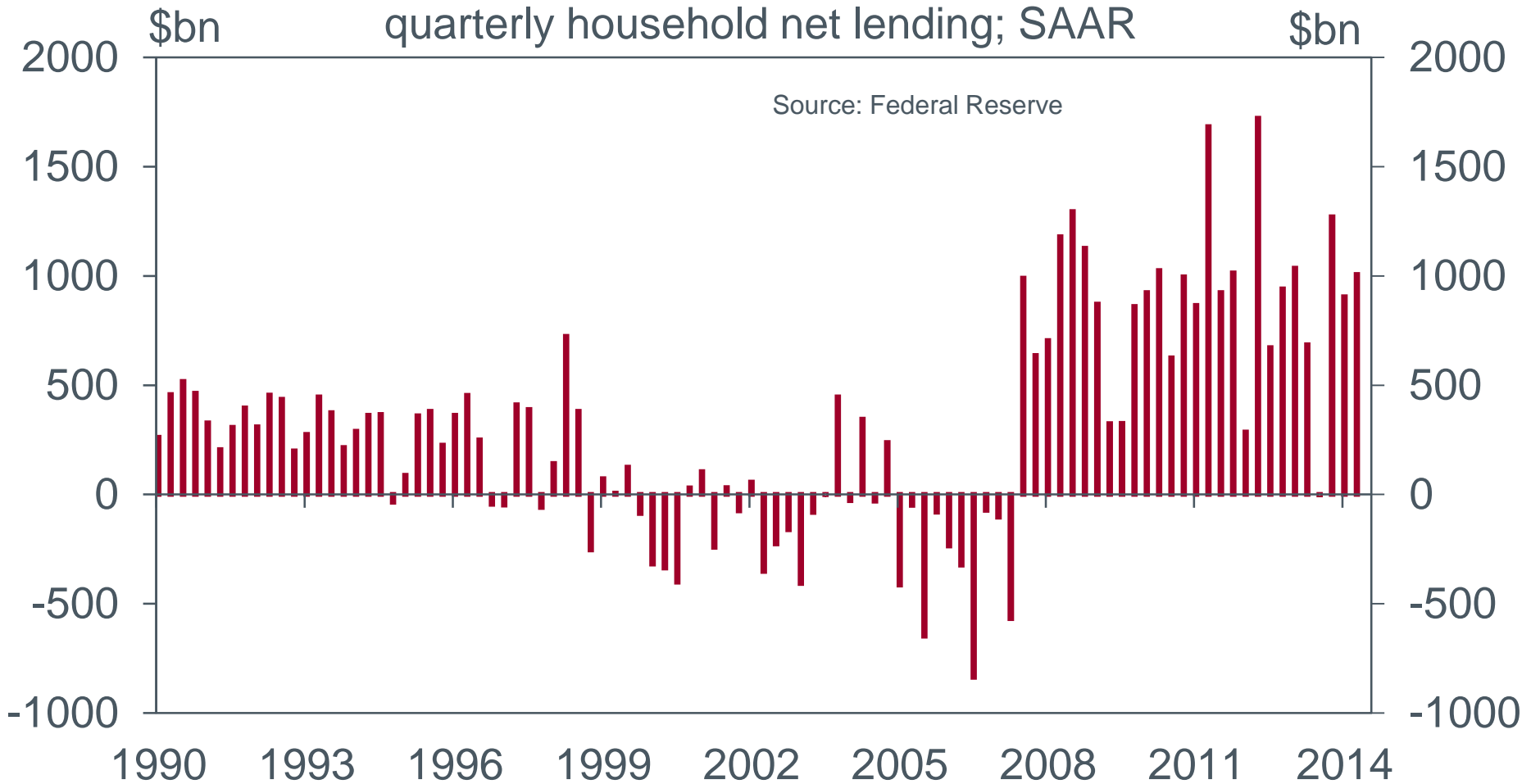
Wealthy benefit from capital gains realisations



Having flow-on benefit for Federal revenue

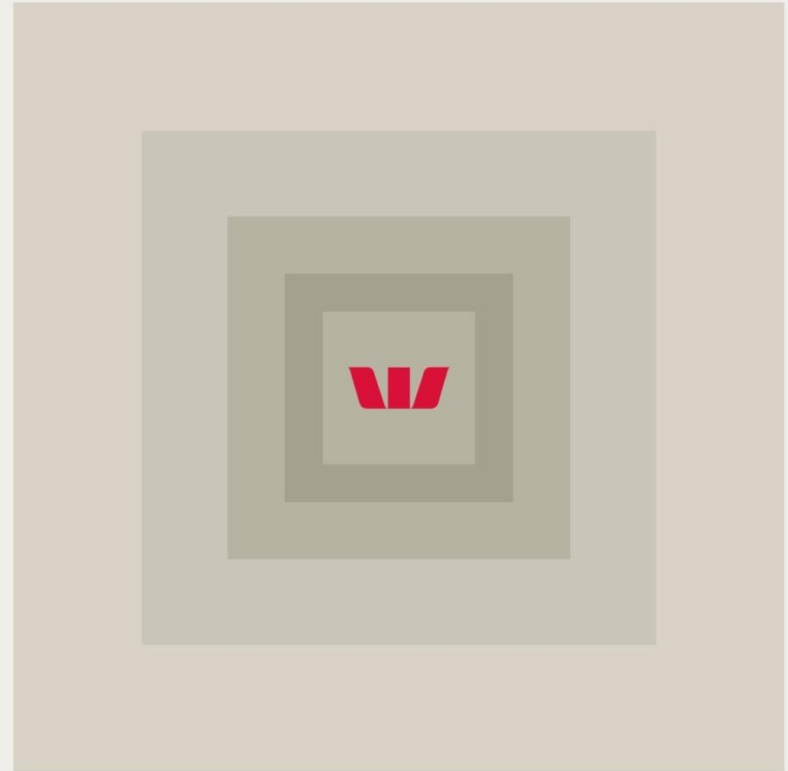


Investment returns and residual income saved

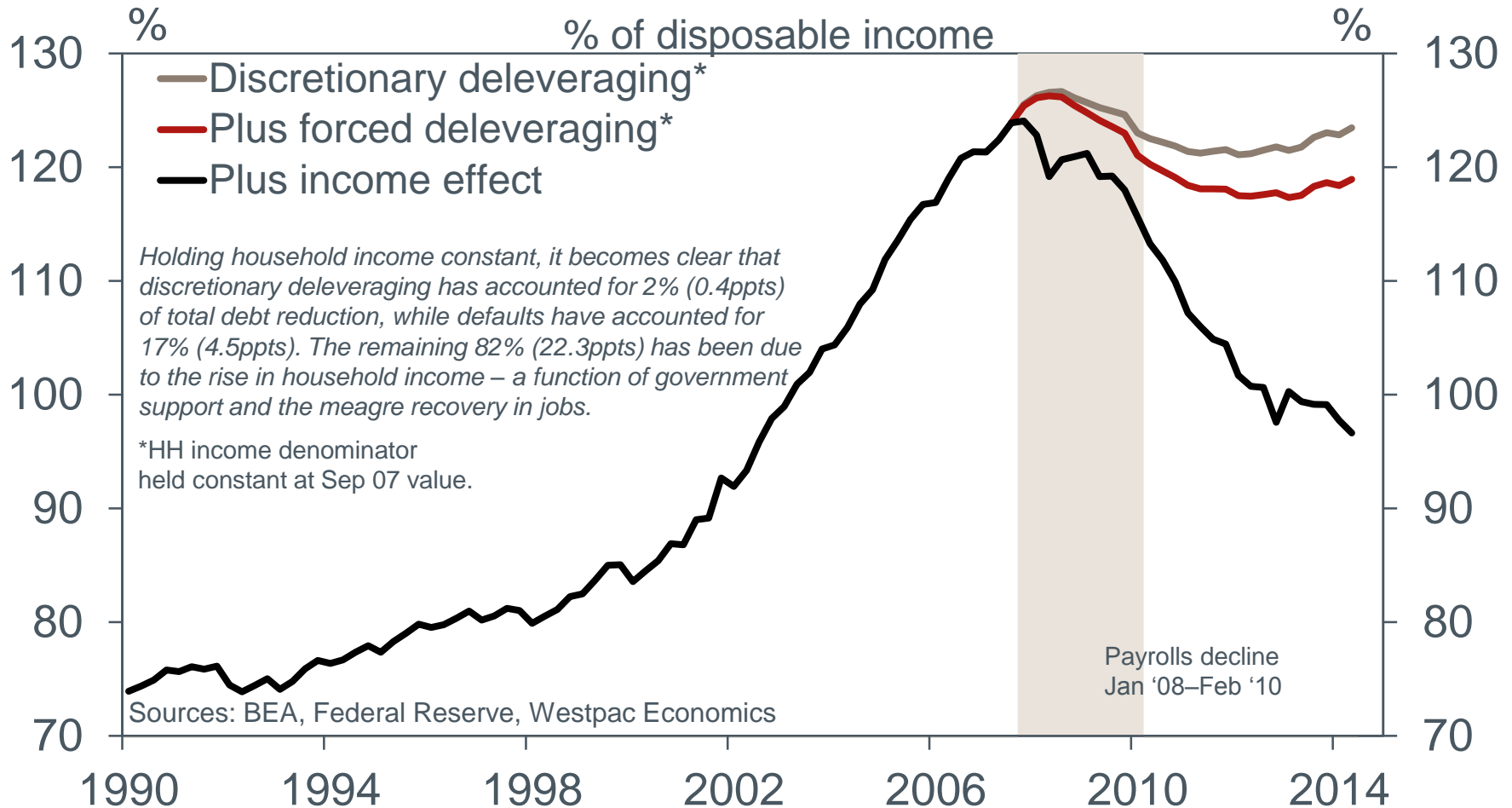


Credit provision & solvency

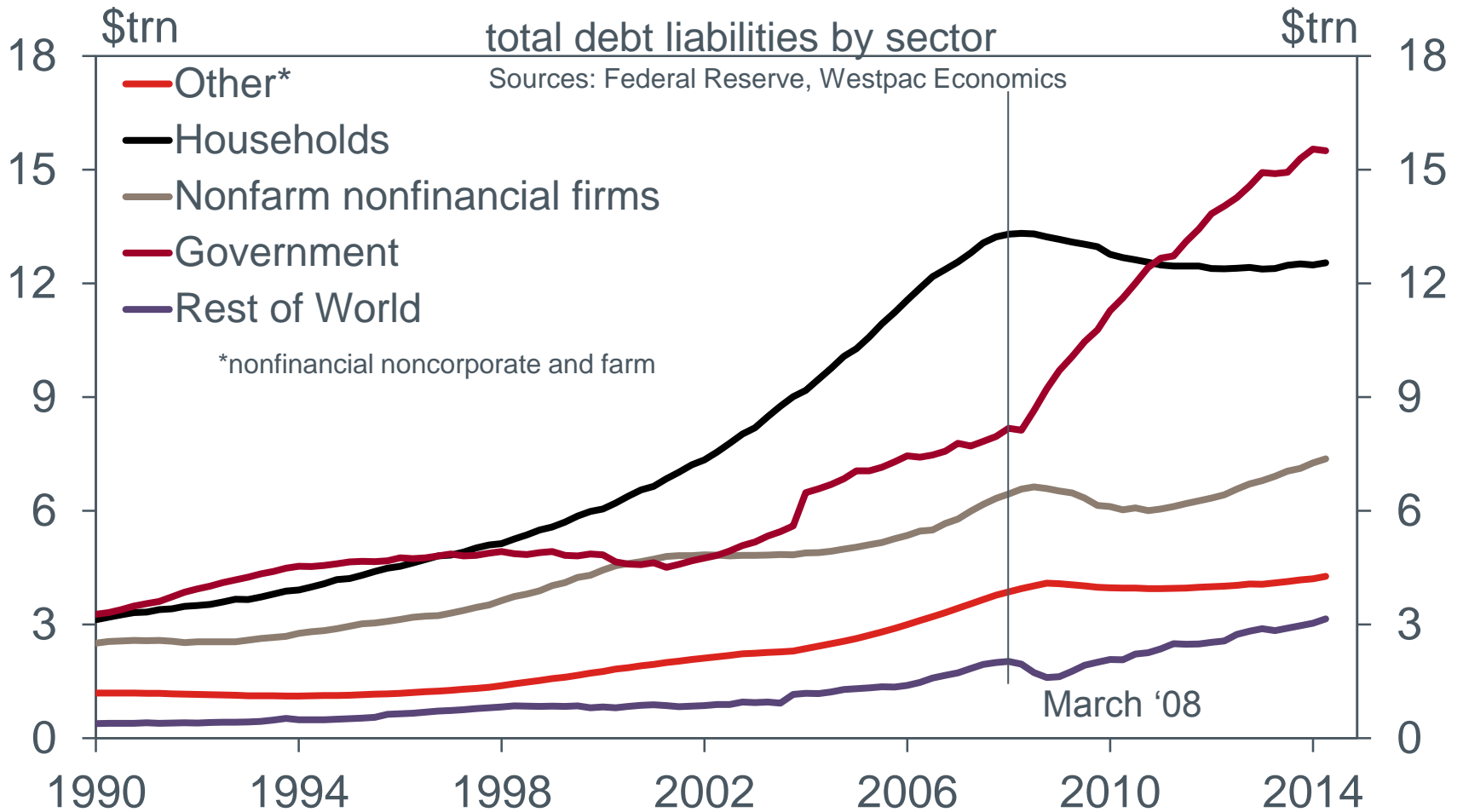
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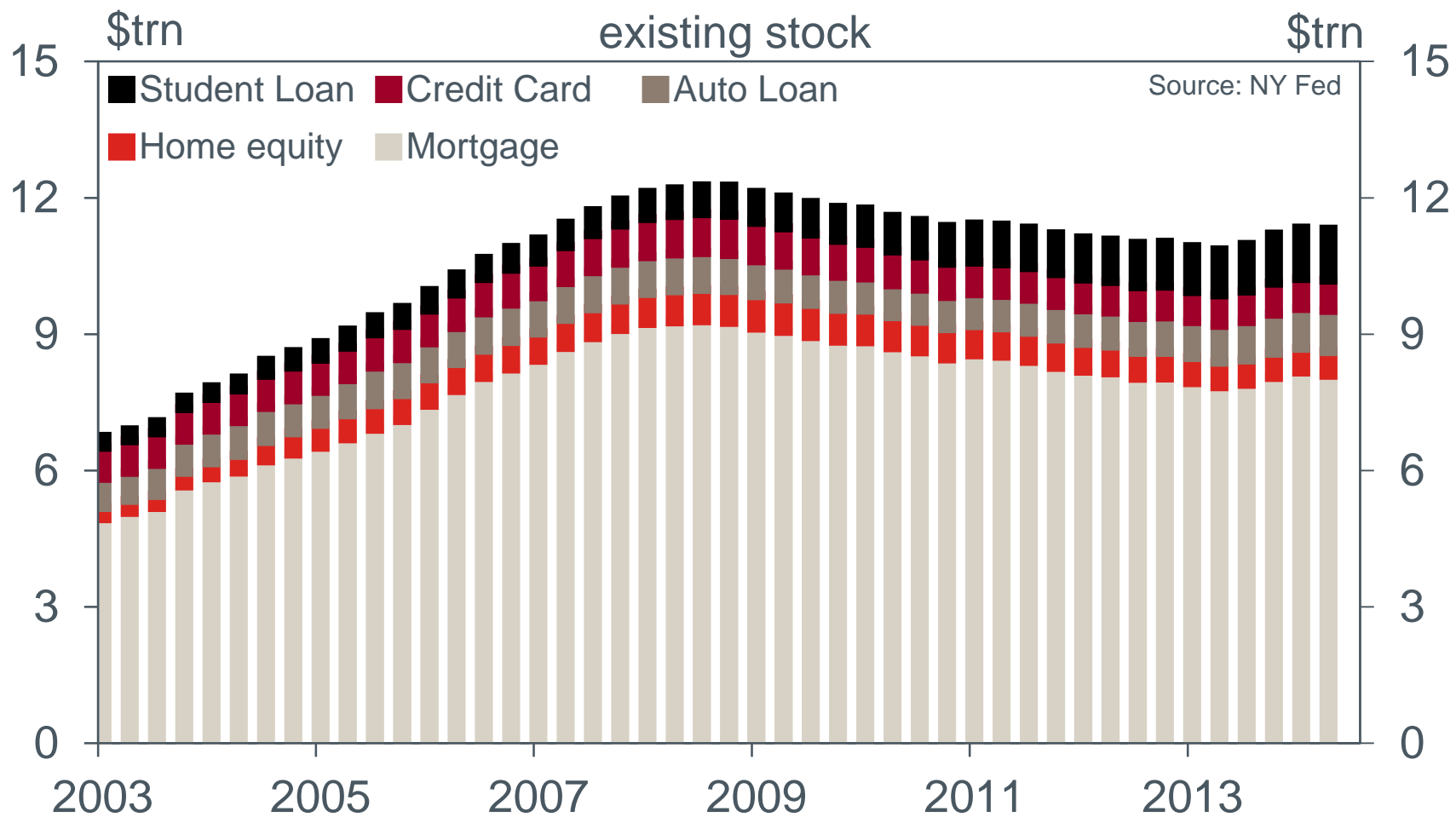
HH deleveraging predominantly passive



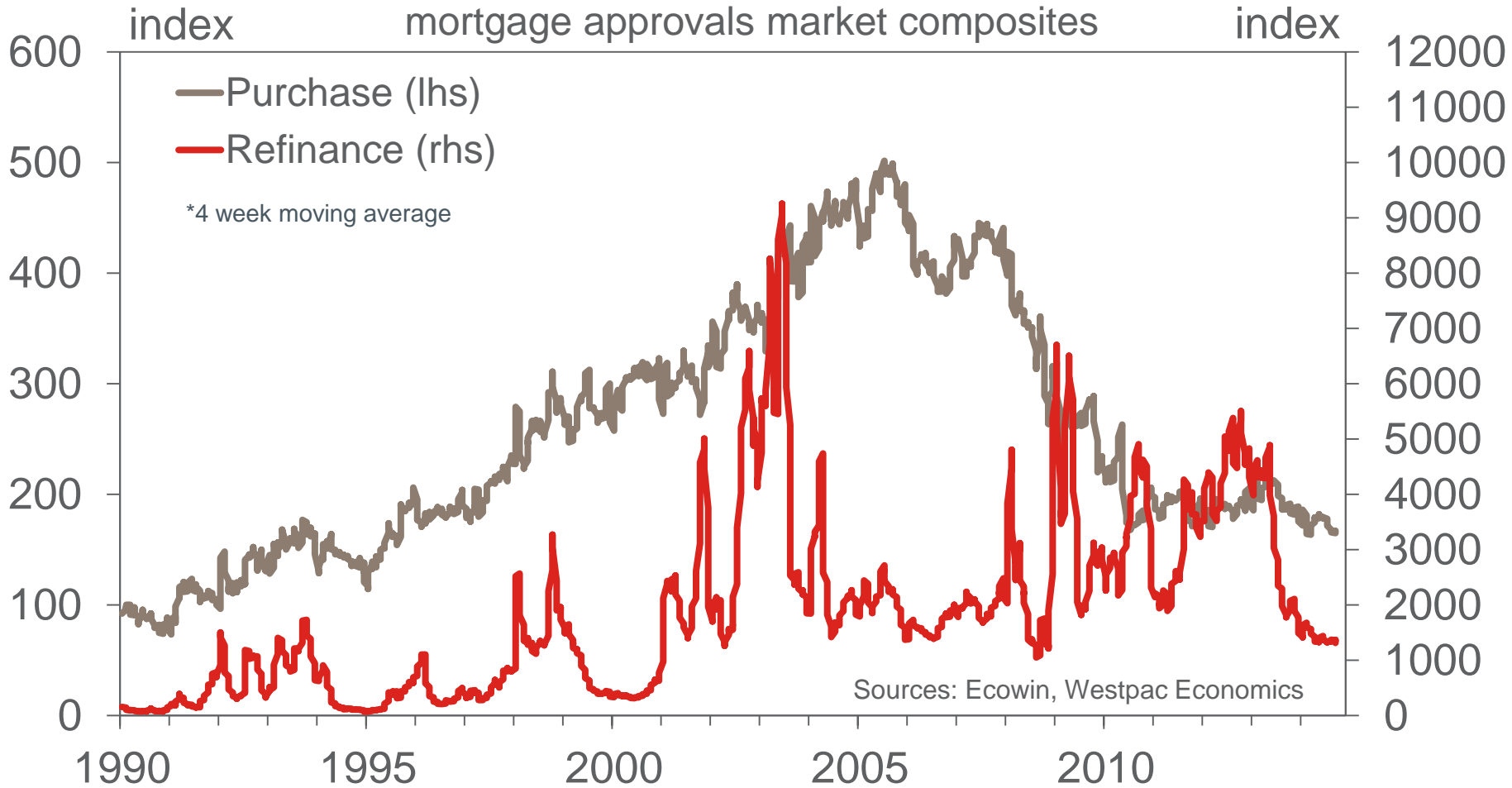
Household debt stock remains substantial



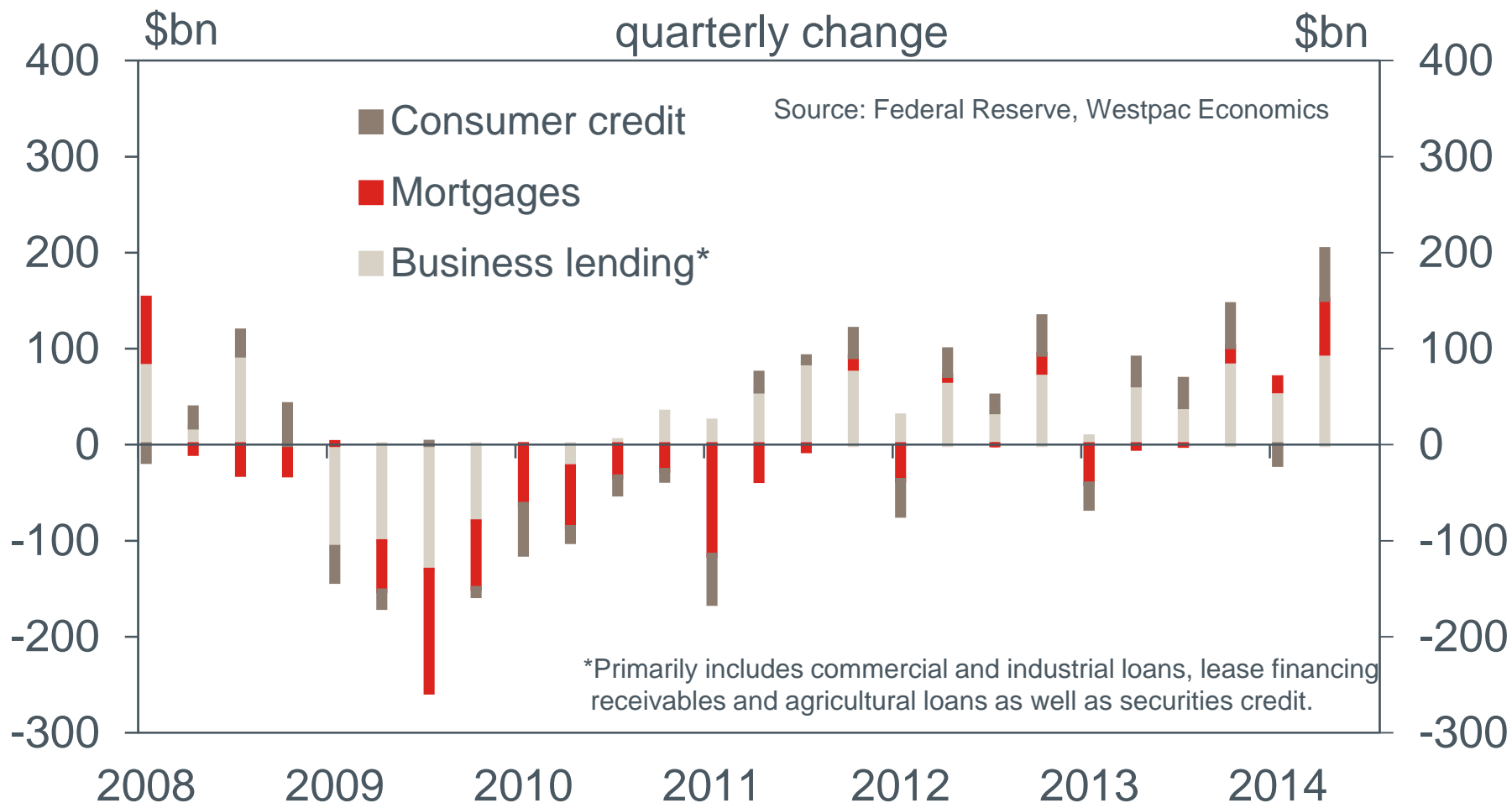
Household debt decomposition



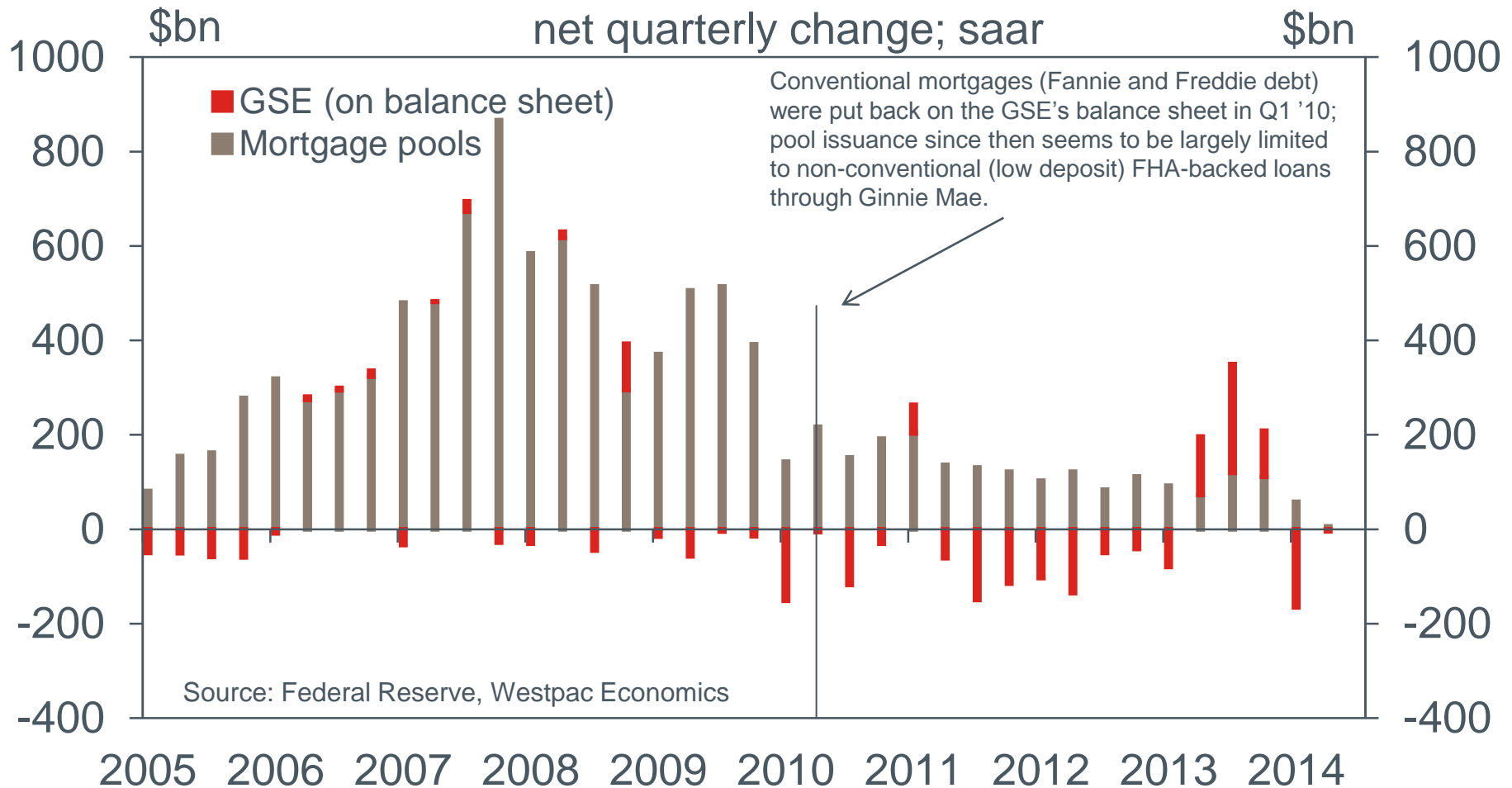
Refi demand weak; purchases trending down



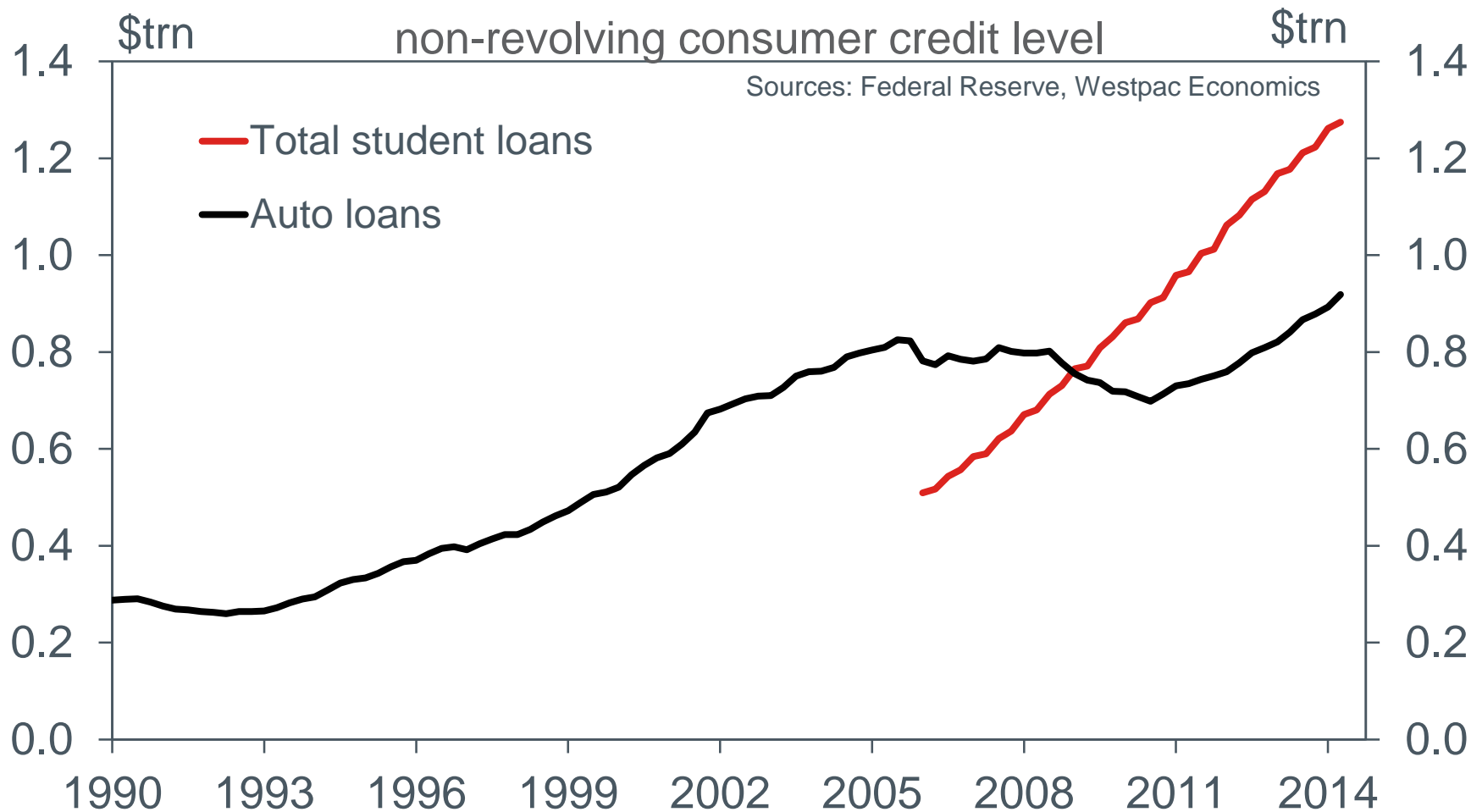
Banks lending to Households still limited



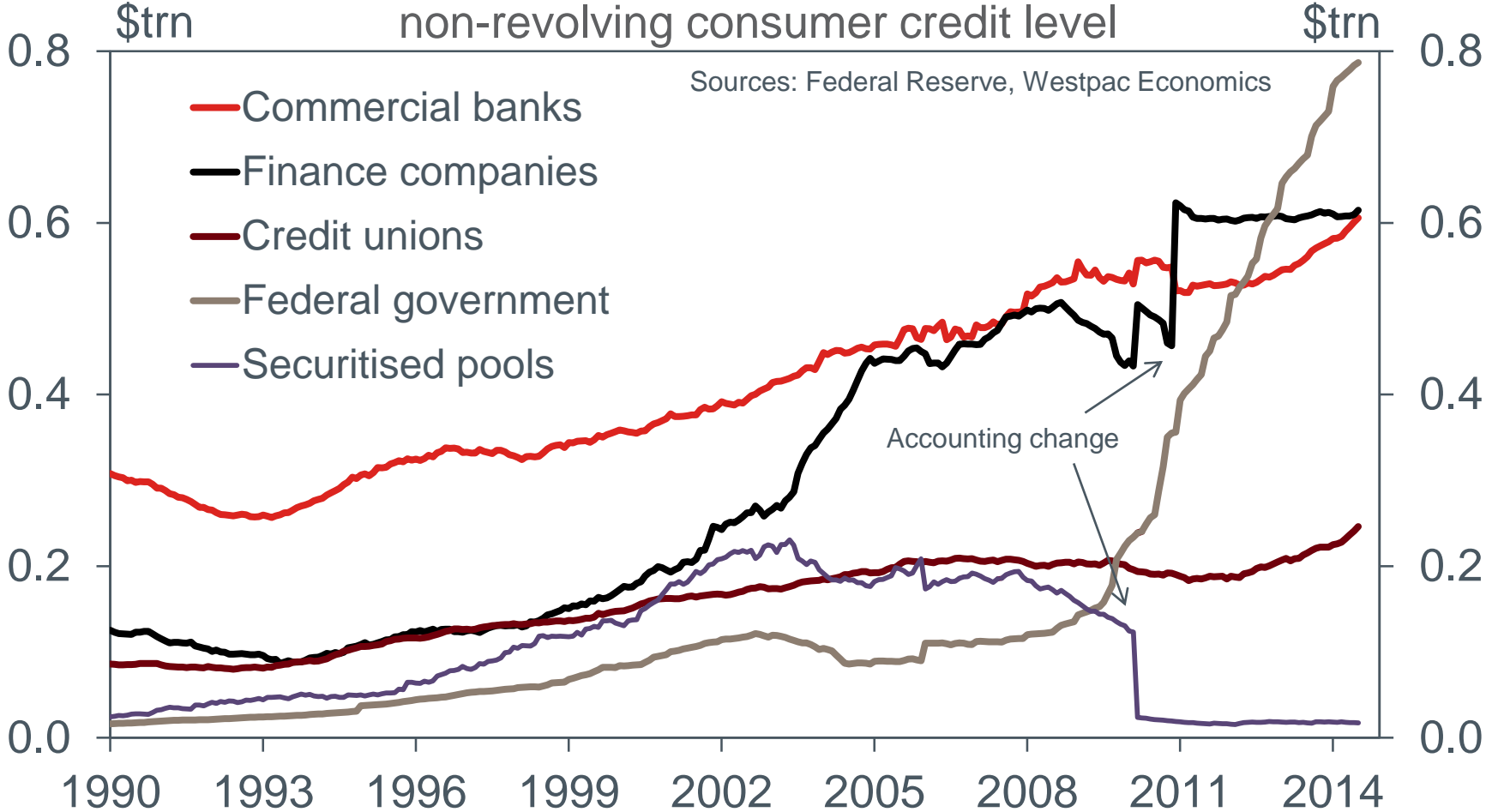
GSE conventional loan growth flat in Q2



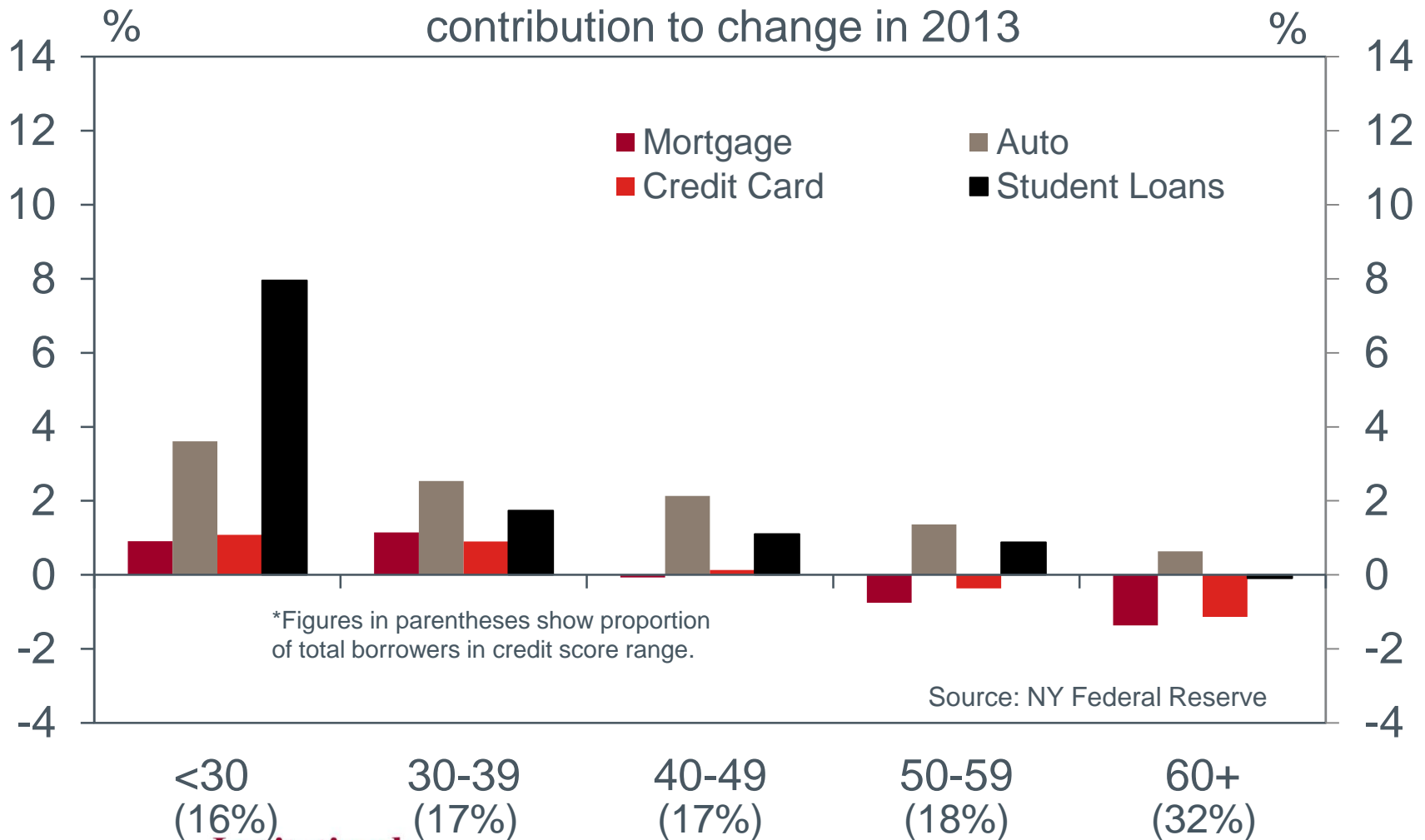
Student and auto loans key driver of HH credit



