Box 1.1

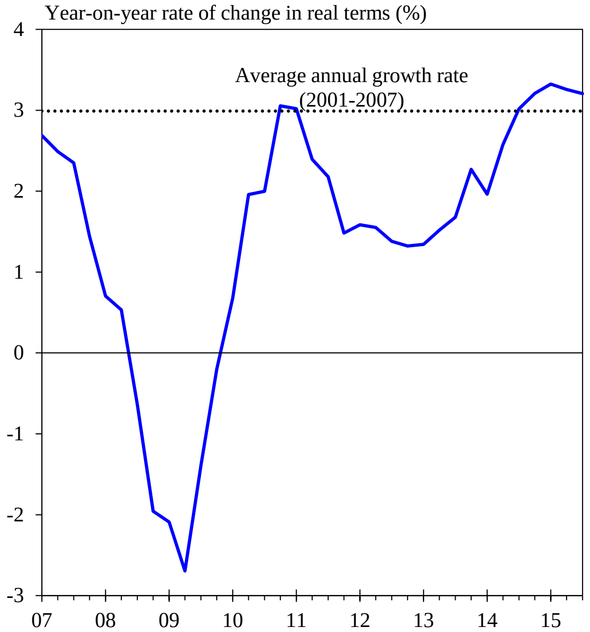
Will personal consumption help sustain economic growth in the United States?

Personal consumption has been the key growth driver of the US economy in the recent past, with personal consumption expenditure (PCE) outpacing exports for four consecutive quarters, as the latter was dragged by the lacklustre international developments and the strength of the US dollar. This note briefly examines the recent personal consumption situation in the US, and how this may affect its near-term economic outlook.

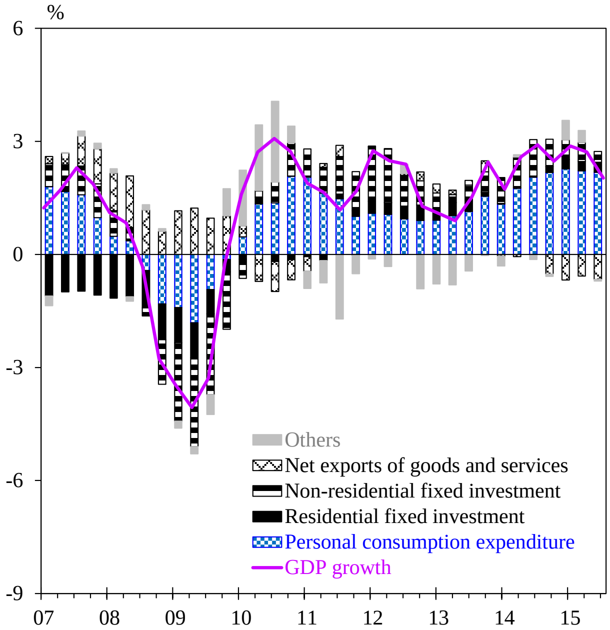
The US economy expanded moderately further by 2.0% in the third quarter of 2015 over a year earlier, after a 2.7% growth in the second quarter. In the first three quarters of 2015, GDP grew by 2.5% year-on-year, slightly faster than the 2.4% growth in 2014. PCE grew notably by 3.3% over the same period, up from 2.7% in 2014, marking the fastest pace of expansion since the Global Financial Crisis (***Chart 1a***). In terms of contribution to the year-on-year GDP growth, PCE contributed 2.2 percentage points in the first three quarters of 2015, in contrast to the negative contribution from net exports (***Chart 1b***).

