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US Q1 GDP: Strength beneath the headline

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Annualized Qtrly Chg.	23 Q1	22 Q4	22 Q3	22 Q2	22 Q1	21 Q4
Real GDP	1.1%	2.6%	3.2%	-0.6%	-1.6%	7.0%
Personal consumption	3.7%	1.0%	2.3%	2.0%	1.3%	3.1%
• Goods	6.5%	-0.1%	-0.4%	-2.6%	-0.1%	2.3%
• Durable goods	16.9%	-1.3%	-0.8%	-2.8%	7.7%	5.1%
• Nondurable goods	0.9%	0.6%	-0.1%	-2.4%	-4.4%	0.7%
• Services	2.3%	1.6%	3.7%	4.6%	2.1%	3.5%
Gross private investment	-12.5%	4.5%	-9.6%	-14.1%	5.4%	32.0%
• Fixed investment	-0.4%	-3.8%	-3.5%	-5.0%	4.8%	0.6%
• Nonresidential	0.7%	4.0%	6.2%	0.1%	7.9%	1.1%
• Structures	11.2%	15.7%	-3.6%	-12.7%	-4.4%	-12.7%
• Equipment	-7.3%	-3.5%	10.6%	-2.1%	11.4%	1.6%
• Intellectual Property	3.8%	6.2%	6.8%	8.9%	10.8%	8.1%
• Residential	-4.2%	-25.1%	-27.1%	-17.8%	-3.1%	-1.1%
Exports	4.8%	-3.7%	14.6%	13.8%	-4.6%	23.5%
• Goods	10.0%	-7.4%	17.8%	15.5%	-7.2%	23.4%
• Services	-5.5%	5.0%	7.5%	9.9%	1.6%	23.6%
Imports	2.9%	-5.5%	-7.3%	2.3%	18.4%	18.6%
• Goods	3.7%	-5.9%	-8.6%	-0.4%	20.4%	19.6%
• Services	-0.2%	-3.7%	-0.8%	16.6%	9.0%	14.0%
Government consumption	4.7%	3.8%	3.7%	-1.6%	-2.3%	-0.9%
• Federal	7.8%	5.8%	3.7%	-3.4%	-5.3%	0.0%
• National defense	5.9%	2.2%	4.7%	1.5%	-8.5%	-5.3%
• Nondefense	10.3%	10.6%	2.5%	-9.2%	-1.1%	7.4%
• State and local	2.9%	2.6%	3.7%	-0.6%	-0.4%	-1.6%

Source: Haver Analytics.

- GDP growth cooled to 1.1% annualized in the US in the first quarter, as a drop in inventory investment compounded declines in the interest-sensitive residential investment and business investment in equipment components. The advance was well below the 1.9% expected by the consensus, but the headline masked an acceleration in consumer spending, with both goods and services increasing, which added to growth in net exports and government spending. Final domestic demand, which removes inventories and net trade, accelerated to an impressive 3.2% annualized pace from 0.7% in Q4, while core PCE prices gained momentum, rising by 4.9% q/q annualized, which will keep the Fed on track for a final 25bp rate hike at next week's FOMC.

- Inventories were the main negative, accounting for the bulk of the deceleration from the end of 2022. Specifically, wholesale trade inventories of machinery, equipment, and supplies led the decline in that component, in line with the decrease in capex over the quarter, signalling that businesses see weaker demand on the horizon and are curtailing investment as a result. Manufacturing inventories were also down notably, particularly in transportation equipment and petroleum/coal products. The drop in transportation inventories coincided with a surge in vehicle sales, which were up 45% annualized, as supply chain normalization helped to satiate pent-up demand. That component of inventories is poised for a rebound ahead, but weaker demand for goods tied to the slowdown in cyclical sectors will keep a lid on inventory investment in other goods sectors.
- The acceleration in consumer spending included lofty advances in discretionary components, which will keep the Fed on high alert. Goods consumption contributed more to growth than services, with auto consumption rising sharply, and adding to higher demand for recreational vehicles, household durables, and gasoline. On the services side, health care spending led the growth, but that was followed by a robust increase in restaurants and accommodations, while recreation services consumption also grew. That left goods consumption 4.2% above its pre-pandemic trendline, and services 1.6% below. Still, the strong demand for services will keep the Fed on track to tighten monetary policy amidst already elevated inflation in those sectors.
- The increase in consumption was aided by a 12.5% annualized surge in disposable incomes, supported by one-time tax cuts/credits in many states, and still strong labor income growth, which has allowed consumers to absorb higher prices. The slowdown in the labor market ahead will limit growth in aggregate incomes, which will be necessary in order to reduce business pricing power and reign in inflation. The savings rate ticked up for the first time since early 2021, but it remains low by historical standards at 4.8%, suggesting that consumers are still relatively confident about their balance sheets.
- The drop in business investment in equipment was implied by weakness in domestic and imported core capital goods shipments, and included another drop in computer equipment, an area that boomed at the height of the pandemic. Forward-looking indicators suggest continued weakness in the second quarter. There was a jump in business investment in structures on progress in manufacturing and mining, although the structures component is still 20% below pre-pandemic levels. Commercial structures investment deteriorated, and will continue to be held back by the shift to working from home and the tightening in lending standards that's underway. Combined with a modest increase in investment in intellectual property products, overall business investment eked out a small gain.
- The contribution from net trade to growth included strong petroleum exports, in line with US efforts to supplant Russian oil supply, but a rebound in consumer goods exports was the main source of strength, as major trading partner economies were largely able to avoid recessions. Imports grew modestly in comparison, with drops in industrial supplies and capital goods, linked to foundering business capex, masking increases in consumer goods and autos.
- The drop in residential investment, primarily reflecting weaker single-family construction, wasn't as pronounced as in the prior three quarters, and leaves total residential investment 19% below year-ago levels. Although the drop in bond yields in March supported home purchase intentions, we expect yields to climb ahead as markets push rate cut expectations into 2024, which would thwart housing market activity, in combination with a tightening in lending standards.
- The Fed's preferred measure of inflation facing consumers, core PCE prices, accelerated to 4.9% q/q annualized, from 4.4% in the prior quarter, leaving it a couple of ticks above the consensus expectation. The GDP deflator, which includes prices faced by producers and export markets in addition to consumers, accelerated by a tick to 4.0%.

Implications & actions

Re: Economic forecast — The strength of the consumer will keep the Fed on track for a final 25bp rate hike in May. With aggregate income growth set to slow with the labor market, and excess savings disappearing, particularly for lower-income earners, Q2 is set to see a deterioration in activity, and possibly a contraction, in line with the tapering off of momentum in monthly indicators over Q1 and tighter financial conditions.

Re: Markets —Bond yields rose slightly and the USD strengthened following the release, as the underlying strength in activity and core PCE price pressures support the notion of higher interest rates for longer.

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