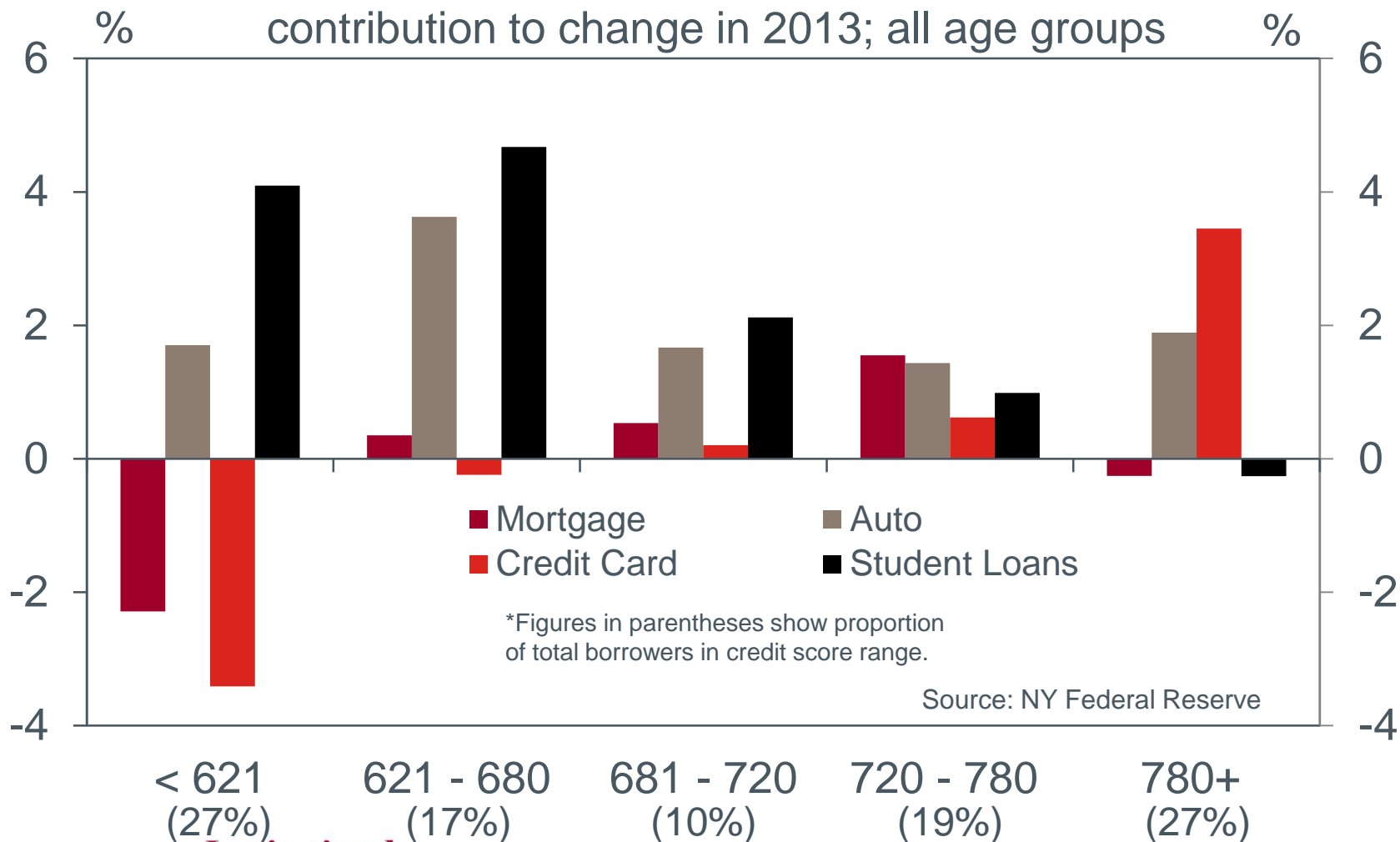
Government support for student loans key



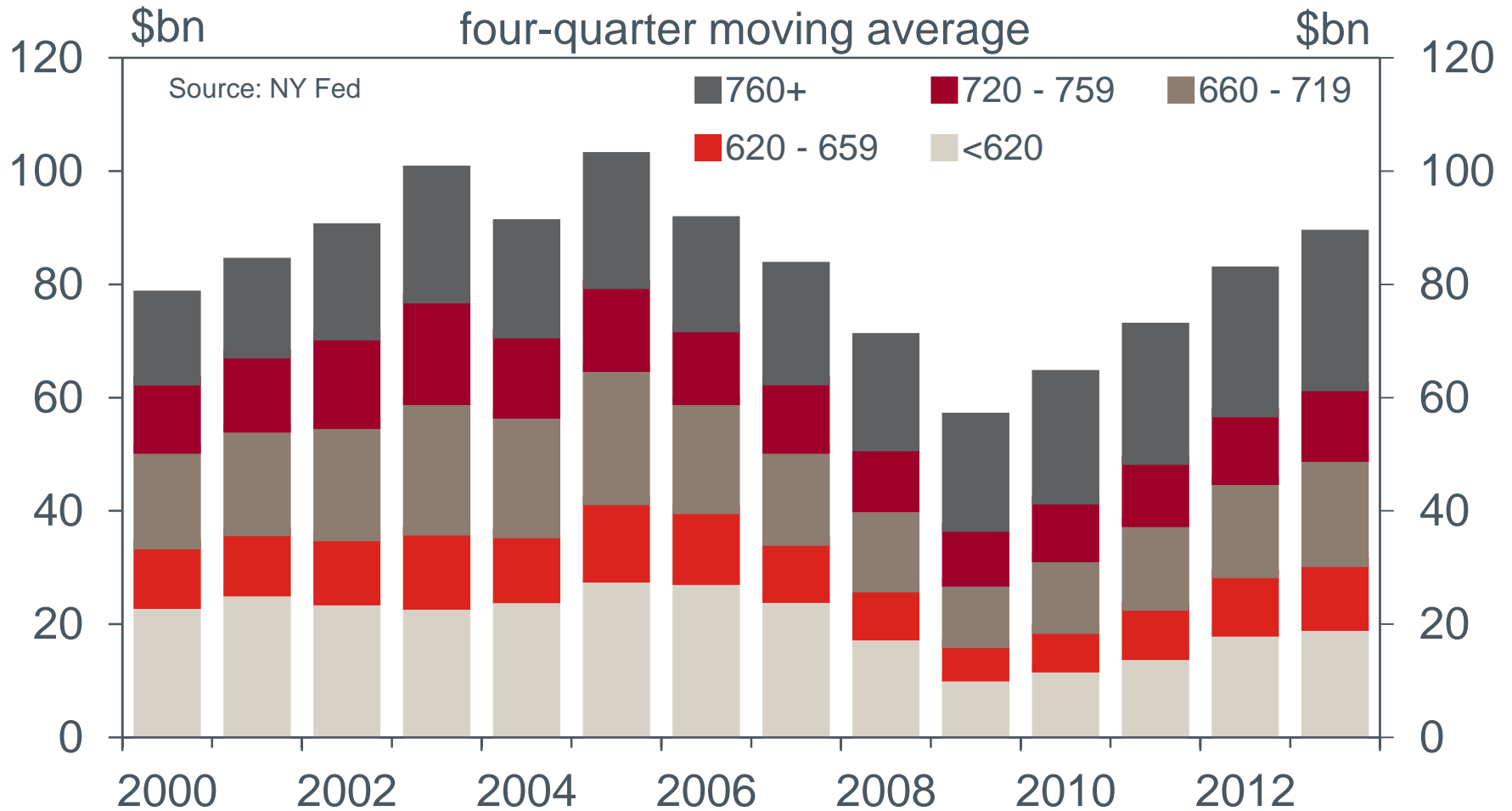
Change in debt by age group in 2013



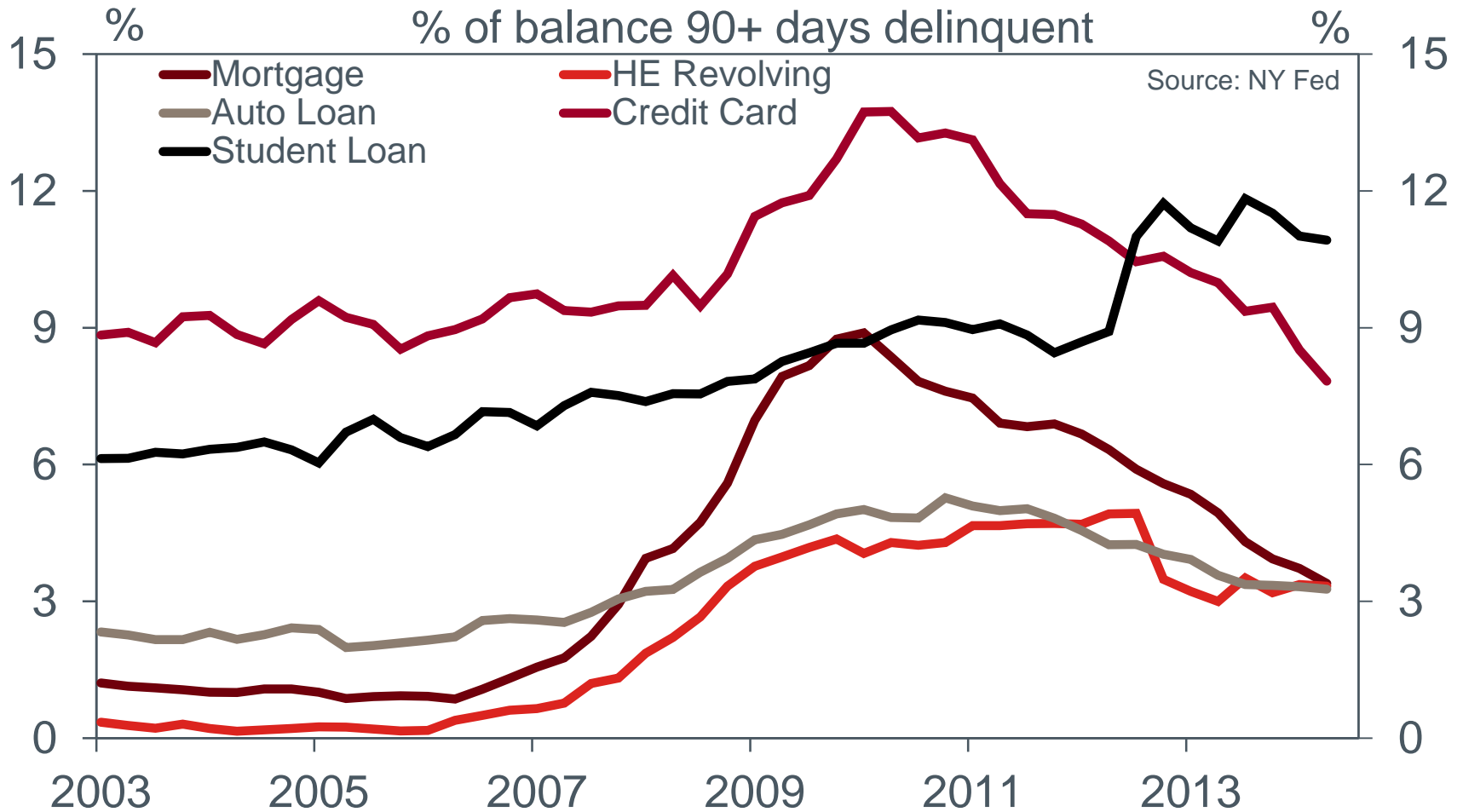
Change in debt by credit score in 2013



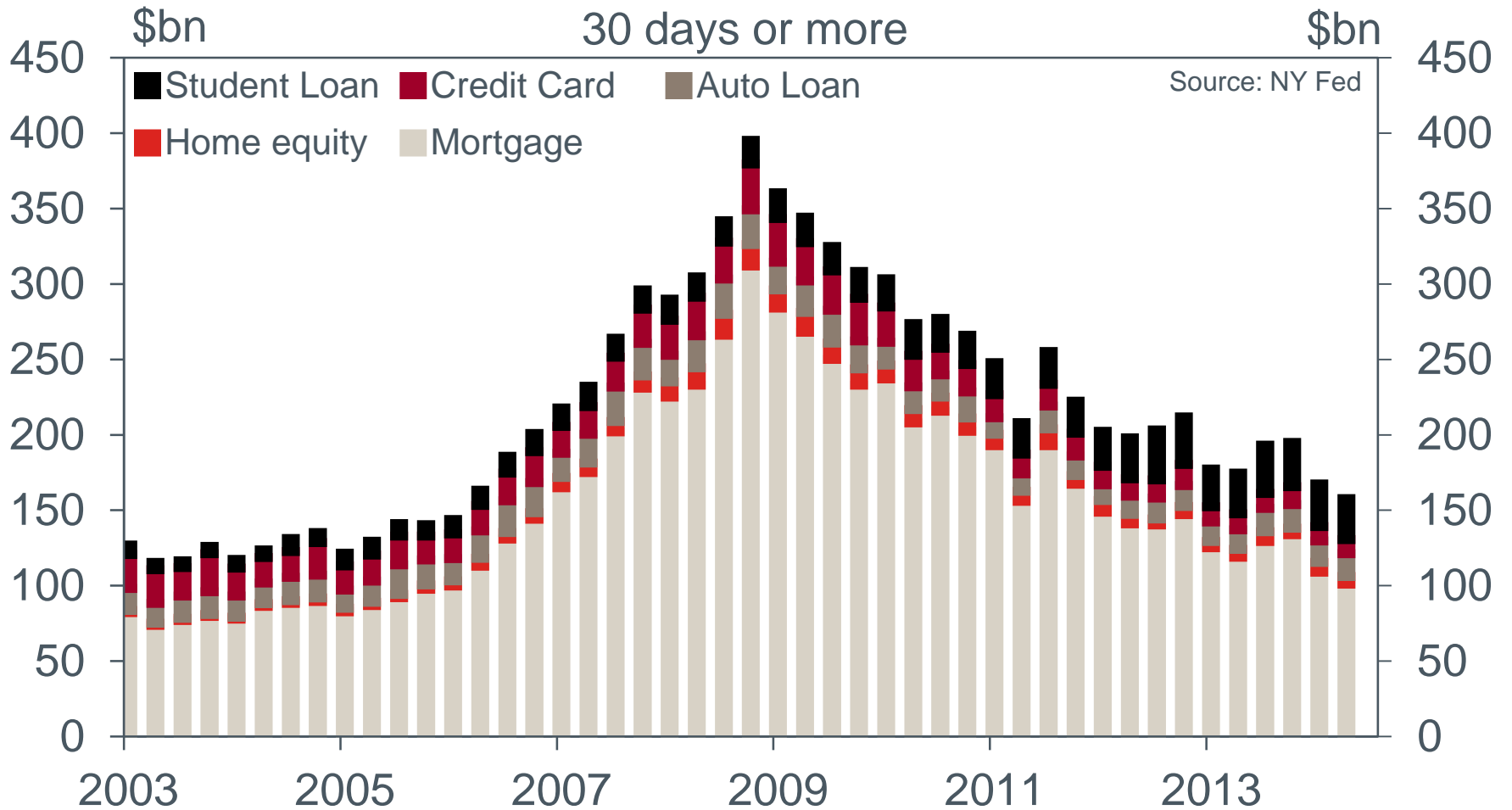
Total auto loans by credit score



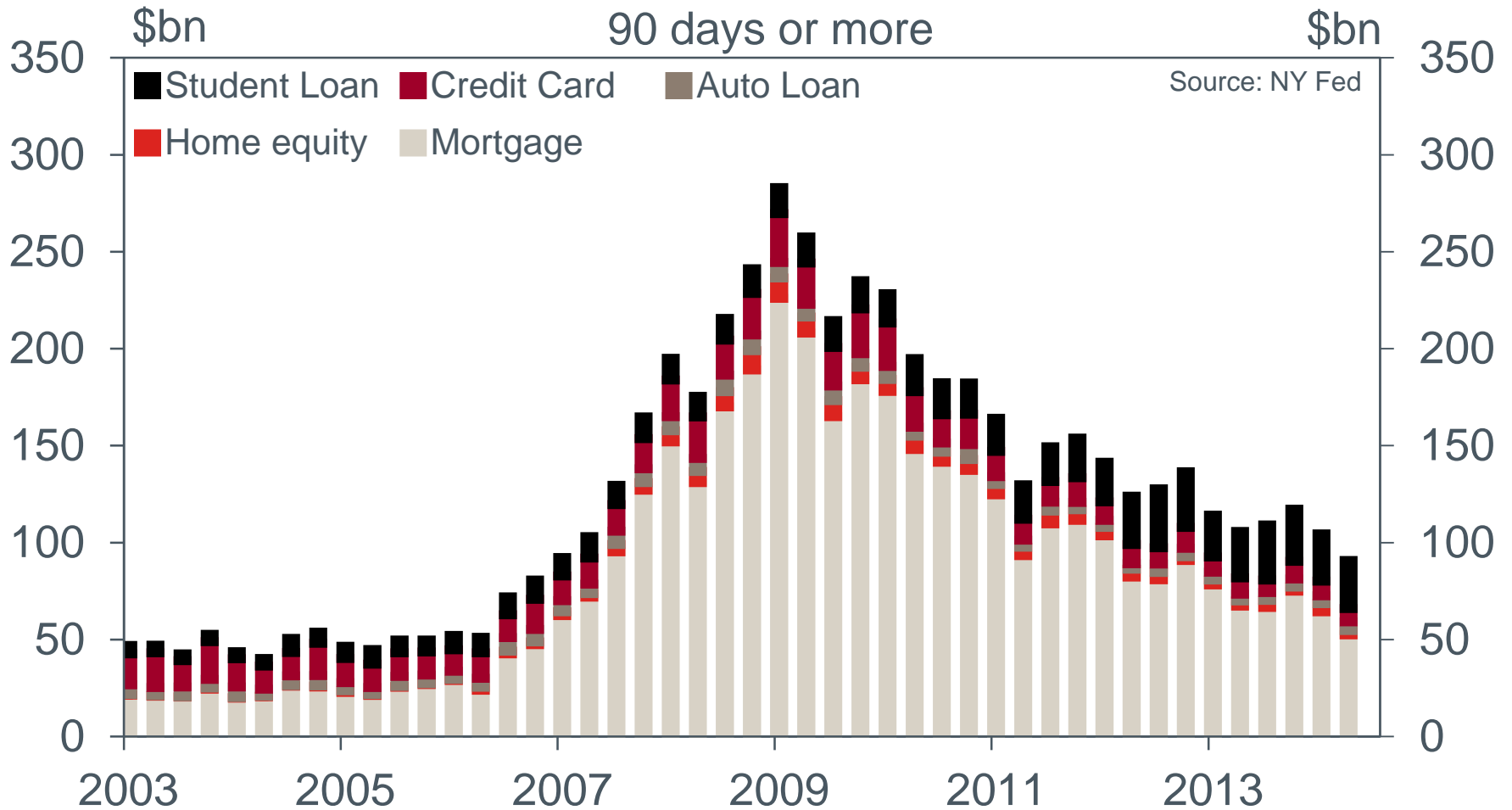
Delinquency rate by debt type



New delinquent balances by loan type

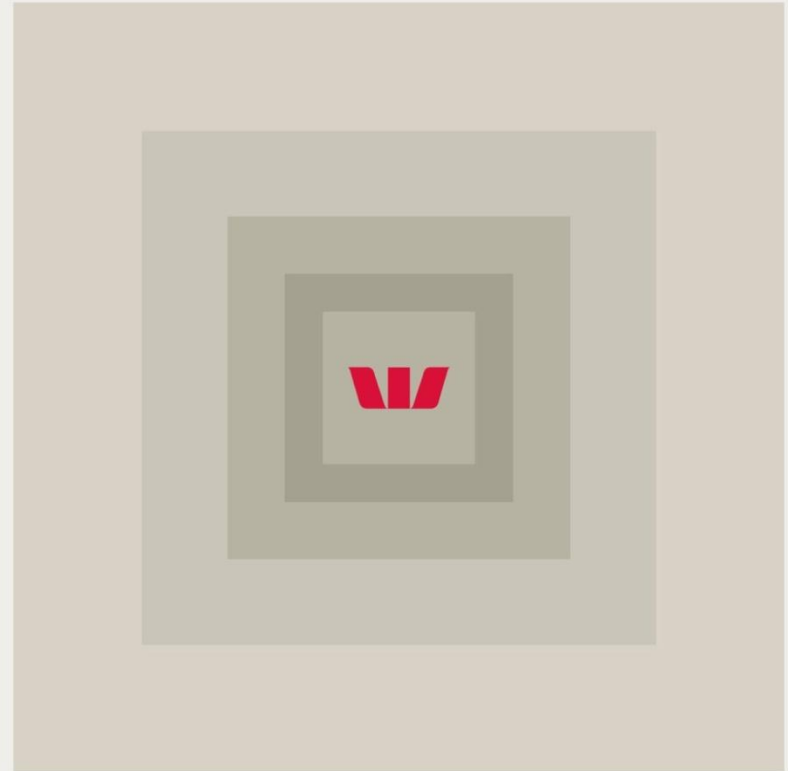


New seriously delinquent balances by loan type

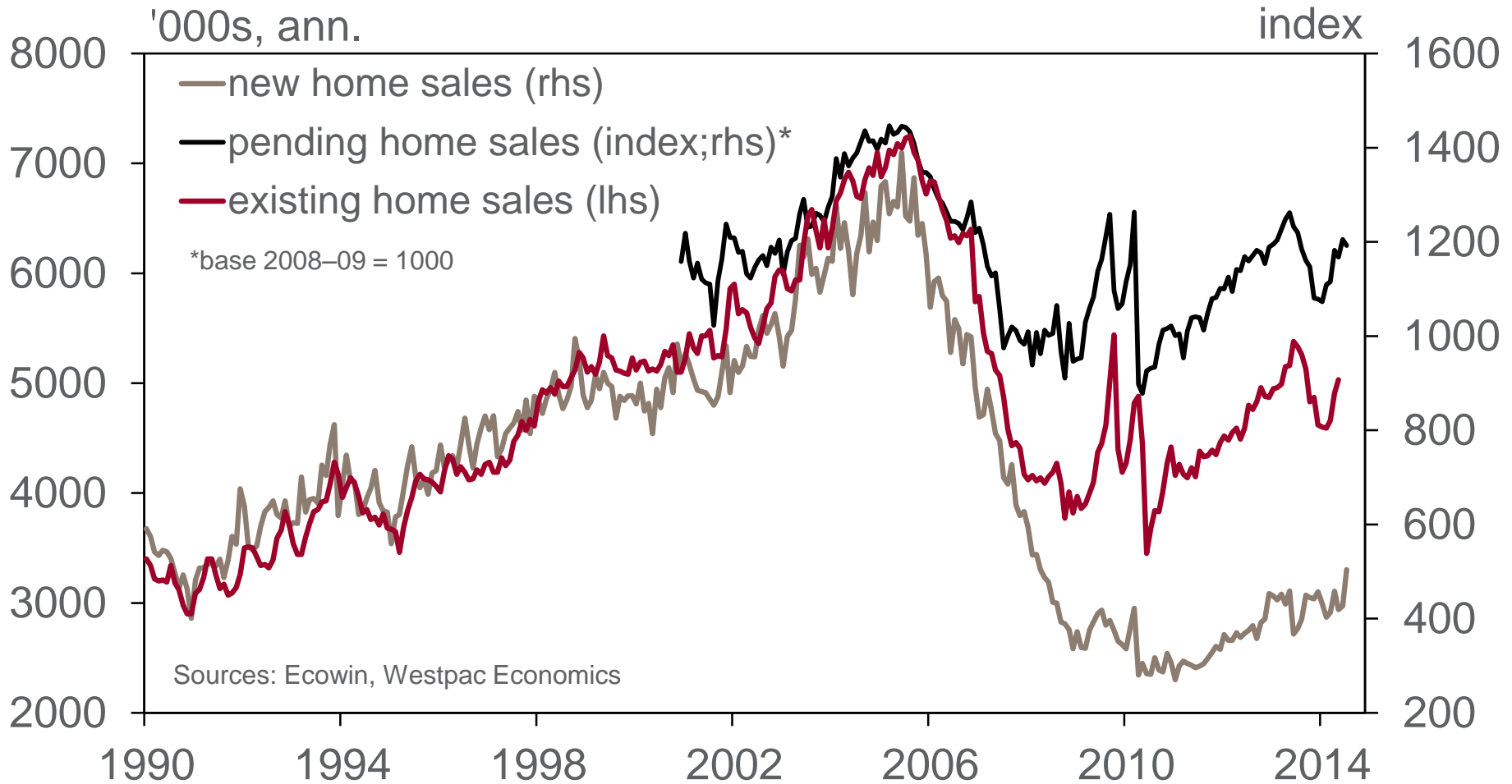


The housing market

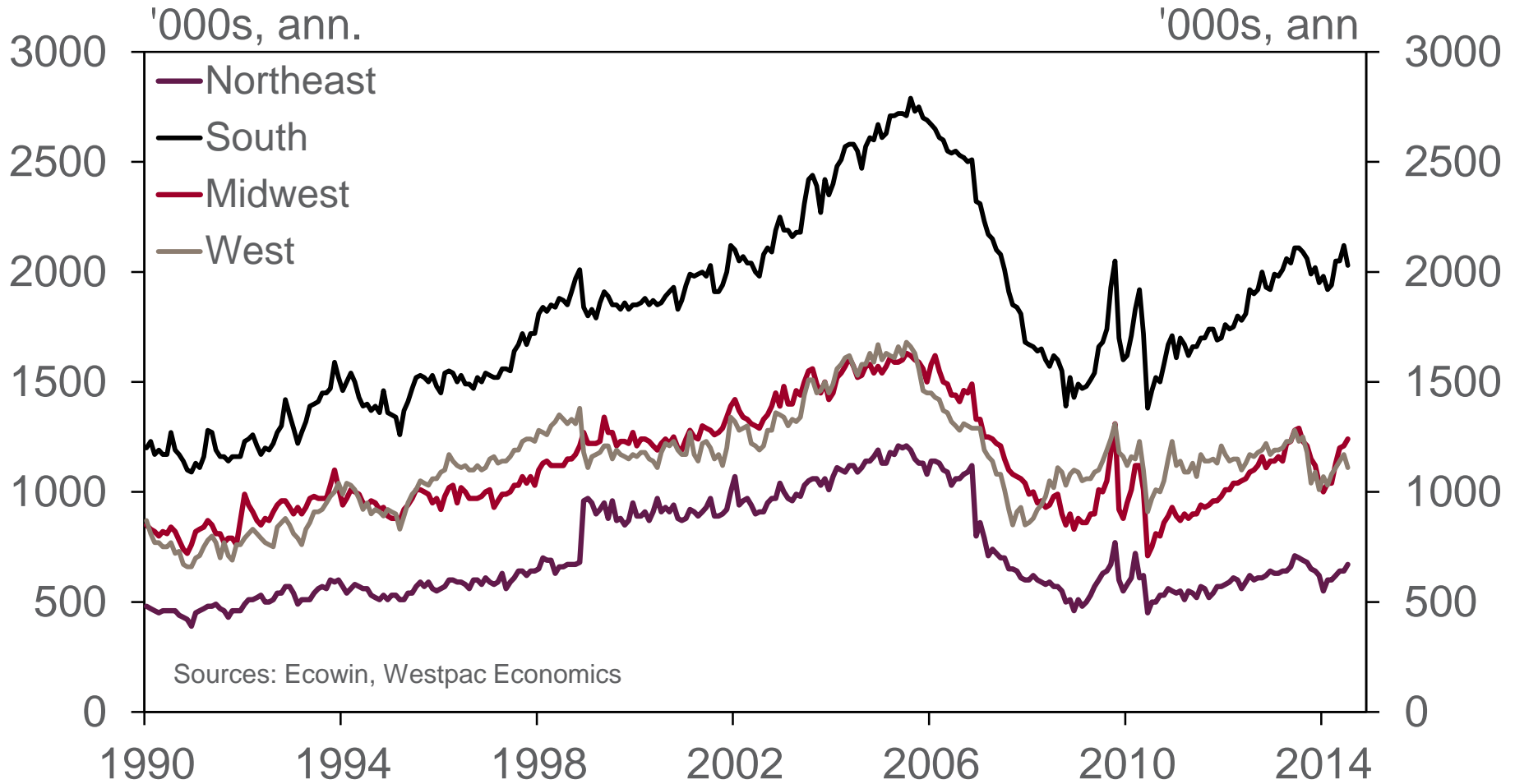
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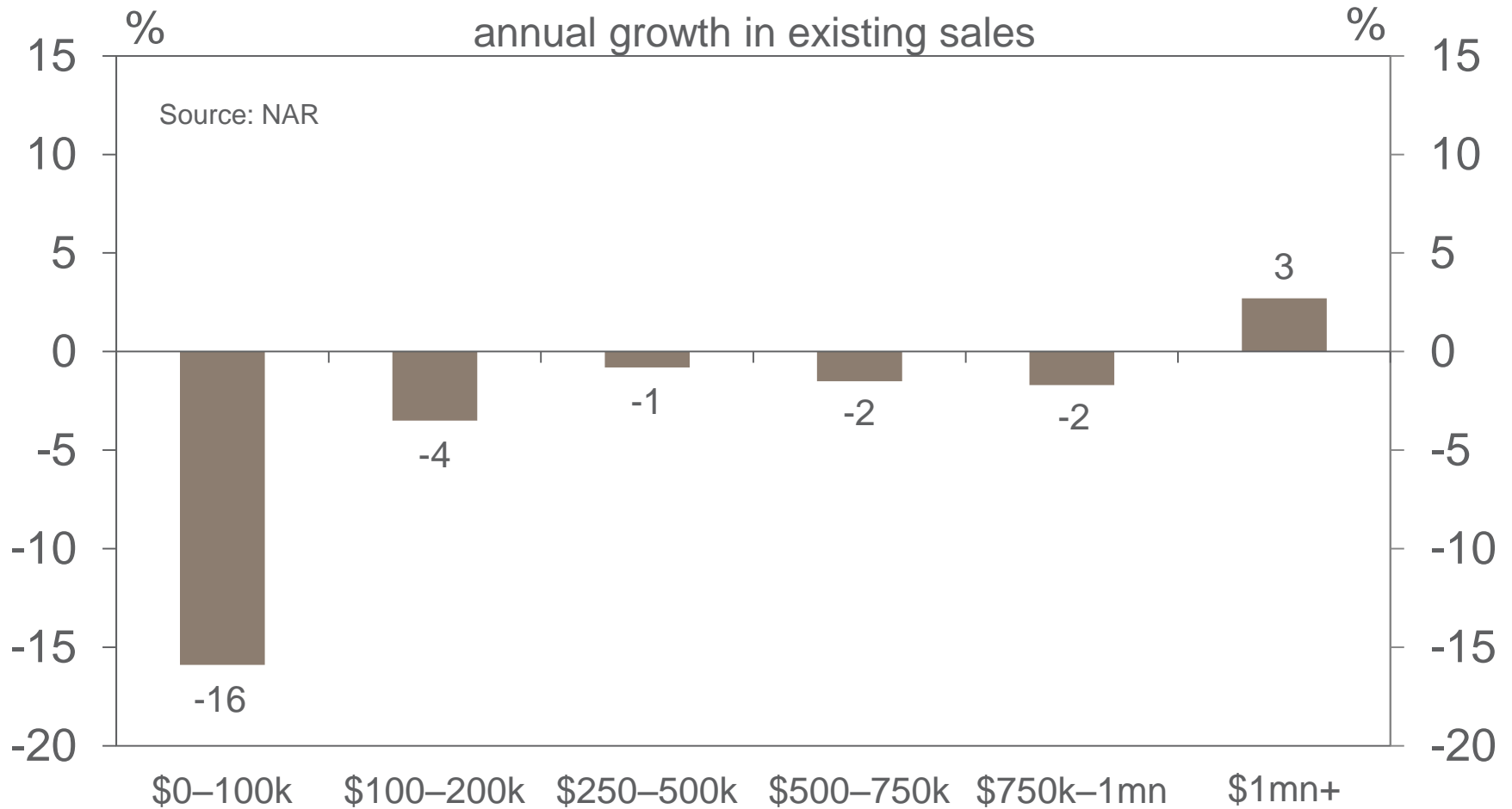
Housing activity concentrated in existing market



