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US Q1 GDP: Shifting into a lower gear?

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Annualized Qtrly Chg.	24 Q1	23 Q4	23 Q3	23 Q2	23 Q1	22 Q4
Real GDP	1.6%	3.4%	4.9%	2.1%	2.2%	2.6%
Personal consumption	2.5%	3.3%	3.1%	0.8%	3.8%	1.2%
• Goods	-0.4%	3.0%	4.9%	0.5%	5.1%	0.0%
• Durable goods	-1.2%	3.2%	6.7%	-0.3%	14.0%	-1.0%
• Nondurable goods	0.0%	2.9%	3.9%	0.9%	0.5%	0.5%
• Services	4.0%	3.4%	2.2%	1.0%	3.1%	1.8%
Gross private investment	3.2%	0.7%	10.0%	5.2%	-9.0%	3.4%
• Fixed investment	5.3%	3.5%	2.6%	5.2%	3.1%	-5.4%
• Nonresidential	2.9%	3.8%	1.5%	7.4%	5.7%	1.7%
• Structures	-0.1%	10.9%	11.2%	16.1%	30.3%	6.5%
• Equipment	2.1%	-1.1%	-4.4%	7.7%	-4.1%	-5.0%
• Intellectual Property	5.4%	4.3%	1.8%	2.7%	3.8%	6.1%
• Residential	13.9%	2.8%	6.7%	-2.2%	-5.3%	-24.9%
Exports	0.9%	5.0%	5.4%	-9.3%	6.8%	-3.5%
• Goods	0.9%	6.2%	7.7%	-16.0%	12.0%	-6.3%
• Services	1.0%	2.8%	1.0%	6.3%	-3.5%	3.0%
Imports	7.2%	2.2%	4.2%	-7.6%	1.3%	-4.3%
• Goods	6.8%	1.3%	5.9%	-6.5%	1.8%	-4.3%
• Services	9.0%	6.2%	-2.8%	-12.3%	-1.2%	-3.9%
Government	1.2%	4.6%	5.8%	3.3%	4.8%	5.3%
• Federal	-0.2%	2.4%	7.1%	1.1%	5.2%	9.8%
• National defense	-0.7%	0.5%	8.4%	2.3%	1.9%	7.7%
• Nondefense	0.3%	4.8%	5.6%	-0.4%	9.4%	12.6%
• State and local	2.0%	6.0%	5.0%	4.7%	4.6%	2.8%

Source: Haver Analytics.

- The US economy started 2024 on a surprisingly tepid note, with GDP growth coming in at 1.6% q/q annualized, well below the 2.5% consensus expectation and last quarter's 3.4% increase. This is the first time in a year and half that growth has fallen below potential growth. There was a large drag on growth from net exports (-0.9pp), as export growth was weak and imports climbed, and also from inventory adjustments (-0.4pp). Government spending and business investment growth also slowed in the quarter. But other components of domestic demand were stronger with the consumer leading the charge on growth again as consumption rose at 2.5% clip, somewhat below expectations of 3.0% growth and residential investment accelerating. The core PCE price deflator came in at 3.7% q/q annualized, three ticks above expectations, and a material acceleration from the Q4 pace of 2.0%. While the drag from imports and inventories exaggerates the slowdown from Q4, there are some signs in this report that US economy might move into a slightly lower gear. But slower inflation progress will be more of a concern with core inflation coming in higher than expected. The Fed will need to see both, the economy sustainable cooling and price pressures abating to feel confident in easing policy.

- Real final sales to domestic purchasers (which strips out trade and inventories) came in at 2.8%, down slightly from the 3.5% average pace over the previous two quarters, gives a sense that the economy did slow somewhat in the quarter abstracting from the shifts in trade and inventories. But the key question is whether this deceleration is going to continue and if so, at what pace?
- The evidence on that front is mixed. The weaker-than-expected consumption we saw in Q1 is mainly due to a stronger pullback in March services spending which could imply soft momentum heading into Q2, absent large revisions to prior months. Service consumption surged by almost 4% in the quarter, lead by volatile categories such as recreational spending and financial services and insurance. A pullback there to a more sustainable pace is likely and that will matter considerably for growth going forward. A slowdown in government spending could in the cards in 2024, as federal and state governments look fully staffed once again.
- The other side of this argument is the labor market and Americans insatiable demand for goods. Job hiring is incredibly strong and goods consumption in the quarter was distorted by weather. Higher imports and inventory levels could also suggest firms are stocking up on expectations of solid goods consumption going forward.
- The bottom line here is that GDP growth is not slowing enough to be confident that demand in the economy is being sapped, especially when judged against the strength in the labor market and higher-than-expected core inflation reading. Services prices jumped 5.4% q/q annualized in Q1, making the last two softer quarters look like flash in the pan.
- The Fed cannot afford to trust its models and believe the economy can slow without seeing it first. Structural shifts in the US economy, be through changing attitudes towards consumption or firms and households being less exposed to interest rate changes, have made the Fed's job very complicated as monetary policy's effect on the economy is not what it used be. Powell and company will want to wait to see more progress on all fronts to regain confidence that we are headed back to .

Implications & actions

Re: Economic forecast — While growth ticked down and there are signs of slowdown in demand, it will not be enough to impress the Fed especially with core inflation coming in hotter and the labor market not showing signs of cooling. We continue to expect two cuts in 2024, with the first cut starting in September.

Re: Markets — Bonds and the broad dollar rallied likely because of the above-consensus core inflation data.