Data Release: Economy shrinks in the first quarter, but details not as scary

- Real GDP declined by an annualized 0.7% in the first quarter of 2015. Still, the second reading was better than market expectations which called for a decline of 0.9%.
- The downward revision was driven mainly by higher imports (5.6% vs. 1.8% previously), lower inventory investment ($95bn vs. $110.3bn), lower intellectual property investment (3.6% vs. 7.8%), and weaker services spending (2.5% vs. 2.8%).
- But, upward revisions across several other investment expenditure categories partly offset the aforementioned downward revisions. Residential investment (5.0% vs. 1.3%) and equipment investment (2.7% vs. 0.1%) were both revised higher, while the decline in structures investment was reduced slightly (-20.8% vs. -23.1%).
- Price deflators for GDP and PCE were not materially revised, declining by 0.1% and 2.0% respectively.
- Corporate profits declined by 5.9% (after inventory and capital adjustment) after declining by 1.4% in the previous quarter. The decline was largely related to nonfinancial firms (-7.7%) and profits in the rest of the world (-6.0%).

Key Implications

- While certainly disappointing, the contractionary second estimate of Q1 economic growth does not significantly alter our view of U.S. economic growth. The contraction was broadly anticipated with the revisions coming precisely where we anticipated them with some of it related to transitory factors during the quarter.
- At 1.8% annualized, the pace of spending by consumers disappointed as services spending appeared slower. However, this performance could still materially change with the inclusion of the Quarterly Services Survey results, released in the coming weeks and will be incorporated in the third estimate of GDP at the end of June. Still, with credit beginning to flow more freely, the labor market continuing to improve, and gasoline prices still well below last year's levels, the pace should improve in the coming quarters.
- Other than the anticipated downward revisions, the upward revisions to investment are an encouraging sign. Aside from nonresidential investment in structures which were plagued by a 50% annualized drop in mining exploration, shafts, and wells, business investment looks stronger than before, suggesting an increased confidence in the economy by U.S. firms. At the same time, residential investment was higher than expected on upward revisions to housing starts and home sales – both of which are pointing to a strong recovery in the second quarter and beyond.
- Bottom line is that the economy contracted, but not as much as expected, with the details of the report proving to be somewhat encouraging. At this point, given the continued drag from oil and gas drilling activity and lower inventory investment we expect the second quarter growth to remain subdued, at about 1.5% to 2.0%. As these factors wane, the economy should get back on its more robust growth path, generating near-3% growth in the second half of 2015.

Michael Dolega, Senior Economist
416-983-0500

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