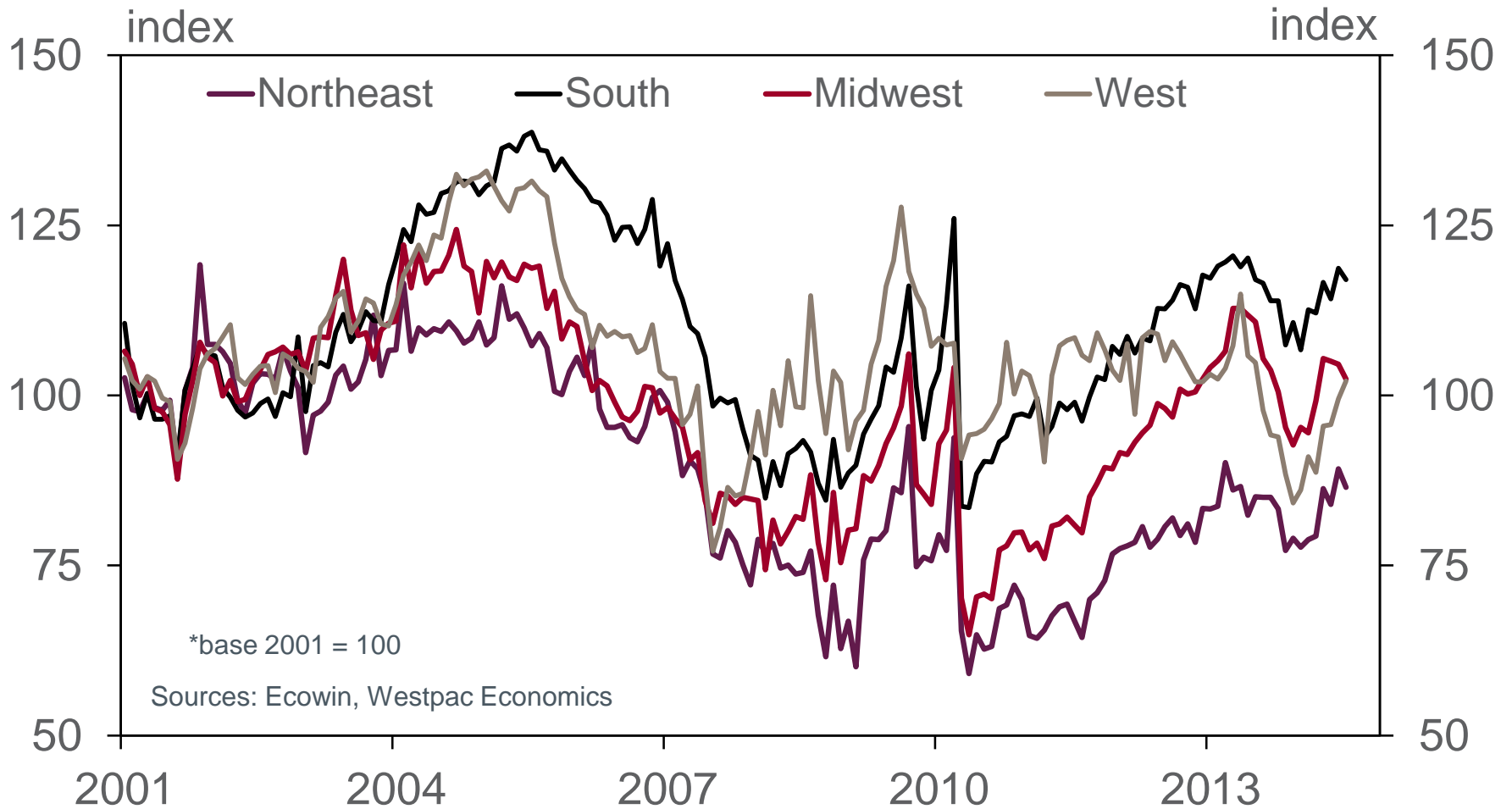
Existing home sales across the nation



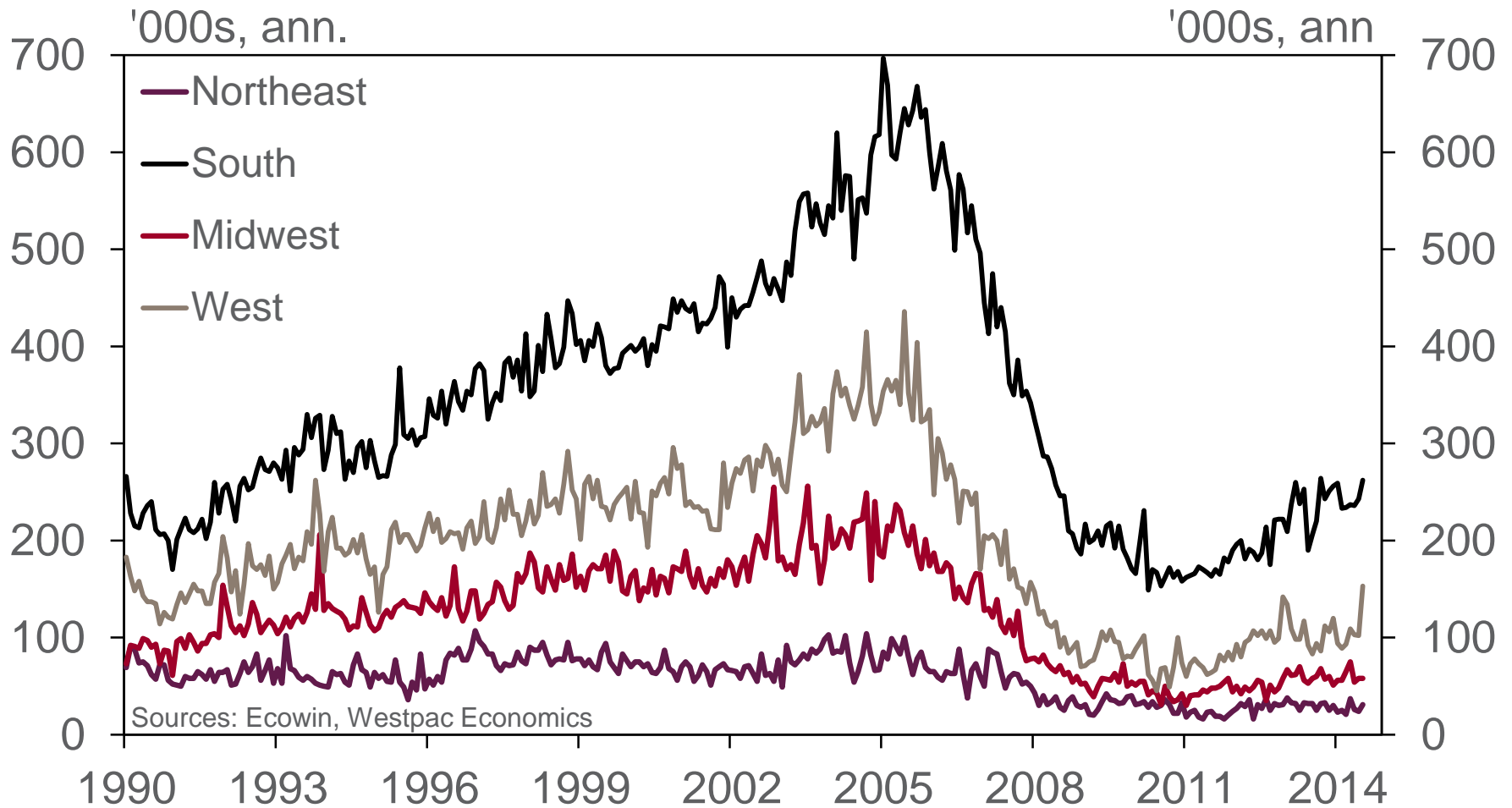
Existing home sales by price bracket



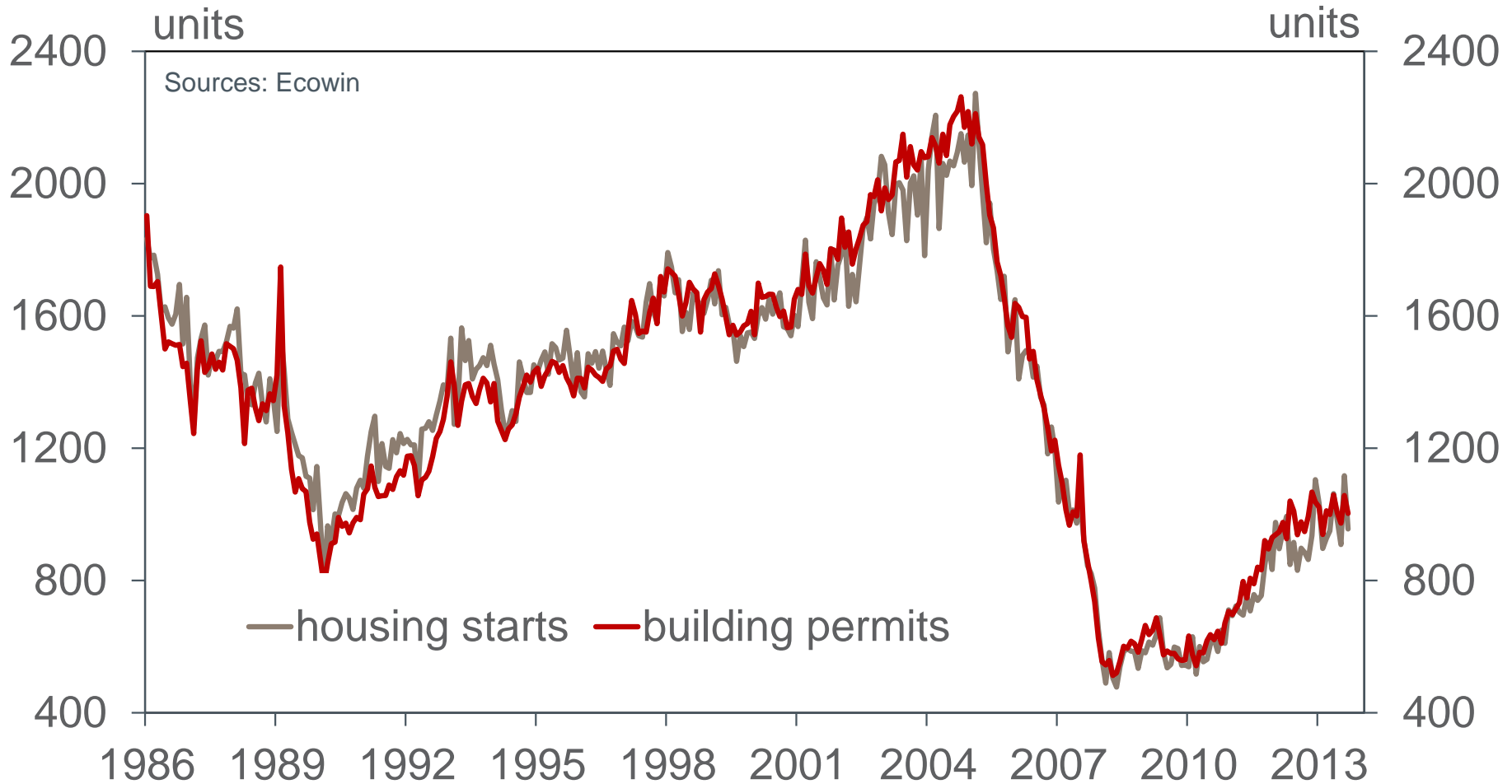
Pending home sales across the nation



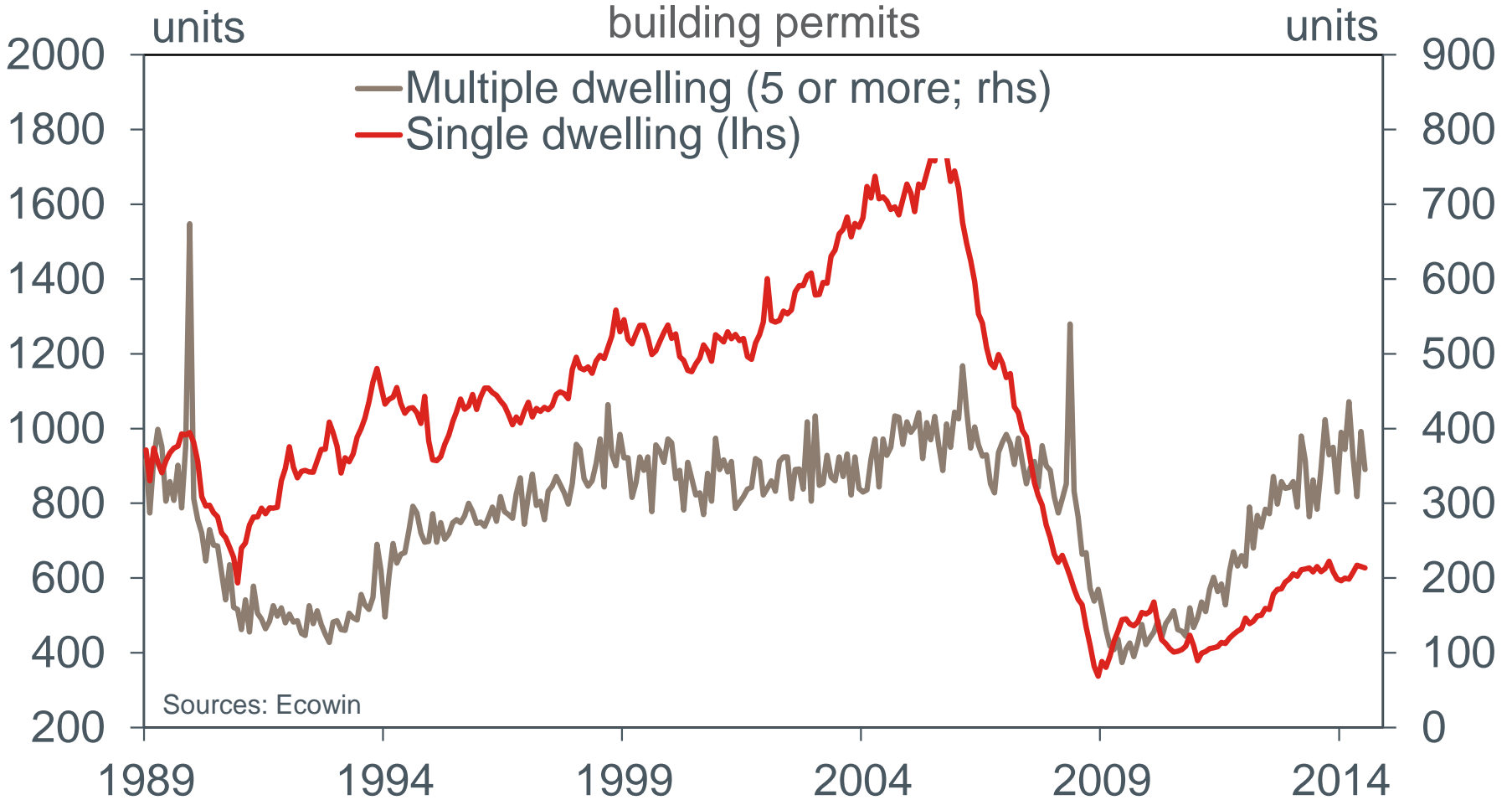
New home sales across the nation



US housing starts & permits, uptrend has slowed

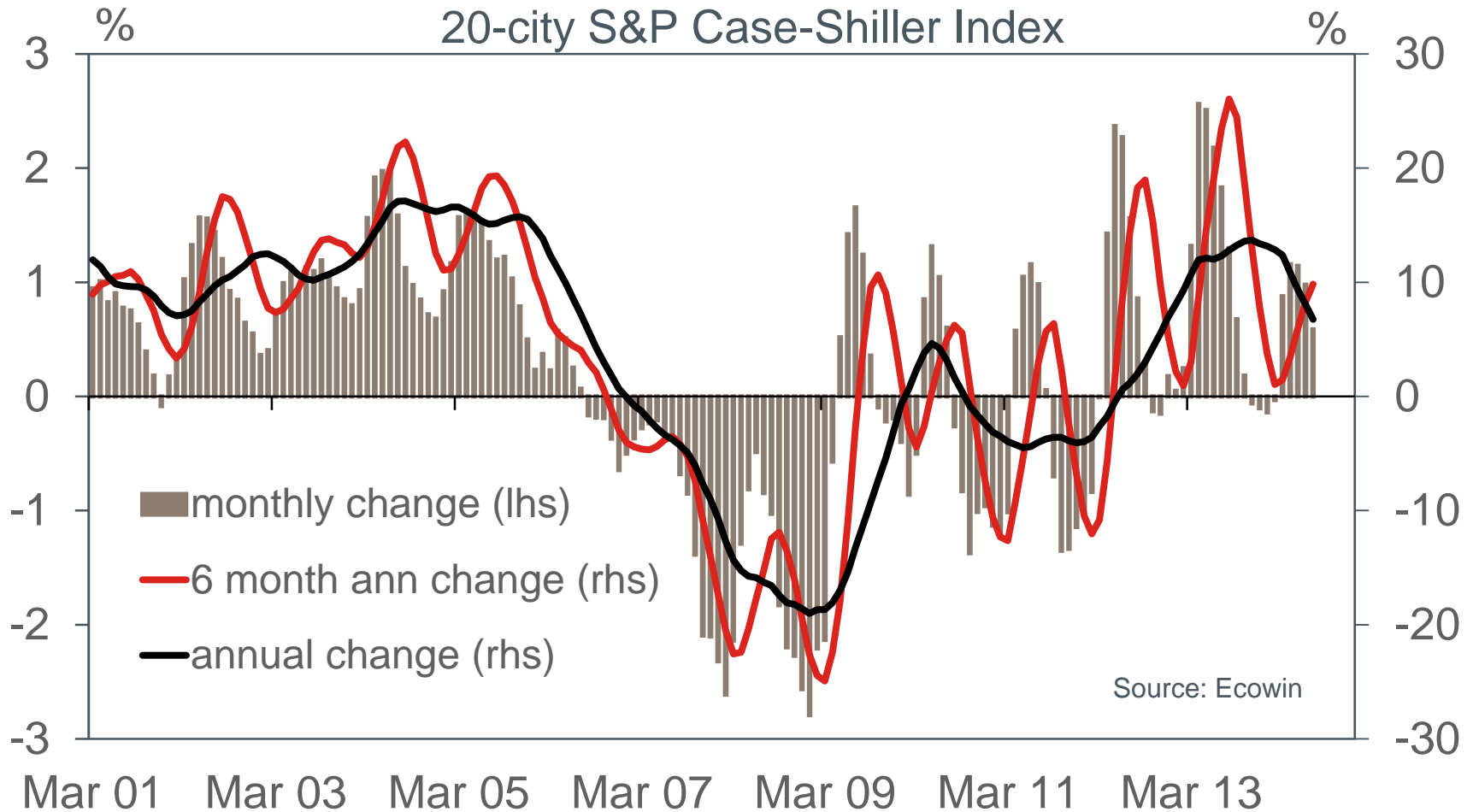


Volatile multiples, supported by investors



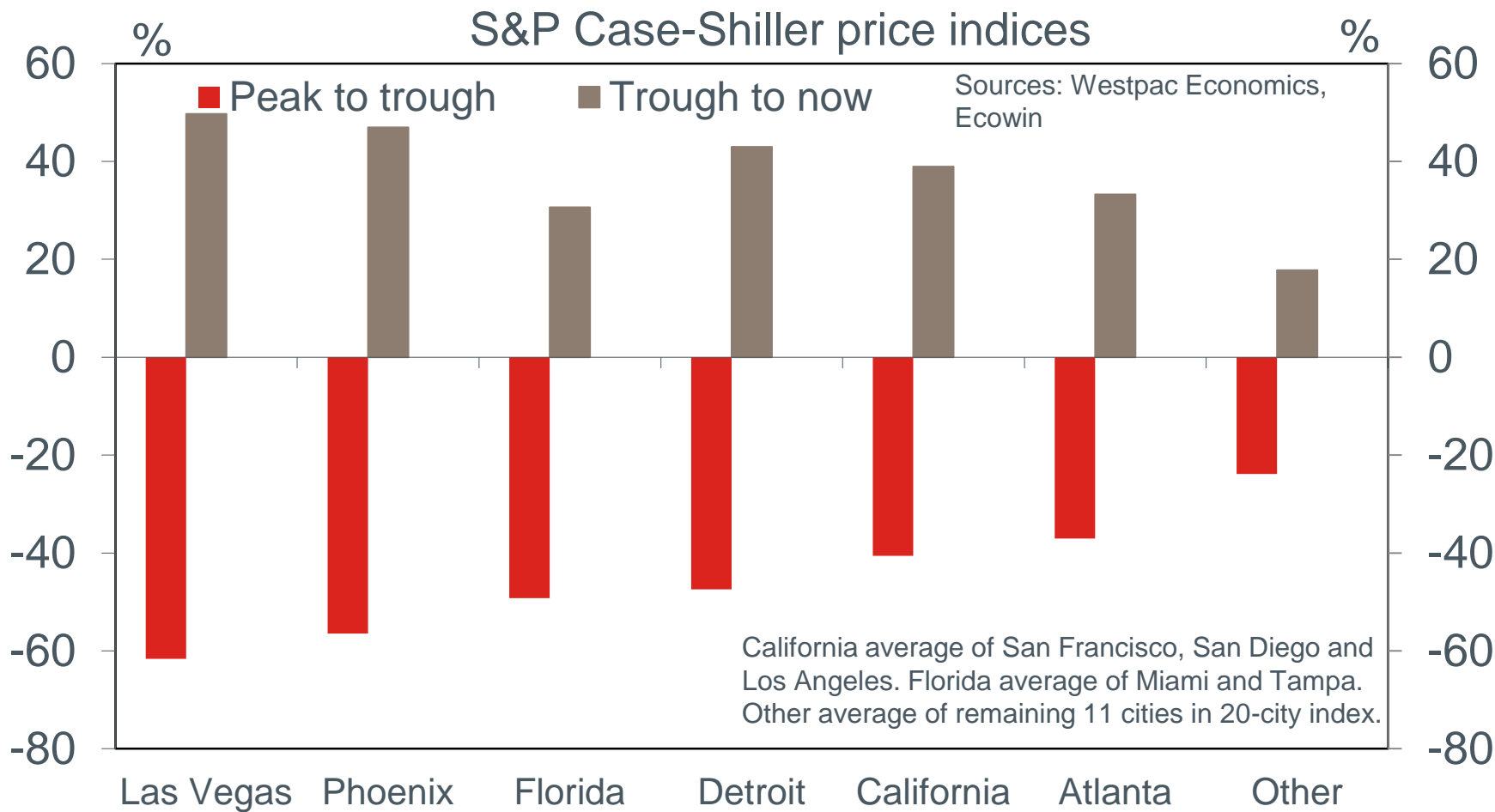
Sources: Ecowin

House prices continue to rise



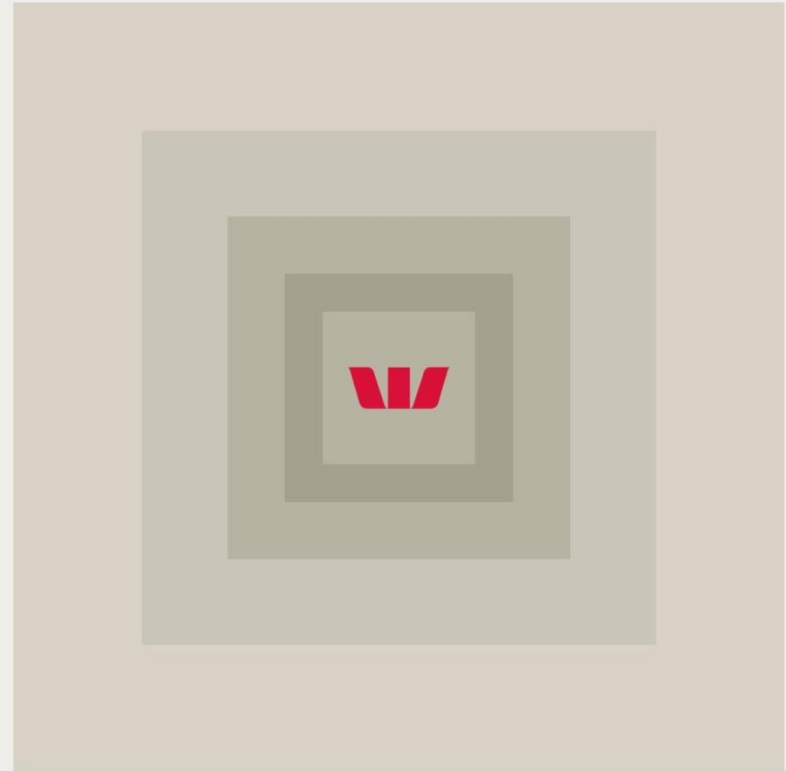
Source: Ecowin

Price gains much larger in distressed areas

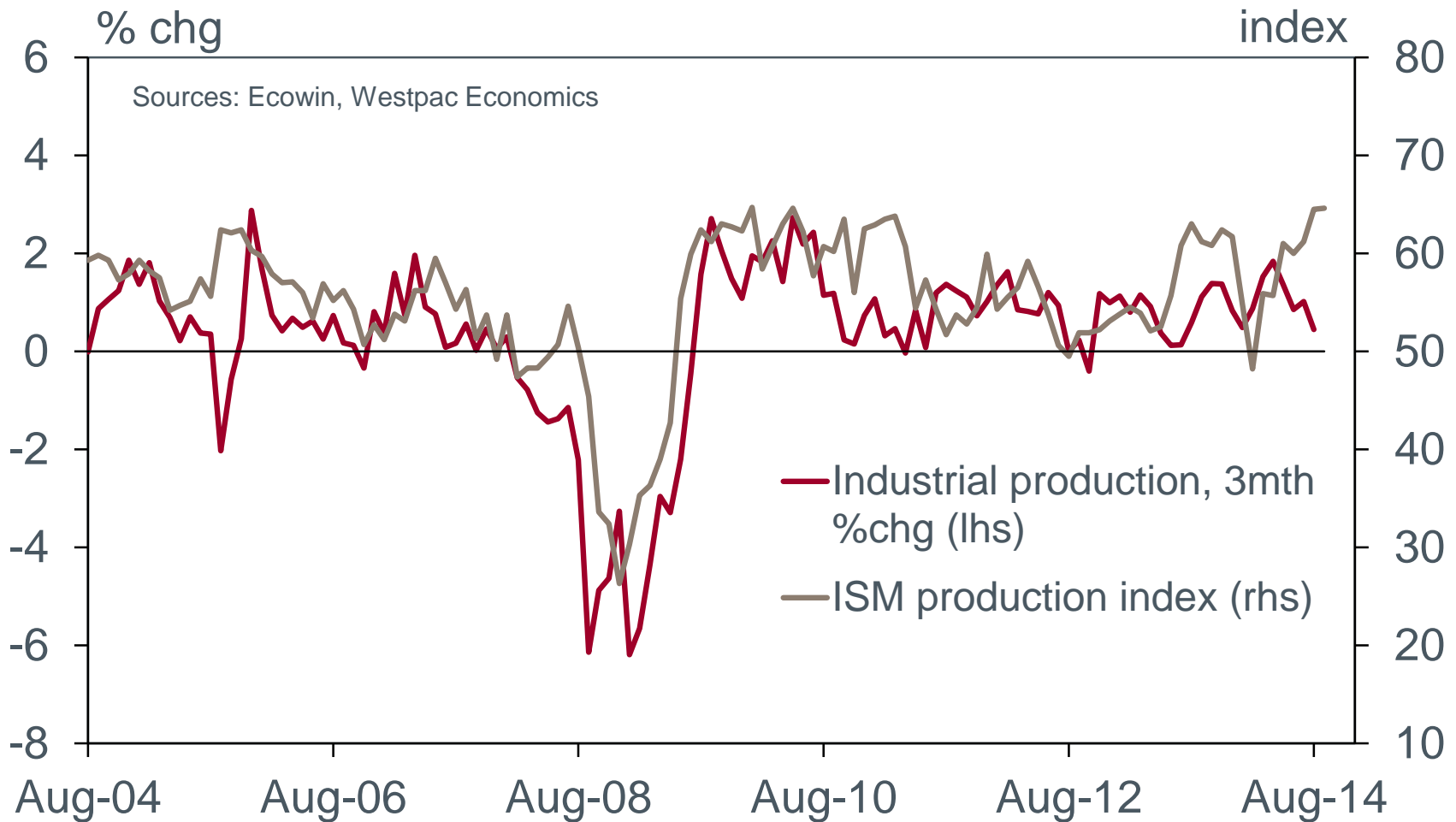


Business conditions, investment & financing

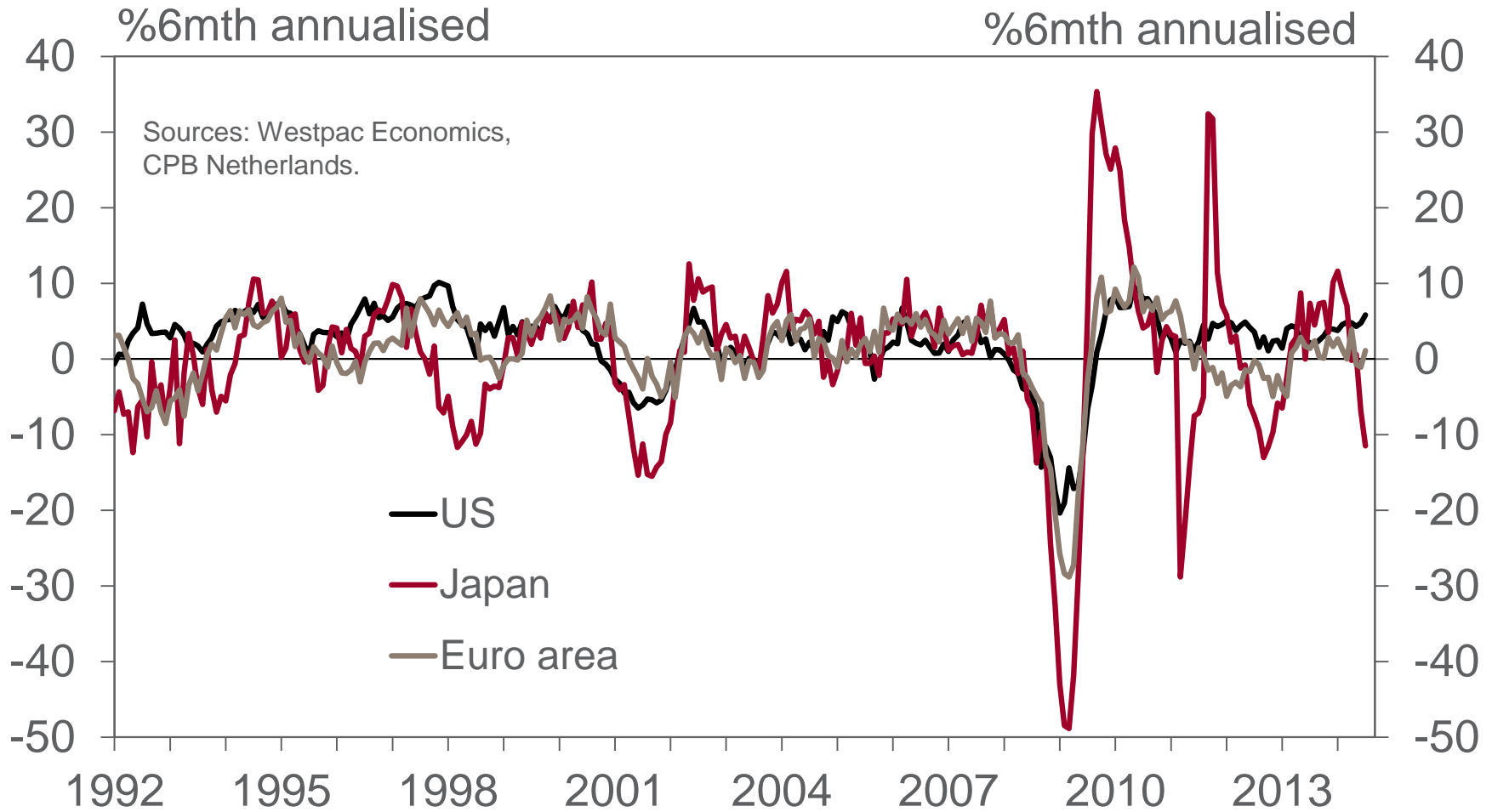
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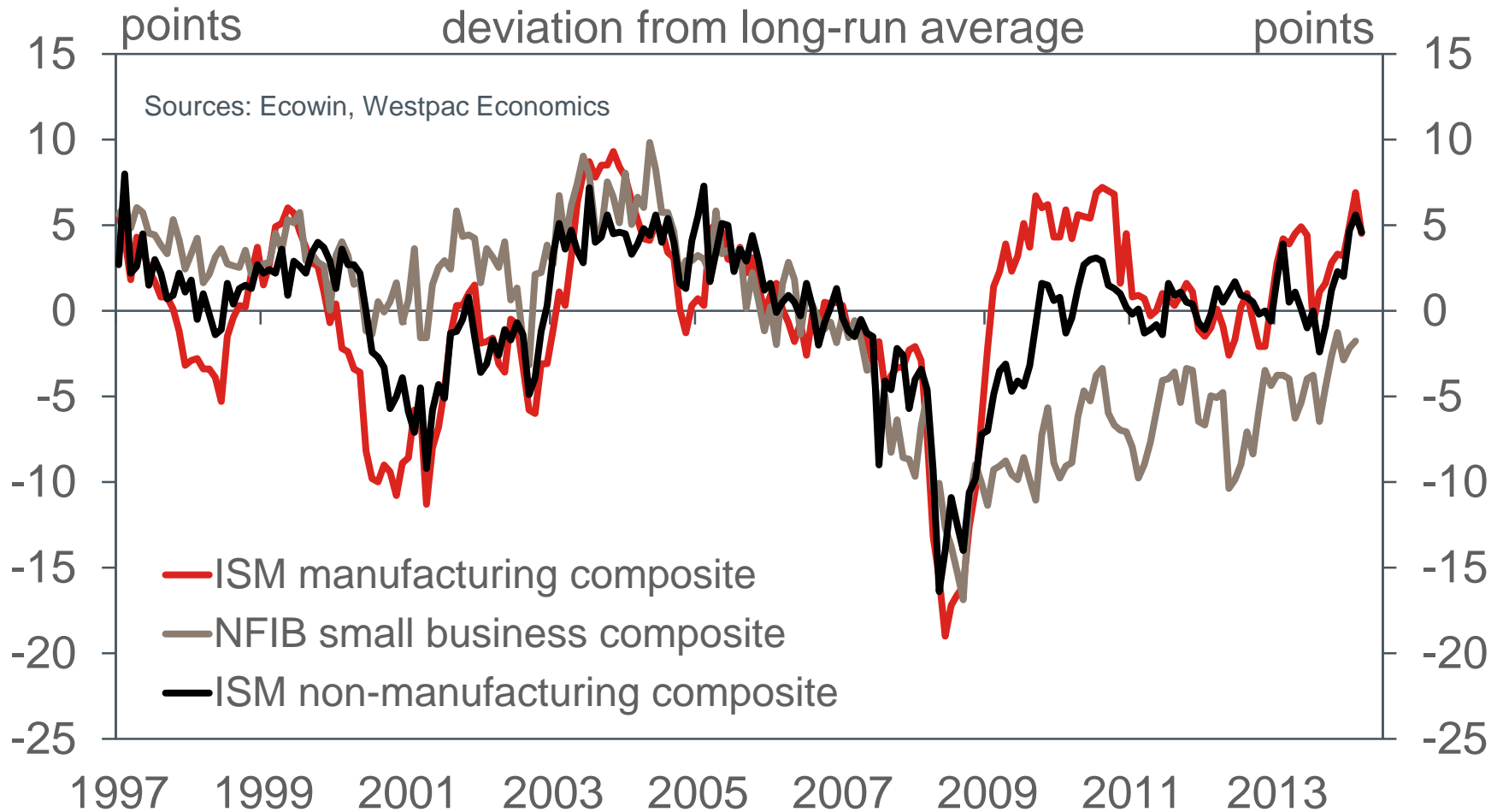
US industrial sector activity firming



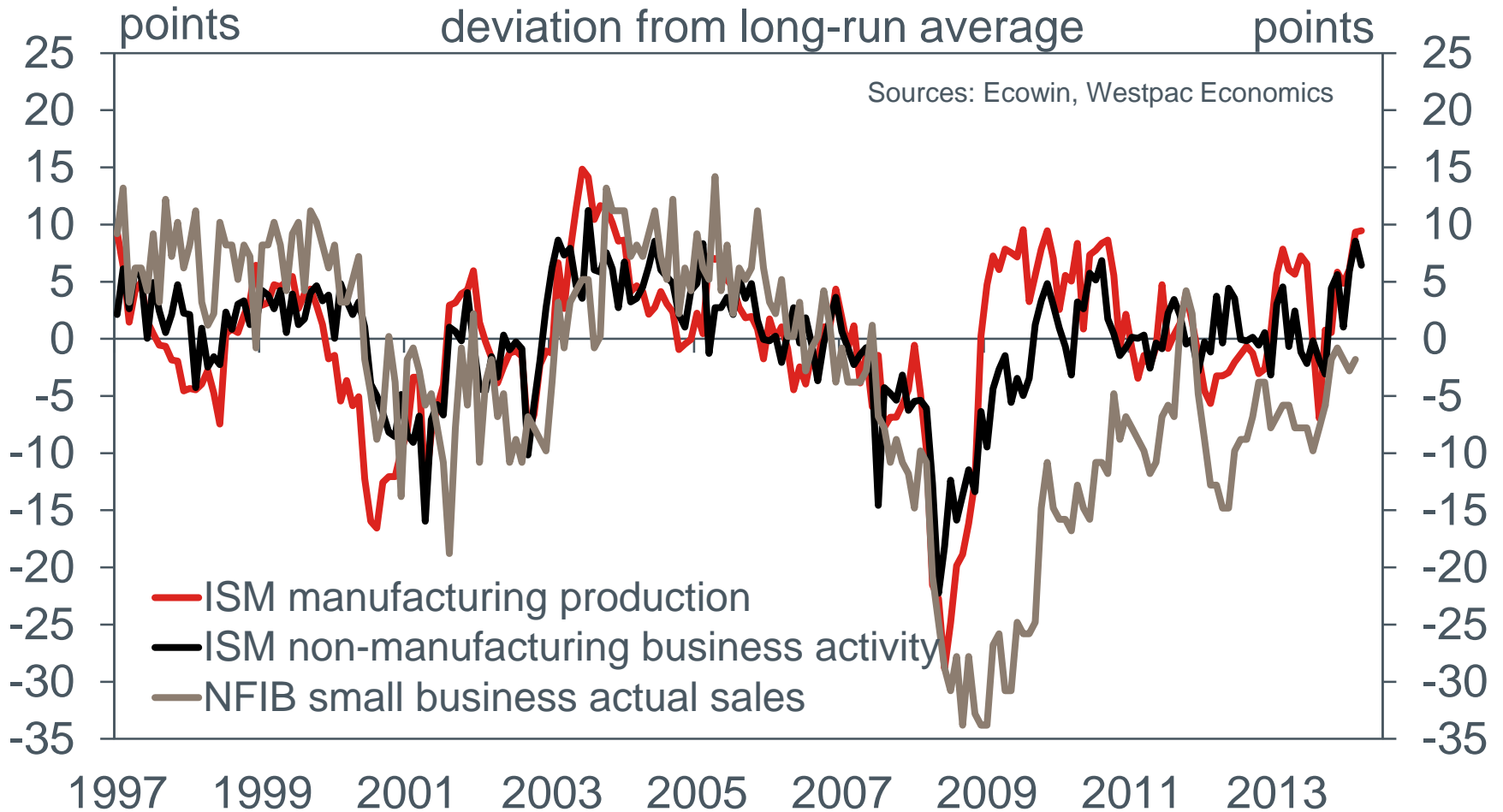
G3 industrial production volume



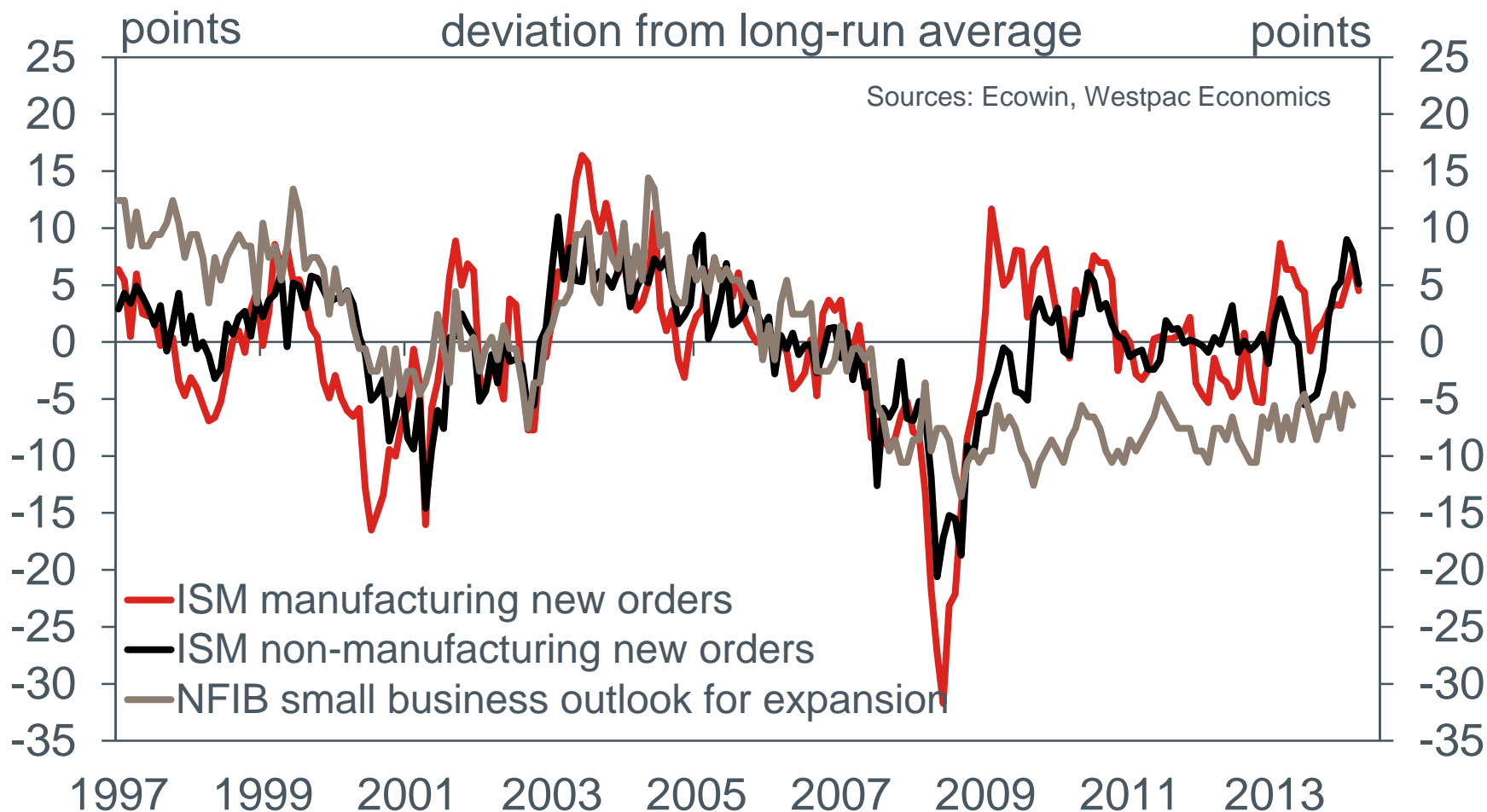
Business conditions differ by firm size & industry



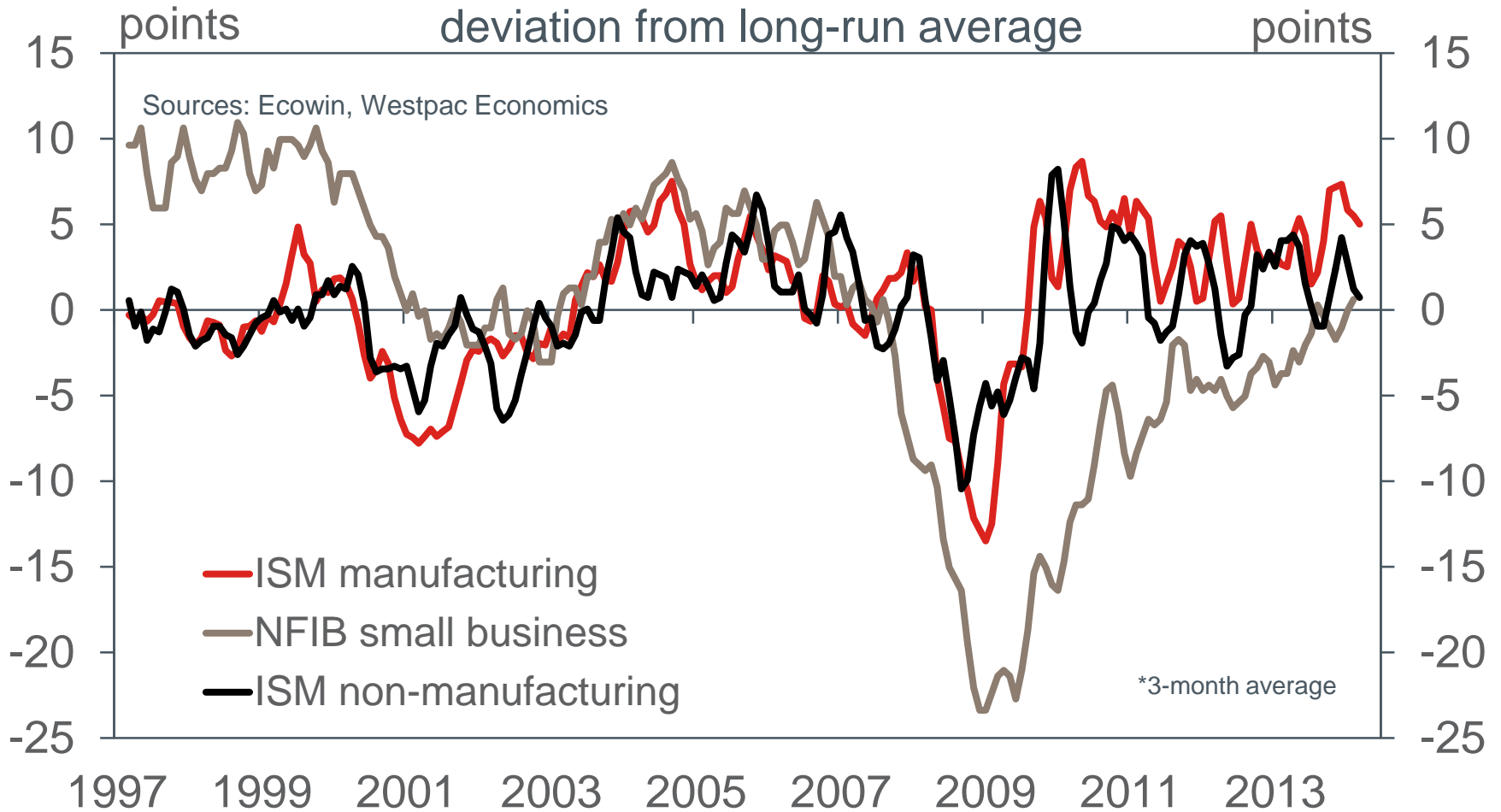
Small firms at competitive disadvantage



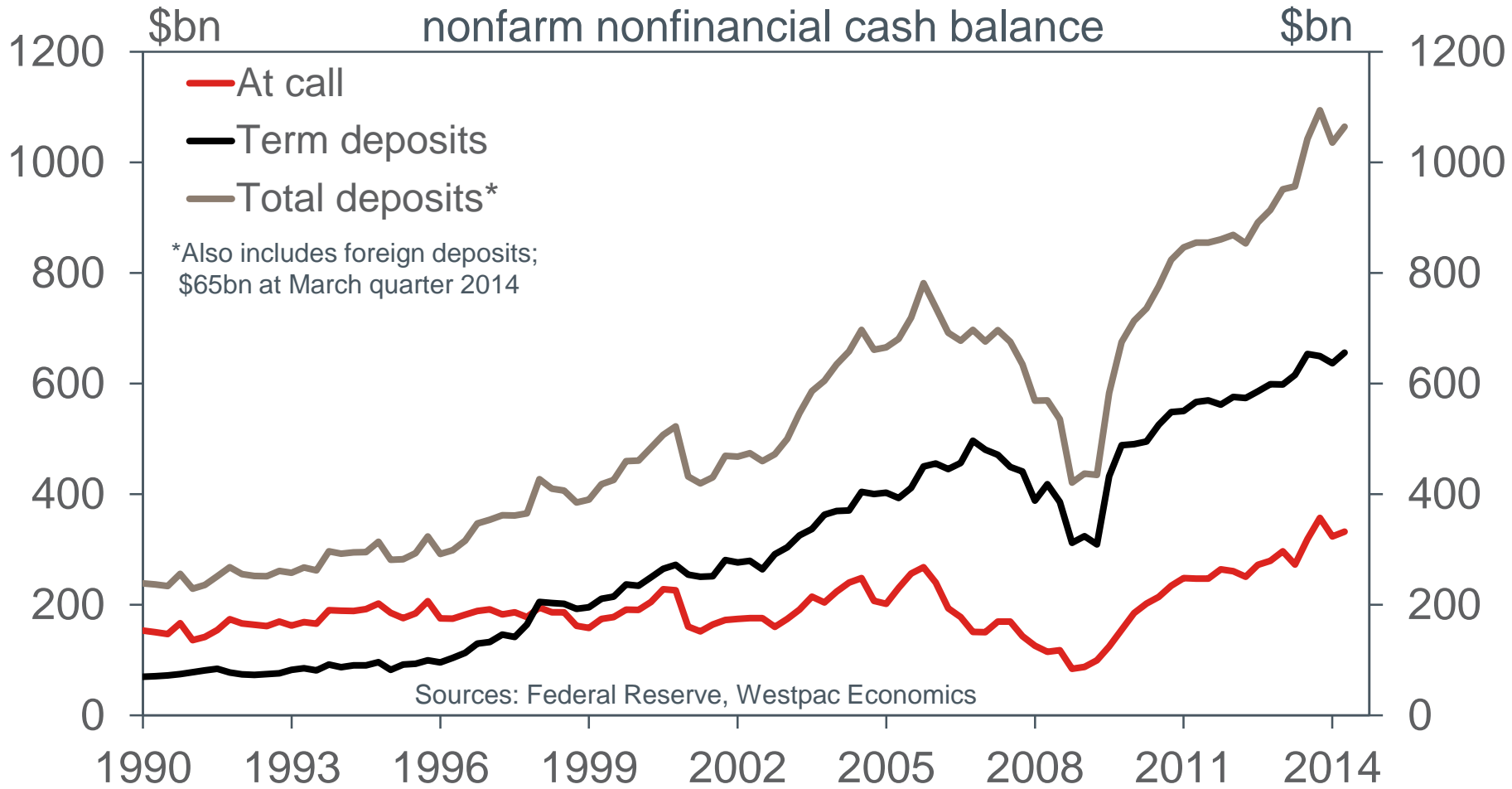
Global reach a substantial benefit of scale