Chart 1 : Domestic consumption continued to be the key driver of the US economy

(a) PCE growth



(b) Contribution to real GDP growth



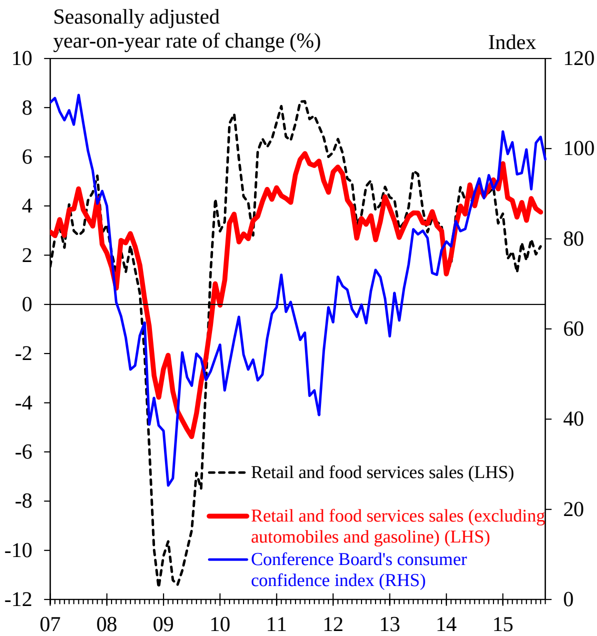
Personal consumption in the US was buoyed by the improving labour market. In the first nine months of 2015, job creation was solid, adding an average of some 198 000 new jobs per month, and the unemployment rate went down to 5.1% in September, falling within the central tendency range of the long-run normal level of 4.9-5.2% as estimated by the Federal Reserve's Federal Open Market Committee (FOMC) participants in September. The favourable effect of improving job and income conditions was also evidenced by the performance of retail and food services sales, which increased by 2.3% year-on-year in value terms in the first nine months of 2015. Excluding the volatile automobile and gasoline sales, the core measure rose even faster, at 4.1% (***Chart 2***).

Box 1.1 (Cont'd)

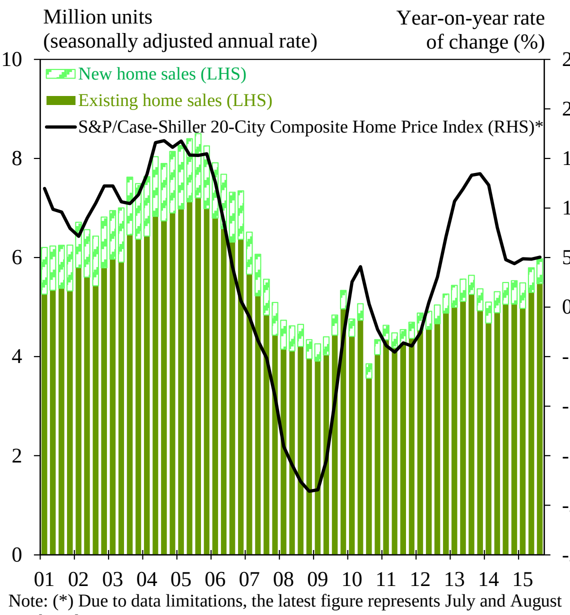
The progressive housing market recovery in the US also helped. Housing market activity not only directly contributed to US economic growth through higher residential investment and trading, but also indirectly bolstered consumption through the wealth channel. Amid a very low interest rate environment, total home sales, comprising existing and new home sales, rose to the highest level since 2008 in recent months, along with steady rises in house prices (***Chart 2***).

Chart 2 : Improved consumer sentiment and the progressive housing recovery both helped support personal consumption in the US

(a) Buoyant consumer sentiment also evidenced by steady core retail sales growth



(b) Home sales rose to a multi-year high, and prices increased moderately year-on-year



Note: (*) Due to data limitations, the latest figure represents July and August combined.

On current trends, personal consumption should continue to help support US economic growth in the rest of the year. Consumer confidence, as gauged by the Conference Board's index, trended up successively to reach a multi-year high before easing somewhat in October (***Chart 2***). Indeed, the central tendency of the GDP growth estimates made by the Fed's FOMC participants in September for the fourth quarter of 2015 was 2.0-2.3%, while the IMF in October projected US GDP growth in 2015 to be 2.6%.

Yet, uncertainties still prevail. The pace of job creation in August and September was notably slower than expected, conceivably reflecting the negative feedback from developments in the rest of the global economy. If continued, this could weaken consumer sentiment going forward. Another key source of uncertainty relates to the impending US interest rate lift-off, which would eventually lead to higher borrowing costs for individuals and businesses. How the housing market and business climate will react to higher interest rates could have a significant bearing on household wealth and income prospects and hence on personal consumption behaviour.

With the increased downside risks to the global economy, the volatile financial conditions of late, and the Fed's inclination to normalise monetary policy, a sustained strengthening of the US economy cannot be taken for granted. We have to monitor the situation closely, as this would inevitably impinge on the Hong Kong economy.