

Economics

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April 30, 2026

US Q1 GDP: Government re-opening and AI roll out drive rebound

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Annualized Qtrly Chg.	26 Q1	25 Q4	25 Q3	25 Q2	25 Q1	24 Q4
Real GDP	2.0%	0.5%	4.4%	3.8%	-0.6%	1.9%
Personal consumption	1.6%	1.9%	3.5%	2.5%	0.6%	3.9%
• Goods	-0.1%	0.3%	3.0%	2.2%	0.2%	6.9%
• Durable goods	0.0%	0.1%	1.5%	2.3%	-3.4%	13.0%
• Nondurable goods	-0.2%	0.4%	3.9%	2.2%	2.2%	3.8%
• Services	2.4%	2.7%	3.6%	2.6%	0.8%	2.5%
Gross private investment	8.7%	2.3%	0.0%	-13.7%	23.3%	-6.8%
• Fixed investment	6.2%	1.5%	0.8%	4.4%	7.1%	-1.9%
• Nonresidential	10.4%	2.4%	3.2%	7.3%	9.5%	-3.7%
• Structures	-6.7%	-6.6%	-5.0%	-7.5%	-3.1%	-8.0%
• Equipment	17.2%	4.3%	5.2%	8.5%	21.3%	-4.2%
• Intellectual Property	13.0%	5.4%	5.6%	15.0%	6.5%	-0.6%
• Residential	-8.0%	-1.7%	-7.1%	-5.1%	-1.0%	4.3%
Exports	12.9%	-3.2%	9.6%	-1.8%	0.2%	-0.9%
• Goods	18.2%	-1.7%	8.6%	-4.7%	6.3%	-3.9%
• Services	4.1%	-5.7%	11.5%	3.5%	-9.7%	4.6%
Imports	21.4%	-1.0%	-4.4%	-29.3%	38.0%	-0.2%
• Goods	25.8%	-2.4%	-7.1%	-35.0%	52.0%	-3.1%
• Services	6.6%	4.2%	6.4%	-1.2%	-5.8%	11.5%
Government	4.4%	-5.6%	2.2%	-0.1%	-1.0%	3.3%
• Federal	9.4%	-16.7%	2.7%	-5.3%	-5.6%	4.4%
• National defense	2.3%	-10.8%	5.7%	0.9%	-6.9%	4.5%
• Nondefense	20.3%	-24.3%	-1.4%	-13.0%	-3.8%	4.0%
• State and local	1.6%	1.5%	2.0%	3.1%	1.9%	2.7%

Source: Haver Analytics.

- GDP growth rebounded in the US in the first quarter, reflecting a bounce from the government re-opening and surging business investment. The 2.0% annualized pace was a few ticks below the consensus expectation, but only a tick above our forecast, and included a 4.4% jump in government expenditures. Inventory investment also contributed to growth, while net trade was a drag. Looking beyond the noise, private domestic demand (which excludes government, inventory, and trade) posted a 2.5% annualized advance, up from 1.8% in the prior quarter. The acceleration reflected business investment gains, which masked a slowdown in consumption to a 1.6% pace. And we expect a further slowdown ahead as households grapple with higher gasoline prices, and with the saving rate ending the quarter at a lean 3.6%, there isn't much room to drawdown further in order to sustain spending. That will compound the impacts of

a sluggish labor market and immigration restrictions on spending. The core PCE price index surged to an uncomfortably hot 4.3% annualized over the quarter, up from 2.7% in Q4, with the March reading sitting at 3.2% y/y, in line with consensus expectations.

- The surge in business investment reflected a jump in equipment investment by 17% and intellectual property investment rose by 13%, as businesses upgraded computers and software. This continues to reflect the roll out of AI, with other areas of business investment subdued. Industrial equipment investment rebounded from a decline in the prior quarter, while transportation equipment and structures investment both declined, with the latter attributable to lower investment in manufacturing structures.
- Exports increased by 13% on higher shipments of industrial supplies and materials, while imports spiked by 21% on inbound shipments of capital goods, namely computers, and industrial supplies and materials. The implication is that AI capital spending is not as much of a lift to US GDP as it looks to be on the surface, given that much of the equipment is sourced abroad. Imports of consumer durable goods (ex. food/autos) were also up strongly, but overall consumer goods imports fell on decreases in non-durable categories. That left net trade as a drag on growth for the quarter, and overall, exports are sitting 4% above year-ago levels, while imports are down by 5%.
- There was evidence of consumers shifting spending away from discretionary categories, as recreation vehicles, clothing, and restaurants decreased, while recreation services spending was flat. Gasoline consumption rose but the full impact of the oil shock won't be realized until the second quarter, with some passthrough of higher prices to other goods working to restrain consumption of discretionary items further. Health care spending accelerated, as hospital and nursing home services increased.
- Residential investment fell for the fifth consecutive quarter, concentrated in a pullback in new single-family units and broker commissions on weak new and existing home sales. Leading indicators suggest continued weakness in Q2, as homebuilder confidence has plummeted in line with higher material costs tied to the war in Iran and muted demand as a result of elevated mortgage rates. That suggests that interest rates are still somewhat above neutral, and opens the door to some modest Fed cuts if the energy-induced spike in inflation proves, dare we say it, transitory.

Implications & actions

Re: Economic forecast — Growth is set to slow in the second quarter as the one-time lift from the government re-opening fades and consumers continue to grapple with higher gasoline prices that will limit discretionary consumption. Looking further out, we doubt that surging business investment tied to AI expansion can continue at this pace without delivering big returns for investors, and we see investment enthusiasm easing off in that category as the year progresses. The hot inflation figures for the quarter will keep the Fed firmly on the sidelines for most of this year.

Re: Markets — There was little market reaction to the data as the downside in the headline number was likely offset by the fact that some of the details looked strong, mainly business investment.

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