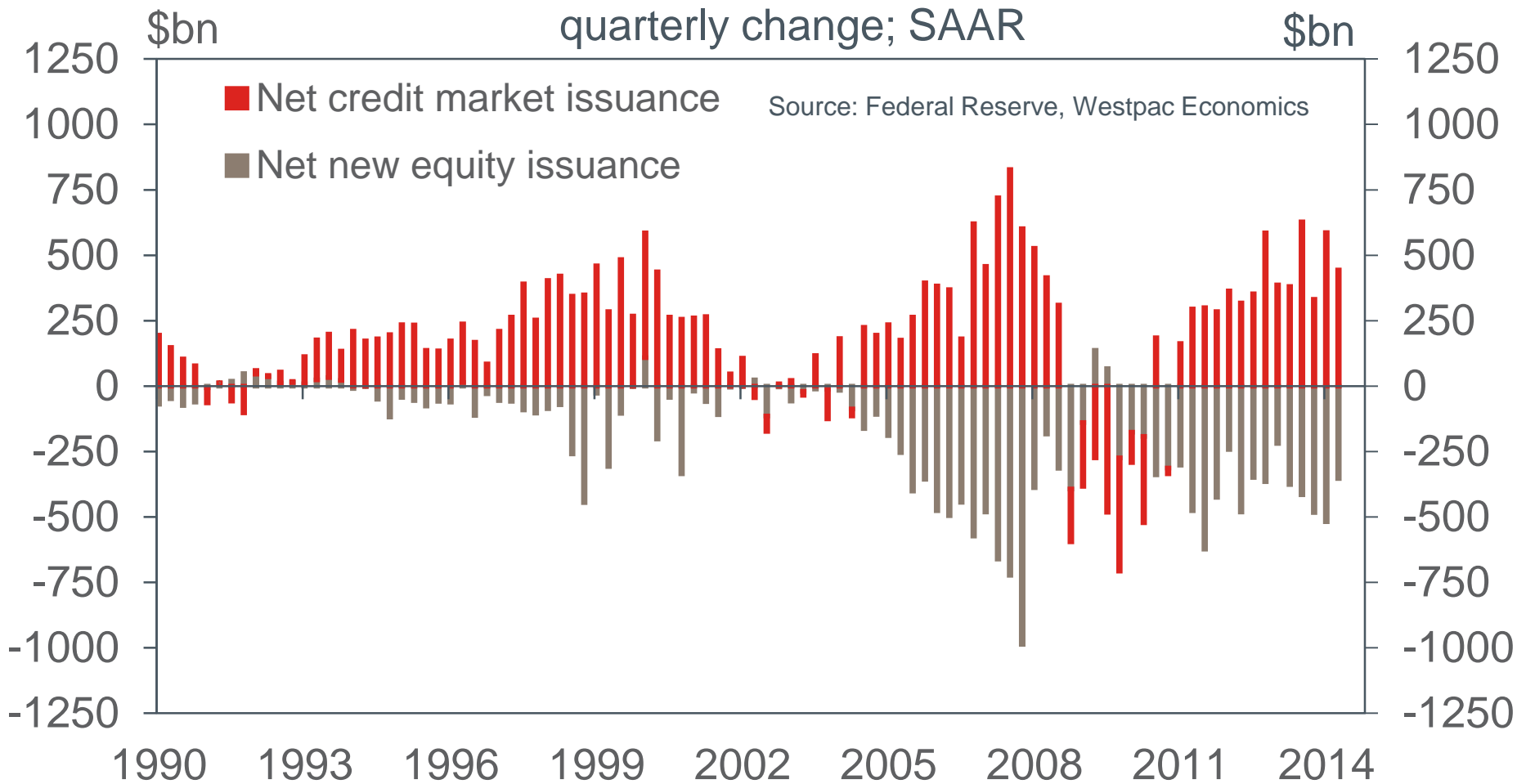
Inventory cycle



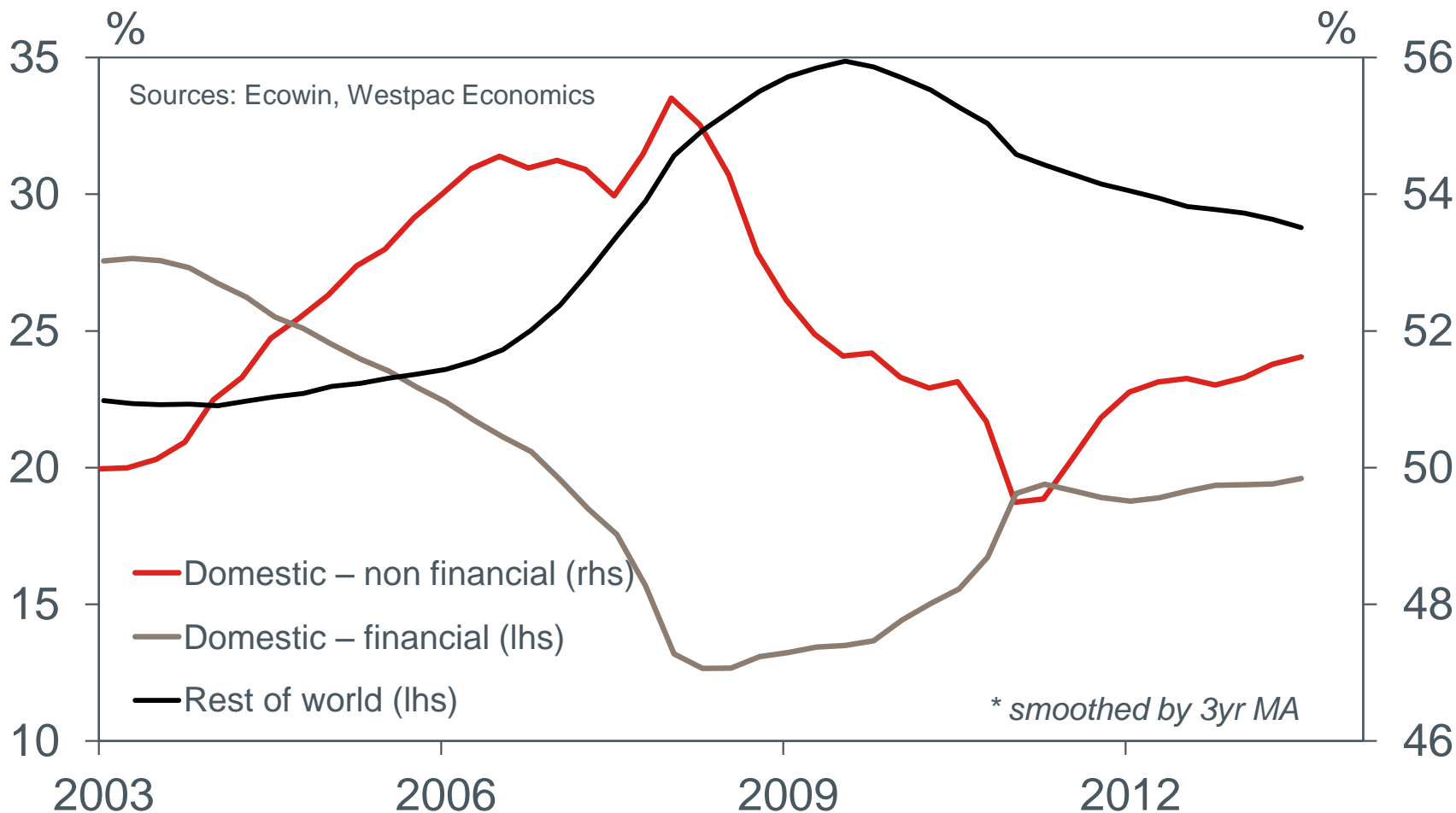
Firms continue to accrue cash



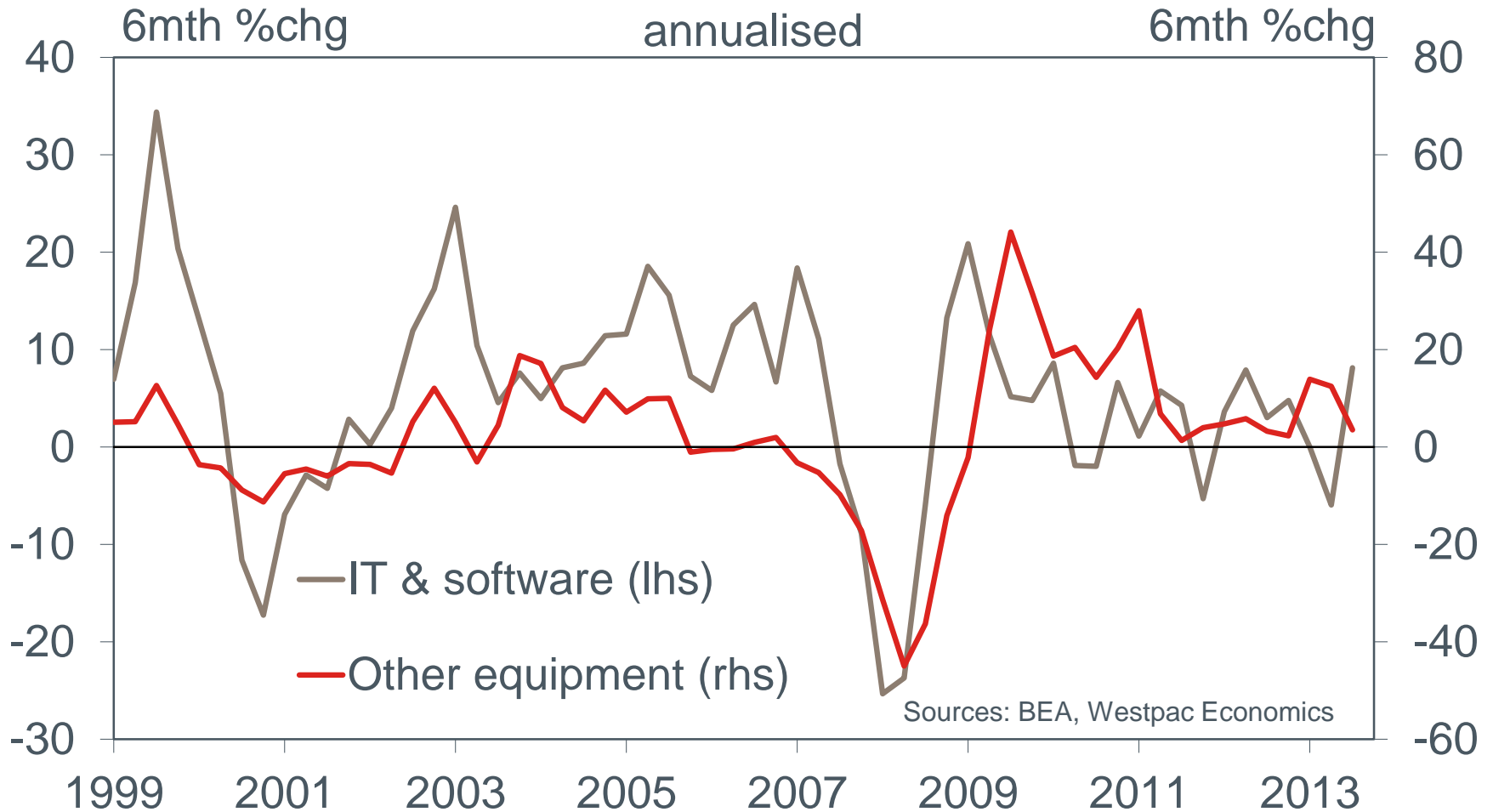
Debt partly to fund equity buy back/ M&A



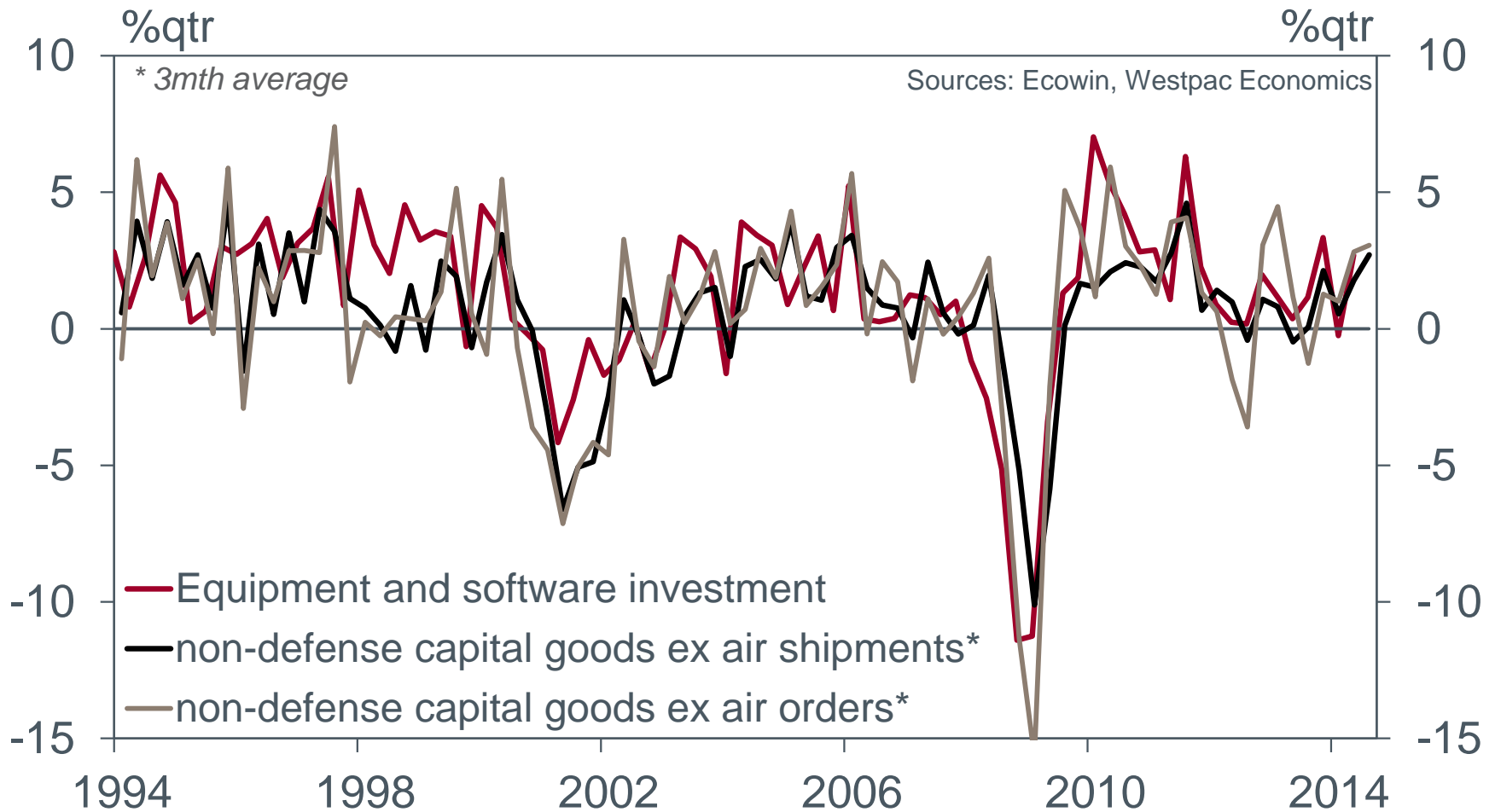
Corporate profits – share of total



US equipment investment lacks momentum

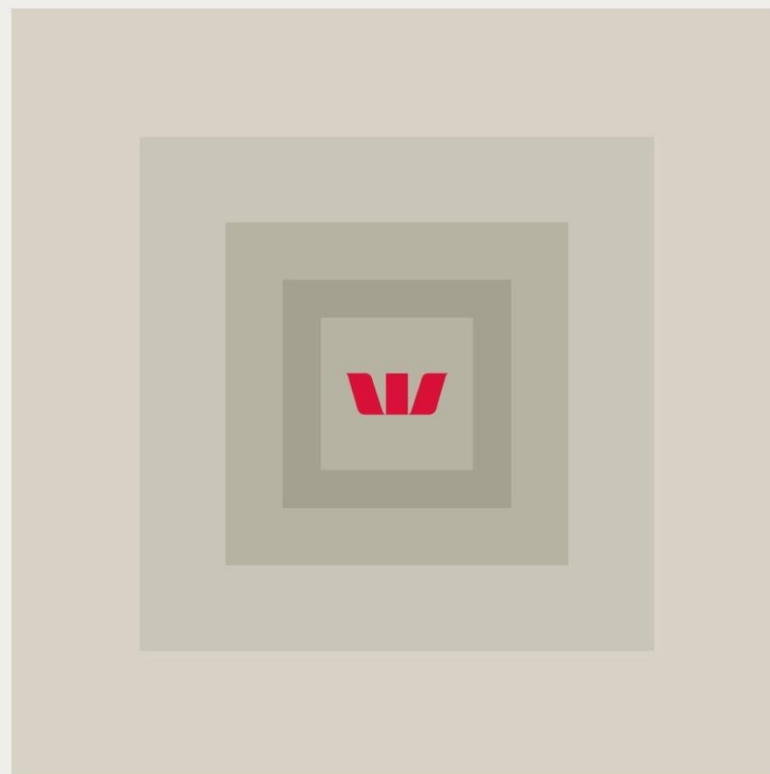


US durable goods stabilising, but no rapid growth

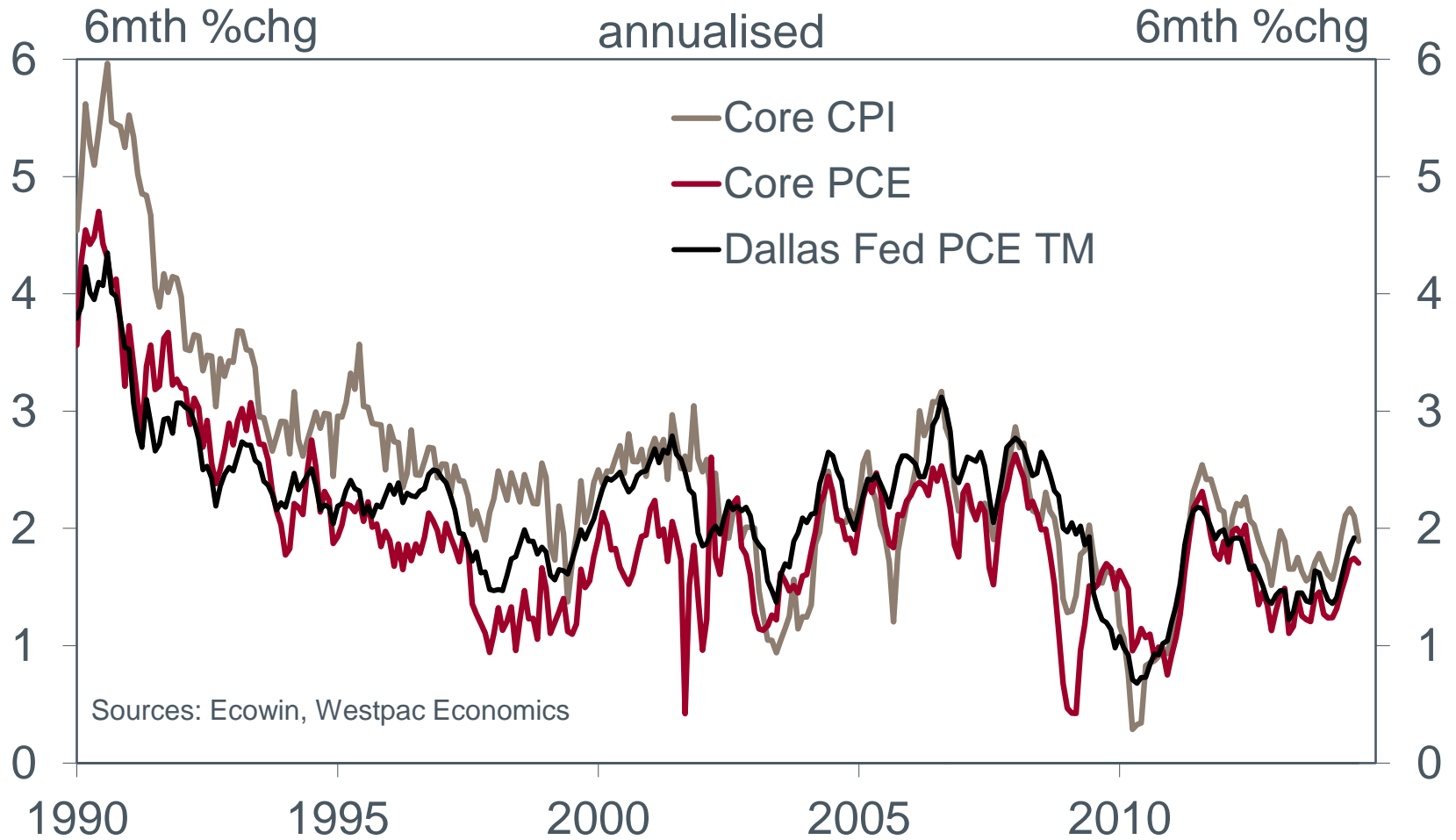


Inflation

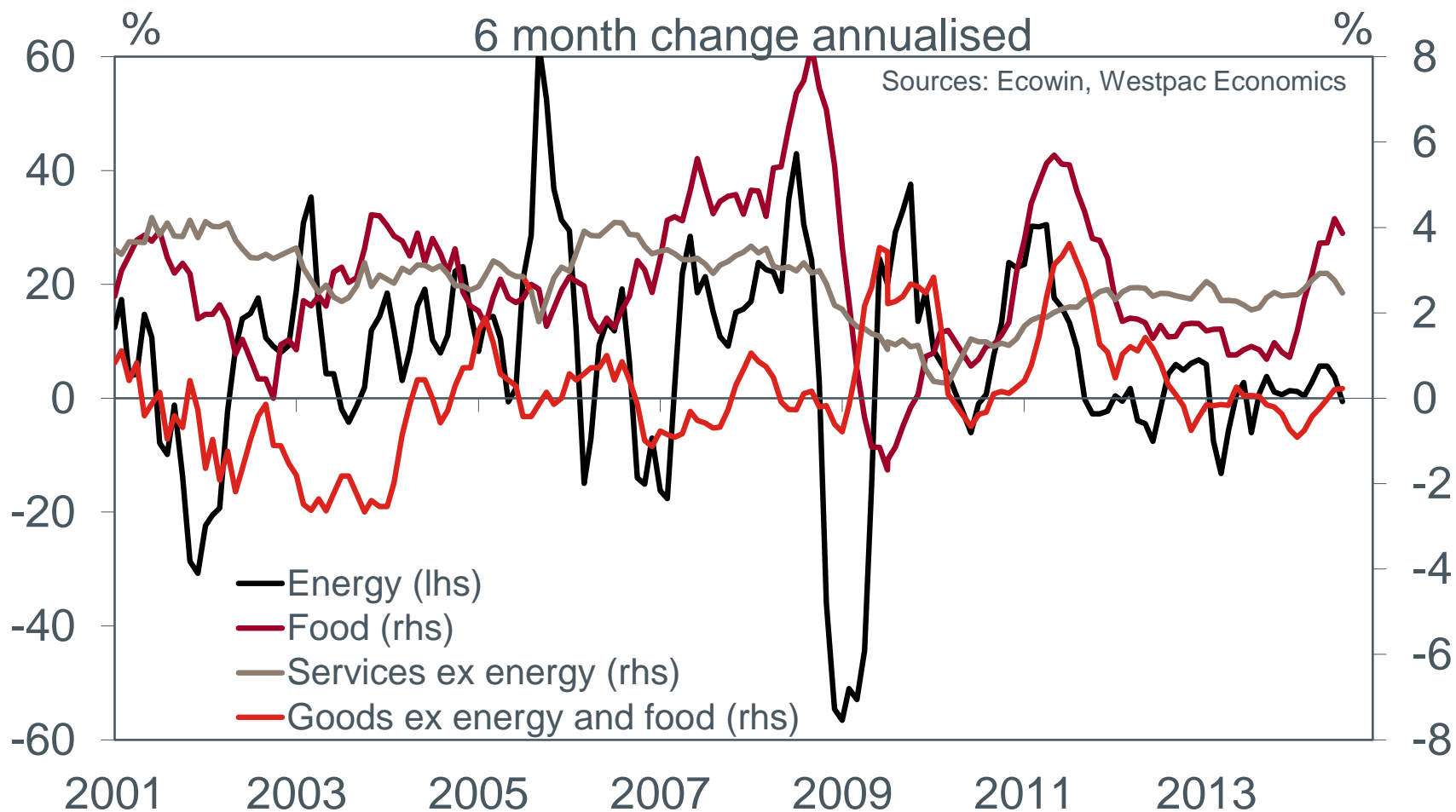
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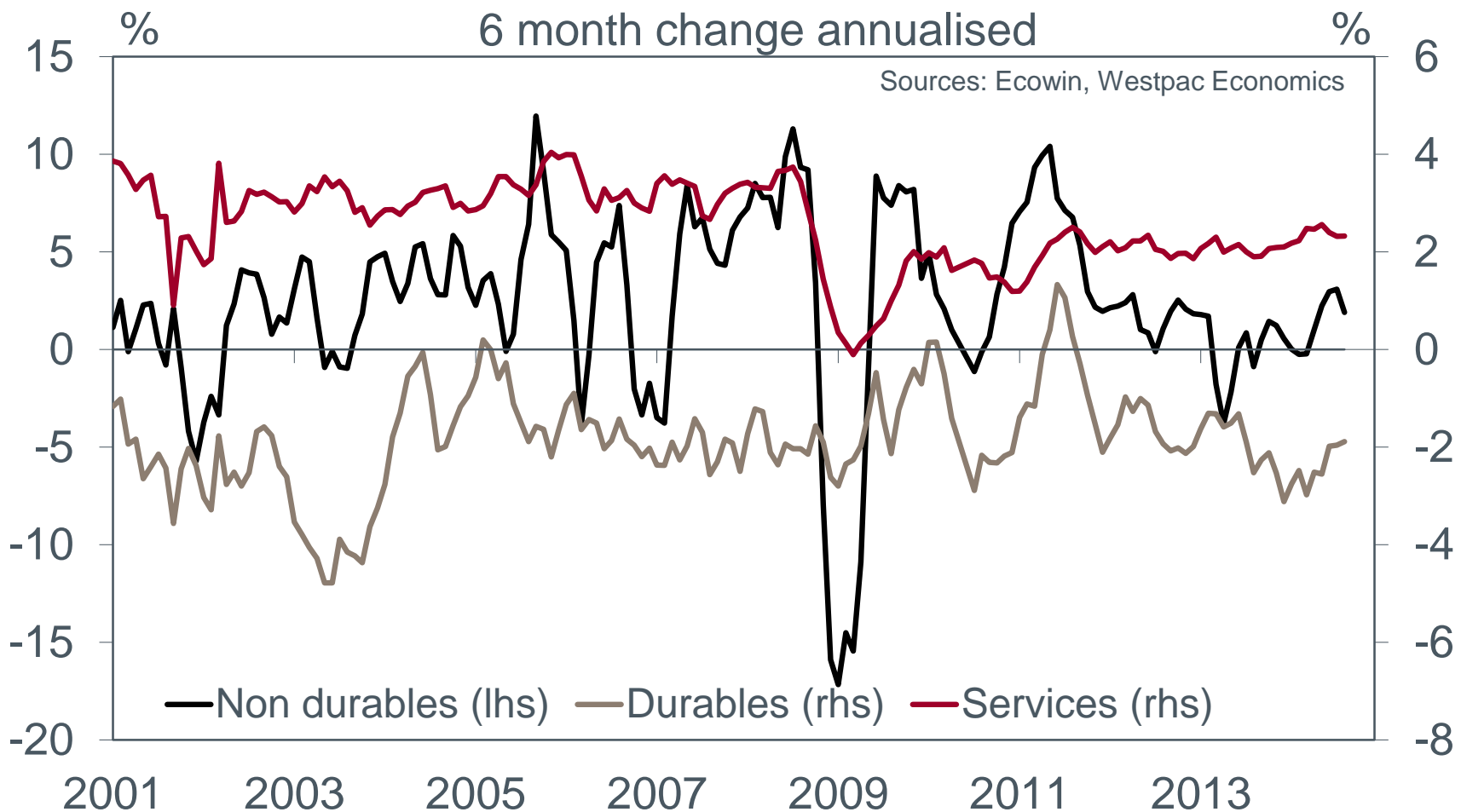
Inflation trending higher



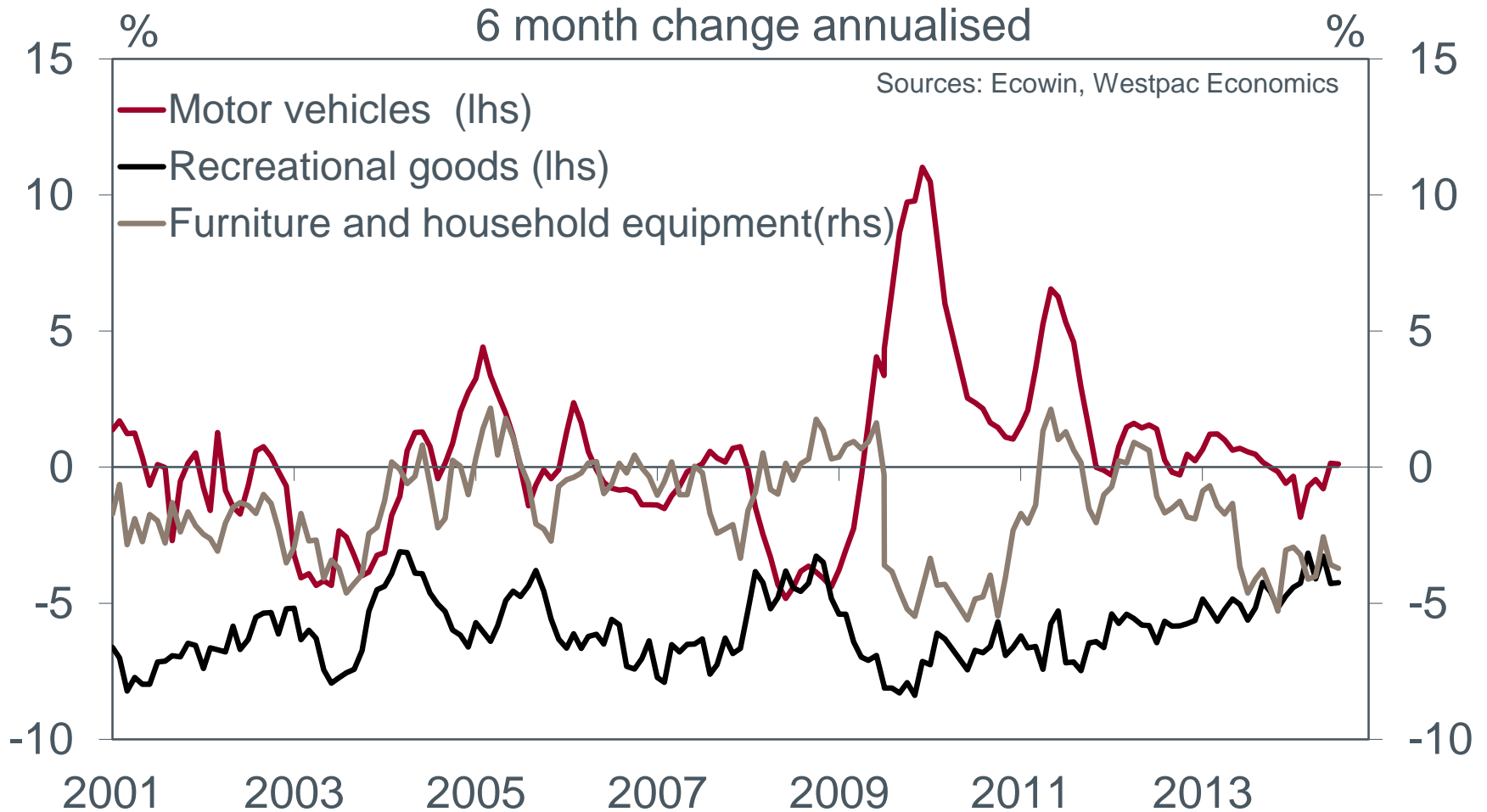
CPI: key components



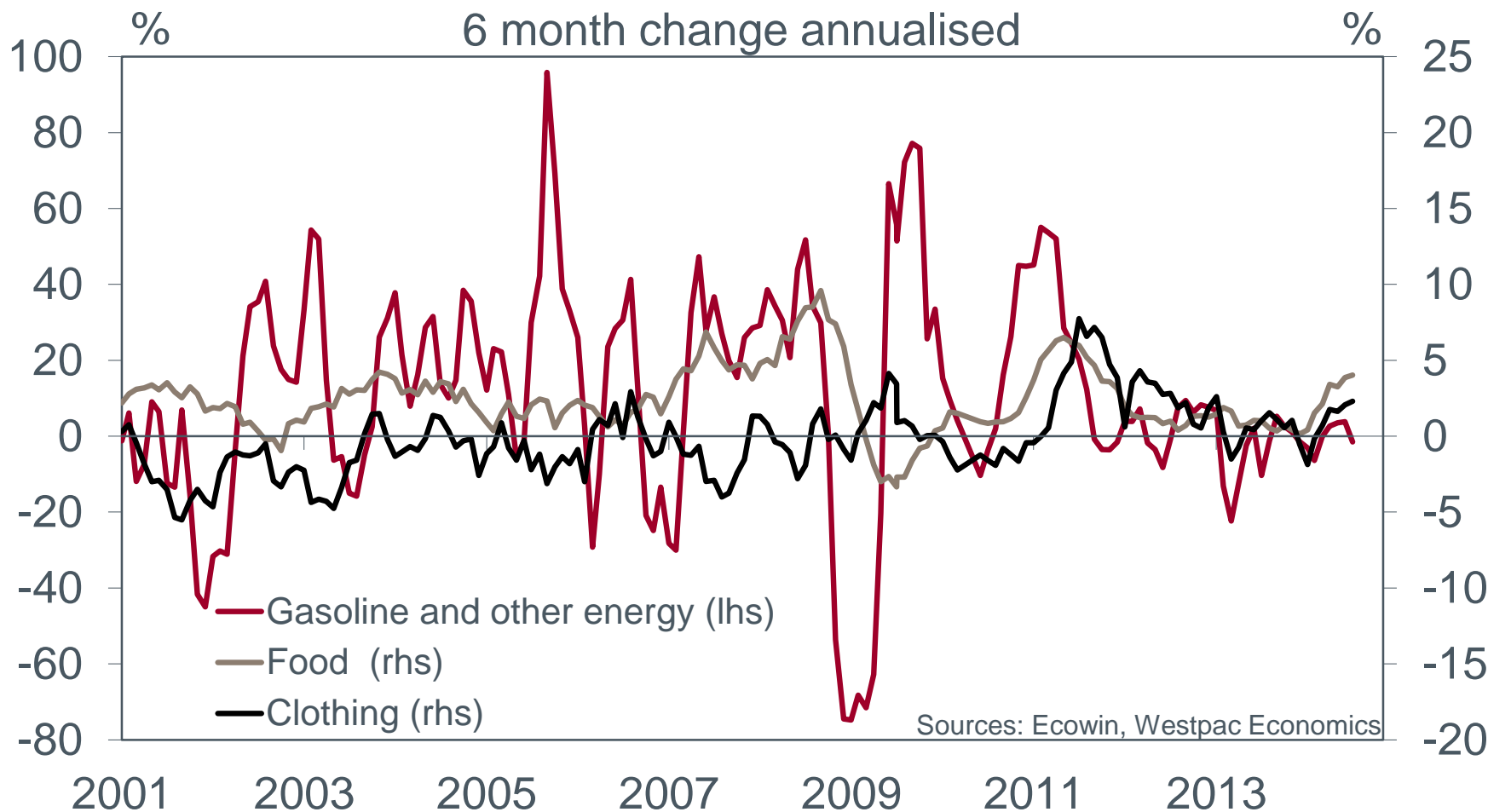
Services inflation and durables deflation (PCE)



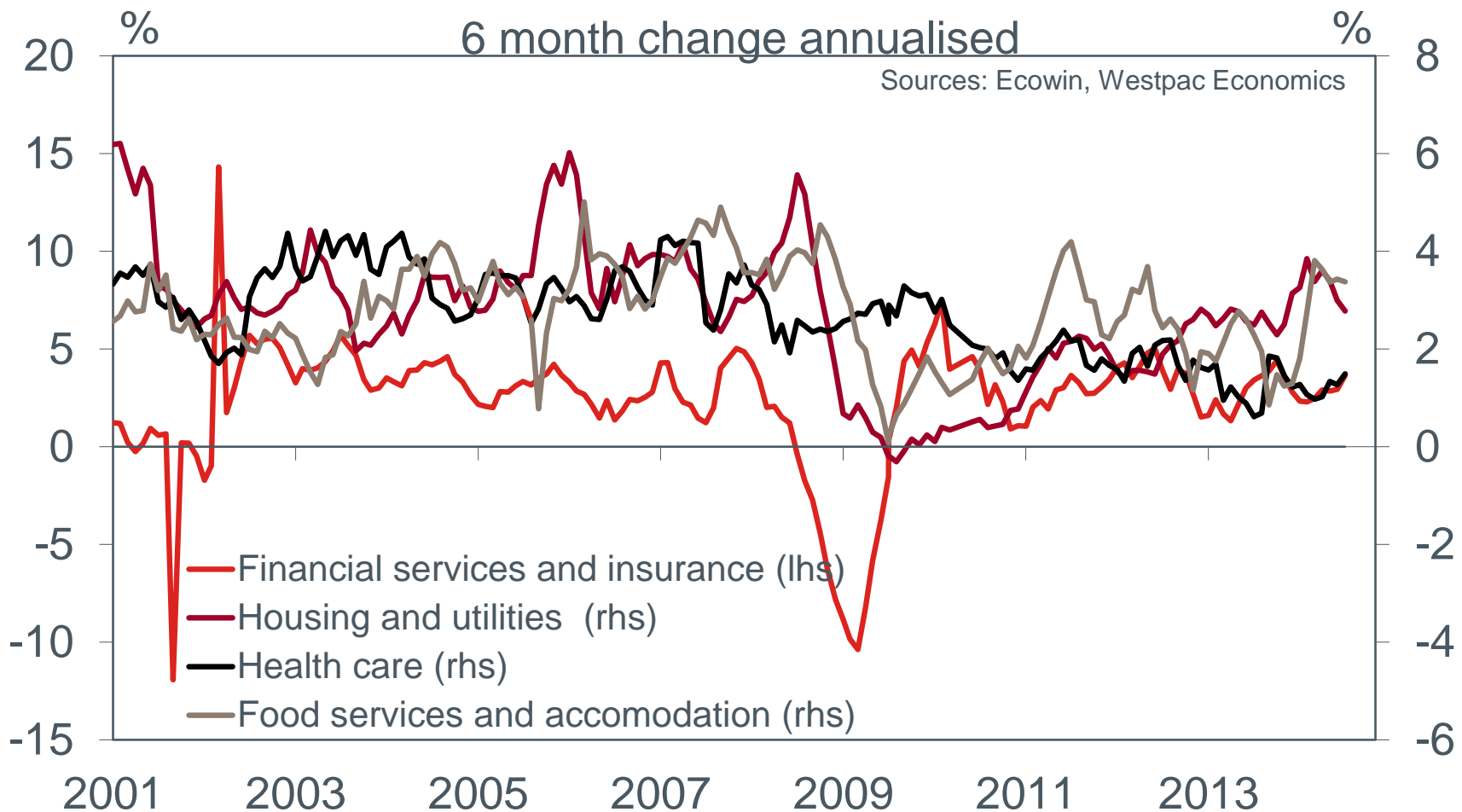
Durables deflation (PCE)



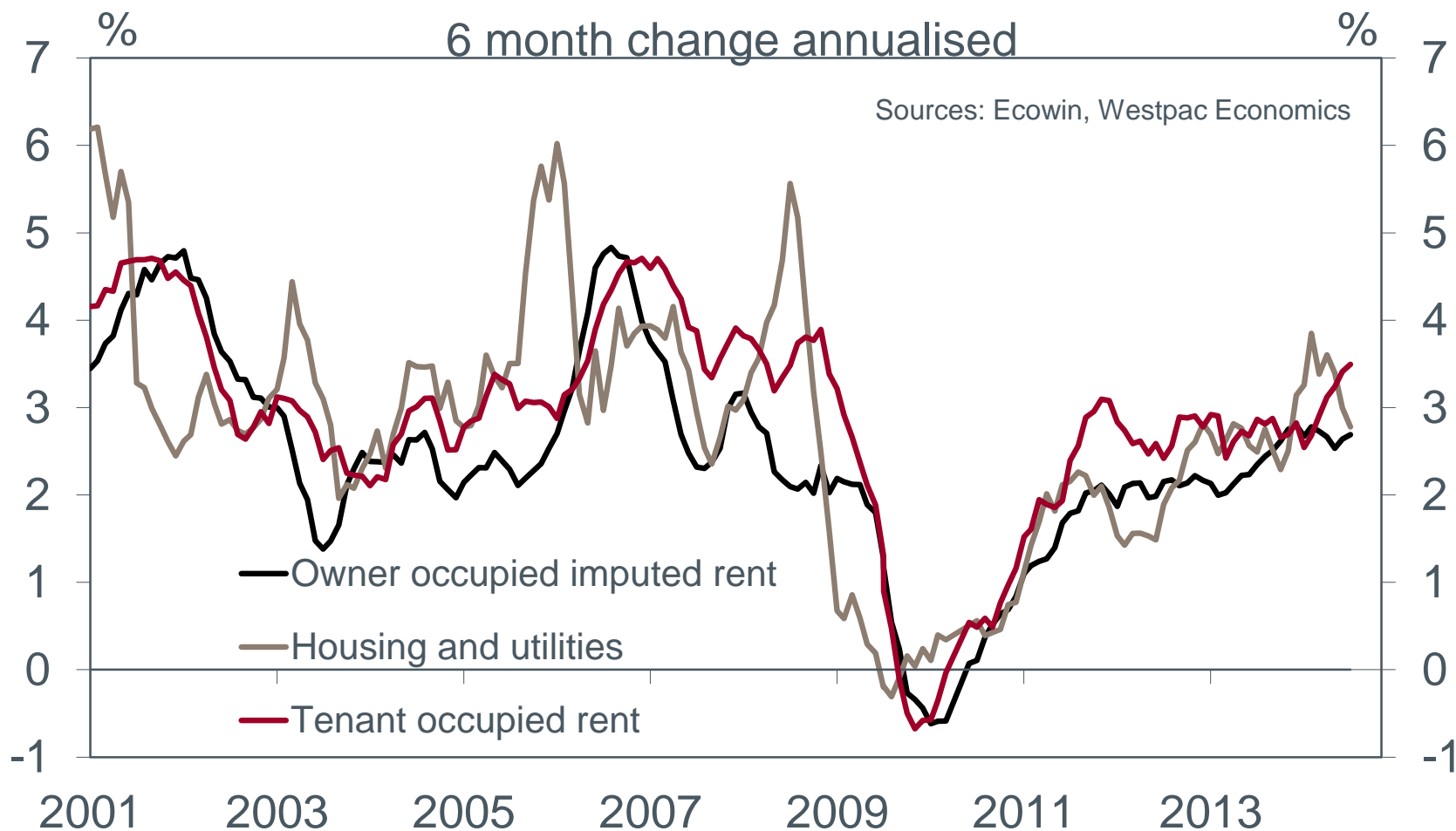
Non-durables inflation relatively restrained (PCE)



