ECONOMIC UPDATE

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Q1 2016 GDP: Another Year, Another Q1 To Forget . . .

- The BEA's first estimate shows real GDP expanded at an annualized rate of 0.5 percent in Q1 2016.
- Business investment spending, inventories, and trade were the main drags on growth, consumer spending and housing the main supports.

Stop us if you've heard this one before – the U.S. economy stumbled out of the blocks in Q1, with real GDP expanding by just 0.5 percent (okay, let's give Q1 its props, it was 0.538 percent, unrounded). This is largely in line with expectations, the consensus estimate was for 0.6 percent growth and our forecast was 0.7 percent, but, really, in a $16.5 trillion economy the differences between these and 0.5 percent (oops, 0.538 percent) don't' even constitute rounding errors. The bigger question is what the Q1 GDP data are really telling us about the underlying health of the U.S. economy, and our answer is not a lot.

First, we'll offer the usual disclaimer – in any given quarter the BEA's initial estimate of GDP is based on highly incomplete source data and, as such, prone to large revision in subsequent months. The average revision between the first and third estimates of real GDP growth is 0.6 percent (this is the absolute value). The second point we'll make is specific to the Q1 data in any given year, in which the issue of residual seasonality (or, the presence of seasonal patterns despite the data being seasonally adjusted) continues to plague the GDP data. This is readily apparent in the GDP data over the past several years, in which the first quarter has persistently underperformed the other three quarters.

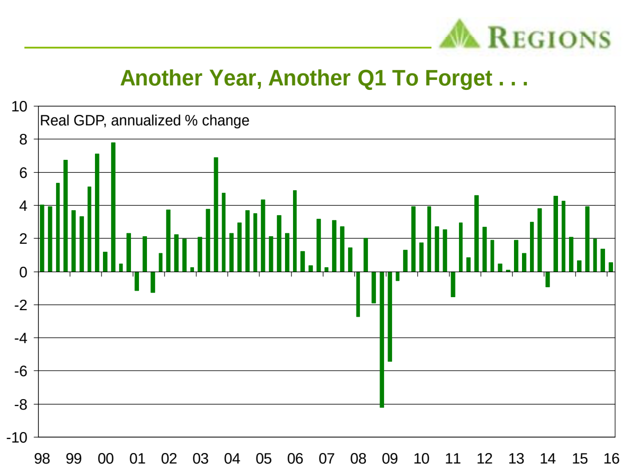
To be sure, these issues, together or alone, will not alter what will be the bottom line when all is said and done and revised – Q1 2016 will go down as a weak quarter. The weak spots were trade, inventories, and business investment spending, which combined to knock 1.4 points off of top-line real GDP growth. These factors largely negated the supports from consumer spending, residential investment, and government spending, leaving us with the 0.5 percent headline growth print.

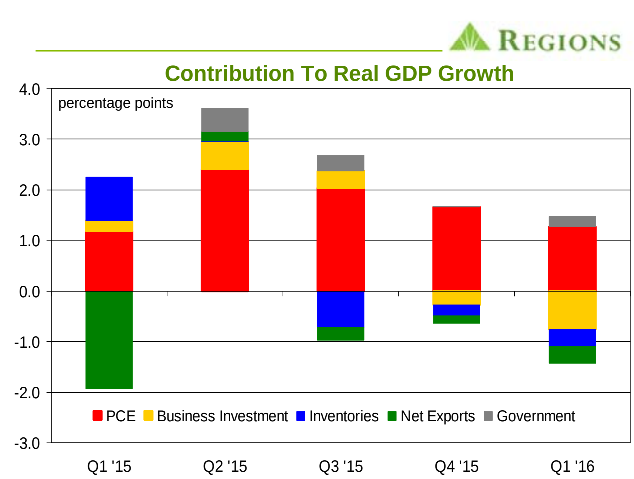
Real consumer spending grew at an annualized rate of 1.9 percent in Q1, slower than the 2.4 percent growth logged in Q4 2015. The slower growth in Q1 is largely a function of a decline in real spending on consumer durables, in turn a reflection of the slowdown in motor vehicle sales from what was an unsustainably fast pace – 17.8 million units – in 2015's final quarter. Spending on motor vehicles and parts fell at an annualized rate of 12.4 percent in Q1 (spending on "other durable goods" fell at a 3.1 percent rate but this category is considerably smaller than motor vehicles and parts), offsetting growth in spending on household furnishings and recreational goods. Spending on nondurable consumer goods picked up in Q1 while growth in spending on household services was basically the same as in Q4 2015.

Residential investment outlays grew at an annual rate of 14.9 percent, with sizeable gains in both single family and multi-family outlays. While we expect residential investment to continue to grow at a healthy rate, we do expect a shift away from multi-family towards single family activity, which would mean housing would have a larger impact on overall economic activity. Government spending grew at an annual rate of 1.2 percent, reflecting a sharp decline in defense spending but higher nondefense spending on the federal level and rapid growth in combined spending on the state and local government levels.

Efforts by firms to right-size inventories continued in Q1, but the slower pace of inventory accumulation took 0.33 percentage points from top-line growth. Real exports of U.S. goods fell at an annual rate of 3.4 percent, leading to a wider trade deficit that took 0.34 percentage points from top-line growth. These drags are of less concern as they will not be persistent drags on growth of this order over the remainder of 2016. Of more concern, however, is the weakness in business investment spending seen in Q1. Though the temptation is to dismiss this as an energy story, as many have done with corporate profits, the reality is the weaker tone of both profits and capital spending goes well beyond energy and the concern is this bleeds over into the broader economy. Productivity growth is already one casualty of what over the course of this expansion has been persistent underinvestment on the part of firms.

While all is not well with the U.S. economy, neither is the economy as moribund as the print on the Q1 GDP report implies. Consumer spending and housing will provide the main support going forward, while business investment spending is the key downside risk.





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