

Economics

ECONOMIC FLASH!

economics.cibccm.com

April 27, 2023

US Q1 GDP: Strength beneath the headline

by **Katherine Judge** katherine.judge@cibc.com

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.

This report is issued and approved for distribution by (a) in Canada, CIBC World Markets Inc., a member of the Investment Industry Regulatory Organization of Canada, the Toronto Stock Exchange, the TSX Venture Exchange and a Member of the Canadian Investor Protection Fund, (b) in the United Kingdom, CIBC World Markets plc, which is regulated by the Financial Services Authority, and (c) in Australia, CIBC Australia Limited, a member of the Australian Stock Exchange and regulated by the ASIC (collectively, "CIBC") and (d) in the United States either by (i) CIBC World Markets Inc. for distribution only to U.S. Major Institutional Investors ("MII") (as such term is defined in SEC Rule 15a-6) or (ii) CIBC World Markets Corp., a member of the Financial Industry Regulatory Authority. U.S. MIIs receiving this report from CIBC World Markets Inc. (the Canadian broker-dealer) are required to effect transactions (other than negotiating their terms) in securities discussed in the report through CIBC World Markets Corp. (the U.S. broker-dealer).

This report is provided, for informational purposes only, to institutional investor and retail clients of CIBC World Markets Inc. in Canada, and does not constitute an offer or solicitation to buy or sell any securities discussed herein in any jurisdiction where such offer or solicitation would be prohibited. This document and any of the products and information contained herein are not intended for the use of private investors in the United Kingdom. Such investors will not be able to enter into agreements or purchase products mentioned herein from CIBC World Markets plc. The comments and views expressed in this document are meant for the general interests of wholesale clients of CIBC Australia Limited.

This report does not take into account the investment objectives, financial situation or specific needs of any particular client of CIBC. Before making an investment decision on the basis of any information contained in this report, the recipient should consider whether such information is appropriate given the recipient's particular investment needs, objectives and financial circumstances. CIBC suggests that, prior to acting on any information contained herein, you contact one of our client advisers in your jurisdiction to discuss your particular circumstances. Since the levels and bases of taxation can change, any reference in this report to the impact of taxation should not be construed as offering tax advice; as with any transaction having potential tax implications, clients should consult with their own tax advisors. Past performance is not a guarantee of future results.

The information and any statistical data contained herein were obtained from sources that we believe to be reliable, but we do not represent that they are accurate or complete, and they should not be relied upon as such. All estimates and opinions expressed herein constitute judgments as of the date of this report and are subject to change without notice.

This report may provide addresses of, or contain hyperlinks to, Internet web sites. CIBC has not reviewed the linked Internet web site of any third party and takes no responsibility for the contents thereof. Each such address or hyperlink is provided solely for the recipient's convenience and information, and the content of linked third-party web sites is not in any way incorporated into this document. Recipients who choose to access such third-party web sites or follow such hyperlinks do so at their own risk.

© 2023 CIBC World Markets Inc. All rights reserved. Unauthorized use, distribution, duplication or disclosure without the prior written permission of CIBC World Markets Inc. is prohibited by law and may result in prosecution.

CIBC Capital Markets – PO Box 500, 161 Bay Street, Brookfield Place, Toronto, Canada M5J 2S8 – Bloomberg @ CIBC