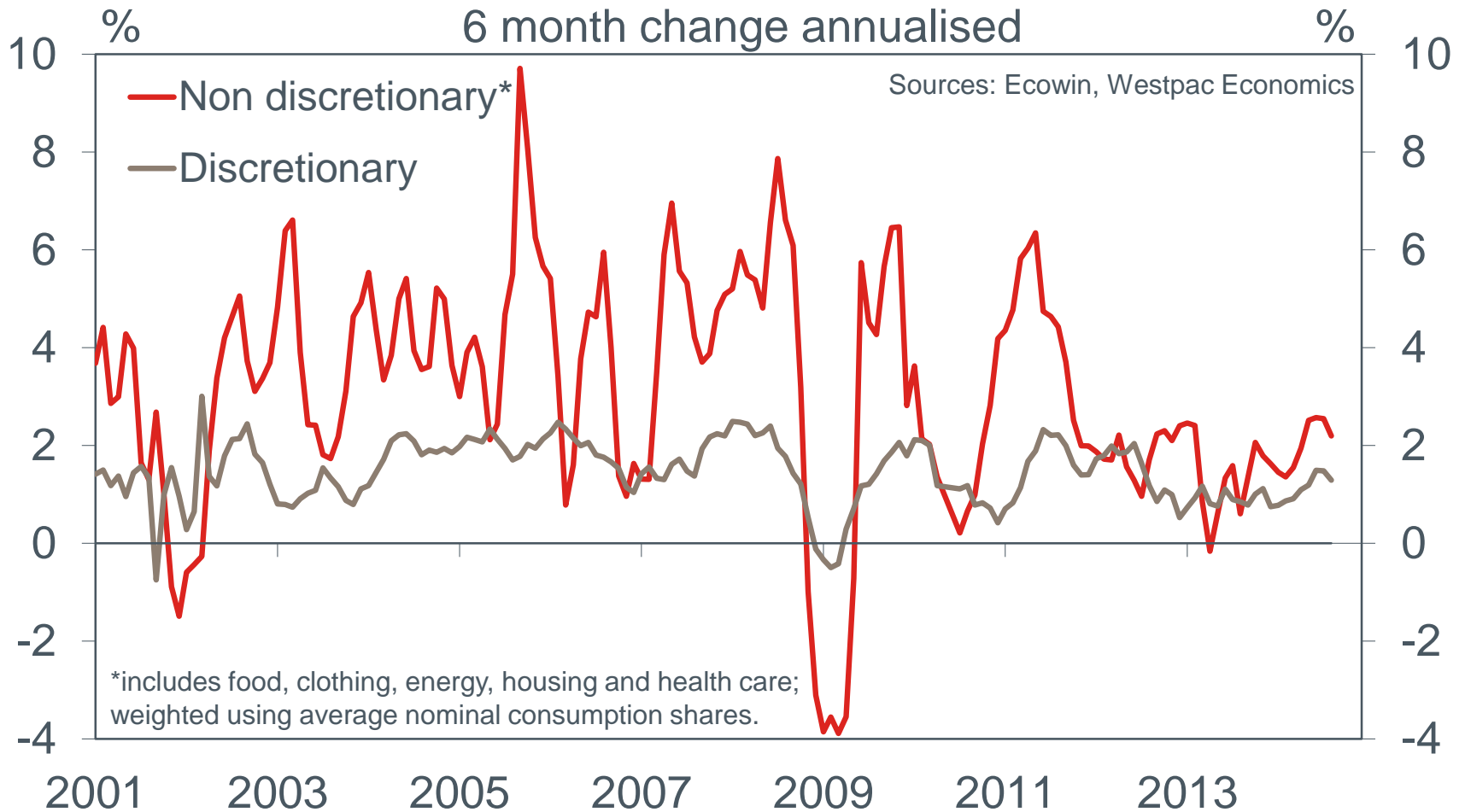
Services inflation driven by non-discretionary PCE



Uptrend in tenant occupied rent, a watching brief

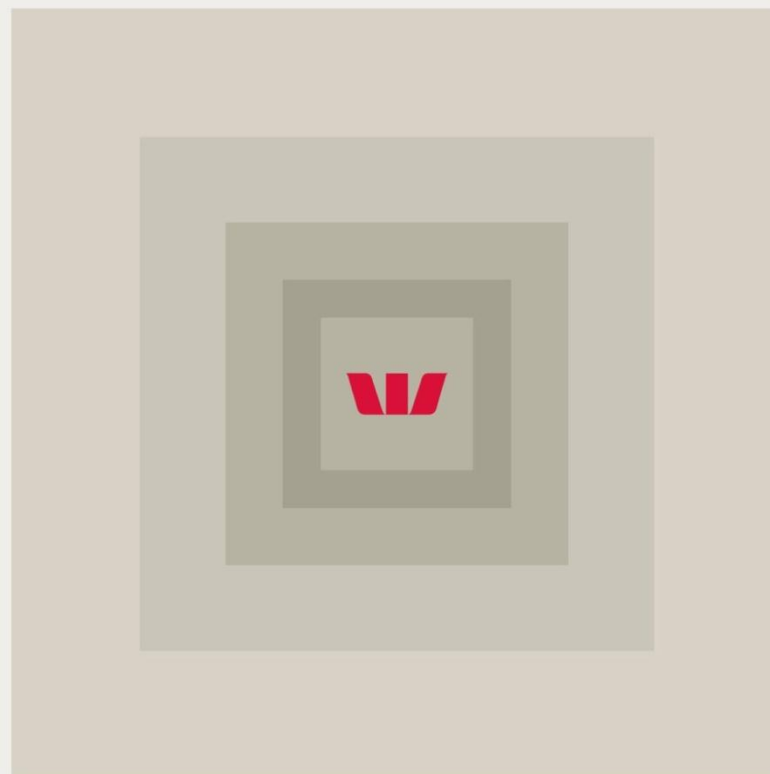


Non-discretionary items driving inflation (PCE)

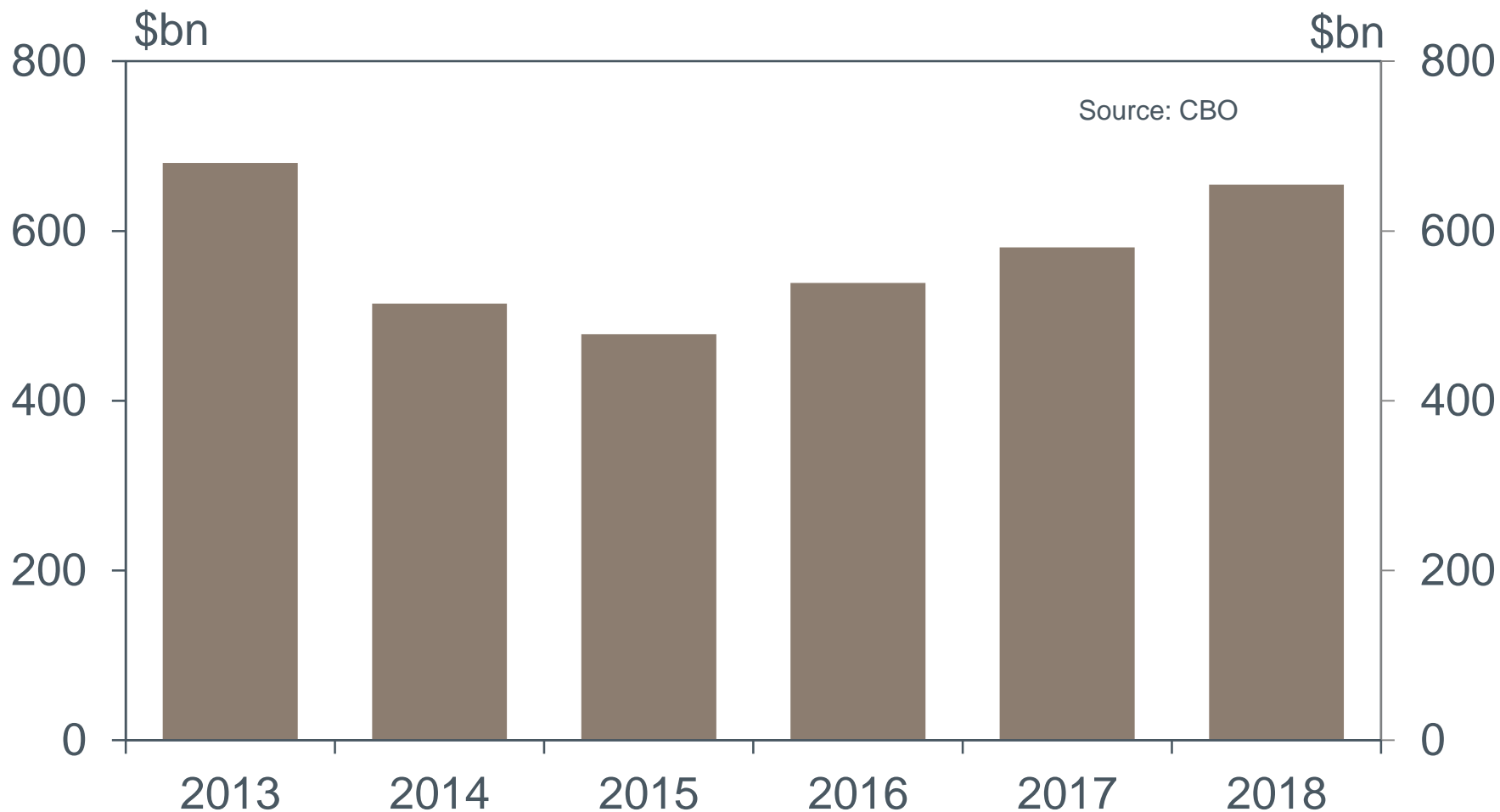


The fiscal position

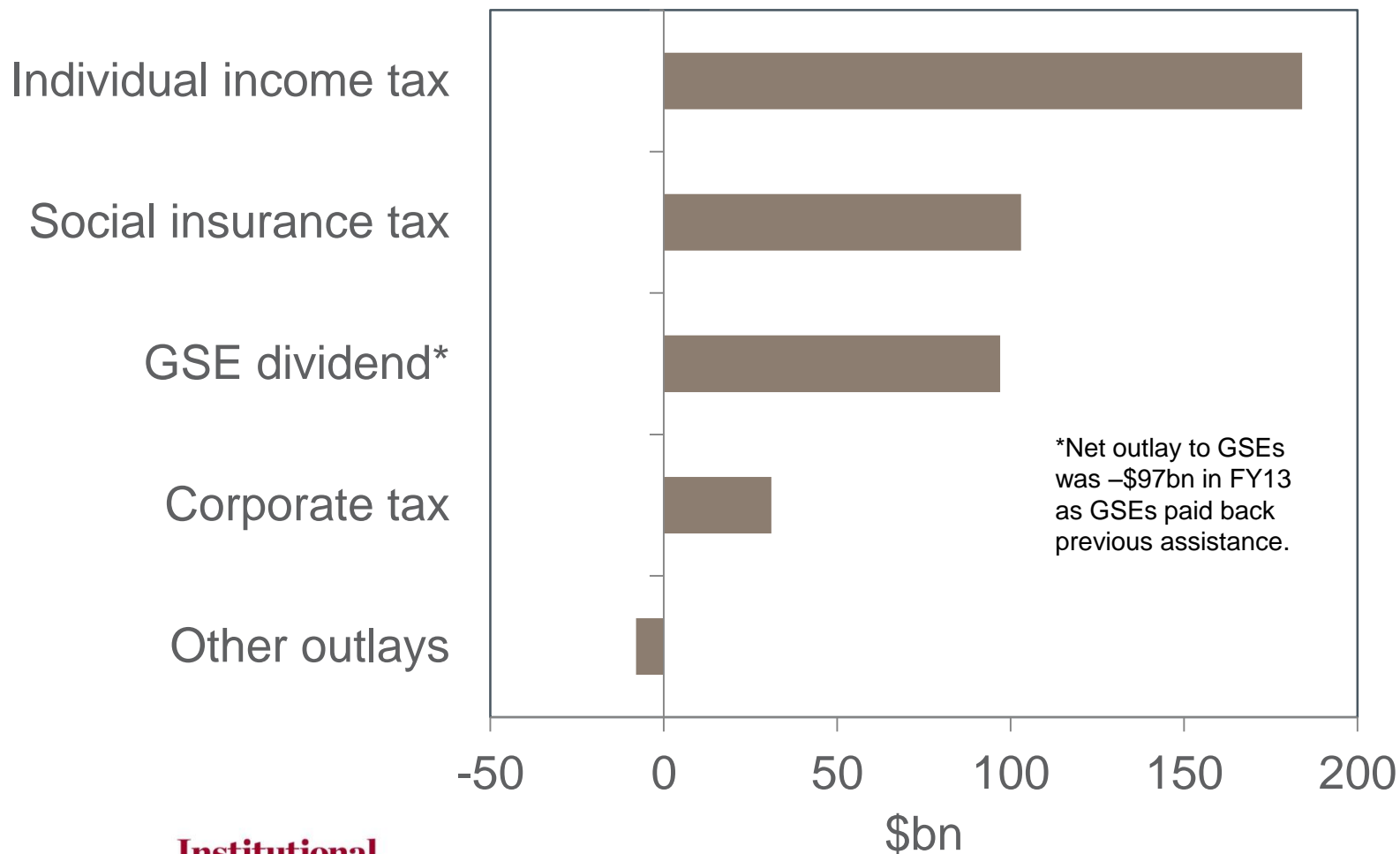
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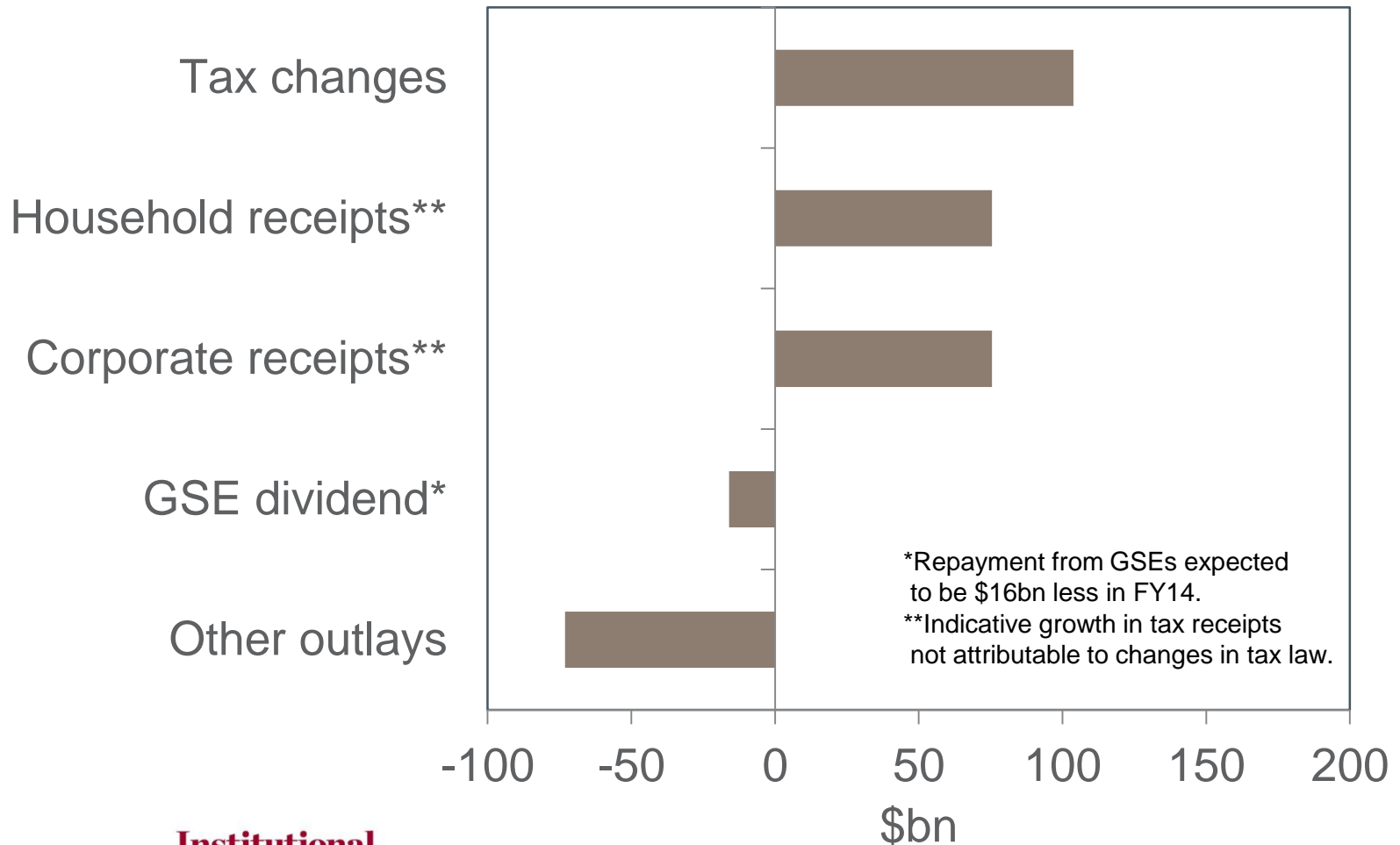
Deficit improvement nearing end



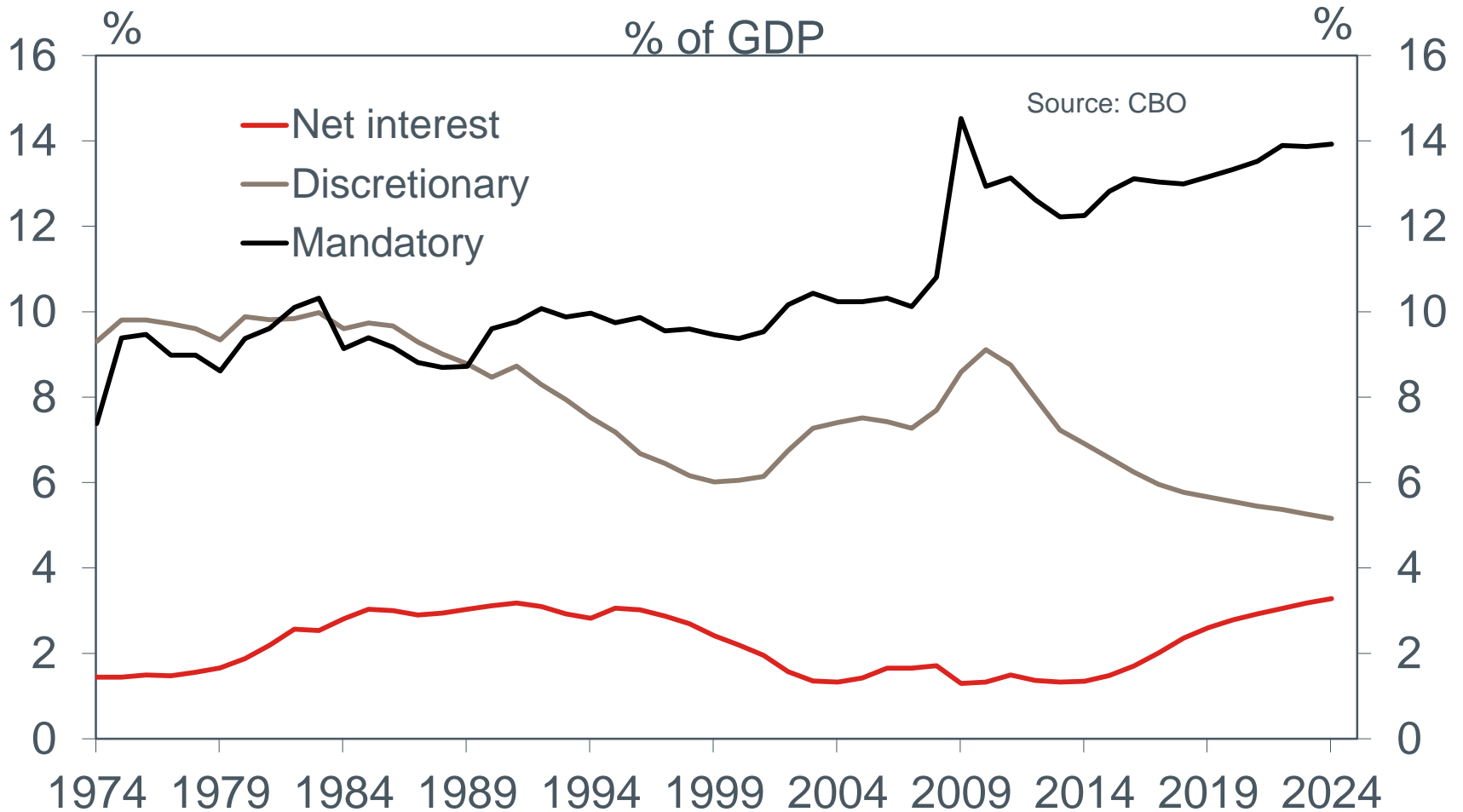
Contributions to FY13 \$407bn deficit reduction



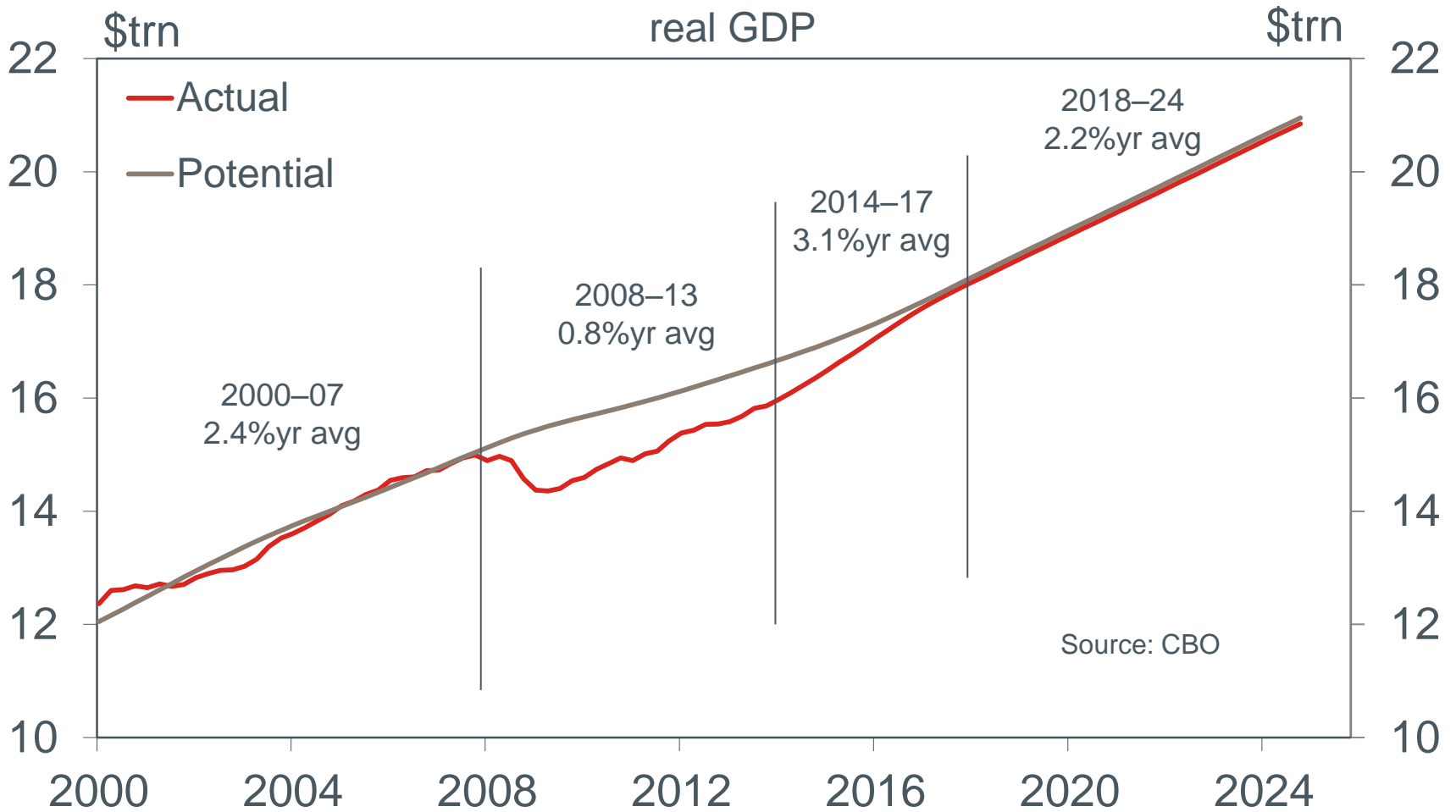
Contributions to FY14 \$166bn deficit reduction



Mandatory outlays will make cuts difficult

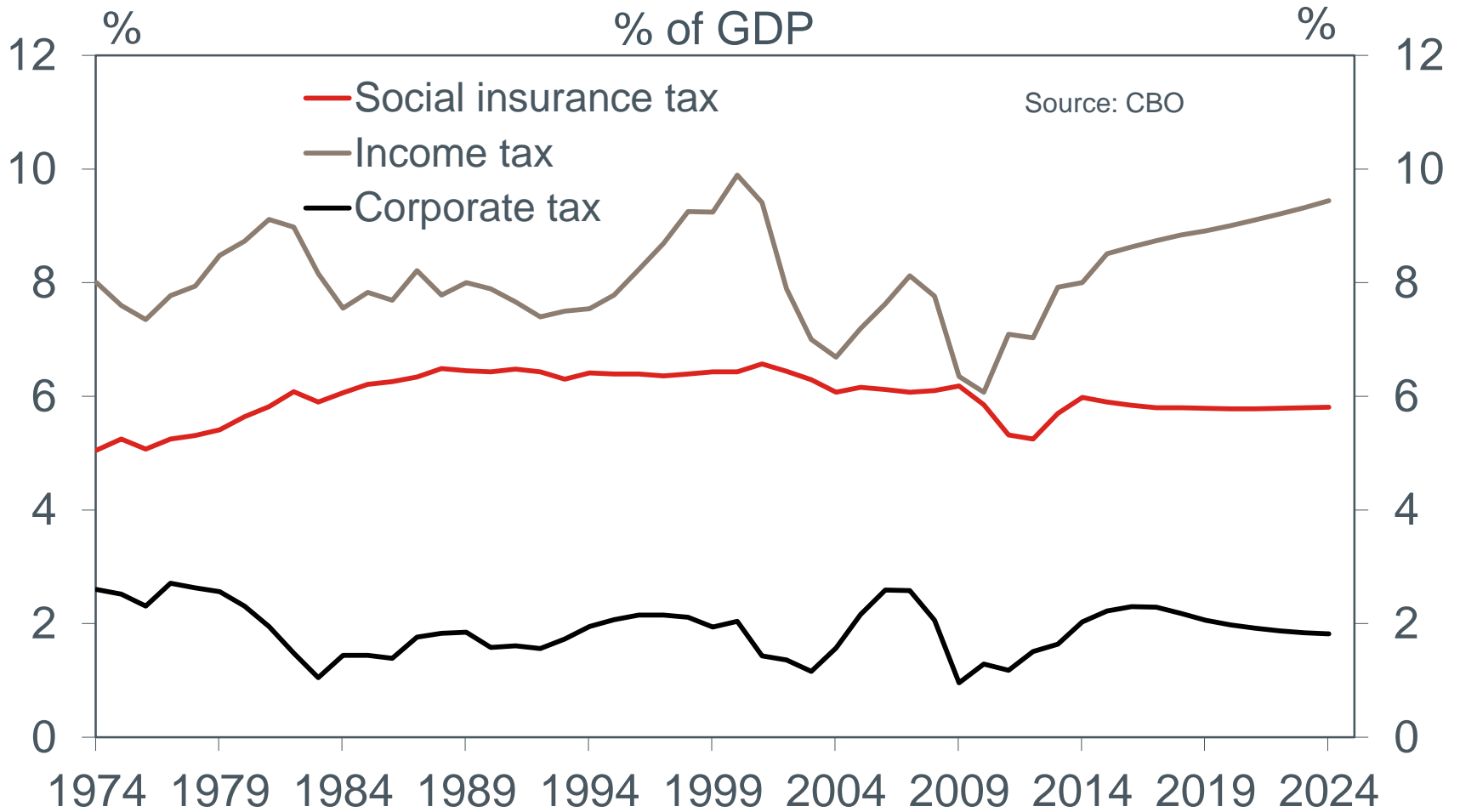


CBO expects output gap to close



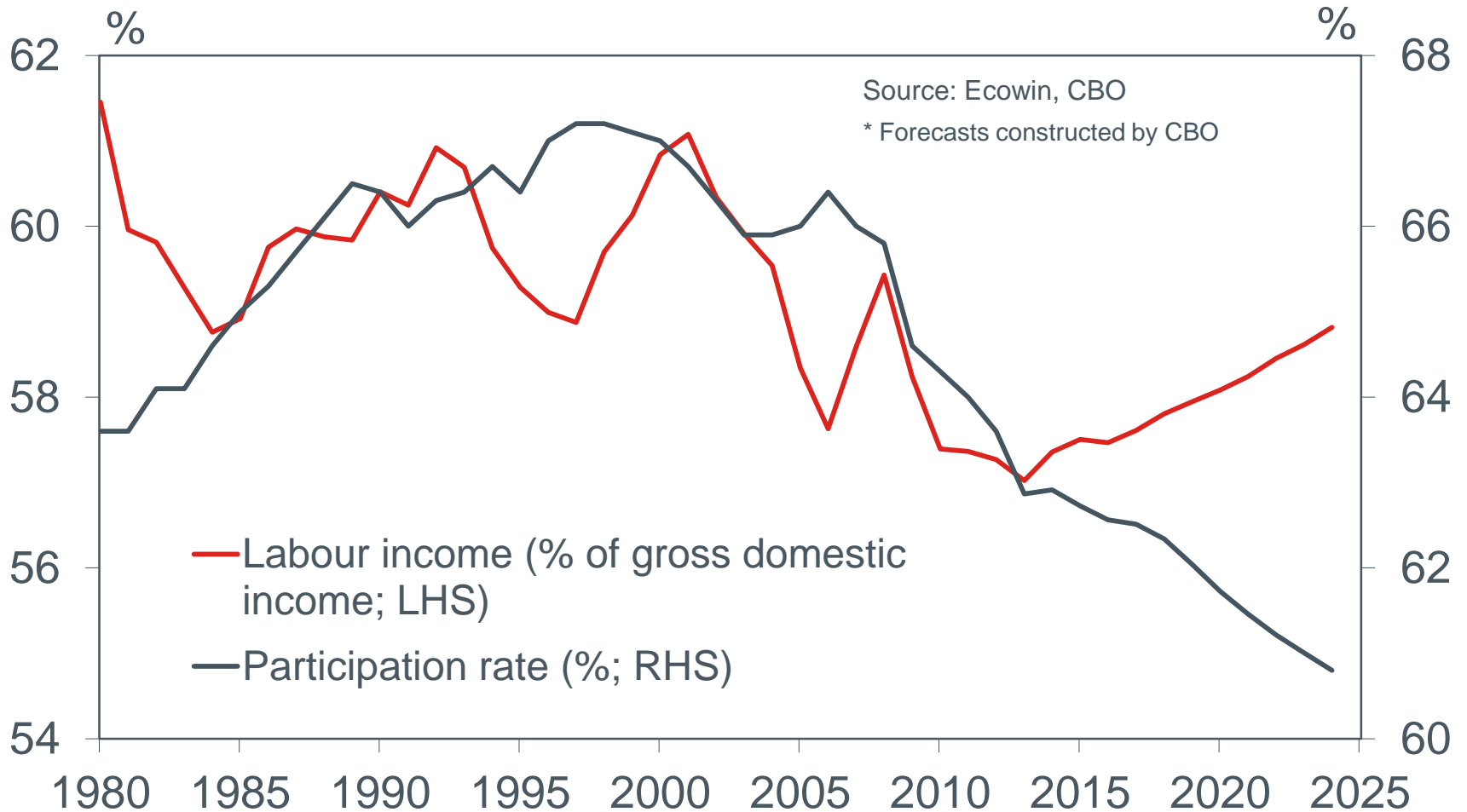
Source: CBO

Revenue burden to rest on households

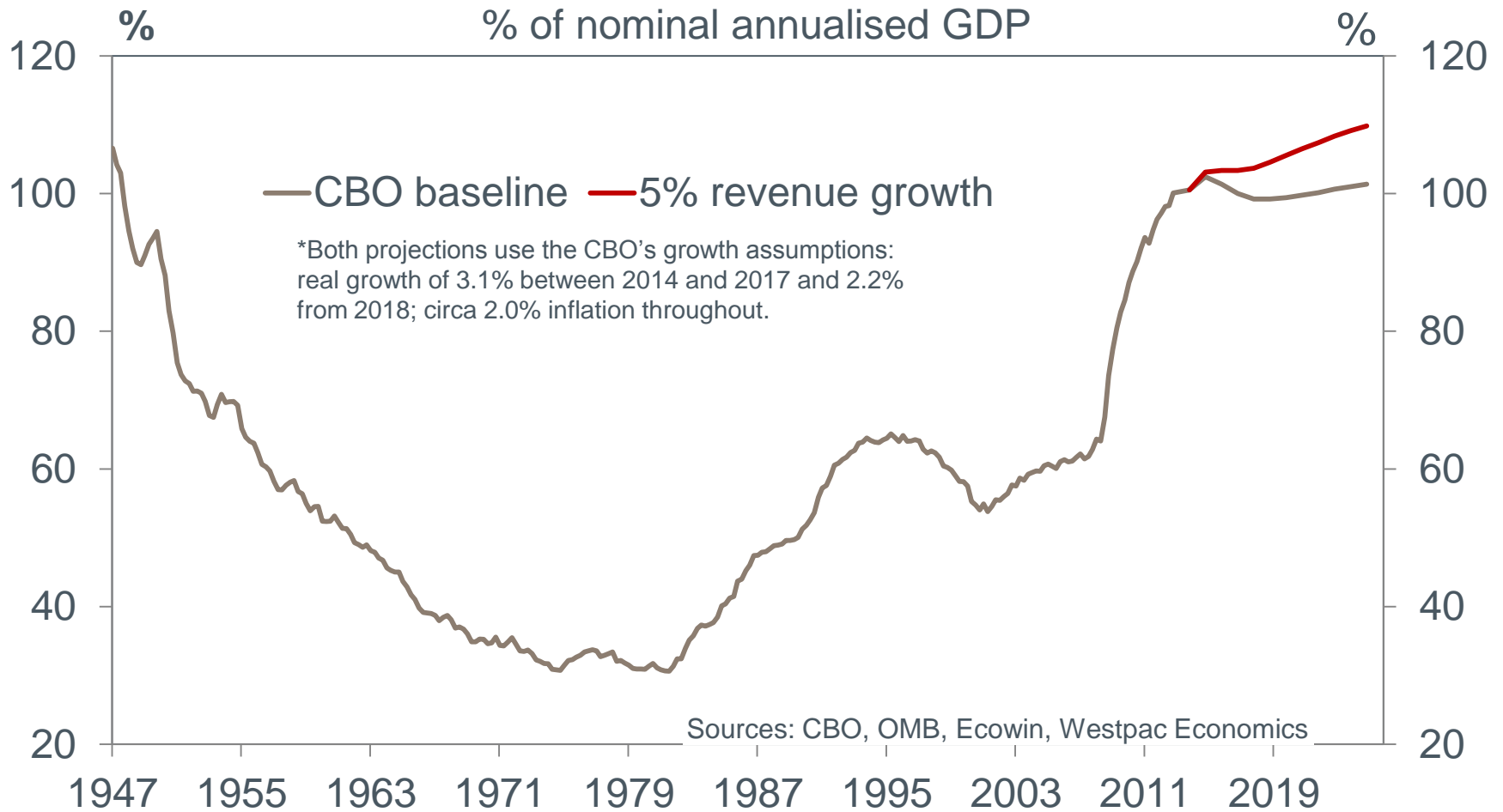


Source: CBO

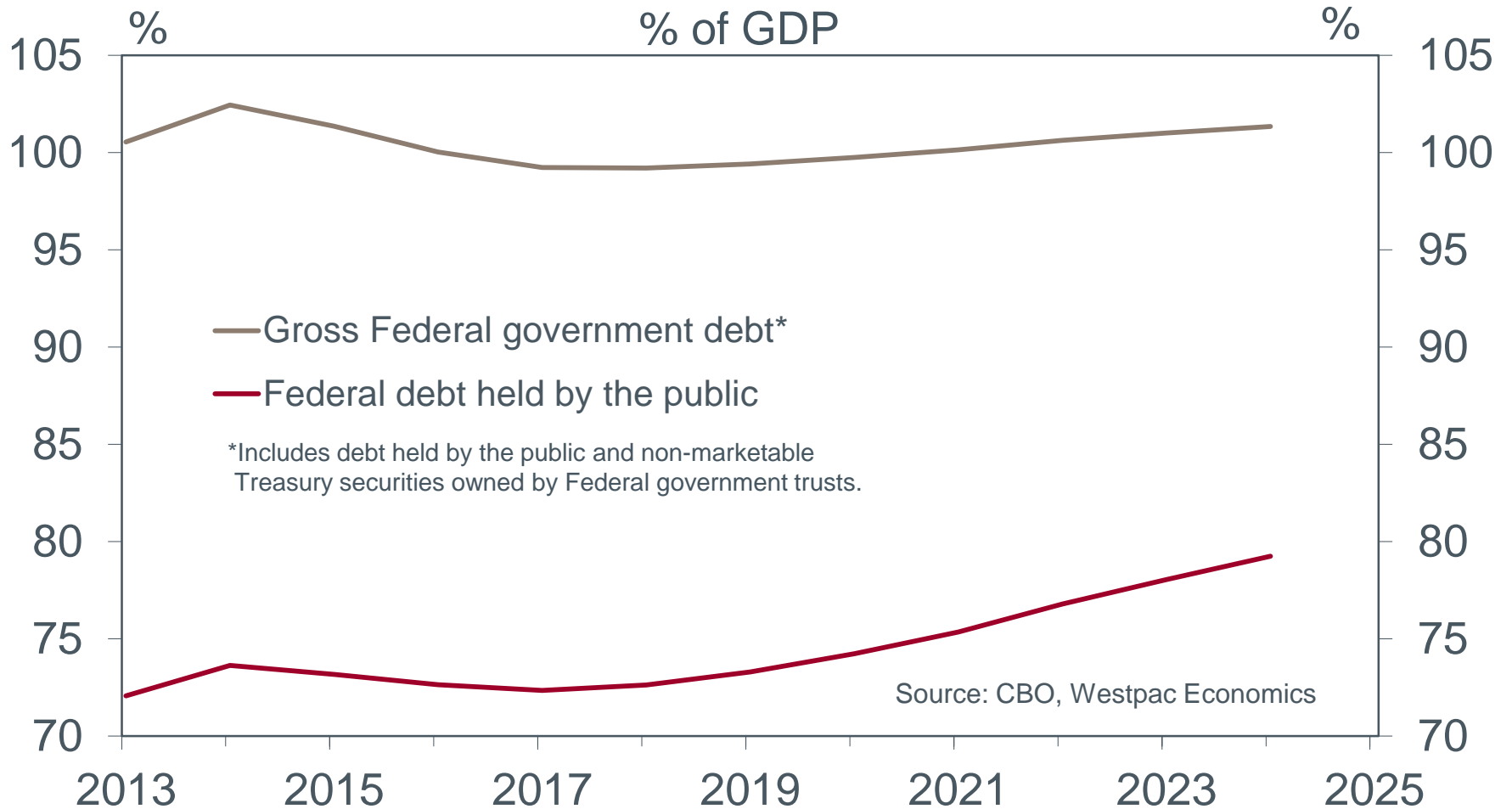
Strong household income growth necessary



Debt stock sensitive to revenue growth

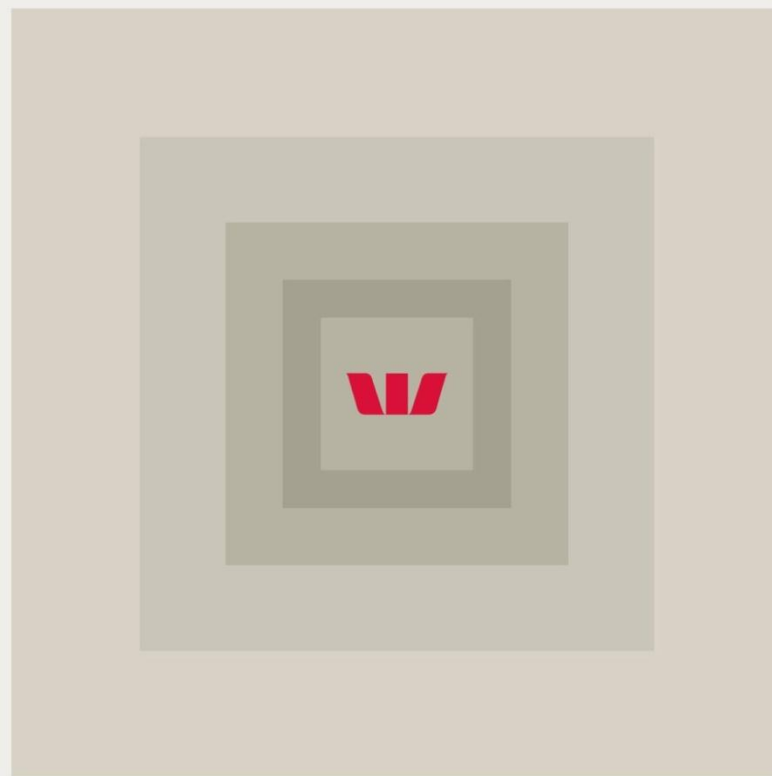


UST supply to public investors to rise

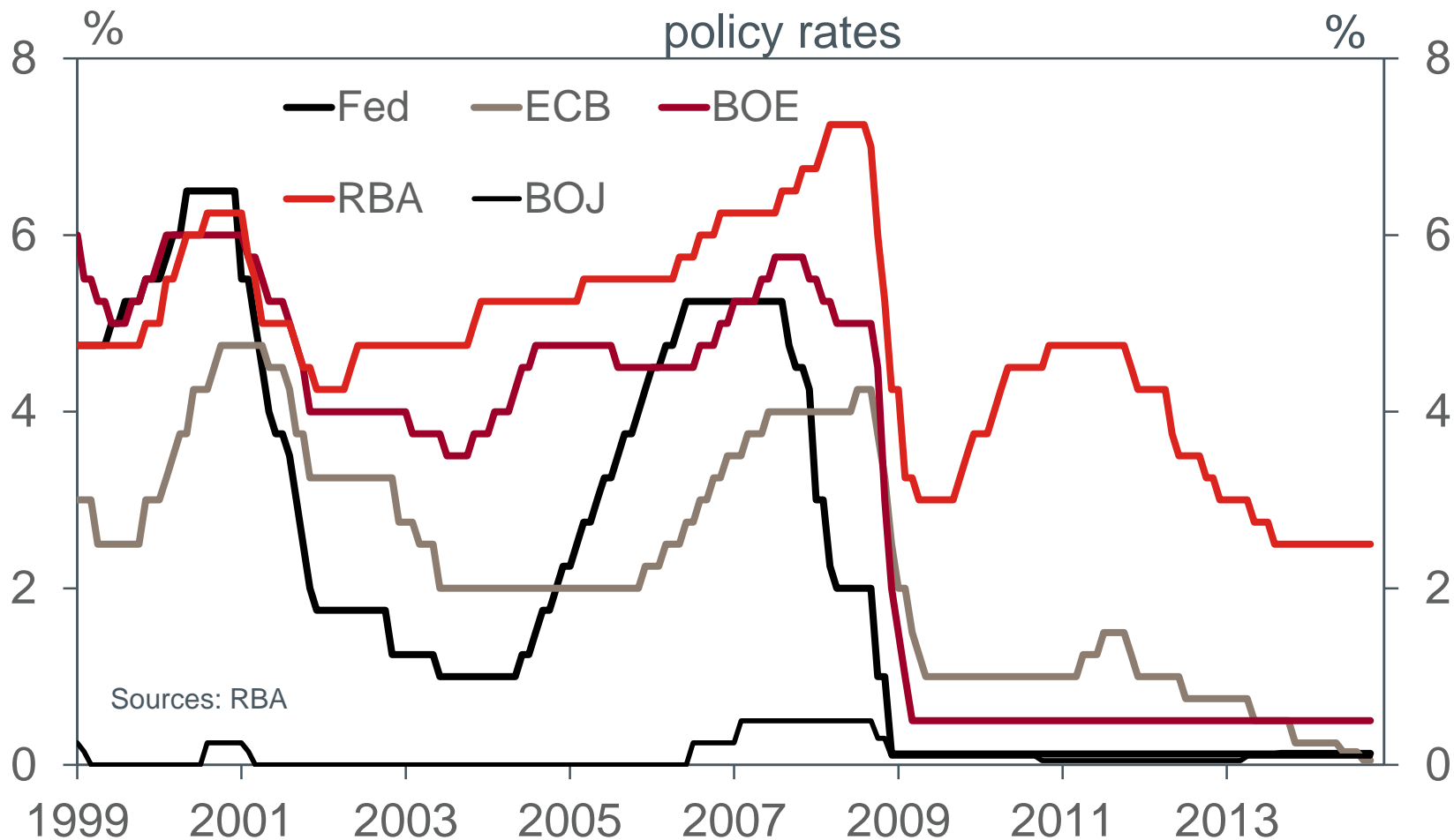


QE, financial flows, markets & interest rates

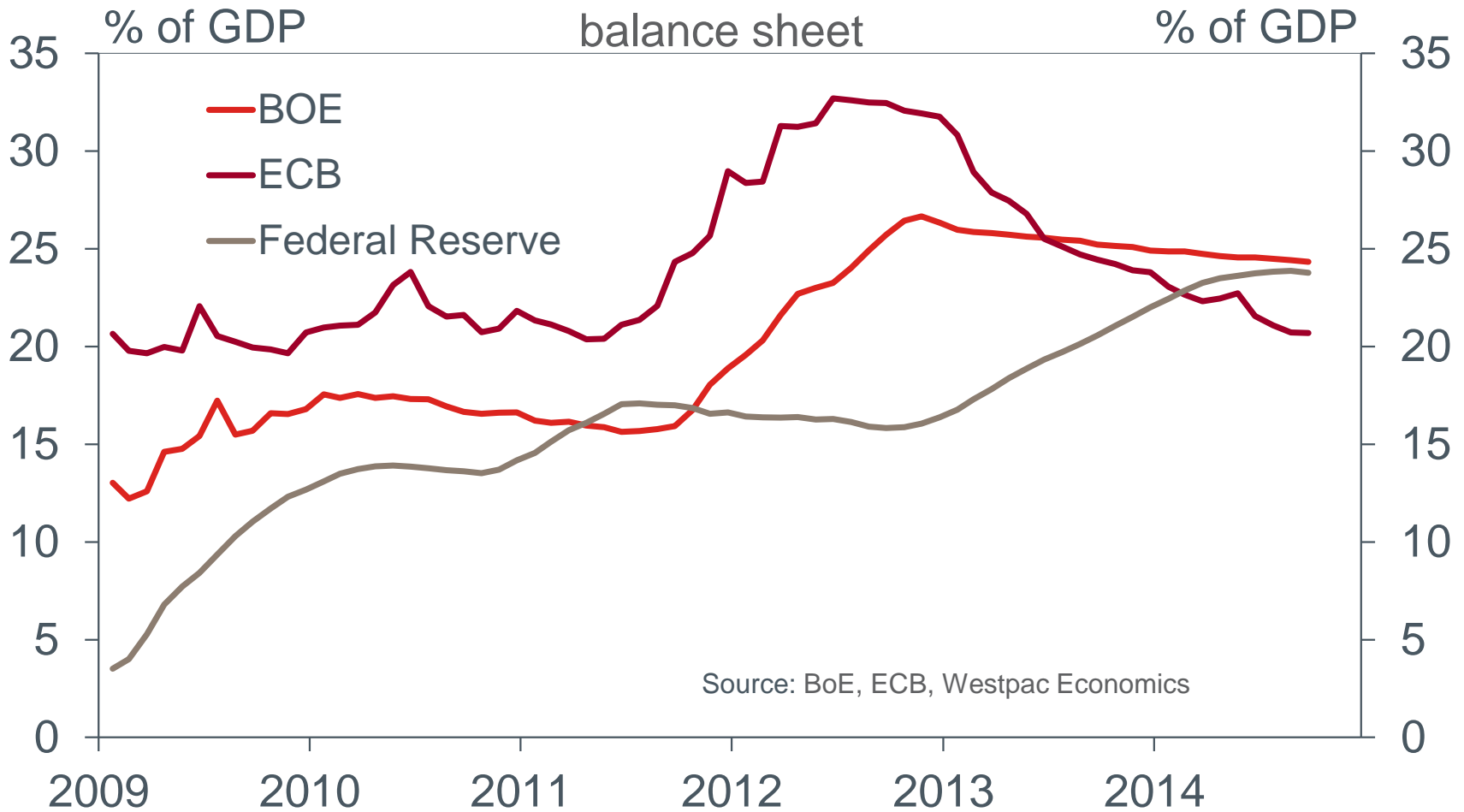
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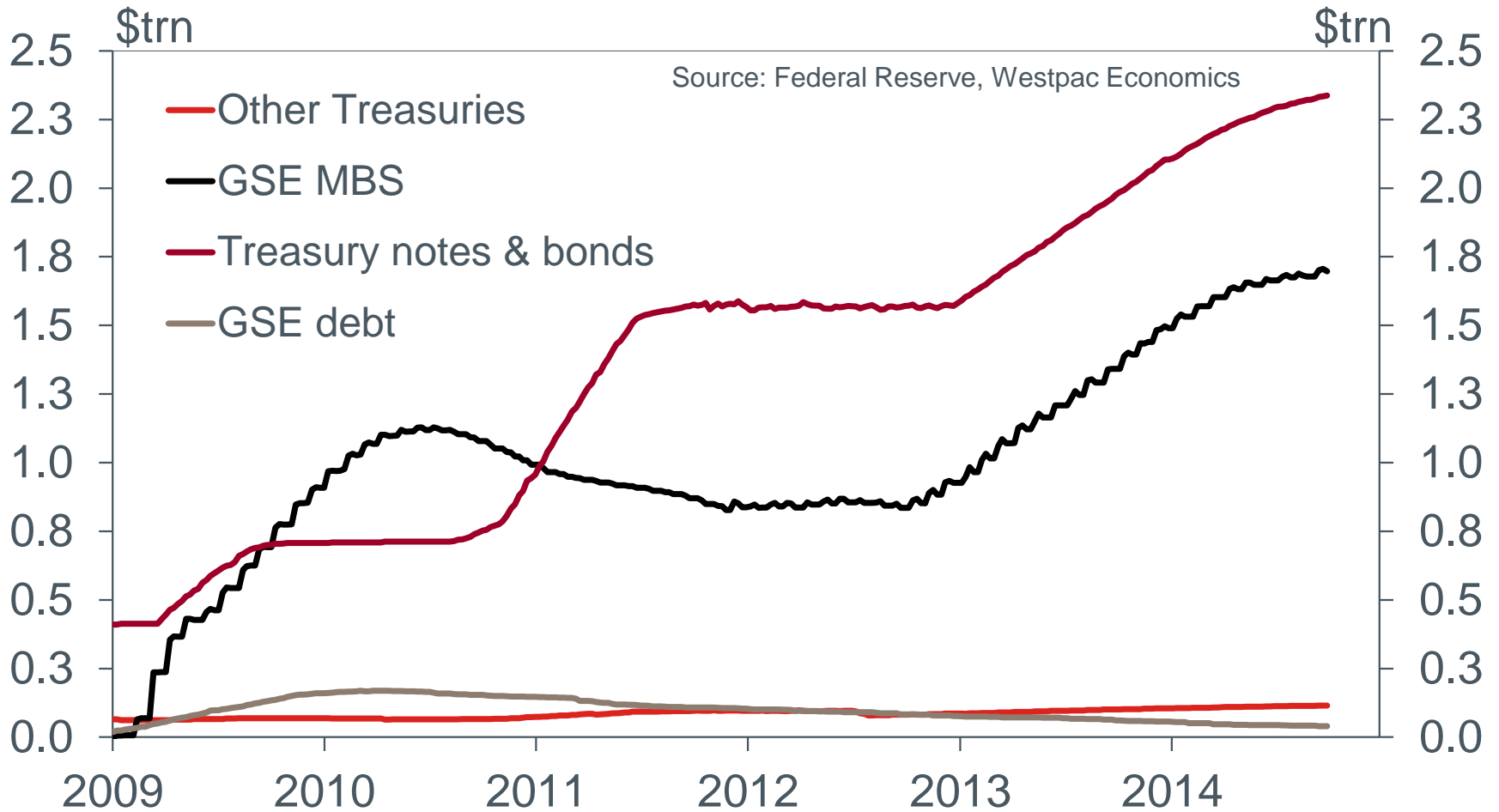
Developed world policy interest rates



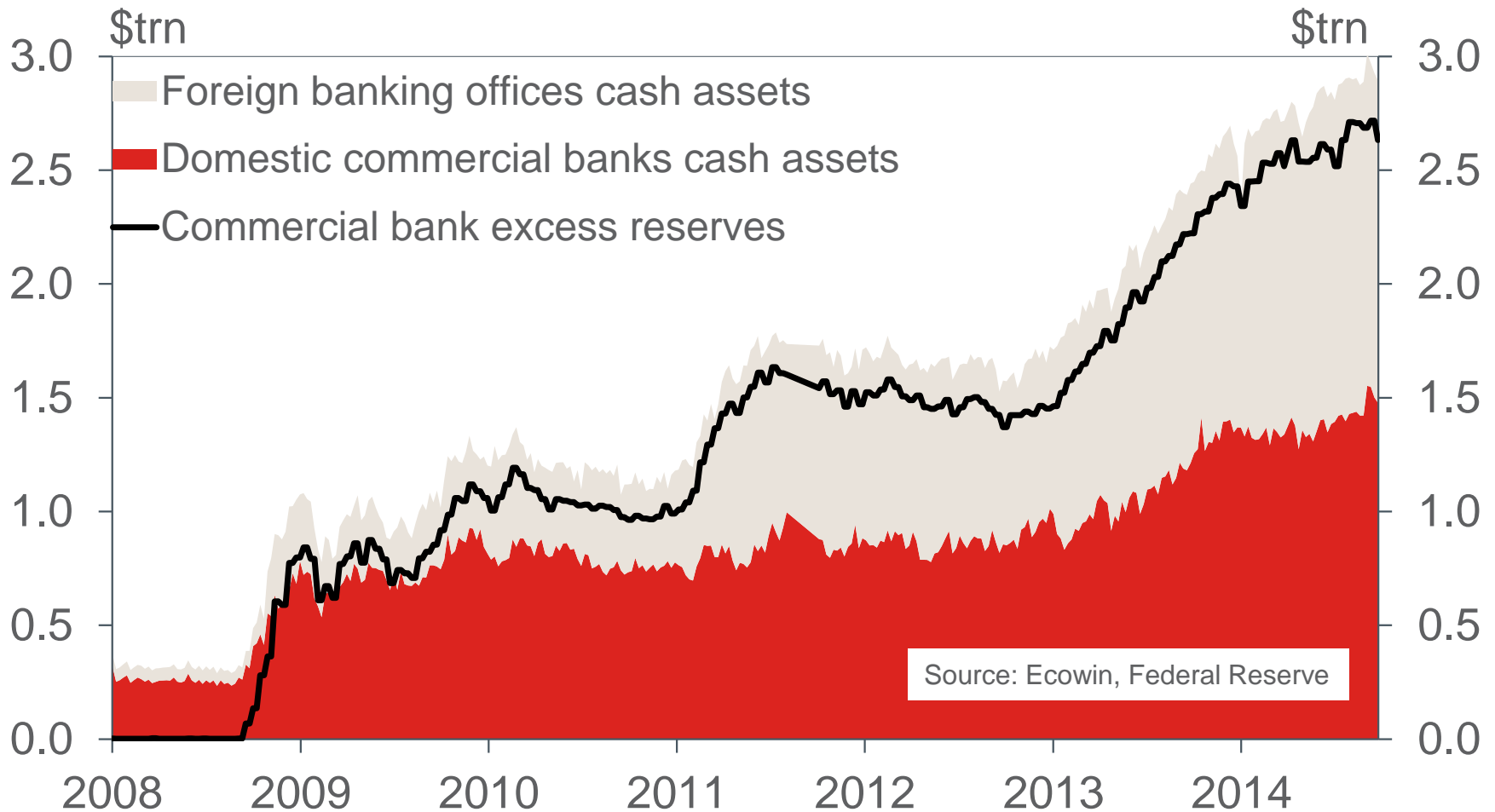
North Atlantic – central bank balance sheets



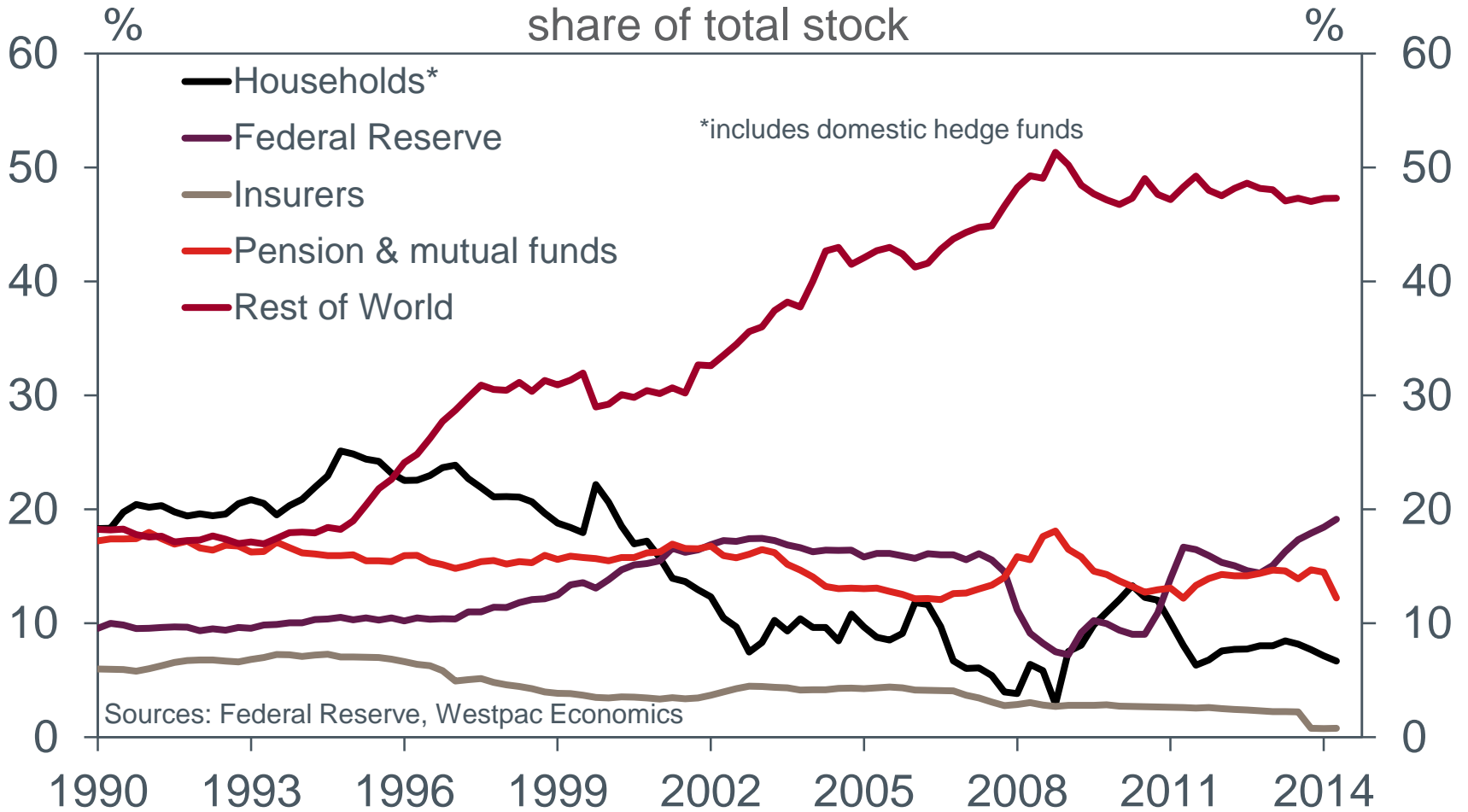
Fed balance sheet – by security type



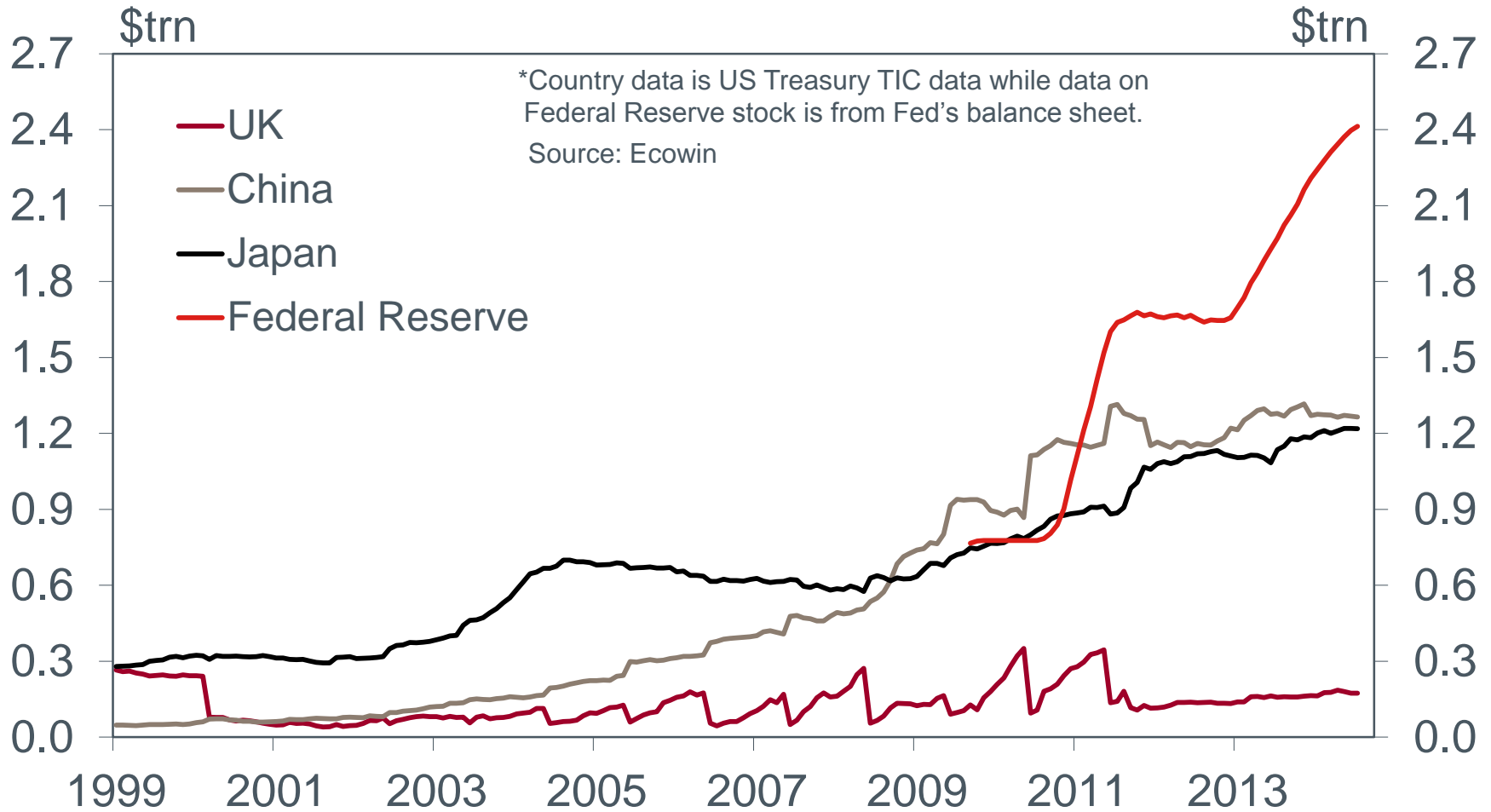
QE funds largely became excess reserves



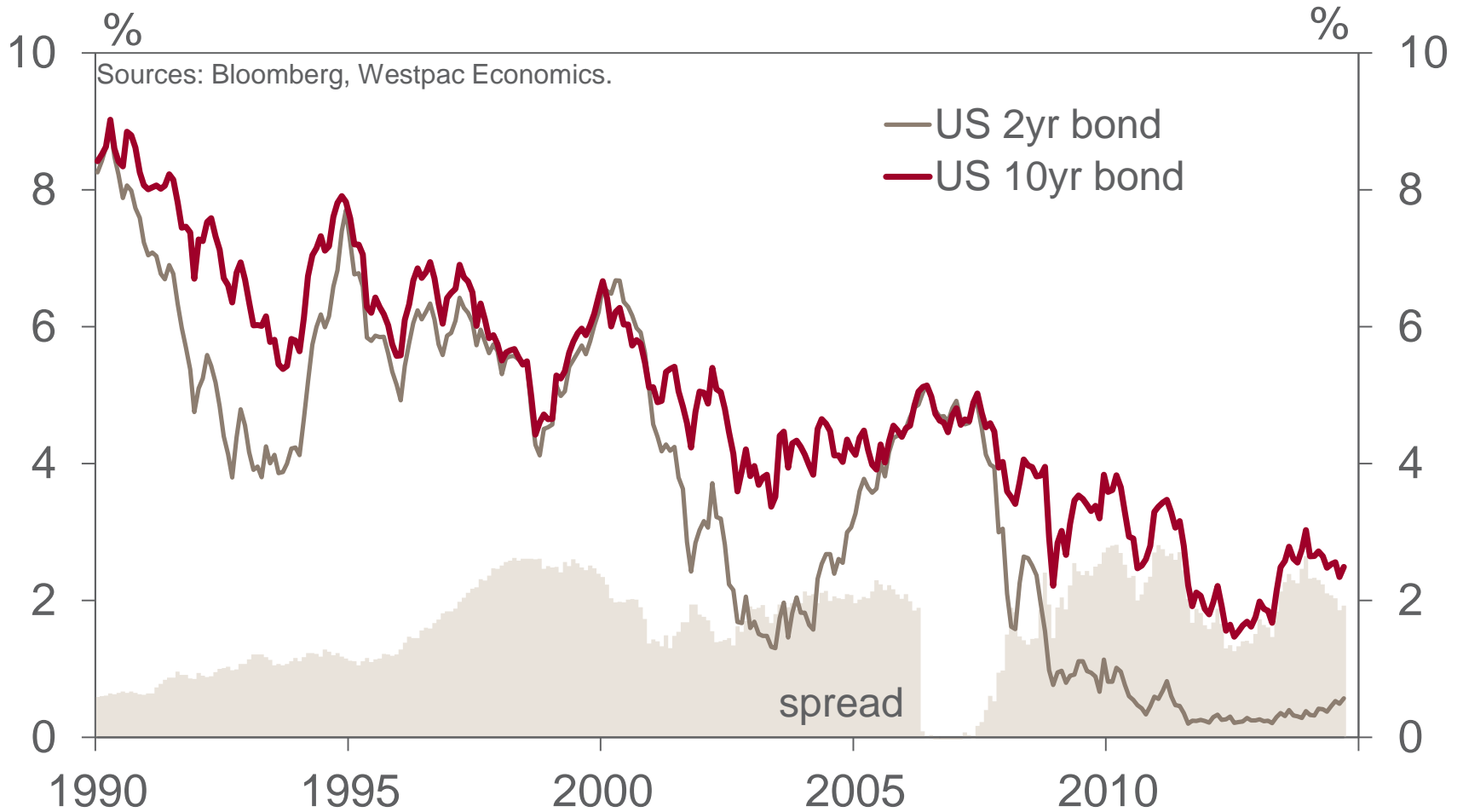
Holders of US Treasury securities



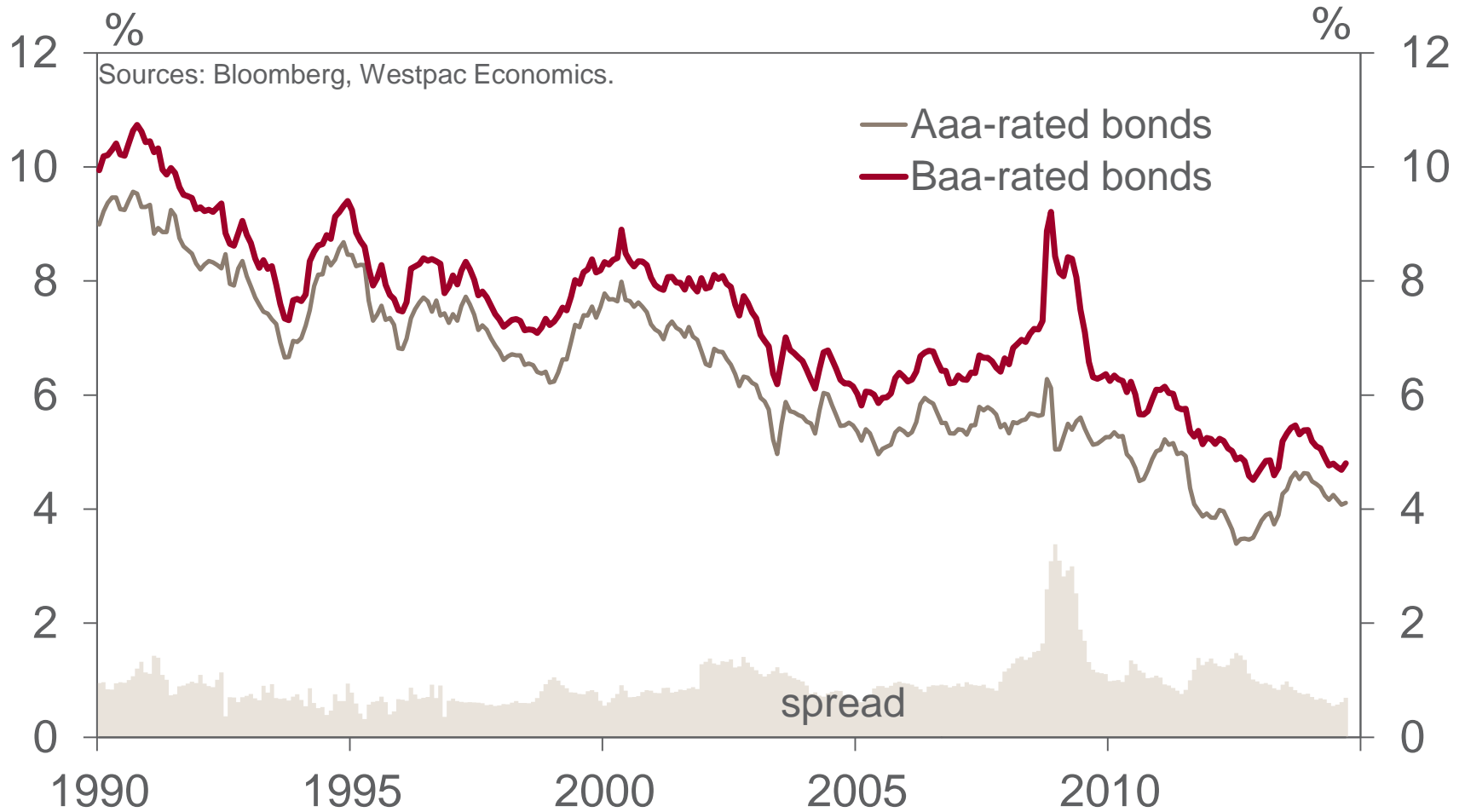
Foreign demand for USTs subdued



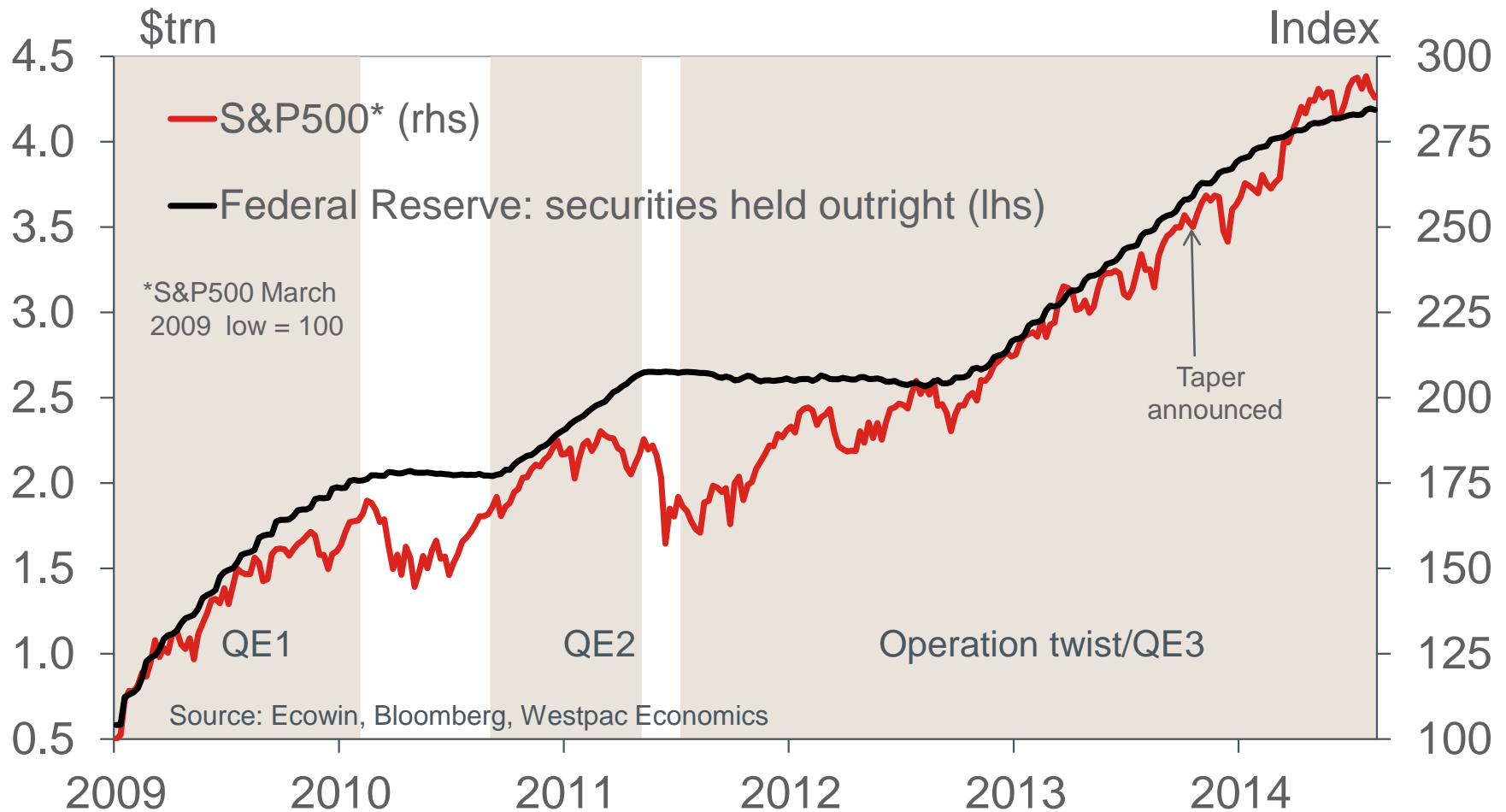
Near-term rate expectations dormant



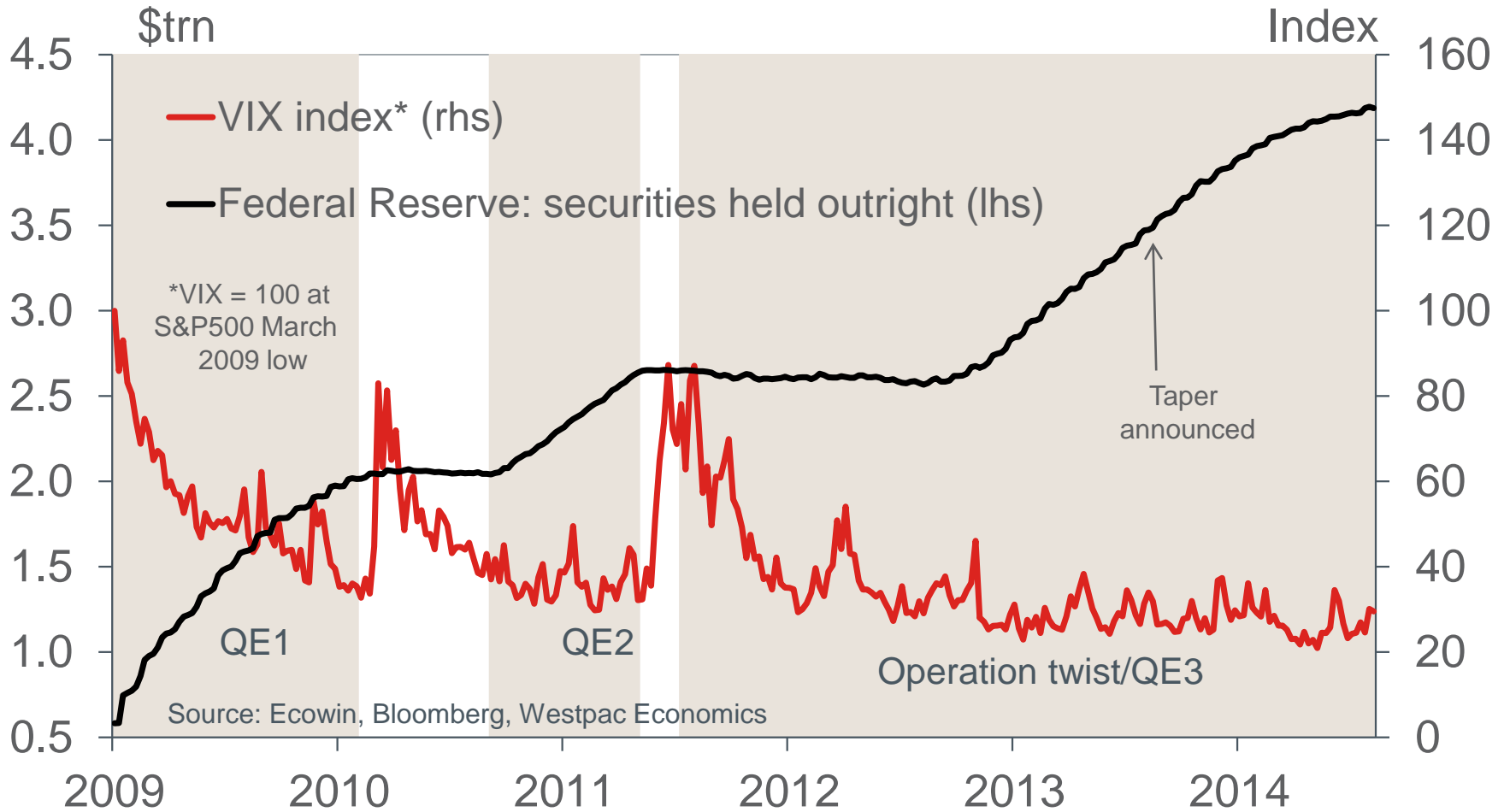
Price of risk has declined in credit markets



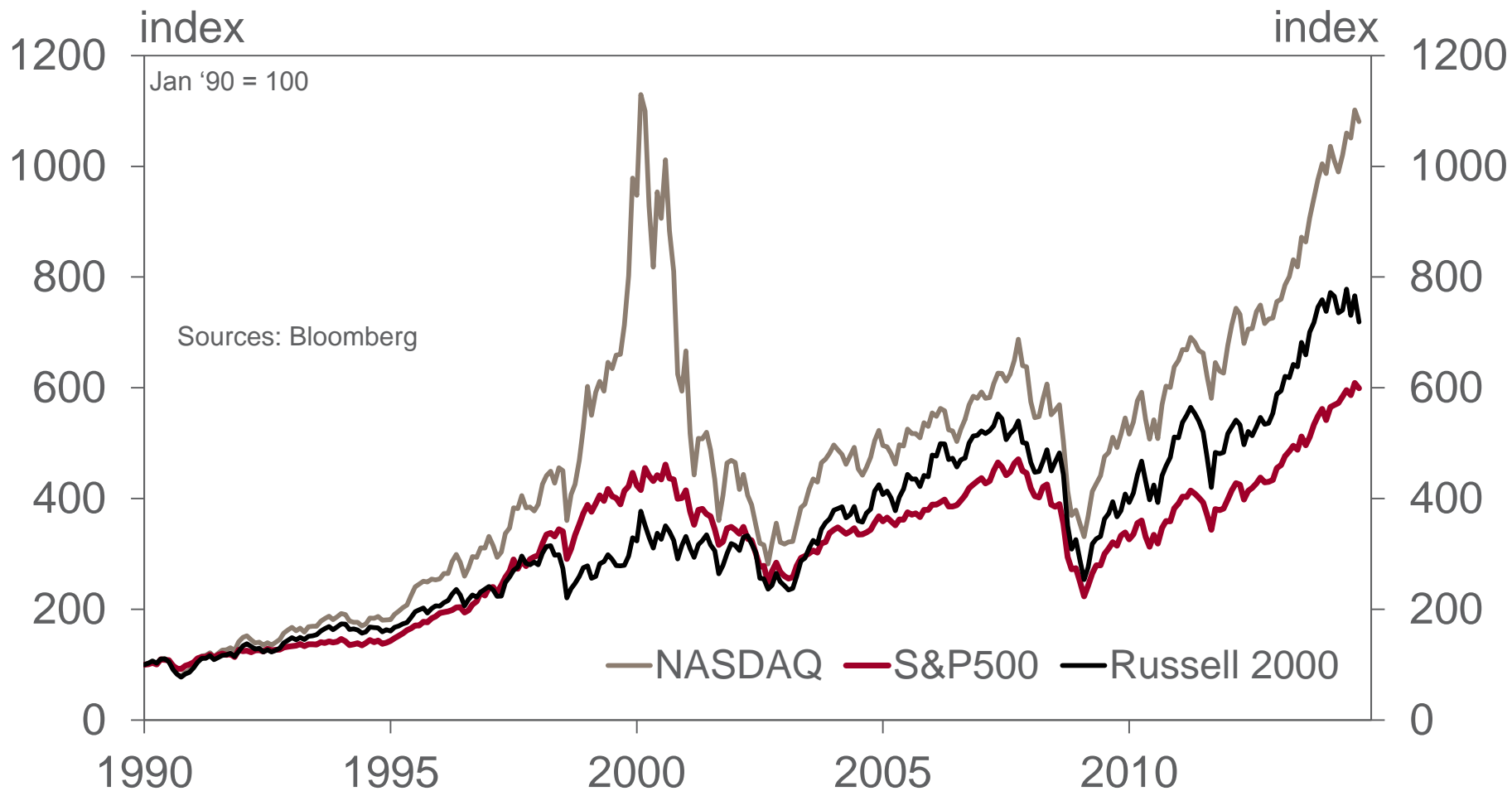
Equities riding on liquidity provision



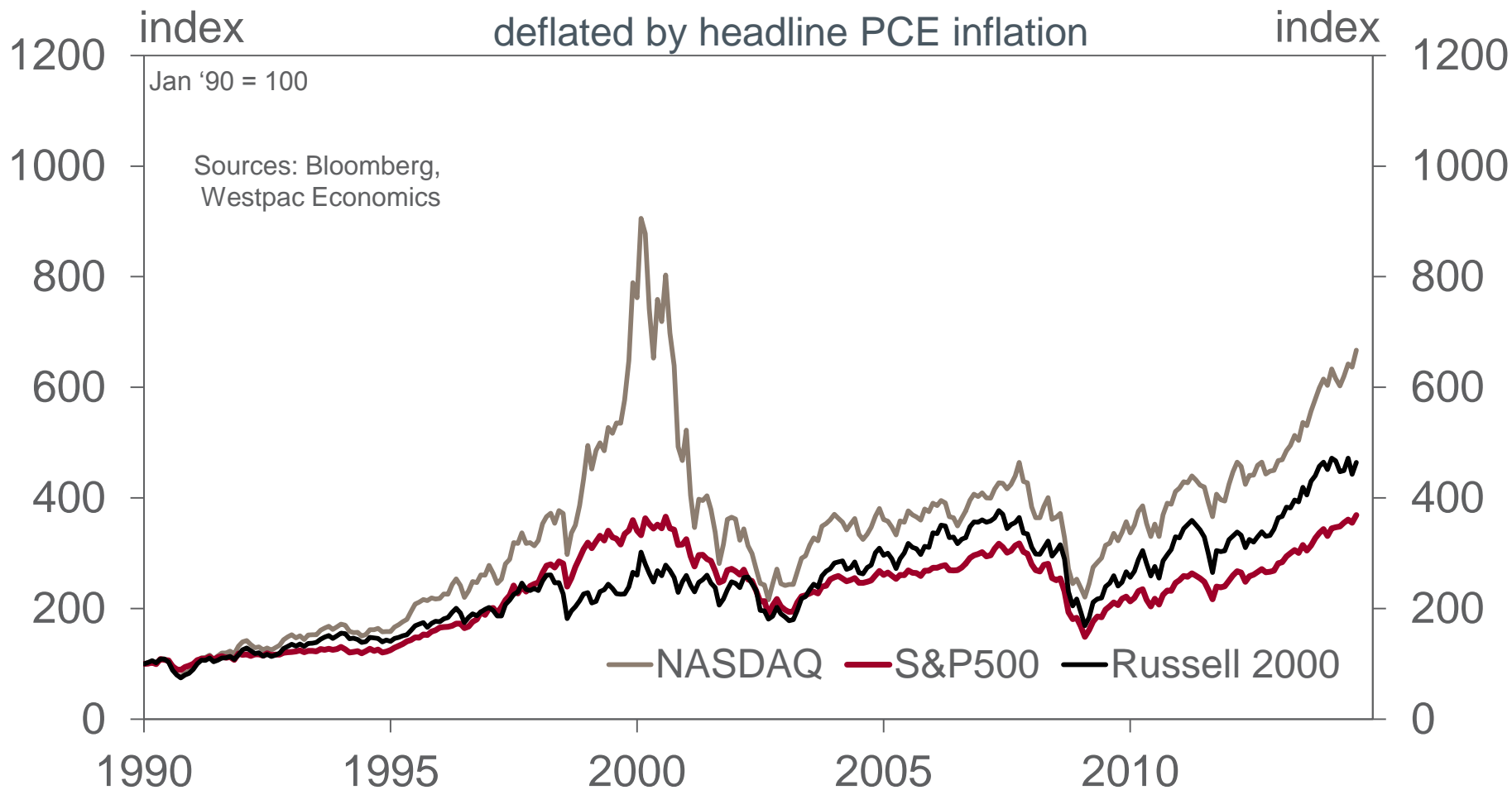
Liquidity provision suppresses volatility



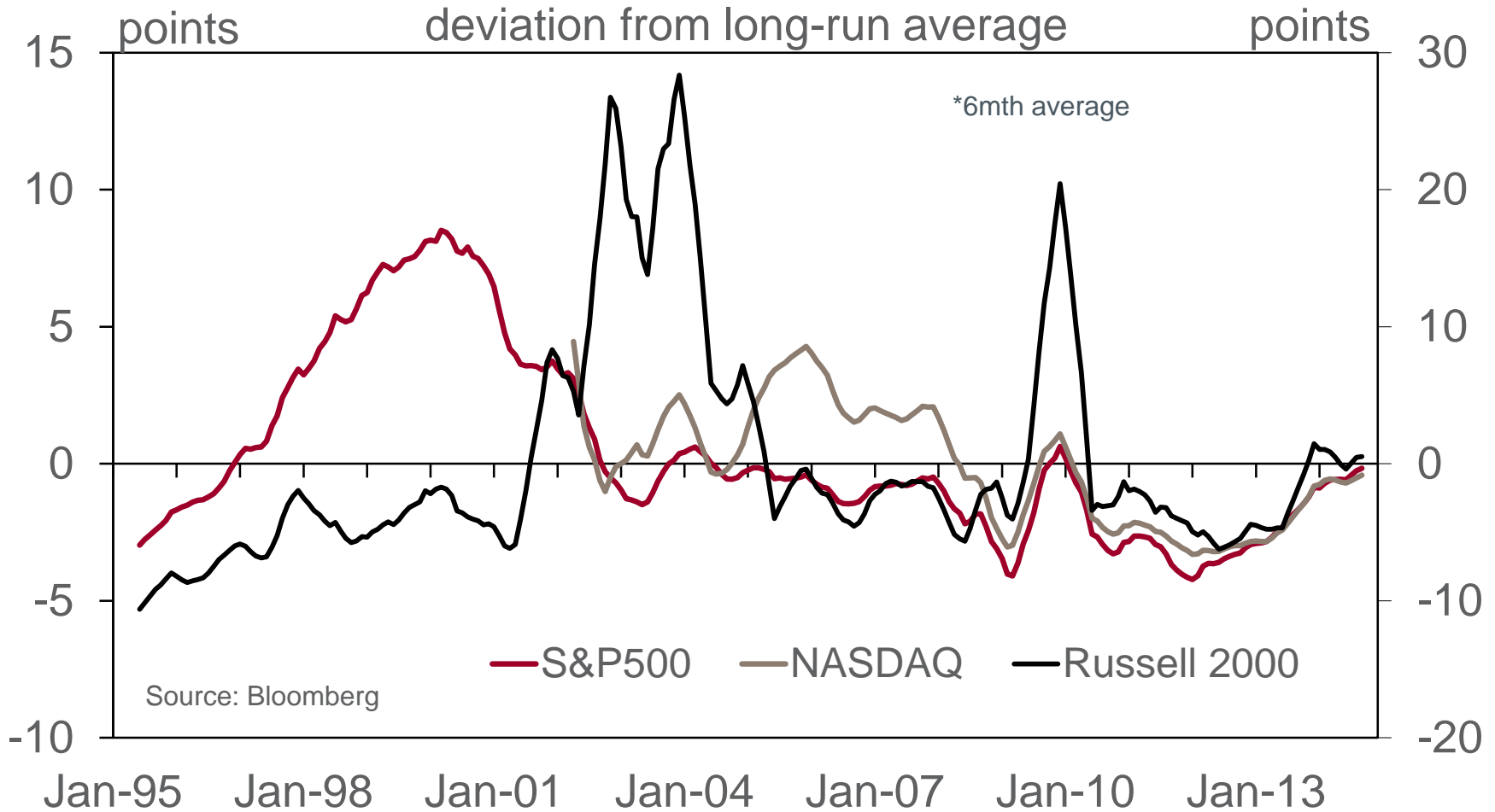
US share markets: tech and small caps lead



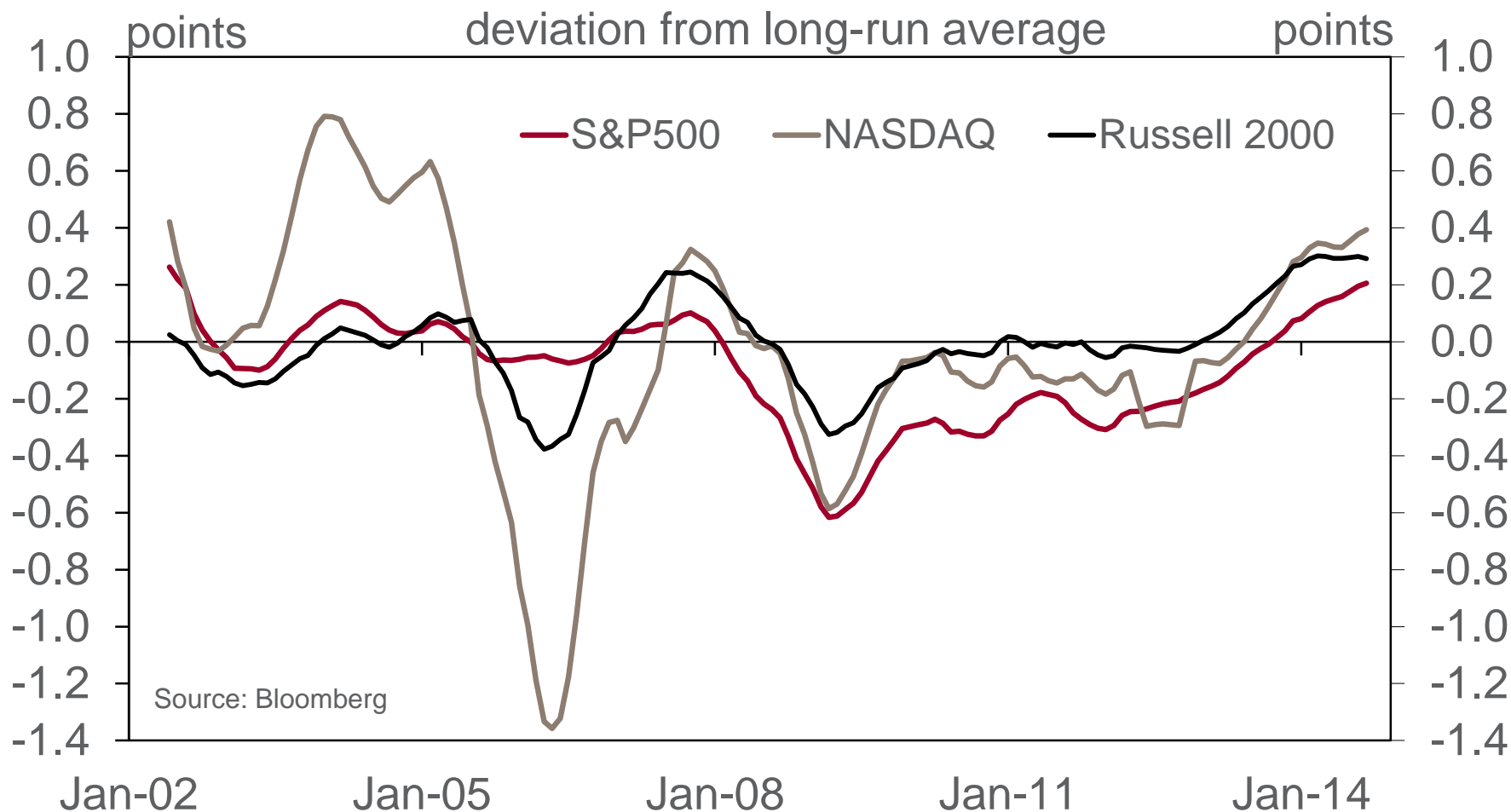
US share markets: real return



US forward Price to Earnings ratios

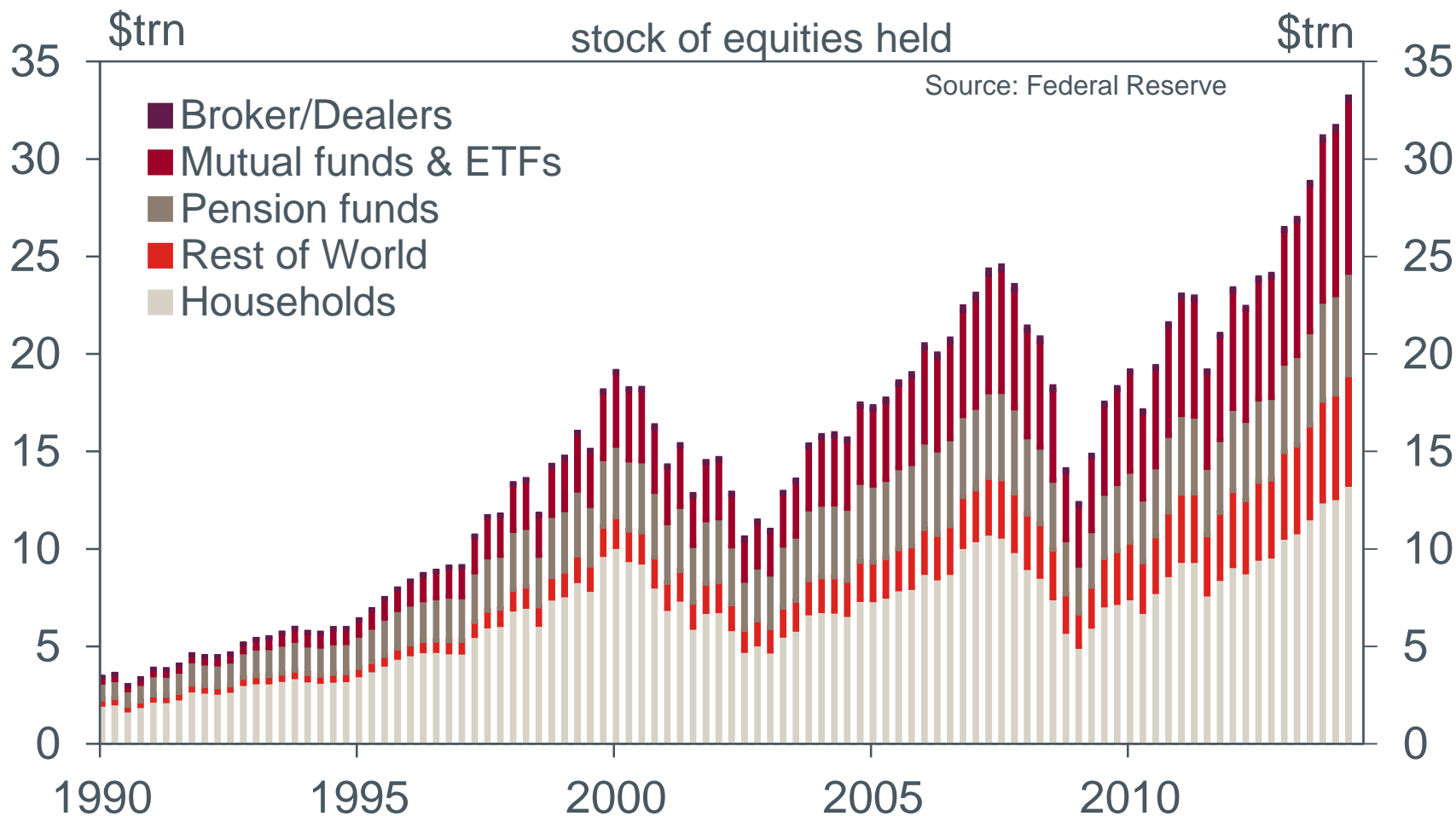


US forward Price to Sales ratios

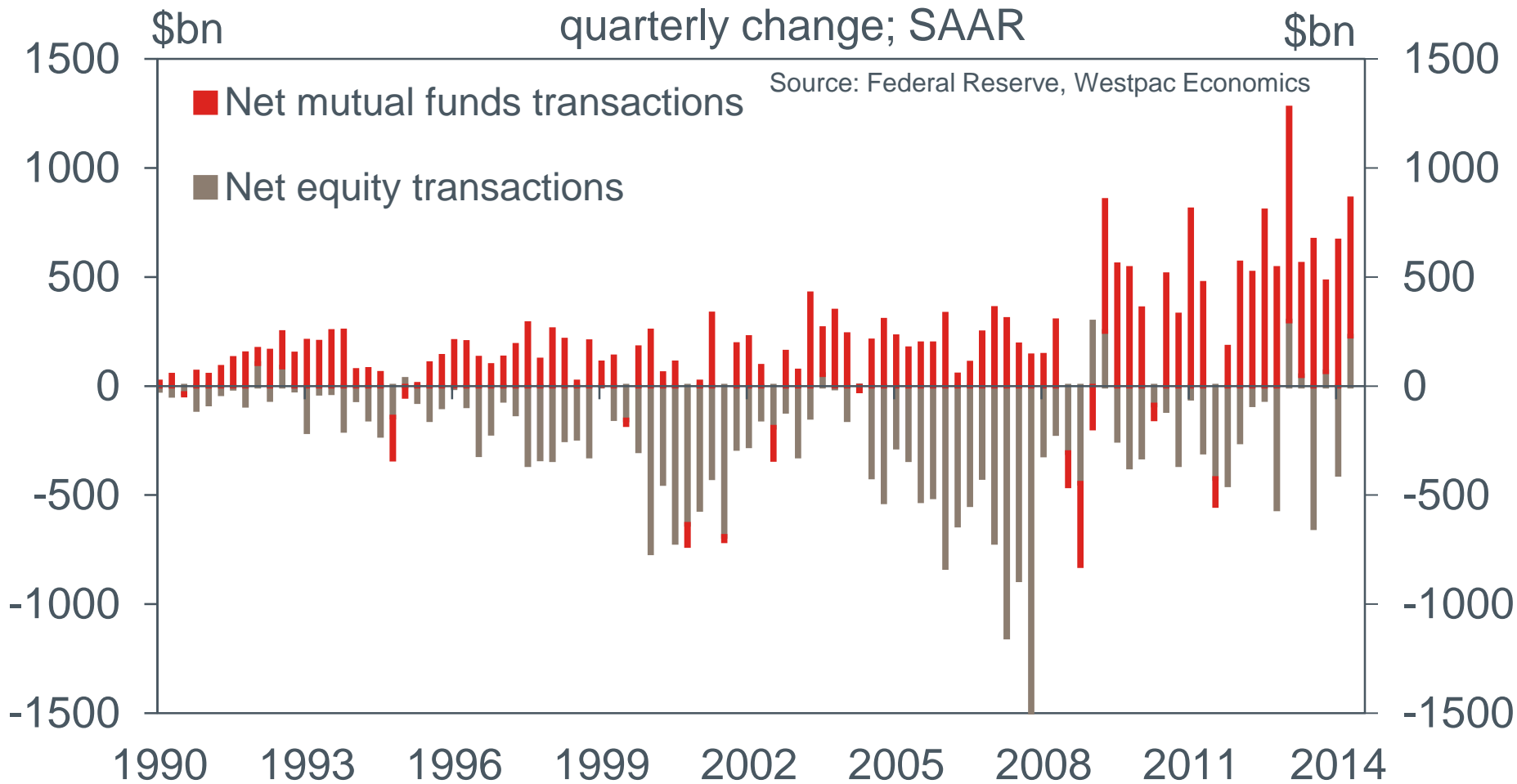


Source: Bloomberg

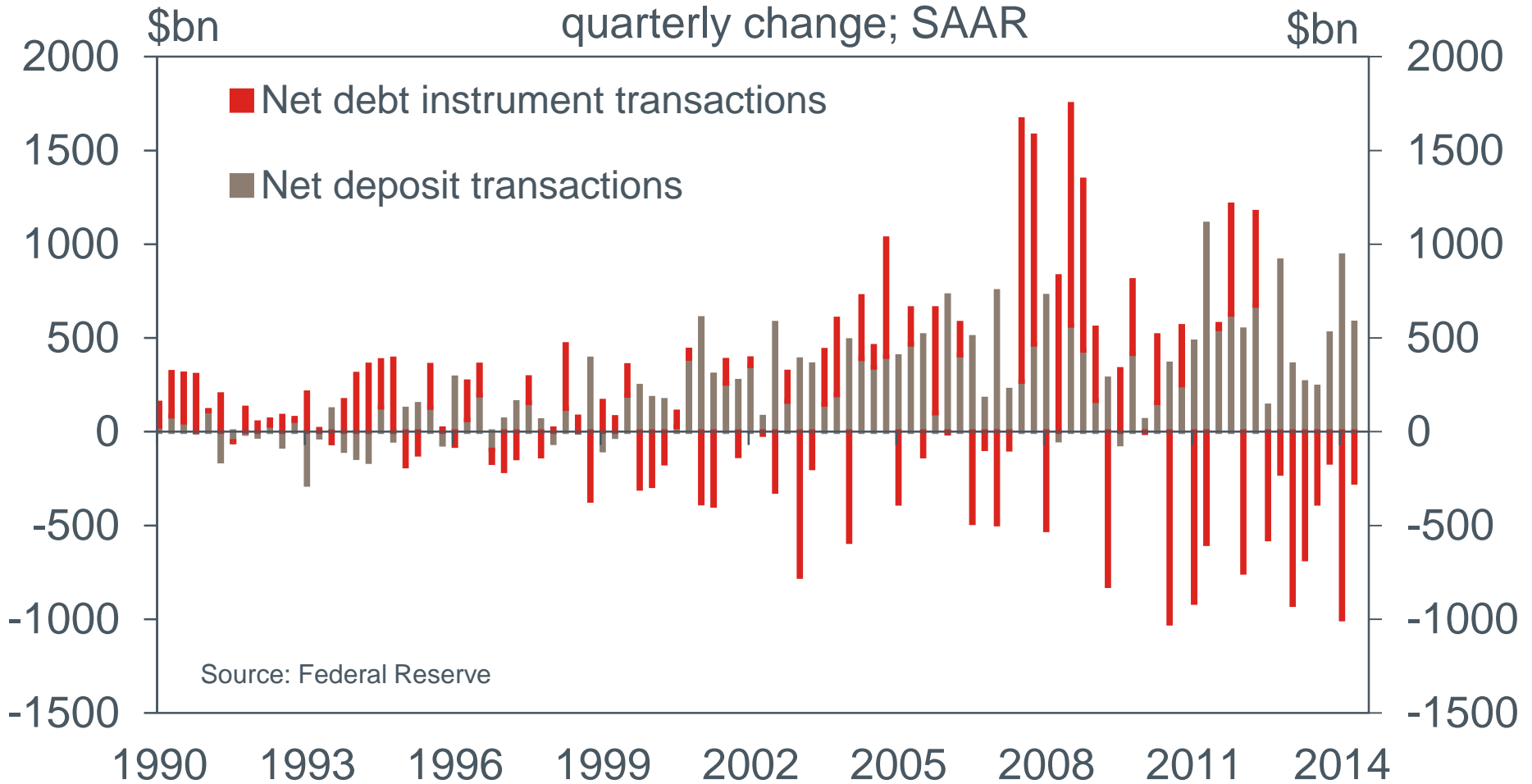
US equity holdings of key sectors



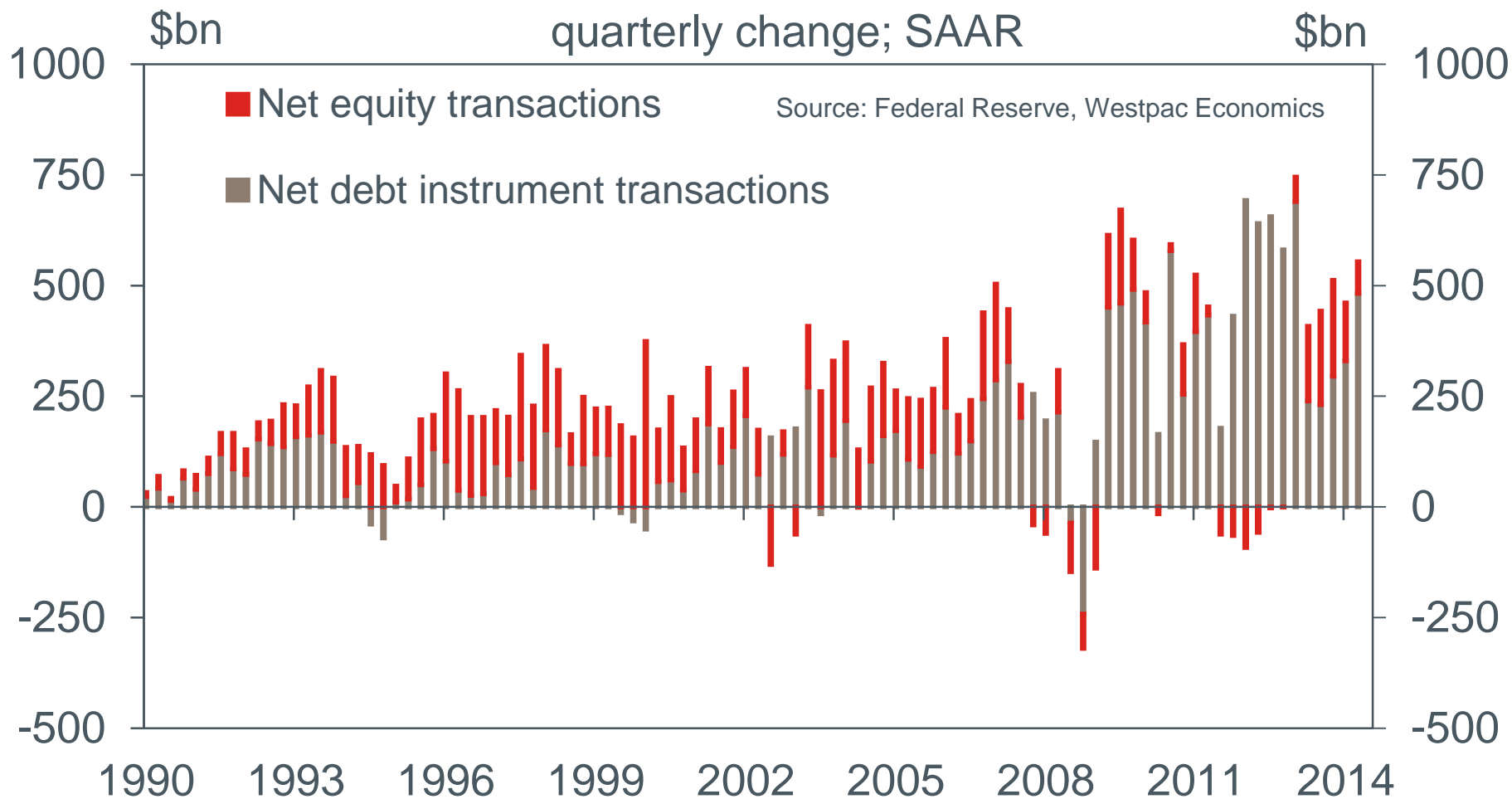
Households net sellers of equities



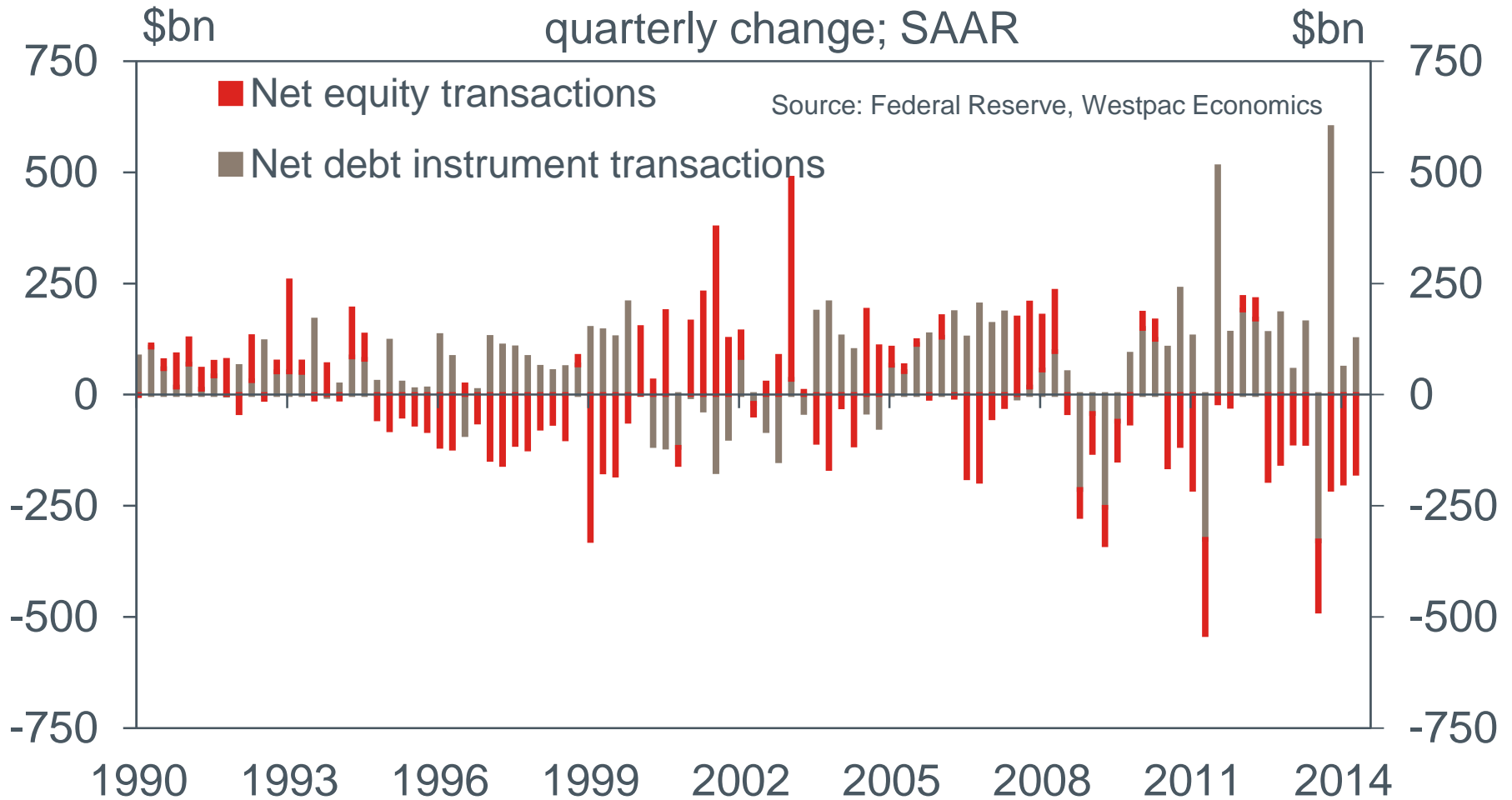
Household deposits continue to grow



Mutual funds primarily investing in debt assets

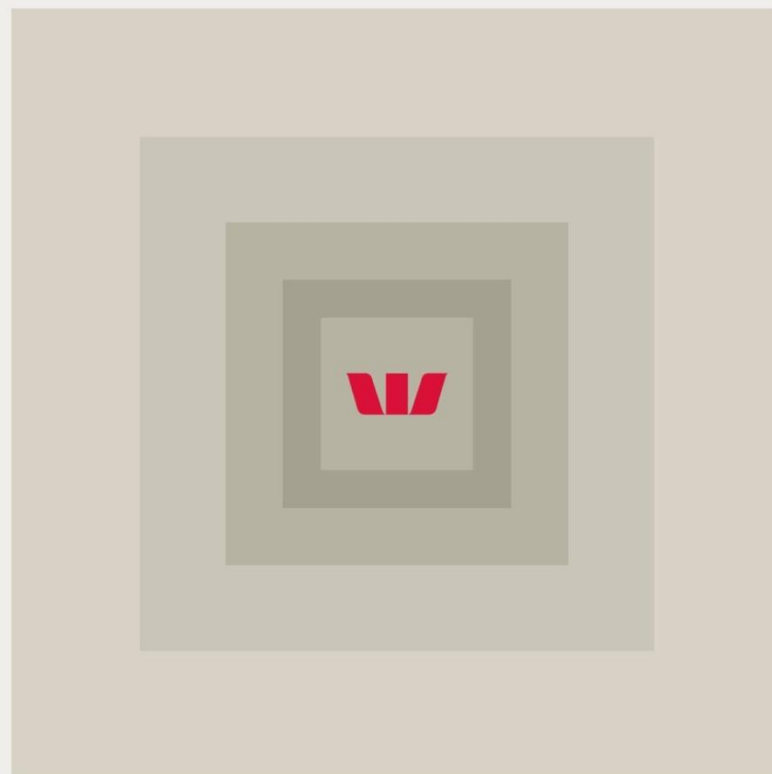


Pension funds demand debt focused

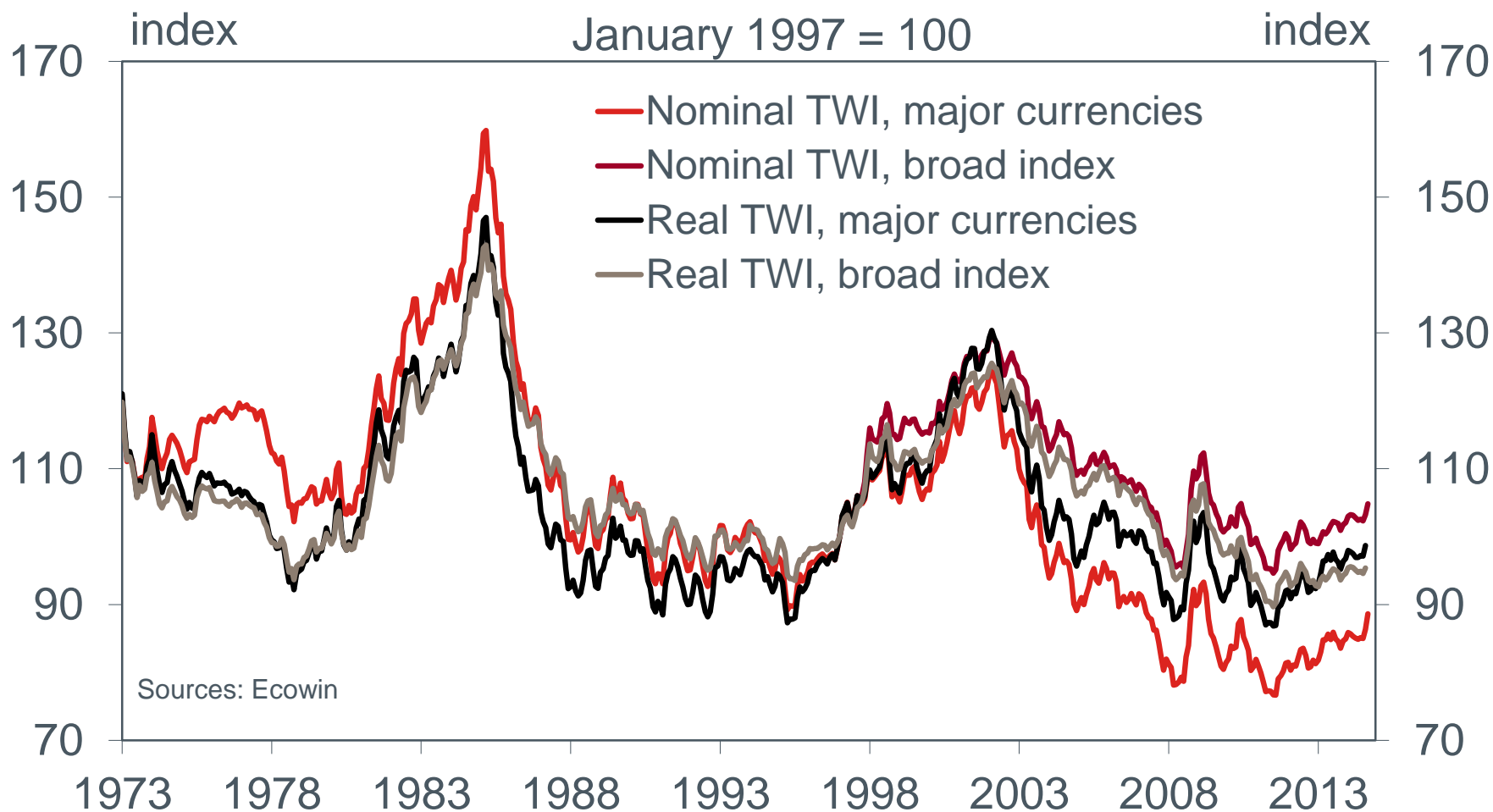


The USD, current account & other global linkages

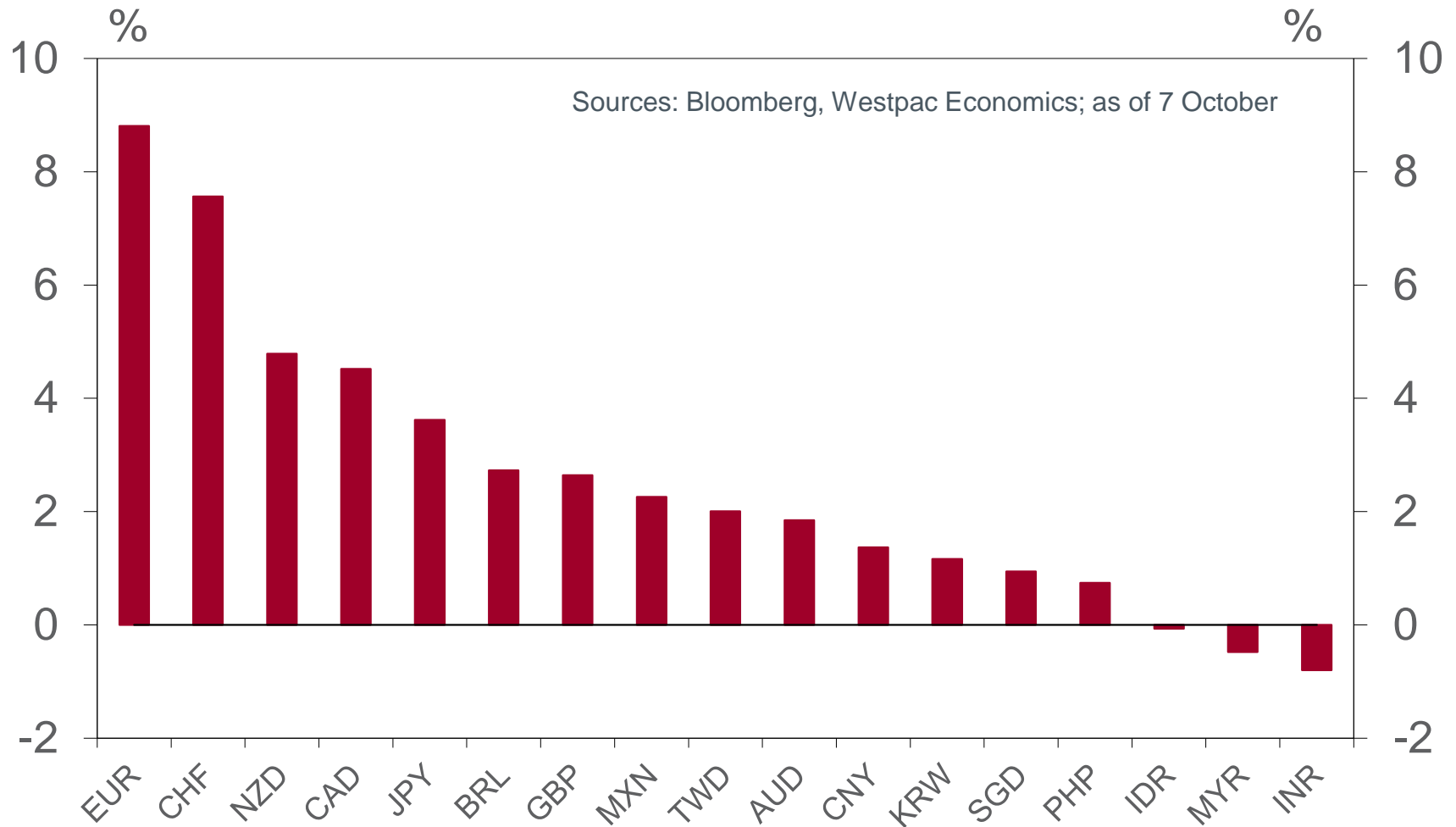
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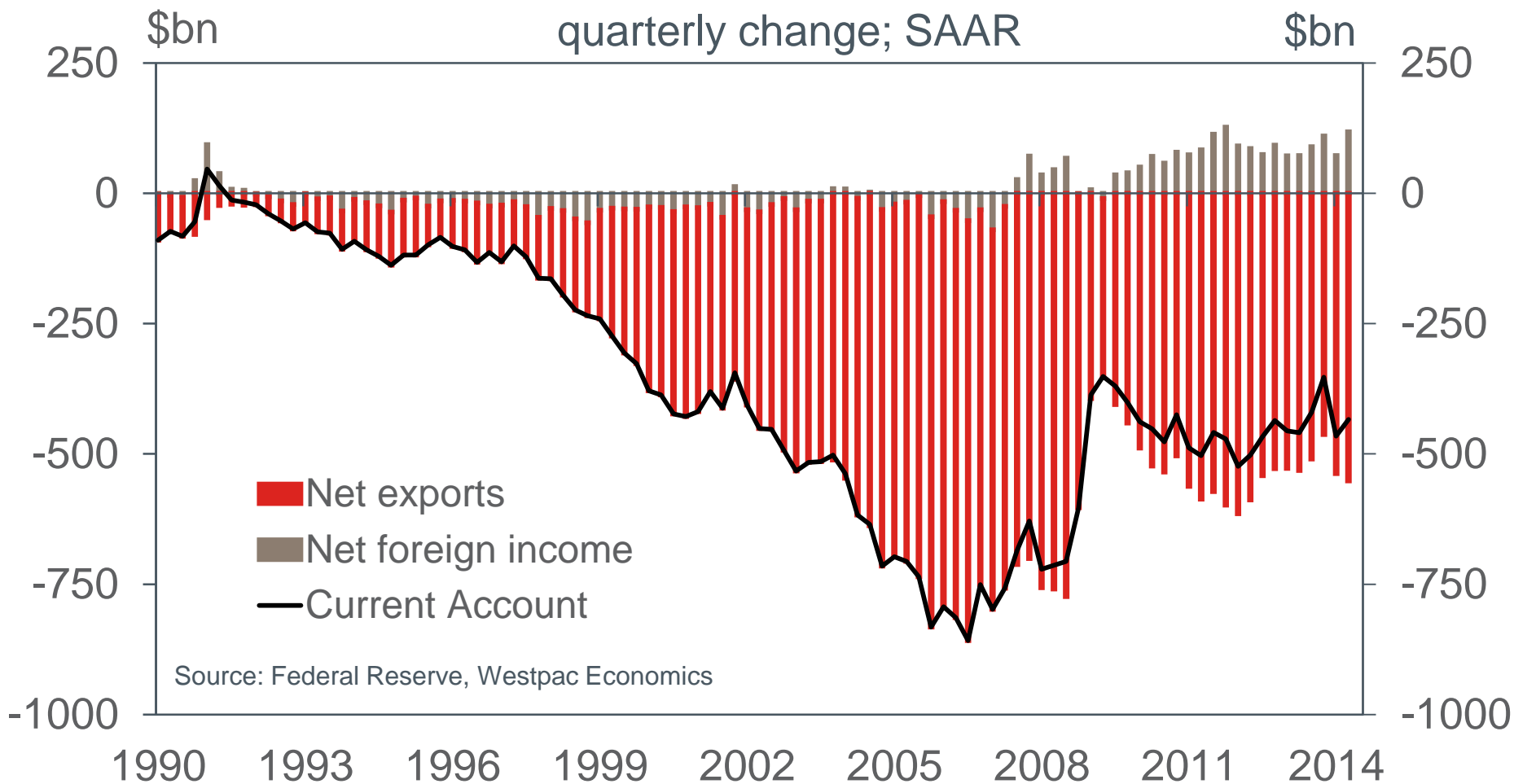
US dollar: real and nominal indexes



Year to date moves for USD

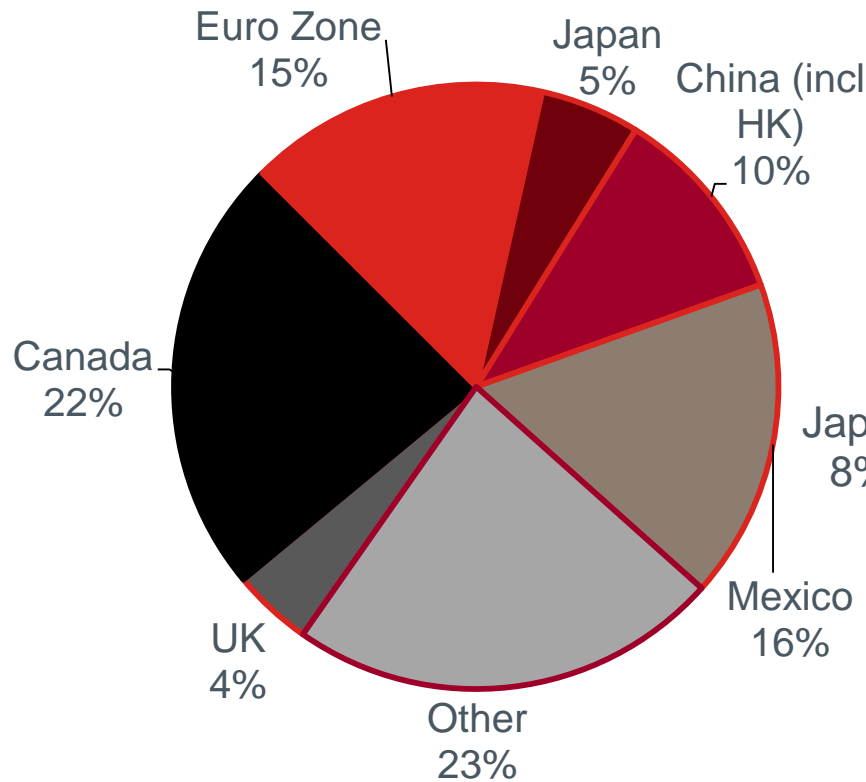


Current account: income a small offset

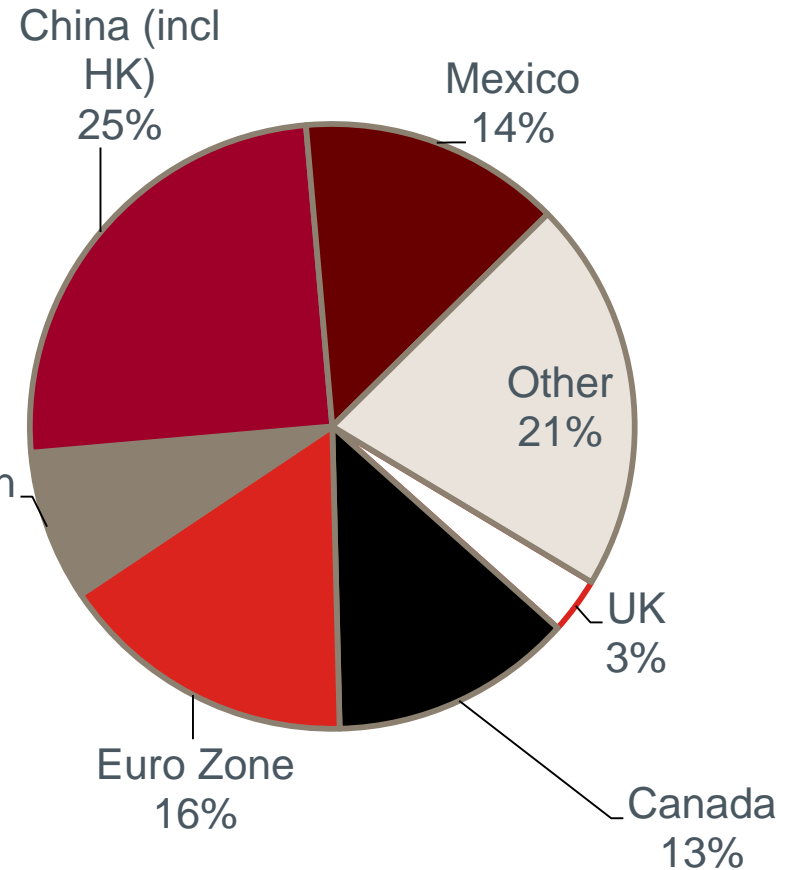


US external trade by country (2013)

Exports

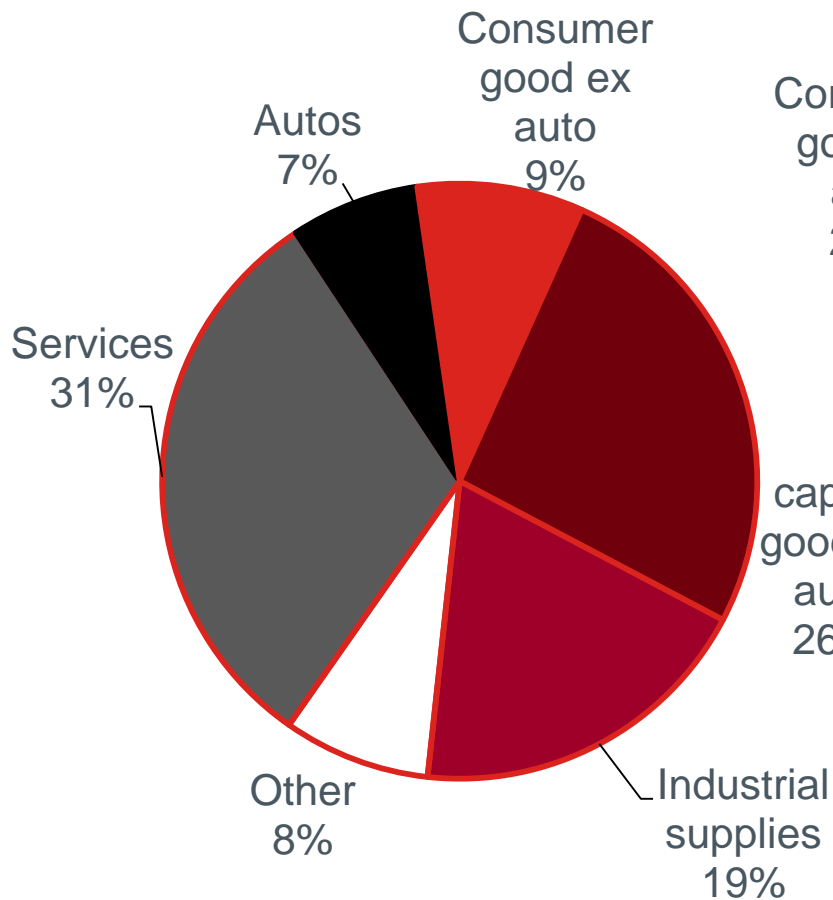


Imports

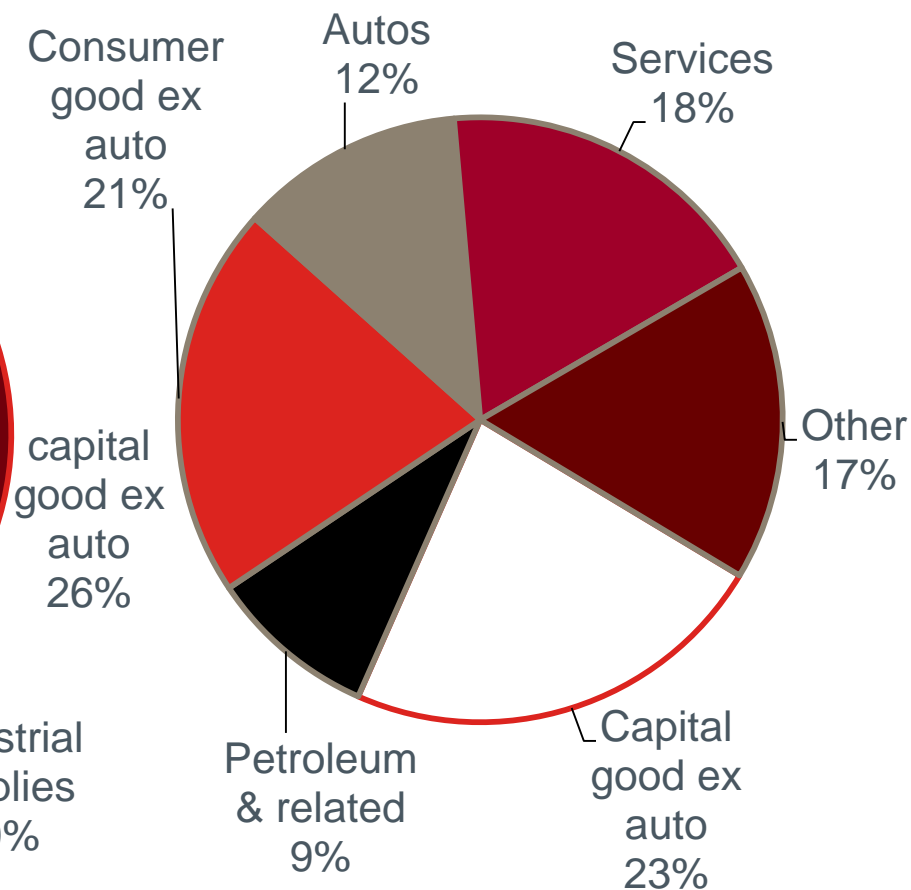


US external trade by commodity group (2013)

Exports

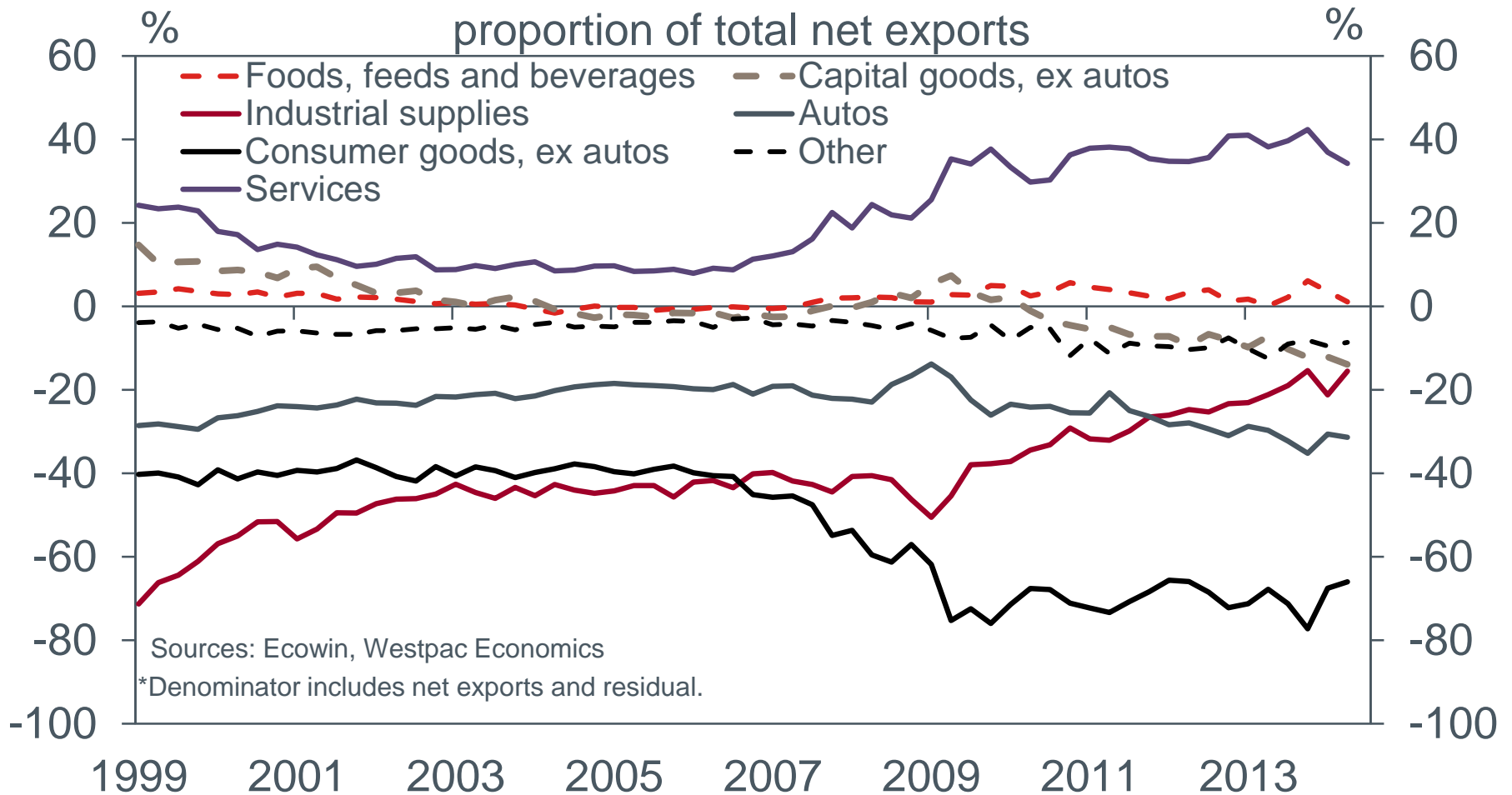


Imports

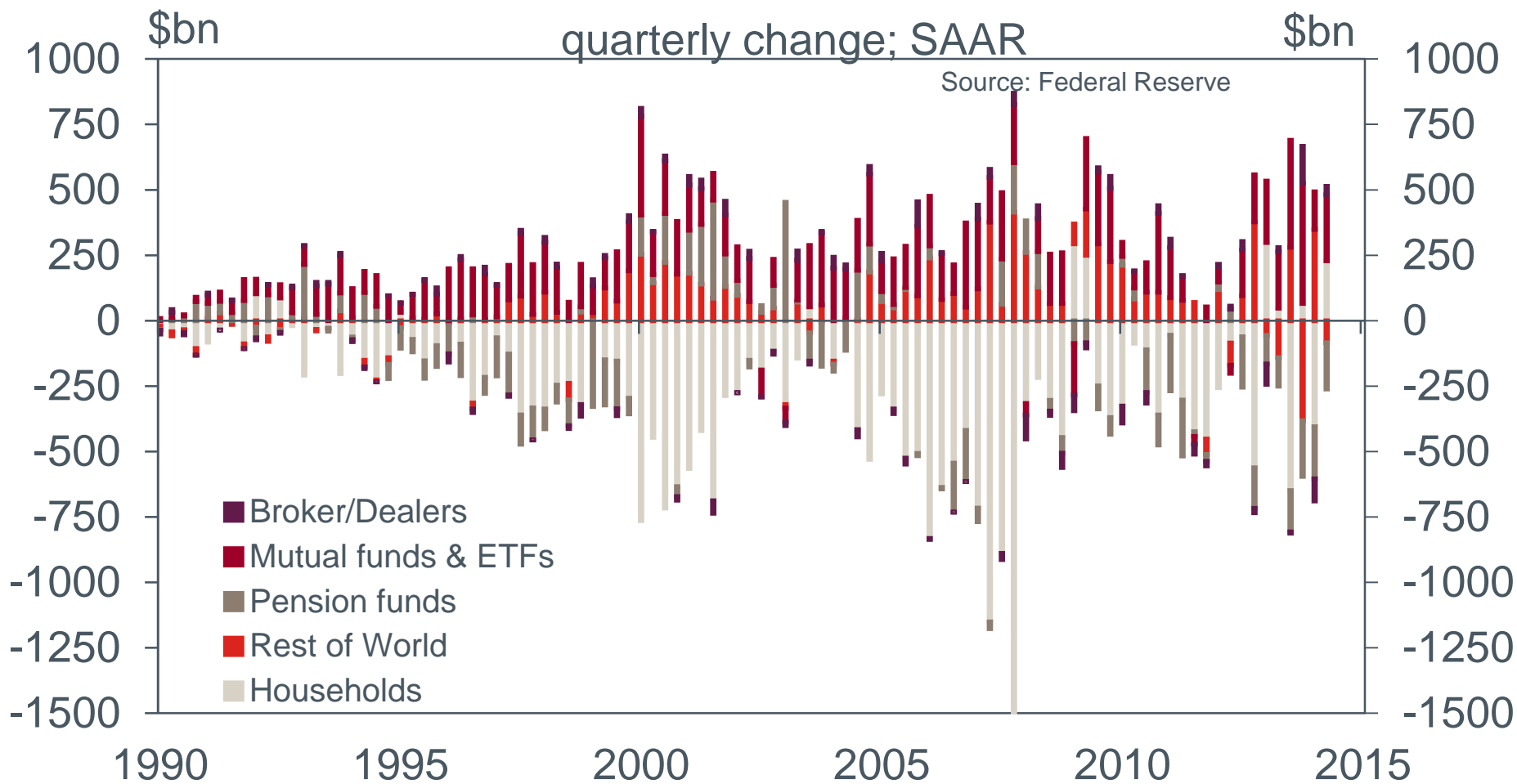


Source: Ecwin

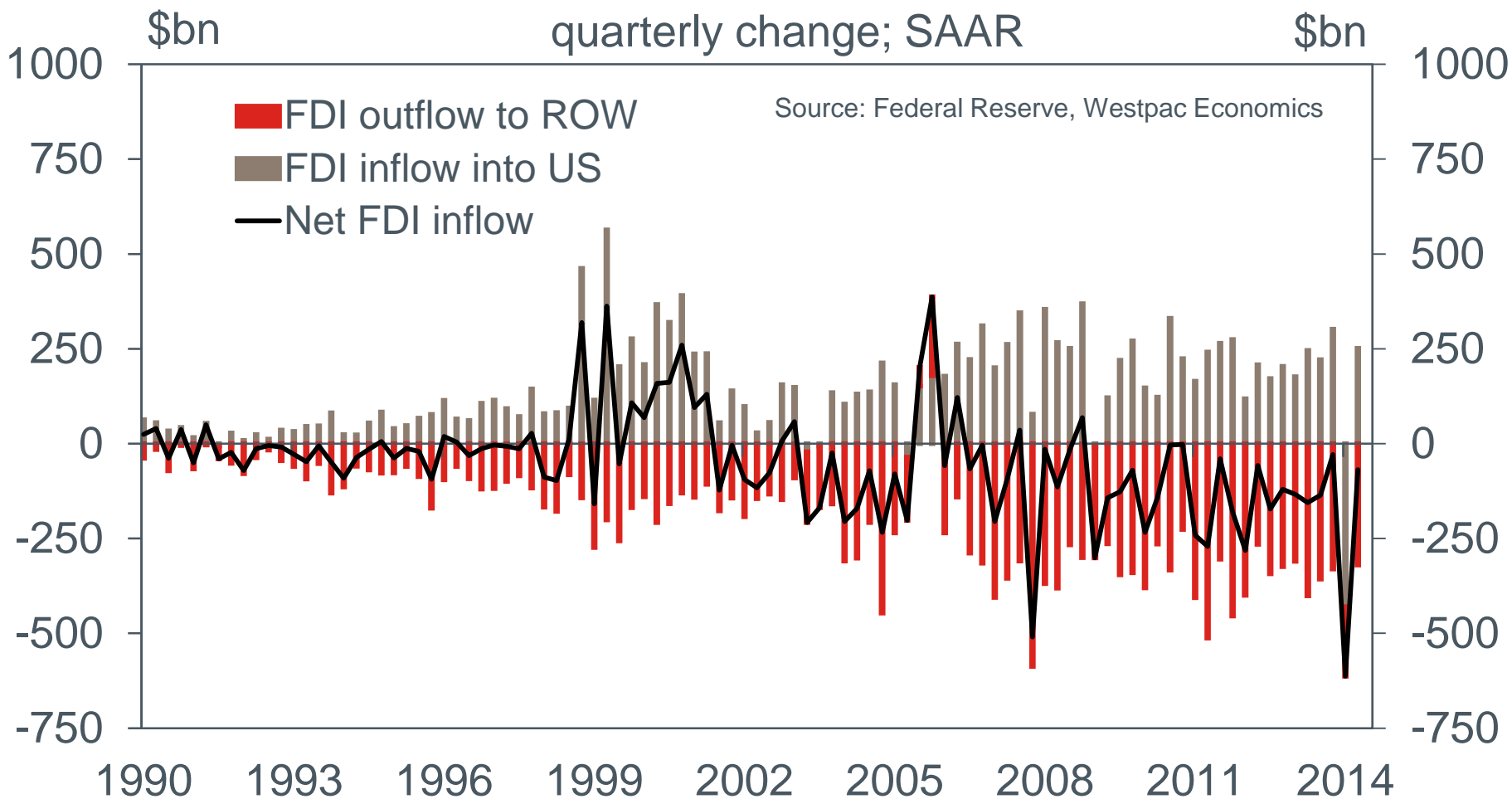
Net exports uptrend persists on services & fuel



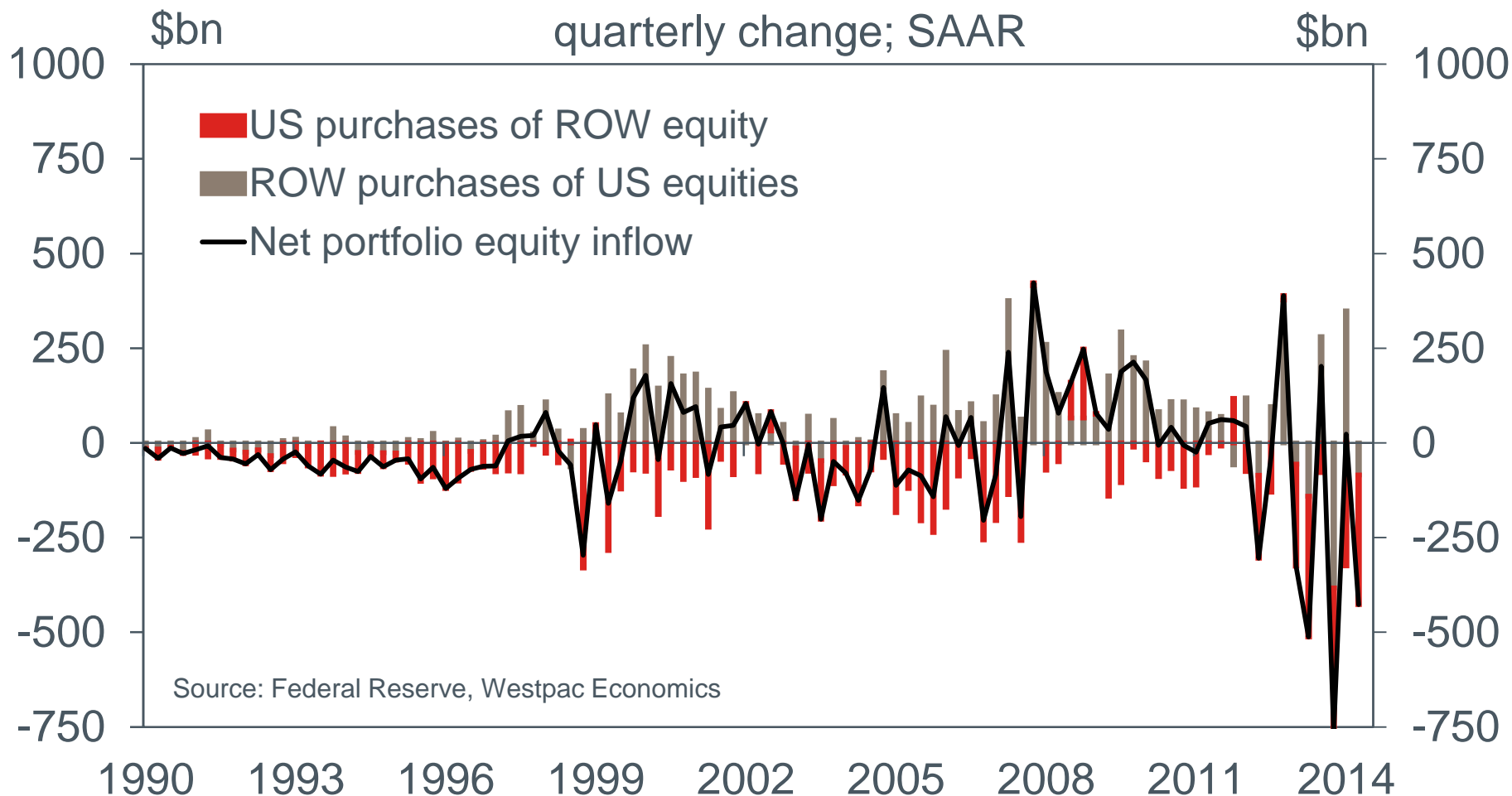
US equity demand from ROW and financials



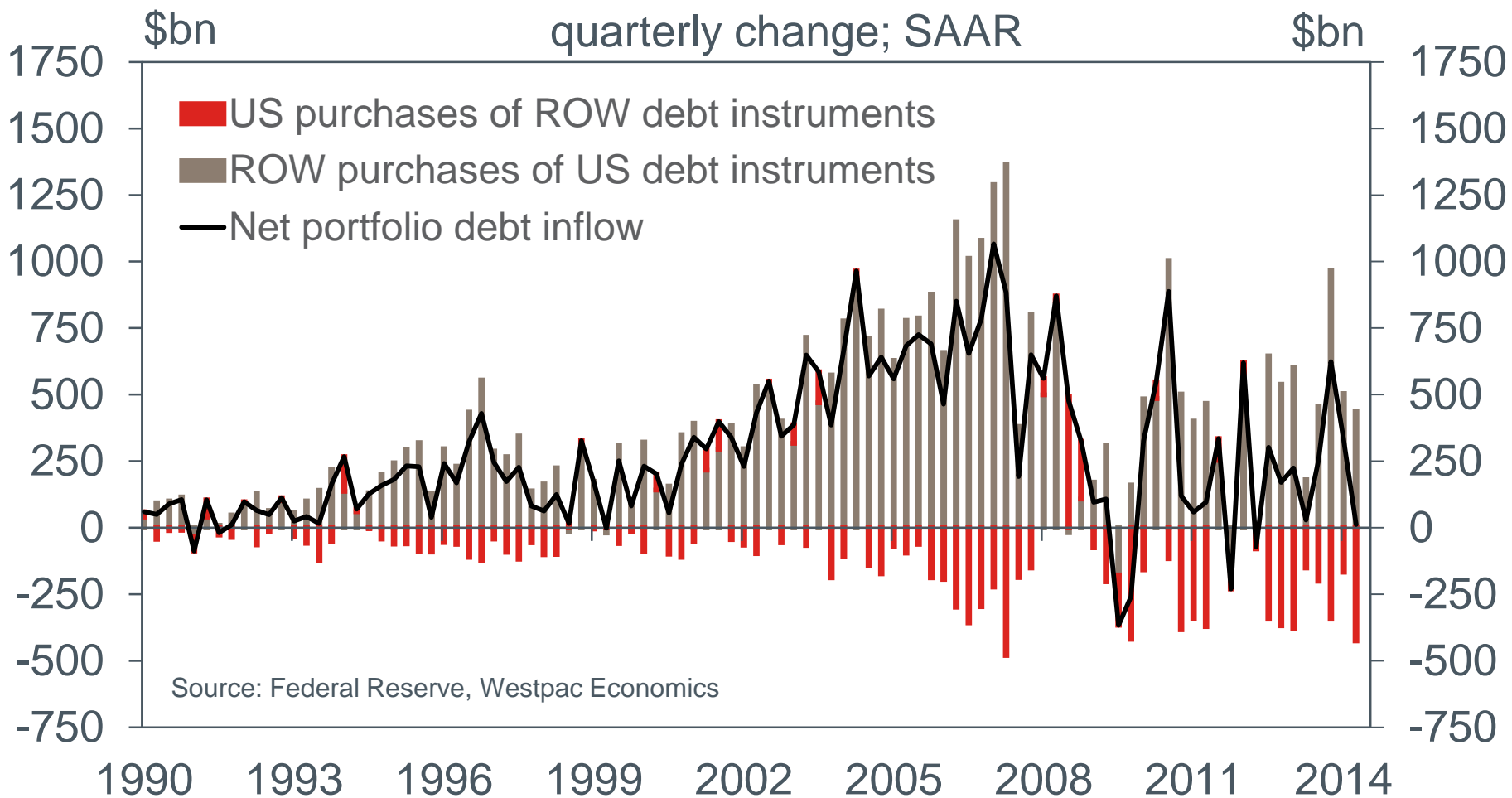
FDI transactions: persistent net outflow of capital



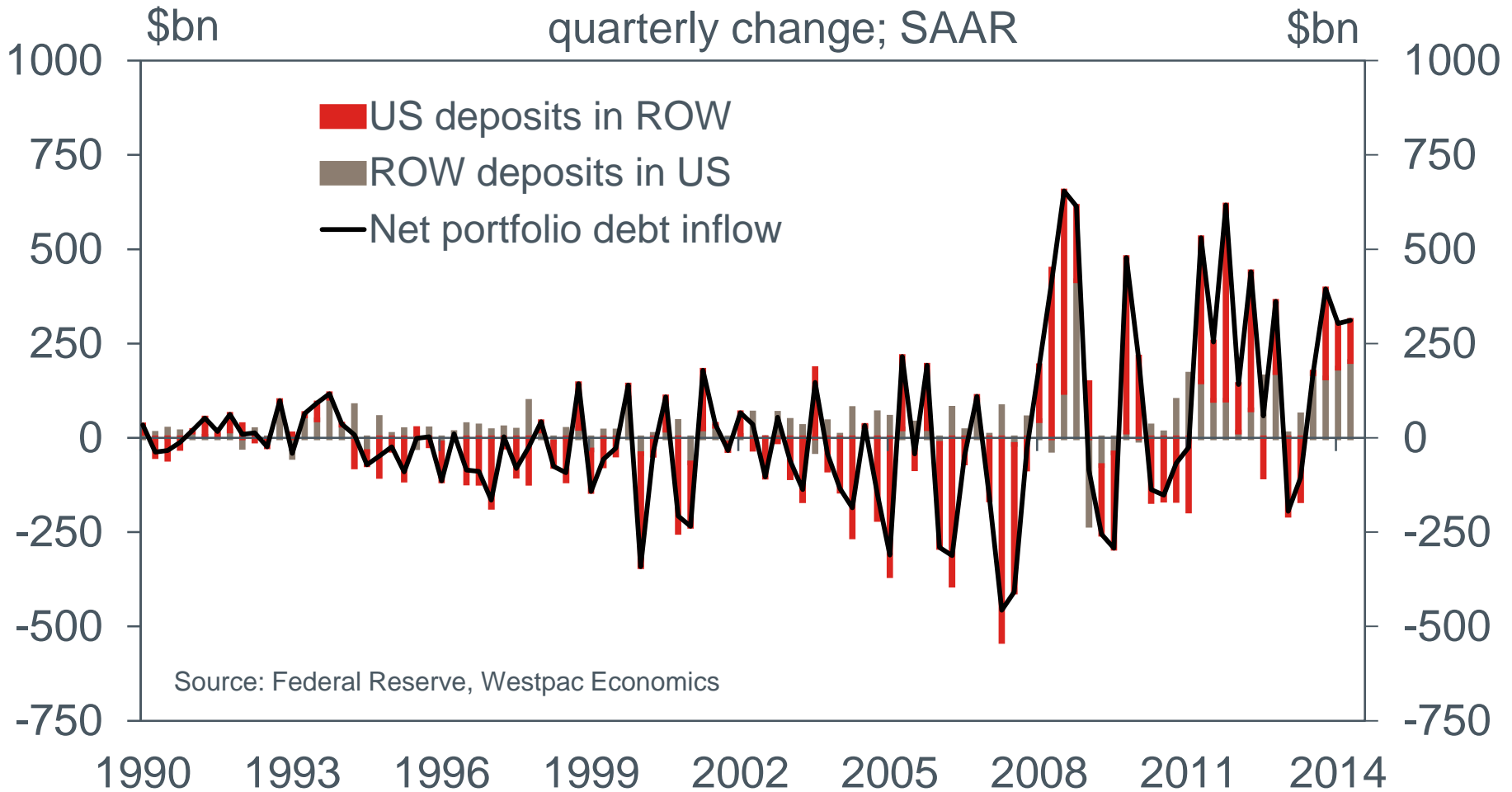
Portfolio equity flows



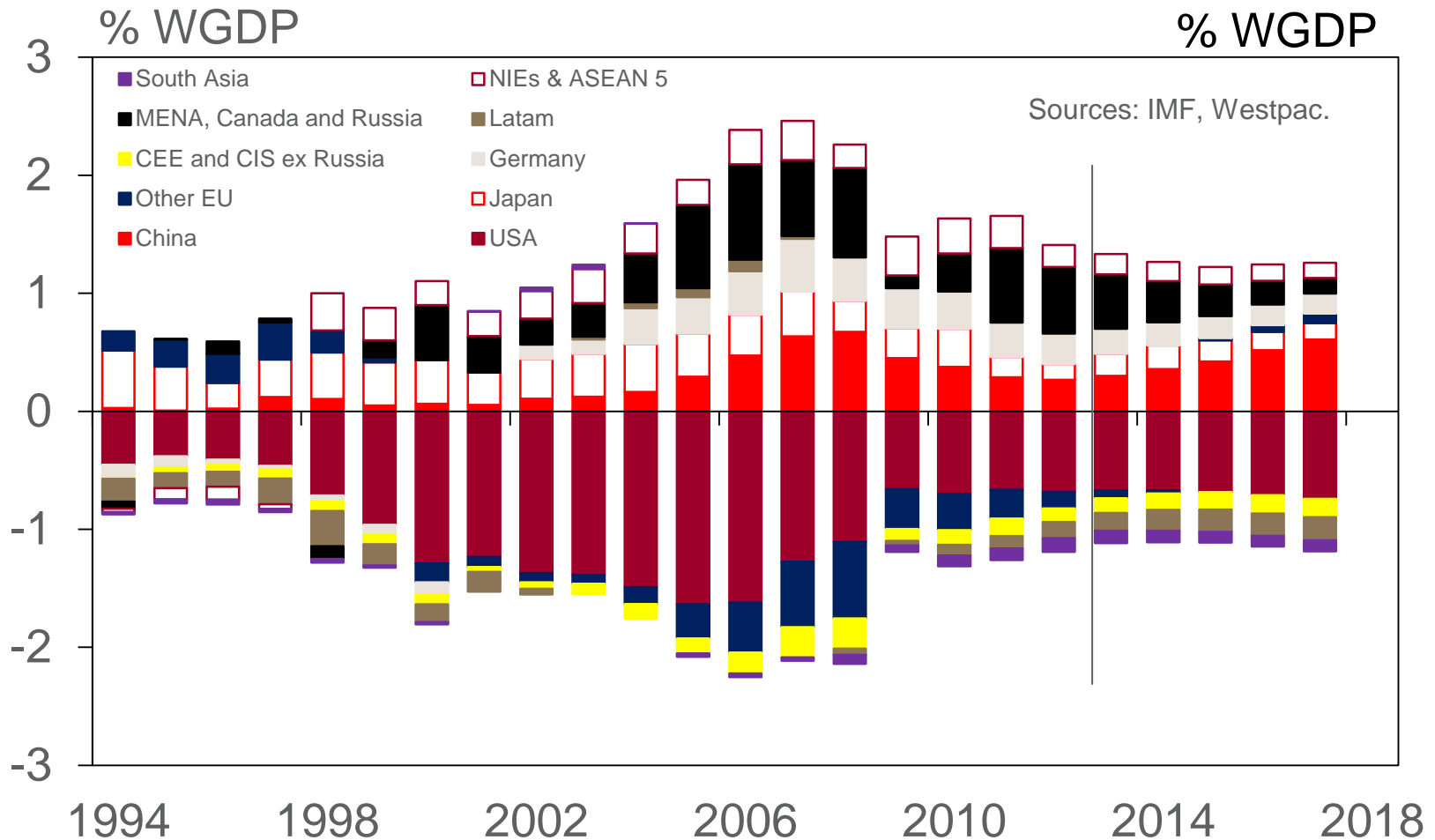
Credit market flows



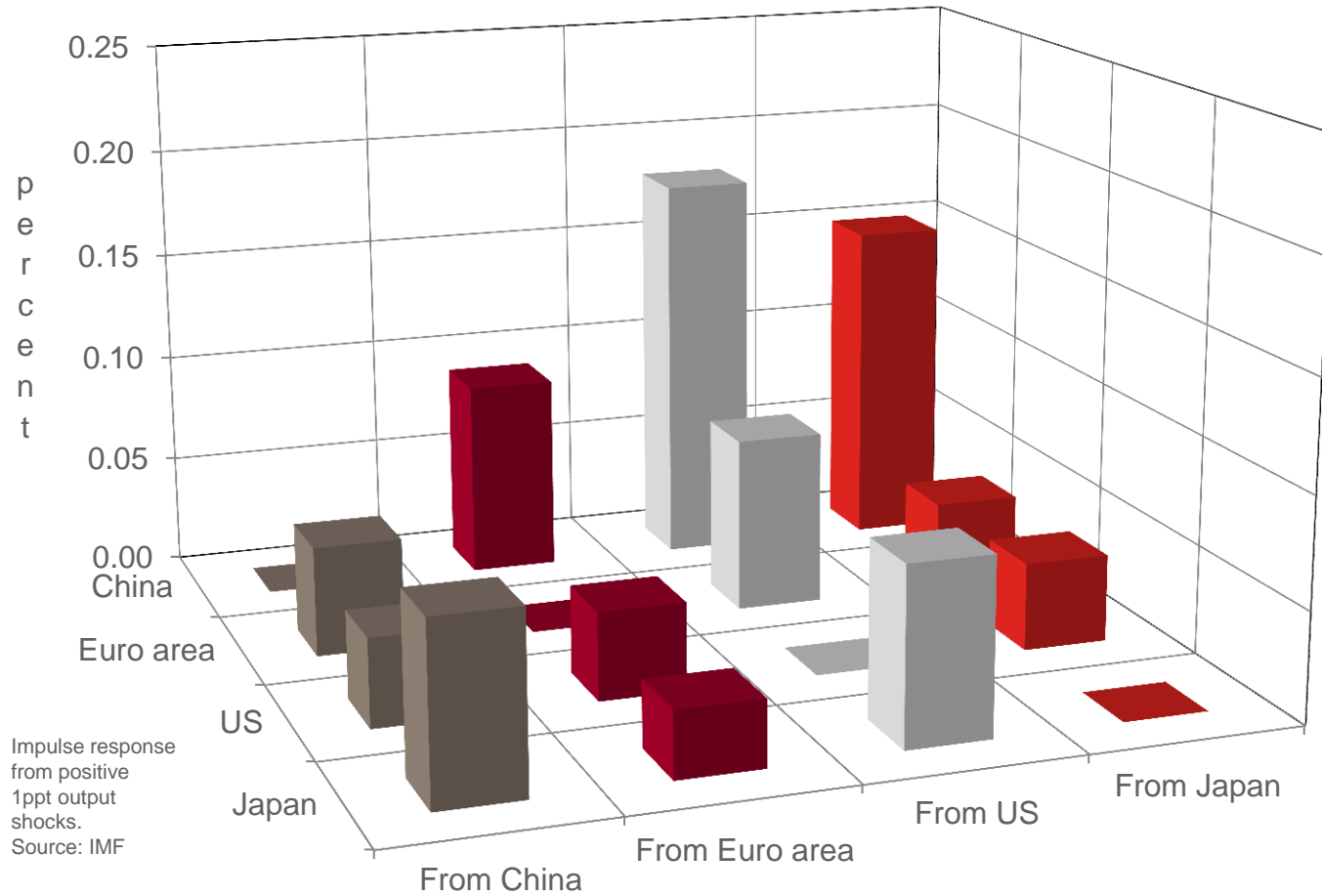
Deposit flows



The state of global imbalances



Growth spillovers between systemic economies



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